

1987

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Recommended Citation

Laura R. Brown, *Limited Liability for Shareholders in Virginia Professional Corporations: Fact or Fiction?*, 21 U. Rich. L. Rev. 571 (1987).
Available at: <http://scholarship.richmond.edu/lawreview/vol21/iss3/6>

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COMMENTS

LIMITED LIABILITY FOR SHAREHOLDERS IN VIRGINIA PROFESSIONAL CORPORATIONS: FACT OR FICTION?

I. INTRODUCTION

In 1970, Virginia enacted the Professional Corporation Act¹ which permits members of certain professions to form corporations for the purpose of rendering professional services.² It is available to most professionals as an alternative to practicing individually or in partnerships. While many professionals have formed such corporations to avail themselves of certain tax benefits,³ others have formed professional corporations simply to gain the advantages of practicing in the corporate form. One traditional advantage of the corporate form is that shareholders are shielded from personal liability for the negligent acts committed by agents or employees of the corporation and for the debts or obligations of the corporation.⁴ Given the current escalation in malpractice liability, the possibility of limited liability may indeed be the primary allure of professional corporations to many professionals today.⁵

Unfortunately, the extent of shareholder liability in professional corporations is not at all certain. At first blush, the language of the Virginia Professional Corporation Act's liability provision is unequivocal.⁶ In essence, the provision states that shareholders in a professional corporation ["PC"] enjoy the same limited liability as that enjoyed by shareholders in

1. VA. CODE ANN. §§ 13.1-542 to -556 (Repl. Vol. 1985).

2. Under the Virginia professional corporation statute, the term "professional service" is defined as "any type of personal service to the public which requires as a condition precedent to the rendering of such service or use of such title the obtaining of a license, certification or other legal authorization" *Id.* § 13.1-543(A). The statute allows the following professions to practice in professional corporations: pharmacists; physicians; optometrists; psychologists; psychiatrists; therapists; veterinarians; surgeons; dentists; architects; professional engineers; land surveyors; certified landscape architects; public accountants; certified public accounts; and attorneys-at-law. *Id.*

3. These tax advantages were effectively eliminated in 1982. *See infra* note 17 and accompanying text.

4. *See generally* 13A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 6213 to 6221 (rev. perm. ed. 1984).

5. Limited liability has been cited as a principal nontax advantage of professional corporations. *See* 1 PROFESSIONAL CORPORATION HANDBOOK ¶ 155 at 1044 (CCH 1974); Note, Nelson v. Patrick: *More Problems for Professional Corporations*, 64 N.C.L. REV. 1216-19 (1986).

6. *See infra* notes 23-25 and accompanying text.

a general business corporation.⁷ However, the statute has yet to be construed by a Virginia court, and a thorough analysis of the provision in light of other state decisions interpreting similar statutory language reveals ambiguities in the provision which may translate into a more extended liability for PC shareholders. In short, PCs in Virginia may currently be operating under a false sense of security regarding the personal liability exposure of member shareholders.

This comment examines the liability provision in Virginia's Professional Corporation Act, and explores its ambiguities in light of recent case law in other jurisdictions. It recommends changes to the statutory language which hopefully would enable the statute to withstand some of the attacks successfully leveled at similar liability provisions in other state PC acts.

A. *The Purpose of Professional Corporation Statutes*

Initially, PC statutes were enacted not to limit professional liability, but to extend corporate tax treatment to certain professional associations.⁸ Before enactment of PC statutes, professionals practiced individually, in partnerships or in professional associations.⁹ In these forms, they were unable to take advantage of an Internal Revenue Code provision¹⁰ permitting employees to exclude from gross income certain employer-provided fringe benefits, such as retirement plans and insurance coverage.¹¹

In 1935, however, the United States Supreme Court in *Morrissey v. Commissioner*¹² ruled that unincorporated business organizations should be taxed as corporations if they exhibit certain corporate characteristics.¹³ These characteristics include: (1) centralized management; (2) continuity of life; (3) limited liability; and (4) ease of transferability of interest.¹⁴

7. See VA. CODE ANN. § 13.1-547 (Repl. Vol. 1985).

8. For an in-depth treatment of the tax history of professional corporations, see Phillips, McNider & Riley, *Origins of Tax Law: The History of the Professional Service Corporation*, 40 WASH. & LEE L. REV. 433 (1983); Bowman, *The Professional Corporation: Has the Death Knell Been Sounded?*, 10 PEPPERDINE L. REV. 515 (1983).

9. Traditionally, professionals were not allowed to incorporate. In Virginia, accountants, architects, attorneys, doctors, engineers and land surveyors have been denied the privileges of corporate practice. See Horsley, *The Virginia Professional Association Act: Relief for the Underprivileged*, 48 VA. L. REV. 777, 778 & n.7 (1962). The noncorporate status of the professional was considered necessary to foster professionals' role as service providers, rather than businessmen. *Id.* at 778.

10. I.R.C. § 162(a)(1) (1985); see also Arnold, *Professional Corporations in Oklahoma*, 17 TULSA L.J. 1, 3 n.10 (1981).

11. Retirement plans include deferred compensation plans, qualified pension plans and profit-sharing plans. Insurance benefits include life, health, medical and disability insurance. See Note, *supra* note 5, at 1219 n.35.

12. 296 U.S. 344 (1935).

13. *Id.* at 359-60.

