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Amicus Brief: Smith v. Kelley

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COMMONWEALTH OF MASSACHUSETTS

SUPREME JUDICIAL COURT

NO. SJC-12759

Robert Smith,
Plaintiff-Appellant,

v.

Robert E. Kelley,
Defendant-Appellee.

ON APPEAL FROM JUDGMENT
OF THE SUPERIOR COURT FOR THE COUNTY OF NORFOLK

BRIEF OF AMICUS CURIAE
BRIAN JM QUINN, NATALI DE CORSO, AND REBECCA RABINOWITZ
SUPPORTING NEITHER PARTY

Respectfully submitted,

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IDENTITY AND INTEREST OF AMICI CURIAE

Brian JM Quinn is an Associate Professor of Law at Boston College Law School. Professor Quinn teaches Corporations and is the author of casebooks on corporate law and mergers and acquisitions. His research focuses on corporate law, mergers and acquisitions, the structuring of transactions, transactional law, and private ordering. Natali De Corso and Rebecca Rabinowitz are third-year law students at Boston College Law School, enrolled in its Amicus Brief Clinic. The Clinic is an experiential learning course designed to encourage faculty and students, as friends of the court, to submit amicus briefs that may assist courts in resolving important legal issues of the day.

Amici have academic and professional interest in the subject of corporate law. The views expressed are their own, and amici represent no institution, group or association. They submit this brief in response to the Court's solicitation of amicus briefs in this case. See Docket No. SJC-12759, June 26, 2019.

DECLARATION OF AMICI INDEPENDENCE

Amici are independent from the parties, have no economic interest in the outcome of this case, and declare that none of the conduct described in Appellate Rule 17 has occurred. Specifically:

1. No party or party's counsel authored this brief in whole or in part;

2. No party or party's counsel contributed money that was intended to fund preparing or submitting this brief;

3. No person or entity—other than the amicus curiae or their counsel—contributed money that was intended to fund preparing or submitting this brief; and

4. None of the amici or their counsel represents or has represented one of the parties to the present appeal in another proceeding involving similar issues, or was a party or represented a party in a proceeding or legal transaction that is at issue in the present appeal.

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ISSUES ADDRESSED BY AMICI

Amici neither support a party nor recommend a specific disposition. The amici address the implications of applying equitable remedies (piercing the corporate veil and successor liability) against individuals who practice their professions as sole proprietors after dissolving a Chapter 156A professional corporation, of which they were the sole shareholder. Amici also address whether Supreme Judicial Court Rule 3:06, warrants a different outcome as to successor liability than Chapter 156A would otherwise dictate. Amici do not address issue preclusion.

STATEMENT OF FACTS

Amici adopt the facts recited in the opinion below, supplemented by certain undisputed facts found by Judge Stearns and the First Circuit. Attorney Kelley was not personally liable to Mr. Smith; Attorney Bertucci, a former employee of R-Kelley, P.C., was personally liable to Mr. Smith for fraud and G. L. c. 93A violations; and the PC was liable on a *respondeat superior* theory for Attorney Bertucci's actions in the scope of his employment. A90-93. Mr. Smith was never a client of Attorney Bertucci, the PC, or Attorney Kelley individually. A92, fn12.

SUMMARY OF ARGUMENT

I. Massachusetts adheres to the general principle of limited liability and acknowledges that it applies with equal force to professional corporations. Massachusetts courts, however, also recognize that equitable considerations sometimes permit a court to disregard the corporate liability shield and assign corporate liabilities to a shareholder. (12-27).

IA. The equitable doctrine of piercing the corporate veil is available to courts to assign corporate liabilities to shareholders who disregard the corporate form. Where the sole shareholder of a professional corporation disregards the corporate entity and fails to interact with it on an arms-length basis, courts should not rescue the shareholder from personal liability when he seeks to raise the corporate veil against creditors. (13-17).

IB. In addition, the equitable doctrine of successor liability is available to courts where the successor corporation is no more than a mere continuation of the predecessor corporation. These doctrines apply to professional corporations and general corporations alike. With respect to successor liability and the professional corporation, where the successor is a limited liability entity, traditional successor liability remedies remain available to courts. (17-23).

IC. If the successor is a sole proprietorship, however, the Court must address a novel question of first impression. No bright line test seems workable. Consequently, the choice before the Court requires it to carefully balance competing interests of justice and fairness. (23-27).

