The Risk Manager

Lawyers Mutual Insurance Co. of Kentucky

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Our new address is:

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We are pleased to announce a major upgrade of our web site that includes:

- A new user friendly format that begins with a home page that contains or leads you to the information you need to know about Lawyers Mutual's insurance program and how to risk manage your practice.
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- Information on how to report a claim and how we manage your claim. When the worst happens we will be with you every step of the way.
- A new search engine that makes research of our archives of newsletters and risk management KBA *Bench & Bar* articles readily available to all.
- Of course, we include company history, profiles of our Board of Directors and staff, frequently asked questions, and links to other helpful sites and resources. Check us out – then let us know how we can do even better.

Nonclient Liability

Too many lawyers still believe that if someone accusing them of malpractice is not a client they have no standing to assert a claim. These lawyers are unaware of the modern trend to expand liability to nonclients that is a major reason for the increased malpractice exposure lawyers face today. The most recent example of this for Kentucky lawyers is the Kentucky Court of Appeals decision in *Cave v. O'Bryan* (No. 2002-CA-002601- MR, 3/23/2004).

In this case a lawyer advised a client on an estate plan to carry out the client's wish to leave his home to his second wife and personal assets to other relatives. The testator's intent was implemented by deed establishing ownership of the home in the testator and wife as joint tenants and a will leaving personal property to specifically named relatives. Upon the testator's death the wife renounced the will effectively halving the amount of personal property named heirs in the

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"Something unpleasant is coming when men are anxious to tell the truth."

Benjamin Disraeli

"Your worst humiliation is only someone else's momentary entertainment."

Karen Crockett

will received. One of the heirs then sued the lawyer for malpractice alleging that the lawyer negligently failed to advise the testator of the wife's renunciation option. The Circuit Court granted a motion for summary judgment by the lawyer based in part on a finding that the heir lacked standing to make a malpractice claim because he was not the lawyer's client. The Court of Appeals reversed the Circuit Court and remanded the case.

This opinion contains a good review of Kentucky law on nonclient liability and contains the strongest language to date on the standing of intended beneficiaries to claim malpractice:

> "As Kentucky law clearly permits intended beneficiaries to hold attorneys liable for damages caused by negligent performance, irrespective of privity, the question is thus reduced to the application of this rule to claims by will beneficiaries against estate planning attorneys. The clear trend among courts is to hold that estate beneficiaries are intended to benefit from the services rendered by attorneys to their clients.
>
> ….
>
> Therefore, in light of current Kentucky law, we conclude an attorney owes a duty of care to the direct, intended, and specifically identifiable beneficiaries of the estate planning client, notwithstanding a lack of privity. Applying this "intent to directly benefit" standard to the facts alleged in the present case, [*the lawyer*] owed a duty of care to appellant as a third-party beneficiary who was directly and specifically identified in [*the*] will." (footnotes omitted)

This case is pending before the Supreme Court on the attorney's motion for discretionary review. The Court of Appeals did not address the effect of the attorney's uncontradicted testimony that he advised the testator that the widow had the right to renounce his will. The opinion of the Court of Appeals appears to mandate that the attorney should have refused to prepare the deed even after the client was advised of the risk and wanted to proceed anyway. Nonetheless, in light of the strength of the Court's language this is a good time to republish risk management guidelines that we have identified for nonclient liability. They first appeared in the KBA *Bench & Bar* article Negligence Liability to Nonclients that is available on our web site at ***www.lmick.com***:

"What follows are some ideas on how to assess your exposure to negligence liability to nonclients and what to do about it. First, be alert to these risky situations:

- The farther you get from the adversarial courtroom the greater the risk that a nonclient will claim reliance on your actions. Friendly business transactions when nonclients are not represented are especially treacherous.
- 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 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.
- 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.
- 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.
- When you disburse all funds to the client with the understanding that the client will pay amounts due nonclients there is a risk that you will end up with the nonclient bill.

Now for some risk management ideas:

> *"The best way of answering a bad argument is to let it go on."*
>
> *Sydney Smith*

✓ 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.

✓ 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).

✓ 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.

✓ Carefully prepare opinion letters by:

- Specifying the scope of the opinion, its purpose, authorized uses and restrictions.
- Setting out the facts and assumptions on which the opinion is based. Be specific about facts based on your own knowledge and those provided by others who bear responsibility for their accuracy. If others are preparing evaluations on other aspects of the transaction, clearly exclude those parts from your opinion. If you are relying on an expert opinion as part of your analysis (e.g., an environmental assessment), spell it out in your opinion.

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- Being complete – include the pros and cons of the matter. Do not expose yourself to the accusation that you misled by omission. Material limitations must be disclosed.

✓ Establish office procedures for quality control of opinion letters. Procedures should indicate who is authorized to sign and release opinion letters for the firm, provide for a formal and cold review before opinion release, and require careful screening for prior inconsistent firm opinion letters. Unrealistically short deadlines for the production of opinion letters should not be accepted from clients and requests for additional information from the client should be made without hesitation. Because opinion letters carry a high risk for claims against both you and the client, they require extra time and often much more than the client anticipates. Be sure the client understands this and is prepared for the high billing that usually goes with a good opinion letter.

"Intuition is reason in a hurry."

