PROFESSIONS AS COMMERCIAL INSTITUTIONS: AN ANALYSIS OF EVOLVING ORGANIZATIONAL FORMS

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L INTRODUCTION

If professions exist primarily to serve society and observe high ethical standards, then, strictly speaking, operating a business for profit is a commercial, and not a professional, endeavor. Drawing a bright line between professional service and commerce allows professionals to focus their talents on bettering society free from mundane commercial issues. But in the professional services, exploding liability costs and increased competition are creating tensions that blur the distinctions between commercialism and professionalism. Recognizing the inevitable union of business and profession represents devolution to some observers,[1] but evolution to others.[2]

Consistent with the latter view, this article proceeds with the thesis that conducting professional services today requires effective management and good business practices. Focusing on the economic and commercial aspects of professional practice is ironic since some argue that the problems facing professionals today are largely a result of commercialism and a preoccupation with economics.[3] But, the spirit of this article is in line with the view that good business practices are not inconsistent with professionalism; they are essential to it.[4]

Professions face a "sea change" where economic pressures abound.[5] Among the pressures are the demands for greater expenditures on business development to respond to increased competition and client sophistication. At the same time, costs have escalated due to the growth in professional malpractice suits. The combination of greater expenditures on business development and exploding

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1.Overemphasis on profits on the part of law firms is a theme of Anthony T. Kronman in THE LOST LAWYER (1993) and Mary Ann Glendon in A NATION UNDER LAWYERS (1994).

2.*See* Ward Bower, *Law Firm Economics and Professionalism,* 100 Dick. L. Rev. 515, 529 (1996), who argues that the use of "effective management" is essential to the survival of the professional law firm. *See also* Larry Ribstein, *Ethical Rules, Agency Costs, and Law Firm Structure*, 84 VA. L. REV. 1707 (1998), who suggests that ethics rules and sound business practices often collide.

3 *See* Kronman, *supra*, note 1.

4 *See* Bower, *supra* note 2, at 529.

5 *See id.* at 515 *See also*, Robert K. Elliott, *Who We Are as a Profession - and What We Must Become*, J. ACCT. at 81 (Feb. 2000).

liability costs threatens the economic viability of professional service providers.[6] Business decisions grow increasingly important in this changing environment.

The commercial nature of professional practice is particularly evident in the professional firms' movement into new organizational forms. Relying on a nationwide sample of business registrations obtained from records filed with the International Association of Corporate Administrators, this article documents the emergence and growth of the Limited Liability Company (LLC) and the Limited Liability Partnership (LLP) as alternative organizational forms in the professional services. Nationwide, the growth in LLC and LLP registrations is phenomenal. For example, there were nearly 25 times as many LLC registrations in 1996 as there were in 1992. From 1994 to 1996, annual LLP registrations grew by a factor of five. Many of these LLC and LLP registrations are professional service firms.

A sample of private-firm business registration records obtained from *Lexis/Nexis* reveals the industry trends in LLC and LLP adoption. In this sample of nearly 2000 businesses, firms in the "emerging" professions, such as consulting and management services, tend to register as LLCs.[7] Firms in the traditional professions, such as accounting, law, and medicine, comprise the majority of the businesses identifiable as LLPs.

The article's discussion attempts to link professional firms' choice of organizational form with the characteristics of their operating environment. The choices appear to be an efficient self-selection by the owners of professional service firms. Becoming an LLC or LLP addresses high (or rapidly growing) tort liability risks while preserving desirable pass-through tax treatment.[8] It thus appears that the change from an existing form, such as the general partnership, to *either* the LLC or LLP form is based on considerations of liability exposure and tax treatment for cash distributions. In addition, it is arguable that the choice of LLC *versus* LLP form is based on considerations of organizational fit and custom as well as ethical concerns.

From this point, the article provides some general background on why firms undertake organizational form change and what advantages certain forms can provide. The focus then shifts to an examination of the operating environments for firms in the emerging and traditional professions. The article then presents a short description of the evolution of the LLC and LLP, followed by the data on LLC and

[6] *See Bower, supra* note 2, at 520. *See also* BaiTy C. Melancon, *The Changing Strategy for the Profession, the CPA, and theAICPA: What This Means to the Education Community,* 12 ACCT. HORIZONS 397(1998).

[7] The term "emerging professions" is used in this article to describe service industries, such as consulting, that have attributes similar to those of the traditional professions. For firms in a number of service industries, their legal status as "professionals" is largely unsettled. *See* Richard A Glaser & Leslee M. Lewis, *Redefining the Professional: The Policies and Unregulated Development of Consultant Malpractice Liability,* 72 U. Det. Mercy L. Rev. 563 (1995).

[8] Proving that the liability risks are indeed increasing is not the focus of this article. That owners perceive the liability risks to be increasing is enough justification to explain adjustments in form.

LLP registration growth and choices by professional firms. The final sections offer a discussion and a brief summary of the results.

n. BACKGROUND ON EVOLVING ORGANIZATIONAL FORMS

Prior to examining the sample of professional firms that adopt the LLC or LLP form, it is appropriate to ask two basic questions. First, why do firms change organizational form? Second, what are the advantages of the LLC and LLP relative to other existing choices? This section briefly addresses these questions.

A. General Considerations

Prior research suggests that firms organize to deliver products and services at the lowest cost.[9] At the same time, firms structure themselves with the goal of increasing revenue through the use of available technology.[10] The choice of particular organizational forms can often be traced to the firm's underlying attributes.[11] For example, some authors trace organizational form changes to concerns for reducing agency costs between owners and managers.[12] This research exists in different contexts, including studies of savings and loans that convert from mutual to stock charter, and choices of company-owned versus franchise outlets.[13] Previous research also analyzes firms that convert from corporate to partnership form.[14] To take advantage of tax treatments, firms increase cash distributions and cut capital expenditures after becoming partnerships. In sum, the literature demonstrates that changes in form are made when the new structure provides advantages in the firm's evolving operational environment.

This article examines why firms in the traditional and emerging professional service industries are choosing to become LLCs or LLPs. Evidence

[9] *See* Ribstein, *supra,* not« 2. *See, e.g.,* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control,* 36 J.L. & ECON. 301 (1983); Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims,* 36 J.L. & ECON. 327 (1983); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure,* 3 J. Fin. ECON. 305 (1976).

[10] *See* Armen A Alchian, *Uncertainty, Evolution, and Economic Theory,* 58 J. POL. ECON. 211 (1950).

[11] *See* Kenneth Lehn, *et al., Consolidating Corporate Control: Dual-Class Recapitalizations Versus Leveraged Buyouts,* 24 J. FIN. ECON. 557 (1990).

[12] *See id.* at 578.

[13] *See* Ronald Masulis, *Changes in Ownership Structure: Conversion of Mutual Savings and Loans to Stock Charter,* 18 J. FIN. ECON. 29 (1987); *see also* James Brickley and Frederick Dark, *The Choice of Organizational Form: The Case of Franchising,* 18 J. FIN. ECON. 401 (1987). The authors find that franchising choices reflect concern about agency costs in company-owned outlets.

[14] The master limited partnership (MLP) provides an excellent opportunity to study organizational form changes involving partnerships as the MLP is a public entity with available financial records. *See* Conrad S. Ciccotello & Chris J. Muscarella, *Matching Organizational Structure with Firm Attributes: A Study of Master Limited Partnerships,* 1 EUR. FIN. REV. 169 (1997).

suggests that existing firms in these industries are leaving the corporate, partnership, or proprietorship forms. Data from the Internal Revenue Service (IRS) Statistics of Income Survey for 1985 reveals that for service firms, the percentages of business tax forms received break down as follows: 13.8 percent from corporations (including professional corporations), 5.0 percent from partnerships, and 81.2 percent from proprietorships. Additionally, total tax receipts are proportioned as follows: 9.7 percent from corporations (including professional corporations), 46.4 percent from partnerships, and 43.9 percent from proprietorships.[15] The inference from this data is that partnerships are, on average, the largest of the firms in the service industries. Partnerships comprise only five percent of the number of returns, but nearly 50 percent of the tax receipts.[16] From the IRS data, it is apparent that professional service firms held a variety of forms prior to the availability of the LLC and LLP.

B. Summary of the Advantages of the LLC and LLP

LLCs and LLPs provide improved liability protection compared to existing forms, such as the general partnership. If professional service providers are currently organized as either general partnerships or proprietorships, plaintiffs are able to pursue unlimited liability in tort against the principal (or any of the principals) of the firm.[17] The LLC and LLP are forms that limit liability to those individuals close to the alleged tort. By breaking the unlimited liability link to the larger pool of assets, these forms offer an attractive option in a highly litigious environment.

For some service firms, the professional corporation (PC) form is available. But the majority of PC statutes do not eliminate members' joint and several liability for malpractice, and courts continue to retain individual partnership-based liability .[18] The LLP or LLC may thus offer additional liability protection compared to the PC.

[15] This information is based on a population of over 6.8 million returns received by the IRS in 1985. *See* 1985 IRS STAT. INCOME SURV. 82. The year 1985 is chosen as it is prior to the availability of the LLC and LLP forms in virtually all states.

[16] *See id.*

[17] The plaintiif may sue one or more of the parties to the liability separately, or all of them together, at the plaintiff's option. For a comprehensive review of unlimited liability for partners in an accounting context, *see* Jordan H. Leibman and Anne S. Kelly, *Accountant s Liability to Third Parties for Negligent Representation: The Search for a New Limiting Principle*, 30 AM. Bus. L.J. 347 (1992).

