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THE RISK MANAGER

A QUARTERLY NEWSLETTER BY LAWYERS MUTUAL INSURANCE COMPANY OF KENTUCKY

RISK MANAGING THE NEW KENTUCKY LAW ON POWERS OF ATTORNEY – KRS 457

KRS 457, Uniform Power of Attorney Act (2006), took effect July 14, 2018. It is an adaptation of the Uniform Power of Attorney Act approved by the Uniform Law Commission. It introduces comprehensive standards, procedures, and guidance on powers of attorney (POA) for lawyers, principals, agents, and third parties. To risk manage this new law, we recommend that all Kentucky lawyers study KRS 457 in its entirety. Follow that by reading Sara Johnston's excellent analysis of KRS 457 in her article in the July/August 2018 issue of the KBA B&B, *Kentucky Powers of Attorney: No Longer Powerless*. The purpose of the following analysis is to identify the risk management considerations that KRS. 457 presents.

Primary ethics rules to consider in mastering this new law are:

COMPETENCE

Kentucky Rule of Professional Conduct SCR 3.130 (1.1), Competence, provides:

> A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.
>
> Comment (5) to the Rule provides in part: Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners. It also includes adequate preparation.

In short, you have to know what you are doing. Incompetence is malpractice. To assure competence in advising on and preparing POAs, Kentucky lawyers must do the study and research recommended above as part of POA risk management.

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WHAT CONSTITUTES REASONABLE DILIGENCE IN ATTEMPTING TO LOCATE A MISSING CLIENT?

Missing clients are always a serious problem, but never more so than when moving to withdraw from representation of a missing client. *Caveman Foods, LLC v. Ann Payne's Caveman Foods, LLC** is an example of just how difficult withdrawing becomes when the moving party fails to exercise reasonable diligence in locating a missing client.

Baker, in a motion to withdraw from representing the defendant, lost the motion for the first time when the judge determined that he could not verify Baker's assertion that the defendant had in fact ceased operations and had terminated Baker. The motion was denied without prejudice. Over a year later Baker renewed the motion to withdraw. This time Baker asserted *inter alia* that the defendant is no longer an active company, has no office, telephone, email or forwarding contact information in the United States. Baker sent notice of the renewed motion to defendant's registered office in Pennsylvania and to the last known address of one of the defendant's former representatives.

Initially the Court dryly noted that a simple Internet search revealed that the defendant is, in fact, an active company in Toronto, Canada, operates an actively

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KRS 457

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COMMUNICATION

SCR 3.130 (1.4) (b), Communication, provides:

> (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

The comment to the rule gives this guidance:

> **Explaining Matters**
>
> (5) The client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued, to the extent the client is willing and able to do so.

KRS. 457 replaces prior POA vague guidance with detailed requirements. Lawyers must know who their client is when rendering POA legal advice. Is the client the principal, the agent, or a third party? Each requires explanation of the law in a different context.

Client is the Principal

In addition to discussing a principal's purpose for the POA, the following parts of the law are among those that should be explained:

- Definitions – KRS 457.020
- What "durable" means – KRS. 457.020 and KRS. 457.040
- How the POA is executed – KRS 457.050
- When the POA is effective KRS 457.090
- How a POA is terminated KRS. 457.100
- Agent's duties – KRS 457.140
- Reimbursement and compensation of the agent – KRS 457.120
- Agent's liability – KRS. 457.170
- Rules for the acceptance of and reliance on a POA – KRS 457.190

Client is the Agent

In addition to general information about the purpose and effect of a POA, agents should be counseled on:

- When the POA is effective – KRS 457.090
- How the agent accepts the POA appointment – KRS. 457.130

(1) A POWER OF ATTORNEY MUST BE SIGNED IN THE PRESENCE OF TWO (2) DISINTERESTED WITNESSES BY THE PRINCIPAL OR IN THE PRINCIPAL'S CONSCIOUS PRESENCE BY ANOTHER INDIVIDUAL DIRECTED BY THE PRINCIPAL TO SIGN THE PRINCIPAL'S NAME ON THE POWER OF ATTORNEY.