14. *Id.*

In 1960, the Internal Revenue Service promulgated regulations¹⁵ which were consistent with the *Morrissey* criteria. Specifically, the regulations provided that where professional associations possessed the corporate attributes identified in *Morrissey*, the professionals associated with the association would be deemed employees of the association and would be eligible for the favorable tax treatment of fringe benefits given to corporate employees.¹⁶

However, the tax benefits conferred on professional associations and corporations were effectively eliminated in 1982 by the Tax Equity and Fiscal Responsibility Act of 1982, which treated partnerships and corporations similarly.¹⁷

It is clear from the history of professional association and professional corporation acts that they were enacted primarily to extend corporate tax treatment to professional associations and not to confer limited liability on their members.¹⁸ One commentator has observed:

15. Treas. Reg. § 301.7701 (1960). The regulations have been referred to as the "Kintner regulations" because they were promulgated in response to the Ninth Circuit Court of Appeals decision in *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954), holding that an association of physicians was taxable as a corporation despite a state common-law prohibition against the incorporation of physicians. 216 F.2d at 428.

Note that the Kintner regulations applied to professional associations only. Corporations formed under professional corporation statutes are deemed true corporations and, as such, are entitled to corporate tax treatment irrespective of the Kintner regulations. See Maier, *Don't Confuse Kintner-Type Associations with New Professional Corporations*, 15 J. TAX'N 248, 248 (1961).

In 1961, Virginia and 15 other states enacted professional association statutes in response to the Kintner regulations. See VA. CODE ANN. §§ 54-873 to -898 (Repl. Vol. 1982). For a detailed discussion of Virginia's professional association statute, see Horsley, *supra* note 9.

16. Treas. Reg. § 301.7701 (1960). With regard to limited liability, the regulations specified: "An organization has the corporate characteristic of limited liability if under local law, there is no member who is personally liable for the debts of or claims against the organization." *Id.* § 301.7701-2(d)(1).

17. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324. The parity and nondiscrimination provisions of the Tax Equity and Fiscal Responsibility Act of 1982 elevated the unincorporated retirement plan and lowered the corporate retirement plan to nearly the same levels. See Bowman, *supra* note 8, at 543.

18. See, e.g., *Vinall v. Hoffman*, 133 Ariz. 322, —, 651 P.2d 850, 851-52 (1982) ("primary reason for creating the professional corporation was to permit professionals to take advantage of various federal tax provisions available to a corporation and its employees but not available to self-employed persons or partnerships"); *In re Florida Bar*, 133 So. 2d 554, 556 (Fla. 1961) (purpose of statute to place professionals "on an equal footing with other taxpayers"); *In re Bar Ass'n of Hawaii*, 55 Hawaii 121, —, 516 P.2d 1267, 1268 (1973) (purpose of statute to "place professional persons on parity with persons in other business corporations who are favored with tax benefits . . ."); *In re Rhode Island Bar Ass'n*, 106 R.I. 752, —, 263 A.2d 692, 695 (1970) (purpose of statute to "enable members of the covered professions not previously allowed to incorporate, to form corporations, thus putting such members on an equal footing with other taxpayers.").

To be sure, there are justifications other than tax savings advanced in defense of the professional corporation. It remains, at bottom, a creature of the aberrations of the Internal Revenue Code, a totally artificial device resorted to almost entirely for the purpose of avoiding taxes—a symptom, not the source, of the real problem.¹⁹

Given the fact that professional associations and corporations need no longer be formed in order for professionals to be given the same tax treatment as corporate employees, there must be another reason for professionals to select the PC as the vehicle for the practice of their profession. As noted earlier, many find the prospect of limited liability a sufficient justification for forming a PC.²⁰ Though all states have professional corporation or professional association statutes dealing with the question of shareholder liability, they deal with the subject in diverse ways.²¹ Moreover, the statutes have been subjected to a variety of interpretations, even where the statutory language is very clear.²² Although the law in this area is unsettled, some conclusions can be drawn that allow a clearer liability provision in Virginia's PC statute to be drafted.

II. THE VIRGINIA PROFESSIONAL CORPORATION STATUTE'S LIABILITY PROVISION

Virginia's PC statute contains a provision addressing shareholder liability.²³ The provision reads:

The provisions of this chapter shall not be construed to alter or affect the professional relationship between a person furnishing professional services and a person receiving such service either with respect to liability arising out of such professional service or the confidential relationship between the person rendering the professional service and the person receiving such pro-

A number of commentators speculated that with the major tax benefits eliminated, professional associations and professional corporations would disappear. *See, e.g.,* Bowman, *supra* note 8, at 543 ("with the new IRS allocation powers provided by TEFRA, the professional corporation may well have been dealt the final blow"); Phillips, *supra* note 8, at 455 ("By virtue [sic] of the reduced marginal benefits available to incorporated service-providers, the enactment of TEFRA likely will decrease the number of PSC's incorporated in the future.").

19. Bowman, *supra* note 8, at 516; *see also* Horsley, *supra* note 9, at 778 (professional corporations are means to tax-related ends).

20. *See supra* note 5.

21. *See* Comment, *Shareholder Liability in Professional Legal Corporations: A Survey of the States*, 47 U. PITT. L. REV. 817 (1986). The author categorized the statutory liability provisions into three basic groups: (1) complete limited liability, except for the shareholder's own negligence; (2) liability limited to the misconduct committed by the shareholder or any person under his direct supervision; (3) vicarious liability of shareholders for the negligence of other shareholders and employees. *Id.*

22. *See infra* text accompanying notes 41-74.

