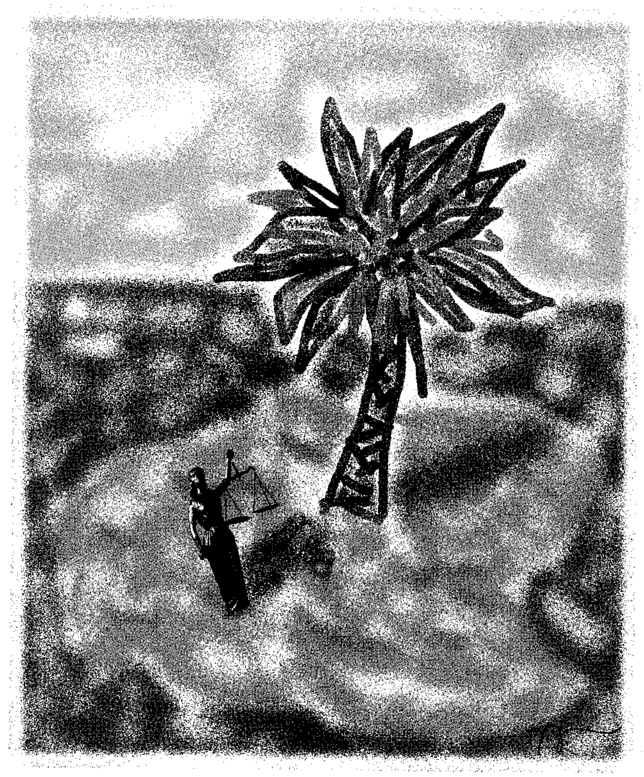
11-1997

Are Law Firm Partners Islands unto Themselves? An Empirical Study of Law Firm Peer Review and Culture

Susan Saab Fortney
Maurice A. Deane School of Law at Hofstra University



Are Law Firm Partners Islands unto Themselves?

AN EMPIRICAL STUDY OF LAW FIRM PEER REVIEW AND CULTURE

By Susan Saab Fortney

AM I MY PARTNER'S KEEPER? A 1995 SURVEY OF TEXAS LAW FIRMS attempted to answer this question by studying law firm peer review and attitudes on peer review, liability, and accountability. The survey instrument defined "peer review" as the process in which law firm partners or principals monitor and evaluate the job performance of their colleagues.

Professor Susan Saab Fortney of Texas Tech University School of Law conducted the study, which was partially funded through a grant from the Texas Bar Foundation. This article is an abridged version of an article published in the Georgetown Journal of Legal Ethics, *vol. X, p. 271.*

Respondent's Profile

A four-page questionnaire was sent to the managing partner or principal of firms reporting 10 or more attorneys to the Texas Interest on Lawyers' Trust Accounts (IOLTA) program. Of the 311 questionnaires mailed, 191 were returned, resulting in a response rate of 61 percent.

The survey responses reflect the trend of law firms to limit principals' vicarious liability by reorganizing as professional corporations or limited liability firms.[1] Approximately 95 percent of the respondents practice in some form of limited liability firm or corporation. The majority of the respondent firms (57 percent) operate as professional corporations rather than as limited liability partnerships or companies.[2] Table One shows firm organization and firm size.

TABLE ONE

Firm Structure and Size

	LARGE FIRMS MORE THAN 50 ATTORNEYS	MEDIUM FIRMS 26-50 ATTORNEYS	SMALL FIRMS 10-25 ATTORNEYS
General partnership	14%	3%	3%
Professional corporation	31%[3]	72%	58%
Limited liability partnership	51%	25%	36%
Limited liability company	3%	0%	3%

This table reveals that even partners in the smallest firms have attempted to limit partners' vicarious liability by practicing in some form of limited liability firm. Despite these efforts, firm structure does not guarantee that firm principals will be shielded from liability.[3] The judiciary, in the exercise of its inherent power to regulate the legal profession, may reject the statutory limits on principals' liability.[4] Even if the courts recognize the limited liability shield that virtually eliminates the vicarious liability of firm principals, the firm's assets and reputation remain at risk. Therefore, many firms recognize that partners must take steps to protect their firms and assets.

