New Law Limits Sale of Structured Settlements

In April Governor Patton signed into law HB 312/HCS, "AN ACT relating to structured settlements." This new law severely limits the ability of payees to sell structured settlements. It was passed in response to reports of high pressure tactics by settlement purchasers that resulted in unsophisticated payees selling at a considerable disadvantage. The new law applies to payment transfer agreements reached after its effective date. Key points are:

- No transfer of a structured settlement may be made unless the transfer has been approved in advance by the appropriate circuit court.
- The payee must show that the transfer is necessary to avoid imminent financial hardship.
- Written disclosure must be made by the purchaser to the payee thatv includes:
    - Amount and due dates of payments to be transferred;
    - The aggregate amount of payments;
    - The discounted present value of payments;
    - The gross amount payable to the payee;
    - An itemized list of all fees, charges, and commissions; and
    - Any penalties if the payee breaches the transfer agreement.

- The payee must consent to the transfer in writing.
- These requirements may not be waived.

Clients negotiating a structured settlement should be advised of the limitations of HB 312 as part of the settlement evaluation process. Consider informing former clients with structured settlements about this law to help them avoid problems. You can obtain the text of the law at the Kentucky Legislature Home Page.

Fair Credit Reporting Act Violations and Lawyer Liability

The Fair Debt Collection Practices Act has been tripping up lawyers for some time. Now it's the Fair Credit Reporting Act that's causing problems as shown in a recent 6th Circuit Court of Appeals decision, Duncan v. Handmaker, Middleton & Reutlinger (No. 96-6523, 6/8/98).

In this case homeowner plaintiffs sued their mortgage lender for negligent failure to inspect a well on the property that was contaminated with fecal matter. In their complaint the homeowners asserted that their property was virtually "unmarketable and uninhabitable." Later when answering interrogatories they asserted that the value of their property had "been reduced to zero." The lawyer representing the mortgage lender obtained a credit report on the homeowners from the consumer reporting agency his firm used. Later when taking the deposition of one of the homeowners the lawyer asked whether the property had been shown as having no value on loan applications made by the plaintiffs after suing the mortgage lender and why a prior existing mortgage had not been listed as a liability on the application for the loan from the defendant. From these questions the homeowners suspected and confirmed that the lawyer had obtained a credit report on them. They then sued the lawyer for violation of the FCRA (15 U.S.C. §§ 1681 et seq.) alleging that the report was ordered under false pretenses.

The lawyer defended on the basis that the credit report request was a "legitimate business need for the information in connection with a business transaction involving the consumer." His motion at trial for summary judgment was granted and the homeowners appealed. The 6th Circuit found that while lawyers could request credit reports for use in the few situations covered in §1681b, the less connected a suit is to debt collection the greater the risk that the request will violate the FCRA. Here the homeowners' action concerned alleged negligence of the lender Ð not the granting of a loan in a business transaction between the parties. Preparing to defend a negligence action is not generally a legitimate business need in connection with a business transaction. Summary judgment was reversed and the case returned to the trial court for further proceedings on the merits.

This opinion analyzes how the FCRA should be construed, has useful cites, and includes pertinent legislative history which helps better understand how the Act has evolved. Because the FCRA is a consumer protection law that has a built in cause of action for violations, it represents yet another significant area of liability risk for lawyers. If you are getting credit reports, it is well worth a read.

The Perils of Splitting Fees

A not well understood Kentucky Rule of Professional Conduct is Rule 1.5e Fees which governs sharing fees between lawyers not in the same firm. States with this same rule are reporting cases involving lawyer disputes over fee sharing and lawyer-client fee disputes because 1.5e was not followed. What's at stake for lawyers who do not follow the rule are ethical violations and malpractice exposure.

What The Rule Requires

Rule 1.5e allows a division of a fee between lawyers who are not in the same firm only in two circumstances:

1. Sharing Fees Proportionate To Services Rendered
Requirements

(a) The division is in proportion to the services performed by each lawyer;
(b) The client is advised of and does not object to the participation of all the lawyers involved; and
(c) The total fee is reasonable.