II. Under certain circumstances, the Massachusetts Supreme Judicial Court's rules assign corporate liabilities to shareholders of a professional corporation organized to engage in the practice of law. The existing Rule 3:06 is not applicable to this case, but the Court has general powers to regulate the practice of law more stringently than Chapter 156A requires. (27-31)

ARGUMENT

Introduction

Theories of successor liability and piercing the corporate veil are not substantive legal doctrines but rather shorthand descriptions of equitable remedies adopted by courts in the interests of fairness and justice. These interests include striking a balance between the limitation on shareholders' individual liability – essential to the modern corporate form – and curtailing incentives for controllers of corporations to use the corporation as a weapon against innocent creditors. Applying principles of Equity, courts analyze a transaction according to its real nature, looking through its form to its substance and intent. Milliken & Co. v. Duro Textiles, LLC, 451 Mass. 547, 560 (2008). Piercing the corporate veil in the context of sole-shareholder professional corporations is noncontroversial. A professional corporation is not a license to engage in fraud. Where a sole-shareholder has abused the corporate form, courts should not bow to form and provide comfort.

As to successor liability, however, this Court's precedents to date have involved only successor business corporations. As the trial judge noted, it appears to be an issue of first impression whether these corporate precedents apply in the same manner or force where the purported successor is not a limited liability

entity, but a sole proprietor conducting a personal services business in which he is licensed to engage. A367-68.

Argument I addresses general principles drawn from the Court's precedents and discusses whether the nature of professional corporations and the specific provisions of G.L. 156A dictate a different result from that which would occur in a case involving a general business corporation. Argument II addresses whether Supreme Judicial Court Rule 3:06, which governs lawyers practicing under a professional corporation, warrants a different outcome than Chapter 156A would otherwise dictate.

I. Shareholders of Chapter 156A Professional Corporations Enjoy the Same Limitations of Liability as Shareholders of Chapter 156D Corporations and Should Likewise Be Subject to the Same Exceptions to Limited Liability

Under Massachusetts law, shareholders of professional corporations enjoy the same degree of limited liability afforded to shareholders of corporations formed under c.156D. See G. L. c. 156A, § 6(a) ("[T]he personal liability of a shareholder of a professional corporation . . . [is] no greater in any respect than that of a shareholder of a corporation organized under chapter 156d."). Consequently, shareholders of professional corporations are generally not "personally liable for the acts or debts of the corporation . . . ." See G. L. c. 156D, § 6.22(b). Consistent with common law doctrines of agency, however, when corporate liabilities arise from the shareholder's own acts or conduct, the shareholder remains personally

liable for the resulting damages. See G. L. c. 156D, § 6.22(b). In addition, this Court has long held that if shareholders disregard or abuse the privileges of the corporate form, the statutory protection of limited liability may be lost.

A. Piercing the Corporate Veil Allows Courts to Assign Liability for Corporate Debts to Shareholders

Although Massachusetts has recognized a shareholder's limited liability as a "general principle of corporate law," the equitable doctrine of corporate disregard allows courts to look beyond the corporate form and assign liability for corporate debts to a shareholder. See Kraft Power Corp. v. Merrill, 464 Mass. 145, 148 (2013); My Bread Baking Co. v. Cumberland Farms, Inc., 353 Mass. 614, 619 (1968). The doctrine applies in "rare, particular situations": (1) where the shareholder exercises "some form of pervasive control" in the activities of the corporation and there is "some fraudulent or injurious consequence"; or (2) where there is "a confused intermingling of activity of two or more corporations engaged in a common enterprise with substantial disregard of the separate nature of the corporate entities, or serious ambiguity about the manner and capacity in which the various corporations and their respective representations are acting." See Cumberland Farms, 353 Mass. at 619.