[18] *See, e.g.*, Deborah A DeMott, *Our Partners' Keepers? Agency Dimensions of Partnership Relationships*, 58 J.L. & CONTEMP. PROBS. 109, 126 (1995) (discussing that professional corporation statutes, "for the most part, do not limit members' joint and several liability for malpractice"); Karen Maycheck, *Comment, Shareholder Liability in Professional Legal Corporations: A Survey of the States*, 47 U. PITT. L. REV. 817, 822 (1986) (noting that in only 12 states does the professional corporation statute limit a shareholder's personal liability to that arising from the shareholder's own acts or omissions, and that even in those states the shareholder may be liable for failing to adequately monitor). Some authors do take the position that protection from liability will be no better in LLCs or LLPs than from corporate-type forms. *See,*

As professional service firms grow, it seems logical that they should move to adopt some type of limited liability form. The corporate form is one possible response, but firms may avoid it because of the penalty of dual taxation.[19] The dualtaxation problem may be especially severe if the firm desires to pass through large amounts of income to its owners. Along with the corporate tax, the funds passed through the corporation as salary or dividends are taxed as personal income. Because of the dual-taxation penalty, many firms chose to accept the unlimited liability inherent in the partnership form. LLCs and LLPs, as pass-through entities, offer the tax advantages of the partnership form without subjecting owners to joint and several liability.

With the PC form also comes the potential election to be treated as an S Corporation for tax purposes.[20] While this S Corporation election in a PC represents an approach to eliminate the dual-taxation problem, the S Corporation has complex tax rules including restrictions on the types of deductions and types of income subject to partnership tax treatment.[21] The LLC or LLP may be valuable for some firms (such as those involved in real estate) if these forms are not subject to as many restrictions.

nr Professional Firms' Liability Environment

This section summarizes the trends in tort liability for professionals, focusing on the issues germane to firms in the "emerging" and traditional professions, respectively.

A. Liability for Professional Malpractice

Liability concerns have become the dominant environmental threat for many professional service providers. General partnerships with unlimited liability

e.g. Robert Thompson, *The Limits ofLiability in the New Limited Liability Statutes,* 32 WAKE Forest L. REV. 1 (1997).

[19] The "C" corporation may also be unavailable for certain professional service firms. These firms may become professional corporations instead.

[20] Professional corporations can generally elect S Corporation status, and be taxed as a partnership. There are often restrictions to deductibility of certain expenses (such as pension contributions) in the S Corporation form. In addition, some states do not limit liability for professionals for malpractice in the professional corporation. *See, e.g.,* David Paas, *Professional Corporations and Attorney-Shareholders: The Decline of Limited Liability,* 11 J. CORP. L. 371, 374 (1986) (observing that the approaches to liability adopted in the various professional corporation statutes vary greatly).

[21] *See* William H. Painter, Corporate And Tax Aspects of Closely-Held Corporations 30 (1981). The tax mechanics of S Corporations are very complex. Some examples of restrictions in S Corporations include limits on deductibility for pension contributions and prohibitions on passive income. *See id.* at 35.

and a large number of partners are inviting, asset-rich targets.[22] If the firm has hundreds of partners, the assets of each (or all) are at risk. Despite this threat, many of today's large professional organizations continue to grow in size. In the legal profession, for example, researchers have documented an increasing number of partnerships relative to proprietorships.[23] But as the bankruptcy of Laventhol & Horwath[24] demonstrates, large size does not prevent the downfall of a firm from legal claims.

Many of the reasons for professional firm growth are economic in nature.[25] Professional service work grows increasingly complex and technical. In many professions, such as law and accounting, supporting material requirements (such as libraries or on-line services) are so vast and expensive that few sole proprietors could generate the volume of business necessary to support the overhead. Most professional entities must respond to diverse client concerns over wide geographic locations. Client service requirements demand geographic scale with varied expertise resident in-house. In other professions, such as engineering and medicine, there are substantial requirements for high-technology equipment. The trends all point toward the need to have a large professional entity that is able to deliver products and services at the lowest cost via economies of scale.

Along with economic reasons, there are social and cultural explanations for professional firm growth. From an historical perspective, growth of professional firms can be traced to the synergy of interpersonal relationships. By combining the various assets and skills of the partners, the firm adds prestige, and becomes able to attract the most affluent clients and best-trained individuals seeking employment. The structure of large professional firms is generally one where partners contract, as agents of the firm, with clients for professional services. Agents trade services for claims on the firm's residual cash flows. Given the economic, social, structural and technological trends leading toward larger organizations, the returns to agents are superior in the large firm to what they could earn individually.[26]

As firms grow, it becomes more unlikely that a given partner would participate in, or even review, all of the firm's activities. If a partner were not a participant in an activity that brings about a tort claim for malpractice, the partner would seem to be immune from suit. But in tort, the plaintiff may sue one or more

[22] In some cases, a professional service firm can become a professional corporation, but adopting this form may not limit liability for professional malpractice.

[23] *See* Sherwin Rosen, *The Market for Lawyers*, 35 J.L. & ECON. 215 (1992). Rosen uses IRS filings to show that over the period from 1950 to 1987, the number of sole practitioner filings increases by 86%, but the number of partnership filings increases by 145%. The average number of partners in a law firm increased from 2.9 in 1960 to 4.75 in 1987.

[24] In 1990, Laventhol & Horwath, then the 7th largest accounting firm, became the nation's largest ever professional firm to file for bankruptcy.

[25] Ironically, one plausible economic reason for increasing the size of the firm is that it reduces the chances that a single lawsuit may overwhelm the firm's assets.

[26] *See* Fama & Jensen, *supra* note 9, at 327; *see also* Marc Galanter & Thomas Palay, *Why the Big Get Bigger: The Promotion to Partner Tournament and the Growth of Large Law Firms*, 76 VA. L. Rev. 747, 748 (1990) (commenting on how large law firms have increased market share and influence).

of the partners, or all them together (joint and several liability) at the plaintiff's option. Joint and several liability is generally thought to encourage settlements, especially when the likelihood of success against one potential defendant is highly correlated to the likelihood of success against another. In this case, potential defendants rush to settle to avoid being the defendant chosen for suit.

When the cases against individually named defendants are more independent, however, there is disincentive for settlement under the doctrine of joint and several liability.[27] Defendants tend to resist settlement when the plaintiff's probability of success depends greatly on whom the plaintiff chooses to sue. Potential defendants hold out, waiting for the plaintiff to sue one of the other defendants.[28] In professional firms, a plaintiff's case against one defendant could be unrelated to (independent from) the plaintiff's case against another. Independence is more likely in larger professional firms, where a given partner's oversight or participation in the allegedly tortious action is often nonexistent. Ironically, the disincentive to settle increases the likelihood of trial and large judgments against the partner(s). The disincentive to settle combined with the access to a large number of potential defendants is a dangerous environment for professional service providers.

B. Liability in the "Emerging" Professions

The term "emerging professions" is used in this article to describe firms in industries whose legal status as "professional" is largely unsettled. Previous researchers have argued that

> today, service industries are booming and more service providers are specializing in extremely technical areas of practice. Both courts and society find it increasingly perplexing to define who really is a professional when it comes to liability. This is especially important in malpractice cases when a plaintiff who is a party to the contract may avoid contractual limitations on liability and pursue unlimited liability in tort.[29]

A "profession" was defined by the New York Court of Appeals in 1974 as having certain distinguishable characteristics, including: (1) requirements for formal training and learning, (2) admission to practice by qualifying licensing, (3) a code of ethics beyond that generally established in the marketplace, (4) a system to discipline its members for violation of the code of ethics, and (5) duties of members

[27] *See* Lewis Komhauser & Richard Revesz, *Multidefendant Settlements: The Impact of Joint and Several Liability*, 23 J. Leoal STUD. 41 (1994).

[28] *See id.*

[29] Glaser & Lewis, *supra* note 7, at 563.

to conduct themselves honorably.[30] At its core, the term “professional” communicated that the client placed an above normal level of trust on the provider and/or a fiduciary duty existed between the client and the provider.

While this definition originally encompassed only the traditional professions such as law, accounting, and medicine, by the 1980’s courts had generally extended professional malpractice liability to pharmacists, architects, and engineers.[31] More recently, courts have begun to apply the notions of trust and fiduciary duty to hold “skilled service persons,” such as consultants, liable for professional malpractice.[32] The rationale behind this position comes from the growing reliance and trust clients must place with providers as service tasks grow more complex and technical.[33] Along with consulting, examples where courts have found professional malpractice in “emerging professions” include computer services,[34] insurance,[35] marketing or sales agency,[36] and project management/contracting.[37]

At the same time, other courts have refused to extend professional malpractice liability to services such as management consulting[38] or computer services.[39] This split between a strict interpretation of “professional” applied by some courts and the more expansive view taken by other courts creates growing uncertainty for service providers and their customers regarding their legal rights and responsibilities.

C. Liability in the Traditional Professions

This section focuses on the growing exposure of the traditional professions, namely accounting, law, and medicine, to plaintiffs’ suits in tort that bring unlimited liability.

[30] *See, e.g.,* Hospital Computer Sys. Inc. v. Staten Island Hosp., 788 F. Supp. 1351, 1361 (D.N.J. 1992) (quoting In re Estate of Freeman, 311 N.E.2d 480 (N.Y. 1974)).

[31] *See, e.g.,* John W. Wade, *An Overview of Professional Negligence,* 17 MEMPHIS St. U. L. REV. 465,477(1987).

[32] *See, e.g.*. Data Processing Serv. Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986).

[33] *See, e.g.,* Joseph Condo, *Computer Malpractice: Two Alternatives to the Traditional "ProfessionalNegligence"Standard,* 11 COMPUTER/L.J. 323, 329 (1991).

[34] *See id.* at 323.

[35] *See, e.g.,* Gary Knapp, Annotation, *Liability of Insurer or Agent of Insurer for Failure to Advise as to Coverage Needs,* 88 AL.R. 4TH 249 (1991).

[36] *See, e.g.,* Apple Records **v.** Capital Records Inc., 137 A.D.2d 50 (N.Y. App. Div. 1988).

[37] *See, e.g.,* Morse/Diesel Inc. **v.** Trinity Indus., 859 F.2d 242, 247-248 (2nd Cir. 1988).

