



The Function of CRCP 265

Rendering Legal Services through a Professional Company

BY DAVID C. LITTLE AND CHRISTOPHER B. LITTLE

During the 1960s, changes began to appear in the composition of legal professional organizations in Colorado. For more than 400 years, to the middle of the 20th century, the delivery of legal services in the United States was essentially an individual, personal activity of a lawyer on behalf of a client, and the legal ramifications of the delivery of such services reflected the intimacy of this process.¹ The fees the lawyer earned for rendering legal services were currently and directly taxed for income tax purposes as personal income to the lawyer.

While lawyers continued to be subject to current personal income taxation on income earned from the furnishing of legal services,

service providers in other professions—such as accountants, doctors, and engineers, who could render their services from within professional companies—were beginning to enjoy more liberal tax treatment for the income they derived from their practices, including being able to establish tax-deferred pension and profit-sharing plans. The law of personal income taxation was changing by virtue of the opportunities created by state legislatures and the federal income tax laws and regulations for those other service providers to incorporate and provide their professional services as a function of their “professional corporations.” They were thus able to take advantage of various characteristics of tax and tax accounting processes.

Those benefits were not available to lawyers because the prevailing constrictions on the practice of law did not allow the delivery of legal services through entities such as corporations for which tax advantages were provided by the tax laws, and state entity-formation laws provided limitations on the liability of each owner for the entities’ commercial obligations as well as for the professional misconduct of their fellow owners and their employees. From time immemorial to the middle of the 1900s, the practice of law was limited to individuals practicing alone or as employees or partners in general partnerships. Corporations and other organizations providing limited tax liability to their owners could not “practice law.”² More specifically, lawyers could not practice law from within entities that were privileged, by state statute, with the attribute of limited liability.

During the second half of the 1900s, bar associations began suggesting, to the courts and other relevant bar regulatory systems, the notion of authorizing the delivery of legal services through corporate vehicles—that is, enabling corporations to practice law. In response, in 1961 the Colorado Supreme Court issued the first of a number of relevant court rules, Colorado Rule of Civil Procedure (Rule) 231.³ This Rule essentially permitted corporations to practice law. More precisely, it permitted lawyers to practice law with other lawyers with the protections of corporate limited liability. And it enabled the lawyer-shareholders of corporations that were organized to practice law to participate in the tax-planning opportunities that were available to other professional practitioners such as accountants, doctors, and engineers. Under Rule 231, lawyers could incorporate under applicable corporate statutes and avail themselves of the tax opportunities of qualified pension plans and deferred profit-sharing plans, while limiting their personal liability for the commercial obligations of their corporations other than those for professional misconduct. The process by which lawyers could avail themselves of such benefits of corporate taxation derived from the simple expedient of the Court allowing them to furnish legal services from within corporations (i.e., permitting corporations to practice law).

When lawyers choose to provide legal services through a professional company, the individual lawyer's liability for actionable errors and omissions that might occur during the provision of legal services can undergo some adjustments associated with the impact of the professional company's involvement and the directive of this Rule.

The Basic Framework

Currently, under Rule 265,⁴ the Court authorizes licensed Colorado lawyers to render legal service to clients through professional companies, a form of practice that may provide benefits of limited liability as well as tax-planning advantages.⁵ As discussed below, limitations on the liability of a lawyer who is an equity owner of a professional company for the misconduct of other lawyers practicing within the professional company—whether they are also owners or associate-employees—depends on the maintenance of professional liability insurance meeting the Rule's specific requirements.

Practitioners who intend to become the owners of a professional company must consider and determine the form of limited-liability entity best suited to their practice and to their relationships with the other lawyers who will practice within the entity, whether they are owners, employees, or associates. The governance of such structures can vary among the available statutory forms of entity, including the conversion of a general partnership, which may require adjustments in the administration of the lawyers' ongoing practices and relationships with one another. Likewise, even a sole practitioner who chooses to practice within a professional company to secure the tax advantages that come with the formation of such an entity, as well as limitations on personal liability for commercial obligations to landlords, suppliers, and the like, will have practical adjustments to make as a result of that choice. The considerations

include selecting a name for the professional company that conforms to the Colorado Rules of Professional Conduct requirements regarding the names of law firms.⁶

When lawyers choose to provide legal services through a professional company, the individual lawyer's liability for actionable errors and omissions that might occur during the provision of legal services can undergo some adjustments associated with the impact of the professional company's involvement and the directive of this Rule. The professional company, whatever its nature—be it corporation, limited liability company, or another of the statutory forms—will be required to function pursuant to the directives of Rule 265.⁷

How It Works

Once a professional company is established, each lawyer who becomes an owner thereof

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will jointly and severally assume the liability the company may incur for any professional act, error, or omission by any of its owners or any other person for whose conduct the company may be liable.⁸ This agreement—under Rule 265(a)(2)—is deemed to occur by the mere fact of the rendering of legal services by that or any other owner of the company or by any other person for whom the company is liable. But that joint and several liability assumed by each such owner will, by Rule 265, be limited if the professional company maintains appropriate professional liability insurance.⁹

The Rule does not change the personal responsibility a lawyer has with respect to his or her own conduct in the representation of a client: The fact of incorporation does not alter the direct client-lawyer relationship or a lawyer's duties and liabilities arising from

that relationship. However, depending on the maintenance of appropriate professional liability insurance, Rule 265 may have a much different impact on the lawyer's vicarious liability for the conduct of other lawyers practicing within the same professional company.