Use of the corporate form to perpetuate a fraud is a significant factor in the decision whether to pierce the corporate veil. The demonstration of fraud in a veil-piercing claim requires "less than a showing of fraudulent intent, which is not

required for piercing under Massachusetts law." George Hyman Constr. Co. v. Gateman, 16 F. Supp. 2d 129, 156 (D. Mass. 1998). Evidence demonstrating that a corporation "was established or operated so as to misrepresent or divert assets" suggests that the corporation was "engaged in promoting fraud." See Evans v. Multicon Constr. Corp., 30 Mass. App. Ct. 728, 736 (1991). A "circumstance strongly suggesting veil piercing is a case of 'financial misconduct of the subsidiary involving such manipulation as asset-stripping or asset-siphoning, which depletes the resources of the subsidiary.'" Gateman, 16 F. Supp. 2d at 155 (quotation omitted); see also Crane v. Green & Freedman Baking Co., 134 F.3d 17, 23 (1st Cir. 1998) ("[T]he wrongful diversion of corporate assets to or for controlling individuals at a time when the corporation is in financial distress [i]s a fraud that can justify piercing the corporate veil.").

When such circumstances arise, "the corporate veil can be pierced, as a tool of equity, to disregard the corporation's existence and impose liability on individual principals." Kraft, 464 Mass. at 148. Because either of the two categories permits piercing the corporate veil, a claim based on "confused intermingling" does not require a showing of a "fraudulent or injurious consequence." Commonwealth v. Springfield Terminal Ry. Co., 80 Mass. App. Ct. 22, 37-38 (2011).

In deciding whether to apply the piercing doctrine, courts evaluate twelve factors:

> (1) common ownership; (2) pervasive control; (3) confused intermingling of business assets; (4) thin capitalization; (5) nonobservance of corporate formalities; (6) absence of corporate records; (7) no payment of dividends; (8) insolvency at the time of the litigated transaction; (9) siphoning away of corporation's funds by dominant shareholders; (10) nonfunctioning of officers and directors; (11) use of the corporation for transactions of the dominant shareholders; and (12) use of the corporation in promoting fraud.

AG v. M.C.K., Inc., 432 Mass. 546, 555 n.19 (2000); see also Pepsi-Cola Metropolitan Bottling Co. v. Checkers, Inc., 754 F.2d 10, 14-16 (1st Cir. 1985). While courts must consider each of the twelve factors, "the exercise is . . . not one in counting." See Evans, 30 Mass. App. Ct. at 736. Rather, courts will examine "the twelve factors to form an opinion whether the over-all structure and operation misleads." Id.

A sole-shareholder professional corporation is not a license to defraud creditors. The fact that an individual is a sole shareholder of a corporation should not preclude the assignment of corporate liabilities to that shareholder via veil piercing. See Talaria Waste Mgmt., Inc. v. Laidlaw Waste Sys., 827 F. Supp. 843, 847 (D. Mass. 1993) (applying veil-piercing and finding that the corporate form, because it was a sham, did not shelter the sole shareholder and officer from the corporate debts); Debreceni v. Graf Bros. Leasing, Inc., Civil Action No 85-3386-MA, 1987 U.S. Dist. LEXIS 1270, at *12-13 (D. Mass. Jan. 23, 1987) ("[A]n

individual may be held personally liable for a corporation's withdrawal payments if the circumstances require piercing the corporate veil under traditional common law principles.”).

Sole shareholders of professional corporations are highly susceptible to veil piercing because shareholders in such corporations can easily run afoul of the piercing factors. To the extent sole-shareholder professional corporations are informally managed, without shareholder or board meetings or attention to other corporate formalities, such corporations make themselves vulnerable to veil-piercing claims. Where the sole shareholder of a professional corporation disregards the corporate entity and corporate separateness in the daily management of the entity, it is as if the shareholder is engaging in the practice of the profession in his own name and not in the name of the professional corporation.

Of course, informality alone is not necessarily sufficient to sustain a veil-piercing claim. However, informality combined with other factors identified by the Court may suffice. See M.C.K., Inc., 432 Mass. at 555 n.19. Where sufficient indicia of a shareholder’s disregard for the corporate form are present, it would be inequitable to permit the shareholder to benefit from a corporation’s limited liability shield.

That the entity in question is a sole-shareholder professional corporation should not raise a significant issue with respect to the Court’s analysis in the

present case. Whether a professional corporation has one or just a small number of shareholders is not an invitation for the shareholders to disregard the corporate form in their dealings with the entity. Accordingly, when the sole shareholder of a professional corporation fails to treat the corporation with due regard, piercing the corporate veil is an appropriate remedy notwithstanding the fact that the entity is a sole-shareholder professional corporation. See id; see also Pepsi-Cola, 754 F.2d at 16 ("Where the principal shareholders of a close corporation fail to observe with care the corporation's existence, a court will not later heed their requests to do so.").

