UNSETTLING SETTLEMENTS

"And It's MALPRACTICE Down the Home Stretch!"

Del O'Roark, Loss Prevention Consultant, Lawyers Mutual Insurance Co. of Ky.

KBA Bench & Bar, Vol. 60 No. 4, Fall 1996

In the good old days done deals stayed done and settled cases were history. The public policy at work was the idea that a functional legal system of commercial transactions requires stability and, therefore, contracts must not be undone lightly. One result of this robust policy was for years legal malpractice claims over settlement contracts were rare and usually did not survive a motion for summary judgment. The idea was that a client's acceptance of a court approved settlement offer should be an absolute bar to a later malpractice claim.

Like so many other things in the legal profession this is no longer the case. In the program "Malpractice Arising Out Of The Settlement of Cases" at the ABA 22nd National Conference on Professional Responsibility the panelist observed that there are now well over 50 reported cases dealing with settlement malpractice, claims are as high as 22 million dollars, and there are instances of both sides to a settlement suing their lawyer. My how times have changed.

What follows is a brief overview of the professional responsibility and malpractice considerations you should have in mind when negotiating the now more risky settlement of cases. The idea is to provide the practicing lawyer with a jump start on spotting issues, identifying risk exposures, and employing good risk management techniques.

What's the Fuss All About?

One wag's definition of a good settlement is when everyone leaves the room unhappy. Thus, it is hardly surprising in this day of blaming your lawyer for most of life's vexations that many clients do not want to live with their settlement remorse. By claiming settlement negligence they expect their lawyer to make good on their disappointment (everyone knows lawyers are insured anyway).

In dealing with the sudden influx of settlement malpractice cases the courts have struggled with several policy concerns that do not lend themselves to an easy balance. First is the strong policy that it benefits the administration of justice to encourage settlements of disputes. Amicable and fair pretrial settlements should be encouraged and should be sustained in most cases to foster this high priority. This policy is countered, however, by the equally strong view that lawyers should be accountable to the public for substandard legal service including botched settlements.

Balancing these competing policies is complicated by the fact that lawyers are vulnerable to allegations of settlement error because of the inherent uncertainty and debatable

aspects of most settlements. These hindsight claims are speculative in amount and often based on information not known to the lawyer at the time the settlement was negotiated. It is a long standing tenant of the legal profession that lawyers do not guarantee results and are not liable for an error of judgment over uncertain but debatable legal propositions such as those attendant to settlement advice. It is from this mix of concerns that the case law in settlement malpractice is evolving.

The situation is further complicated because long standing malpractice law concepts such as the lawyer's standard of care, proximate cause, and damages do not fit well with the dynamics of the negotiation process. The wide open negotiation environment makes it difficult to articulate an objective standard of care for settlement negligence. Damages are even harder to determine. Since the underlying matter (the case within a case) did not go to trial, damages alleged for negligent settlement are often speculation piled on speculation. What damages would a jury have awarded? Would the judgment have been paid? In all this uncertainty how is it ever reasonably proven that the lawyer's negligence was the proximate cause of the claimed loss? Finally, the role of the expert witness, always something of an anomaly in legal malpractice, is even more murky in settlement malpractice claims.

A Little Structure for the Problem

Enough confusion -- what information is available to provide a few hand holds on this developing risk?

Recent cases have offered two approaches to settlement malpractice. A 1991 Pennsylvania case supports the policy encouraging settlements by refusing to allow a malpractice claim "...unless the plaintiff can show he was fraudulently induced to settle the original action. An action should not lie against an attorney for malpractice based on negligence and/or contract principles when that client has agreed to settlement. Rather only cases of fraud should be actionable."[i]

Other jurisdictions have not followed Pennsylvania's lead. These cases are best illustrated by a 1992 New Jersey ruling which held "...we insist that lawyers of our state advise clients with respect to settlement with the same skill, knowledge, and diligence with which they pursue other legal tasks. Attorneys are supposed to know the likelihood of success for the types of cases they handle and they are supposed to know the range of possible awards in those cases."[ii]

While the clear trend of recent decisions is with New Jersey,[iii] it is still hard to cite a definitive standard of care for settlement negligence. The following two quotes are as good a guide as I can find:

> "...to state a cause of action for legal malpractice based on a recommendation that a case be, or not be, settled, the plaintiff must specifically allege that the attorney's recommendation in regard to settlement was one that no reasonable attorney, having undertaken a

> reasonable investigation into the facts and law as would be appropriate under the circumstances, and with knowledge of the same facts, would have made."[iv]
>
> "The standard should be whether the settlement is within the realm of reasonable conclusions, not whether the client could have received more or paid less. No lawyer has the ability to obtain for each client the best possible compromise but only a reasonable one."[v]

These approaches suggest something akin to a gross negligence standard of care for settlement malpractice. This aids the policies favoring settlement and protecting lawyers from second guessing, yet gives clients a day in court.

Finally, note that settlement claims typically come up in two contexts:

1. When the lawyer is alleged to have failed to negotiate a settlement; and
2. When the lawyer obtained a settlement, but the client believes the settlement is flawed.

The following is a snapshot of the various ways these two situations can result in a malpractice claim:[vi]

Failure To Settle When Settlement Could Have Been Achieved:

* When the lawyer fails to communicate to the client an offer that the client would have accepted.

* When the lawyer fails to accept an offer for the client that was made.

* When the lawyer fails to initiate settlement negotiations the client believes resulted in a missed settlement opportunity.