- Agent's duties with stress on the fiduciary duties of acting loyally for the principal's benefit and acting so as not to create a conflict of interest that impairs the agent's ability to act impartially in the principal's best interest – KRS 457.140
- Rules for the acceptance and reliance on a POA – KRS. 457.190
- Reimbursement and compensation of the agent – KRS 457.120
- Agent's liability – KRS 457.170
- When the agent's authority is terminated – KRS 457.100
- Coagents and successor agents – KRS 457.110
- Exoneration of the agent – KRS 457.150

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"IT IS GOOD TO RUB AND POLISH OUR BRAIN AGAINST THAT OF OTHERS." *Michel de Montaigne*

KRS 457

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Client is a Third Party

KRS 457 is designed to fix the problem of third parties refusing to accept valid POAs. Lawyers advising banks and other entities that are often presented POAs should explain the law on:

- Acceptance and reliance upon acknowledged POA – KRS 457.190
- Liability for refusal to accept an acknowledged POA – KRS 457.200
- Laws applicable to financial institutions and entities – KRS 457.220

INCAPACITATED PRINCIPAL AND SCR 3.130(1.14) CLIENT WITH DIMINISHED CAPACITY

KRS 457 deals with incapacitated principals in three places:

KRS. 457.020 Definitions for chapter.

As used in this chapter:

(5) "Incapacity" means inability of an individual to manage property or business affairs because the individual:

(a) Has an impairment in the ability to receive and evaluate information or make or communicate decisions even with the use of technological assistance; or

(b) Is:

1. Missing;
2. Detained, including incarcerated in a penal system; or
3. Outside the United States and unable to return.

KRS 457.050 Execution of power of attorney.

(1) A power of attorney must be signed in the presence of two (2) disinterested witnesses by the principal or in the principal's conscious presence by another individual directed by the principal to sign the principal's name on the power of attorney. If signed in the principal's conscious presence by another individual, the reason for this method of signing shall be stated in the power of attorney.

KRS 457.090 When power of attorney effective.

(3) If a power of attorney becomes effective upon the principal's incapacity and the principal has not authorized a person to determine whether the principal is incapacitated, or the person authorized is unable or unwilling to make the determination, the power of attorney becomes effective upon a determination in a writing or other record by:

(a) A physician, an advanced practice registered nurse, a psychologist licensed or certified under the provisions of KRS Chapter 319, or a person licensed or certified as a social worker or an employee of the Cabinet for Health and Family Services who meets the qualifications of KRS 335.080(1)(a), (b), and (c) or 335.090(1)(a), (b), and (c), that the principal is incapacitated within the meaning of KRS 457.020(5)(a); or

(b) An attorney-at-law or a judge that the principal is incapacitated within the meaning of KRS 457.020(5)(b).

In evaluating a client's suspected incapacity, consult SCR 3.130(1.14) Client with Diminished Capacity. The rule provides detailed guidance in making this determination.

SUMMING UP

KRS 457 includes many requirements and standards that pose malpractice risks. What follows are some of the key risk management considerations:

- The agent as fiduciary is a significant upgrading of the role of an agent in POAs. It exposes the agent to a greater degree of liability and their lawyers to malpractice claims if they fail to advise the agent accurately.
- Principals must understand that a POA is durable unless specifically declared otherwise in the POA. Document the file.
- The requirement for two disinterested witnesses to sign the POA must be carefully observed. Omitting it is another malpractice exposure for lawyers. Query: Who is a disinterested witness – someone from your office? We suggest you call the KBA Ethics Hotline for clarification.
- Carefully cover (and document) as appropriate for the client:
  - who must accept acknowledged POAs;
  - liability for improperly refusing a POA;
  - and agent liability.

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"IT IS A GOOD THING TO **TURN YOUR MIND UPSIDE DOWN** AND THEN, LIKE AN HOUR-GLASS, TO **LET THE PARTICLES RUN** THE **OTHER WAY.**" *Christopher Morley*

WHAT ARE A TRANSACTION LAWYER'S DUE DILIGENCE REQUIREMENTS WHEN A CLIENT'S MATTER RAISES A SUSPICION OF ILLEGALITY?

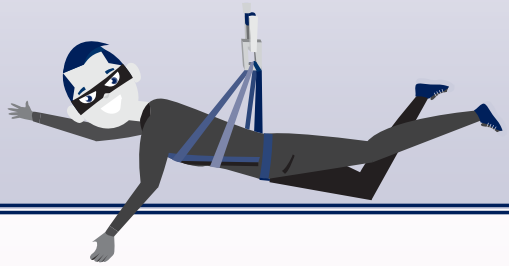
One of the many ways the Internet and social media have changed the practice of law is the increased risk of assisting a client's illegal act. Scams targeting lawyers include money laundering, real estate transactions, debt collections, business loans, and spousal support payments. The day is long past when a lawyer can turn a blind eye to red flags that alert the lawyer to suspected fraudulent conduct. Willful ignorance and conscious avoidance of disturbing facts are no longer a viable defense for a lawyer engaged in assisting a client with an illegal act.