Amici express no view about whether application of these well-established principles to the detailed facts of this case warrants piercing the corporate veil.

B. Successor Liability Permits Imposing Liability for a Seller Corporation's Debts Upon A Buyer of Its Assets in Certain Circumstances

Massachusetts adheres to the general tenet of corporate law that the liabilities of a seller-predecessor do not attach to a buyer-successor when purchasing the seller's assets. See McCarthy v. Litton Indus., Inc., 410 Mass. 15, 21 (1991). However, for policy reasons akin to those of veil piercing, the Court developed the remedy of successor liability to address abuse of the privileges of the corporate form in the structuring of corporate transactions. In such cases, a court may impose liability on a successor corporation.

The doctrine seeks to balance two goals: "provid[ing] a necessary remedy to injured parties . . . and [offering] transactional clarity and certainty for business parties engaged in fundamental corporate transactions." Matheson, Successor Liability, 96 MINN. L. REV. 371, 372-373; see also Milliken, 451 Mass. at 556 (noting that the doctrine of successor liability seeks to protect innocent creditors). Because successor liability is a doctrine rooted in equity, courts will inquire into the substance of a transaction rather than its form. See Milliken, 451 Mass. at 560. Additionally, courts assess liability with an eye towards fairness. See Demoulas v. Demoulas, 428 Mass. 555, 580 (1998) ("Equitable remedies are flexible tools to be applied with the focus on fairness and justice"). Ultimately, courts may impose liability when, in the exercise of their sound discretion, it is "fair under the circumstances and in light of the underlying policies." See Matheson, supra at 406.

Courts may impose liability on corporate successors in any of the following four generally recognized circumstances: (1) the buyer impliedly or expressly assumed the seller's liabilities; (2) the transaction constituted a de facto merger; (3) the buyer is a mere continuation of the seller; or (4) the transaction was a fraudulent attempt to avoid the seller's liabilities. Dayton v. Peck, Stow & Wilcox Co. (Pexto), 739 F.2d 690, 692 (1st Cir. 1984). The plaintiff bears the burden of demonstrating the existence of an exception.

1. Implied or Express Assumption

A buyer-successor may be liable for the obligations of a seller-predecessor when the buyer impliedly or explicitly assumes those liabilities. DeJesus v. Bertsch, Inc., 898 F. Supp. 2d 353, 364 (D. Mass. 2012). In DeJesus, the court concluded that under the terms of a transaction agreement, the buyer of a significant portion of the seller's assets agreed to assume only those liabilities expressly provided for under the agreement. Id. at 365. Consequently, successor liability did not extend to tort liabilities, which were not covered under the transaction agreement. See id.

There is no suggestion in the case before this Court that Attorney Kelley impliedly or explicitly assumed the PC's liability for the judgment obtained by Mr. Smith when he voluntarily dissolved the PC and transferred its assets to his sole proprietorship. Indeed, there is evidence that Attorney Kelley specifically intended to leave behind the judgment in controversy. A236.

2. De Facto Merger

The de facto merger theory of successor liability applies when "the ownership, assets and management of one corporation are combined with those of another, preexisting entity." Nat'l Gypsum Co. v. Cont. Brands Corp., 895 F. Supp. 328, 336 (D. Mass. 1995). In determining whether a transfer is a de facto merger, courts generally consider:

> whether (1) there is a continuation of the enterprise of the seller corporation so that there is continuity of management, personnel, physical location, assets, and general business operations; whether (2) there is a continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its own stock, this stock ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation; whether (3) the seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible; and whether (4) the purchasing corporation assumes those obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.

Cargill, Inc. v. Beaver Coal & Oil Co., 424 Mass. 356, 360 (1997). No single element is necessary or sufficient. Id.

In Cargill, Inc. v. Beaver Coal & Oil Co., a home heating oil retailer sold substantially all of its assets to a corporation that continued the retailer's business. Id. at 357. At the time of the sale, the retailer had outstanding obligations to another party. Id. The Court concluded that, under the de facto merger theory, the buyer was liable for the retailer's obligations. Id. at 360-362 (pointing to the buyer's continuation of the retailer's operations, some overlap in shareholders, the retailer's ceasing of operations under the transaction agreement, and the buyer's assumption of the retailer's liabilities that were critical to ensuring uninterrupted business operations).

