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THE RISK MANAGER

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AVOIDING PROSPECTIVE CLIENT CONFLICTS OF INTEREST AND MALPRACTICE CLAIMS

Prospective client conflicts of interest:

The most sensitive time in client intake procedures is when a lawyer first consults with a prospective client to determine the nature of the requested representation. In addition to gaining enough information to evaluate whether the matter warrants taking, the lawyer must also obtain enough information to do a conflict of interest check. If the prospective client is declined, getting too much information exposes the lawyer to a disqualification motion if the lawyer later represents a party adverse to the former prospective client in the same or substantially related matter.

Fortunately for Kentucky lawyers the 2009 revision of the Kentucky Rules of Professional Conduct included new rule SCR 3.130 (1.18), Duties to Prospective Client. Rule 1.18 is one of those rules that in addition to establishing ethics standards also provides useful practical guidance. It is a must read for all lawyers, especially those who are new to the profession. Key provisions of the Rule include:

- Providing guidance on who is and is not a prospective client.
- Establishing that the fiduciary duties of confidentiality and avoidance of conflicts of interest apply to prospective clients.
- No matter how brief the consultation, any information learned by a lawyer can only be used or revealed as Rule 1.9, Duties to Former Client, allows.
- A conflict of interest is created when the lawyer receives information that could be "significantly harmful" to the former prospective client.
- Comment 5 to the Rule permits, with the prospective client's informed consent, conditioning consultation with the understanding that information revealed to the lawyer will not preclude the lawyer from representing a different client in the matter.
- Waiver of a conflict of interest is permissible with the written informed consent of the affected client and the former prospective client.
- Prospective client conflicts of interest are imputed to other members of a firm, but screening is permissible to overcome the disqualification.

When is information "significantly harmful?"

Rule 1.18 lacks a definition for the "significantly harmful" standard for determining when information learned from a declined prospective client creates a conflict of interest. We know of no Kentucky authority on this issue, but a recent Wisconsin ethics opinion offers this helpful analysis:

- *Wisconsin Formal Ethics Opinion EF-10-03: Conflicts arising from consultations with prospective clients; significantly harmful information (12/17/ 2010).*

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"Competitiveness is a personality thing and competitive people don't become pushovers the day they turn fifty."

Hale Erwin, Senior Professional Golfer

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Information may be "significantly harmful" if it is sensitive or privileged information that the lawyer would not have received in the ordinary course of due diligence; or if it is information that has long-term significance or continuing relevance to the matter, such as motives, litigation strategies, or potential weaknesses. "Significantly harmful" may also be the premature possession of information that could have a substantial impact on settlement proposals and trial strategy; the personal thoughts and impressions about the facts of the case; or information that is extensive, critical, or of significant use.

The opinion includes these instructive examples of significantly harmful:

- **Sensitive personal information:** A court disqualified a law firm from representing the wife in a child custody proceeding because the father had previously consulted with, but chose not to retain, a lawyer in the firm…. During the father's consultation with the lawyer, the father gave the lawyer a copy of his journal, told the lawyer facts that were not in the journal, and disclosed his concerns about the children and his former wife. He even acted on advice he received from the lawyer during the conference. The Arkansas Supreme Court concluded that a prospective client would not know whether the information disclosed during the consultation "could be significantly harmful," and further concluded that disqualification was warranted based on finding that the information was "significantly harmful." *Sturdivant v. Sturdivant*, 367 Ark. 514, 241 S.W.3rd 740 (2006).

- **Premature possession of the prospective client's financial information:** Such information could have a substantial impact on settlement proposals and trial strategy and therefore be significantly harmful. *Artificial Nail Technologies, Inc. v. Flowering Scents, LLC*, 2006 WL 2252237(D., Utah) (unpublished opinion).

- **Settlement position:** Likewise, the percentage of settlement that the prospective client is willing to accept and the concessions that the prospective client is willing to make could be significantly harmful. *ADP, Inc. v. PMJ Enterprises, LLC.*, 2007 WL 836658 (D.N.J.) (unpublished opinion).

- **Litigation strategies:** Furthermore, a prospective client's personal thoughts and impressions regarding the facts of the case and possible litigation strategies are significantly harmful, even though the lawyer claims that when he read and responded to the e-mail, he was not aware of and did not open the e-mail attachments that contained the information. *Chemcraft Holdings Corp. v. Shayban*, 2006 WL 2839255 (N.C. Super) (unpublished opinion).

