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THE RISK MANAGER

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LAWYER SCAMS CONTINUE TO PLAGUE KENTUCKY LAWYERS

Lawyers are frequently the target of scams that, if effective, result in huge losses in client trust accounts and violations of trust account fiduciary rules. These losses are seldom, if ever, covered by insurance. We recently learned of several Kentucky lawyers either being the victim of a scam or realizing just in time that something was really wrong with a requested representation.

Lawyers Mutual began alerting the Kentucky Bar to this risk in our newsletter in early 2009 with follow up alerts in late 2009 and 2010 newsletters. An old Army maxim is that 10% never gets the word. This article is an effort to get the last 10% of the Bar informed and updates the other 90% on developments in lawyer scams.

The Scam Concept:

- Lawyer scams are fraudulent schemes that trick lawyers into depositing a counterfeit certified or cashier's check in a client trust account, and after deducting a fee, wiring the proceeds to the "client" fraudster. When the counterfeit check is discovered and the funds withdrawn from the trust account by the bank, the lawyer is left with a major overdraft in the account. It has been uniformly held that lawyers liability insurance does not cover this situation because it does not involve professional services.

A Fatal Misunderstanding about Check Clearing is the Trap in Lawyer Scams:

- ***There is a serious misunderstanding by many lawyers on what it means when a bank makes funds available in an account:***
  - Some lawyers are skeptical and will not order a wire transfer until they have confirmed that the cashier's check has "cleared" or that the funds from the check are "available." The problem is that most lawyers do not understand banking jargon. A bank often confirms that funds are "available" for withdrawal and agrees to wire transfer the funds as directed by the lawyer.
  - **THIS DOES NOT MEAN, HOWEVER, THAT THE FUNDS FROM THE CASHIER'S CHECK ARE IRREVOCABLY CREDITED TO THE LAWYER'S TRUST ACCOUNT AND HAVE BEEN ACTUALLY WITHDRAWN FROM THE ACCOUNT ON WHICH THE CASHIER'S CHECK WAS WRITTEN. RATHER, THE BANK IS PROVIDING PROVISIONAL CREDIT TO THE LAWYER. THIS MEANS THAT THE BANK CAN STILL REVERSE THE TRANSACTION IF THE ISSUING BANK ULTIMATELY DISHONORS THE CASHIER'S CHECK. THE FUNDS FROM THE CASHIER'S CHECK ARE NOT IRREVOCABLY CREDITED UNTIL THERE IS "FINAL SETTLEMENT," AND THIS CAN TAKE A CONSIDERABLE PERIOD OF TIME. A LAWYER CAN BE SAFE ONLY BY HOLDING THE FUNDS UNTIL THE BANK CONFIRMS IN WRITING THAT THE FUNDS ARE IRREVOCABLY DEPOSITED IN THE LAWYER'S TRUST ACCOUNT.**

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Question:
What do we call a lawyer who bats .987?
Answer:
Defendant

Peter Jarvis at the 2011 Legal Malpractice & Risk Management Conference

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Risk Management for Check Clearing:

Remember that the best risk management practice with any check deposited in a client trust account is to make no disbursements on it until the check irrevocably clears regardless of its apparent validity or whether the bank shows the funds available. The lawyer must wait until the funds are irrevocably credited to the trust account by "final settlement" which can take a considerable period of time. In today's economy bank failures are a common experience making this practice even more important. Check with your bank on its final settlement procedures and how you can verify that funds are irrevocably credited to your trust account. Advise clients at the inception of a representation that they will not receive funds until a check received in payment of their matter is irrevocably credited after final settlement. Put this in your letter of engagement.

The Basic Scam Scenario:

- A person claiming to represent what turns out to be a fictitious company in a foreign country e-mails a lawyer in the U.S. seeking representation.
- This person informs the lawyer that the company has a customer in the U.S. that is delinquent in payment of funds due the company.
- The lawyer is asked to represent the company in collecting the funds. The company is agreeable to virtually any terms of representation. The lawyer accepts the representation and e-mails a retainer agreement that is signed and faxed to the lawyer.
- The company promptly e-mails the lawyer with the information that the customer has agreed to pay some or all of the delinquent funds – often close to $300,000.
- The lawyer is requested to provide an address to which the customer can send a certified check. The lawyer is instructed that upon receipt of the certified check to deposit it, subtract his fee, and wire the balance to a designated overseas account.
- The lawyer is then sent a counterfeit certified check delivered by an independent overnight carrier. (In one case the certified check was in the amount of $298,720.) The unsuspecting lawyer deposits the check in his client trust account, withdraws his fee, and, believing that the funds are guaranteed, routinely wires the balance to the overseas account.
- A few days later the bank notifies the lawyer that the check is counterfeit and requires that the lawyer restore the funds to the bank.