3. Mere Continuation

The mere continuation line of successor liability cases imposes liability when there is "a reorganization transforming a single company from one corporate

entity into another." McCarthy, 410 Mass. at 21-22; see Matheson, supra at 392. Thus, when a buyer-successor is simply the seller-predecessor wearing a "new hat," courts will deem the buyer-successor a "mere continuation" and, notwithstanding an explicit agreement to the contrary, the seller's liabilities will follow to the buyer. Bud Antle, Inc. v. E. Foods, Inc., 758 F.2d 1451, 1458 (11th Cir. 1985). Liability is justified because the buyer-successor "in substance if not in form" is the same company as the predecessor. McCarthy, 410 Mass. at 22. Several traditional factors point to a mere continuation: "continuity of directors, officers, and stockholders; and the continued existence of only one corporation after the sale of assets." Id. at 23. No one factor is dispositive and each set of facts much be assessed on a case-by-case basis. Milliken, 451 Mass. at 558.

In McCarthy v. Litton Industries, Inc., a lathe-manufacturing business transferred its assets to its only shareholder's sole proprietorship, which later incorporated. 410 Mass. at 17-18. After the transfer, the shareholder sold his shares in the company to a Delaware corporation. Id. at 18. The Court concluded that the buyer of the lathe-manufacturing business was not liable under a continuation theory of successor liability because the seller of those assets continued to exist after the transaction. Id. at 22.

In Milliken & Co. v. Duro Textiles, LLC, on the other hand, the Court considered whether the foreclosure sale of nearly the entirety of a borrower's

assets generated successor liability for the purchaser. See 451 Mass. at 558-559 (analyzing the successor liability of "New Duro" as a result of its purchase of nearly all of the assets of "Old Duro"). Following the underlying transaction, Old Duro ceased its regular business operations in the textile industry, but did not formally dissolve. Id. at 559. Instead, operating under a new name, it leased its property to New Duro, which continued Old Duro's work in the textile industry. Id. New Duro argued that successor liability was inapposite since Old Duro was not dissolved and continued in existence. Id. at 558. The Court rejected this "form over substance" argument, however, concluding that Old Duro's continued existence did not "trump[] the existence of New Duro as the successor corporation on whom liability properly should be imposed." See id. at 559 (noting that Old Duro's sale of its business operations to New Duro enabled the latter to continue without interruption of the former's manufacturing operations).

4. Fraud

Finally, under the fraud line of successor liability cases, a buyer of fraudulently transferred assets (i.e., transferred by a seller for less than fair value merely to escape a liability) is responsible for the assets' liabilities. Dayton, 739 F.2d at 692. For purposes of this brief, amici proceed on the assumption that the $85,000 paid by Attorney Kelley to the bankruptcy trustee was fair value for those assets, and put aside any further fraudulent conveyance analysis. If the transfer and

use of the PC's assets was for less than fair value, presumably Attorney Kelley would be (or was) liable to the bankrupt estate. Amici do not address whether liability to Mr. Smith exists on a fraudulent transfer theory for the value of those assets.

C. Successor Liability and the Professional Corporation

Like its sister remedy of veil-piercing, successor liability should be generally available for application against professional corporations that leave behind unsatisfied liabilities.

1. Corporate Successor

Where the successor entity is another professional corporation or other limited liability entity, the application of successor liability doctrines to professional corporations should be relatively noncontroversial. In Groman v. Watman, a professional corporation was liable for the debts of a prior professional corporation under a mere continuation theory of successor liability. 27 Mass. L. Rep. 359, 362 (Mass. Super. Ct. 2010). In Groman, Children's Dental ("Children's"), in which Watman was the sole officer and director, filed for bankruptcy after Groman obtained a judgment against Watman for falling behind on monthly payments. Id. at 359-360. Watman then left Children's and began to practice dentistry under Lowell Dentistry ("Lowell"), which later incorporated as a professional corporation with Watman as the sole officer, director and shareholder.

Id. at 360. The court found that Lowell was a mere continuation of Children's – and thus liable for Children's debts under successor liability. Id. at 362. In effect, Lowell was a "reincarnat[ion]" of Children's "in all its essential attributes." Id. Groman is consistent with this Court's precedents and should be applied in these cases.

