

1995

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## Recommended Citation

Susan Saab Fortney, *Am I My Partner's Keeper? Peer Review in Law Firms*, 66 U. Colo. L. Rev. 329 (1995)

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# AM I MY PARTNER'S KEEPER? PEER REVIEW IN LAW FIRMS

SUSAN SAAB FORTNEY\*

*[T]he actions of a partner you don't even know, working in an office on the other side of the country, could cost you your house and force your kids to go to public school.<sup>1</sup>*

## INTRODUCTION

This lament captures the concern of attorneys who bemoan their liability exposure for the acts or omissions of their law partners. In the wake of the explosion of legal malpractice claims, attorneys are reappraising the risks of law firm practice. Until recently, the risks were largely covered by professional liability insurance. Still, as dramatized by the \$41 million settlement paid by the New York-based firm of Kaye, Scholer, Fierman, Hayes and Hadler ("Kaye, Scholer"), even multi-million dollar insurance policies may be exhausted, leaving partners personally liable for malpractice claims.<sup>2</sup>

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1. Michael Orey, *The Lessons of Kaye, Scholer: Am I My Partner's Keeper?*, AM. LAW., May 1992, at 3, 81.

2. In an unprecedented move on March 2, 1992, the Office of Thrift Supervision (OTS) sued Kaye, Scholer for \$275 million and moved to freeze the firm's assets. The OTS and the Justice Department claimed that Kaye, Scholer attorneys participated in regulatory violations in the course of the firm's representation of the now-defunct Lincoln Savings and Loan Association and Lincoln's parent. *OTS Freezes Kaye, Scholer's Assets, Asks For \$275 Million in Restitution*, 58 Banking Rep. (BNA) No. 10, at 419 (Mar. 9, 1992). Because the firm's insurance carrier had already paid \$20 million to settle securities and racketeering lawsuits brought against it by investors who had purchased bonds in Lincoln's parent company, Kaye, Scholer's insurance carrier only contributed the remaining policy limits of \$25 million to the settlement with the OTS. The Kaye, Scholer partners had to personally pay the remaining \$16 million due under the OTS settlement agreement. Sharon Walsh, *Top Lawyers Leave Kaye, Scholer; OTS Lawsuit, Freeze on Assets Send Partners to Other Firms*, WASH. POST, Sept. 19, 1992, at A8.

Recognizing their vulnerability, law firm attorneys have taken different steps to minimize their malpractice exposure.<sup>3</sup> Some firm attorneys have begun to practice defensively, adopting malpractice avoidance measures and instituting law practice management programs.<sup>4</sup> Other firm attorneys are seeking shelter by converting their law partnership into a professional corporation ("PC"), limited liability company ("LLC"),<sup>5</sup> or limited liability partnership ("LLP").<sup>6</sup> Through

3. Emily Couric, *The Tangled Web: When Ethical Misconduct Becomes Legal Liability*, A.B.A. J., Apr. 1993, at 64, 64-65 (quoting Ronald Mallen, a California malpractice defense lawyer and, according to Couric, considered by many as dean of the malpractice bar: "People didn't sue large law firms before because they would fight' . . . 'Now large law firms are seen as deep pockets.'"). To avoid being a deep pocket and thus an inviting target, law firms are attempting to make their pockets shallower by making changes in law firm structure. See Dennis E. Curtis, *Old Knights and New Champions: Kaye, Scholer, the Office of Thrift Supervision, and the Pursuit of the Dollar*, 66 S. CAL. L. REV. 985, 1014-15 (1993) (discussing changes in law firm structure intended to lower liability exposure).

4. A survey of 101 chief administrators of the nation's largest law firms revealed that 74% of the firms surveyed had already modified the way they operate. Of the 74% of the firms that have made changes in operations, 63% of the firms have implemented a new management structure. *Firms Re-engineer: Technology, Practice Areas Overhauled*, A.B.A. J., June 1994, at 24, 24. For a general description of the various prophylactic measures that firms may institute, see Anthony E. Davis, *Law Practice Management: Preventing Massive Money Claims*, N.Y. L.J., Nov. 12, 1992, at 1; Robert B. Yegge, *Risk Management in Law Practice: Produce, Protect & Satisfy*, PRAC. LAW., Oct. 1993, at 25.

5. The first LLC legislation in the United States, enacted in Wyoming, does not specifically address whether professionals may organize as LLCs. Although the Maryland and Rhode Island statutes explicitly prohibit professionals from organizing as LLCs, the Alabama, Iowa, Kansas, Texas, Utah, and Virginia statutes expressly allow professionals to operate as LLCs. Jimmy G. McLaughlin, Comment, *The Limited Liability Company: A Prime Choice for Professionals*, 45 ALA. L. REV. 231, 244 (1993). In an LLC, individual members are liable for their own misconduct. *Id.* at 245. An LLC provides members with the non-tax benefit of limiting their personal liability, while providing the flow-through tax advantages available in a general partnership. Sheldon I. Banoff & Burton W. Kanter, *LLC Announcements: Damage Control*, 80 J. TAX'N 255, 255 (1994). In regulating the practice of law, courts and regulators may refuse to recognize the liability limitations. See Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 458 (1992) (predicting that as part of the evolution of LLCs, the profession's regulators will have to approve the LLC).

6. Texas was the first state to adopt legislation allowing for the registration of limited liability partnerships, providing professionals with protection from vicarious liability for malpractice and other torts. Under the Texas statute, TEX. REV. CIV. STAT. ANN. art. 6132b, § 15(2) (West Supp. 1993), partners in an LLP are not liable for

errors, omissions, negligence, incompetence, or malfeasance committed in the course of the partnership business by another partner or a representative of the partnership not working under the supervision or

reorganization, attorneys seek to limit their vicarious liability.<sup>7</sup> At the same time, an examination of banking regulators' lawsuits against attorneys reveals that reorganization may not provide an impervious shield to claims against nonparticipating partners.<sup>8</sup>

In at least six such actions brought in connection with failed savings and loan associations, the government has alleged that *each law firm partner is personally liable for failing to monitor*

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direction of the first partner at the time the errors, omissions, negligence, incompetence, or malfeasance occurred, unless the first partner: (a) was directly involved in the specific activity in which the errors, omissions, negligence, incompetence, or malfeasance were committed by the other partner or representative; or (b) had notice or knowledge of the errors, omissions, negligence, incompetence, or malfeasance by the other partner or representative at the time of occurrence.

Cf. DEL. CODE. ANN. tit. 6, § 1515(b) (1993) (stating that a partner in an LLP "is not liable for debts and obligations of the partnership arising from negligence, wrongful acts, or misconduct committed . . . in the course of the partnership business by another partner or an employee, agent or representative of the partnership"). Each partner remains personally liable for his/her own malpractice and jointly and severally liable for all other partnership obligations. Partnerships remain liable for the torts of their partners and employees. The LLP structure provides the tax advantages of a general partnership while affording its members the benefits of corporate limited liability. David B. Rae, *Limited Liability Partnership: The Time to Become One Is Now*, HOUSTON LAW., Jan.-Feb. 1993, at 47, 47.

7. The Texas and Louisiana LLP acts were motivated by the escalating number of suits brought by the banking regulators against professionals who performed services for financial institutions which later failed. Robert T. Bowsher, *RLLPs Can Limit a Partner's Personal Liability*, 2 J. MULTISTATE TAX'N 232 (1992). In reaction to the aggressive efforts by banking regulators to target attorneys, Louisiana enacted legislation to limit the liability of attorneys who represent federally insured financial institutions. LA. REV. STAT. ANN. § 6:1351 (West Supp. 1994). The Louisiana law effectively limits the responsibility of attorneys to that provided under the Louisiana Rules of Professional Conduct. *Louisiana Statute Sets Limits on Liability of Attorneys Who Represent Banks/Thriffs*, 57 Banking Rep. (BNA) No. 172 (July 26, 1991); see also Christi Harlan, *Texas and Louisiana Move to Shield Personal Assets of Law Firm Partners*, WALL ST. J., Mar. 13, 1992, at A6.

8. The term "nonparticipating partner" refers to partners or principals who did not participate in the alleged wrongdoing. Although the regulators' claims against attorneys depend on the particular facts and circumstances of each case, some general patterns emerge. One commentator identifies four recurring issues: (1) participation in insider misconduct, (2) conflicts of interest and failure to exercise independent judgment, (3) failure to monitor and supervise attorneys, and (4) failure to protect depositors. Michelle D. Monse, *Ethical Issues in Representing Thriffs*, 40 BUFF. L. REV. 1, 13-14 (1992).

the conduct of *other firm partners*.<sup>9</sup> The following claim typifies the government's allegations:

The firm and its members further owed duties to [the institution] . . . to detect and prevent the negligent breaches of fiduciary duty and other acts of negligence described herein. The firm and its members negligently failed to implement such procedures and to properly monitor its members, resulting in substantial harm to [the institution].<sup>10</sup>

This claim, characterized as a "*failure to monitor*" claim, assumes that there is a recognized duty for attorneys to monitor the conduct of their partners.<sup>11</sup> In making such allegations, the government has asserted that the failure to monitor claims are distinct from the vicarious liability claims.<sup>12</sup> In a vicarious liability claim, attorney-partners not directly involved in the alleged acts or omissions are alleged to be vicariously liable for the acts and omissions of their partners by virtue of the principle of partnership law, which holds a partnership and its members liable for the tortious wrong or contractual breach committed by one partner within the scope of partnership

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9. See, e.g., First Amended Complaint at 50, *FDIC v. Wise*, No. 90-F-1688 (D. Colo. filed Feb. 4, 1991) (alleging that Sherman & Howard attorneys "failed to monitor properly and supervise the activities of Sherman & Howard partner Ron Jacobs as counsel to Silverado [Savings & Loan Association]"); Amended Complaint at 21, *FDIC v. Bauman*, No. CA3-90-614-H (N.D. Tex. filed June 14, 1990) (alleging that "[e]ach of the defendants individually owed a duty [to their clients] to ensure that there were in effect measures giving reasonable assurance that all attorneys in the firm conformed to required standards of care, and other applicable ethical, professional and legal standards").

10. Complaint at 40, *FSLIC v. Lensing, Gravel, Rosenzweig, Christen & Lebeau*, No. 89-329 (M.D. La. filed Apr. 23, 1989). Compare the more general allegations in Plaintiffs Original Complaint at 41-42, *FDIC v. Jones, Day, Reavis & Pogue*, No. 90 CA 925 (W.D. Tex. filed Oct. 30, 1990) (alleging that one or more of the partners at Jones, Day "[f]ailed to properly monitor and supervise attorneys working on [bank] matters").

11. First Amended Complaint at 49, *FDIC v. Wise*, No. 90-F-1688 (D. Colo. filed Feb. 4, 1991). Some pleadings merely state that firms have a responsibility to monitor their lawyers' compliance with professional standards. See, e.g., Plaintiffs Original Complaint at 6-7, *FDIC v. Nathan*, No. H-91-2845 (S.D. Tex. filed Sept. 25, 1991) (According to the government's pleadings, "[b]ecause of the complexities inherent in the practice of law and the difficulties nonlawyers face in determining who is a competent and ethical lawyer, law firms have the responsibility of monitoring and maintaining their lawyers' compliance with high professional standards.").

12. See, e.g., First Amended Complaint at 60-61, *FDIC v. Eckert Seamans Cherin & Mellott*, No. CV 90-0488 (E.D.N.Y. filed May 1, 1990) (asserting a direct negligence claim against an attorney for his failure to monitor another attorney in the firm and for failing to discover the second attorney's misconduct).

activities. The government differentiates its vicarious liability claims from its failure to monitor claims by alleging that each partner is personally liable for failing to monitor and supervise other partners. By alleging a failure to monitor, the government is attempting to convert a vicarious liability claim into a direct liability claim. This reformulation has some practical consequences.

First, the government may bypass the provisions in statutes that allow professionals to limit their personal liability by practicing in LLPs, LLCs, and PCs. Under some PC statutes, attorneys in a PC are not personally liable for other shareholders' acts or omissions.<sup>13</sup> Similarly, professionals in LLPs and LLCs may be protected from vicarious liability claims. Although an attorney in a PC, LLC or LLP may not be liable for vicarious liability claims, the attorney is still liable for his or her own negligence.<sup>14</sup> By suing each attorney for his or her own negligence in failing to monitor other attorneys, the government is attempting to avoid the personal liability limitations under PC, LLC, and LLP statutes.<sup>15</sup>

Second, by alleging the failure to monitor claim as a direct negligence claim, the government may avoid application of certain exclusions under professional liability policies. For example, professional liability policies typically exclude coverage for dishonest, fraudulent, criminal, or malicious acts (the "dishonesty exclusion").<sup>16</sup> Unless the policy contains

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13. David Paas, *Professional Corporations and Attorney-Shareholders: The Decline of Limited Liability*, 11 J. CORP. L. 371, 374 (1986) (noting that the Professional Corporations Supplement to the Model Business Corporation Act recognizes that the approaches to vicarious liability used in various professional corporation statutes were "remarkable in their diversity"). For a discussion of the different variations and court interpretations, see Karen M. Maycheck, Comment, *Shareholder Liability in Professional Legal Corporations: A Survey of the States*, 47 U. PITT. L. REV. 817 (1986).

14. Under the PC statutes found in 12 states, each shareholder's personal liability is limited to that shareholder's own acts or omissions. Maycheck, *supra* note 13, at 822. In those states, a nonparticipating shareholder may not be vicariously liable, but may be liable for his or her own negligence in failing to monitor the alleged wrongdoer.

15. Banking regulators may also attack state liability limitations, asserting that the courts should apply "federal common law." In *O'Melveny v. Myers*, 114 S. Ct. 2048, 2052-53 (1994), the U.S. Supreme Court rejected such an argument in holding that in a state law negligence action, California law rather than federal law governs imputation of corporate officers' knowledge of fraud to the corporation.

