

Advisory Committee on Professional Ethics
Committee on Attorney Advertising
Appointed by the Supreme Court of New Jersey

JOINT OPINION

Opinion 704
Advisory Committee on Professional Ethics

Opinion 37
Committee on Attorney Advertising

Creation and Ownership of a Wholly-owned Subsidiary Limited Liability Company or Professional Corporation to Practice a Specialized Area of Law By a Law Firm That is Organized as a Professional Corporation.

We are asked by a law firm (the “Firm”), organized pursuant to the Professional Services Corporation Act, whether it may form, and be the sole shareholder of, a limited liability company or a professional services corporation, which would engage in the practice of a specialized area of law. According to the Firm, one or more of its existing shareholders and associates will be employed by the new entity (the “Subsidiary”) and will direct and handle its operations. The Subsidiary will maintain its own books and records, bank accounts, and trust accounts and will open its own files. It may, however, share office space with the Firm. The Firm indicates that it is prepared to cross reference all conflict searches with the Subsidiary and refrain from representation where a conflict exists.

With regard to the proposed business arrangement, the Firm raises the following three questions:

- (1) Can a professional corporation engaged in the practice of law form a subsidiary law firm either as a professional corporation or as a limited liability company?;
- (2) If so, can the Firm, as the sole shareholder or member of the Subsidiary, receive the Subsidiary’s net profits?; and
- (3) Can the Subsidiary’s name include the name or names of one or more current shareholders or associates of the Firm who will be employed by the Subsidiary and responsible for the legal services rendered by that entity?

The Committee has never considered whether a law firm may form a wholly-owned subsidiary of any type. Furthermore, the Rules of Professional Conduct do not expressly address the proposed business arrangement. Rule 1:21-1A, which governs professional corporations, and Rule 1:21-1B, which governs limited liability companies, do provide us with some guidance and serve as the starting point for our analysis.

Rule 1:21-1A, which was adopted in 1969 and last amended in April 1996, permits a law firm to organize as a professional corporation pursuant to the Professional Services Corporation Act, N.J.S.A. 14A:17-1 to 14A:18A. That Rule requires that all shareholders of a professional corporation be actively engaged in the practice of law as an employee or agent of the corporation. R. 1:21-1A(d). A shareholder may, however, be another professional corporation engaged in the practice of law. Id. Rule 1:21-1A(d) expressly authorizes “a professional corporation actually and actively engaged in the practice of law” to hold “shares of stock in another professional corporation covered by this rule.” The Rule is silent with respect to whether a professional corporation may acquire an ownership interest in a limited liability company.

Rule 1:21-1B, which was adopted on November 25, 1996, authorizes a law firm to organize as a limited liability company. In many respects, the provisions of Rule 1:21-1B parallel Rule 1:21-1A. For example, subsection (d) of Rule 1:21-1B bars any person from holding any interest in a limited liability company unless he or she is “licensed to practice law and actually and actively engaged in the practice of law as a member, employee or agent of, or ‘of counsel’ to the limited liability company[.]” In addition, subsection (d) of Rule 1:21-1B grants limited liability companies the power to own an interest in another limited liability company engaged in the practice of law. Particularly relevant to our analysis is the additional authority conferred on a limited liability company to “hold shares of stock in a professional corporation covered by R. 1:21-1A.”

Rules 1:21-1A and 1:21-1B also impose similar standards of personal liability and professional responsibility. Lawyers practicing in professional corporations and limited liability companies are subject to the “same standard of personal liability.” Michels, New Jersey Attorney Ethics § 5.5. Furthermore, both type of entities must comply with all rules governing the practice of law by attorneys and refrain from doing anything “which, if done by an individual attorney would violate the standards of professional conduct[.]” R. 1:21-1A(a)(2); R. 1:21-1B(a)(3).

In addressing the central question presented by the Firm, we first consider whether a professional corporation can own an interest in a limited liability company. On that issue, we agree with the Firm that Rule 1:21-1A’s failure to expressly grant a professional corporation the power to own an interest in a limited liability company is inadvertent. Rule 1:21-1A has not been amended since the adoption of Rule 1:21-1B and, therefore, does not take into account the possibility that a law firm may be organized as a limited liability company. In view of the similarity in the treatment of limited liability companies and professional corporations under the Court Rules, we find no

reason to preclude a professional corporation from owning an interest in a limited liability company.