23. VA. CODE ANN. § 13.1-547 (Repl. Vol. 1985).

fessional service, if any, and all such confidential relationships enjoyed under the laws of this Commonwealth, whether now in existence, or hereafter enacted, shall remain inviolate.²⁴

A director, officer, agent or employee of a professional corporation shall not, by reason of being any director, officer, agent or employee of such corporation, be personally liable for any debts or claims against, or the acts or omissions of the corporation or of another director, officer, agent or employee of the corporation, but the corporation shall be liable for the acts or omissions of its directors, officers, agents, employees and servants to the same extent to which any other corporation would be liable for the acts or omissions of its directors, officers, agents, employees and servants while they are engaged in carrying on the corporate business.²⁵

A. *The Saving Clause*

The first paragraph²⁶ of the provision is referred to by most commentators²⁷ as a "saving clause" and is present in some form in nearly all state professional corporation statutes.²⁸ The intent of most saving clauses is to preserve, to some extent, the common-law relationship between professional and client/patient, as well as the traditional liability arising out of that relationship.²⁹ The extent to which the saving clause preserves any liability arising out of the professional relationship is subject to debate. There are at least three interpretations:³⁰ (1) the saving clause is meant only to preserve the liability of the professional for his own tortious conduct; (2) the saving clause preserves the liability of the professional for his own tortious conduct and the tortious conduct of those directly under his supervision; (3) the saving clause preserves the traditional partnership liability³¹ for the tortious conduct of the professional, those directly

24. Section 13.1-547 reads as a single paragraph. It has been divided into two separate paragraphs for purposes of this discussion.

25. VA. CODE ANN. § 13.1-547. In order to render professional services on behalf of the corporation, the shareholder must be an employee, agent or officer of the corporation. *Id.* § 13.1-546.

26. *See supra* note 24.

27. *See, e.g., Note, Professional Corporations and Associations*, 75 HARV. L. REV. 776 (1962); Comment, *supra* note 21, at 834-35.

28. *See Bittker, Professional Associations and Federal Income Taxation: Some Questions and Comments*, 17 TAX L. REV. 1, 9 (1961). Professor Bittker hypothesized that the saving clause was included by state legislatures to assuage fears that the new professional corporation statutes would adversely affect clients. *Id.*; *see also supra* note 9.

29. *See Note, supra* note 27, at 780-81.

30. *Id.*

31. Partners in a partnership are jointly and severally liable for the tortious conduct of all the other partners as well as that of any employees of the partnership. *See* VA. CODE ANN. § 50-15(a) (Repl. Vol. 1986); *see also* E.H. Parrish & Co. v. Pulley, 126 Va. 319, 101 S.E. 236 (1919) (negligence of one partner is negligence of all); McCormick v. Romans, 214 Va. 144, 198 S.E.2d 651 (1973) (plaintiff may sue partners individually and need not name the partnership as a party defendant).

under his supervision, and other shareholders in the corporation.³²

Reading the Virginia provision as a whole leads to the preliminary conclusion that the General Assembly intended that the saving clause preserve only the liability of the professional for his own tortious conduct. The second and third interpretations appear to be precluded by the second paragraph of the provision which expressly states that professionals in a PC will not be personally liable for the debts or liabilities of the corporation, or for the negligent acts of any other employee, officer, or director of the corporation.³³

1. The Professional Association Act Liability Provision

The interpretation that the Virginia saving clause preserves only the liability of the professional for his own negligence is buttressed by an examination of the Professional Association Act ["PA Act"].³⁴ The purpose of the PA Act was to allow professionals to form unincorporated associations in order to take advantage of tax benefits granted to such organizations.³⁵ Although the provisions of the PA Act parallel the provisions of the PC Act, its liability provision differs from the PC liability provision.

The PA Act provision contains a saving clause nearly identical to the

32. Arguably, this interpretation of the saving clause is untenable in light of the IRS' original requirement that professional associations and professional corporations have the attribute of limited liability. *See supra* note 14 and accompanying text. Nevertheless, five states—Arizona, Colorado, Oregon, Wisconsin, and Wyoming—have PC statutes which contain liability provisions requiring shareholders to retain joint and several liability for the tortious conduct of the corporation, its employees and other shareholders. *See* ARIZ. REV. STAT. ANN. § 10-905 (1977); COLO. REV. STAT. § 265 (Colorado makes an exception for the PC with adequate insurance to cover the claim); OR. REV. STAT. § 58.185 (1981); WIS. STAT. ANN. § 180.99(8) (West Cum. Supp. 1986) (Wisconsin excepts debts and other contractual obligations of the corporation); WYO. STAT. § 17-3-102 (1977); *see* Comment, *supra* note 21, at 820-21.

33. *See supra* notes 24-25 and accompanying text.

34. As noted *supra* note 15, Virginia enacted a Professional Association Statute in 1961. Because the General Assembly does not record its legislative history, it is not clear why Virginia enacted both a professional association act and a professional corporation act. Only eight other states have done so: Georgia; Tennessee; Illinois; Pennsylvania; Nevada; Connecticut; Alabama; and Texas. *See* PROFESSIONAL CORPORATION HANDBOOK ¶ 4008 (CCH 1984).

Although one commentator has maintained that professional associations and professional corporations are distinct entities, *see* Maier, *supra* note 15, at 248, they are nevertheless both creatures of the same need for tax equality. *See supra* text accompanying notes 18 and 19.

Section 13.1-545 of the PC act provides that a professional association can become a professional corporation, provided that such merger became effective prior to July 1, 1972. This section provides further that the professional association's articles of association shall be deemed to contain all the corporate powers and purposes of a professional corporation. VA. CODE ANN. § 13.1-545 (Repl. Vol. 1985).

35. *See supra* notes 8-18 and accompanying text.

one in the PC Act.³⁶ However, the PA Act provision expressly preserves the liability of the professional for the negligence or wrongful act of any person "under his direct supervision or control."³⁷ It is therefore arguable that had the General Assembly wished to preserve more than the liability of the professional for his own misconduct, it would have adopted the express language of the PA provision.