The question then becomes what due diligence should a lawyer exercise to avoid an accusation of assisting in an illegal act. The New York City Bar Association Committee on Professional Ethics Opinion 2018-4, 7/18/18, offers a helpful analysis of this question. The New York Rules of Professional Conduct, like the Kentucky rules, are based on the ABA Model Rules. While there are minor differences between the two states' rules, the principles are the same. We think the opinion is valid secondary authority for Kentucky lawyers.

The New York rules, like the Kentucky rules, prohibit a lawyer from knowingly assisting a client in crime or fraud. They do not explicitly cover the duties of a lawyer who has doubts about the legality of a client's conduct; nor do they require a lawyer to investigate these doubts. The opinion, however, parlays several rules to reach the conclusion:

> When asked to represent a client in a transaction that a lawyer believes to be suspicious, the lawyer has an implicit duty under some circumstances to inquire into the client's conduct. If the lawyer believes that her client is entering into a transaction that is illegal or fraudulent, the lawyer ordinarily must attempt to inquire in order to provide competent representation to the client under Rule 1.1. Further, under Rule 1.2(d), which forbids knowingly assisting a client's illegal or fraudulent conduct, a lawyer has the requisite knowledge if the lawyer is aware of serious questions about the legality of the transaction and renders assistance without considering readily available facts that would have confirmed the wrongfulness of the transaction. Implicit in the rule, therefore, is the obligation to take reasonably available measures to ascertain whether the client's transaction is illegal or fraudulent. The lawyer's inquiry must be consistent with the confidentiality duty of Rule 1.6, which governs disclosures the lawyer may make to third parties during the inquiry, as well as with the duty to keep the client informed during the representation. If the lawyer concludes that the client's conduct is illegal or fraudulent, the lawyer must not further assist the wrongdoing and may undertake remedial measures to the extent permitted by the exceptions to the confidentiality rule.

THE NEW YORK RULES, LIKE THE KENTUCKY RULES, PROHIBIT A LAWYER FROM KNOWINGLY ASSISTING A CLIENT IN CRIME OR FRAUD.



What constitutes an adequate due diligence inquiry?

The opinion provides this guidance for making a reasonable inquiry into suspected crime or fraud:

> Ordinarily, a lawyer will begin an inquiry by seeking information from the client before turning to other sources. After concluding a reasonable inquiry, the lawyer may ordinarily credit the client when there are doubts. Whether a particular inquiry is adequate will vary with the circumstances.
>
> To the extent that the lawyer must seek information from others, the Rules may impose conditions or limits. In general, the duty under Rule 1.4 to keep the client reasonably informed will require the lawyer to explain why there are doubts about the legality of the transaction and what steps the lawyer proposes to take to allay or confirm suspicions. If suspicions are sufficiently serious

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"IF FACTS ARE THE SEEDS THAT LATER PRODUCE KNOWLEDGE AND WISDOM, THEN THE EMOTIONS ... ARE THE FERTILE SOIL IN WHICH THE SEEDS MUST GROW."

Rachel Carson

TRANSACTION LAWYER'S DUE DILIGENCE

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> to give rise to a duty of inquiry under Rule 1.2(d), then the lawyer would render further assistance at her peril. A lawyer's fear that a client may seek to cover up his actions does not eliminate the duty of communication. Rule 1.4(a)(5). If the lawyer does suspect a cover-up and cannot persuade the client to be forthcoming, she may choose to terminate the representation. Rule 1.16(c)(2). *(Kentucky Rule 1.16(b)(2)).*

Red Flags

The opinion makes it clear that a lawyer cannot ignore "red flags" and that willful ignorance cannot be used to avoid the duty of further inquiry if a lawyer suspects that the client's actions are illegal. The website https://www.practicepro.ca/practice-aids/fraud-prevention/ provides this comprehensive red flag list from its Fraud Fact Sheet Law Pro:

> These are the common red flags that can indicate that a matter is a fraud. While some of these things may occur on legitimate matters, you should proceed with extreme caution if many of them appear on any matter you are handling.
>
> - Initial contact email is generically addressed (e.g., "Dear attorney") and BCC'd to many people.
> - The name and/or email address in the FROM line is different from the name and/or email address of the person you are asked to reply to in the body of the email.
> - Client uses one or more email addresses from a free email service (e.g., Gmail, MSN, Yahoo!), even when the matter is on behalf of a business entity.
> - Client raises issues of conflicts or payment of a retainer.
> - Domain name used in email address or website was recently registered (check at WhoIs.net).
> - Email header indicates sender is not where he/she claims to be.
> - Client is new to your firm.
> - Client is in a distant jurisdiction.
> - Client shows up and wants the matter completed around banking holidays.
> - Client says he prefers email communication due to time zone differences.
> - Client is in a rush – and pressures you to "do the deal" quickly.
> - Client and others involved don't seem concerned if shortcuts are taken.
> - Client is willing to pay higher-than-usual fees on a contingent basis from (bogus) funds you are to receive.
> - Despite the client stating a lawyer is needed to help push for payment, the debtor pays without any hassle.
> - Cheque or bank draft arrives at your office in a plain envelope and/or without a covering letter.
> - Cheque is drawn from the account of an entity that appears to be unrelated (e.g., a spousal arrears payment from a business entity).
> - Payment amounts are different than expected or change without explanation.
> - Client instructs you to quickly wire the funds to an offshore bank account based on changed or urgent circumstances.
> - Some or all of the payment is going to third party who appears unrelated to the matters.

The opinion concludes with a review of remedial actions lawyers should consider upon discovering that illegal activity has occurred during the representation. If you are concerned that you may be assisting a client in illegal activity, we recommend you start your inquiry by reading Opinion 2018-4. Just Google the opinion title.

A Duty of Reasonable Inquiry Applies to Litigation Too

A recent New York case* considered sanctions in a litigation matter against a lawyer for failing to inquire whether his client's representation that digital photos offered in evidence were taken two days after the incident. When the defendants viewed the metadata for the pictures, they discovered that they were taken two years after the incident. The lawyer escaped discipline for failing to verify the client's representations based on the Court's lawyer friendly finding that:

> Finally, Leventhal explains that at the time he produced the photos he was unfamiliar with the process for checking a digital photograph's metadata, which entails right-clicking it and navigating to its properties. Based on these facts, Leventhal's production of the photos may have been careless, but was not objectively unreasonable. *(citations omitted).*

**Lawrence v. City of New York*, 2018 BL 267050, S.D. N. Y., No. 15cv8947, 7/27/18.

"NEVER BE AFRAID TO SIT AWHILE AND THINK." *Lorraine Hansberry*

MISSING CLIENT

CAREFULLY DOCUMENT YOUR EFFORTS TO COMMUNICATE WITH THE CLIENT AND GIVE STRONG CONSIDERATION TO WITHDRAWING FROM REPRESENTATION WHEN THE PROBLEM FIRST DEVELOPS.

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maintained website that displays products that correspond to those in the lawsuit, and includes numerous press releases by the defendant. Most significant of all, the website lists current mailing addresses, phone numbers, email addresses, and the names and contact information of its representatives. The Court, thus, concluded that Baker had not conducted the minimal inquiry required to verify whether its representations regarding defendant were accurate and once again denied the motion.

In reaching this ruling the Court cited these examples of reasonable diligence:

- The moving party "attempted to notify defendants at their home, office, and cellular phone numbers, sent them faxes and numerous emails, attempted to contact them through their website, and mailed then notice with delivery confirmation and UPS signature requests."
- The moving party "obtained a comprehensive report of the client's contact information, had called, emailed, and mailed the client notice with a return receipt requested, used an address obtained through Facebook, contacted the client's friends and acquaintances, and hired an investigator to locate the client and serve him with a motion to withdraw."

Risk manage the problem of missing clients by client intake procedures that obtain the following information

- Addresses.
- Telephone numbers.
- Names of people who will know where the client will be.
- Social security numbers.
- Drivers license numbers.
- Dates of birth.
- With impaired clients, get the names and numbers of professionals assisting the client with health problems, e.g., health care providers and government agencies working with the impaired client.

Cover in the letter of engagement:

- The client's continuing requirement to cooperate and communicate with the attorney and to always inform the lawyer of any change in address;
- The requirement that before any suit is filed the client must authorize it in writing;
- That the attorney may expend a reasonable amount of the client's trust account funds in an effort to locate the client should the client go missing;

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"ABOVE ALL, NEVER FORGET THE REAL SECRET OF MENTAL TOUGHNESS IS CONTINGENCY PLANNING." *Denis Waitley*

MISSING CLIENT

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- Designation by the client of another beneficiary in the event the client's whereabouts remain unknown after a diligent effort to locate the client; and
- That the lawyer has the right to withdraw from representation if the lawyer decides the case is without merit.