16. See, e.g., CNA, *Lawyer's Insurance Coverage, Professional Liability Policy, Exclusion II.D.3.* (Feb., Sept. 1985) (stating that the policy does not apply

provisions protecting innocent insureds who did not have knowledge of the alleged wrongdoing, the dishonesty exclusion could eliminate coverage for both the wrongdoer and other partners who are vicariously liable.<sup>17</sup> On the other hand, the dishonesty exclusion may not apply if the nonparticipating partners are sued for failing to monitor the wrongdoer. The U.S. Court of Appeals for the Fifth Circuit reached such a conclusion in recognizing that such failure to supervise allegations could be negligence or breach of duty claims which do not fall under the dishonesty exclusion.<sup>18</sup> Therefore, in alleging a duty to monitor claim, a plaintiff may obtain recovery that otherwise would be excluded.<sup>19</sup>

Third, the failure to monitor claim may also enable the government to recover proceeds under multiple professional

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to "any dishonest, fraudulent, criminal or malicious act or omission") (on file with the *University of Colorado Law Review*).

17. Under the policy terms, the dishonesty exclusion may be waived for any insured who did not personally participate in any fraudulent, criminal, or dishonest conduct, or remain passive after having personal knowledge of such act or omission. This waiver is commonly referred to as "innocent partner protection." Such protection is important in states in which members of partnerships and PCs share joint and several liability with other members in the firm. See Robert W. Minto, Jr. & Marcia D. Morton, *The Anatomy of Legal Malpractice Insurance: A Comparative View*, 64 N.D. L. REV. 547, 574 (1988) (discussing the case of *Aragona v. St. Paul Fire & Marine Co.*, 378 A.2d 1346 (Md. 1977), in which the court held that a professional liability policy without innocent partner protection did not afford coverage where the insured's partner misappropriated escrow funds).

18. *Jensen v. Snellings*, 841 F.2d 600, 615 (5th Cir. 1988). In *Jensen*, the professional liability insurance policies each contained an exclusion for any dishonest, fraudulent, criminal or malicious acts or omissions of any insured, partner, or employee. The insurers unsuccessfully argued that the exclusions eliminated coverage for the wrongdoer and the firm because the fraudulent act of the wrongdoer was imputed to the partnership. *Id.* at 614-15. Compare *FDIC v. Mmahat*, 907 F.2d 546, 553 (5th Cir. 1990), *cert. denied*, 499 U.S. 936 (1991), where the court concluded that the policy provision protecting innocent partners did not apply because the jury had specifically found that the firm had breached its fiduciary duty.

19. The failure to monitor claims could also avoid the application of a number of other policy exclusions, including exclusions that eliminate coverage for "intentional acts" and "business activities." For example, exclusion (H) in the International Insurance Company's Lawyers Professional Liability Policy excludes coverage for "any claim arising out of or in connection with the conduct of any business enterprise . . . which is owned by any Insured or in which any Insured is a partner, or which is directly or indirectly controlled, operated or managed by any Insured either individually or in a fiduciary capacity." For a discussion of the exclusions most frequently encountered in a professional liability policy, see Andrew S. Hanen & Jett Hanna, *Legal Malpractice Insurance: Exclusions, Selected Coverage and Consumer Issues*, 33 S. TEX. L. REV. 75, 78-111 (1992).

liability policies covering attorneys who leave the defendant law firm and join new law firms which have their own claims-made insurance policies. In one case, a federal district court ruled that the new law firm's \$15 million policy did not cover the vicarious liability claims relating to an insured attorney's former law firm.<sup>20</sup> At the same time, the court ruled that the new law firm's policy covered the direct liability claims which alleged that the insured attorney negligently failed to monitor his former partners at the defendant law firm.<sup>21</sup>

To date, the government has not had to prove its failure to monitor claims. Nevertheless, the government's claims should provoke serious consideration of the concept of peer review in law firms. If attorneys have an affirmative duty to monitor peers, then law firms' reorganizational efforts may not shield them from liability for the acts or omissions of their peers. If, on the other hand, courts determine that the duty to monitor claim is nothing more than a disguised vicarious liability claim, courts may conclude that the statutory limits on vicarious liability protect professionals from personal liability for wrongful acts committed by fellow professionals in the firm.<sup>22</sup>

After briefly reviewing perspectives on the emergence, growth, and structure of law firms in part I, I use a matrix to show how firm culture and organizational structure affect internal and external controls on attorney conduct. Part II then discusses the concept of law firm peer review, identifying its goals and purposes. Part III considers whether law firm principals have a legal duty to monitor their peers. In part IV, I will capsulize the organized bar's initiatives relating to peer review. Part V generally reviews types of law firm peer review. Finally, part VI speculates on the future of peer review. As

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20. Memorandum Opinion and Order, *National Union Fire Ins. Co. v. FDIC*, No. CA3-90-0492 (N.D. Tex. Jan. 25, 1991), *appeal docketed*, No. 91-1329 (5th Cir. Apr. 1, 1991).

21. *Id.* at 14. The court did not address the merits of the government's duty to monitor allegations because the only issue before the court was whether the insurer had a duty to defend those claims in the underlying litigation. *Id.* at 11. The underlying case was eventually settled.

22. For example, in *FDIC v. Cocke*, 7 F.3d 396, 403 (4th Cir. 1993), *cert. denied*, 115 S. Ct. 53 (1994), the FDIC asserted that the claims against a defendant-attorney were not derivative claims and, therefore, should not be barred by Virginia's PC statute. The Fourth Circuit rejected this argument, stating that the statute exculpates shareholders for the negligent activities of other shareholders. *Id.* According to the court, the attorney could not be personally liable if he was not personally responsible for any of the work done. *Id.*



speculated, various approaches to peer review may emerge if attorneys continue to limit their liability. Regulators may require some form of peer review or courts may impose civil liability if principals fail to monitor their peers. Such action could be avoided if firms take the lead and institute peer review programs in managing client service. Such an approach helps protect the firm and its assets, as well as the consuming public, resulting in a merger of good management and ethics.

## I. DEVELOPMENT AND STRUCTURE OF LAW FIRMS

### A. *Historical Perspective*

In exploring the duty of an attorney to monitor his/her partners, one must consider the reasons why attorneys band together in a law firm. Historians, sociologists, and economists have different perspectives relating to the emergence, growth, and structure of large law firms.

Historians have treated the emergence of law firms as an evolutionary process beginning with attorneys who practiced law as individuals.<sup>23</sup> In the first quarter of the nineteenth century, some attorneys formed two person partnerships. By the end of the century, these partnerships grew into firms with more members.<sup>24</sup> The membership continued to increase until the 1930s when firms began to be called pejoratively "law factories."<sup>25</sup> Before the Second World War, the big firm had come to dominate law practice.<sup>26</sup> By the 1950s and 1960s large firms had reached their "golden age" as prosperous, stable, and untroubled institutions.<sup>27</sup>

For the next two decades firms continued to grow and flourish.<sup>28</sup> Firms expanded their practices, adding specialties

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23. JAMES W. HURST, *THE GROWTH OF AMERICAN LAW* 306 (1950) (noting that the typical partnership had a "court" member and an "office" member).

24. For statistics demonstrating the growth of law firms, see RICHARD L. ABEL, *AMERICAN LAWYERS* 182-83 (1989).

25. See MARC GALANTER & THOMAS PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM* 16-18 (1991) (attributing the term "law factory" to Karl Llewellyn's book review published in 31 COLUM. L. REV. 1215, 1218 (1931) (reviewing MORRIS GISNET, *A LAWYER TELLS THE TRUTH* (1931)).

26. *Id.* at 20.

27. *Id.*

28. See *id.* at 46 (indicating that firms with more than 100 lawyers grew from less than 12 in 1960 to 251 in 1986).

and branch offices in the United States and abroad.<sup>29</sup> By the 1980s the large law firms were sitting "atop the pyramid of prestige and power within the American legal profession."<sup>30</sup> Large firms represented the most affluent clients and attracted the best trained and skilled attorneys.<sup>31</sup> In recent years, firms have contended with increased competition, turmoil, declining business and high overhead.<sup>32</sup> Nevertheless, the large law firm has achieved success in the Darwinian sense.<sup>33</sup>

### B. *Sociological and Economic Theories*

Various sociological and economic theories have been used to explain the structure and growth of firms. Case studies of the early firms suggest that interpersonal relationships played a significant role in institutional growth.<sup>34</sup> These studies indicate that, at least initially, successful firms arose out of interpersonal relationships where partners' skills and assets complemented one another.<sup>35</sup> Although such interpersonal relationships cannot be ignored, the interpersonal approach does not provide a complete explanation of the growth and

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29. *See id.* at 47-48.

30. ROBERT L. NELSON, *PARTNERS WITH POWER: THE SOCIAL TRANSFORMATION OF THE LARGE LAW FIRM* 1 (1988). In his book, Nelson uses an "organization dominance" framework to explain how large law firms have achieved and maintained a dominant position in the market for corporate legal services. *Id.* at 18-24.

31. *See* GALANTER & PALAY, *supra* note 25, at 50, 57.

32. *See* Daniel B. Kennedy, *Cutbacks Profit Partners*, A.B.A. J., Sept. 1994, at 32 (reporting that a 1993 survey indicated that the largest firms were growing at a "snail's pace" and attributing partner compensation increases to "internal cost controls").

33. Marc Galanter & Thomas M. 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) (elaborating on how large law firms have successfully commanded a larger market share and provided the standard format for the "delivery of comprehensive, continuous, high-quality legal services").

34. *See* Thomas P. Pinansky, *The Emergence of Law Firms in the American Legal Profession*, 9 U. ARK. LITTLE ROCK L.J. 593, 598-604 (1986) (describing case studies of Shearman & Sterling and Reed Smith Shaw & McClay, firms in New York and Pittsburgh, respectively).

35. *Id.* For a discussion of the rough division of labor and specialties, see LAWRENCE M. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 311 (2d ed. 1985). Paul D. Cravath, founder of the present Cravath, Swaine & Moore, is recognized as the first person to set out deliberately to institutionalize a law firm as an entity that would transcend and outlive the influence of individual partners. For a discussion of Cravath's philosophy, see PAUL HOFFMAN, *LIONS IN THE STREET: THE INSIDE STORY OF THE GREAT WALL STREET LAW FIRMS* 6-8 (1973).

longevity of firms.<sup>36</sup> Therefore, scholars advance other sociological and economic explanations.

One such sociological explanation holds that large firms have emerged as a functionally appropriate response to structural-technological forces in American society.<sup>37</sup> This demand-side explanation contrasts with the supply-side perspective which focuses on the entrepreneurial interests of attorneys to organize in law firms in order to attract corporate clients.<sup>38</sup> In considering both internal and external factors, the rise of organizational law practice can be attributed to the "[e]conomies of scale, increasingly complex and geographically expansive litigation, diverse client concerns, and the rapid growth of corporate entities."<sup>39</sup> In short, size enables the firm to meet the needs of both the clients and firm members.<sup>40</sup>

In analyzing the structure of law firms, economists have characterized the law firm as an organization consisting of a nexus of contracts between owners of factors of production and customers.<sup>41</sup> Economists explain that these contracts specify agents' rights, performance standards, and payoffs.<sup>42</sup> By specifying payoffs as promised payments to agents, the contract

36. Pinansky, *supra* note 34, at 604 (suggesting that an effective analysis must also consider the prevailing social conditions in which firms emerged).

37. *See id.* at 604-21 (discussing the five structural and technological developments in the nineteenth century which contributed to the growth of firms: "(1) the law changing to meet the developmental goals of 19th-century America; (2) the rise of corporations and the response of government; (3) the expansion of the field of finance; (4) technological change and an attendant ideology of science; and (5) the changing conception of organizations").

38. *Id.* at 624 (applying Magali Sarfatti Larson's theory of collective mobility conceptualized in her seminal work, *THE RISE OF PROFESSIONALISM: A SOCIOLOGICAL ANALYSIS* (1977)).

39. Colin Croft, *Reconceptualizing American Legal Professionalism: A Proposal for Deliberative Moral Community*, 67 N.Y.U. L. REV. 1256, 1288 (1992).

40. In economic terms, "[s]ize permits diversification while protecting individual partners from the threat that their human capital will depreciate if their specialty becomes obsolete." ABEL, *supra* note 24, at 183.

41. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 302 (1983). Under this theory of organization, each individual contributes factors of production to a cooperative enterprise in order to achieve greater returns than the individual would receive independently. Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 332 (1985).

42. Fama & Jensen, *supra* note 41, at 302.

structure of the organization limits the agents' risks.<sup>43</sup> In law firms, attorneys as agents of the firm offer inalienable human capital and perform services for clients.<sup>44</sup> In exchange, the attorney-agents have residual claims against the firm's net cash flow.<sup>45</sup>

Under this economic model, monitoring plays an important role in law firms. Monitoring minimizes the risk of a partner taking a free-ride on the efforts of colleagues and protects the firm and its members from the acts or omissions of incompetent or malfeasant partners.<sup>46</sup> Monitoring also helps maintain the value of human capital which is sensitive to the performance of agents.<sup>47</sup> In order to avoid shirking by partners (agents), while controlling liability and protecting reputational capital, firms monitor the performance of firm attorneys.<sup>48</sup>

In the case of law partnerships, this monitoring must be provided by attorneys because of the asymmetry between the knowledge possessed by the attorney-professionals and the client-consumers.<sup>49</sup> Commonly, senior attorneys act as monitors in supervising associates and screening associates before inviting the associates to join the partnership ranks. During this screening period, partners closely evaluate associates' work-product and behavior.<sup>50</sup> To assure maximum effort by

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43. Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 328 (1983) (characterizing the organization's agents as residual claimants or residual risk bearers).

44. *Id.* at 336-37 (asserting that this professional human capital which cannot be sold to cover liability losses to customers is the dominant asset of a professional partnership).

45. *Id.* at 334.

46. Under the principles of partnership law, partners in firms share unlimited liability for the acts or omissions of partners in the scope of partnership business. For a discussion of partnership principles, see *infra* part III.A.

47. Fama & Jensen, *supra* note 43, at 334-35.

48. See Gilson & Mnookin, *supra* note 41, at 380-81 (asserting that partners who share compensation on a seniority basis can minimize shirking problems by employing monitoring techniques and by developing a "supportive firm culture").