[38] *See, e.g.,* RKB Enter. Inc. **v.** Ernst & Young, 182 A.D.2d 971 (N.Y. App. Div. 1992).

[39] *See, e.g.,* Columbus McKinnon Corp. v. China Semiconductor Co., 867 F.Supp. 1173 (W.D.N.Y. 1994).

1. Accountants' Liability

The public accounting liability crisis is traceable to a number of economic and social factors.[40] Large, international firms such as the "Big Six," for example, dominate the auditing profession.[41] The profession has responded to many challenges in recent years, including meeting increased demands in its role as public watchdog, evaluating more complex transactions such as financial derivatives, and interpreting a rash of difficult, new accounting standards, such as the disclosures associated with granting of employee stock options.[42] The auditor is also vulnerable to litigation because of reliance on qualitative terms such as *probable, going concern,* and *more likely than not*,[43] The end result for accounting firms is that legal liabilities associated with audit work have become truly staggering, consuming about 12 percent of total revenues, even after insurance reimbursement.[44]

Accounting firms are vulnerable to securities lawsuits, regardless of degree of fault. The Securities Act of 1933 and the Securities Exchange Act of 1934, respectively, govern the public disclosures required for the original issue of financial securities and subsequent resale of these securities in the secondary markets. Since these laws require the public filing of audited financial statements, they provide the link that exposes accountants to public liability claims. Under the 1933 Act, joint and several liability for a defective registration statement may be imposed not only on the issuing entity and its officers and directors, but also on the independent accountants and each underwriter.[45] Rule 10b-5 of the 1934 Act is an anti-fraud provision governing the sale of securities. Rule 10b-5 makes material misstatements of financial statements unlawful. Both buyers and sellers may bring actions under rule 10b-5. In addition, there is no federal statute of limitations specifically applicable to rule 10b-5.[46]

The desire to sue the auditor when their client firm's stock does not perform up to financial expectations is compounded by the auditor being a general partnership. Quoting from the Big Six position statement on the liability crisis,

[40] The purpose of this section is not to prove whether a "liability crisis" actually exists. Perceptions alone may drive the decision to make organizational form changes.

[41] The six largest multinational accounting firms are referred to as the "Big Six." Before mergers, there were eight large multinational accounting firms known as the "Big Eight"

[42] *See* Conrad S. Ciccotello & C. Terry Grant, *Employee Stock Option Changes,* J. ACCT., Jan. 1995, at 72, for a more complete discussion of the impacts of changes in accounting and an examination of the differences in financial performance ratios resulting from option expense calculations.

[43] *See* comments on the liability crisis in the United States and its impact on the accounting profession in Walter Schuetze, *Commentary on The Liability Crisis in the US and Its Impact on Accounting,* 7 ACCT. HORIZONS 88 (1993).

[44] *See* Lee Berton, *Big Accounting Firms Weed Out Risky Clients,* WALL ST. J., June 26, 1995, atBl.

[45] *See* ALAN B. AFTERMAN, SEC REGISTRATION OF PUBLIC COMPANIES 35 (1995).

[46] *See id.* at 73.

a survey by the six largest accounting firms of the cases against them involving 10b-5 claims which were concluded in fiscal year 1991 showed that: (i) the average claim subjecting the accounting firm to joint and several liability was for $85 million; (ii) the average settlement by the firm was $2.7 million, suggesting there might have been little or no merit to the original claim against the accountant; yet, (iii) the average legal cost per claim was $3.5 million.[47] To behave in a rational manner dictates that accounting firms settle cases for less than what they would likely spend in legal fees. At the same time, settlement avoids the risk of incurring liability of over thirty times the settlement value. Proceeding to trial invites the wrath of a jury that may be sympathetic to plaintiffs and hostile to a business with the "deep pockets" of several hundred partners.[48]

As public accounting firms have increased in size, they have become more inviting targets for lawsuits in tort. As in the Laventhol & Horwath Chapter 11 bankruptcy case, partners, many who had nothing to do with the alleged negligence, were called upon to remit $47.3 million in personal assets to satisfy liabilities. Twenty-two of these partners were assessed over $200,000 each.[49]

Since increased size as a response to the liability crisis is not necessarily a cure-all, the Big Six have reacted in other ways. Risk management through client screening is one way that the Big Six accounting firms have reacted to the liability crisis. KPMG Peat Marwick is currently dropping 50 to 100 audit clients per year compared with only zero to 20 five years ago.[50] Another Big Six firm, Arthur Andersen & Co., has dropped over 100 companies in the past two years.[51] The implications of dropping clients are far reaching. Start-up companies, such as high technology firms seeking to go public, may have difficulty obtaining a much-desired audit from a Big Six firm. As evidence, the percentage of all initial public offerings audited by the Big Six accounting firms dropped from 84% in 1992 to 75% in

[47] *See* Big Six Position Statement, The Liability Crisis In The United states: Impact On The Accounting Profession 2 (1992).

[48] *See id.* at 1.

[49] One study discusses the financial disaster at Laventhol in detail. *See* Howard Wolosky, *Laventhol & Horwath Equity Partners Bear Brunt of Bankruptcy Liability of Firm Members,* PRAC. ACCT., Oct 1992, at 8.

[50] *See* Berton, *supra* note 44, at Bl.

[51] Lawrence Weinbach, Andersen's managing partner, is quoted as saying, "When the company has a risky profile and its stock price is volatile, we're just not going to jump in and do the audit and invite a lawsuit" Other auditors interested in growth have faced dire liability consequences. Anxious to compete with the "Big Six," from 1984 to 1990 Laventhol & Horwath added 63 smaller accounting practices which doubled revenues; however, by 1990 the accounting firm also faced over 100 audit related lawsuits. Poor client screening associated with a philosophy of rapid growth contributed heavily to their downfall. Joseph Weber, Michele Galen, Catherine Yang, & David Greising, *Behind the Fall of Laventhol,* Bus. WK., Dec. 1990, at 54.

1994.[52] Over time, such a trend could seriously impact the ability of new firms to attract financial resources through the capital markets.

2. Lawyers ' Liab ility

The 1970s marked the beginning of a significant upward trend in legal malpractice cases (the number of published appellate decisions of legal malpractice cases increased over 400 percent nationwide from the 1960s to the 1970s).[53] Liability exposure for lawyers is widespread and growing rapidly. In one empirical survey, twenty percent of responding lawyers in two major metropolitan areas say they have already been sued for malpractice at least once (of these, over sixty percent believe they will be sued again in the next decade), over eighty percent of survey respondents indicate that they have at least a moderate concern for being sued, and virtually all respondents indicate that they expect the number of suits for malpractice to grow in their profession over the next decade.[54]

The scope of concern for legal liability for lawyers extends far beyond the survey respondents in these metropolitan areas. The widespread downturn in the real estate market in the late 1980's marked a renewed surge in suits against lawyers associated with failed financial institutions. While these failures were concentrated in certain states, such as Texas, the scope of the problem was nationwide.

The size of legal malpractice claims has also soared in recent years as plaintiffs have sought large rewards against partners, past and present. In March of 1992, the Federal Office of Thrift Supervision sued the law firm of Kaye, Scholer, Fierman, Hayes, and Hadler for $275 million in response to regulatory violations associated with the firm's representation of the Lincoln Savings and Loan Association. The settlement amounted to over $41 million, of which the firm's insurers paid $25 million. The Kaye Scholer partners were responsible for the remaining $16 million under the settlement.[55]

Along with representation of savings and loans associations, certain areas of legal practice are gaining reputations as being especially risky in terms of the likelihood of a lawsuit for legal malpractice. Among these areas are estate planning,[56] tax practice,[57] family law,[58] client fraud,[59] and attomey-client

[52] *See* Berton, *supra* note 44, at Bl.

[53] *See* Ronald Mallen, *Legal Malpractice: The Legacy of the 1970s,* 16 FORUM 119, 120 (1980).

[54] *See* Douglas Peters, *et al., An Empirical Analysis of the Medical and Legal Professions ' Experiences and Perceptions of Medical and Legal Malpractice,* 19 MICH. L. Rev. 601 (1986).

55. *See* Susan Fortney, *Am I My Partner's Keeper?,* 66 U. COLO. L. Rev. 329, 329 (1995).

[56] *See, e.g.,* Melissa Brown, *Estate Planning Malpractice: A Guide for the Alabama Practitioner*, 45 ALA. L. REV. 611 (1994).

57. *See, e.g.,* Frederic G. Cornell, *The Service and the Private Practitioner: Face to Face and Hand in Hand: A Private Practitioner's View*, 11 AM. J. TAX POL'Y 343 (1994).

privilege.[60] Similar to the public accounting areas where liability is growing, each of these legal domains involves increased complexity, a great deal of professional judgment, and large stakes. Where law firms did not get sued in the event of an undesirable result (for the plaintiff) in the past, they are now seen as deep pocket defendants and an inviting target. The reactions by law firms, in some cases, to increased liability has been to avoid high-risk clients, much as public accounting firms have done.[61] While the threat of malpractice could potentially increase the quality of legal services, the threat certainly does appear to have increased costs. In addition to the added indirect costs for consumers associated with the higher difficulty of finding representation, the "preventative practices" used by legal providers increase the direct costs for the consumer, thereby explaining some of the rise in the costs of legal services.[62]

3. Doctors' Liability

The liability crises in accounting and law are relatively new phenomena compared to the liability exposure that has engulfed the medical profession. Some commentators argue that medical malpractice has been in a state of crisis since 1961.[63] Numerous studies and articles support the assertion that medical malpractice continues to grow and have profound effects on medical service providers.[64] Surveys of doctors in major metropolitan areas indicate that well over half have already been sued, with over seventy percent of this group expecting to be sued again in the next decade.[65] Similar to the trends discussed earlier in accounting and law, large exposures to liability have contributed to physicians being more selective in choosing patients and avoiding high-risk medicine, such as the practice of obstetrics, where patients may seek legal damages on the basis of deep pockets regardless of fault or negligence on the part of the physician.[66] As medical

[58] *See, e.g.,* Andrew S. Morrison, *Is Divorce Mediation the Practice of Law?: A Matter of Perspective,* 75 CAL. L. Rev. 1093 (1987).