Peer Review Measures Employed

Because the majority of the claims against firms relate to the conduct of firm principals,[5] legal malpractice experts recommend that law firms implement peer review to obtain information and evaluate the work of firm principals.[6] Such peer review takes different forms ranging from traditional review of productivity and contributions for compensation purposes to more subjective performance assessment of the manner in which principals handle client matters.

An increasing number of firms are setting the stage for peer review by adopting standard procedures and policies applicable to all firm attorneys. For example, firms typically implement policies and procedures relating to conflict checks, engagement letters, and opinion letters.[7] When firms actually monitor principals' compliance with established procedures and policies, firms institute a rudimentary form of peer review. Compliance with these technical standards can be determined by reviewing selected client files.

Firm Controls on Principals Serving as Officers/Directors

The survey reveals that many firms have taken steps to avoid problem areas identified by legal malpractice insurers and commentators. For example, legal malpractice experts recommend that firms prohibit or carefully monitor firm attorneys acting as officers or directors of for-profit entities.[8] The majority of respondent firms appreciate the risks associated with attorney-director service, adopting firm policies to manage the problem.[9] Sixty-eight percent of the respondents indicated that their firms require approval or simply prohibit principals serving as officers or directors of for-profit entities.[10]

Evidently, firms are less concerned about exposure for the activities of not-for-profit entities. Only 33 percent of the respondent firms monitor principals serving as officers or directors of not-for-profit entities. Firms may be less concerned about attorneys serving as directors of nonprofit corporations because directors of such corporations have less exposure than directors of for-profit corporations.[11]

Firm Controls on Principals Serving as Fiduciaries And Entering Business Transactions with Clients

The results suggest that principals recognize the vulnerability when firm attorneys hold fiduciary positions. Fifty-four percent of the respondents reported that their firms require approval or prohibit principals from serving as trustees or holding some other fiduciary position. A law firm's professional liability policy may cover claims arising out of trustee activities while specifically excluding claims relating to directorship activities.[12] This may explain why a smaller percentage of firms monitor attorneys serving in fiduciary positions than the percentage of firms that monitor attorneys' activities as directors of for-profit corporations.

The majority of the respondents also appreciate the risks involved when a firm principal accepts stock in lieu of fees. Approximately 61 percent of respondents noted that their firms monitor this practice. Nearly as many (50 percent), monitor firm principals investing in business ventures with clients. Firms that have not instituted any procedures may not recognize the malpractice exposure related to firm attorneys entering into business transactions with clients. If such investments are permitted, the firm and its attorneys are subject to legal malpractice actions alleging conflicts of interests, negligence, and fraud.[13] If the firm is sued, the firm's legal malpractice policy may not provide coverage since such policies commonly exclude claims relating to attorneys' business ventures.[14]

He left for South America in 1968. His sister cared for their parents 'til the day they died. She thinks he doesn't deserve one red cent. The court, however, disagrees.

Who should pay the heir location fee?

Every case, every situation, every heir is different. For some heir location cases, our flat fee, paid by the estate, is the right option. It's fine with the court—which insists on the location, but has no vested interest in the estate. But what if there's an heir who doesn't want to share the legacy—and *absolutely* does not want to pay to find any missing persons? In that case, the best solution is a contingency fee, negotiated with the lost heirs, from their share.

Blake and Blake is pleased to provide you with *your choice* of fee arrangements. With rapid results. With success guaranteed or there's no fee at all. We offer international capabilities through a network of regional offices, correspondents, and leading edge technologies. Call us toll free at 1-800-525-7722. For heir location to meet the needs of your case. Whether you're dealing with an impartial court—or an impassioned sister.

B&B

Blake & Blake Genealogists, Inc.

Searching farther, faster, with guaranteed results.