49. In the case of large corporate clients, in-house counsel and consultants may monitor some performance. For example, in-house counsel and legal consulting firms can scrutinize billing statements for irregularities. See Darlene Ricker, *Auditing Lawyers for a Living*, A.B.A. J., Aug. 1994, at 65 (discussing the trend of clients to hire consultants to audit legal bills). In analyzing the role of outside counsel in changing the demand side of the legal marketplace, Professors Gilson and Mnookin suggest that the sophistication of outside counsel will reduce the value of firm-specific capital which depends on high information costs and unsophisticated clients. Gilson & Mnookin, *supra* note 41, at 384.

50. GALANTER & PALAY, *supra* note 25, at 99.

associates, firms defer a significant amount of compensation to the outcome of the "promotion to partner tournament."<sup>51</sup> After the tournament winners cross the line and receive the trophy of partnership status, their work is no longer continuously monitored because they have attained peer status.

### *C. Culture and Organizational Structure of Law Firms*

The degree to which law firm principals monitor or review their peers depends on a number of factors including the firm's culture and organizational structure. A firm's culture may fall somewhere on a continuum between a "confederation" culture and a "team" culture at the opposite end.<sup>52</sup>

At one end of the continuum attorneys function as loose confederations of individuals, rather than as organized teams.<sup>53</sup> In a confederation culture, each attorney practices independently as a "master of his or her craft," essentially functioning as an individual practitioner sharing offices with others.<sup>54</sup> These attorneys perceive peer review as a threat to autonomy because they prefer to practice with little supervision or accountability.<sup>55</sup>

In contrast, attorneys who function as teams emphasize firm practice as a joint effort to serve firm clients.<sup>56</sup> Attorneys in a team firm seek to represent clients as a single entity, rather than as a collection of individuals.<sup>57</sup> This team approach requires the subordination of individual attorneys' interests to the firm's interests.<sup>58</sup> In setting firm-wide standards, team

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51. *Id.* at 100-08 (theorizing that the promotion to partner tournament propels exponential growth of law firms).

52. See ALTMAN & WEIL, INC., COMPENSATION PLANS FOR LAWYERS AND THEIR STAFFS: SALARIES, BONUSES AND PROFIT-SHARING 6-8 (1986) (characterizing these attitudes toward group practice).

53. *Id.* at 6-7.

54. *Id.* at 7 (explaining that the office exists merely to facilitate each lawyer's practice providing staff support, a library, amenities, coverage during absence or illness, and companionship).

55. See *id.* (noting that the attorneys enjoy the sense of independence and the lack of accountability that the confederation culture allows).

56. *Id.* at 7 (explaining that in a team firm, clients "belong" to the firm rather than to any individual partner).

57. *Id.*

58. *Id.*

firms lay the foundation for using peer review to manage firm members.<sup>59</sup>

The organizational structure of a firm also affects attitudes toward peer review. If a firm is organized as a general partnership in which partners have unlimited liability, peer review helps firms avoid malpractice, thus limiting the liability exposure of the firm and individual partners. In such a general partnership, peer review acts as an internal control, while liability exposure acts as an external control.

On the other hand, if a firm is organized as a PC, LLP, or LLC (collectively called "limited liability firms"), a principal's liability may be limited to claims arising out of that principal's own acts or omissions. Because the firm's assets and reputation are at stake, principals in limited liability firms may monitor other members to prevent malpractice. More commonly, principals in such firms may avoid monitoring or reviewing another attorney's work because the act of monitoring may destroy the liability protection which is only afforded to nonparticipating partners.<sup>60</sup> This acts as a disincentive to attorneys reviewing the work of other members of the limited liability firm. Rather than risk the possibility of liability exposure for a colleague's conduct, a principal may choose to avoid any involvement, deliberately shutting his or her eyes.<sup>61</sup>

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59. Attorneys function more like a team when they share common aspirations and interests. Lon Fuller used this principle of shared commitment to explain human associations. Lon L. Fuller, *Two Principles of Human Association*, in *THE PRINCIPLES OF SOCIAL ORDER* 67, 70-76 (Kenneth I. Winston ed., 1981) (contrasting the principle of shared commitment with the opposing legal principle of associations held together by formal rules of duty and entitlement).

60. For example, the Texas statute identifies the following situations when the LLP provisions will not shield a partner from vicarious liability: (1) the miscreant partner or representative is working under the supervision or direction of the partner; (2) the partner was "directly involved in the specific activity in which the errors, omissions, negligence, incompetence, or malfeasance were committed by the other partner or representative"; or (3) the partner "had notice or knowledge of the errors, omissions, negligence, incompetence, or malfeasance by the other partner or representative at the time of occurrence" and then failed to take reasonable steps to prevent or cure the wrongdoing. TEX. REV. CIV. STAT. ANN. art. 6132b, § 15(2) (West Supp. 1995). In an attempt to limit their liability under these sections, partners may intentionally avoid any direct involvement or peer review which might charge them with notice or knowledge of other partners' misconduct.

61. Such abdication of responsibility could be discouraged if an attorney whose conduct rises to the level of reckless disregard is deemed to have knowledge of the wrongdoing. Federal courts have used a similar approach in holding that scienter can be predicated on reckless conduct for liability under § 10(b) of the

In this event, neither internal peer review nor external unlimited liability protects clients.

In considering both the firm culture, as well as firm organizational structure, one can further analyze the extent to which clients and firm attorneys can be protected by internal peer review controls and external controls of unlimited liability. The following matrix illustrates the interplay of internal and external controls in law firms with different cultures and organizational structures.

LAW FIRM STRUCTURE		
	GENERAL PARTNERSHIP	LIMITED LIABILITY FIRM
TEAM CULTURE	I PEER REVIEW & UNLIMITED LIABILITY	II PEER REVIEW & LIMITED LIABILITY
CONFEDER- ATION CULTURE	III NO PEER REVIEW & UNLIMITED LIABILITY	IV NO PEER REVIEW & LIMITED LIABILITY

In quadrant I, firm partners operate as a team and engage in some degree of peer review. This peer review protects both the clients and partners from the consequences of malfeasant partners. At the same time, the unlimited liability of partners in a general partnership protects clients in the event of a claim.

Firms in quadrant II organize as limited liability firms rather than general partnerships. Nevertheless, partners may take a team approach, using peer review to protect both the clients and members of the firm. Unless a firm principal

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Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1988), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1994). See, e.g., *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (noting that conduct is deemed sufficiently reckless to constitute scienter if that conduct represents "an extreme departure from the standards of ordinary care, and which presents a danger . . . either known to the defendant or so obvious that the actor must have been aware of it") (citations omitted), *cert. denied*, 449 U.S. 976 (1991).

directly participates in the delivery of legal services, or acts as a monitor, that principal should not have vicarious liability if courts recognize the statutory limits on liability of principals in a limited liability firm.

The firms in quadrants III and IV operate as confederations. In confederated firms, there is no peer review to protect either clients or firm principals. In quadrant III, the unlimited liability of the general partnership protects clients. At the same time, attorneys experience the most exposure in quadrant III because they must share the risks of unlimited liability, with no peer review to control those risks.

Clients have the least protection in quadrant IV, when confederations of attorneys organize as limited liability firms and resist any form of peer review. As a result, in quadrant IV, neither peer review nor unlimited liability controls peer misconduct, thereby leaving clients completely unprotected.

In short, the peer review and unlimited liability exposure in quadrant I provide the most protection for clients. At the other extreme, clients obtain the least protection in quadrant IV where the firm attorneys have limited liability and no form of peer review. Attorneys in quadrant II seek to limit their liability by organizing as limited liability firms and by instituting some form of peer review.<sup>62</sup> Finally, the attorneys in quadrant III share the most exposure as general partners in a confederation firm with no peer review.

During the last few years, many attorneys have moved their firms into quadrant IV.<sup>63</sup> In doing so, attorneys are relying on

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62. Notwithstanding the fact that they may not have vicarious liability, attorneys in quadrant II may use peer review to protect the firm's assets and reputation.

63. Richard C. Reuben, *Added Protection*, A.B.A. J., Sept. 1994, at 54 (discussing the rush of firms to reorganize as limited liability firms). In characterizing limited liability firms as "clearly the hottest topic in the law today, at least when it comes to practice management," Robert R. Keatinge, the chairman of the ABA Business Law Section Partnership Committee's Subcommittee on LLCs, stated that every law firm in the country is probably looking at limiting liability. *Id.* at 55-56.

Prior to the enactment of legislation providing limited liability status to LLPs and LLCs, Frank G. Mathewson and Jack L. Carr analyzed 1972 to 1977 census data to compare firm size to liability status. Ronald J. Gilson, *Unlimited Liability and Law Firm Organization: Tax Factors and the Direction of Causation*, 99 J. POL. ECON. 420, 421 (1991). They concluded that a change in liability status through incorporation significantly increases the average firm size. *Id.* In criticizing this conclusion for failing to take into account the institutional setting in which the change occurred, Professor Ronald J. Gilson analyzed the tax



statutory liability limits rather than peer review controls. The following discussion suggests reasons why these firms—and, in fact, all firms—should revisit implementing peer review.

## II. THE CONCEPT OF LAW FIRM PEER REVIEW

In law practice, “peer review” refers to a spectrum of concepts.<sup>64</sup> For the purposes of this article, “law firm peer review” means the process in which law firm partners or principals monitor and evaluate the job performance of their colleagues.<sup>65</sup> Firms may design peer review programs to obtain information for assessment and improvement of partners’ work.<sup>66</sup>

Law firm peer review serves a number of purposes. First, partners can use peer review to assess colleagues’ performances prior to the delivery of the legal services. Such performance assessment allows ex ante regulation of the quality of services. Ex ante regulation helps partners control and possibly enhance

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advantages of incorporating. *Id.* This analysis indicated that better economic performance caused firms to incorporate to obtain tax benefits. *Id.* at 423-24. According to Professor Gilson, successful firms are more likely to incorporate for tax reasons than limited liability reasons. *Id.* Other factors may now be influencing firms’ decisions to reorganize as LLPs or LLCs. For example, multistate firms may elect LLP status rather than PC status because most states require that all PC members be licensed in the state of incorporation. McLaughlin, *supra* note 5, at 259. A firm may elect LLP status to avoid state franchise taxes payable by corporations. For a comparison of LLPs and LLCs, see Byron F. Egan, *LLC’s and LLP’s: Practical Considerations About Limited Liability Companies and Limited Liability Partnerships*, in UNIVERSITY OF HOUS. L. FOUND., CORPORATE, PARTNERSHIP AND BUSINESS LAW INSTITUTE, at D-1 (1994).

64. The spectrum of proposals for peer review ranges from lawyer to lawyer individual help, through law practice peer review, to disciplinary peer review. For a discussion of the range of proposals, see A.L.I.-A.B.A. COMM. ON CONTINUING PROF. EDUC., *ENHANCING THE COMPETENCE OF LAWYERS* 255-63 (1981).

65. This article uses “partner” or “principal” to denote any equity holder in a firm, including a partner of a partnership and shareholder in a professional corporation. The ABA Model Rules of Professional Conduct take a similar approach, defining a “partner” to be “a member of a partnership and shareholder in a law firm organized as a professional corporation.” MODEL RULES OF PROFESSIONAL CONDUCT Terminology (1983) [hereinafter MODEL RULES].

66. Harry H. Schneider, Jr., *Your Partner’s Keeper*, A.B.A. J., Nov. 1993, at 104.

the quality of legal services rendered.<sup>67</sup> Clearly, such regulation protects clients and a firm's relationships with clients.

Second, peer review can operate as a risk management program to reduce the likelihood of malpractice claims and grievances. Specifically, peer review may eliminate grievances and claims arising out of errors or omissions by individual partners. By instituting a peer review program, partners may also avoid violations of state disciplinary rules that are based on Model Rules of Professional Conduct Rule 5.1(a), requiring that partners make reasonable efforts to ensure that the firm has effectuated measures giving reasonable assurance that all attorneys in the firm conform to the rules of professional conduct.<sup>68</sup>

Firms may also institute a peer review program because a particular state may not recognize statutory limits on liability.<sup>69</sup> When a firm's practice spans multiple states, the liability limitations in one state may not provide protection in other states.<sup>70</sup> Rather than relying only on liability limits, partners in multistate firms may attempt to lower their liability exposure by instituting peer review.

In the event of a suit, peer review efforts would enable the defendant partners to defend those legal malpractice claims alleging a duty to monitor. Diligent peer review could defeat

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67. This ex ante regulation of professional norms compares with other enforcement strategies, including disciplinary and liability controls, which operate on the basis of ex post complaints by injured parties. David Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 799, 807 (1992). For an analysis of all four paradigmatic models of enforcement systems and the inadequacy of disciplinary and liability schemes which largely depend on ex post complaints, see *id.* at 805-07.

68. For a discussion of Model Rules of Professional Conduct Rule 5.1(a), see *infra* notes 117-29 and accompanying text.

69. For an examination of the states which have abolished limited liability under professional corporation statutes, see Paas, *supra* note 13, at 375-83.

70. Given that states differ widely, the limitation of liability under the laws of one state may not provide any protection in another state where the law firm practices. First, a firm must determine if a foreign professional corporation can qualify to do business in all states of practice. Then, the firm must determine if the courts in particular states of practice have upheld statutory liability limits. Problems arise when some firm members have limited liability and others do not. As one legal malpractice defense counsel explained, "the 'worst of all possible worlds' is a law firm where some lawyers do business as professional corporations and others do not, leaving those without PC protection as vulnerable targets." Sandra Torrey, *More Firms Searching for Ways to Limit Partners' Liability*, WASH. POST, May 11, 1992, at F5.

the plaintiff's claims that the nonparticipant failed to monitor the alleged wrongdoer.