59.See, e.g., Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers ' Responsibility for Clients ' Fraud,* 46 Vand. L. Rev. 75 (1993).

60.See, e.g., Roberta M. Harding, *Waiver: A Comprehensive Analysis of the Consequences of Inadvertently Producing Documents Protected by the Attorney Client Privilege,* 42 CATH. U. L. Rev. 465 (1993).

[61] *See* Robert B. Yegge, *Risk Management in Law Practice: Produce, Protect, and Satisfy,* PRACTICING Law., 1993, at 25; *see also* Peters, Nord, and Woodson, *supra* note 54, at 616 (indicating that over seventy percent of lawyers responding to the survey indicated they would be more selective in accepting clients).

[62] *See,* Peters, Nord, and Woodson, *supra* note 54, at 616.

[63] *See id.* at 601.

[64] *See id.* at 602.

[65] *See id.* at 613.

[66] *See* Patrick F. Hubbard, *The Physicians ' Point of View Concerning Medical Malpractice: A Sociological Perspective on the Symbolic Importance of "Tort Reform, "* 25 Ga. L. Rev. 1327 (1989). There appears to be a parallel between accountants' liability when stock prices fail to meet expectations and the "liability even without fault" nature of some areas of medicine, such as obstetrics.

firms have grown, unlimited liability suits in tort have increased the risk that the assets of all partners will be made available for judgment.

IV. Evolution of The LLC and LLP

Having summarized the growing liability threats to firms in the emerging and traditional professions, the article turns to describing the attributes of the evolving organizational forms that may address the threats. LLCs and LLPs are the subject organizational forms in this article's survey results, and their descriptions in the sub-sections below are relevant to arguments that link organizational form choice with operating environment.

A. Evolution of the LLC

The development and attributes of LLCs have been described in detail by other authors and will only be reviewed in this article in a summary fashion.[67] Originating in Wyoming in 1977, the LLC had the original mission to provide a "flexible, tax-advantaged vehicle primarily for small business."[68] The LLC is legally recognized in all 50 states and the District of Columbia.[69] The LLC is very flexible, and can be tailored almost entirely by the agreement of its members, so it is generally simple to form. The formation of a one-member LLC is permissible in a number of states.[70] The LLC Operating Agreement details the "relations among the members, managers, and the limited liability company."[71]

LLC statutes are far from uniform, and some argue that a more widespread adoption of uniform LLC statutes would increase the clarity and predictability of LLC law.[72] Despite the uncertainties, the LLC does offer limited liability protection

[67] *See* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 Ohio St. L. J. 1459 (1998), for an insider's story of the interest groups that were influential in starting the LLC. *See also,* Larry E. Ribstein, *A Critique of the Uniform Limited Liability Company Act,* 25 STETSON L. Rev. 311 (1995); Wayne Gazur, *The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role,* 58 Law. & CONTEMP. PROBS. 131 (1995); Vasilios T. Nacopoulos, *Note and Comment: Whither (Wither) Subchapter C?: The Effect of the Double Tax System's Progeny (The LLC, Check the Box, and Subchapter S),* 17 J.L. & COM. 159 (1997).

[68] Gazur, *supra* note 67, at 139.

[69] *See* Carol M. Cochran, *Key LLC Issues and Answers,* Tax ADVISOR, July 1996, at 418; Allan Karnes, Roger Lirely, and Lori Cundiffi *The Limited Liability Company: A State by State Look at the New Pass-Through Entity,* 1997 Det. C.L. Rev. 1 (1997).

70.At present, these are Arizona, Arkansas, Colorado, Delaware, Georgia, Idaho, Indiana, Kentucky, Mississippi, Missouri, Montana, New Jersey, North Dakota, Oregon, Texas, Virginia, Washington, and Wyoming. The formation and tax treatment issues of one-member LLCs continue to be hotly debated topics. *See* Pomy Ketema, *Note: Did the Federal Check-the-Box Regulations Open Up a State Tax Pandora's Box? A Reflection on State Conformity to the New Federal Classification Scheme of Single- Member LLCs,* 82 Minn. L. Rev. 1659 (1998).

[71] U.L.L.C.A,§ 103a (1995).

[72] *See* Ribstein, *supra* note 67, at 311.

as well as the possibility of favorable tax treatment. At the same time, the LLC avoids the expenses associated with the maintenance and preparation of separate partnership tax records and returns.

The Internal Revenue Service generally grants LLCs pass-through federal income tax treatment if certain restrictions are met. In order for LLC members to avoid corporate-style taxation, LLCs must avoid two of the four corporate characteristics in Treasury Regulation § 301.7701-2: (1) limited liability, (2) centralized management, (3) continuity of life, and (4) free transferability of interests.[73]

Each of these characteristics is assigned equal weight in determining the classification of the business. An entity possesses limited liability if no member is personally liable under local law for the debts of or claims against the entity. LLCs generally possess limited liability by state statute. Centralized management can be avoided if the LLCs' members perform the management and control function. On the other hand, if management decisions are vested in non-owner managers, the LLC would be deemed to have centralized management. An LLC can avoid the corporate characteristic of continuity of life if it dissolves upon the death, retirement, insanity, bankruptcy, resignation, or expulsion of a member. However, state statutes may permit the LLC to continue with the consent of all remaining members or as otherwise provided in the LLC agreement. An LLC will be considered to possess free transferability of interests if each of its members have the power, without the consent of the other members, to substitute for himself or herself a person who is not a member of the organization. It is critical that the LLC's Operating Agreement addresses these issues in such a way that the LLC will be accorded partnership status for tax purposes.[74]

To maintain partnership taxation, for example, the LLC could avoid continuity of life and free transferability of interests. This arrangement would permit the LLC to have limited liability and centralized management, while maintaining partnership tax status. Regarding the availability of the form, the Uniform Limited Liability Company Act (ULLCA) provides that the "limited liability company may be organized ... for any lawful purpose, subject to any specific provisions of the law of the State governing or regulating business."[75] The vast majority of states do not limit the types of businesses that can become LLCs.

73.See Susan Kalinka, *The Louisiana Limited Liability Company Law After "Check-the-Box,"*
57 La. L. REV. 715 (1997) for an overview of LLC tax issues. Despite the IRS test, states took different views as to how LLCs should be taxed. *See id.* There are also significant tax differences among various ownership forms when funds are reinvested or distributed. *See* H. Wayne Cecil, Conrad S. Ciccotello, and C. Terry Grant, *The Choice of Organizational Form,* J. ACCT., Dec. 1995, at 45.

[74] *See* Michael E. Mares, Stephen E. Pascarella, II and Albert S. White, III, *The Importance of a Well-Drafted LLC Operating Agreement,* Tax ADVISOR, Aug. 1996, at 484.

[75]U.L.L.C.A i 112(a) (1995).

But a few states, including Oregon and Rhode Island, prohibit the conduct of professional services by an LLC.[76]

Regarding liability exposure in an LLC, individual members' personal assets are not at risk for a debt, obligation, or liability of the LLC, or for the acts or omissions of any other member, manager, agent or employee of the LLC. Generally, the LLC member should have the same liability as a corporate shareholder, with the exception that the LLC does not protect a member from liability created by his own negligence or malfeasance. The potential for limited liability *for ALL* participants is the LLCs "comparative advantage" over other forms like the general and limited partnership.[77]

The LLC is available for a wide range of options regarding management structure, as it can be "member managed" or "manager managed."[78] The LLC can choose a hierarchical (corporate) structure with a managing board for formalized decision making, or adopt a more decentralized control structure similar to that of a traditional partnership. Some believe that fiduciary duties in LLCs will evolve toward partnership type duties for members in member-managed LLCs, and toward corporate director-type duties for managers in manager-managed LLCs.[79] Within the realm of fiduciary concerns, the express duties of care and loyalty may vary depending on management structure, meaning that there is non-uniformity in the approach toward indemnification of managers.

PLLC Statutes

Mississippi enacted legislation in 1994 permitting professional firms to organize as a professional limited liability company (PLLC). The liability protection offered by the PLLC can be very attractive relative to other forms such as the general partnership. But due to the high levels of fiduciary trust placed in

[76] *See* OR. REV. STAT. 5 63.074(2) (1994 Supp.); R.I. GEN. Laws § 7-16-3 (1992). Other states prohibit the LLC in certain other industries, such as insurance or banking. *See* LA. Rev. Stat. Ann. { 12:1302A (West 1994); Nev. Rev. Stat. Ann. S 86.141 (Michie 1994); Wyo. Stat. Ann. § 17-15-103 (Michie 1994 Supp.). Simonetti and Andrews point out that the LLC would be a desirable form for CPA firms. *See* Gilbert Simonetti & Andrea R. Andrews, *A Profession at Risk: A System in Jeopardy,* J. ACCT., Apr. 1994, at 45. *See* Jimmy G. McLaughlin, *Comment, The Limited Liability Company: A Prime Choice for Professionals,* 45 ALA. L. REV. 231 (1993). McLaughlin argues that LLCs are a good match for professional firms.

[77] *See* Gazur, *supra* note 67, at 137; *see also,* David L Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility, and Securities Regulation for the Limited Liability Company?* 51 OKLA. L REV. 427(1998).

[78] In a member-managed LLC, each member has "equal rights in the management and conduct of the company business." U.L.L.C.A. § 404(a) (1995). In a manager-managed LLC, the managers have "exclusive authority to manage and conduct the company business." U.L.LC.A 3 404(b) (1995).