2. Apparent Superfluity of the Saving Clause

While the intent of the General Assembly appears clear with respect to the saving clause, interpreting the clause to preserve only the liability of the professional for his own negligence makes little sense.³⁸ An employee of a corporation is liable for his own negligence notwithstanding the concurrent liability of his employer under the doctrine of respondeat superior.³⁹ Accordingly, the professional is liable for his own negligence with or without the saving clause. Thus, under this interpretation, the saving clause adds nothing to the professional's liability that does not exist without the saving clause. To be meaningful, then, the saving clause must preserve liability beyond that of the professional for his own negligence.

36. The saving clause reads:

The provisions of this chapter shall not be construed to alter or affect the professional relationship between a person furnishing professional services and a person receiving such service, either with respect to liability arising out of such professional service or the confidential relationship between the person rendering the professional service and the person receiving such professional service, if any, and all such confidential relationships enjoyed under the laws of this State, whether now in existence or hereafter enacted, shall remain inviolate.

VA. CODE ANN. § 54-886 (Repl. Vol. 1982).

37. Section 54-892 reads:

Any associate of a professional association shall remain personally and fully liable and accountable for any negligent or wrongful acts, or misconduct committed by him, or by any person under his direct supervision and control, while rendering professional services on behalf of the association to the person for whom such professional services were being rendered. Such associate shall not, by reason of being an associate, be personally liable for any debts or claims against, or the acts or omissions of the association or of another associate or employee of the association, but the association shall be liable for the acts or omissions of its associates, officers, agents, employees and servants to the same extent to which a corporation would be liable for the acts or omissions of its officers, agents, employees and servants while they are engaged in carrying on the corporate business.

VA. CODE ANN. § 54-892 (Repl. Vol. 1982).

38. See Bittker, *supra* note 28, at 9.

39. See generally D. DOBBS, R. KEATON, D. OWEN, PROSSER AND KEETON ON TORTS, § 70 (5th ed. 1984).

III. JUDICIAL INTERPRETATION OF STATE PROFESSIONAL CORPORATION STATUTES

While interpreting the saving clause to preserve only the liability of the professional for his own negligence renders the clause superfluous, interpreting it to preserve a more extended liability would be inconsistent with the limited liability language in the provision.⁴⁰ This inconsistency makes the Virginia provision susceptible to judicial whim should the statute be invoked in a negligence action against a PC. Other state PC acts with liability provisions similar to Virginia's have been subjected to twisted interpretations for a variety of public policy reasons. Despite limited liability language in their state's PC act, courts have found that professionals should be held liable for the wrongful conduct of other members or employees of the PC.

A. *Professional Legal Corporations*

*First Bank & Trust Co. v. Zagoria*⁴¹ is illustrative of the sort of reasoning employed by courts to circumvent limited liability language in PC statutes. In that case, the Georgia Supreme Court held the defendant, a lawyer in a professional legal corporation, liable for checks refused by the bank because of insufficient funds. The defendant was found liable even though the checks were issued by another member of the law firm and the defendant was not a party to the transaction in question.⁴²

Georgia's PC statute is substantively similar to Virginia's. Subsection (a) of the Georgia statute contains a saving clause⁴³ which is followed by subsection (b) which provides:

Subject to subsection (a) of this Code section, the members or shareholders of any professional association organized pursuant to this chapter shall not be individually liable for the debts of, or claims against, the professional association unless such member or shareholder has personally participated in the transaction for which the debt or claim is made or out of which it arises.⁴⁴

Virtually ignoring subsection (b), the court in *Zagoria* stated that it would "make no distinction between partnerships and professional corporations" with respect to professional liability.⁴⁵ The court reasoned that limited liability would drastically alter the relationship between the professional corporation and its clients. Vicarious liability must be preserved

40. See *supra* text accompanying note 25.

41. 250 Ga. 844, 302 S.E.2d 674 (1983).

42. *Id.* at ___, 302 S.E.2d at 676.

43. GA. CODE ANN. § 14-10-7(a) (1982).

44. *Id.* § 14-10-7(b).

45. 250 Ga. at ___, 302 S.E.2d at 676.

in order to protect adequately the client's expectations that the entire corporation would be engaged on his behalf.⁴⁶ To ensure that the practice of law would not become merely a commercial venture but remain a professional service with its highest obligation being the public interest, the court concluded that "a corporate veil [must not be allowed] to hang from the cornices of professional corporations which engage in the practice of law."⁴⁷

The holding in *Zagoria* rested on the premise that the Georgia Supreme Court has the inherent power to regulate the practice of law.⁴⁸ The court conceded that the legislature has the right to enact legislation governing the creation and operation of professional corporations and providing limited liability for purely business obligations. However, the court maintained that the Georgia PC statute could not be applied to insulate lawyers from liability because only the court has the power to regulate the practice of law.⁴⁹

Other states have also determined that PC statute liability provisions are inapplicable to professional legal corporations. In *In re Rhode Island Bar Association*,⁵⁰ the Supreme Court of Rhode Island granted the request of the state bar association to permit attorneys to engage in the practice of law in the corporate form under the state's professional service corporation law.⁵¹ However, the court held that lawyers practicing in PCs will have limited liability only when they do not participate in the rendering of services which give rise to an actionable wrong, and will not be personally liable for the ordinary business debts of the corporation.⁵² The court explained that as officers of the court, attorneys are subject to regu-

46. *Id.* at ___, 302 S.E.2d at 676. The court proclaimed, "[i]t is inappropriate for the lawyer to be able to play hide and seek in the shadows and folds of the corporate veil and thus escape the responsibilities of professionalism." *Id.* at ___, 302 S.E.2d at 675.

47. *Id.* at ___, 302 S.E.2d at 676.