Holbrook Jackson

✓ If you deliver documents to a nonclient for your client, be sure you know what information is in them. If the documents do not contain some semblance of truth, you will in all likelihood be held responsible for their accuracy along with the client.

✓ Be sure to cover with the client in writing (preferably a letter of engagement) precisely how client funds are to be disbursed.

- Get written authority to pay creditors with an interest in the recovery or settlement. This is particularly important for those you have personally engaged such as medical services required to develop a personal injury case. If your client gets all the recovery proceeds and stiffs those people, you could be liable. Maybe as bad, it is your credibility that suffers on the next case when you try to get needed services.
- Get client approval before hiring experts and incurring other high expense aspects of a case or transaction. At final disbursement don't surprise your client with a huge nonclient claim on funds.
- Consider getting the client to pay large expenses directly while the case or transaction is ongoing and prior to final disbursement. This simplifies things at the conclusion of the matter for all concerned.

Bank Failure Exposes Lawyer to Liability for Trust Fund Loss

A New York lawyer representing the seller deposited a total of $2,730,000 earnest money for the purchase of condominiums in his IOLTA trust account. The sale proved difficult and took longer than anticipated. As a result the funds were still on deposit when the bank was placed into receivership. After being sued by the purchaser, the client cross-claimed against the lawyer for improperly depositing the money in a non-interest bearing account and negligently exposing the funds to bank failure – a fiduciary breach and malpractice. The lawyer moved for dismissal primarily on the basis that he was only an escrow agent.

The court found that the lawyer served as both escrow agent and lawyer, noting that the lawyer had deposited the funds in his trust account. The client, therefore, had properly alleged an issue of malpractice by complaining that the lawyer was negligent in depositing the money in a relatively small bank without protection beyond the FDIC insurance of $100,000 per account and was entitled to offer expert testimony on the standard of care for this transaction.

It remains to be seen if a lawyer has a duty to anticipate a bank failure, but the lessons to be learned from this matter are ripe now. Representing a client in a transaction in which the lawyer also provides escrow service exposes a lawyer to greater risk than someone who acts only in a neutral escrow capacity. A nonclient may misunderstand the lawyer's duty of loyalty to the client and allege a conflict of interest. The lawyer must be sure to comply with SCR 3.130 (1.15(c), Safekeeping Property) when a dispute arises between a client and another person over entitlement to the funds. Finally, the lawyer must apply good business sense when depositing funds in a trust account. The best practice when the amount to be deposited is large and will be held more than a few days is to get client instructions on how the funds are to be deposited and with what security. Document the file and never disburse the proceeds of a real estate transaction until the title search is updated, the transaction documents recorded, and all checks providing funds for the transaction deposited to a trust account have cleared.

Sources: Bazinet v. Kluge, 764 N.Y.S.2d 320(2003); Client Funds – Liability For Depositing Funds In A Bank That Failed, Hinshaw & Culbertson Newsletter, The Lawyer's Lawyer, Jan. 2004, Vol. 9, Issue 1.

TAKING ON SOMEONE ELSE'S DISSATISFIED CLIENT

Clients have the option of firing their lawyer at will. Often before making that decision they will consult another lawyer – in effect becoming that lawyer's prospective client. This raises the question of the professional responsibility of the consulted lawyer in terms of the client and the client's current lawyer. The Philadelphia Bar Association considered this situation in its Ethics Opinion 2004-1 (Feb. 2004).

Points covered in the opinion are:

1. There is no duty to notify existing counsel before meeting with the dissatisfied client. In fact, to do so without the consent of the dissatisfied client would breach confidentiality requirements.
2. There is no obligation to reconcile the dissatisfied client and existing counsel.

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3. The lawyer may accept the retention as substitute counsel even though existing counsel has not been notified of his termination. The prospective client, however, should be informed about discharged counsel's potential claim for fees and costs and the impact of this on the new representation and any recovery realized in the matter.

4. The lawyer may contemporaneously have the client sign an engagement letter and assist the client in preparing and sending a letter discharging the existing counsel.

5. Lawyers in these situations should inform themselves on substantive law issues such as intentional interference with contractual relations and other claims that may be implicated by the particular facts of the matter.

Often accepting a client under these circumstances is in the best interest of all concerned. Nonetheless, there are risk management considerations beyond any substantive law claims the discharged lawyer may have. Client screening is one of the most effective ways to prevent a malpractice claim and a client switching lawyers is often a signal that the client is difficult and more likely to make a malpractice claim if things don't go well. Some things you should consider before accepting a dissatisfied client are whether you have difficulty reaching a fee agreement; have other lawyers rejected the matter; and most important of all, whether time limits that apply to the matter are too close to permit adequate investigation and preparation time.

One final thing to consider before accepting the matter is whether the scope of the engagement will include any malpractice by the discharged lawyer discovered during the representation. If malpractice is discovered, the client must be notified. If, however, you do not want to become involved in a malpractice claim, be sure to limit scope to preclude that aspect of the matter.

"Information voids will be filled by rumors and speculation unless they are preempted by open, credible and trustworthy communications. Pull no punches. When you know an answer, give it. When you don't, say so. When you're guessing, admit it. But don't stop communication."

Jean B. Keffeler

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Malpractice Avoidance Update

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