[79] *See* Robert R. Keatinge, Larry E. Ribstein, Susan Pace Hamill, Michael L. Gravelle, & Sharon Connaughton, *The Limited Liability Company: A Study of the Emerging Entity,* 47 Bus. Law. 375, 398 (1992).

professionals, PLLC statutes expose members to greater liability risks in PLLCs than in ordinary LLCs.

The Mississippi statute addresses professional liability as follows:

> Each individual who renders professional services as an employee of a domestic or foreign professional limited liability company is liable for a negligent or wrongful act or omission in which he personally participates to the same extent as if he rendered the services as a sole practitioner. A member or an employee of a domestic or foreign professional limited liability company is not liable, however, for the conduct of other members or employees of the limited liability company, except a person under his direct supervision and control, while rendering professional services on behalf of the professional limited liability company to the person for whom such professional services were being rendered.[80]

Relative to the LLC, the scope of potential liability is wider; the PLLC exposes members to liability for failure to adequately supervise. But, the PLLC continues to protect members' personal assets from obligations of the company itself, similar to the LLC.

B. Evolution of the LLP

The LLP originated in August 1991 in Texas with Texas House Bill 278.[81] Since that time, the LLP form has grown rapidly. At present, LLP statutes exist in 46 states, with legislation likely in the four remaining states during 1997.[82]

The LLP grew out of the collapse of the real estate and energy markets in Texas in the late 1980s. Regulators from the Federal Deposit Insurance Corporation and the Resolution Trust Corporation aggressively pursued the lawyers and public accountants who had been affiliated with failed banks and savings institutions. These firms were natural targets as the financial institutions sued could remit only a small portion of the total losses. In addition, the law and accounting firms themselves were deep pockets with many wealthy partners.[83]

[80] *See* MISS. CODE Ann. § 79-29-920 (1996). Mississippi is used as an illustrative example due to the authors' familiarity with the law and practices in that state.

[81] *See* Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly), 66* U. COLO. L. REV. 1065 (1995).

[82] *See* Bruce P. Ely, *et. al,LLC/LLP Update*, 11 St. TAX NOTES 709 (1996). LLP legislation is currently pending in Arkansas, Nebraska, Rhode Island, and Vermont. *See id.* at 709-714.

[83] *See* Hamilton, *supra* note 81, at 1068.

The original idea behind the LLP concept was to provide "peace of mind" to innocent partners in scenarios where they had no connection to the tort.[84] Much of the attractiveness of the LLP springs from its favorable liability provisions relative to the general partnership. The Texas statute has the following five provisions: (1) The shield of limited liability extends to "debts and obligations of the partnership arising from errors, omissions, negligence, incompetence, or malfeasance committed ... by another partner or a representative of the partnership not working under the supervision or direction" of the partner; (2) A partner loses the shield of limited liability if he or she "was directly involved in the specific activity in which the errors, omissions, negligence, incompetence, or malfeasance were committed" or "had notice or knowledge of the errors, omissions, negligence, incompetence, or malfeasance . . at the time of occurrence and then failed to take reasonable steps to prevent or cure the errors, omissions, negligence, incompetence, or malfeasance;" (3) LLP status does not affect the liability of a partner "for debts and obligations of the partnership arising from a cause other than the causes" specified above; (4) LLP status does not affect the liability of the partnership itself to pay all debts and obligations out of partnership property; and, (5) The LLP must either (a) "cany at least $100,000 of liability insurance of a kind that is designed to cover the kinds of errors, omissions, negligence, incompetence, or malfeasance for which the liability is limited" or provide $100,000 of funds specifically designated and segregated for the satisfaction of judgments against the partnership based on the kinds of errors, omissions, negligence, incompetence, or malfeasance for which the liability is limited."[85]

Statutes in Texas and Delaware follow the original conception of the LLP.[86] Partners are generally only at risk for their own acts and omissions, those of persons under their supervision, and obligations of the firm incurred in the ordinary course of business.[87] There is some variation in LLP provisions, however, as some states have passed "bulletproof' LLP statutes.[88] Bulletproof LLP statutes virtually eliminate the personal liability of partners for partnership obligations. In this sense, bulletproof LLPs are similar to LLCs.

Despite the differing LLP provisions regarding the scope of liability protection, the LLP has fewer areas of legal operation open to interpretation than

[84] *See id.* at 1067.

85 TEX. REV. Civ. STAT. ANN. art. 6132b-3.08. (West Supp. 1995).

86 *See id.*

87.See id.

[88] At present, 17 states, including Alabama, California, Colorado, Connecticut, Georgia, Idaho, Indiana, Maryland, Massachusetts, Minnesota, Missouri, Montana, New York, North Dakota, Oregon, South Dakota, and Wisconsin have bulletproof statutes. *See. e.g..* MINN. STAT. ANN. g 323.14 (West 1981 and Supp. 1995) (stating that partners have limited liability for all types of liabilities, including those of the firm itself). For a description of how Massachusetts came to adopt the bulletproof LLP statute, *see* Patrick Cammarata, *Note: Allowing Attorneys to Swing for the Fences: The Massachusetts Limited Liability Partnership Act*, 38 B.C. L. REV. 949 (1997).

the LLC. For example, since the LLP is a form of the general partnership, avoidance of double taxation is automatic. LLP provisions are usually part of the general partnership statutes and do not include separate operational rules in areas such as fiduciary duties.

The LLP form has gained recent popularity because of the combination of improved liability protection and favorable tax treatment. The LLP protects law and accounting firms from large liabilities associated with failure of financial institutions. The LLP form should be popular with traditional professional service providers, such as law and accounting firms. Currently, all of the Big Six accounting firms are LLPs.

V. SOURCES OF DATA ON LLC AND LLP ADOPTIONS

LLCs and LLPs, as privately held firms, are not required to provide detailed operating information for public review. They are only required to file cursory registration data with the state in which they are organized. Accessing what information is available on LLCs and LLPs depends on several sources. First, the Annual Reports of the Jurisdictions compiled by the Secretaries of State are obtained through the records of the International Association of Corporation Administrators. Each state's annual records list the number of new registrations each year in the state for firms in various forms, including the LLC and LLP, corporations (including C, S, and PC), and limited partnerships. The data is available for 49 states and provides a nearly complete basis from which to assess the growth patterns of LLCs and LLPs relative to other forms.[89] From these data sources, LLC registration information is available from 1992 through 1996; for the more recently created LLP, the data is obtained for 1994 through 1996.

This article also relies on data contained in the *Lexis/Nexis* database. This database accesses documents for private companies in most states. Keyword searches based on words or phrases such as "*LLC*," "*LLP*," and "*limited liability company (partnership)*" in the "*company*' and "*all documents*" databases initially produces over 5,700 records. These records reflect entries from companies in 43 states.[90] Each of these records encompasses a single firm's filing, usually a three to five-page registration document. Once all of these records are pulled from the database, each is then examined to determine the nature of the firm's business.

The most directly interpretable information in the records is the title of the business. In some cases, the business function is captured in the title and is easily understood. Examples include: *Jones and Jones: Certified Public Accountants,* or

[89] West Virginia is not included because the Corporation Administrator did not report that state's data.

[90] The states not represented in the sample are Arkansas, Hawaii, Iowa, Kansas, Montana, Vermont, and West Virginia. No large states, such as New York or California, are missing.

Smith and Smith: Consulting Engineers,[91] Other business titles are not as helpful, such as *Jones and Associates.* In these cases, the record must be more carefully studied to ascertain the business function. In some instances, a short and clear description of the business' activities is provided. But from the registration records alone, it is often not possible to determine the business' function. If the nature of the business is not apparent in the registration document itself, the firm is not included in the final sample.[92] From over 5,700 records, specific business functions were ascertainable for 1,252 LLCs and 680 LLPs.[93]

VI. SURVEY RESULTS AND DISCUSSION

A. Growth ofLLC and LLP Registrations

[Insert Table 1 about here]

Table 1 illustrates the rapid growth of LLCs and LLPs registrations relative to corporate and limited partnership (LP) registrations. While the number of new registrations for corporations and LPs grows noticeably (approximately 15 percent in both cases) over the period from 1992 to 1996, the LLC growth over that period is nearly 25 fold (6,118 in 1992 to 148,309 in 1996). In 1992, new LLC registrations are less than one percent of the corporate total; in 1996, they are in excess of 20 percent. Nearly one in every six new business registrations nationwide in 1996 is an LLC.

The growth in LLP registrations is similar. For the period 1994-1996, the number of new LLP registrations increased from 1,933 to 9,310, almost fivefold. Again, this expansion in the growth of LLPs far exceeded that for corporations and LPs.

Together, these LLC and LLP findings support the argument that these forms are rapidly gaining popularity. The data tracks registrations from very small numbers (6,118 LLCs in 1992 and 1,933 LLPs in 1994), capturing almost all of the growth in the use of these forms. The issue remains as to what types of firms are choosing to adopt and become part of the growth in registrations just documented.

[91] Such identification of business function within the business name is typical for accounting firms. *See, e.g.*, COLORADO STATE BOARD OF ACCOUNTANCY, RULES OF THE COLORADO STATE BOARD OF ACCOUNTANCY (1995), stating that an individual or entity carrying on the practice of accounting may use an assumed or trade name if it is not misleading and clearly indicates that the individual or entity is engaged in providing accounting services.

[92] There are a small number of cases (approximately 30) where the registration document provides the professional designation of a point of contact for the firm (such as Esq. or CPA). Since a lawyer or CPA could be the point of contact for a firm in a business outside of law or accounting, we did not rely on this designation to determine the firm's business function.

[93] This is a large loss of data from the original 5700 firms. But the nearly 2000 firms that remain have clearly identifiable business functions.