48. *Id.* at ___, 302 S.E.2d at 675. The court declared:

We do not view this case as one in which we need to interpret that statute providing for the creation and operation of professional corporations. We rather view this case as one which calls for the exercise of this court's authority to regulate the practice of law. This court has the authority and in fact the duty to regulate the law practice and in the past two decades we have been diligent in our exercise of this duty

The diligence of this court has been directed toward the assurance that the law practice will be a professional service and not simply a commercial enterprise. The primary distinction is that a profession is a calling which demands adherence to the public interest as the foremost obligation of the practitioner.

Id. at ___, 302 S.E.2d at 675.

49. *Id.* at ___, 302 S.E.2d at 675 (legislature "cannot constitutionally cross the gulf separating the branches of government by imposing regulations upon the practice of law").

50. 106 R.I. 752, 263 A.2d 692 (1970); see R.I. GEN. LAWS §§ 7-5.1-1 to 5.1-12 (1985).

51. 106 R.I. 752, 263 A.2d 692.

52. *Id.* at ___, 263 A.2d at 697; see R.I. GEN. LAWS § 7-5.1-8 (1985) (providing that professional corporations must carry liability insurance).

lation by the court.⁵³ Thus, though statutorily authorized, legal practice in the corporate form must be authorized by the state supreme court.⁵⁴

Although no Virginia court has construed the Virginia PC statute, the Virginia Supreme Court has the same inherent power to regulate the practice of law as does the Georgia Supreme Court.⁵⁵ It is not difficult to conceive of a case in which a court could find that the preservation of high standards of professionalism requires that the limited liability language be set aside. Where, for example, an associate attorney commits professional malpractice resulting in substantial loss to the client and the PC has no insurance coverage, the court could conclude that preservation of the high standards of the legal profession mandate that a shareholder attorney be held liable.

B. *Professional Medical Corporations*

Although the inherent power of courts to regulate the practice of law may provide a justification for ignoring limited liability language in PC statutes, there are decisions involving other professions which also abrogate the limited liability language of PC statutes. In *Boyd v. Badenhausen*,⁵⁶ the Supreme Court of Kentucky held that the veil of a professional medical corporation does not protect its members from personal responsibility for the negligence of its corporate employees.⁵⁷ *Boyd* involved a lawsuit against a physician for damages caused by a delay between the time the patient contended that surgery should have been performed and the time when surgery was actually performed. The delay occurred because one of the physician's employees misplaced the patient's

53. 106 R.I. at ___, 263 A.2d at 696. The court stated:

The profession will not become a mere business operation or commercial venture. Under the strict direction and control of this court, and in keeping with the highest traditions of the bar, it will continue to dedicate itself to the administration of justice in accordance with the oath or affirmation taken by every person seeking admission to the bar of this state. In substance, insofar as the relationship of attorney and client and of attorney and the general public is concerned, practice in corporate form will be as we have previously pointed out, substantially similar to the practice of law as it presently exists in firms operating as law partnerships.

Id. at ___, 263 A.2d at 698.

54. *Id.*; see also *In re Bar Ass'n of Hawaii*, 55 Haw. 121, ___, 516 P.2d 1267, 1268 (1973) (permitting attorneys to practice in professional corporations but denying limited liability because limited liability would result in derogation of the attorney-client relationship).

55. See VA. CODE ANN. § 54-48 (Repl. Vol. 1982); cf. *Woodard v. Virginia Bd. of Bar Examiners*, 454 F. Supp. 4 (E.D. Va. 1978), *aff'd*, 598 F.2d 1345 (4th Cir. 1979) (though Virginia Supreme Court has no explicit statutory authority to review the Board's decisions or to reverse its evaluation of a particular candidate, it is well settled that the court retains such inherent power).

56. 556 S.W.2d 896 (Ky. 1977).

57. *Id.* at 898.

file.⁵⁸ In spite of a professional corporation statute shielding shareholders from liability for the negligence of the corporation's employees,⁵⁹ the court found the physician responsible for the "derelictions of persons employed by [the] corporation to carry out for him the clerical details that are necessary to the successful performance of his duty to render skillful care and attention to whomever he accepts as a patient."⁶⁰ The court explained that if the physician had been an "old-fashioned country doctor without any office help and had mislaid his notes," he would certainly be held liable.⁶¹ The court concluded that "[p]lacing a layer of other people . . . between a physician and his patient does not alter the situation, because the physician's professional duties are not susceptible of being delegated or diffused."⁶²

Similarly, in the recent case of *Nelson v. Patrick*,⁶³ the North Carolina Court of Appeals interpreted the North Carolina PC statute's saving clause⁶⁴ to require that members of a professional medical corporation be held jointly and severally liable for one of the other member's negligence.⁶⁵ *Nelson* involved a medical malpractice action against two radiologists and the professional corporation of which they were members. Plaintiff had undergone a complete hysterectomy and was advised by her gynecologist to undergo radiation therapy to reduce the risk of cancer.⁶⁶

58. *Id.*

59. The statute reads:

The provisions of this chapter shall not alter any law applicable to, or otherwise affect the fiducial, confidential or ethical relationship between a person rendering professional services and a person receiving such services. The corporation shall be jointly and severally liable, with the tort-feasor, to the full value of its assets for any negligent or wrongful acts or actionable misconduct committed by any of its officers, shareholders, agents or employes while they are engaged on behalf of the corporation in the rendering of professional service. *Provided, however, that no shareholder, director, officer, or employe of a professional service corporation shall be personally liable for the negligence, wrongful acts, or actionable misconduct of any other shareholder, director, officer, agent or employe nor shall such shareholder, director, officer or employe be personally liable for the contractual obligations of the corporation.*

KY. REV. STAT. ANN. § 274.055(1) (Baldwin 1981) (emphasis added).