What constitutes a diligent effort in attempting to locate a missing client is fact specific. Some of the steps that can be taken are:

- Write and telephone the client at all known addresses and telephone numbers.
- Check readily available public information sources such as the telephone directory.
- Attempt to make contact on Google, social networking websites, and through newspaper notices.
- Call the client's employer.
- Visit last known addresses.
- Talk to family, friends, acquaintances, or neighbors either known to the lawyer or who may be discovered by the lawyer through the exercise of reasonable diligence.
- Review the file for leads from documents such as medical files or police reports.
- Contact the client's medical provider(s).

Consider this practical advice from Beverly Michaelis, Practice Management Advisor, Oregon State Bar Professional Liability Fund, included in her article *I Can't Find My Client!*

- Look for red flags. Clients who move frequently, change jobs often or have no friends or family in the community are likely to fall out of touch. Proceed with caution.
- Listen to your intuition. If your gut sends out a warning flare, turn the case down. Don't be swayed by pressure from a friend, the amount of fees involved, or the promise of a quick resolution. Such cases are rarely worth the trouble and often result in malpractice claims that could have been avoided.
- If a client becomes unresponsive or difficult to reach, the situation is not likely to improve. Carefully document your efforts to communicate with the client and give strong consideration to withdrawing from representation when the problem first develops.
- Recognize that certain practice areas such as criminal law involve clients who are more likely to move without notifying you.

Finally, if still in a quandary, call the KBA Ethics Hotline for guidance.

**2015 BL 364214, E.D. Cal., Civ. No. 2:12-1112 WBS DAD, 11/4/15*

KRS 457

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- Unlike prior law, KRS 457 is silent about whether an agent is automatically authorized to make gifts of real or personal property without express authority from the principal. Good risk management is for the principal to explicitly provide in the POA whether an agent is allowed to make gifts.
- All POA forms and boilerplate used in your practice must be reviewed and updated. It is doubtful that old forms will satisfy this new law. Using them after July 14, 2018 could be malpractice.
- POAs executed before July 18, 2018 remain valid. KRS 457.060(2) provides " A power of attorney executed in this state before July 14, 2018, is valid if its execution complied with the law of this state as it existed at the time of execution.

PILLOW TALK

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all one has to do is never identify or discuss clients when providing assistance. Carefully redact client information from any document given to a non-affiliated lawyer.

Disciplinary Counsel vs. Thomas Charles Holmes and Ashleigh Brie Kerr, Docket No. 2018-0818, Ohio Sup. Ct. 6/11/2018).

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DEL O'ROARK
Newsletter Editor

"I THINK WE ALL HAVE A NEED TO KNOW WHAT WE DO NOT NEED TO KNOW." *William Safire*

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PILLOW TALK AND CLIENT CONFIDENTIALITY ARE NOT A GOOD MATCH

Two Ohio lawyers face disciplinary action for sharing confidential client information. Thomas Holmes and Ashleigh Kerr, practicing in different firms, meet at a conference, began dating, moved in together, and became engaged. Both lawyers practiced school law and over a period of two years they exchanged confidential information over a dozen times. A typical exchange was a client email asking for a legal document that one of the lawyers would forward to the other asking for help. The receiving lawyer would then email back with an attachment of a relevant document prepared for a client without redacting client information. They were charged with violation of Ohio Professional Conduct Rule 1.6 – a lawyer shall not reveal information relating to the representation of a client; and Rule 8.1(h) – a lawyer shall not engage in conduct that adversely reflects on a lawyer's fitness to practice law.

The lawyers stipulated to the facts and accepted discipline by consent. The Board of Professional Conduct noted that the lawyers had no prior discipline, had been cooperative, and had evidence of their good character. The Board also took into account the aggravating facts that the lawyers had made multiple disclosures over two years and continued to do so after their firms discovered the conduct. The Board recommended that the lawyers be given six-month suspensions, stayed on the condition of no further misconduct. The Ohio Supreme Court now has the case for consideration.

Several commentators on this disciplinary action observed that this was a novel case and that the lawyers' misconduct was easily avoidable. Lawyers, as a professional courtesy, often assist non-affiliated lawyers with a legal question. As a matter of risk management,

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