Peer review also provides a mechanism for reexamining the competency of all attorneys on a continuing basis.<sup>71</sup> Such reexamination is important because, as malpractice statistics reveal, senior partners cause problems more than associates or nonlawyers.<sup>72</sup> Periodic peer review may empower firm management to detect and deal with senior partners who are incapacitated or incompetent.<sup>73</sup>

The peer review process can also boost intra-firm communication and identify serious problems, including partners' substance abuse and other physical and mental problems affecting attorney performance.<sup>74</sup> Peer review may uncover such problems before they pose a serious risk to the law firm.<sup>75</sup>

A peer review program can also serve marketing purposes. A law firm's commitment to maintain and enhance quality through peer review should impress prospective and current clients. In particular, sophisticated corporate clients whose companies have instituted total quality management ("TQM")

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71. Because of the hierarchy in firms, peer review provides a vehicle for holding partners accountable. The importance of monitoring the conduct of senior attorneys was illustrated by the recent withdrawal of the respected managing partner of the Chicago firm of Winston & Strawn, following financial irregularities amounting to approximately \$500,000. Stephanie B. Goldberg, *An Unexpected Ouster*, A.B.A. J., July 1994, at 28. In another instance where Minneapolis based Moss & Barnett's president embezzled \$220,000, a firm partner stated, "[W]hen the chief executive officer and head of the firm decides to do something, it takes a strong-willed subordinate to say no to him." *Id.* at 28. If all firm attorneys must comply with internal control measures, financial irregularities could be detected.

72. The Eighth Annual Judicial Conference of the United States Court of Appeals for the Federal Circuit, 133 F.R.D. 245, 287 (1990). In a speech presented at the Eighth Annual Judicial Conference of the United States Court of Appeals for the Federal Circuit, Robert E. O'Malley, one of the founders of the Attorneys Liability Assurance Society, underscored that senior partners are the problem. *Id.* O'Malley reported that of 300 malpractice claims seeking one million or more in damages, not one claim arose out of the acts or omissions of an associate or young partner. *Id.*

73. See Timothy G. Shelton, *What Happens When Aging Lawyers Don't Know When to Quit?*, L. PRAC. MGMT., July-Aug. 1992, at 40, 42 (recommending peer review as a means of dealing with incapacitation among elderly attorneys). Although peer review should cover all attorneys, the review can be tailored to each attorney's practice area.

74. Scott Graham, *Four Divergent Approaches to Peer Review*, RECORDER, May 24, 1991, at 5.

75. *Id.*

programs may be inclined to retain law firms that have instituted peer review as part of a program of quality control.<sup>76</sup>

In the legal marketplace, a prospective client's decision to retain a firm typically rests on the firm's reputation. For example, an issuer of securities may retain the services of a prestigious law firm so that the firm's national reputation is associated with the offering. Similarly, clients may pay higher fees for a tax opinion that bears the name of a reputable firm which presumably has quality controls. Peer review efforts operate as an investment in reputation or brand name capital.<sup>77</sup> By investing time and resources in peer review, firms signal to outsiders "their commitment not to shirk."<sup>78</sup> At the same time, within the firm, peer review acts as a prophylaxis to shirking.

In addition to improving individual performance and conduct, peer review helps shape attorneys' perspectives of the law firm as a team, rather than a confederation of individual attorneys practicing together in the same office. In a team firm, the clients appear to belong to the firm, rather than to individual attorneys. If active monitoring prevents a partner from becoming too autonomous, peer review may minimize the risks of partners grabbing clients and leaving the firm.<sup>79</sup>

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76. Corporate America has followed the lead of Japanese and European industrialists in embracing TQM programs to assure consistent performance. Gary R. Garrett, *What Does Total Quality Management Mean for Legal Organizations?*, LEGAL MGMT., May-June 1992, at 20. It was predicted that by 1994, an estimated 80% of corporate law departments of Fortune 500 companies would have implemented TQM programs. Ward Bower, *In Search of Excellence—Applying TQM to a Legal Environment*, L. PRAC. MGMT., Apr. 1993, at 22. These corporate clients would be positively impressed by a law firm's efforts to assure quality through a partner review program. As revealed by a survey of Fortune 500 general counsel, 71% of the attorneys polled indicated that their selection of outside counsel would be influenced by a firm's implementation of a TQM program. Nancy Blodgett, *More and More Law Firms Take the TQM Plunge*, LEGAL MGMT., May-June 1993, at 25.

77. In economic terms, the law firm essentially rents its reputation to its clients.

78. See Jack Carr & Frank Mathewson, *The Economics of Law Firms: A Study in the Legal Organization of the Firm*, 33 J.L. & ECON. 307, 311 (1990) (explaining that the investment in brand name capital includes advertising, expenses associated with the solicitation of new clients, accumulation of satisfied clients, and fulfillment of commitments, including the punishment of chiselers).

79. For a thorough analysis of the problems of grabbing and leaving, see Robert W. Hillman, *Law Firms and Their Partners: The Law and Ethics of Grabbing and Leaving*, 67 TEX. L. REV. 1 (1988).

Finally, a peer review program can foster a positive law firm culture where all attorneys are accountable. In such a culture, ethical, competent performance merits recognition.<sup>80</sup> A peer review program communicates to persons inside and outside the law firm that the firm is committed to providing quality legal services.

### III. DO MEMBERS OF LAW FIRMS HAVE A DUTY TO MONITOR THEIR PEERS?

Regardless of the value of a peer review program, few attorneys would concur with the premise that law firm partners have a duty to monitor their peers. The government's pleadings generally allege the existence of such a duty without identifying the source of the duty.<sup>81</sup> Therefore, various sources of law must be consulted in considering whether firm members or principals have a duty to monitor their peers.

#### A. *Partnership Law*

Because law firms traditionally function as general partnerships, one must first determine if partnership law imposes such a duty. The rights, duties, and liabilities of partners in general partnerships are defined in the Uniform Partnership Act ("UPA"),<sup>82</sup> as adopted in most jurisdictions, and in the Revised Uniform Partnership Act ("RUPA").<sup>83</sup> Under the UPA, all partners share an equal right in the management and conduct

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80. See MODEL RULES Rule 5.1 cmt. (explaining that the "ethical atmosphere of a firm influences the conduct of all its members").

81. See, e.g., Complaint, FSLIC v. Lensing, Gravel, Rosenzweig, Christen & Lebeau, No. 89-329 (M.D. La. filed Apr. 23, 1989); see also Plaintiff's Original Complaint, FDIC v. Nathan, No. H-91-2845 (S.D. Tex. filed Sept. 25, 1991); First Amended Complaint, FDIC v. Wise, No. 90-F-1688 (D. Colo. filed Feb. 4, 1991).

82. UNIFORM PARTNERSHIP ACT (1914) [hereinafter UPA].

83. REVISED UNIF. PARTNERSHIP ACT (1993) [hereinafter RUPA]. In August 1993, the final revisions to the RUPA were approved by the National Conference of Commissioners on Uniform State Laws. Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1, 1 n.1 (1993). Dean Donald J. Weidner and Professor John W. Larson served as reporters for RUPA. For their analysis of the principal changes made by the RUPA, see *id.* at 1. Unlike the UPA which does not settle whether a partnership should be characterized as an "aggregate" of its partners, or a distinct legal entity, RUPA specifically states that partnerships are entities. *Id.* at 3 (RUPA § 201). Within a year of the National Conference of Commissioners' approval, Montana and Wyoming adopted the RUPA. *Id.* at 1 n.1.

of partnership business.<sup>84</sup> Although the UPA recognizes a right of a partner to participate in the management and conduct of the partnership, the UPA does not actually impose a duty on a partner to participate in management or to monitor the conduct of other partners.

At the same time, the UPA's liability provisions do provide incentives for partners to monitor each other because both the firm and its partners may be liable for the acts or omissions of partners.<sup>85</sup> This liability on the firm level and individual partner level encourages partners to monitor and control unethical activity.<sup>86</sup>

First, the partnership itself is subject to tort liability for the acts or omissions of a partner. Section 13 of the UPA provides that the partnership is liable for loss or injury caused "to any person, not being a partner," for "any wrongful act or omission of any partner acting in the ordinary course of partnership business or with the authority of the co-partners."<sup>87</sup> Under this section, which codifies common law,<sup>88</sup> the partnership is ordinarily liable for a tort committed by one of the members acting within the scope of the firm's business, even though the

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84. Under UPA § 18 "all partners have equal rights in the management and conduct of the partnership business" unless an agreement provides to the contrary. ALAN BROMBERG & LARRY E. RIBSTEIN, *PARTNERSHIP* § 6.03, at 6:38 (1994). Under the terms of the partnership agreement, partners may concentrate management power in one or more managing partners. *Id.* § 6.03, at 6:39-40 (explaining that professional partnerships commonly rely on managing partners because there are too many members to permit all to participate effectively in daily decision-making). Normally, the partnership agreement will identify categories of management decisions that must be made by the members and other limits on the managing partner's decision-making authority.

85. See UPA § 13.

86. Jeffrey A. Barker, *Professional-Client Sex: Is Criminal Liability an Appropriate Means of Enforcing Professional Responsibility?*, 40 UCLA L. REV. 1275, 1316 n.164 (1993). For cases imposing liability for the negligence of an innocent partner in the event of fraudulent activities by another partner, see *id.*

87. UPA § 13. Although this language covers negligent acts of partners, some question remains as to whether nonparticipating partners may be liable for wrongdoing which requires a high level of culpability. BROMBERG & RIBSTEIN, *supra* note 84, § 4.07, at 4:78.

88. The common law principle as articulated in *Filter v. Meyer*, 41 S.W. 152 (Tex. Civ. App. 1897), states:

Every member of an ordinary partnership is its general agent for the transaction of its business in the ordinary way; and the firm is responsible for whatever is done by any of the partners when acting for the firm within the limits of the authority conferred by the nature of its business it carries on.

*Id.* at 153 (quoting 1 NATHANIEL LINDLEY, *PARTNERSHIP* 256-57 (1888)).

persons sought to be charged did not participate in, ratify, or have knowledge of such conduct.<sup>89</sup>

Second, under the UPA, each member of the partnership is liable for all partnership debts and obligations, including those arising from wrongful acts or omissions of a partner or from breaches of trust chargeable to the firm.<sup>90</sup> Under the UPA, a partner who has not participated in or condoned the wrongful actions of another partner may still be vicariously liable for the acts or omissions of other partners.<sup>91</sup> Partners may also be vicariously liable under agency and respondeat superior principles.<sup>92</sup>

Partnership tort liability imposes losses on the party who can most efficiently control misconduct.<sup>93</sup> A partnership and its partners may reduce the risks of wrongdoing by effectively

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89. In order for a nonparticipating partner to be personally liable for the wrongful, tortious, or criminal acts of another partner, the act must fall within the scope of the partnership business or the nonparticipating partner must ratify, authorize, or adopt the acts or omissions. *K & G Oil & Tool Serv. Co. v. G & G Fishing Tool Serv.*, 314 S.W.2d 782, 793 (Tex. 1958), *cert. denied*, 358 U.S. 898 (1958).

90. Under UPA § 15(a), partners are "[j]ointly and severally liable for everything chargeable to the partnership under" UPA § 13 (covering wrongful acts and omissions) and UPA § 14 (covering breaches of trust). Under UPA § 15(b) partners are jointly liable "for all other partnership debts and obligations." For an analysis of the procedural differences between "joint" and "joint and several" liability, see Alan R. Bromberg, *Enforcement of Partnership Obligations—Who Is Sued for the Partnership?*, 71 NEB. L. REV. 143, 146 (1992). Unlike the UPA which differentiates between tort and contract liability, the RUPA imposes on partners joint and several liability for all partnership obligations. RUPA § 306 cmt.

91. See J.R. Kemper, Annotation, *Vicarious Liability of Attorney for Tort of Partners in Law Firm*, 70 A.L.R. 3d 1298 (1976) (surveying case law on an attorney's liability for partners' torts).

92. See BROMBERG & RIBSTEIN, *supra* note 84, § 4.07, at 4:80 n.8 (citing cases applying respondeat superior and agency principles). Under § 9(1) of the UPA, "the partnership is bound by the torts of a partner in the 'ordinary course of the business' without other proof that the partner was acting as a servant of the partnership." *Id.* § 4.07, at 4:79.

93. *Id.* § 4.07, at 4:78 (explaining that the ability of a partnership to reduce the costs of partners' acts depends on "how closely the loss relates to partnership business, because this bears on the partnership's costs of obtaining information about the risk and of implementing risk avoidance procedures, including those regarding the selection and supervision of partners").

monitoring its agents.<sup>94</sup> The risk of vicarious liability provides a powerful incentive for partners to monitor each other.<sup>95</sup>

A survey of malpractice case law indicates that most cases against nonparticipating partners turn on vicarious liability principles. Occasionally, plaintiffs have asserted a direct negligence claim alleging failure to monitor and supervise the malpracticing partner.<sup>96</sup> For example, in *Myers v. Aragona*,<sup>97</sup> the plaintiff alleged a vicarious liability claim, as well as an independent negligence claim. The plaintiff asserted that the nonparticipating partner "failed to inspect books of account and other financial records of the partnership, and further that he failed to make inquiry as to the application of the . . . funds or to familiarize himself with the transactions carried on by his law partner."<sup>98</sup> Because the court determined that the nonparticipating partner was vicariously liable under the UPA, the court concluded that it was unnecessary to consider the direct liability claim.<sup>99</sup> As stated by the court, because of the vicarious liability law of partnerships, any discussion of the direct liability claim is "purely academic."<sup>100</sup>

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94. Presumably, a partner implicitly agrees to be subject to the risks of partnership in return for the ability to monitor and control the activities of other partners. See Larry E. Ribstein, *A Statutory Approach to Partner Dissociation*, 65 WASH. U. L.Q. 357, 405 (1987) (asserting that a disabled partner or estate should have a right of unpenalized withdrawal because the disabled partner or partner's estate does not have control over other partners' activities and should not remain exposed to partnership risks).

95. See Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427, 468 (1991) (arguing that the allocation of risk of loss inside the partnership is not necessary in order to encourage either good performance or good monitoring).

96. See, e.g., *Dollman v. Shutts & Bowen*, 575 So. 2d 320, 321 (Fla. Dist. Ct. App. 1991) (holding that material issues of fact precluded summary judgment for defendant attorney and the firm). Jurisdictions vary on whether the partnership may be sued as an entity or whether each partner must be sued individually. 1 RONALD E. MALLIN & JEFFREY M. SMITH, *LEGAL MALPRACTICE* § 5.3, at 51 (3d ed. 1989 & Supp. 1993). For example, under Texas law individual partners will not be personally liable for the judgment unless they are actually served as parties. TEX. CIV. PRAC. & REM. CODE ANN. § 31.003 (West 1994).