2. Individual Successor

In the case before the Court, Attorney Kelley acted as the sole shareholder to voluntarily dissolve Kelley-PC. He then transferred various business liabilities of the dissolved PC (e.g., phone, lease, etc.), as well as the PC's customers, some receivables, and other assets, to himself as a sole proprietor. He declined, however, to assume the PC's single, largest liability: the judgment in controversy. Arguably, Attorney Kelley's sole proprietorship is a mere continuation of the defunct PC.

This case presents the Court with what appears to be a hard choice. On the one hand, a bright-line rule that the successor liability remedy is not available where a sole shareholder of a professional corporation voluntarily dissolves the corporation and then practices as a sole proprietor, would create a roadmap for fraud. In that situation, shareholders of professional corporations would have an incentive to abuse the corporate form by moving back and forth between a corporate entity and a sole proprietorship in order to avoid unwanted liabilities, and form would triumph over substance.

On the other hand, the Court could simply look through the form of the transaction at issue and decide that, in substance, Attorney Kelley's sole proprietorship is a mere continuation of the predecessor corporation and, thus, he is liable for the judgment, just as a corporate successor would have been. Yet significant differences exist between successor corporate liability and successor individual liability.

In successor corporation liability cases, a judgment against the successor corporation exposes stockholders to the loss of their investment in the successor corporation, but not to personal liability. Here, Mr. Smith seeks an in personam judgment against Attorney Kelley for the entire amount of Mr. Smith's judgment against the PC, irrespective of the value of the PC's assets transferred to Attorney Kelley. Such a judgment against Attorney Kelley could presumably be executed against any of his personal assets.

Mr. Smith also broadly defines the successor enterprise as encompassing Attorney Kelley's entire professional practice including, so far as appears, not only clients who had once been clients of the PC but also any clients he has taken on since then. It is relatively straightforward to require disbursement of particular property or assets that may have been obtained without paying full value. But encumbering revenues from future professional services to customers of a defunct professional corporation or new customers seeking professional services from a

former shareholder implicates additional concerns. Restriction of a right to practice any profession is potentially problematic.[1]

Read as broadly as Mr. Smith seems to urge, any continuation of a professional's career is arguably a continuation of the prior business, but Chapter 156A makes it clear that professionals do not sacrifice their rights to practice individually by becoming stockholders of a professional corporation. Chapter 156A, § 5 provides that nothing in this statute shall be construed "to prohibit the rendering of professional services by a licensed natural person acting in his individual capacity, notwithstanding that such person may be a shareholder, director, officer, employee or agent of a professional corporation . . . ." Section 5 also makes it clear that the PC as an abstract legal entity may render services only through duly licensed individuals.

Equity has traditionally been sensitive to the use of its remedies in connection with personal services contracts. Licensed professionals have statutory and constitutional rights to practice their professions, and the legislature carefully preserved those rights in the professional corporation statute. These are all factors to take into account in applying the equitable doctrine of successor liability, and may caution against an overly broad conclusion about the scope of what constitutes

[1] Amici discuss in Argument II particular aspects of the legal profession.

the successor entity in cases involving licensed professionals performing personal services.

II. Successor Liability Of Individual Lawyers Is Governed By Both Chapter 156A And SJC Rule 3:06, Which Must Be Construed In Light Of The Ethical Standards Governing The Practice Of Law, Particularly Those That Recognize A Client's Right To Choose A Lawyer

The Court has adopted additional rules with respect to the use of limited liability entities in the provision of legal services. Under Rule 3:06, attorneys may use limited liability entities to practice law, subject to certain limitations. See SJC Rule 3:06. First, every shareholder of a professional corporation is "liable for damages which arise out of the performance of legal services on behalf of the entity and which are caused by his or her own negligent or wrongful act, error, or omission." SJC Rule 3:06 (3)(a); see also Grand Pac. Fin. Corp. v. Brauer, 57 Mass. App. Ct. 407, 414 (2003). Attorney Kelley was found in the federal litigation not to have committed any personal wrongdoing.