A typical proportionate fee sharing situation is when a lawyer is asked to serve as local counsel or handle a specific aspect of a matter such as an environmental law issue. The referring lawyer is lead counsel for the matter.

2. Sharing Fees Not Proportionate To Services Rendered
Requirements

(a) By written agreement with the client, each lawyer assumes joint responsibility for the representation;
(b) The client is advised of and does not object to the participation of all the lawyers involved; and
(c) The total fee is reasonable.
A typical disproportionate fee sharing situation is when a lawyer refers a case to a trial specialist who will be lead counsel. The referring lawyer usually will do little, if any, of the work on the matter.

The comment to Rule 1.5e offers this guidance:
A division of fee is a single billing to a client covering the fee of two or more lawyers who are not in the same firm. A division of fee facilitates association of more than one lawyer in a matter in which neither alone could serve the client as well, and most often is used when the fee is contingent and the division is between a referring lawyer and a trial specialist. Paragraph (e) permits the lawyers to divide a fee on either the basis of the proportion of services they render or by agreement between the participating lawyers if all assume responsibility for the representation as a whole and the client is advised and does not object. It does not require disclosure to the client of the share that each lawyer is to receive. Joint responsibility for the representation entails the obligations stated in Rule 5.1 [Responsibilities of a Partner or Supervisory Lawyer] for purposes of the matter involved.

Rule Analysis and Recent Developments
Rule 1.5e does away with the pure referral fee where a lawyer passes a case to another lawyer, does no work on the case, has no responsibility for the case, but unknown to the client will be paid a fee by the other lawyer. If the referring lawyer will receive fees, Rule 1.5e must be followed and the referring lawyer will retain in some degree both professional responsibility and malpractice exposure for the matter. A lawyer unaware of the requirements for sharing fees may be surprised by a malpractice claim or bar complaint over a matter referred and ignored.

The reasons for Rule 1.5e center on the idea that referral fees are under the table arrangements which are inherently unfair to clients. They work to increase the overall fee charged, interfere with a client's right to choose his own lawyer, encourage neglect and unprofessional conduct by the referring lawyer, and are unfair to the lawyer who does all the work.

Violations of the rule are coming to light most frequently in contingency fee cases when a referring lawyer sues the associated lawyer for unpaid fees. Some jurisdictions hold that as a matter of public policy understandings between lawyers to share fees that do not comply with 1.5e will not be enforced. Other jurisdictions take the approach that violations of the rule are a matter for bar disciplinary authorities. The enforceability of the fee sharing agreement is a matter of law for the courts. These jurisdictions usually are concerned with one lawyer receiving a windfall because of a rule violation for which both lawyers have responsibility.

Risk Management
Compliance with 1.5e is not complicated. Written notification is required in disproportionate fee sharing matters, while oral notification will suffice in proportionate fee sharing cases. The rule does not require the client to agree in writing. Better risk management, however, is to give the client in all shared fee representations a short letter advising that another lawyer is being associated with the case who will share the client's fee. Even though the client's written acknowledgement is not required, it is recommended that you include a signature line for the client to show receipt of the letter.

Good risk management for associated lawyers in proportionate fee sharing matters include:

(1) documenting carefully with the referring lawyer the scope of engagement to include the fee sharing understanding;
(2) making sure that the client is fully informed of the scope of engagement in writing; and
(3) during the representation, documenting telephone calls and meetings with the referring lawyer, and all other aspects of the representation of the client.
If properly risk managed, associated lawyers should not be held jointly responsible with the referring lawyer for the overall representation.

In disproportionate fee sharing situations the referring lawyer is jointly responsible for the representation with the associated lawyer even though the associated lawyer is doing most, if not all, of the work. The comment to Rule 1.5e makes it clear that both lawyers have the duties of a partner for the representation. It is essential that the referring lawyer put the fee sharing agreement in writing and track the matter as diligently as any other case she practices. Frequently, referring lawyers rely completely on the associated lawyer and learn of problems only after the statue of limitations has passed or default judgment entered. It's too late then and it is surprising how often the associated lawyer has no insurance or assets to help with the malpractice claim.