60. 556 S.W.2d at 898-99.

61. *Id.* at 899.

62. *Id.*

63. 73 N.C. App. 1, 326 S.E.2d 45 (1985).

64. The saving clause states:

Nothing in this Chapter shall be interpreted to abolish, modify, restrict, limit or alter the law in this State applicable to the professional relationship and liabilities between the person furnishing the professional services and the person receiving such professional service, or the standards of professional conduct applicable to the rendering therein of such services.

N.C. GEN. STAT. § 55B-9 (1982).

65. 73 N.C. App. at ___, 326 S.E.2d at 50.

66. *Id.* at ___, 326 S.E.2d at 47. Plaintiff's gynecologist referred her to defendants for therapy. *Id.*

As a result of the radiation treatments, plaintiff suffered damage to her intestines.⁶⁷ Plaintiff alleged that the defendant who administered the radiation was negligent in failing to obtain plaintiff's informed consent to undergo radiation therapy.⁶⁸

The saving clause in section 55B-9 of the North Carolina PC statute is similar to Virginia's saving clause.⁶⁹ Section 55B-3 of the statute provides, however, that "professional corporations . . . shall be subject to the duties, restrictions and liabilities of other corporations, except insofar as the same may be limited or enlarged by this Chapter."⁷⁰ Section 55B-3 further provides that "[i]f any provision of this Chapter conflicts with the provisions of the Business Corporation Act, the provisions of this Chapter shall prevail."⁷¹ Arguably, section 55B-3 establishes that shareholders in a PC enjoy the same limited liability as shareholders in business corporations.⁷² The *Nelson* court held, however, that the traditional notion of joint and several liability of partners in a partnership also applies to shareholders in a PC.⁷³

The *Nelson* decision is not well reasoned and has been criticized.⁷⁴ Nevertheless, it is another recent instance where a court has been unwilling to extend limited liability to shareholders in a PC despite the apparent grant of such limited liability by the state's PC statute.

C. *Judicial Acquiescence to PC Act Liability Provisions*

Some courts have given effect to statutory provisions granting limited liability to PC shareholders. For example, in *Fure v. Sherman Hospital*,⁷⁵ the Illinois Court of Appeals held that a physician shareholder of a professional medical corporation formed under the Illinois Medical Corporation Act⁷⁶ and the Illinois Professional Service Corporation Act,⁷⁷ was not

67. *Id.* at ___, 326 S.E.2d at 47-48.

68. *Id.* at ___, 326 S.E.2d at 48.

69. *See supra* note 64.

70. N.C. GEN. STAT. § 55B-3 (1982). Under § 55-53(e) of the Business Corporation Act, shareholders of a corporation have limited liability. *Id.* § 55-53(e).

71. *Id.* § 55B-3.

72. *See Note, supra* note 5, at 1221-22.

73. 73 N.C. App. at ___, 326 S.E.2d at 50; *see supra* note 31.

74. *See Note, supra* note 5, at 1221. There is virtually no explanation given by the court for its holding. The court merely cited the saving clause in the North Carolina professional corporation statute and quoted dicta from *Zimmerman v. Hogg & Allen*, 286 N.C. 24, 30, 209 S.E.2d 795, 798 (1974). The issue in *Zimmerman*, however, was whether a professional association could be held liable under a theory of apparent authority for the misappropriation of funds by one of its employees. The *Zimmerman* court did not consider the question of joint and several liability of PC shareholders. *See Note, supra* note 5, at 1221.

75. 55 Ill. App. 3d 572, 371 N.E.2d 143 (1977).

76. ILL. ANN. STAT. ch 32, paras. 631 to 648 (Smith-Hurd 1970 & Cum. Supp. 1986).

77. *Id.* paras. 415-1 to 415-18.

liable for the alleged malpractice of another physician shareholder.⁷⁸ The defendant physician's only connection with the plaintiff was his signature on the voucher form allowing the corporation to collect fees from the plaintiff's insurance carrier.⁷⁹

The Illinois Professional Service Corporation Act provides that although a shareholder will be liable for his own negligence, he otherwise will have no greater liability for the conduct of the corporation's agents or employees than a general business corporation.⁸⁰ Similarly, the Illinois Medical Corporation Act provides that the physician furnishing medical service will retain personal liability for his own conduct but not for the conduct of any other employee or shareholder in the corporation.⁸¹ Applying the express language of the statutes, the Illinois court concluded that absent any participation in the negligent acts, the defendant was entitled to the protection of the corporate veil.⁸²

In *O'Neill v. United States*,⁸³ the Court of Appeals for the Sixth Circuit held that an Ohio professional corporation statute containing a saving clause⁸⁴ and a provision stating that general corporate law would govern professional corporations,⁸⁵ "merely preserves the personal liability of the professional man in his professional dealings"⁸⁶

The *O'Neill* case did not involve a tort action against a PC but was instead an action for a tax refund. Moreover, as noted earlier,⁸⁷ it makes little sense to interpret saving clauses as preserving only the professional's liability for his own negligence. The *O'Neill* court's statements were, in fact, ignored by the Ohio Supreme Court in *South High Development v. Weiner*,⁸⁸ which held an attorney shareholder in a professional legal corporation personally liable for the corporation's breach of its lease of office space.⁸⁹ Deciding that the Ohio Professional Corporation Act⁹⁰ has no provision directly addressing shareholder liability, the court concluded that there is no need for shareholders in professional corporations to have limited liability. The court advanced a novel justification for its conclusion:

[A] private corporation's sole purpose is to accumulate capital so that the

78. 55 Ill. App. 3d at ___, 371 N.E.2d at 145.