97. 318 A.2d 263, 264 (Md. Ct. Spec. App. 1974).

98. *Id.* at 266. The plaintiff also asserted that the nonparticipating partner failed to discover the other partner's misappropriation. *Id.*

99. *Id.* at 269.

100. *Id.* In the subsequent insurance coverage case, the Maryland Court of Appeals concluded that the policy's dishonesty provision excluded coverage for all firm partners. *Aragona v. St. Paul Fire & Marine Ins. Co.*, 378 A.2d 1346 (Md. 1977). For a note on the insurance case, see Minto & Morton, *supra* note 17.



Those few malpractice cases that actually discuss the failure to monitor claim appear to turn on the professional responsibility of attorneys as third-party fiduciaries.<sup>101</sup> Unlike ordinary commercial partnerships, a legal partnership and its members owe fiduciary obligations to clients. As articulated by Justice Cardozo, a fiduciary must uphold a standard "stricter than the morals of the marketplace[, n]ot honesty alone, but the punctilio of an honor" most high.<sup>102</sup>

A client retaining a partner in a firm retains the entire firm.<sup>103</sup> Once retained, the firm and its members owe fiduciary obligations to the clients. In the case of *Blackmon v. Hale*,<sup>104</sup> the California Supreme Court focused on an attorney's fiduciary duties, reasoning that partners in a law firm are co-trustees of clients' funds deposited in the firm's trust account. While recognizing that a co-trustee is not strictly liable for the wrongful acts of a co-fiduciary, the court concluded that the nonparticipating partner must exercise reasonable supervision over the other partners' conduct in relation to the trust property.<sup>105</sup> "Negligent inattention" to his duties rendered the partner liable, notwithstanding the fact that he did not actually participate in the misapplication of client funds.<sup>106</sup>

Similarly, in *Dresser Industries v. Digges*,<sup>107</sup> a federal

101. See *infra* text accompanying notes 104-08. Similarly, the liability of a medical partnership may turn on its professional obligations to its patients. Cf. *Kelsey-Seybold Clinic v. Maclay*, 466 S.W.2d 716 (Tex. 1971). The court recognized that a medical partnership is under a duty to exercise ordinary care to protect its patients from harm resulting from tortious conduct of persons upon the premises. *Id.* at 720. The court also noted that the clinic was under a duty to use reasonable means to prevent a partner from misusing his position with the clinic. *Id.* If the clinic failed to exercise ordinary care, it could be liable for its negligence. *Id.*

102. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (recognizing fiduciary duties of "co-adventurers" in a business enterprise).

103. Once a client retains the firm, any firm attorney can perform legal services absent an agreement to the contrary. *MALLEN & SMITH, supra* note 96, § 5.3, at 266; Stephen E. Kalish, *The Sale of a Law Practice: The Model Rules of Professional Conduct Point in a New Direction*, 39 U. MIAMI L. REV. 471, 491-92 (1985) (arguing that in hiring the firm, the client expects that the particular partner he hires will monitor other partners working on his case).

104. 463 P.2d 418 (Cal. 1970).

105. *Id.* at 424.

106. *Id.* at 424-25.

107. No. JH-89-485, 1989 WL 139234 (D. Md. Aug. 30, 1989). Dresser retained the law firm of Digges, Wharton and Levin. When Dresser discovered that Digges charged for services and expenses that were never performed or incurred, Dresser sued the firm and its partners, alleging fraud, breach of

district court predicated liability on a theory of negligent supervision. In that case, Dresser alleged that nonparticipating partners were vicariously liable because of their partnership with Digges, the partner who engaged in improper billing practices. In addition, Dresser alleged that the nonparticipating partners were independently liable for failing to monitor or supervise Digges' billing practices. In granting summary judgment against the nonparticipating partners, the court relied on the affidavit of an expert witness who opined that a partner in a law firm owes a duty to all clients to ensure that the law firm has measures in effect which give reasonable assurance that "all attorneys in the firm conform to the rules and standards of professional conduct."<sup>108</sup>

### B. Disciplinary Cases and Rules

Several reported disciplinary cases have based professional misconduct on the respondent attorney's failure to supervise law office operations.<sup>109</sup> As noted by the court in *In re Neimark*,<sup>110</sup> for example, an attorney may and should be disciplined for his own carelessness and failure to adequately supervise the operations of his office.<sup>111</sup> Although the disciplinary rules do not define standards for civil liability, the rules

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fiduciary duty, breach of contract and negligence.

108. *Id.* at \*8. In his deposition, a defendant attorney admitted that the firm operated without any system or checkpoints which would reveal dishonest acts or breaches of ethics by members of the firm. *Id.* at \*7. The failure to have any system or checkpoints could have been viewed as a violation of Maryland Rule of Professional Conduct 5.1, which requires partners "make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the rules of professional conduct." MD. CODE ANN. app. MD. LAWYERS' RULES OF PROFESSIONAL CONDUCT Rule 5.1 (Supp. 1994). This rule is based on Model Rule 5.1 discussed *infra* notes 117-29 and accompanying text.

109. *See, e.g., In re Kiley*, 256 N.Y.S.2d 848, 849 (N.Y. Sup. Ct. 1965) (sustaining professional misconduct charges because the respondent failed to uncover irregularities in firm billings and reports).

110. 214 N.Y.S.2d 12 (N.Y. App. Div. 1961).

111. *Id.* at 13. The *Neimark* opinion does not specifically identify the disciplinary rule that the respondent violated. The New York disciplinary rules limit the responsibilities of a supervisory lawyer, stating that a lawyer shall be responsible for a violation of the disciplinary rules by another lawyer if (1) the lawyer orders the conduct; or (2) the lawyer has supervisory authority over the other lawyer and knows or should have known of the conduct at a time when its consequences can be avoided or mitigated, but failed to take reasonable remedial action. N.Y. Disciplinary Rule DR 1-104, N.Y. COMP. CODES R. & REGS. tit. 22, § 1200.5 (1994).

may indicate some evidence of the applicable standard of care.<sup>112</sup> Using this approach, a court might examine the applicable disciplinary rules to determine the extent to which they impose a duty to monitor peers.

No provision of the Model Code of Professional Responsibility ("Model Code")<sup>113</sup> even tangentially addresses the question of whether attorneys have a duty to supervise or monitor another attorney's conduct.<sup>114</sup> Although the Model Code mentions law firms in various provisions, the Model Code focuses on attorneys as individual practitioners, largely ignoring the professional responsibility of attorneys practicing in entities.<sup>115</sup> The Model Code treats a law firm simply as an environment within which the individual attorney operates.<sup>116</sup>

The Model Rules of Professional Conduct ("Model Rules")<sup>117</sup> go a bit further in addressing the problems faced by attorneys practicing in group situations, including partnerships and public service entities. Model Rule 5.1(a) states: "A partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that *all lawyers in the firm* conform to the rules of professional conduct."<sup>118</sup> Although Model Rule 5.1(a) refers to "a partner," the official comments to the rule clarify that the provisions of

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112. See *Woodruff v. Tomlin*, 616 F.2d 924, 936 (6th Cir. 1980) (holding that ethical rules constitute some evidence of the standards required of attorneys). Commonly in legal malpractice cases, experts rely on ethical rules in opining on the applicable standard of care.

113. MODEL CODE OF PROFESSIONAL RESPONSIBILITY (1980) [hereinafter MODEL CODE].

114. GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, *THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT* § 5:101 (2d ed. Supp. 1994) (noting that the Model Code took a "single lawyer, single client" approach).

115. Mary Twitchell, *The Ethical Dilemmas of Lawyers on Teams*, 72 MINN. L. REV. 697, 704 & n.19 (1988) (explaining that the Model Code does not recognize that the division of function and responsibility within a firm can create different and greater professional responsibility problems than those that confront a solo practitioner).

116. George W. Overton, *Supervisory Responsibility: A New Ball Game for Law Firms and Lawyers*, 78 ILL. B.J. 434 (1990) (referring to the Illinois Code of Professional Responsibility which was based on the Model Code).

117. A version of the Model Rules has been adopted in approximately 39 jurisdictions. Myer O. Sigal, Jr. & Susan M. Freeman, *Ethical Considerations in Commercial Transactions*, C931 A.L.I.-A.B.A. 83 (1994).

118. MODEL RULES Rule 5.1(a) (emphasis added). In addition to the duties under Rule 5.1(a), Rule 5.1(b) addresses the responsibilities of supervisory attorneys.

section (a) also apply to shareholders in a law firm organized as a professional corporation.<sup>119</sup>

The history of the adoption of the Model Rules indicates that the drafters intended Model Rule 5.1 to establish the principle of supervisory responsibility without introducing a vicarious liability concept.<sup>120</sup> Model Rule 5.1 establishes an institutional check on attorneys' conduct by requiring that partners implement measures giving reasonable assurances that all attorneys in the firm comply with the rules of professional conduct.<sup>121</sup> Therefore, under Model Rule 5.1(a), a partner can be disciplined for his/her own omission in failing to ensure that the firm implements measures such as docket and conflict control systems.<sup>122</sup>

The Model Rules do not define the specific measures that must be implemented to be in compliance with Model Rule 5.1(a). The official comments to Model Rule 5.1 recognize that the propriety and adequacy of measures depend on the firm's structure and its practice. As stated, "[i]n a small firm, informal supervision and occasional admonition ordinarily might be sufficient. In a large firm, or in practice situations in which intensely difficult ethical problems frequently arise, more elaborate procedures may be necessary."<sup>123</sup> Regardless of the size of the firm, Model Rule 5.1(a) requires that partners create

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119. *Id.* Rule 5.1 cmt. 1. Paragraph (a) refers to "lawyers who have supervisory authority" over the professional work of a firm or legal department, including members of a partnership and shareholders in a law firm organized as a professional corporation, as well as lawyers having supervisory authority in a law department of an enterprise or government agency.

120. A.B.A. CTR. FOR PROF. RESPONSIBILITY, *THE LEGISLATIVE HISTORY OF THE MODEL RULES OF PROFESSIONAL CONDUCT: THEIR DEVELOPMENT IN THE ABA HOUSE OF DELEGATES* 153 (1987).

121. Mary C. Daly, *Ethical Challenges for Law Departments in the Twenty-First Century*, in SEVENTH ANNUAL INSTITUTE ON CORPORATE LAW DEPARTMENT MANAGEMENT: CONTROLLING AND REDUCING COSTS 277, 234 (PLI Corp. Law & Practice Course Handbook Series No. 833, 1993).

122. In an incorporated firm, the directors monitor or oversee corporate affairs. See A.B.A. Committee on Corporate Laws, *Corporate Director's Guidebook*, 33 BUS. LAW. 1591, 1600 (1978) (noting that corporate directors assume a duty to act carefully in fulfilling the important tasks of monitoring and directing the activities of corporate management). A director who fails to fulfill the duty of care is liable for the corporation's losses. See A.L.I., *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* §§ 4.01, 7.18 (1994).

123. MODEL RULES Rule 5.1 cmt.

reasonable safeguards to promote firm-wide compliance with ethical rules.<sup>124</sup>

In order to comply with the requirements of Model Rule 5.1(a), a law firm partner must ensure that the firm implements measures to monitor compliance with the rules of professional conduct.<sup>125</sup> Disciplinary authorities could view the failure to monitor compliance by all attorneys as a violation of Model Rule 5.1(a).<sup>126</sup> A partner avoids such a violation by making "reasonable efforts" to ensure that the firm has in effect measures giving reasonable assurance that the associates' and other partners' conduct conforms to the Rules of Professional Conduct.<sup>127</sup> The official comments to Model Rule 5.1 recognize that partners in private firms "have at least an indirect responsibility for all work being done by the firm."<sup>128</sup> With respect to the work and conduct of other partners, the implementation of a peer review program should meet a partner's responsibilities under Model Rule 5.1(a).

Commentators have applied the provisions of Model Rule 5.1(a) to all partners in a firm.<sup>129</sup> The Illinois version of the

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124. See HAZARD & HODES, *supra* note 114, § 5.1:101 (Supp. 1994) (explaining that the affirmative steps include educational efforts, the institution of routine procedures for solving ethical problems, and the creation of a general atmosphere of attention to professional ethics); see also Kathryn W. Tate, *The Boundaries of Professional Self-Policing: Must a Law Firm Prevent and Report a Firm Member's Securities Trading on the Basis of Client Confidences*, 40 KAN. L. REV. 807, 811-17 (1992) (discussing Model Rule 5.1 within the context of a firm's obligation to take measures to ensure that no firm members engage in insider trading).

125. A.B.A., ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.1 (1992).

126. See, e.g., *In re Lenaburg*, 864 P.2d 1052 (Ariz. 1993) (disciplining a managing attorney for violating Arizona Ethical Rule 5.1 by failing to make reasonable efforts to ensure that the conduct of firm lawyers conformed to the rules of professional conduct).

127. For an illustrative case dealing with partners' responsibility to establish firm policies, procedures, and programs, see HAZARD & HODES, *supra* note 114, § 5.1:202 (Supp. 1994). In one illustration, a partner could be disciplined if another partner had not read the newly promulgated Rules of Professional Conduct. As suggested, reasonable efforts to ensure compliance with the Rules of Professional Conduct would include a directive that all firm attorneys study the rules. *Id.*

128. MODEL RULES Rule 5.1 cmt. 4.

129. See, e.g., HAZARD & HODES, *supra* note 114, § 5.2:101 (Supp. 1994) (noting that Model Rule 5.1(a) effectively says that all partners in a firm are "supervisory" lawyers per se and, accordingly, are responsible for making "reasonable efforts" to ensure compliance by members of the firm, including other partners). If Model Rule 5.1(a) applies to all partners, a partner may not be able to avoid responsibility under the rule by simply delegating compliance matters to

Model Rule clarifies that the provisions of Illinois Rule 5.1(a) apply to all partners. As stated in Rule 5.1(a) of the Illinois Rules of Professional Conduct: "Each partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the conduct of all attorneys in the firm conforms to these Rules."<sup>130</sup> Under Illinois Rule 5.1(a) both the firm and each partner in the firm could be subject to direct discipline for failure to effect "measures" giving "reasonable assurance" that all partners' and associates' conduct conforms to the Illinois Rules of Professional Conduct.<sup>131</sup>

The Committee on Professional Responsibility of the Association of the Bar of the City of New York ("New York Bar Committee") has also urged that the New York Code of Professional Responsibility be amended to include provisions for firm discipline and partner supervision of other partners.<sup>132</sup> Specifically, the New York Bar Committee's report recommended amendments requiring that firms provide "reasonable" supervision of their attorneys and requiring that "[p]artners [be] responsible for supervision of each other's work as well as the work of associates."<sup>133</sup> According to the committee report, the proposed changes will encourage the firms to police their

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another partner or administrator.

