

An Update on the Insurance Requirements for LLP Status:  
When are you really safe?

The professional business status of a Limited Liability Partnership has existed in California since 1996 with the adoption of the Uniform Partnership Act. Lawyers can take advantage of this hybrid business form, gaining the benefits of running an informal practice between partners without the concern of personal liability for the negligence or wrongful acts of the other partners. Of course, there is a price to pay for this "corporate veil" status. Worse, the "corporate veil" status may end up of no protection at all! The intent of this article is to address the recent revisions that all LLP's must meet and to point out an ambiguity in the applicable code section. That being said, "LLP status" may still be an excellent entity choice for young attorneys here in California looking for a solid foundation heading into the business arena of law practice!

The idea of not being responsible for the errors of one's partners is extremely important to California attorneys. LLP's have flourished over the past twelve years; there are now over 1900 LLP's made up of lawyers in our state. In fact, many LLP's have been formed strictly as a cost sharing means towards decreasing expenses. Some attorneys barely know their fellow partners and they are not concerned about that partner's ability to practice law due to their perceived isolation from liability for the partner's incompetence.

Senate Bill 414, an act to amend Section 16956 of the Corporations Code, relating to partnerships, effective January 1, 2008, mandated that LLP's must meet either a financial security threshold or purchase malpractice insurance. The financial securitization can be: "to maintain in trust or bank escrow, cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance or surety companies as security for payment of liabilities imposed by law for damages arising out of all claims; however, the maximum amount of security for partnerships with five or fewer licensed persons shall not be less than one million dollars (\$1,000,000), and for partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional one hundred thousand dollars (\$100,000) of security shall be obtained for each additional licensee; however, the maximum amount of security is not required to exceed seven million five hundred thousand dollars (\$7,500,000)."

The vast majority of LLP's purchase the insurance. Recently Amended California Corporations Code Section 16956 A reads, "Maintaining a policy or policies of insurance against liability imposed on or against it by law for damages arising out of claims; however, the total aggregate limit of liability under the policy or policies of insurance for partnerships with five or fewer licensed persons shall not be less than one million dollars (\$1,000,000), and for partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional one hundred thousand dollars (\$100,000) of insurance shall be obtained for each additional licensee; however, the maximum amount of insurance is not required to exceed seven and a half million dollars (\$7,500,000) in any one designated period, less amounts paid in defending, settling, or discharging claims as set forth in this subparagraph. The policy or policies may be issued on a claims-made or occurrence basis, and shall cover: (i) in the case of a claims-made policy, claims initially asserted in the designated period, and (ii) in the case of an occurrence policy, occurrences during the designated period."

Professional Liability policies are typically issued with a per claim limit along with an aggregate limit of liability. This year's revision only mentions the aggregate limit of exposure and it is clear after conferring with Thomas Clark, the staff counsel for Assembly Judiciary Committee, that the revision was not intended to increase the per claim limit, only the aggregate. "Per claim" limit of liability is the maximum that the insurance company will pay on behalf of an insured for any one claim. "Aggregate" limit of liability is the maximum the carrier will pay on behalf of an insured for an entire policy period, without regard to the number of claims.

The vast majority if not all of California professional liability policies are sold on a claims-made and reported policy form. The responsible insurance carrier is the one insuring the entity when the claim is actually made as opposed to when the reported act occurred. This raises an interesting issue with regards to insurance requirements to maintain this "corporate veil" status for non-negligent partners. What happens when the LLP dissolves?

Clearly, the legislative intent was to continue protecting the general public (clients) through financial securitization or mandated professional liability insurance. The issue of dissolution was addressed in California Corporations Code Section 16956 A as follows, "Upon the dissolution and winding up of the partnership, the partnership shall, with respect to any insurance policy or policies then maintained pursuant to this subparagraph, maintain or obtain an extended reporting period endorsement or equivalent provision in the maximum total aggregate limit of liability required to comply with this subparagraph for a minimum of three years if reasonably available from the insurer." This Section raises critical issues!

When contemplating formation of an LLP, partners should be sure their professional liability policy offers at least a three-year extended reporting endorsement (many do not) and, as importantly, that the limits of liability are reinstated upon the purchase of the extended reporting period endorsement (ERP) or "tail coverage". Again, under the provisions of many policies, the limits available are less any monies paid out in claims during the last policy period. It is very possible that if these requirements are not met, an attorney will be financially exposed to the negligent acts of any and all of his or her partners. For example, if AB LLP dissolves on December 31, 2007 and a client of attorney A sues both attorneys A and B, attorney B could be financially responsible for any damages attorney A cannot satisfy if the proper ERP was not in place. To be in place, it must be first available through the insurance carrier and this is why it is important to perform due diligence while setting up your LLP or while part of an LLP. The February edition of California Lawyer magazine does a spreadsheet of current Professional Liability insurance companies in California and outlines many of their policy features.

The end of California Corporations Code 16956A with regards to the "maintain or obtain an extended reporting period endorsement or equivalent provision in the maximum total aggregate limit of liability ....if reasonably available from the insurer." is an extremely gray way of affording protection to the partnership's former clients and allowing the isolated exposure benefit to limited partners. This gray area creates a business decision for the partners. The partners can continue gaining the protection of the LLP status by purchasing a minimum three year ERP with the required limits or if they find the cost unreasonably expensive, the partners may elect to lose the LLP protection. Hopefully, the California legislature will address both this ambiguity along with increasing the minimum per claim limit as they did the aggregate in the near future. Potential changes to these requirements would be posted at the California Assembly's Judiciary Committee website, [www.assembly.ca.gov/acs/newcomframeset.asp?committee=15](http://www.assembly.ca.gov/acs/newcomframeset.asp?committee=15) .

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