Second, with respect to liability arising from the professional corporation's provision of legal services, shareholders who did not cause the negligent or wrongful act are nonetheless jointly and severally liable for damages resulting from "any negligent or wrongful act, error, or omission of any owner or employee of said entity which occurs in the performance of legal services by said entity and which results in damages to the person or persons for whom the services were

being performed," to the extent such claims exceed the assets of the professional corporation, up to $500,000.[2] See SJC Rule 3:06 (3)(b). Mr. Smith was not a client of Attorney Kelley or the PC.

Attorney shareholders thus enjoy limited liability for regular business liabilities of the professional corporation, including contractual debts or torts. In addition, shareholders of professional corporations are liable for damages to clients (subject to a cap) arising from professional negligent or wrongful conduct performed in the name of the corporation. Shareholders remain exposed to unlimited liability for their own professional negligent or wrongful actions.

Rule 3:06 clearly envisions that the professional corporation is not an absolute shield against shareholder liability and that shareholders shall remain subject to personal liability for at least some of the corporation's liabilities. By reaching through the corporate shield and assigning at least some portion of liability derived from malpractice claims to attorney shareholders of professional corporations, the Court appropriately exercises its inherent power to regulate the practice of law.

In the case before the Court, damages arise out of the performance of legal services, but the injured party was not a client of the professional corporation.

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[2] The liability cap for shareholders is equal to $50,000 plus $15,000 multiplied by the number of owners and employees of said entity who are licensed to practice law, capped at no more than $500,000 in the aggregate. SJC Rule 3:06(3)(b).

Arguably, Rule 3:06(3)(b) by its terms does not assign liability for these damages to the shareholder of the professional corporation. Although Rule 3:06(3)(b) may not assign liability to Attorney Kelley, the common law doctrines of piercing the corporate veil and successor liability remain available because the Rule does displace liability that might exist under Chapter 156A.

Rule 3:06 permits shareholders of professional corporations to leave regular business liabilities behind while assigning at least some portion of the liabilities – those related to the wrongful or negligent conduct of the professional corporation's shareholders and employees – with the professional corporation and its shareholders. By imposing personal liability on shareholders for liabilities associated with the wrongful conduct, the Court incentivizes attorneys operating through limited liability entities to engage in self-regulation of the type that was commonplace under traditional rules of partnership. In the exercise of its constitutional and supervisory powers over the practice of law, the Court may wish to limit the ability of lawyers operating under a professional corporation to escape liability for certain torts committed during the practice of law but not against a client.

This does not, however, suggest that a solo practitioner of law should always be liable for the debts of a purported corporate predecessor. To do so could raise

the prospect that lawyers, having availed themselves of the benefits of limited liability entities in good faith, would never be free of corporate liabilities

In resolving this case, the Court should be guided by a number of considerations. First, a lawyer's ability to practice law in the Commonwealth is a privilege subject to regulation by the Court. See In re Application for Admission to the Bar, 444 Mass. 393, 397 (2005), quoting In re Prager, 422 Mass. 86, 101 (1996) ("The right to practice law 'is a peculiar privilege granted . . . to those who demonstrate special fitness in intellectual attainment and in moral character.'"). The harm that follows from a restriction on the ability to practice can be substantial. In re Ellis, 425 Mass. 332, 341-342 (1997) (citing reputational harm and the loss of clients resulting from suspension of the right to practice). Having granted to a lawyer the privilege of admission to the bar, Massachusetts courts have consistently affirmed that restrictions on a lawyer's ability to practice are void as against public policy when they unduly impinge on the freedom of clients to retain counsel of their choosing. See, e.g., Pierce v. Morrison Mahoney LLP, 452 Mass. 718, 724 (2008) (affirming that SJC Rule of Professional Conduct 5.6 – preventing a lawyer from engaging in a partnership agreement that restricts an attorney's ability to practice after leaving the partnership – protects clients rather than lawyers). Assigning successor liability to a lawyer-successor may contravene the strong public interest in allowing clients to retain counsel of their choice by

potentially causing lawyers to decline to represent clients of the predecessor corporation in order not to trigger potential successor liability obligations. But in the context of claims related to wrongful conduct toward clients, the Court has already assigned personal liability to lawyer-shareholders of professional corporations without regard to any potential adverse effects on the right of clients to retain counsel of their choice.

Conclusion

Equitable remedies used in determining the scope of shareholder liabilities under Chapter 156D are fully available for use in determining shareholder liabilities under Chapter 156A, but must be applied in light of the special equitable considerations involved in professional services licensed and regulated by the state.