We also conclude that a professional corporation covered by Rule 1:21-1A may form a subsidiary to provide legal services and that such a subsidiary may be organized as either a professional corporation or a limited liability company, provided that the requirements and limitations set forth in Rules 1:21-1A and -1B are followed. Such an arrangement does not violate the general prohibition on the corporate practice of law. The central goal of that prohibition is to keep the rendition of legal services from being under the control and direction of nonlawyers. As the New Jersey Supreme Court recognized in In re Education Law Cntr., Inc., “[a]n overriding fear in this regard is that the corporation may place its own interest, whether political goals or profits, ahead of the interests of its clients” Id. at 135. Those concerns are not present when lawyers are employed by a corporation actively engaged in the practice of law. In that scenario, lawyers will be working “for lawyers fully aware of pertinent standards of ethics and professional responsibility and subject to the discipline of this Court.” Id. at 134 n.4. Furthermore, the relationship of confidentiality and undivided loyalty that is the centerpiece of the lawyer-client relationship will not be threatened by the financial or political interests of a corporation owned and managed by nonlawyers. Id.

We do, however, stipulate that to avoid the possibility that clients and members of the public may be misled as to who controls and owns the subsidiary, it is necessary that this ownership/subsidiary relationship be disclosed in all subsidiary advertising and marketing materials and upon the first contact of a new client with the subsidiary firm.

Having reached that conclusion, we find also that the distribution of profits from the Subsidiary to the Firm is ethically permissible. Such an arrangement does not violate RPC 5.4(a), which prohibits a lawyer from sharing fees with a non-lawyer. As discussed above, because the Firm is a professional corporation governed by Rule 1:21-1A, only lawyers will be receiving the fees generated by the Subsidiary.

Finally, we address the Firm’s question concerning permissible names for the Subsidiary. The Firm submits that the Subsidiary should be permitted to use as its firm name the name or names of lawyers employed by the Subsidiary and primarily responsible for the Subsidiary’s provision of legal services. For the reasons discussed below, we agree.

RPC 7.5 sets forth the requirements for and restrictions on firm names. In pertinent part, that rule states:

- (a) A lawyer shall not use a firm name, letterhead, or other professional designation that violates RPC 7.1. . . . [T]he name under which a lawyer or law firm practices shall include the full or last names of one or more lawyers in the firm or office or the names of a person or persons who have ceased to be associated with the firm through death or retirement.

RPC 7.1(a) precludes a lawyer from making “false or misleading communications about the lawyer, the lawyer’s services, or any matter in which the lawyer has or seeks a professional involvement.” A false or misleading communication is defined as a statement that “contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading.” RPC 7.1(a)(1).

Rules 1:21-1A and 1:21-1B also include provisions regarding firm names. Rule 1:21-1A requires that the name of a professional corporation contain “only the full or last names of one or more of its shareholders . . . , whether the shareholder . . . be living, deceased, or retired.”¹ Furthermore, the phrase “professional corporation” or an abbreviation of that phrase must follow the firm name. Subsection (c) of Rule 1:21-1B imposes similar restrictions on the permissible names for limited liability companies. The name of a limited liability company must include only the full or last names of one or more of its present members.² R. 1:21-1B(c). The phrase “limited liability company” or an abbreviation of that phrase must appear after the firm name.

Application of the above rules to the business arrangement proposed by the Firm necessarily creates a conflict. Under RPC 7.5, the Subsidiary must include in its name the full or last names of one or more lawyers employed by the Subsidiary. By contrast, Rules 1:21-1A and 1:21-1B restrict the names included in the Subsidiary’s name to the name of the Firm based on its role as the Subsidiary’s sole shareholder or member.

In resolving this conflict between rules, we are guided by the central purpose and policy motivating the restrictions on law firm designations. “The rationale behind our regulation of how lawyers identify themselves is that there is a need to protect the public from being misled and to ensure that the nature of an attorney’s practice is clearly communicated.” In re 1115 Legal Service Care, 110 N.J. 344, 354 (1988). The proposal to include in the name of the Subsidiary only attorneys employed by it is consistent with that rationale. Including in the Subsidiary’s name only the name of the Firm would lead the public to believe incorrectly that the attorneys in the Firm were actually rendering the legal services provided by the Subsidiary. Therefore, the Subsidiary must include the names of one or more of the attorneys who are principally responsible for the legal services provided by the Subsidiary. Nevertheless, we conclude that to ensure clear disclosure, the name of the Subsidiary also must contain the following phrase beneath or next to the Subsidiary’s name “a subsidiary of X law firm.”

¹ The Professional Services Corporation Act similarly mandates that the corporate name of a professional corporation “contain the full or last names of one or more of the shareholders or a name descriptive of the type of professional services in which the corporation will be engaged[.]” N.J.S.A. 14A:17-14.

² The Limited Liability Company Act is less restrictive than the Court Rules. That statute provides that the name of a limited liability company “may contain the name of a member or manager.” N.J.S.A. 42:2B-3 (emphasis added).