Call us toll free at 1-800-525-7722 • Fax us toll free at 1-800-525-5672
eMail us at info@ blakeandblake.com • Visit us on our web at www.blakeandblake.com
Florida Office: 1515 South Federal Highway • Suite 105 • Boca Raton, Florida 33432
Corporate Office: 50 Braintree Hill Office Park • P.O. Box 9128 • Braintree, Massachusetts 02184

Internal Procedures and Efforts to Monitor Principals' Compliance with Office Procedures

The majority of the respondents do not have procedures to monitor daily affairs such as withdrawal of client funds. Surprisingly, only 35 percent of respondents require that two principals sign for withdrawals of client funds.

A series of questions asked whether the respondent firm conducts periodic reviews to determine principals' compliance with various office procedures. As illustrated in Table Two, the responses indicate that firms are more likely to monitor compliance with office procedures relating to firm finances than procedures relating to client representation matters.

TABLE TWO

Firms that Periodically Review Principals Compliance with Office Procedures

Billing	82%
Accepting contingent fee cases	80%
Conflicts of interest	75%
Suing clients	68%
Engagement letters and fee agreements	64%
Screening new litigation	52%
Calendar control	47%
Client screening	44%
Non-engagement letters	30%
Responding to sanctions motions	26%
Seeking sanctions	24%

Monitoring compliance with conflicts of interest is the strongest example of a practice that deviates from the pattern of firms focusing on financial matters rather than client service matters. The national attention focused on conflict of interest problems probably accounts for these results. Law firm managers have learned that conflicts of interest can only be identified if all firm attorneys, including principals, comply with office procedures.

Opinion and Audit Letter Procedures

Managing attorneys of law firms should also appreciate the importance of firm-wide guidelines and procedures for issuance of legal opinions. These procedures provide quality control and reduce the firm's liability exposure for opinion letters. By taking steps to avoid improvidently rendered opinions, law firms may be able to avoid disciplinary and regulatory actions, as well as civil and criminal liability.[15]

Although commentators and various bar committees highly recommend internal review procedures,[16] only 20 percent of the firms require committee approval of all written opinions. A more frequently reported practice (by 35 percent of the respondents) is that written opinions be approved by two principals. A larger percentage (59 percent) require a "standard approach" to legal opinion letters.

A significant number of respondent firms exercise additional precautions for audit letters, a strategy encouraged by organized bar groups over the past 20 years.[17] Seventy-six percent of the respondent firms require principal approval of all audit response letters.

Designation of In-House Ethics Counsel

The survey results reflect that Texas firms have participated in the national trend to appoint in-house counsel.[18] The majority of respondents (73 percent) indicated their firms have designated a principal or committee to handle ethics or malpractice problems. Interestingly, only 61 percent of the respondent firms have a principal or committee assigned to handle risk management and quality assurance. This indicates that firms may be more inclined to designate persons to handle ethics problems that arise, than to rely on risk managers who might be able to take steps to avoid problems.

Vehicles for Obtaining Information on Peers

Approximately half of the respondents reported that their law firm sections and departments engage in some peer review, though predominately on an informal basis.[19] In response to a general question regarding peer review programs, 34 percent of the respondent firms designate a principal or committee to evaluate the manner in which principals handle client matters. At the same time only 10 percent employ formal procedures for reviewing the work of principals, other than review conducted in connection with compensation decisions. These results indicate that review of principals is largely done on an informal basis by managing partners or management committees.

According to survey responses, firm principals tend to rely more on feedback from firm attorneys than from clients. When asked if firm managers formally seek feedback on principals' performance, 55 percent of the respondents exclusively seek information from other firm principals, while 36 percent obtain information from firm associates. Only 30 percent solicit information from clients.

As expected, the survey results confirm that as firms grow they become more bureaucratic, imposing more controls on the conduct of principals. Of the 34 questions relating to peer review measures, the responses to 27 questions indicated a relationship between firm size and the implementation of formal peer review measures. Obviously, principals in smaller firms can more easily rely on informal mechanisms to evaluate one another.

Conclusion — Reshaping Firm Culture

Although the concept of law firm peer review may appear to be novel, the study revealed that firms are in fact engaging in some form of peer review. Most firms periodically monitor principals' compliance with procedures relating to firm finances, but devote less vigilance to procedures related to client services. In certain areas, firms have heeded the warnings of malpractice experts by implementing controls to deal with problems such as conflicts of interest and attorneys' service as members of boards of directors of for-profit corporations.

