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THE RISK MANAGER

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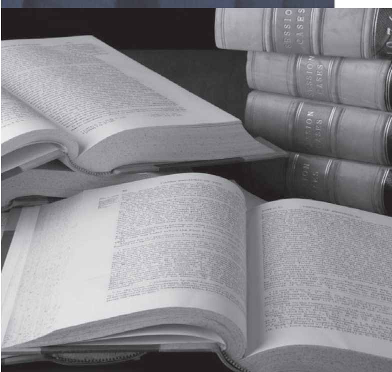

Latest News From the Malpractice Front

The 9th Annual Legal Malpractice & Risk Management Conference held in Chicago in March focused primarily on the impact of the economic downturn on malpractice claims and risk management. What follows is a report on some of the major issues covered in panel presentations.

Since 1987 22

"There are few sorrows, however poignant, in which a good income is of no avail."

Logan Pearsall Smith

The Insurance Marketplace: *What lawyer liability insurers are seeing as a result of the bad economy.*

- The market for lawyer liability insurance is being roiled by:
  - Large law firm closures.
  - Unprecedented layoffs.
  - Massive lawyer lateral movement.
  - Increased firm mergers, acquisitions, and dissolutions.
- The result is fewer lawyers to insure, fewer risks to cover, fewer premium dollars available for risk transfer, and some desperate insurance companies doing cash flow underwriting (much like a Ponzi scheme).
- The current fierce competition in the lawyers liability market has led to a "soft market" with lowball premium quotes that in turn cause other insurers to reduce their quotes. It was observed that this situation could go on longer, but is not actuarially sustainable and will end badly for many insurers as it always does. One panelist described this recurring destructive cycle as a form of insanity: Doing the same thing over and over, expecting a different outcome.
- Currently, large firms are anticipating an increase in both the number of claims and their severity – but this is not happening yet. Small firms are experiencing an increase in smaller less severe claims – often in real estate and bankruptcy matters.
- Insurers are anticipating an increase in coverage controversies concerning:
  - Lawyer and law firm mobility and change.
  - Gaps in coverage for those moving on – tail policies are expensive.
  - Prior acts coverage for lateral hires.
  - Failure to report malpractice incidents and claims.
  - Reservation of rights by insurers, claim denials by insurers, and insurer declaratory judgment actions.
- The panelists advised lawyers in the audience that constantly changing insurers creates the risk of a gap in coverage with the potential result that both the former and current insurer may deny coverage. The best practice is to build a relationship with an insurer. Continuity in coverage with a single insurer builds up a "bank" of premium dollars with the insurer that creates good will and should insulate a firm from a large premium increase when the insurance market hardens, as it must.

Law Firm Breakups: *Risk management considerations in restructuring and winding-up law firms.*

- ***Firms are now more at risk for employment claims:*** Panelists stressed that law firms as employers now face the same risk of an employee claim as any other business. These suits are brought by:

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- Partners claiming that they are employees and not owners.
- Employed lawyers.
- Non-professional employees of the firm.

- ***Eight primary types of employment claims were identified:***
  - Breach of contract
  - Discrimination
  - Retaliation
  - Failure to accommodate
  - Harassment
  - State law breach of fiduciary duty
  - Other tort claims
  - Statutory claims – there are over 20 significant federal and state laws applicable to the employment relationship

- ***When is a partner an employee with standing to claim?*** Whether a partner is an owner or employee is the critical question in an employment claim by a lawyer that had a title of partner. See *Clackmas Gastroenterology v. Wells,* 538 U.S. 440 (2003), for guidance on answering this question. The panelists recommended a conservative approach by "Presuming coverage under the civil rights acts and afford all partners with the same policy and administrative protections that would be afforded employees – in other words – treat it as a risk management issue."

- ***Managing a reduction-in-force (RIF):*** Firms should prepare a RIF or winding up plan when restructuring or dissolving. Panelists recommended that RIF plans cover:
  - The underlying business reasons for the RIF.
  - The criteria used to determine how the selection process is made.
  - The procedures used in administering the RIF plan.
  - The separation benefits that will be provided to affected employees.
  - Identification of decision-makers.
  - Recall opportunities, if any.

It was pointed out that RIF plans often go wrong when:

- RIF documentation is created in response to a lawsuit.
- The employer is unable to identify who actually made the decision with regard to laid off employees.
- Different members of management offer different reasons for selection.
- There is a lack of consistency in the process and procedures.

- ***Be especially careful when terminating employees over the age of 40:*** It was strongly recommended that an impact assessment be made for employees over 40 under consideration for termination with special attention to the Age Discrimination Employment Act as amended by the Older Worker Benefit Protection Act.

- ***Distinguish between at will employees who can be terminated for any reason and those with contractual rights:*** Some firms have employment contracts with law firm administrators and some levels of partner or shareholder. These can be in the form of written agreements or written firm policies covering specific classes of persons working in the firm. The panelists recommend that no RIF or restructuring decisions be made before reviewing individual employment contracts and firm employee policies and procedures.