130. ILL. S. CT. RULES OF PROFESSIONAL CONDUCT Rule 5.1(a) (1994).

131. See Overton, *supra* note 116, at 436 (discussing impact of Illinois Rule 5.1(a) and minimum measures a firm should implement to comply with rule).

132. Edward A. Adams, *Bar Report Urges Courts Apply Disciplinary Rules to Law Firms*, N.Y. L.J., June 25, 1993, at 1.

133. The New York Bar Committee recommended that Disciplinary Rule 1-104 be amended to include a section (B) to read:

A law firm shall adequately supervise the work of all partners, associates and nonlawyers who work at the firm. The degree of supervision required is that which is reasonable under the circumstances, taking into account factors such as the experience of the person whose work is being supervised, the amount of work involved in the particular matter, and the likelihood that ethical problems might arise in the course of working on the matter. Partners are responsible for supervision of each other's work as well as the work of associates, and every lawyer's and non-lawyer's work should be supervised to some degree. Depending upon the circumstances, adequate supervision may include steps such as review of work product, discussion of disclosure issues and other client problems, review of billing practices, periodic performance reviews, and informal or formal auditing of records concerning disposition of client funds and expense reimbursements.

COMMITTEE ON PROF. RESPONSIBILITY OF THE ASS'N OF THE BAR OF THE CITY OF N.Y., DISCIPLINE OF LAW FIRMS 13 (1993). Cf. provisions of Model Rule 5.1 discussed *supra* notes 117-29 and accompanying text.

own attorneys and will "further the model of self-governance which is the cornerstone of the legal profession."<sup>134</sup>

### C. *Factors Affecting Judicial Determination*

The proposed New York rule, the Illinois Disciplinary Rule, and Model Rule 5.1(a) all recognize, for disciplinary purposes, the management obligation of firm principals.<sup>135</sup> As attorneys increasingly seek to limit their malpractice exposure by organizing as LLPs, LLCs, and PCs, courts will consider the extent to which firm principals should have a duty to monitor or supervise their peers and law firm operations. In making this determination, courts will consider common law, disciplinary rules, and public policy.<sup>136</sup>

Under the law of some jurisdictions, the liability standards governing the practice of law in partnerships also govern shareholders in PCs.<sup>137</sup> Because court opinions have focused on the professional responsibility of attorneys to the firm's clients, courts in those states could easily conclude that principals have an independent duty to monitor their peers.<sup>138</sup>

134. COMMITTEE ON PROF. RESPONSIBILITY OF THE ASS'N OF THE BAR OF THE CITY OF N.Y., *supra* note 133, at 3. The Disciplinary Committee for the First Department will propose changes to narrow the provisions of the proposed rule. Telephone Interview with Hal R. Lieberman, Chief Counsel for the Disciplinary Committee for the First Department, Appellate Division of the Supreme Court of New York (July 25, 1994).

135. See generally Stephen E. Kalish, *Lawyer Liability and Incorporation of the Law Firm: A Compromise Model Providing Lawyer-Owners with Limited Liability and Imposing Broad Vicarious Liability on Some Lawyer-Employees*, 29 ARIZ. L. REV. 563, 574 (1987) (noting that Model Rule 5.1(a) imposes a responsibility of general management to institute systems).

136. In other areas involving the public trust and interest, statutes and regulations impose duties to supervise. For example, under section 15(b)(4)(E) of the Securities Exchange Act of 1934, the Securities and Exchange Commission can sanction a broker-dealer if the firm has "failed reasonably to supervise" associated persons who violate the federal securities laws. 15 U.S.C. § 78(o)(b)(4)(E) (1988 & Supp. 1993).

137. In invalidating the statutory limits on liability, courts have cited the separation of powers doctrine and relied on the inherent power of the judiciary to regulate the practice of law. For a critical analysis of this line of cases, see Paas, *supra* note 13.

138. See, e.g., *First Bank & Trust Co. v. Zagoria*, 302 S.E.2d 674 (Ga. 1983). In holding that a shareholder in a PC is liable for the misdeeds of other members of the firm, the Georgia Supreme Court referred to the professional duties of attorneys in stating: "The professional nature of the law practice and its obligations to the public interest require that each lawyer be civilly responsible for his professional acts. . . . It is inappropriate for the lawyer to play hide-and-seek in the shadows and folds of the corporate veil and thus escape the responsibilities

The task of convincing jurists to recognize an independent duty may be more difficult in those states where courts have upheld the statutory limits on liability of shareholders.<sup>139</sup> In those states, the courts may fashion a standard of care from the applicable disciplinary rules. In the event that the state has a version of Model Rule 5.1(a), the court may impose liability if the attorneys' conduct fails to meet the requirements of the applicable disciplinary rule. On the other hand, courts may refuse to base civil liability on violations of disciplinary rules, reasoning that disciplinary rules only cover disciplinary matters.<sup>140</sup>

Public policy considerations may also influence courts to impose an affirmative duty on principals to monitor their peers. Because firm principals can most effectively monitor their peers, clients might retain a firm with the reasonable expectation that firm principals will do just that.<sup>141</sup> Additionally, since firm principals stand to gain most from their peers' conduct, arguably the firm should also bear the cost of the activity.<sup>142</sup> In short, imposing civil liability may serve the public by encouraging monitoring.<sup>143</sup>

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of professionalism." *Id.* at 675.

139. Certain states, "like Alabama and Nevada, provide almost complete personal liability protection for professional corporation shareholders from the acts of their co-shareholders and the corporation's ordinary business debts." Alson R. Martin et al., *Protecting the Assets of a Professional or Other Closely Held Business Owner from Creditors*, 796 A.L.I.-A.B.A. 639, 646 (1993).

140. See, e.g., *Stewart v. Coffman*, 748 P.2d 579, 581 (Utah Ct. App. 1988) (rejecting the plaintiffs' argument that the Utah Rule of Professional Conduct 5.1(a) created vicarious liability for professional corporation shareholders), *cert. granted*, 765 P.2d 1277 (Utah 1988), *cert. dismissed*, Aug. 19, 1988 (unpublished order). In concluding that a disciplinary rule should not be the basis for civil liability, the Utah Court of Appeals referred to the official comment to Rule 5.1 which states that the question "[w]hether a lawyer may be liable civilly or criminally for another lawyer's conduct is a question of law beyond the scope of these Rules." *Id.* at 582. This comment is based on the official comments to Model Rule 5.1.

141. See Stephen E. Kalish, *Comment: A Departed Partner's Liability for the Post-Departure Malpractice of Her Ex-Colleagues—A Practical Approach*, 70 NEB. L. REV. 265, 268-73 (1991) (discussing public policy considerations in imposing vicarious liability).

142. See *id.* at 270 (referring to the enterprise theory imposing liability on the firm that stands to gain from the activity).

143. See Ted Schneyer, *Professional Discipline for Law Firms?*, 77 CORNELL L. REV. 1, 38 (1991) (noting that the prospect of civil liability should give firms a considerable incentive to monitor properly attorney conduct and to promote a good law firm infrastructure).



Finally, the courts may consider the *Restatement (Third) of The Law Governing Lawyers* ("Restatement").<sup>144</sup> Although the last draft of the Restatement does not specifically discuss an independent duty to monitor one's peers, the draft includes a specific provision relating to vicarious liability of law firm principals.<sup>145</sup> As stated in chapter four, section seventy-nine: "A law firm and each of its principals is subject to civil liability for injury legally caused to a person by any wrongful act or omission of any principal or employee of the firm who was acting in the ordinary course of the firm's business or with actual authority."<sup>146</sup>

The commentary following section seventy-nine explains that the rationale for imposing vicarious liability is based on principles of respondeat superior or enterprise liability.<sup>147</sup> In addition, the commentary notes that vicarious liability also helps maintain the quality of legal services by requiring principals to stand behind the performance of other firm personnel.<sup>148</sup> As justified, vicarious liability of principals is appropriate to assure client compensation despite a thinly capitalized firm.<sup>149</sup>

At the last annual meeting, the members of the American Law Institute ("ALI") requested that the reporters revise the Restatement section and comment to take into account legislation allowing attorneys to limit their liability.<sup>150</sup> The rejection of section 79 in its present form indicates that the majority of

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144. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (Tentative Draft No. 7, 1994) [hereinafter RESTATEMENT]. According to a study conducted by Professor Susan Martyn of the University of Toledo College of Law, an advisor on the Restatement project, federal and state courts have cited tentative drafts of the Restatement 61 times in 44 different cases. Of these cases, only two criticize or refuse to follow the Restatement. Susan Martyn, *Judicial Reliance on the Restatement (3d) of The Law Governing Lawyers*, PROF. LAW., Feb. 1995, at 8.

145. RESTATEMENT § 79.

146. *Id.* A footnote to § 79 states that the Council of the American Law Institute rejected a motion to prefix § 79 by the phrase, "Except as otherwise provided by statute." *Id.* § 79 n.5. As stated in the footnote, the supporters of the motion "believed that it was reasonable . . . for a legislature to exclude the liability of a lawyer-shareholder of a professional corporation who has not been involved in the wrong out of which the liability arises." *Id.*

147. *Id.* § 79 cmt. b.

148. *Id.*

149. *Id.* The same policy arguments can be made to support recognition of a duty to monitor one's peers.

150. Telephone Interview with Professor John Leubsdorf, Associate Reporter for the *Restatement* (August 17, 1994).

ALI members refused to approve a provision which failed to distinguish between ethical responsibility and legal liability.<sup>151</sup> This action reflects that the bar remains split on the extent to which principals in firms should be responsible for the conduct of their peers.

#### IV. BAR INITIATIVES RELATING TO PEER REVIEW

During the last fifteen years, various bar conferences have explored peer review.<sup>152</sup> The organized bar's interest in peer review arose out of the competence movement in the 1970s.<sup>153</sup> In response to the widespread criticism of the quality of legal services, attorneys seriously considered peer review as a means of improving the quality of legal services.<sup>154</sup> By 1980, William Smith, as president of the American Bar Association ("ABA"), hailed peer review as an idea "whose time has come."<sup>155</sup> Fifteen years after this pronouncement, the practicing bar has yet to embrace the concept of peer review.<sup>156</sup>

The American Law Institute-American Bar Association ("ALI-ABA") Committee on Continuing Professional Education authorized the profession's first project to study peer review.

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151. In addressing whether attorneys can practice as PCs or professional associations, ABA Formal Opinion 303 distinguished between ethical responsibilities and lawyers' legal liability. Paas, *supra* note 13, at 390. As stated, "All lawyers within an organization bear a professional responsibility for the legal services of the organization, whether they are under any personal legal liability for all of such services or not." ABA Comm. on Professional Ethics, Formal Op. 303 (1961) (permitting attorneys to practice as a professional association or PC, provided that firm observes appropriate safeguards).

152. Since 1980, the American Law Institute-American Bar Association Committee on Continuing Professional Education has convened various conferences to consider professional competence and peer review. For an overview of the committee's peer review initiatives, see A.L.I.-A.B.A. COMM. ON CONTINUING PROF. EDUC., A PRACTICAL GUIDE TO ACHIEVING EXCELLENCE IN THE PRACTICE OF LAW at ix-xi (1992) [hereinafter PRACTICAL GUIDE].

153. See A.L.I.-A.B.A. COMM. ON CONTINUING PROF. EDUC., *supra* note 64, at ix (discussing peer review in context of the "competence movement" of the 1970s).

154. See PRACTICAL GUIDE, *supra* note 152, at ix (noting that criticism of the quality of services evoked a variety of corrective proposals, including peer review).

155. W. Reece Smith, Jr., *Peer Review: Its Time Has Come*, A.B.A. J., Apr. 1980, at 451, 452 (explaining that the American Law Institute-American Bar Association Committee on Continuing Professional Education and other groups proposed peer review as a remedial program for lawyers who perform inadequately).

156. PRACTICAL GUIDE, *supra* note 152, at ix.

The project resulted in the 1980 publication of a discussion draft of A Model Peer Review System ("Model System").<sup>157</sup>

In 1981, the ALI-ABA's National Conference on Enhancing the Competence of Lawyers ("Houston Conference")<sup>158</sup> addressed the feasibility of the Model System.<sup>159</sup> The conferees recommended that experimentation with peer review should go forward.<sup>160</sup> The ALI-ABA responded, creating the Peer Review Institute to observe, evaluate, and report on peer review activities and experiences, including pilot programs.<sup>161</sup>

Despite these efforts, the ALI-ABA recognized that the concept of peer review had gained little, if any, acceptance by

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157. A.L.I.-A.B.A. COMM. ON CONTINUING PROF. EDUC., A MODEL PEER REVIEW SYSTEM (Discussion Draft Apr. 15, 1980) [hereinafter MODEL SYSTEM]. After defining the "Criteria of Attorney Competence," the Model System proposed three forms of peer review: referral peer review, law practice peer review, and disciplinary peer review. The three types of peer review work in tandem. Referral peer review commences when third parties such as judges refer an attorney to a board established by the highest court in the jurisdiction. If the board finds incompetence, it recommends remedial action. If the referred attorney declines to participate, the board can report the referred attorney to a disciplinary committee. If the disciplinary committee finds that the attorney has violated the disciplinary rules, the committee can order that the attorney participate in a competency training program. The Model System reserved disciplinary peer review for the egregious cases of incompetence. *Id.* Critics insist that disciplinary peer review and referral peer review are cumbersome, expensive and oppressive. For a discussion of these criticisms, see Edmund B. Spaeth, Jr., *To What Extent Can a Disciplinary Code Assure the Competence of Lawyers*, 61 TEMP. L. REV. 1211, 1226-27 (1988). Attorneys and firms can also voluntarily participate in law practice peer review by requesting that an independent review team audit attorneys' performance and practice. See MODEL SYSTEM, *supra*, at 41-44. The audit could be compared to a report commonly prepared by law practice management consultants.