More on the Basic Scenario and Risk Management of Scams

The Lawyers' Professional Indemnity Company (LawPro) fact sheet *Fraud – How to avoid becoming its next victim* provides more details on scams and risk management:

Business loan fraud

- New client retains your firm's services to help with buying small business equipment or inventory.
- Documentation in client's file looks real (invoices, letters, etc).
- Background checks (corporate … searches) may look normal.
- You're asked to represent lender and borrower.
- Certified check from "lender" arrives promptly, gets deposited to your trust account.
- Certified check looks authentic and has all normal security features.
- Funds are disbursed to the client.
- Days later your bank tells you the check/draft is fraudulent.

Debt collection fraud

- Generally targets litigators.
- New client (often offshore) contacts your firm seeking representation on a debt collection.
- Client provides legitimate documentation including invoices, demand letters, etc.
- Collection is hassle-free; debtor returns calls and pays up promptly.
- Certified check looks authentic and has all normal security features.
- You're instructed to send funds, minus legal fees, to an offshore account.
- Days later your bank tells you the check/draft is fraudulent.

Red Flags

- Client is offshore, unknown to the firm and/or in a rush – pressures you to "do the deal" quickly.
- Client willing to pay higher-than-usual fees on a contingent basis from (bogus) funds you are to receive.
- Client shows up around banking holidays – when banks are closed and offices short-staffed.
- Debtor pays without any hassle – unusual given client's need to retain you to get payment in the first place.

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"This is the precept by which I have lived: Prepare for the worst; expect the best; and take what comes."

Hannah Arendt

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Tip: **Dig Deeper**

- Do a reverse phone number search on the company and use Google to verify phone numbers, addresses and e-mail contacts.
- Contact the company to confirm that they are expecting debtor's payment or business loan.
- Go to bank website to verify branch transit number, address and phone number on the check.
- Hold funds until your bank confirms the funds are "good" by contacting the other bank, and it's safe to withdraw the deposit.

Go to LawPro's Website www.practicepro.ca/fraud (*last viewed on 6/2/11*) for the rest of this article and many other highly useful articles on dealing with fraud from both within and without the firm.

New Fraud Variations Using Websites:

Advanced-Fee Fraud:

The United Kingdom Solicitor Regulation Update – January 2011 describes advanced-fee fraud as follows:

> In the wake of recent fraudulent activity involving "cloning" identities of bona fide firms and solicitors, we advise firms to be vigilant and to check the Internet regularly to ensure that their details are not being misused.
>
> We are aware that a small number of firms have had their company names used and their websites cloned by criminals, who use firms' identities to obtain money fraudulently.
>
> The circumstances vary. In some cases, an exact copy of a firm's name and website is used. Only the contact details are changed – usually to an address and telephone number abroad.
>
> In other cases, the name of the firm has been very slightly changed. At first sight, the fake website appears to be genuine. Sometimes, the difference from the genuine website is simply a missing letter or punctuation mark in the firm's name.
>
> The cloned websites are used in scams, usually originating from overseas, in which individuals are asked to send money in advance. This is known as advanced-fee fraud.
>
> The criminals provide their targets with details of the cloned solicitor or firm—with false contact details. The involvement of a "solicitor" lends credibility to the transaction. Often, targets are asked to send money to the "solicitor's" false contact details.
>
> We work closely with the police and other law enforcement agencies to stop the activity of those involved. But it is important that all solicitors' firms, no matter how small, are alert to this type of criminal activity—as it can damage credibility and can be difficult to rectify.
>
> We recommend that you regularly search for your own firm name on the Internet and report any concerns as soon as possible…

Fake Law Firm Websites:

The ABA Journal (5/6/11) reported that firms in Canada are experiencing copycat websites in which the scammers use photos from a firm's website along with most of the rest of the website to set up a website for a seemingly reputable law firm. One way the plagiarized website is used is to entice lawyers into believing that a counterfeit certified check that the fake firm has sent them for assistance with closing a real estate deal for a foreign client is valid. The deal, of course, falls through and the fake firm then requests a refund. If the lawyer pays the refund before realizing that the certified check is counterfeit, he has been scammed with no recourse.