Respectfully submitted,

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Addendum 1: G. L. c. 156A, Section 6: Shareholder Liability; Professional Relationship; Privileged Communications

(a) Except as otherwise provided by law or regulation, the personal liability of a shareholder of a professional corporation organized under this chapter shall be no greater in any respect than that of a shareholder of a corporation organized under chapter 156D.

(b) This chapter shall not alter any law applicable to the relationship between a person rendering professional services and a person receiving such services, including liability arising out of such professional services.

(c) Any privilege applicable to communications between a person rendering professional services and the person receiving such services shall extend to communications between a professional corporation or its employees rendering professional services and the person receiving such services.

G. L. c. 156A, Section 5: Rendition of professional services; construction of chapter A professional corporation may render professional services in the commonwealth only through its officers, employees and agents who are duly licensed to render such professional services in the commonwealth; provided, however, that nothing in this chapter shall be construed (a) to require any person who is employed by a professional corporation to be licensed to perform services for which no license is otherwise required, (b) to prohibit the rendering of professional services by a licensed natural person acting in his individual capacity, notwithstanding that such person may be a shareholder, director, officer, employee or agent of a professional corporation, or (c) to prohibit unlicensed persons employed by a professional corporation from rendering professional services under the supervision of licensed officers, employees or agents of such professional corporation, to the extent permitted by law or the regulations of the applicable regulating board.

Addendum 2: Excerpt From Massachusetts Supreme Judicial Court Rule 3:06: Use Of Limited Liability Entities

(1) As used in this rule, the term "entity" shall mean a professional corporation, a limited liability company, or a limited liability partnership organized to practice law pursuant to the laws of any state or other jurisdiction of the United States and which practices law in the Commonwealth. The provisions of such laws shall be applicable to attorneys practicing law in the Commonwealth subject to the terms and conditions of this rule. Such terms and conditions are necessary and appropriate for the purpose of making the provisions of those laws applicable to attorneys. As used in this rule, the term "owner" shall mean a shareholder of a professional corporation, a member of a limited liability company, or a partner of a limited liability partnership.

. . .

(3) The following provisions are established with respect to the liability of the owners of an entity with respect to damages which arise out of the performance of legal services by the entity, such provisions to be in addition to any statutory or common law rules of general application which deal with the liability of entities and their owners:

> (a) Each owner of the entity shall be personally liable for damages which arise out of the performance of legal services on behalf of the entity and which are caused by his or her own negligent or wrongful act, error, or omission. Owners of the entity whose acts, errors, or omissions did not cause the damages shall not be personally liable therefor, whether or not they have agreed with any owners or employees or other persons to contribute to the payment of the liability, except to the extent provided in subparagraphs (b), (c), and (d).
>
> (b) All the owners of an entity which is a professional corporation at the time of any negligent or wrongful act, error, or omission of any owner or employee of said entity which occurs in the performance of legal services by said entity and which results in damages to the person or persons for whom the services were being performed shall be jointly and severally liable for such damages, but only to the extent of the excess, if any, of (1) the sum of $50,000 plus the product of $15,000 multiplied by the number of owners and employees of said entity at the time of such act, error, or omission who are duly licensed by this court to practice law in the Commonwealth, or duly licensed to practice law by the licensing authority in the jurisdiction in which they practice, and who are owners of or employed by said entity as lawyers, but not in excess of $500,000 in the aggregate, over (2) the sum of the assets of said entity and the proceeds of any insurance policy issued to it which are applied to the payment of such damages.

<u>RULE 17(C) CERTIFICATION</u>

Pursuant to Rule 17(c) of the Massachusetts Rules of Appellate Procedure, undersigned counsel hereby certifies that this brief complies with the rules of court that pertain to filing amicus briefs. Amici complied with Rule 20(a)(3)(E) by using the Microsoft Office (2016) Word program and Times New Roman font in size 14.

According to that program, the number of non-excluded words is 5,226.

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<u>CERTIFICATE OF SERVICE</u>

I hereby certify under the penalties of perjury that I today served this amicus brief by emailing a pdf copy to counsel of record, and will upon receipt mail two printed copies, first class, postage prepaid, to counsel for each party, addressed to the following:

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