158. See A.L.I.-A.B.A. COMM. ON CONTINUING PROF. EDUC., *supra* note 64.

159. *Id.* at xi ("The purpose of the conference was to assist leaders . . . in making a dispassionate assessment of the risks, realities, possibilities of action, and future directions and needs relating to enhancing lawyers' competence.").

160. A.L.I.-A.B.A. COMM. ON CONTINUING PROF. EDUC., LAW PRACTICE QUALITY EVALUATION: AN APPRAISAL OF PEER REVIEW AND OTHER MEASURES TO ENHANCE PROFESSIONAL PERFORMANCE at ix (1987) [hereinafter WILLIAMSBURG REPORT].

161. *Id.* ALI-ABA has also funded two pilot programs. The North Dakota pilot program, based on the referral model, was never completed. The Maryland State Bar Association project resulted in the 1985 publication, *Law Practice Quality Guidelines* (Discussion Draft 1985). The *Law Practice Quality Guidelines* outlines a self-assessment program for practitioners in large and small law firms, public agencies, corporate law departments, and solo practitioners. The voluntary self-assessment study enables attorneys to create mechanisms for improving quality. WILLIAMSBURG REPORT, *supra* note 160, at 47.

the practicing bar.<sup>162</sup> In 1985 the ALI-ABA authorized the Williamsburg Peer Review Conference to consider the bar's rejection of peer review and to consider other approaches to quality evaluation.<sup>163</sup> The conference was "called to study the possibility of a new vision for peer review—the concept of law practice quality evaluation."<sup>164</sup> This statement signals a retreat from any form of external peer review, in favor of an internal evaluation.<sup>165</sup>

In March 1988, the ALI-ABA authorized the Peer Review Project to investigate the feasibility of a neutral self-assessment model for use by practitioners.<sup>166</sup> Subsequently, the project, renamed the "Practice Evaluation Project," produced six drafts culminating in the publication of *A Practical Guide to Achieving Excellence in the Practice of Law*.<sup>167</sup> As indicated by the name change, the project was reformulated as a program of self-evaluation with "the peer being the lawyer's conscience."<sup>168</sup>

## V. MODELS OF PEER REVIEW

Although the organized bar effectively abandoned law practice peer review, several law firms and legal service organizations have implemented peer review programs in an effort to reduce liability exposure, enhance quality, and attract clients.<sup>169</sup> These peer review programs involve more than conventional compensation review.

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162. WILLIAMSBURG REPORT, *supra* note 160, at ix.

163. *Id.*

164. *Id.* at x.

165. Predictably, a sentiment shared at the Williamsburg Conference suggested that peer review may work for other professionals, but law is an "art not a science." *Id.* at 327. This sentiment was articulated by one conference participant who cautioned against comparing the legal profession to other professions that have peer review. As stated, "[a]ccounting, medicine, engineering are much more sciences . . . . It will be infinitely more difficult for us to develop standards because we're more of an art than a science." *Id.*

166. PRACTICAL GUIDE, *supra* note 152, at x.

167. *Id.* at xi.

168. *Id.* In using the checklists included in the *Model System* an attorney can assess his or her own performance and abilities. See James E. Brill, *Long After the Price Is Forgotten*, A.B.A. J., Sept. 1992, at 85 (recommending that solo practitioners use the checklists to complete their own "report card"). Firms can use the *Model System* in training and evaluating attorneys.

169. The Legal Services Corporation ("LSC") was one of the first large organizations to establish a system for evaluating lawyer performance. See Susan R. Martyn, *Peer Review and Quality Assurance for Lawyers*, 20 U. TOL. L. REV. 295, 300-02 (1989) (discussing LSC's monitoring efforts).

Traditionally, firms' compensation systems have included a very limited form of peer review. Depending on the terms of the firm's partnership or shareholder agreement, principals' work and productivity may enter into the compensation determination. Some firms use a seniority approach referred to as a "lock-step system" or "equal sharing system." In a lock-step system partners are paid uniformly by class, advancing together until they reach a full-share interest in the firm.<sup>170</sup> Another approach bases compensation on performance, including productivity, business origination and other contributions to the firm. With such an approach, a managing partner or committee may use a formula or other criteria to determine each partner's compensation or share.<sup>171</sup> In addition to adjusting partners' shares, firms routinely scrutinize and let go less productive associates.<sup>172</sup>

The production system tends to operate in firms where attorneys function as loose confederations rather than disciplined teams.<sup>173</sup> Because attorneys in confederation firms develop their own client base with little collaboration or cooperation among firm attorneys, partners seldom evaluate or monitor their colleagues' work.<sup>174</sup> Rather, partner review amounts to evaluating productivity and calculating partner compensation. Critics maintain that this profit-driven system causes attorneys to pursue profits and neglect other values.<sup>175</sup>

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170. Management consultants have identified three basic categories of compensation and profit division systems: (1) a lock-step system, (2) a subjective, performance-related system in which some individual or committee subjectively determines a relative value for each partner, and (3) an objective, performance-related system in which partners' compensation is based on various criteria. See Robert I. Weil et al., *Paying Partners and Stockholders: A Multi-faceted Decision*, LEGAL ECON., Mar. 1987, at 26, 32-36.

171. For a comparison of the economics of the lock-step system (the sharing approach) to the productivity system (the marginal product approach), see Gilson & Mnookin, *supra* note 41, at 341-53.

172. Richard N. Feferman, *Raising Lawyers for Fun and Profit*, LAW PRAC. MGMT., July-Aug. 1993, at 28.

173. See Weil et al., *supra* note 170, at 28.

174. *Id.* (noting that attorneys in confederation firms enjoy a sense of independence and lack of accountability because each lawyer is viewed as a master of his or her craft).

175. Robert W. Gordon, *Lawyers, Scholars, and the "Middle Ground,"* 91 MICH. L. REV. 2075 (1993). In responding to Judge Harry T. Edwards' complaints in *The Growing Disjunction Between Legal Education and the Legal Profession*, 91 MICH. L. REV. 34 (1992), Professor Gordon recommends a number of reforms to offset the perverse incentives of the compensation system based on "you eat what you kill." One recommendation is that firms employ committees to review lawyers

Partially in response to this criticism, some firms have initiated peer review measures that go beyond compensation review.

Many firms have adopted policies and procedures for all firm attorneys.<sup>176</sup> A firm may institute "cold review" procedures which require that reviewing attorneys be detached from the matter under review.<sup>177</sup> For example, many firms now require that in-house specialists scrutinize opinion letters.<sup>178</sup> Other firms have developed legal systems that consist of written procedures for the comprehensive performance of professional tasks.<sup>179</sup> Such written legal systems create objective standards for measuring the performance of individual attorneys.<sup>180</sup> To the extent that the firm expects partners' compliance with legal systems and other policies and procedures, the firm has a form of peer review.<sup>181</sup>

Rather than assuming partner compliance with firm policies and procedures, firms can implement programs to monitor actual partner compliance. In such a program, a team of

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pressured into dubious conduct and that firms employ compensation schemes that impose heavy penalties for ethical violations. Gordon, *supra*, at 2109-10.

176. See Amy Bach, *Partners Succumb to Checkups from Peers*, AM. LAW., May 1992, at 30 (quoting a management consultant with Hildebrant, Inc. who reported that "one quarter of the 200 firms [he] advises have instituted some kind of program to assess the quality of partners' work").

177. See David A. Schaefer, *Avoiding Malpractice Claims: Help Yourself Because Juries Won't*, 60 DEF. COUNS. J. 584 (1993) (noting that certain areas of practice lend themselves to "cold review" procedures such as sanctions motions being reviewed by a litigator not involved in the litigation or securities offering documents being reviewed by a corporate attorney not involved in the offering).

178. Stephen R. Volk et al., *Law Firm Policies and Procedures in an Era of Increasing Responsibilities: Analysis of a Survey of Law Firms*, 48 BUS. LAW. 1567, 1574 (1993) (surveying firms' policies and procedures, finding 15 of 26 respondents reported they followed the practice of second partner opinion review).

179. For a description of the steps involved in developing legal systems, see Stephen P. Gallagher, *The Law Firm's Role in Attorney Performance Review*, LEGAL ECON., July-Aug. 1986, at 35. As explained, these legal systems will assist firms in establishing performance standards for a constructive, educational peer review process which contributes to the quality of collective office practice and individual professional development. *Id.* at 36.

180. *Id.* While some systems could be firm-wide, other systems must be tailored according to legal specialty. For example, the securities section of the firm would adopt due diligence procedures, while the litigation section would use checklists for filing and answering pleadings.

181. See William Freivogel, *Specific Forms of Partner Peer Review* (Apr. 19-20, 1990) (unpublished manuscript, on file with the *University of Colorado Law Review*) (originally prepared for the A.B.A. Standing Committee on Lawyers' Professional Liability Conference, *Partner Peer Review: An Idea Whose Time Has Come*) (discussing additional techniques firms have developed).

partners will judge partners' work against measurable technical standards. The technical standards review evaluates compliance with certain procedural standards meant to improve the quality of the firm's work product and delivery of services, along with its profitability.<sup>182</sup> At the same time, the process does not measure attorneys' competence or substantive knowledge.<sup>183</sup> During the process attorneys examine selected client files to ensure compliance with the technical standards.<sup>184</sup>

In 1988, the Denver-based firm of Rothgerber, Appel, Powers & Johnson ("Rothgerber") implemented a technical standards review program.<sup>185</sup> Each year, at a time other than compensation setting time, a team reviews each partner.<sup>186</sup> Using a technical standards checklist, the team reviews client files to determine if the reviewed partner complied with clearly defined technical standards. In addition, the Rothgerber program now includes an interview with the reviewed partner.<sup>187</sup> This interview gives both the reviewing team and the reviewed partner an opportunity to discuss matters such as billings, utilization of associates, workload, and frustrations. The last page of the checklist sets forth the goals that the reviewed partner should strive for in the next twelve months and the reviewing team's comments and observations. The reviewing team then provides the completed form to the

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182. Richard K. Clark, Technical Standards Review—1990, at 2 (unnumbered) (Apr. 19-20, 1990) (unpublished manuscript, on file with the *University of Colorado Law Review*) (originally prepared for the A.B.A. Standing Committee on Lawyers' Professional Liability Conference, Partner Peer Review: An Idea Whose Time Has Come); A.B.A. STANDING COMM. ON LAWYERS' PROF. LIABILITY, THE LAWYER'S DESK GUIDE TO LEGAL MALPRACTICE 66 (1992).

183. Clark, *supra* note 182, at 2 (noting that "[p]rocedural standards are not designed to ferret out bad lawyers, but to improve the performance of a better-than-average group of lawyers"); see also Kathryn McGlothlin, Peer Review—Some Modern Trends 9 (1990) (unpublished manuscript, on file with the *University of Colorado Law Review*) (originally prepared for the Texas Lawyers' Insurance Exchange Seminar, The Malpractice Trap: Seminar '90).

184. See Schneider, *supra* note 66, at 104 (suggesting that the inquiry cover a number of areas including compliance with firm procedures relating to conflicts of interest, screening, engagement letters, and entrepreneurial activities with clients).

185. Clark, *supra* note 182, at 1.

186. Letter from Richard K. Clark, Managing Partner of Rothgerber, to author 2 (June 22, 1994) (on file with the *University of Colorado Law Review*) (stating that each team consists of two partners assigned by the firm's Peer Review Committee "with related, but not identical practices, to the partner being reviewed"); see also McGlothlin, *supra* note 183, at 10.

187. Clark, *supra* note 186, at 2.

reviewed partner, who adds his or her comments, observations, and objectives on the last page of the form.<sup>188</sup>

A more subjective evaluation of a partner's performance taps associate opinions and perspectives. In such a program, associates evaluate partners' performance. The San Francisco-based firm of Morrison & Foerster implemented such a program in 1988.<sup>189</sup> Partner review at this firm begins with each associate completing a written evaluation of partners with whom the associate has worked. The managing partner or department chair reviews the compiled comments and discusses them with the individual partner.<sup>190</sup>

Associate comments may provide a special insight into a supervising partner's competence and manner.<sup>191</sup> This formal reporting opportunity may also expose problems that an associate might otherwise hesitate to raise.<sup>192</sup> Firms that use a form of associate review remark that the process serves the reviewing associates, the firm, and the reviewed partner.<sup>193</sup>

The last type of partner review, called a "client audit," relies on information obtained from the clients. Firms use different approaches inviting clients to evaluate the firm and its attorneys. Some client audits are conducted by independent consultants who interview clients.<sup>194</sup> The interviewer attempts to elicit a candid evaluation from the client. To obtain such an evaluation, the attorneys who regularly represent the

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188. *Id.* After the Management Committee reviews the entire form, the firm retains only the last page. *Id.*

189. Richard D. Lee, *Evaluation of Partners by Associates* (Apr. 19-20, 1990) (unpublished manuscript, on file with the *University of Colorado Law Review*) (originally prepared for the A.B.A. Standing Committee on Lawyers' Professional Liability Conference, *Partner Peer Review: An Idea Whose Time Has Come*).

190. *Id.* The Rothgerber firm uses a similar approach in their associate review program. A nonlawyer Chief Operating Officer summarizes the associates' comments and provides the summary to the associates and the reviewed partners. Clark, *supra* note 182, at 3.

191. See Schneider, *supra* note 66, at 104.

192. See Freivogel, *supra* note 181, at 3.

193. See Lee, *supra* note 189, at 1 (describing program benefits). The evaluation program better enables the firm and each partner to assess strengths and weaknesses as perceived by associates. At the same time, the associates learn what it takes to become a good supervisor, and to recognize the link between becoming good lawyers and having good supervisors. See also McGlothlin, *supra* note 183, at 11 (reviewing the favorable observations made by the Director of Professional Development at Morrison & Foerster, Richard Diebold Lee).