If these scams are occurring in the United Kingdom and Canada, it is only a matter of time before we see it here in the United States – Caveat!

"You remember emails you sent that were not answered better than emails that you did not answer."

Nassim Nicholas Taleb in The Bed of Procrustes

Keeping Up With Fratzke v. Murphy: *Recent Court of Appeals Case Offers Opportunity for Avoiding Malpractice When Plaintiff Lawyer Fails to Seasonably Answer Interrogatories Requesting Specification of Damages*

- ***The Malpractice Risk:***

Our Summer 2003 newsletter includes the article "Another One Bites The Dust! *Civil Rule 8.01 Takes Out Plaintiffs (And Their Counsel)"* by Ruth H. Baxter. The article begins with this description of the malpractice issue:

> You only have to pick up a copy of *Kentucky Trial Court Review* to read of another plaintiff's counsel ignoring the Supreme Court decision of *Fratzke vs. Murphy* (Ky., 12 S.W.3d 269 (2000)) by failing to supplement the client's answers to interrogatories to state the exact amount of damages, type of damages or both. The result is case dismissal during trial or on appeal. In five reported civil trials this year from a dismissal last January during plaintiff's opening remarks in a Rowan County suit involving motor vehicle injuries to the most recent dismissal following the parties' opening statements in a personal injury lawsuit in McCracken County, trial courts granted defense motions to dismiss plaintiff's claims for failure to answer or supplement CR 8.01(2) interrogatories. Not only is the attorney left explaining to clients why they will never see their day in court, the attorney is now exposed to a significant malpractice claim for failing to follow a well-established rule of civil procedure.

- ***Engle v. Baptist Healthcare System* (336 S.W.3d 116 (Ky. App. 2011)):**

In this case the Kentucky Court of Appeals appears to have interpreted *Fratzke* in a way that offers plaintiff lawyers relief for failing to amend damages interrogatories seasonably as required by CR 8.01(2), and exposes defense lawyers to claims when they rely on the absence of plaintiff's compliance rather than getting witnesses to dispute damages. The following extract from *Engle* addresses the *Fratzke* issue:

> Engle's complaint … requested an unspecified amount of punitive damages. … one of Baptist's interrogatories asked Engle to categorize and specify the amount of his damages. In his answer to Baptist's interrogatory, Engle made no reference to punitive damages.
>
> The trial in this matter concluded on October 9, 2009. After the close of evidence at trial, but before the matter was submitted to the jury, Engle moved to supplement his answers to Baptist's interrogatories because he wished to specify a sum of punitive damages for the jury to consider. Baptist objected, contending that Kentucky Rule(s) of Civil Procedure (CR) 8.01(2) precluded Engle from supplementing his interrogatories at that time. In support, Baptist cited *Fratzke v. Murphy*, … which "recognized that a trial court can authorize answers or supplemental answers to interrogatories for good cause, as late as during the trial itself. **4** Baptist urged that Engle's motion was untimely because both sides had already finished presenting their cases. Nevertheless, the trial court granted Engle's motion to supplement his answers to Baptist's interrogatories, and the question of punitive damages was submitted to the jury.
>
> In its cross-appeal, Baptist repeats its argument that Engle's motion was improper solely because it occurred after both sides had presented their respective cases. Baptist urges that, should we remand this matter, Engle should be precluded from seeking punitive damages upon retrial.
>
> However, Baptist presents no authority supporting that a motion to supplement answers to interrogatories is improper within the meaning of *Fratzke* if it is made after the close of evidence but prior to submitting a matter to the jury. Moreover, *Fratzke* merely holds that a motion to supplement answers to interrogatories may be granted as late as during trial. We have determined that a new trial is warranted in this matter, the new trial in this matter has yet to occur, and Baptist presents no authority that would prohibit Engle from moving to supplement his answers during the course of retrial. Therefore, we find no error in the trial court's decision to grant Engle leave to amend his answers to Baptist's interrogatories.