79. *Id.* at ___, 371 N.E.2d at 143.

80. ILL. ANN. STAT. ch. 32, para. 415-8 (Smith-Hurd 1970).

81. *Id.* para. 644.

82. 55 Ill. App. 3d at ___, 371 N.E.2d at 144.

83. 410 F.2d 888 (6th Cir. 1969).

84. OHIO REV. CODE ANN. § 1785.04 (Baldwin Supp. 1986).

85. *Id.* § 1785.08.

86. 410 F.2d at 898.

87. See *supra* notes 38-40 and accompanying text.

88. 4 Ohio St. 3d 1, 445 N.E.2d 1106 (1983).

89. *Id.* at ___, 445 N.E.2d at 1109.

90. See *supra* notes 84 & 85.

owners, those contributing capital, may get a return on their capital. Thus, it may reasonably be concluded that the rationale behind the constitutional protection for shareholders applies only toward private corporations and not professional ones. The shareholders of a professional corporation, whether legal, medical, or other, will be the professionals who actually practice the profession. However, the shareholders of a private corporation will in most instances not be employees of the corporation. Therefore, there is a logical need for shareholders of private corporations to be insulated from corporate debts since they will have no practical participation in the management of the corporation. The shareholders of the professional corporation will have direct contact with the running of the corporation, so limited liability is not necessary for them.⁹¹

The best reasoned decision involving a malpractice action against PC shareholders was handed down in *Birt v. St. Mary's Mercy Hospital*.⁹² In that case, the Indiana Court of Appeals held that one member of a PC could not be held vicariously liable for the tortious conduct of another.⁹³ *Birt* involved a suit against a professional medical corporation which contracted to provide emergency room medical services to a local hospital. The plaintiff alleged malpractice by one of the treating physicians in the emergency room and sought to hold all of the shareholders jointly and severally liable.⁹⁴ The court interpreted the Indiana Medical Professional Corporation Act's saving clause,⁹⁵ observing first that the saving clause must preserve more than the personal liability of a corporate employee for his own negligence.⁹⁶ The court continued: "[w]ithout deciding, we note that the statute may impose personal liability . . . for the negligence of assistants acting under the physician's direction."⁹⁷ The court rejected the plaintiff's argument, however, that the saving clause requires shareholders in professional corporations to be held vicariously liable for the torts of other shareholders:

The [PC statute] manifests legislative intent that medical professional corporations be imbued with as many of the attributes of general corporations

91. 4 Ohio St. 3d at ___, 445 N.E.2d at 1108. The court apparently failed to take into account the realities of many close corporations in which the business is run by the shareholders.

92. 175 Ind. App. 32, 370 N.E.2d 379 (1977).

93. *Id.* at ___, 370 N.E.2d at 385.

94. *Id.* at ___, 370 N.E.2d at 380.

95. *Id.* at ___, 370 N.E.2d at 382. The saving clause provides: "This act does not modify any law applicable to the relationship between a person furnishing professional medical service and a person receiving such service, including liability arising out of such professional service." IND. CODE ANN. § 23-1-14-14 (Burns 1972) (repealed) (replaced by §§ 23-1.5-1-1 to 1.5-5-2).

96. 175 Ind. App. at ___, 370 N.E.2d at 383; see also *supra* notes 38-40 and accompanying text.

97. *Id.* (citing Comment, *Professional Corporations and Associations*, 75 HARV. L. REV. 776 (1962)).

as may be, without destroying the traditional professional relationship between physician and patient. We conclude that neither the express language of the statute, nor the qualification purpose of maintaining strong professional relationships require importation of the partnership doctrine of vicarious liability into the professional corporate arena. Plainly general corporate concepts preclude it.⁹⁸

The *Birt* court also advanced cogent responses to some of the policy concerns raised by other courts opposing statutory grants of limited liability to PC shareholders.⁹⁹ The primary concern over limited liability is that it would adversely affect the relationship between the professional corporation and its clients. Vicarious liability is needed to ensure a high standard of professionalism and dedication to public service,¹⁰⁰ and to protect the client's expectation that the entire professional team is engaged on his behalf.¹⁰¹

The *Birt* court observed first that penalties imposed for violations of professional ethics are sufficient to ensure proper quality of services.¹⁰² The *Birt* court also recognized that although clients may expect to have the organization's entire expertise available to him, experience shows that a professional's relationship to the client "is often intensely personal, rather than collective."¹⁰³ Because the professional corporation itself can be held liable for the negligence of a member, the corporation has great incentive to use any and all professionals necessary to render effective professional service.¹⁰⁴

Another concern is that plaintiffs may be unable to collect a damage award from a professional corporation without the existence of vicarious liability.¹⁰⁵ This concern is also unfounded since both the corporation and

98. *Id.* at ___, 370 N.E.2d at 385.

99. *Id.* at ___, 370 N.E.2d at 383-85.

100. See *First Bank & Trust Co. v. Zagoria*, 250 Ga. 844, ___, 302 S.E.2d 674, 676 (1983) (in order to foster professional dedication to public service, a "corporate veil [must not be allowed] to hang from the cornices of professional corporations"); see also Bittker, *Professional Service Organizations: A Critique of the Literature*, 23 TAX. L. REV. 429, 429-30 n.1 (1968); Note, *supra* note 5, at 1224.

101. See *Zagoria*, 250 Ga. at ___, 302 S.E.2d at 675 (client seeking professional services has the right to expect the fidelity of other members of the firm).