194. See 1 MALLIN & SMITH, *supra* note 96, § 2.29, at 19-20 (Supp. 1993) (warning that results are mixed, depending on the ability of the interviewer/consultant).



client do not participate in the interview.<sup>195</sup> In other programs, such as the one pioneered by the Seattle-based firm of Perkins Coie, firm partners obtain information and interview selected clients of the reviewed partner.<sup>196</sup>

At Perkins Coie, the billing partner contacts clients to ask them to participate in the firm's client audit program. The billing partner explains that the review is a periodic, standard procedure, conducted at firm expense to ensure the firm's performance of high quality legal services.<sup>197</sup> Client representatives then meet with the client audit team. The client audit team consists of an administrative partner, the billing partner, and a professional standards committee member.<sup>198</sup> During the meeting, the team interviews the client to gauge client satisfaction.<sup>199</sup> Following the meeting, the three firm attorneys evaluate the information and seek ways to improve future legal services.<sup>200</sup> Thereafter, the team meets with the client and retains all material generated in the client audit process.<sup>201</sup>

Law firm consultants recommend client audits over other partner review systems because the audits focus on client needs

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195. See Schneider, *supra* note 66, at 104.

196. See Harry H. Schneider, Jr., *One Approach to Partner Peer Review: The Client Audit*, LAW. LIABILITY REV., Aug. 1987, at 1.

197. *Id.* at 3.

198. Bach, *supra* note 176, at 32. Each partner performs a different function. The billing partner acts as the principal contact between the firm and the client, the administrative partner's presence emphasizes the importance the firm places on the audit, and the partner from the professional standards committee records and helps evaluate client concerns. *Id.*

199. During a portion of the meeting, the billing partner steps out in an effort to facilitate open communication and candor, which enables the client to comment on the billing partner, as well as other members of the firm. For specimen forms used by Perkins Coie, see the exhibits to the paper presented by Harry H. Schneider, Jr., *One Approach to Partner Peer Review: The Client Audit*, at exs. A-D (unpublished manuscript, on file with the *University of Colorado Law Review*) (originally prepared for the A.B.A. Standing Committee on Lawyers' Professional Liability Conference, *Partner Peer Review: An Idea Whose Time Has Come*).

200. *Id.* at 4.

201. Although the actual procedures for the client audit may vary, one author has identified three basic elements of the successful program: (1) an initiation procedure designed to select clients on a uniform and consistent basis; (2) an interview questionnaire that serves as the backbone of the actual interview; and (3) an effort to train the interviewers and to foster attorney cooperation and interest. Marilyn A. Tarlton, *Client Interview*, in *THE QUALITY PURSUIT* 175, 176-77, app. (Robert Greene ed., 1989) (discussing each of these elements and specimen forms).

rather than on internal performance standards.<sup>202</sup> The obvious advantage of the client audit is that it provides information on the services provided by the firm. The firm can use this information in evaluating and improving the performance of associates, partners, and nonlawyers. In addition, the audit gives the firm the opportunity to improve client relations by addressing any deficiencies perceived by the client. In meeting with clients and addressing their concerns, firm management communicates to clients that they are valued by the firm. In fortifying client loyalty to the firm and involving the client with additional firm partners, the client may tend to stay with the firm in the event that the partner with the primary client contact leaves the firm.<sup>203</sup> The client audit also serves a loss prevention function, by addressing problems and cultivating satisfied clients less likely to bring claims.<sup>204</sup> Finally, the client audit may generate additional business.<sup>205</sup>

Firms report that their clients have warmly received the audits.<sup>206</sup> Partners have also reacted positively, requesting that additional clients participate in the program.<sup>207</sup> Prospective clients and legal malpractice underwriters also appreciate efforts to improve client relations and attorney performance.<sup>208</sup>

Although client audits serve multiple purposes, such audits may not provide enough information to judge overall quality

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202. See Bach, *supra* note 176, at 30 (quoting Joel Henning, a senior vice-president with the legal consulting firm of Hildebrant, Inc.).

203. See 1 MALLEN & SMITH, *supra* note 96, § 2.29, at 19 (Supp. 1993) (explaining that the firm will probably have a better chance of retaining clients if additional partners are involved with the clients, even if only in the peer review process).

204. Schneider, *supra* note 196, at 4-5 (explaining that the client audit program creates a "healthy atmosphere of self-evaluation within the firm, so that each partner realizes that at any given time his or her clients may be asked to critique the firm's performance").

205. Bach, *supra* note 176, at 32. Perkins Coie uses its review to inform clients about the firm's services, resulting in additional business.

206. See, e.g., Schneider, *supra* note 196, at 5 (indicating that, without exception, clients express approval of the process); see also Clark, *supra* note 182, at 3 (indicating that "clients welcome the opportunity to exchange information").

207. See McGlothlin, *supra* note 183, at 13 (reporting on the comments made at the A.B.A. Standing Committee on Professional Liability Spring Conference, "Partner Peer Review: An Idea Whose Time Has Come").

208. As recognized by Robert O'Malley, vice-chairman and loss-prevention counsel of the Attorneys' Liability Assurance Society, Inc., Washington, D.C. office, "a good . . . review program can detect some forms of potential malpractice before clients actually bring a suit." Bach, *supra* note 176, at 32.

performance. First, individual clients may not possess the expertise, ability, time, or access to evaluate attorney performance. Second, various aspects of attorney performance go beyond client satisfaction. For example, a client may be dissatisfied if an attorney refuses to issue a legal opinion.<sup>209</sup>

Finally, client audits and peer review programs can be implemented in connection with a firm's TQM program.<sup>210</sup> Because a comprehensive quality control program emphasizes the consistent delivery of quality legal services,<sup>211</sup> TQM requires the participation and evaluation of all firm attorneys, including partners. In focusing on client perceptions, a TQM program relies on client audits and surveys to gauge client satisfaction with partners' performance. Firms also rely on department-level peer review to obtain statistical data to compare partners' views of the quality of service provided by each partner.<sup>212</sup> Firm management uses this data in measuring improvement and rewarding quality performance.

#### VI. THE FUTURE OF PEER REVIEW—MERGER OF MANAGEMENT AND ETHICS

The American legal profession stands at the "crossroads of change, providing a unique opportunity to assess its past and chart the . . . future."<sup>213</sup> Traditionally, law firms grew as partnerships in which partners shared both profits and liabilities which accompany partner status.<sup>214</sup> In the past, most firm attorneys practiced in general partnerships in which unlimited liability provided an incentive to monitor peers. Because partners shared unlimited liability, the existence of an

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209. In issuing legal opinions, attorneys must comply with applicable rules, regulations and laws. See, e.g., MODEL RULES Rule 2.3 (balancing the needs of clients and third parties).

210. Although law firms have only recently discovered TQM, the concept dates back to 1950 when Dr. W. Edwards Deming, a statistician, advised Japanese businesses to implement statistical quality control. W. Keith Shannon & Russell J. White, *TQM—Ready or Not!*, S.C. LAW., Jan.-Feb. 1994, at 11, 12. For an entertaining case study of a Detroit firm's TQM program, see JOSEPH V. WALKER & BARBARA L. CIARAMITARO, *TQM IN ACTION: ONE FIRM'S JOURNEY TOWARD QUALITY AND EXCELLENCE* (1994).

211. See John Mixon & Gordon Otto, *Continuous Quality Improvement, Law, and Legal Education*, 43 EMORY L.J. 393 (1994) (applying the continuous quality improvement principles to the practice, teaching, and development of the law).

212. Bower, *supra* note 76, at 27.

213. Croft, *supra* note 39, at 1259.

214. Torry, *supra* note 70, at F5.

independent duty to monitor their peers seldom arose as an issue. As attorneys chart a new course by practicing in limited liability firms, the courts and the legal profession must deal with the ramifications of the death of the traditional partnership.<sup>215</sup> While the courts consider whether firm principals have a duty to monitor their peers, the legal profession will reevaluate the role of peer review in the new legal environment.<sup>216</sup>

Three approaches to peer review may emerge: (1) the regulatory approach; (2) the professional liability approach; and (3) the management approach. Under the regulatory approach, disciplinary authorities or government regulators may articulate and enforce peer review standards. For example, state disciplinary authorities may discipline an attorney for violating the state's version of Model Rule 5.1(a).<sup>217</sup> Similarly, government regulators, such as the U.S. Securities and Exchange Commission<sup>218</sup> and the Office of Thrift Supervision ("OTS"),<sup>219</sup> may discipline attorneys and require remedial peer review measures.

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215. For an analysis of the long-term effects of the new limited liability business forms, see Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of Partnership*, 70 WASH. U. L.Q. 417 (1992) (concluding that the traditional partnership form would not survive if firms were free to choose organizational form without tax or regulatory constraints).

216. See Edward C. Roberts, *Professional Responsibility after Kaye, Scholer*, S.C. LAW., Mar.-Apr. 1993, at 38 (suggesting that the Kaye, Scholer litigation will cause firms to review their governance procedures).

217. For a skeptical view of the prospects of enforcing Model Rule 5.1(a), see Ted Schneyer, *Now Is the Time for Firm Discipline*, TEX. LAW., Aug. 24, 1992, at 14, 15 (suggesting that Model Rule 5.1(a) will remain a disciplinary "dead letter" for large firms as long as enforcement of the rule remains linked to individual discipline rather than firm discipline).

218. The SEC has disciplined attorneys under Rule 2(e) of the SEC's Rules of Practice, 17 C.F.R. § 201.2(e) (1994). The peer review procedure of requiring a "cold review" of opinion letters was first imposed by the SEC on the firm of White & Case in the settlement of SEC v. National Student Marketing Corp., [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,027. Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 72 n.59 (1986).

219. In seeking to bar Kaye, Scholer from representing federally insured depository institutions, the OTS relied on their authority under 12 C.F.R. § 513.4(c) (1994). As part of the settlement with the OTS, Kaye, Scholer agreed to comply with a number of practices and procedures and to evaluate regularly the performance and conduct of Kaye, Scholer attorneys. Order to Cease and Desist for Affirmative Relief from Kaye, Scholer, Fierman, Hays & Handler, *In re Peter Fishbein*, No. 92-24, 1992 WL 560945 (OTS Mar. 11, 1992).

Using the second approach, courts may impose civil liability if principals fail to monitor their peers. The courts may determine that client expectations and the professional nature of law practice require that firm principals be liable. This professional liability exposure may persuade firms to implement peer review.

Some firms, such as the ones discussed in part V, are using the third approach, implementing peer review as an aspect of good management. Rather than wait for the courts to recognize the existence of an independent duty to monitor peers, these firms have identified sound business reasons for voluntarily implementing some form of partner review. These firms recognize that they have much at stake, including the firm's assets and professional reputation.<sup>220</sup> In taking the initiative, firm principals adopt review standards suitable to their firm.<sup>221</sup>

In the current competitive environment, peer review and other quality control measures distinguish a firm from its competitors.<sup>222</sup> Commercially aggressive firms can use peer review in marketing. Peer review will appeal to unsophisticated clients who rely on the firm's self-policing. The firm's commitment to quality control will also impress sophisticated clients who have the ability and resources to monitor attorneys. Corporate clients, who represent the majority of law firms' billings, may come to expect quality controls, including peer review.

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220. Regardless of the type of organization, firm assets will generally be subject to attachment to pay malpractice judgments. In the event of a claim, the firm will tap the professional liability policy covering all firm attorneys. The defense and payment of claims attributed to any insured will reduce the policy's limits of liability. As a result, any claims made under the firm policy will directly affect the amount of insurance available to respond to other claims made during the policy period. In addition, the number and severity of claims will directly affect the future availability of insurance. This illustrates that claims against any attorney directly impact principals in all types of firms.

221. The standards formulated by each firm are self-enforcing in that the firm monitors compliance and determines the appropriate action to take when attorneys fail to meet the firm's standards.

222. See Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud*, 46 VAND. L. REV. 75, 117 (1993) (suggesting that firms that invest heavily in an internal monitoring system will not reap a commensurate reward unless they can distinguish themselves from competitors).

Law firm principals are rethinking whether their firm should operate as a team with accountability, or as a confederation of autonomous practitioners sharing offices. Operating as a confederation, firm attorneys may reject any notion of peer review, preferring to reorganize in an attempt to limit their liability. With this approach, peer review does not act as an internal control protecting the firm and its clients. At the same time, unlimited liability does not provide an external control on misconduct.

Eventually, if firms refuse to take responsibility for their attorneys, leaving clients unprotected, the courts and legislators may refuse to allow attorneys to limit their liability.<sup>223</sup> Firm attorneys' failure to police themselves may provoke the public to demand more accountability and outside regulation of attorneys.<sup>224</sup>

When given these choices, some firms may accept their management responsibilities and emulate their corporate clients in instituting quality control measures.<sup>225</sup> These measures are both firm-driven and client-driven because they protect the firm and its clients. In voluntarily instituting a partner review program, firms recognize that the merger of ethics and management sells in the legal marketplace. While attorneys' efforts to limit their liability may elevate public scrutiny of the legal profession, voluntary peer review may help restore public trust in attorney self-regulation.

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223. *Developments in the Law—Lawyers' Responsibilities and Lawyers' Responses*, 107 HARV. L. REV. 1547, 1664 (1994) (noting that "state supreme courts hostile to limited liability for the legal profession may frustrate lawyers' attempts to seek it").

224. The public's demand for more accountability and outside regulation has already caused states to include more lay participation in the disciplinary process. For example, in 1993, California adopted legislation requiring that nonlawyers hold the majority of the positions on the Complainants' Grievance Panel. CAL. BUS. & PROF. CODE § 6086.11 (West 1990 & Supp. 1994).

225. Duncan A. MacDonald, *Speculations by a Customer About the Future of Large Law Firms*, 64 IND. L.J. 593, 595 (1989) (as firms get bigger "they will need to adopt the common styles of other successful businesses"). One commentator predicted that large firms' organizational structure will resemble the large accounting firms, including "centralized management monitoring overall quality control" and "firm-wide standards." James F. Fitzpatrick, *Legal Future Shock: The Role of Large Law Firms by the End of the Century*, 64 IND. L.J. 461, 463 (1989).