B. Choosing the LLC or LLP Form

State regulators and professional certification agencies traditionally have been reluctant to allow liability limiting organizational form changes. But professional organizations have been granted more flexibility with regard to changes in form in recent years. For example, prior to 1992, CPAs could practice only in proprietorships, general partnerships, or as a professional corporation. Since January 1992, the American Institute of CPAs (AICPA) has permitted CPAs to practice in any organizational form permitted under state law. This flexibility makes the study of LLC or LLP adoption more interesting, as it frees firms to choose among the available forms.

1. Firms Choosing the LLC Form

[Insert Table 2 about here]

From the search of the *Lexis/Nexis* database, LLC registration documents were obtained and classified. Table 2 shows the breakdown for the 1,252 LLCs that could be classified into a particular business activity. Three hundred twenty five of the firms (26 percent of the sample) are in management service industries (Standard Industrial Classification (SIC) 87XX). About 14 percent (180) of these companies are in engineering and architecture, consulting, or employment recruiting. Other heavily represented management service activities (12 percent of the sample) include businesses such as maintenance, trash removal, and painting.

The second most-represented industry in the sample is real estate services, including brokerage and property management. Two hundred thirty three companies (19 percent of the sample) are in this industry. Construction and general contracting is the third most-heavily represented business type with 149 firms (12 percent), followed by 108 (9 percent) investment companies in the LLC sample. Other industries notably represented include 105 retailers (8 percent), 82 health services providers (7 percent), 74 amusement and recreation providers (6 percent) 52 agriculture (crops) businesses (4 percent), 36 oil and gas extractors (3 percent), 35 agricultural (livestock) firms (3 percent), 27 restaurants (2 percent), and 26 leasing companies (2 percent).

To discuss some of these individual industries separately, the initial focus is an analysis of the findings for 87XX (management services), the largest group. As discussed earlier, engineering and architecture firms are often deemed "professional" and subject to malpractice liability.[94] The engineering or architecture firm owners thus have significant concerns about professional liability arising from negligence.[95] Large judgments may be associated with design failures of water or sewer systems, bridges or buildings, and the like. In a general partnership, the assets of all partners could be subject to claims. Liability in an

[94] *See* Wade, *supra* note 31,

[95] *See id.*

LLC is generally limited to the individual whose actions gave rise to the claim. This advantage is also in stark contrast to other forms such as the general partnership or limited partnership (LP), where management participation by a limited partner carries the risk of being treated as a general partner and losing limited liability status.[96] An LLC offers the advantage of limited liability for all members, regardless of their participation in the management of the business.

A striking feature of the LLC sample is the large number of emerging professions. Consulting firms make up a significant proportion of the sample. Businesses such as consulting, real estate services, contracting, and investment advising would all arguably fall into this emerging profession category.[97] These are technical, complex service activities with above-average levels of trust and fiduciary care.[98] With the current law regarding the extension of professional liability so muddled, members of these firms practicing under the partnership, proprietorship, or PC form could be held to professional liability standards and be sued in tort for malpractice.[99]

In a number of the management services businesses in the sample, owners/managers rely on agents (employees) to perform the tasks. Liability for agents' actions may arise from poor performance leading to disaster, such as shoddy maintenance that results in an industrial accident. Agents or employee actions leading to accidents may also lead to large liabilities in construction and contracting. For businesses such as oil and gas and agriculture, environmental liabilities may be quite large in case of accident or negligence of workers. In other businesses where employees must travel, such as trash collection or painting, liability for accidents and from *frolic* or *detour* incidents (agent involved in auto accident on way to the job site) may result in heavy damage claims on the owners under *respondeat superior.*[100] The LLC provides the necessary protection against such suits reaching the owners' personal assets.

The LLC also provides protection against the *slip and fall* type accidents on the property of the business. As a proprietorship or partnership, these accidents could impact the owners' personal wealth. Arguably, as an LLC, the owners would be protected absent some proof of their direct negligence in maintaining the area.

[96] *See* Naomi R. Lamoreaux, *Partnerships, Corporations, and the Theory of the Firm*, 88 AM. ECON. REV. 66 (1998) (arguing that opportunistic withdrawal by limited partners worsens liability problems for the general partner); *see also* Aleta G. Estreicher and Warren S. Green, *Heavy Duty II: Forming a Business Entity in the United States*, 17 N. Y.L. SCH. J. INT'L & COMP. L. (1997).

[97] Real estate brokerage is a highly technical area with a number of "professional" characteristics, including licensing and ethical codes of conduct. Drops in property values or failure to close prospective sales or purchases could bring large damage claims to the firm. Poor investment performance relative to expectations or lack of fiduciary care of assets may result in large claims against investment advisory firms.

[98] *See* Wade, *supra* note 31, at 465.

[99] *See* Glaser & Lewis, *supra* note 7, at 563.

[100] Black's Law Dictionary defines "respondeat superior" as "let the master answer." It is a maxim meaning that a principal is liable in certain cases for the wrongful acts of his or her agent.

This could be an extremely valuable protection for several of the businesses in the LLC sample that have high public traffic. They include retail, amusement and recreation, and restaurants.

The LLC is gaining popularity since other organizational forms do not offer the same combination of benefits. For example, real estate firms may earn significant revenues from passive sources, such as rents, making their organization as an S corporation or a PC with S Corporation tax treatment less desirable.[101] The LLC is thus an attractive alternative to provide liability protection and allow tax- advantaged distributions of cash to owners. The owners may have significant concerns about personal liability if they are active in the management of the business. Organizing as an LLC would thus be superior to choosing the limited partnership form.

The LLC also provides favorable tax treatment. If the LLC meets the restrictions described earlier, its members are taxed as partners. The desire in many service businesses is to pass through as much of the cash flow as possible to the owners.[102] The LLC offers favorable tax treatment of cash distributions to owners relative to what a corporation would provide.[103] The LLC permits the distribution of this cash without double taxation while providing owners with limited liability. Examining the level of dividend payments by public corporations in these Standard Industrial Classifications (SICs) may be instructive as to the desire of these types of businesses to distribute cash. In particular, computing the average dividend yields of publicly traded firms in the 65XX SIC (real estate services) and 67XX (investment services) confirms this notion. These firms had an average dividend yield of 5.01 percent and 6.96 percent in 1994 compared to a dividend yield in 1994 of 2.49 percent for the S&P 500. The results show that the average dividend yield is far above the level of the S&P 500 and that a tax-advantaged form such as the LLC is desirable.[104]

The results for LLCs are consistent with earlier research on organizational form changes that focused on issues such as growth opportunities and agency costs.[105] In the case of LLCs, owners or managers who face highly uncertain exposure to liability for professional negligence are adopting forms to reduce that exposure. At the same time, owners preserve favorable pass through tax treatment. In this choice, firms are reducing costs to remain competitive and maximizing aftertax cash flows to owners.

[101] See Gary W. Derrick, *Oklahoma Limited Liability Companies and Limited Liability Partnerships*, 22 OKLA. CITY U.L. REV. 643 (1997), for additional discussion of the advantages and disadvantages of the LLC relative to the S Corporation.

[102] The corporate form may be relatively advantageous over the partnership form if cash flow tends to be reinvested in the business.

[103] *See* Cecil, Ciccotello, and Grant, *supra* note 73, at 52.

[104] For firms with large amounts of cash in excess of what is needed for reinvestment, having a tax- advantaged form from which to distribute that cash is desirable. *See, e.g.*, Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance and Takeovers*, 76 AM. ECON. REV. 323 (1986).

[105] *See* Lehn, *supra* note 11, at 578.

2. Firms Choosing the LLP Form

[Insert Table 3 about here]

Table 3 shows the breakdown of the 680 LLPs that could be classified into a particular activity. Firms in the traditional professions dominate the sample. The largest single activity represented is the practice of law. Law firms make up 29.7 percent of the sample (202 firms). For very large law firms with several hundred partners, changing the organizational structure to an LLP makes the law firm less of a deep pocket by reducing liability exposure. Partners who have no direct connection to the tort are arguably protected from suit.

The survey results in Table 3 are consistent with the original conception of the LLP in Texas.[106] The LLP provides peace of mind to innocent partners. The LLP remains a partnership from a tax standpoint; the partnership itself is not a taxable entity.[107] The presence of a large number of law firms in the sample supports arguments made by previous researchers. They conclude that the availability of limited liability organizational forms for professional services will greatly diminish the use of the traditional partnership.[108]

The degree to which law partners will be responsible to monitor the work of other associates and partners remains an interesting issue. Despite the potential legal protections of the LLP form, some authors believe that attorneys will remain liable in cases where reasonable monitoring of other partners or associates would have uncovered negligence or fraud.[109] From an economic standpoint, peer review is important to law firms as an investment in reputation and brand name.[110] Failing to perform close monitoring may thus avoid legal liability under the LLP, but may damage the firm's reputation for quality services. But firms investing heavily in internal monitoring may not reap rewards unless they can successfully distinguish themselves from competitors that invest less in internal monitoring.[111]

The second largest group of LLPs are medical firms (194 firms or 28 percent of the sample). Within this group are many types of medical providers including anesthesiologists, family practitioners, oncologists, obstetricians, pediatric specialists, and surgeons. Similarly, 26 dental firms (about 4 percent of the sample) are found to be identifiable as LLPs. The common denominator of all these groups

[106] *See* Tex. Rev. Civ. STAT. Ann. art. 6132b-3.08. (West Supp. 1995).

[107] *See id.*

[108] *See* Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of Partnership,* 70 WASH. U. L.Q. 417 (1992).

[109] *See* Susan S. Fortney, *Professional Responsibility and Liability Issues Related to Limited Liability Law Partnerships,* 39 S. TEX. L. Rev. 445 (1998); Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy,* 2 J.L. ECON. & Oro. 53 (1986).

[110] *See, e.g.,* Jack L. Carr & Frank G. Malhewson, *The Economics of Law Firms: A Study of the Legal Organization of the Firm,* 33 J.L. & ECON. 307, 308 (1990).