Flawed Settlements:

* Fraudulent Settlement: When the lawyer commits malpractice and attempts to cover the error by falsifying a settlement offer; or without informing the client recommends acceptance of an offer substantially reduced by the lawyer's negligence.

* Lawyer Negligence Induced Settlement: When as a result of the lawyer's negligence a disadvantageous settlement is the only reasonable course of action for the client to take (e.g., lawyer misses statute of limitation, excuses a necessary witness).

* Inadequate Settlement or Overpayment: When the lawyer's negligence in recommending a settlement causes the client to either pay too much or receive too little.

* Unauthorized Settlement: When the lawyer without authority compromises the client's demand or liability. (This situation is particularly pertinent to Kentucky lawyers in light of Clark v. Burden, Ky., 917 S.W.2d 574 (1996) which held that Kentucky lawyers do not have apparent authority to settle client suits. They must have actual authority.)

* Negligent Execution of Settlement Agreement: When the lawyer's negligence involves drafting errors such as omission of key provisions, inappropriate inclusions or exclusions of other parties or claims, and imperfect releases.

Risk Managing Settlements

It is gratifying how often the Kentucky Rules of Professional Conduct in providing good ethics also foster good practice. Rule 1.2 Scope of Representation directs that "A lawyer shall abide by a client's decision whether to accept an offer of settlement of a matter." Rule 1.4 Communication then develops the lawyer's duties generally and specifically on the degree to which a client is to be advised and consulted about settlement negotiations:

> (a) A lawyer should keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information.
>
> (b) A lawyer should explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.
>
> Comment
>
> (1) 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. For example, a lawyer negotiating on behalf of a client should provide the client with facts relevant to the matter, inform the client of communications from another party and take other reasonable steps that permit the client to make a decision regarding a serious offer from another party. A lawyer who receives from opposing counsel an offer of settlement in a civil controversy or a proffered plea bargain in a criminal case should promptly inform the client of its substance unless prior discussions with the client have left it clear that the proposal will be unacceptable. See Rule 1.2(a). Even when a client delegates authority to the lawyer, the client should be kept advised of the status of the matter.

Simply adhering to the rules will take a lawyer a long way toward claims-free settlements. Also helpful is the risk management advice that the panelist at the ABA 22nd National Conference on Professional Responsibility offered:

4 Do not encourage false or unreasonable expectations. Compromise is hard enough to achieve with reasonable expectations.

4 Discuss settlement with the client throughout the representation. It is not a sign of lawyer weakness to discuss reality with a client.

4 Take plenty of time to explain the advantages and disadvantages of a legitimate offer to the client. Since settlement involves compromise, the client must process some amount of disappointment. This is easier for a well counseled client.

4 Keep your client involved in settlement negotiations from start to finish. (Under Kentucky's Clark v. Burden getting the client's decision in writing is the only safe way to consummate a settlement agreement.) Document thoroughly all settlement negotiations and client discussions about settlement.

4 Recognize that settlement of a divorce case does not carry with it the same finality typical of other settlements. A divorce settlement is not the end of the matter for the client -- rather a new beginning. Future consequences of faulty divorce settlements will reveal a lawyer's negligence with a vengeance. Many of the recent decisions involve divorce settlements that have not adequately covered taxation, pensions, IRAs, and valuation of real estate.

Summing Up

If you need to look further into this issue Mallen and Smith's Legal Malpractice just out in a 4th edition is the place to go. § 29.38 Recurring Areas of Error -- Settlement is a current, 22 page, well footnoted analysis (3 Legal Malpractice 4th ed. at 738). You really do need to read Clark v. Burden. That decision will more than motivate you to document the settlement process which is the critical path to avoiding claims. Space does not permit going into the conflict of interest issues for insurance defense counsel when settling claims. With Kentucky's "only-the-insured is client" rule maybe that problem has subsided for Kentucky lawyers. See § 28.23, 3 Legal Malpractice 4th ed. at 605 if you need an update.

Finally, I was startled to read in a cheeky article in the September 1996 issue of Smart Money magazine that lawyers are asking clients to sign agreements waiving all claims against the lawyer just before the client settles a case (Ten Things Your Lawyer Won't Tell You). This assertion goes along with reports of lawyers who, when settling fee disputes with clients, condition the agreement on a release from any malpractice liability. Kentucky Rule of Professional Conduct 1.8(h) provides guidance for lawyers when settling disputes with clients and both these situations carry considerable risk of running afoul of this rule. The August 1996 issue of the ABA Journal has a short article on page 92, Please Release Me, which is a quick survey of the issue. If you are considering a settlement with a client, it's worth a read.

Endnotes

[i]Muhammed v. Strassburger, McKenna, 587 A.2d.1346 at 1348 (Pa.1991).
[ii]Ziegelheim v. Apollo, 607 A. 2d 1298, at 1304(N.J. 1992).
[iii]See McWhirt v. Heavey, Neb SupCt, No. S-94-589, 7/12/96; ABA/BNA Lawyers' Manual On Professional Conduct, Current Reports, Vol. 12, No.15, p..278, 8/21/96.

[iv]Prande v. Bell, 660 A.2d 1055 at 1065 (Md. App 1995).
[v]§29.38, 3 Legal Malpractice 4th ed (1996) at 747.
[vi]These categories are based primarily on the analysis of Mallen and Smith in §29.38, 3 Legal Malpractice 4th ed. (1996) at 740-760.