Presumably, the percentage of firms with formal procedures should be higher, given that a large percentage of respondents recognized one or more advantages to peer review. Respondents, however, perceived countervailing disadvantages and obstacles to peer review. Some obstacles can be addressed by persons outside the law firm. For example, state legislators can provide confidentiality to peer review communications.[20] In an effort to encourage quality control and risk management, malpractice insurers could allow a premium discount for law firm peer review programs.[21]

Successful implementation of peer review ultimately turns on attitudes and structures within law firms. The study results indicate that attorneys who share an institutional perspective are more likely to implement peer review measures than attorneys who function as a confederation of individual practitioners. Therefore, firms can only overcome resistance to peer review by "cultivating a collegial atmosphere wherein quality is revered to the point that partner autonomy becomes secondary to the recognized benefits of quality enhancement."[22]

When firm principals aspire to build and maintain a team, the principals must change firm structures that undermine team culture. For example, firm principals might alter a firm compensation system that gives substantial credit for origination of legal business. Instead, firms could emphasize collective marketing rather than the individualistic, entrepreneurial "eat what you kill" approach.[23] In monitoring the manner in which attorneys handle client matters, technical standards review promises to be the type of peer review that will encounter the least resistance from principals. By adopting standards, firms may condition principals to accept more intrusive peer review measures by creating an environment of accountability.

In this context, accountability encompasses both individual and corporate dimensions.[24] On the individual level, firm attorneys must take responsibility for the manner in which they practice law. Understanding that their acts and omissions may subject the firm and the other firm members to liability and possible damage to their reputations, firm members should be willing to participate in peer review. On both an individual and corporate level, attorneys and their firms are accountable to the legal profession for maintaining the highest ethical standards. Finally, law firms and the legal profession must be held accountable for assuring that the system of self-regulation protects the public. Such accountability may earn the public trust by demonstrating that firm attorneys are dedicated to keeping their own houses clean.

---

1. Following the storm of malpractice suits against major Texas law firms, the Texas Legislature enacted various statutes to limit professionals' liability. In 1989, the Texas Legislature modified the Texas Professional Corporation Act to explicitly state that "the corporation (but not the individual shareholders, officers, or directors) shall be jointly and severally liable" with the tortfeasor. Tex. Rev. Civ. State. Ann. art. 1528e, § 16 (Vernon Supp. 1996). Following banking regulators' malpractice lawsuits alleging failure by principals to supervise their peers, the legislature, in 1991, amended § 5 of the Texas Professional Corporation Act to state that "shareholders of professional corporations shall have no duty to supervise the manner or means whereby the officers or employees of the corporation perform their respective duties." *Id.* In 1991, the Texas Legislature was the first in the nation to enact a limited liability partnership act. Tex. Rev. Civ. Stat. Ann. art. 6132b-

3.03 (Vernon Supp. 1996). That year the legislature also adopted a limited liability company act. Tex. Civ. Stat. Ann., art. 1528n (Vernon Supp. 1996).