102. 175 Ind. App. at ___, 370 N.E.2d at 384; see also Paas, *Professional Corporations and Attorney-Shareholders: The Decline of Limited Liability*, 11 J. CORP. L. 371 (1986) (courts have adequate redress against attorney shareholders in a professional legal corporation under the rules of professional responsibility).

103. 175 Ind. App. at ___, 370 N.E.2d at 383.

104. See Note, *supra* note 5, at 1224.

105. See 175 Ind. App. at ___, 370 N.E.2d at 383; see also *In re Hawaii Bar Ass'n*, 55 Haw. 121, ___, 516 P.2d 1267, 1268 (1973) (limited liability "would not provide adequate protection to a client's claims against a law corporation"); cf. *Zagoria*, 250 Ga. at ___, 302 S.E.2d at 675 ("It is inappropriate for the lawyer to be able to play hide-and-seek in the shadows and folds of the corporate veil and thus escape the responsibilities of professionalism.").

the negligent professional can still be held liable for the damages suffered by the client.¹⁰⁶ Moreover, many PCs maintain malpractice insurance sufficient to cover most damage claims.

IV. PROPOSAL FOR STATUTORY CHANGE IN VIRGINIA

The extent of shareholder liability in professional corporations is unsettled. Even where legislative intent and statutory language are clear, courts called upon to apply the statutes have found ways to circumvent the statute's literal meaning. The Virginia PC statute's liability provision is vulnerable to some of the same attacks leveled at other state statutes, but the risk that these attacks would be successful could be reduced if the liability provision were amended.

First, the General Assembly should state specifically the purpose of the saving clause. As it presently stands, the Virginia saving clause is subject to at least three different interpretations.¹⁰⁷ If its purpose is to preserve only the liability of the professional for his own negligence, the saving clause is superfluous and should be removed by amendment. If the saving clause means that the professional retains liability for the negligence of other shareholders or for those under his direct supervision or control, then it conflicts with the language in the statute providing for limited liability.¹⁰⁸

The liability provision in the PC statute should be harmonized with the liability provision in the PA Act.¹⁰⁹ First, if the liability provisions of both statutes were consistent, the possibility of inconsistent results would be minimized. There is currently a risk of confusing the professional association act with the professional corporation act,¹¹⁰ and indeed, some commentators draw no distinction between the two.¹¹¹ Because of the disparity in the liability provisions of the two acts, a physician who happens to be a member of a professional association could be held liable for the negligence of his nurse while a physician who is a shareholder in a professional corporation apparently could not be held vicariously liable. This would be true regardless of whether the facts surrounding the alleged negligence were identical in both cases or whether they were more egregious in the case of the professional corporation.

106. *Birt*, 175 Ind. App. at ___, 370 N.E.3d at 383; see also Note *supra* note 5, at 1226.

107. See *supra* notes 30-39 and accompanying text.

108. See *supra* note 25 and accompanying text.

109. See *supra* notes 34-37 and accompanying text.

110. See Maier, *supra* note 15, at 248 (warning against confusing professional associations with professional corporations); see also Comment, *supra* note 21, at 826 n. 54 (citing Virginia Professional Association Act in discussion of state professional corporation acts).

111. See Comment, *supra* note 21; cf. Horsley, *supra* note 9, at 778 ("professional corporation or association is but a means to an end").

Harmonizing the two provisions would also have the advantage of clarifying the meaning of the saving clause. If the PC Statute expressly provides, as does the PA Act, that professionals will remain liable for the negligence of those directly under their supervision, there would be less room for speculation about the meaning of the saving clause and less likelihood that a court would decide that the saving clause requires the professional to be held liable for the negligence of all other shareholders.

Finally, the liability provision should be amended to require PCs to maintain an adequate amount of liability insurance. This requirement would ensure that clients served by the corporation will not suffer because of limited liability.¹¹²

CONCLUSION

The suggested changes, if adopted, would not guarantee that Virginia courts would honor the PC statute's liability provision. In the case of a professional legal corporation, the court may invoke its power to regulate the practice of law and determine that limited liability should not be available to attorneys. The recommended changes would, however, eliminate the ambiguities in the liability provision and make it much easier for courts to apply. Moreover, the changes would give better guidance to pro-

112. Other state PC acts contain such a requirement. For example, Rhode Island's Professional Services Corporation Act provides:

Every professional service corporation shall maintain insurance against any liability imposed by law upon the corporation or its employees arising out of the performance of professional services Such insurance shall be . . . with respect to each claim, in the aggregate amount of fifty thousand dollars (\$50,000) multiplied by the number of professional employees of the corporation as of the policy anniversary date; Provided, however, that in no case shall the coverage be less than one hundred thousand dollars (\$100,000) and not more than five hundred thousand dollars (\$500,000)

R.I. GEN. LAWS § 7-5.1-8 (Supp. 1985). Colorado also requires PCs to maintain adequate insurance. If Colorado PCs fail to maintain adequate insurance, then shareholders will be held jointly and severally liable for all the acts, errors, and omissions of the corporation's employees. *See* COLO. R. PROF. SERV. CORP. § 265 (1973).

Some professions which have promulgated rules permitting members to form professional corporations allow member shareholders to have limited liability only if adequate insurance is procured. For example, the American Institute of Certified Public Accountants passed a resolution stating:

The stockholders of professional corporations or associations shall be jointly and severally liable for the acts of a corporation or association, or its employees—except where professional liability insurance is carried, or capitalization is maintained, in amounts deemed sufficient to offer adequate protection to the public. Liability shall not be limited by the formation of subsidiary or affiliated corporations or associations each with its own limited and unrelated liability.

AICPA, Vol. B, ET Appendix C, 5141 (CCH, June 1984).

professionals who desire to incorporate but who are unsure about how incorporation would affect their personal liability exposure.

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