As noted above, under Rule 265 each owner of the professional company will be deemed to agree to personally assume all of the company's professional liability arising from the conduct of any lawyer practicing within the company, unless at the time of the commission of the act the professional company is covered by appropriate professional liability insurance. In other words, by simply participating in the professional company as an owner, a lawyer impliedly agrees to be jointly and severally liable for the consequences of a malpractice act by a colleague—whether also an owner or

merely an associate—unless the professional company secures the appropriate level of professional liability insurance covering such liability. To that extent, the lawyer-owner of the professional company is in a position equivalent to that of a general partner in a classic law partnership, unless qualifying professional liability insurance coverage is maintained. If there is such insurance, the exposure to monetary damages for the innocent owner “shall be the lesser of the actual liability of the professional company in excess of insurance available to pay such damages . . .” or the amount calculated according to Rule 265(a)(3)(D).¹⁰ As noted above, the Rule does not diminish a lawyer's personal liability for his or her personal conduct.

This potential for relief from liability for the non-participating owners of the professional

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Once a professional company is established, each lawyer who becomes an owner thereof will jointly and severally assume the liability the company may incur for any professional act, error, or omission by any of its owners or any other person for whose conduct the company may be liable.

company is the unique product of Rule 265. Thus, in Colorado, lawyers may associate within a professional company and enjoy the benefits of the collegiality that accompanies group association and the protection of the limited liability otherwise provided by law, but only if the professional company secures professional liability insurance prescribed by Rule 265.¹¹


Rule 265(a)(3)—Professional Liability Insurance Policy Requirements

The insurance that must be maintained to permit the entity to secure the limited-liability benefits of a professional company under Rule 265 is, specifically, professional liability insurance that insures the professional company against liability from the rendering of legal

services.¹² The insurance must cover the actions of both attorneys and non-attorneys involved in furnishing legal services. The policy itself may contain customary and usual provisions concerning policy periods, claims, conditions and other matters.

Under Rule 265(a)(3)(C), the minimal amount of insurance coverage mandated by the Rule is the lesser of \$100,000 for each claim multiplied by the number of attorneys in the professional company, or \$500,000. If the policy provides for an aggregate top limit for all claims, the limit must not be less than the lesser of \$300,000 times the number of attorneys or \$2 million. The Rule is rather vague in this regard, and the directions for calculating aggregate amounts and minimum top limits as well as the impact of defense cost expenditures and deductibles must be carefully evaluated by an attorney with due regard for the provisions of Rule 265(a)(3)(D).

The Functionality

This Rule focuses on the procedures involving insurance coverage and the freedom from personal liability for professional errors and omissions by non-involved colleagues and associates. It permits lawyers to act through professional entities while preserving the personal responsibilities and characteristics historically associated with the lawyer-client relationship. It does this by distinguishing the professional aspects of the lawyer-client arrangement from the attendant characteristics of a routine commercial business transaction. The Rule specifically excludes from its unique operation the usual and routine liabilities incurred by the professional company operation.¹³ The liability assumed by the owners limited through the assumption may depend on the professional liability insurance that is maintained by the entity, and it applies only for acts, errors, or omissions incurred in the rendering of professional legal services. As noted above, the owners are protected from the commercial obligations of the professional company in the same manner as are shareholders of non-law companies formed under a statute, such as those governing corporations or limited liability companies. 

David C. Little is the founding partner of the Greenwood Village firm of Montgomery, Little & Soran, P.C. He works primarily in the field of civil litigation—dlittle@montgomerylittle.com. **Christopher B. Little** is a shareholder with Montgomery, Little & Soran, P.C. His practice is focused on complex civil litigation with an emphasis in professional liability defense—clittle@montgomerylittle.com.

Coordinating Editor: Chris Little, clittle@montgomerylittle.com

NOTES

1. Bye and Young, "Law Firm Incorporation in Colorado," 34 *Rocky Mountain L.Rev.* 427 (Summer 1962).
2. Corporations could not practice law. *People ex rel. Committee on Grievances of Colorado Bar Ass'n v. Denver Clearinghouse Banks Performing Trust Functions*, 59 P.2d 468 (Colo. 1936).
3. CRCP 231.
4. See also Colo. RPC 7.1 and 7.5.
5. CRCP 265(e) defines a professional company to be "a corporation, limited liability company, limited liability partnership, limited partnership association, or other entity that may be formed under Colorado law to transact business or any entity that can be formed under the law of any other jurisdiction and through which attorneys may render legal services in that jurisdiction, except that the term excludes a general partnership that is not a limited liability partnership and excludes every other entity the owners of which are subject to personal liability for the obligations of the entity."
6. Colo. RPC 7.5.
7. CRCP 265.
8. CRCP 265(a)(2).
9. CRCP 265(a)(3)(D).
10. *Id.*
11. *Id.*
12. The requirements for such insurance are detailed in CRCP 265(a)(3)(A) through (F).
13. See CRCP 265(e).