2. One respondent checked both "Professional Corporation" and "General Partnership." Assuming that the firm operates as a general partnership of professional corporations, the firm was included in the PC category. The percentages in the Large Firm category do not total 100 percent because of rounding to the nearest whole number.
3. For a discussion of the traps associated with practicing limited liability partnerships and companies, *see* Susan Saab Fortney, *Seeking Shelter in the Minefield of Unintended Consequences — The Traps of Limited Liability Law Firms,* Wash. & Lee Law Review, vol. 54, p. 717.
4. *See* Debra L. Thill, Comment, *The Inherent Powers Doctrine and Regulation of the Practice of Law: Will Minnesota Attorneys Practicing in Professional Corporations or Limited Liability Companies Be Denied the Benefit of Statutory Liability Shields?* 20 Wm. Mitchell L. Rev. 1143, 1151 (1994) (referring to the split in the courts as to whether to allow attorneys to limit their vicarious liability). For example, the court in *Stewart v. Coffman*, 748 P.2d. 579 (Utah Ct. App. 1988) *cert. granted,* 765 P.2d 1277 (Utah 1988), *cert. dismissed*, Aug. 19, 1988 (unpublished order) held that a shareholder in a law firm organized as a professional corporation was not vicariously liable for the legal malpractice of another shareholder. *Contra First Bank & Trust Co. v. Zagoria*, 302 S.E.2d 674, 675 (Ga. 1983) (rejecting the statutory limits on liability "in the interest of professionalism"). Recently, the Georgia Supreme Court overruled *Zagoria* "to the extent that it states that this court, rather than the legislative enabling act, determines the ability of lawyers to insulate themselves from personal liability for the acts of other shareholders in their professional corporation." *Henderson v. HSI Financial Services, Inc.,* 471 S.E. 2d 885, 886 (Ga. 1996). This reversal illustrates the uncertainty involved in predicting whether courts will recognize the new liability shields.
5. According to American Bar Association statistics, attorneys with 10 or more years of legal experience generate 66 percent of all malpractice claims. ABA Standing Committee on Lawyers Professional Liability, The Lawyers' Desk Guide to Legal Malpractice 31 (1992).
6. For example, Robert O'Malley, loss prevention counsel to the Attorneys' Liability Assurance Society, a captive liability insurer insuring the nations' largest firms, has stressed the importance of peer review. Larry Smith, *Malpractice Update: Loss Control Not Always a Cure-all,* Of Counsel, Feb. 1, 1993, at 1.
7. As revealed by a 1992 study of 50 law firms nationwide, the majority of the respondents utilized computerized conflicts systems, required engagement letters, and second partner review of formal opinion letters. *See* Stephen R. Volk et al., *Law Firm Policies and Procedures in an Era of Increasing Responsibilities: Analysis of a Survey of Law Firms,* Bus. Law., August 1993, at 1567, 1571, 1573, 1581.
8. *See* Dennis J. Block et al., *Lawyers Serving on the Boards of Directors of Clients: A Survey of the Problems,* Insights, April 1993, at 3, 8 (explaining that professional liability insurers have discouraged the practice of attorney-directors and have added policy provisions specifically excluding all malpractice claims relating to conduct that occurred when a law firm member held an executive office with a client corporation).
9. For a thorough discussion of the ethical and liability problems created when an outside counsel serves in the dual capacity of attorney-director, see Craig C. Albert, *The Lawyer-Director: An Oxymoron?* 9 Geo. J. Legal Ethics 413 (1996).
10. The results also show that as firms grow they are more likely to monitor principals' directorship activities.
11. Some legal malpractice experts believe that attorneys serving on charitable boards face significantly less liability exposure than those serving on the boards of for-profit entities. *See* Robert E. O'Malley & Harry H. Schneider, *Danger: Lawyer on Board*, 79 A.B.A.J., July 1993, at 102 (attributing heightened liability for service on for-profit corporations to the threat of shareholder derivative suits). A number of states, including Texas, have enacted legislation shielding uncompensated directors of charitable corporations from liability to third person. Daniel L. Kurtz, Board Liability: Guide for Nonprofit Directors 23, 99 (1988). *E.g.,* Tex. Civ. Prac. & Rem. Code Ann. § 84.004 (Vernon 1996) (providing that a "volunteer who is serving as an officer, director, or trustee of a charitable organization is immune from civil liability for any act or omission resulting in death, damage, or injury if the volunteer was acting in the course and scope of his duties or functions as an officer, director, or trustee within the organization").
12. Volk, *supra* note 8, at 1571.