[111] *See* Langevoort, *supra* note 59, at 75.

is a concern for professional malpractice claims."[2] The LLP limits liability to those in close proximity to the alleged tort. The LLP thus provides a understandable limit on liability in most medical activities, such as a surgical procedure, where it is fairly clear who is directly involved. During an operation, for example, the surgeon may "directly" supervise the assisting physicians and nurses and be responsible for their actions.

Accounting firms are the third largest activity in the sample (82 firms or about 12 percent of the sample). As previously discussed, the perceived liability crisis in accounting is driving firms in this business toward enhanced protection."[3] The LLP again provides a valuable piece of mind for those partners not involved in a specific activity, such as an audit."[4] Audits are typically performed by junior personnel in the firm under the supervision of a responsible partner. Arguably, that partner is the direct supervisor for the purpose of that audit.

Sixty-six (9 percent) real estate service firms also appear in the sample as well as 28 (4 percent) investment advisors. For these firms, the LLP may be favorable to the S Corporation or PC with S Corporation taxation because of the tax-advantaged treatment of passive income."[5] Other notable industries represented include engineering and architecture (3.7 percent), retailers/wholesalers (3.4 percent), and general contractors (2.6 percent). As previously discussed, these businesses operate in highly-uncertain service areas where there is a chance they may be held to professional liability standards, or there is a significant risk of an accident on the property. Owners or partners are thus vulnerable to claims based on the negligence of an individual partner, associate, or employee. The LLP breaks the liability link to the larger pool of partners' assets.

The LLP findings are again consistent with the larger picture of organizational-form research."[6] LLPs are concentrated in the traditional professions, where liability claims have been at crisis level for a long period of time (medicine/law) and/or have been escalating rapidly (public accounting).[117] Firms in these industries choose LLPs to help reduce the costs of operating and to maximize after-tax cash flow to owners. For other businesses, such as real estate and investment advising, the LLP offers liability protection, favorable tax treatment on passive income, and fewer restrictions on deductibility of certain expenses. The LLP offers an attractive alternative to other forms, like the S Corporation or PC, in this regard.

[112] *See* Peters, *supra* note 54, at 601.

[113] *See* Schuetze, *supra* note 43, at 88.

[114] *See* Tex. Rev. Civ. STAT. Ann. art. 6132b-3.08. (West Supp. 1995).

[115] *See* Painter, *supra* note 21.

[116] *See*, Lehn, *supra* note 11, at 578.

[117] *See* Peters, *supra* note 54, at 601; Schuetze, *supra* note 43, at 88.

C. LLC Versus LLP

Examining why some industries and firms favor the LLC while others want to become LLPs may help to shed light on rationales for organizational-form selection. Two sample characteristics may limit the usefulness of this discussion. First, if a number of states do not recognize the LLC and/or LLP, industry trends in the sample may be biased. Currently, the LLC is recognized in all 50 states and the LLP in 46.[118] Further, the states not currently recognizing the LLP form are small states. The sample discussed in this article includes data from 43 states; no large states are missing. A second bias may be widespread regulations forbid firms in certain industries to adopt one of the forms. But there are only a few examples of direct prohibitions, as previously discussed. These concerns do not overwhelm the utility of examining the sample results to analyze trends in LLC and LLP selection.

The choice of the LLC or LLP may be based on considerations of organizational fit and customs. For many of the established partnerships in the traditional professions, changing to the LLP is preferable to adopting the LLC because the LLC is not a partnership. The LLP thus serves the customs of the traditional professions better than the LLC.[119] Firms of traditional professionals (lawyers, physicians, and accountants) may prefer to continue in a traditional partnership structure as many of the members perform the service work for clients quite independently.[120] While the LLC certainly offers the flexibility to be set up this way, firms made up of these "independent contractors" have customarily formed as partnerships.[121]

For partners in long-lived firms in the traditional professions, the LLC's rise and rapid growth may represent just the latest fad in organizational design. Partners in traditional professional service firms may believe that the change to LLC form could unnerve or confuse customers. Becoming an LLC requires that the partnership leave the partnership form entirely.[122] Conservative older and larger partnerships in the traditional professions are more likely to be gripped by inertia and thus less likely to make this change away from the partnership form.

[118] *See* Cochran, *supra* note 69, at 418.

[119] The authors are grateful to Martin Homyak for the term "organizational fit and custom" and for the ideas and prose used in the entire discussion of this issue.

[120] *See* Fortney, *supra* note 55, at 329.

[121] *See* Hamilton, *supra* note 81, at 1067.

[122] For existing partnerships, there may be a very practical concern about the impacts of dissolving the existing enterprise to become an LLC. While dissolving the partnership to become an LLC could be as easy as importing the old partnership agreement into the LLC Operating Agreement verbatim, becoming an LLC could bring about a discussion on a number of contentious issues. These could include valuation of various ownership stakes, and a reexamination of the governance of the organization. Debate on issues like these could be acrimonious and expensive in terms of manager/partner time. For partnerships adopting the LLP form, on the other hand, the election represents essentially no change (in strict organizational terms) from the general partnership.

The LLP's liability shield, as defined in the Texas statute, fits the typical traditional professional firm organization well.[123] Partners customarily perform the service work itself somewhat independently from each other. Each partner has associates under his or her supervision. The LLP "peace of mind" comes to a partner who carefully evaluates the work under his or her review.[124] Such work may be neatly divided. Performing an audit, trying a case, or leading a surgical team are excellent examples. In these cases, the LLP provides a cleaner picture of the scope of responsibility than the LLC.

LLCs limit liability to the actions of the individual only. Even if traditional professional firms become LLCs and have these liability limits, the canons of the profession itself may demand responsibility for the work under the partner's review. In the legal profession, for example, the Pennsylvania Rules of Professional Conduct state that a lawyer must provide competent and diligent service to a client.[125] In addition, a lawyer remains responsible for code violations of her fellow lawyers (peers), those lawyers she supervises, and those non-lawyer associates she supervises.[126] These ethical provisions seem inconsistent with the LLC concept of liability for the actions of the individual only. In addition, professional liability insurance tends to reinforce the desire for "nonparticipating" partners to oversee other partners' work and actions.[127] If "professional" means standing behind the work of the firm, then attempts by a partner to limit her liability to her own actions are futile.[128]

On the other hand, an LLC may be more appropriate for many of the firms in the emerging professions. In these businesses, a great deal of coordination among those performing the actual service work may be needed. Possible examples include consulting, engineering or architecture, contracting, real estate, and investment advising. The work in these businesses comes in harder-to-define bundles than those work units in the traditional professions. The LLP's liability protections have less meaning, since supervisory responsibility may be more diffuse.

[123] *See* TEX. REV. CIV. STAT. ANN. art. 6132b-3.08. (West Supp. 1995).

[124] *See id.*

[125] *See* PA RULES OF PROF. CONDUCT Rules 1.1-1.2 (1988).

[126] *See* PA RULES OF PROF. CONDUCT Rules 5.1-5.3 (1988); *see also,* Robert W. Hillman, *The Impact of Partnership Law on the Legal Profession,* 67 FORDHAM L. Rev. 393 (1998) (arguing that monitoring subordinates is an investment in firm reputation that is superior to relying on liability shields.

[127] *See, e.g.,* Robert Minto, Jr. and Marcia Morton, *The Anatomy of Legal Malpractice Insurance: A Comparative View,* 64 N.D.L. Rev. 547, 574 (1988) (indicating that a professional liability policy without innocent partner protection may not provide a personal liability shield to partners who fail to adequately monitor). Failing to monitor adequately may lead to gaps in professional liability insurance coverage. *See also*, George M. Cohen, *Legal Malpractice Insurance and Loss Prevention: A Comparative Analysis of Economic Institutions*, 13 CONN. J. INT'LL. 379 (1999).

[128] *See* Elizabeth C. Woodford, *Note: The Ethical Implications of the Limited Liability Status in the Practice of Law,* 87 KY. L.J. 489 (1998/1999), who argues that professionals are still "on the hook." *See also* Martin C. McWilliams, *Limited Liability Law Practice*, 49 S.C. L. Rev. 359 (1998), who discusses the origins of vicarious liability for professionals. The Mississippi PLLC statute discussed earlier is evidence of the pressure to hold partners responsible for those they supervise.

Malpractice standards in the emerging professions are also muddled. In sum, the LLP's coverage provides less peace of mind in the emerging professions where the standards for negligence/malfeasance etc. and supervision are not very well established. In this scenario, the LLC offers the flexibility to design a manager- managed or owner-managed hierarchical structure more akin to the corporate form and a better fit with the unique requirements of these businesses. Besides flexibility, the LLC generally offers a broader liability shield than the LLP.[129] For service providers in the emerging professions, where the liability landscape is already highly unsettled, the prospect of the LLC's broader shield may well also be worth accepting risks associated with less-well settled issues, such as fiduciary duties, in LLCs.

The LLC is a flexible, tax-advantaged vehicle appropriate for small businesses. Although there is no direct data on age or size of the firms in the sample, the industry makeup of the LLC firms is broader. Since traditional professional firms dominate the LLP sample, it is likely that the LLC sample has a much higher percentage of small firms.[130]

The requirements of becoming an LLP may burden smaller firms. In Texas, for example, becoming an LLP requires that the firm have $100,000 in malpractice insurance or an equivalent amount of capital dedicated to meeting malpractice claims; in Delaware this amount is $1,000,000.[131] This coverage and/or capital requirement raises small firms' costs considerably. The resulting financial burden for small firms may make the LLC preferable. For a small firm, the LLC is also simple and inexpensive to set up, relative to an LLP. In addition, the maintenance and reporting of separate partnership tax records is not required in an LLC, as in an LLP.

From the Internal Revenue Service data, it is apparent that a large number of sole proprietorships exist in the professional service professions.[132] For these firms, the LLP is not even available; a partnership must have at least two people. On the other hand, one-person LLCs are recognized in 18 states.[133] The LLC would thus be available for sole proprietors, and could provide significant liability protection compared to proprietorship status.[134]

[129] There are exceptions, such as the bulletproof LLP statutes.