- **Information that could be used to the detriment of the prospective client:** Any information that could be reasonably used to the detriment of the prospective client, such as information that would be useful in impeaching the testimony of the prospective client, is by definition, information that could be significantly harmful.

Avoiding former prospective client malpractice claims:

As we have previously advised in this newsletter:

> A lawyer's worst nightmare is to discover that a prospective client the lawyer orally declined did not understand this and believed that he was a client of the lawyer – sometimes reasonably so. Typically, after the statute of limitations has run, the prospective client will inquire about the status of his case. Upon learning that the lawyer has done nothing on it, a malpractice claim soon follows. To avoid this risk always use letters of nonengagement for declined representations that are best sent by certified mail, return receipt requested. Former prospective clients with a complaint or claim *never* receive nonengagement letters sent by regular mail. A typical letter:
>
> - Thanks the prospective client for making the personal contact, calling, or coming into the office.
> - Includes the date and subject matter of the consultation.
> - Provides clearly that representation will not be undertaken.
> - Repeats any legal advice or information given -- making sure that it complies with the applicable standard of care.
> - Advises that other legal advice be sought.

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"The young man knows the rules, but the old man knows the exceptions."

Oliver Wendell Holmes, Sr.

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- Advises that there is always a potential for a statute of limitations or notice requirement problem if the matter is not promptly pursued elsewhere. *(Providing specific statute of limitations times should be avoided because of the limited information typically received in a preliminary consultation. If, however, it appears that a limitations period will expire in a short period of time, the declined prospective client should be informed of this concern and urged to seek another lawyer immediately.)*

- Avoids giving an exact reason for the declination, why the claim lacks merit, or why other parties are not liable.

- Returns any original documents or property the prospective client may have provided during the interview.

- Encourages the person to call again.

We have also cautioned about the malpractice risk of negligent referral of prospective clients as follows:

> Many lawyers do not appreciate that declining a matter and referring a prospective client to another lawyer may result in malpractice liability. This is true even though the referring lawyer receives no fee and has no further participation in the representation. A preliminary consultation with a prospective client is sufficient to create a duty to exercise ordinary care and skill when referring that person to another lawyer. The applicable standard of care is based on the nature of the declined representation.
>
> Often it will be enough to confirm that the recommended lawyer is licensed to practice law in Kentucky. Licensure gives rise to a presumption that the lawyer is competent and possesses the requisite character and fitness. If the declination is because the matter requires special skill or knowledge, the referring lawyer must be careful to ascertain that the suggested lawyer has the necessary competence. If the matter requires immediate action, the referring lawyer should advise that the new lawyer be consulted expeditiously. Recommending the right lawyer without cautioning that prompt action is necessary can also be a negligent referral.

Are YOU Competent in Computer-Assisted Legal Research -- CALR?

In the article "10 Ways to Commit Malpractice With Your Computer," # 4 is: Not using computer-assisted legal research. Competence is the first rule in the Kentucky Rules of Professional Conduct and competence is the best risk management for avoiding malpractice claims. As the Internet has blossomed as a tool for research and conducting investigations, a lawyer not competent at CALR is increasingly at risk for being found negligent when failing to find relevant authority and information on the Internet. Examples are:

- In *Norgaard v. DePuy Orthopaedics, Inc.*, 121 F.3d 1075 (7th Cir. 1997) a lawyer missed a US Supreme Court decision available on the Internet essential to his appeal. The Court ruled "Ignorance of the Supreme Court's docket, although 'neglect,' is not 'excusable' – it is nothing but negligence, which does not justify untimely action."

- Another lawyer reported to the judge that he could not locate his client. The judge did an Internet search for the missing client and located him in about 10 minutes – certainly one of life's embarrassing moments for that lawyer.

In an effort to help the cause we offer the following information on these two Internet Websites that are important to lawyers:

- ***PubMed:*** This website is a free gateway to the National Library of Medicine. It offers more than 21 million citations for biomedical literature from MEDLINE, life science journals, and online books. Citations often include links to full-text content from PubMed Central and publisher websites. This is an outstanding resource for researching medical issues.

- ***FDsys:*** The Federal Digit System Website replaced the GPO Access Website last December. FDsys provides free online access to official Federal Government publications for all three branches of the Federal government. It is an easier and much improved research tool for researching Federal publications.

The quickest way to these Websites is to Google PubMed or FDsys. (*Last viewed 9/6/2011.*)

"The only way not to think about money is to have a great deal of it."

Edith Wharton

Lawyers Mutual understands your business. Other companies just want your business.