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2010 ANNUAL POLICYHOLDERS' MEETING

The Annual Policyholders' Meeting of Lawyers Mutual Insurance Company of Kentucky is scheduled for 8:00 a.m. EDT, Wednesday, June 16, 2010 in the Jessamine-Franklin Room, Hyatt Regency Hotel, 401 West High Street, Lexington, Kentucky. Included in the items of business are the election of a class of the Board of Directors and a report on company operations. Proxy materials will be mailed to policyholders prior to the meeting. We urge all policyholders to return their proxies and to attend the meeting.

"Civility costs nothing and buys everything."
Lady Mary Wortley Montague

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The Trojan Horse Lateral Hire: *Potential problems with lateral hires and the due diligence risk management required.*

- The severe economic downturn in the legal profession has led to massive lay offs and lawyers leaving distressed firms resulting in a glut of lawyers looking for new positions. When these lawyers are laterally hired, the gaining firm risks conflict of interest issues and claims for a lateral hire's prior malpractice. At the conference Anthony Davis, a well-known risk management consultant, identified the direct risks of a lateral hire as:
  - The lateral hire is accused of breach of fiduciary duties by the former firm and the gaining firm is accused of aiding and abetting the lateral hire (suits often concern clients leaving with the departing lawyer).
  - The lateral hire may claim money from the former or dissolved firm leading to a counterclaim against the gaining firm.
  - The gaining firm may be sued for wrongful interference in recruiting a lateral hire.
  - The gaining firm may be drawn into a malpractice claim against the lateral hire for work done at the former firm in which the former firm alleges the lateral hire committed some of the malpractice at the gaining firm.
- Davis also identified lateral hire indirect risks:
  - Problems with a former firm distract the lateral hire from work with the gaining firm.
  - Lateral hires under pressure from the gaining firm to produce results as claimed in the interview process leads to cutting corners increasing the risk of malpractice.
- What follows is a gloss of Davis' risk management recommendations to a gaining firm given at the March conference and at a prior risk management program: *
  - Before hiring screen candidates thoroughly by checking for:
    - Legal qualifications by getting authority to obtain information from law schools and bar admission and disciplinary authorities – trust, but verify.
    - Ethics complaints and malpractice claims – inquire about potential claims.
    - Financial status and credit record.
    - Membership in organizations such as officer, director, or other interests in business; and fiduciary services such as trustee, conservator, administrator, or executor.
    - Powers of attorney held involving financial matters.
  - As a practical matter consider these questions before making a hiring decision:
    - Will this lawyer stay with us or jump to another firm at the first opportunity?
    - Why will this lawyer succeed and be satisfied here if one or the other was not the case in the former firm?
    - Is the investment the firm will make in hiring this lawyer cost effective recognizing that often both the firm and the lawyer are too optimistic about the synergistic results the move will bring?

Note: Lawyers Mutual recommends that you also consider: If a malpractice claim is filed against the lateral hire for something done at a previous firm, will your malpractice carrier be obligated to defend it and will that claim require you to pay your deductible?

  - After hiring:
    - Perform a lawyer review of every file brought by a lateral hire. (One panelist suggested that the gaining firm get client consent in writing before accepting a client's file brought by a lateral hire.)
    - Determine if the lateral hire has client funds and, if so, have them immediately deposited in the firm's client trust account.
    - Inventory client property for which the lateral hire is responsible.

* This list is derived in part from the following materials used in the ABA 26th National Conference on Professional Responsibility program *On The Road Again:* "Insurance Issues Related To Lateral Hire Musical Chairs," by Professor Susan S. Fortney, and the Alexander & Alexander article "Evaluating and Managing the Risks of Mergers, Acquisitions and Lateral Hires" edited by Mr. Davis

- Davis concluded his remarks by observing that ideally a lateral hire's employment contract will cover capital contribution, income, and client files.

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Suing Clients for Fees: *Does the current bad economy warrant a quicker decision to sue for uncollected fees?*

- Standard risk management thinking is that suing a client for fees is an invitation for a malpractice counterclaim and should be avoided. Many firms have a policy of never suing a client for a fee while others do so only with great reluctance. The panelists discussed this policy in light of the tremendous pressure firms are currently under to stay solvent and meet payroll. The upshot of the contrasting opinions expressed is that there are cases when the risks, costs, and strain of suing a client for fees is warranted; i.e., never say never.
- The panelists discussed fee arbitration as an alternative to suing for fees. The pros of arbitration were identified as:
  - Avoiding a jury where lawyers do not fare well.
  - Avoiding bad publicity.
  - Should be less costly and more efficient.
- The cons discussed were:
  - Very unlikely to get a dispositive motion approved by an arbitrator; i.e., the equivalent of a summary judgment.
  - On the contrary, arbitration can be very expensive.
  - Often no appeal in an arbitration procedure.