[130] Many of the traditional professional firms in the LLP sample were probably general partnerships prior to changeover to the LLP. IRS statistics show that partnerships tend to have be the largest firms in the service professions. *See* IRS STAT. INCOME SURV., *supra* note 15, at 82.

[131] *See* TEX. REV. STAT. ANN. art. 6132b-3.08(d) (West Supp. 1995); DEL. CODE ANN. tit 6, $ 1546(a) (1993).

[132] *See* 1985 IRS STAT. INCOME SURV., *supra* note 15, at 82.

[133] *See* Timothy R. Koski, *Guidance for Former and Future Single-Member LLCs*, 62 PRAC. Tax STRATEGIES 138 (1999), for more information about tax issues associated with single-member LLCs.

[134] See Larry E. Ribstein, *The New Choice of Entity for Entrepreneurs*, 26 CAP. U.L. REV. 325 (1997) , for additional discussion of the business association issues for single-person entities.

Both the LLC and LLP samples show a clear pattern of following the original intent behind the creation of the form. The dominance of traditional professional firms in the LLP sample fits the original conception of the LLP as a form that establishes a peace of mind for innocent partners. LLCs, on the other hand, fit the needs of smaller service providers in more uncertain legal and operating environments. The LLC is a more flexible organizational vehicle, as evidenced by the variety of industries in the LLC sample.[135]

D. Crossover in the Future

An interesting question at this point is whether crossover from this original sample pattern will occur as the LLC and LLP develop and mature. Will traditional professions move more toward the LLC through time? And, will more firms in the emerging professions choose to become LLPs? In the future, the answers to these questions may depend less on considerations of fit and custom and more on the statutory creation and availability of various blending forms.[136]

Given the availability, a professional partnership could choose to reorganize as a Professional LLC (PLLC) instead of an LLP. Similar to the corporate form, PLLC members' assets are shielded from obligations of the firm which arise from the ordinary course of business. In some states, PLLC members are liable only for their own negligent or wrongful acts or omissions, as well as the negligent or wrongful acts or omissions of persons under their direct supervision and control.[137] In contrast, LLP partners' assets are exposed to professional malpractice and supervisory liability risks as well as the general debts and obligations incurred by the firm in the ordinary course of business. However, those states with bulletproof LLP statutes offer essentially the same liability protection to LLP partners as PLLC statutes offer to members.[138] Of course, the LLP is taxed as a partnership by definition. Given the other restrictions and conditions associated with being an LLC, a general partnership professional service firm may better achieve its objectives through the bulletproof LLP form.
[Insert Table 4 about here]

Table 4 shows that the PLLC and bulletproof LLP statutes bring the LLC and LLP closer together. The PLLC moves the LLC toward the LLP model by invoking supervisory liability. The bulletproof LLP moves the LLP toward the LLC liability posture by eliminating partners' personal liability for partnership

135 *See* William H. Copperwaite, *Limited Liability Companies: The Choice for the Future*, 103 COMM. L. J. 222 (1998), for a summary of the advantages and disadvantages of LLCs.

136 *See* Larry E. Ribstein and Mark A Sargent, *Check-the-Box and Beyond: The Future of Limited Liability Entities*, 52 BUS. LAW. 605 (1997), and David M. Deaton, *Comment: Check-the-Box: An Opportunity for States to Take Another Look at Business Formation*, 52 SMU L. REV. 1741 (1999), for additional perspective on the future of LLCs and LLPs.

137 *See* Miss. Code Ann. S 79-29-920 (1996).

138 See, *e.g.*, MINN. STAT. Ann. § 323.14 (West 1981 and Supp. 1995)

obligations. For traditional professional firms, the PLLC provides additional personal liability protection against firm obligations not available in the LLP.[139] For larger firms in the emerging professions, on the other hand, the bulletproof LLP may be a better choice than the LLC since partnership (pass through) taxation is automatic, while the scope of overall liability protection is similar. Blending statutes (PLLC and bulletproof LLP) thus blur the distinction between the LLC and LLP. The blending of these two forms increases the likelihood of crossover of traditional professions into LLCs and emerging professions into LLPs.[140]

VIL SUMMARY

Although some bemoan the marriage of professionalism and commerce, economic pressures are driving the professions to an increased emphasis on management issues. For professional service firms, organizing to provide services at lowest cost is essential. Responses such as the LLC and LLP have become very popular with professional service providers whose owners face large potential legal liability but want pass-through tax treatment. This article documents the growth of these forms and finds that the LLC and LLP's distinguishing features are desirable to firms in certain professions. LLCs are concentrated in the emerging professions such as management services and consulting. LLPs are largely found in the traditional professions, such as law, accounting, and medicine.

Considerations of organizational fit and customs drive the choice of LLC or LLP. The LLP's liability shield fits traditional professions well, as tasks and supervisory relationships are well defined. Ethical canons in the traditional professions demand overview of the work of others in the firm. The LLP's liability provisions align with this ethical consideration. In contrast, the types of emerging professions in the LLC sample reflect the need for flexibility in organizational design and increased liability protection that the LLC offers. The LLC is amenable to various structures including the corporate, hierarchical management structure that may be desired by firms in the emerging professions. The LLC also tends to have low set-up costs relative to the LLP, making it attractive for small service providers. One-member LLCs are permitted in a number of states, making conversion from the proprietorship possible. Lastly, PLLC and bulletproof LLP

139. For firms becoming PLLCs, the bulletproof LLP form may not be available.

140 Crossover may become moot if business associations consolidate. Articles that provide perspectives on the future of business association consolidation are numerous. *See, e.g.*, Robert R. Keatinge, *Universal Business Organization Legislation: Will It Happen? Why and When*, 23 DEL. J. CORP. L. 29
(1998) , and Dale A Oesterle and Wayne M. Gazur, *What's in a Name? An Argument for a Small Business "Limited Liability Entity" Statute (With Three Sets of Default Rules)*, 32 WAKE FOREST L. REV. 1 (1997), for a discussion of the potential for statutory uniformity. Other articles, such as, Larry E. Ribstein, *Limited Liability Unlimited*, 24 DEL. J. CORP. L. 29 (1999), discuss business formation issues associated with the growing number of "quasi-firm" types of organizations, such as joint ventures.

statutes are available in some states. These unique forms effectively bridge the gaps between the LLC and LLP forms.

From the registration data, it is apparent that professional firms will continue to adopt these forms at a rapid pace. To forego the protections that these forms offer may make a professional service provider noncompetitive in an environment where their competitors have the advantages that the forms provide. But as the LLC and LLP mature and forms such as the PLLC emerge to fill the gaps between the forms, the trends for traditional professional firms to become LLPs and emerging professional firms to become LLCs may begin to blur. As statutoiy schemes stabilize, future studies can focus on the evolving choices and evaluate and update the rationales for form selection.

Table 1

Patterns of Growth in the Number of LLCs and LLPs*

This table gives the total annual number of new registrations for LLCs, LLPs, LPs, and corporations.

Form	1992	1993	1994	1995	1996
LLC	6,118	22,256	59,490	115,507	148,306
LLP			1,933	6,569	9,310
LP	43,457	47,092	54,013	50,278	50,068
Corporations	643,083	681,252	715,617	756,561	728,798

*To gather the information in this table, data was compiled from the Annual Reports of the Jurisdictions and the records of the International Association of Corporation Administrators. The data reflects entries from 49 states. Corporations include registrations from C and S corporations, as well as PCs.

Table 2

Industry Breakdown of LLC Sample*

Frequency distribution by two-digit SIC code and primary industry for 1252 LLCs.

SIC	Industry	Number of LLCs	% of Total
87	Engineering and Management Support Services	325	25.9
65	Real Estate	233	18.6
15	Construction/General Contracting	149	11.9
67	Investments	108	8.6
53	Retail	105	8.4
80	Health Services	82	6.5
79	Amusement & Recreation	74	5.9
01	Agricultural Production/Crops	52	4.2
13	Oil and Gas Extraction	36	2.9
02	Agricultural Production/Livestock	35	2.8
58	Restaurants	27	2.2
73	Leasing Services	26	2.1
	Total	1252	100.0

♦To gather the information in this table, a search of the "company" and "all documents" files of Lexis/Nexis was conducted. The data reflects entries from 43 states.

Table 3

Industry Breakdown of LLP Sample*

Frequency distribution by primary activity for 662 LLPs.

SIC	Activity	Number of LLPs	% of Total
82	Law	202	29.7
80	Medicine	194	28.5
82	Accounting	82	12.1
65	Real Estate Services	66	9.7
67	Investment Management	28	4.1
80	Dentistry	26	3.8
87	Engineering	25	3.7
59	Retail/Wholesale	23	3.4
15	General Contracting	18	2.6
73	Leasing	5	0.7
87	Public Relations	4	0.6
76	Equipment Repair	4	0.6
79	Entertainment	2	0.3
	Total	680	100.0

•To gather the information in this table, a search of the "company" and "all documents" files of Lexis/Nexis was conducted. The data reflects entries from 43 states.

Table 4

The LLC/LLP Continuum

This table compares the liability and tax provisions of the LLC and LLP, and the blending forms, the PLLC and "Bulletproof' LLP

	Availability:
LLC: Liability for individual's acts only. No liability for obligations of organization. Pass-through taxation based on four-pronged test.	All 50 states
PLLC: Liability for individual's acts and those under direct supervision. No liability for obligations of organization. Pass-through taxation based on four-pronged test.	**Availability:** Mississippi, Tennessee
LLP **(Bulletproof):** Liability for individual's acts and those under direct supervision. No liability for obligations of organization. Pass-through taxation is automatic.	**Availability:** 17 States
LLP: Liability for individual's acts and those under direct supervision. Liability for obligations of organization. Pass-through taxation is automatic.	**Availability:** 46 states; legislation pending in other four