In-house counsel from left to right: Pete Gullett, Jane Broadwater Long, Del O'Roark, Bob Breetz

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Approved by: Kentucky Bar Association, Kentucky Justice Association, Louisville Bar Association, Northern Kentucky Bar Association, The Young Lawyers Section of the KBA

The Top Five Ethical Violations Found in Malpractice Claims

The ABA's 2011 Spring National Legal Malpractice Conference included the program "Top Five Ethics Violations and Resulting Claims for Legal Malpractice." What follows is a synopsis of the program plus some risk management thoughts of our own.

1. Client Identity

The panelists pointed out these situations when problems over who is a client often arise:

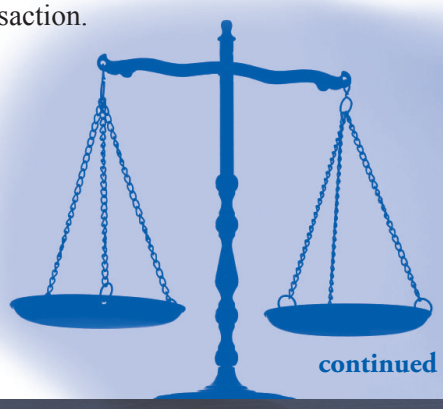
- Prospective clients
- Joint representations
- Corporate affiliates
- Unincorporated entities: LLCs, partnerships, associations, consortium, pre-incorporation
- Controlling shareholders
- Individuals v. entities: board members, officers, employees, constituents
- Third party payors
- Other third parties: beneficiaries, lenders, investors, joint venturers, opposing parties

Risk management procedures recommended by the panel include:

- Use file-opening procedures that clearly identify the client.
- Always use letters of engagement to document who the client is.
- Have as firm policy that joint representations are discouraged.
- Have as firm policy that representing individuals within client entities is discouraged.
- Always use letters of nonengagement when a prospective client does not become a client.
- Be thoroughly familiar with the professional responsibility rule on Organization as Client. (*Note: In Kentucky SCR 3.130, Rule 1.13*)

We add to the panel's thoughts these risk management considerations in client identification from our newsletter and *Bench & Bar* articles:

- When you represent a business entity client there is always the risk of giving nonclient officers and employees the erroneous impression that you are their lawyer and acting in their interest. Make sure everyone (including you) knows whom your client is. In any ambiguous situation clarify your role early. If necessary to make your position perfectly clear, advise nonclients to get counsel. Make sure that officers and employees of business entity clients no matter how high ranking understand you represent the business -- not them.
- When you provide information verbally or in writing directly to a nonclient in a business transaction there is always the risk that your role will be misunderstood and the nonclient will later claim reliance on your "advice."
- When you do a legal service favor for a nonclient "just" to facilitate your client's business there is a risk that this favor will justify the nonclient's reliance on you as if they were also a client. Avoid tempting reliance on you by nonclients through your affirmative conduct (accommodative minor legal service to get the deal done) and passive conduct (allowing impressions to stand that you are acting in the nonclient's interest as well as your client's).
- When you provide information and opinion letters to clients that you know will be passed on to nonclients it is reasonable to expect the nonclient to rely on that information. This usually exposes you to liability for erroneous or misleading representations. In appropriate circumstances caution your client that your advice is offered in the client's best interest and should not be passed on as "good advice" to nonclients involved in the same business transaction.



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2. Scope of Representation

The panelists discussed the scope problems created by a mushrooming scope, unbundling of services, client budget restrictions on scope, and partnering with other lawyers. The panel recommended:

- Use a letter of engagement to carefully document the scope of representation and any limitations on scope.
- Document communications with the client about case status.
- Document cost-benefit discussions and client imposed limitations on research and number of lawyers working on the matter.

Lawyers Mutual recommends that a limited scope representation letter of engagement include the following:

- The client's situation and goals.
- The tasks the lawyer will accomplish.
- The available options and opportunities.
- The anticipated costs of various tasks necessary to achieve the client's goals.
- Tasks not assigned the lawyer.
- The benefits and risks of the tasks that the lawyer will undertake.
- Tasks the client has agreed to perform. (*From "Avoiding Malpractice In Unbundled Services," Katja Kunzke, Wisconsin Lawyers Mutual Ins. Co.*)

3. Conflicts

The panelists discussed conflict issues that involved erroneous client identification as the root problem. Also covered were conflicts involving joint representations, hot potato clients, and those arising during a representation. It was suggested that lawyers:

- Avoid any appearance of a conflict.
- Notify clients of a possibility of or potential conflict that may become adverse.
- Avoid, or discuss with clients, representing competitors.
- Advance no legal position adverse to the interest of a client.
- Do not engage in representation of a new client involving differing interests with a current client whether conflicting, inconsistent, diverse, or discordant.
- Do not engage in positional or issues conflicts.