13. Dennis Horan and George W. Spellmire, Jr., The Associates' Primer for Prevention of Legal Malpractice 4 (1987). Because courts will scrutinize business transactions with clients and presume the transactions to be fraudulent, unless proven otherwise, "lawyers who start out as investors in clients' businesses could find themselves winding up as insurers." Jon Newberry, *Perilous Partnerships*, A.B.A.J., August 1996, at 106.
14. Jo Ann Felix-Retzke, Practical Guide To Preventing Legal Malpractice 310 (1983) (explaining the scope of the typical business pursuits exclusion).
15. *See* John P. Freeman, *Current Trends in Legal Opinion Liability,* 1989 Colum. Bus. L. Rev. 235 (1989) (explaining that an opinion could lead to a number of claims including claims based on negligent malpractice, negligent misrepresentation, common law fraud, securities law violations, civil conspiracy, breach of fiduciary duty, aiding and abetting a breach of duty, actions under the Racketeer Influenced Corrupt Organizations statute, and penalties under the Internal Revenue Code). In addition to providing some assurance against claims, internal review procedures assist firms in developing uniformity in approaching opinion matters, educate attorneys on relevant developments, and provide a source of experienced and knowledgeable attorneys with whom difficult or novel issues may be discussed. Richard H. Rowe, *Law Firm Internal Opinion Review Procedures,* in Opinions in SEC Transactions 1991, at 427 (PLI Corp. Law & Practice Course Handbook Series No. 725, 1991). Internal peer review procedures for opinion letters may also insulate the attorney handling the transaction against pressure from clients to give broad opinions and may shield the attorney from unreasonable demands from attorneys on the other side of the transaction. Arnold S. Jacobs, Introduction to Securities Law § 11 (1993).
16. *E.g.,* Darrel A. Rice & Marc I. Steinberg, *Legal Opinions in Securities Transactions,* 16 J. Corp. L. 375, 440-41.
17. In 1976, the ABA adopted the ABA Statement of Policy Regarding Lawyers' Responses to Auditors Requests for Information, reprinted at 31 Bus. Law. 1709 (1976). The ABA Statement provides specific guidelines for attorneys drafting audit responses and recommends a format for audit responses. Leland C. de la Garza, *Auditor's Letter: Understanding and Responding to an Audit Inquiry Letter,* Tex. B.J., January 1994, at 22-23.
18. In response to the explosion of legal malpractice awards, many firms have appointed firm members to serve as ethics counsel or on ethics committees. *See* Daniel B. Kennedy, *New Trend is General Counsel in Firms,* A.B.A.J., January 1995, at 29. Reportedly, the primary motivation behind the appointment of in-house ethics counsel is the need to establish an attorney-client privilege with respect to intra-firm communications. For a discussion of the confidentiality of intra-firm communications, see Gary Taylor, *Counsel to Firms Goes In-House: Legal Costs Are Leading Firms, Like Their Clients, to Look Inside for Advice,* Nat'l L.J., July 18, 1994, at A1.
19. While only 18 percent of the respondents indicated that the principals within the same section formally review one another, 51 percent reported that department heads or section leaders monitor the progress of all matters in their sections. Half of the respondents noted that department heads or section leaders conduct regular meetings where participants discuss principals' as well as associates' work.
20. Understanding the risks associated with the discoverability of peer review communications, seven percent of the respondents noted that their firms do not engage in formal peer review because the results might be discoverable. Moreover, 36 percent indicated that their firms would be more likely to institute peer review measures if peer review communications were protected from discovery.
21. According to the survey results, 75 percent of the respondents would institute peer review if legal malpractice insurers provide a premium discount for peer review. The amount of premium discount that respondents noted varied from three percent to 30 percent, with an average of 13 percent.
22. John F. Corrigan, *Peer Review in the Law Office,* in The Quality Pursuit 61, 62 (Robert Greene ed. 1989).
23. For an account of the experience of a large Texas firm which has abandoned the "eat what you kill" philosophy and adopted a more comprehensive scheme that includes production and origination as well as community service, pro bono work, teamwork, and management contributions, see Amy Boardman, *High Risk Strategy Pays Off for Gardere*, Tex. Law., April 10, 1995, at 1, 31.
24. *See* Paul Y. Ertel & M. Gene Aldridge, Medical Peer Review: Theory and Practice 386-87 (1977) (analyzing the different aspects of public and professional accountability within the context of medical peer review).