Note: Kentucky SCR 3.810, Legal Fee Arbitration, provides Kentucky lawyers with a procedure for arbitrating fee disputes.

- The panelists offered this risk management advice on fee collection:
  - Avoid the problem by getting an adequate retainer that must be replenished periodically. One size does not fit all.
  - The billing lawyer should have no control over the decision to sue for fees.

Note: Lawyers Mutual advises extreme caution in suing a client for fees. One authority estimates that at least 20%, and perhaps as much as 30%, of all malpractice claims and counterclaims, are directly or indirectly attributable to disputes over legal fees and expenses. When considering whether to sue a client for fees, use the following checklist:

- *Was a good result obtained in the underlying case?*
- *Is the size of the fee sufficient to warrant the risk of a malpractice counterclaim?*
- *Has a disinterested lawyer of experience reviewed the file for malpractice?*
- *How reasonable were the fees?*
- *Will work on the matter as reflected on billing withstand cross-examination?*
  - *Does billing indicate over-practicing?*
    - *Too many meetings, telephone calls, and research hours.*
    - *Billing for several lawyers reviewing or preparing to discuss the file.*
    - *Over-qualified personnel for the work.*
  - *Are entries vague?*
    - *No names and no billing rates for the work done.*
    - *Itemized bills use generic terms such as "phone call" or "meeting" with no substantive information.*
  - *Subject to being misconstrued?*
    - *Billing for "soft costs" (copying, fax) and general overhead (heat, air conditioning).*
    - *All telephone calls take .3 hours; all dollar amounts are nice round numbers or end in five.*
- *How much non-billable time will be spent defending any malpractice counterclaim?*
- *Will any judgment obtained be collectible?*
- *Will you recover more than you spend?*

Note: Kentucky guidance on billing for soft costs is contained in KBA Ethics Opinion E-303 (1985) citing Kentucky Bar Association v. Graves 556 S.W.2d 890 (Ky. 1977).

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"Never attribute to malice that which is adequately explained by stupidity."
Hanlon's Razor by Arthur Bloch

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Lawyer Scams: *In hard economic times lawyers are showing an alarming tendency to be caught in check cashing scams.*

- Panelists discussed fraudulent schemes that trick lawyers into depositing a counterfeit certified or cashier's check in a client trust account, and after deducting a large 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.

- The panelists pointed out a serious misunderstanding by many lawyers on what it means when a bank makes funds available in an account as follows:
  - Some lawyers are skeptical and will not order the 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. The bank may very well confirm that the lawyer can draw on the funds from the cashier's check, and agree to send the wire. This does not mean, however, that the funds from the cashier's check are irrevocably credited to the lawyer's 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 cashier's check is ultimately dishonored by the issuing bank. The funds from the cashier's check are not irrevocably credited until there is "final settlement," and this can take a week or more.

Note: We have covered scams in our Winter and Fall 2009 newsletters available on Lawyers Mutual's Website on the Risk Management page (lmick.com). Although there can be some variation in the scammer's approach, as reported in our newsletters, the following is a typical approach:

- *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.*

The problems for a lawyer caught up in a scam like this once the counterfeit certified check is discovered are obvious and enormous. They include being implicated in a fraud and potentially found responsible for restoring the transferred funds since the likelihood of recovering them is nil.

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 clears and regardless of its apparent validity or that the bank shows the funds available. This means after the funds are irrevocably credited to an account by "final settlement" that can take a week or more. 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 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 conversational overachiever is someone whose grasp exceeds his reach. This is possible but not attractive."

Fran Lebowitz

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Temporary Changes to FDIC Insurance Coverage for IOLTA Accounts

The FDIC on its Website "Your Insured Deposits – FDIC's Guide to Deposit Insurance Coverage" (*last viewed on 3/24/2010*) provides this guidance on insurance limits for IOLTA bank accounts:

> **Temporary Changes to FDIC Deposit Insurance Coverage**
>
> The standard insurance amount of $250,000 per depositor is in effect through December 31, 2013. On January 1, 2014, the standard insurance amount will return to $100,000 per depositor for all account categories except IRAs and other certain retirement accounts, which will remain at $250,000 per depositor.
>
> The FDIC's temporary Transaction Account Guarantee Program provides depositors with unlimited coverage for noninterest-bearing transaction accounts at participating FDIC-insured institutions. Noninterest-bearing checking accounts include Demand Deposit Accounts (DDAs) and any transaction account that has unlimited withdrawals and that cannot earn interest. Also included are low-interest NOW accounts (NOW accounts that cannot earn more than 0.5% interest) and IOLTA accounts. This unlimited insurance coverage is temporary and will remain in effect through June 30, 2010.

Periodically check "Your Insured Deposits" on the FDIC Website to remain current on IOLTA insurance coverage at fdic.gov/deposit/deposits/insured/.