4. Doing Business with Client

The panelists discussed stock ownership and other investments in clients. Other business relationships covered were litigation financing, landlord-tenant, customer of client's business, and client requested referrals. The panel's recommendations were succinct:

- Don't do business with clients.
- If you must, then disclose and document. (*Note: See SCR 3.130, Rule 1.8 (a)*).
- Consider requiring independent counsel or paying for it.
- Get advance consents to foreseeable conflict issues.

Lawyers Mutual recommends that when doing business with a client include in the required documentation:

1. The nature of the transaction and each of its terms including all circumstances of the transaction known to the lawyer.
2. The nature and extent of the lawyer's interest in the transaction and any potential adverse effects the transaction could have on the client including the effect they could have on the lawyer's and client's relationship.
3. The ways in which the lawyer's participation in the transaction might affect the lawyer's exercise of professional judgment on concurrent legal work for the client, if any.
4. A clear statement of the risks and advantages to each of the parties to the transaction.
5. An agreement that if future circumstances affecting the lawyer's independent judgment occur, renewed disclosure and consent must precede continued representation.

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"Everything of importance has been said before by somebody who did not discover it."

Alfred North Whitehead

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6. The kind of advice the client would have received if the client had been a stranger.

7. Specific advice stressing the importance of seeking independent legal counsel to obtain a detailed explanation of all risks associated with the business transaction.

This list is a combination of disclosure recommendations in Wolfram, § 8.11.4, Modern Legal Ethics; and the ABA/BNA Lawyers' Manual on Professional Conduct, Business Transactions with Clients, 51:501 at 51:506.

5. Getting Paid and Getting Out

This topic concerned the classic situation when a lawyer is owed considerable unpaid fees and wants to be paid and to be shed of the deadbeat client. Dunning the deadbeat often results in a malpractice claim. The panelists recommended:

- Avoid the problem by getting an adequate retainer.
- Watch out for clients in bankruptcy.
- Get out; don't get in deeper.
- Don't sue clients for fees.

Lawyers Mutual's long-standing risk management advice on suing clients for fees is to use the following check list:

- 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?
    - o 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.
    - o 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.
    - o 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?

How Dumb Is This?

- ***Ohio lawyer dumps client files in dumpster:*** The lawyer in clearing files out of a storage area took some files with him, but placed some boxes of files in a dumpster and left approximately 20 other boxes by the dumpster. The boxes were discovered leading to television and newspaper coverage of the blunder. The lawyer received a public reprimand for this breach of his fiduciary duty of confidentiality. *Disciplinary Counsel v. Shaver*, 121 Ohio St.3d 393 (2008)

- ***Connecticut retired lawyer wanted to destroy client files without reviewing them:*** The Connecticut Committee on Professional Ethics ruled that a retired lawyer may not destroy client files before reviewing them for critical documents, even if the files have been inactive for over 10 years. A diligent effort must be made to return critical documents to clients. If unable to locate a client, the critical documents must be safeguarded as long as practicable. *(Opinion 2010-07, 9/15/2010)*

- ***Discarded laptop computer contained confidential information:*** The New York Times was given materials for a story from a laptop found in the garbage concerning legal defenses for a Goldman Sachs trader. Even after the laptop was found, e-mail concerning the defendant

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"You are you because your little dog knows you."

Gertrude Stein

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continued to be received on the laptop. It is not clear to whom the laptop belonged, but it is clear that throwing a laptop in the garbage is dumb.

Risk Management Tip: Laptops, Ipads, Smart Phones, and other communication devices look alike and can easily be confused with someone else's. This can be a real problem when going through airport security. For example, it is easy for lookalike laptops to be mixed up in the security process if several laptops are being scanned near each other. To avoid this risk, put a distinguishing sticker on each of your electronic devices for easy recognition just as many people do with their luggage when flying.

The Latest Scam of Special Interest to Lawyers

From the Florida Land Title Association:

One of our members reports having been hit with a new fraud of a type that could easily catch any of us. A couple left their closing with a check for their proceeds. A couple of hours later, they returned to the closing office with the check and asked for a wire transfer instead. The closer voided the check and processed the wire. Unfortunately, the couple had used their smart phone and deposited the check before returning to the [closing office]. Even normal "Positive Pay" protections would not have caught this as the original check had already been approved for payment.