4 In *Tennill v. Talai*, 277 S.W.3d 248, 251 (Ky. 2009), the Supreme Court of Kentucky interpreted *Fratzke* in this manner.

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"Prod ye the donkey's rump ye are sure of a kick."

Patience Worth

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The Court of Appeals may have confused its interpretation of *Fratzke* by noting at the end of the decision that there will be a retrial and there was no authority before it that would prohibit Engle from amending interrogatories at the retrial. The following language from *Fratzke* may avoid this confusion:

> We note that nothing in the rules precludes a trial court from entertaining a motion to supplement answers to interrogatories after trial has commenced. However, Fratzke never made such a motion. Nor is there anything in the record to indicate that she in any way brought her supplemental answers to the attention of the trial court. Therefore, we hold that Fratzke's attempt to supplement her answers to interrogatories to include amounts claimed for unliquidated damages, which was made on the last day of trial and without leave of court, was ineffective.

- ***Managing the Risk:***

The Baxter article recommends these risk management procedures for *Fratzke* issues:

- Docket a personal injury case using either a computer system or a reliable manual system, just as in any other file in the office. The client should be contacted at a minimum at thirty-day intervals to obtain updated information about treatment, medical bills and lost wages. By keeping the file current, the client's claim can be reevaluated periodically and the insurance company or defense counsel updated on recent developments.

- The response to CR 8.01(2) interrogatories should be immediate. The client must sign the answers to comply with the civil rules. Failing to answer the interrogatories or stating "unknown" or "to later be determined" only leaves a potential *Fratzke* hole to be exploited later. Pay careful attention to the listing of the type of damages claimed, even if defense counsel's interrogatories are vague or fail to ask about a type of damage that you seek at trial. Failure to state in answers to interrogatories the intention to seek damages for future suffering, for example, can preclude recovery on that damage at trial.

- When a motion to set the case for trial is filed triggering the trial judge's scheduling order, an immediate review of the client's file is necessary to advise the court of the status of the case. During this review ascertain compliance with CR 8.01(2). Answers to interrogatories should be amended as necessary to provide an updated itemization of damages and a current amount of each of those damage claims. Plaintiff's counsel should consider that defense counsel in the opening statement could attempt to show the jury that the plaintiff's answers to interrogatories on damages establish that the claimant is money hungry, greedy or exploiting the minimal injuries sustained. Beware of this risk and state the list of damages accurately and fairly in light of the evidence.

- The trial brief submitted to the court should outline the factual basis for each damage claim as well as supporting legal authority for the plaintiff's entitlement to each stated claim. Reference the plaintiff's most recently updated answers to interrogatories to show awareness of the *Fratzke* rule.

- Docket the plaintiff's case not less than thirty days prior to the scheduled trial date for one last review of the answers to interrogatories. The courts require that answers to interrogatories be updated seasonably. The Supreme Court has explained that updating answers during the pendency of a trial is not seasonable. Counsel should anticipate the closer an update is to trial the more likely a finding that it is not seasonable.

Managing the Risk

"The man is most original who can adapt from the greatest number of resources."

Thomas Carlyle

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Client Screening – Can you Spot an Unworthy Client?

Many of the largest malpractice losses result from representing a dishonest client. At the 2010 Aon Law Firm Symposium program "Recurring Risks Posed by Dishonest or Unworthy Clients" panelists identified seven factors to consider in determining whether a client is worthy of your services.

1. Is the client a public or private company? Unworthy clients are typically not public companies.
2. Is the client's business financial services or a related industry dealing with other people's money?
3. Has the business experienced phenomenally aggressive recent growth that could be the result of cutting corners?
4. Is the client unusually secretive and does the client refuse to provide requested information purportedly to protect their competitive position?
5. Does the business have a dominating CEO who runs the business with an iron hand?
6. Does the business employ a bullying style when dealing with outside professionals?
7. Is a foreign business client unusually secretive?

If you decide that a client is unworthy, risk manage the situation by withdrawing immediately.

Source: Conference Report: Aon Law Firm Symposium, ABA/BNA Lawyers' Manual On Professional Conduct, Current Reports, Vol. 26, No. 22, p.657 (10/27/10).