LPL Advisory

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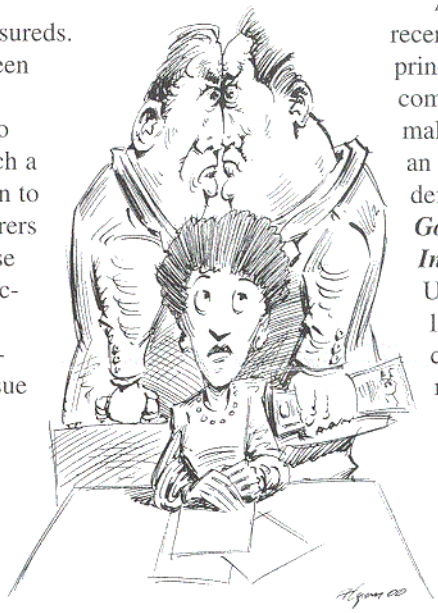
A newsletter from The ABA Standing Committee on Lawyers' Professional Liability

Rift Between Insurers and Panel Defense Counsel

by Joseph P. McMonigle and Jeanette Traverso

What has happened to the close, loyal relationships between insurers and their panel defense counsel? Some say, gone are the days when insurers and their panel defense counsel forged strong alliances for a common purpose – defending insureds. The relationships between insurers and their panel defense counsel seem to have deteriorated to such a degree that we've begun to see more and more insurers suing their panel defense counsel for legal malpractice.



Virtually all jurisdictions allow insurers to sue their panel defense counsel, provided there is no insurer-insured conflict of interest. In a seminal decision, ***Unigard Ins. Group v. O'Flaharty & Belgum*** (1995) 38 Cal.App.4th 1229, an insurer sued panel defense counsel for legal malpractice. The court found that when an insurer hires counsel to defend its insured, and there is no conflict of interest between the insurer and the insured that would preclude counsel from representing both, counsel has a dual attorney-client relationship with both the insurer and the insured, permitting the insurer to sue counsel for negligence in representing the insured. A recent California decision, ***Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone*** (2000) 79 Cal.App.4th 114, is in accord.

A federal district court recently affirmed the principle that an insurance company may pursue a malpractice action against an attorney it hired to defend an insured. ***Government Employees Ins. Co. v. Forbes***, U.S.D.C., E.D. Penn., 1999 WL 371625. The court cited the general rule that an attorney-client relationship is a condition precedent to a malpractice action. The court relied on an earlier Pennsylvania district court decision, based on New Jersey law, which held that an insurance company is also a client of the law firm it hires to represent the insured and, therefore, the company has standing to bring a separate malpractice action.

The ***Forbes*** court observed that under the forthcoming *Restatement of the Law Governing Lawyers*, regardless

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Mark Your Calendar

April 18-20, 2001
Spring National Legal Malpractice Conference
Washington Monarch
Washington D.C.

September 12-14, 2001
Fall National Legal Malpractice Conference
Hilton LaJolla Torrey Pines
LaJolla, CA

Defending Liberty
Pursuing Justice

Rift. . .

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whether a jurisdiction considers an insurer a co-client with an insured, "a lawyer designated by an insurer to defend an insured owes a duty of care to the insurer concerning matters in which the interests of the insurer and the insured are not in conflict." Citing ***Unigard***, the court stated that the only person who benefits from a rule prohibiting claims by the insurer is the malpracticing attorney.

In ***Paradigm Ins. Co. v. Langerman Law Offices***, 2 P.3d 663 (Ariz. 1999) (review granted 5/23/00), the Arizona Court of Appeals also relied on ***Unigard*** and employed the same reasoning as ***Forbes***. The Arizona court added that making a lawyer accountable to both insurer and insured is consistent with rules of professional conduct that permit the representation of more than one client in the absence of conflicting interests. The court explained that allowing one lawyer to represent the interests of both insurer and insured makes economic and practical sense.

Even in a jurisdiction where an insurer is not considered to be panel defense counsel's client, an insurer was allowed to assert the insured's rights against counsel, under an equitable subrogation theory. In ***Atlanta International Ins. Co. v. Bell,*** 475 N.W. 2d 294 (Mich. 1991), the court found that equitable subrogation served the public policy underlying the attorney-client relationship. The court noted equitable subrogation was a less sweeping, less rigid solution than creation of an attorney-client relationship between the insurer and panel defense counsel.

Although suing panel defense counsel for mistakes in defending insureds appears to be on the rise, perhaps stronger relationships between insurers and panel defense counsel, which hopefully lead to better lawyering, will minimize the need for such litigation.

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Levit Essay Call for Papers – Golden Opportunity for Young Lawyers

Submissions are now being accepted for the 2001 Levit Essay Contest on Lawyers' Professional Liability. The competition, only open to law students and young lawyers, encourages innovative and original research and writing in the field of lawyers' professional liability. As in the previous year, this year's format asks the contest applicant to render a judicial opinion. The complete hypothetical and contest rules are available at www.abanet.org/legalservices/levit.html

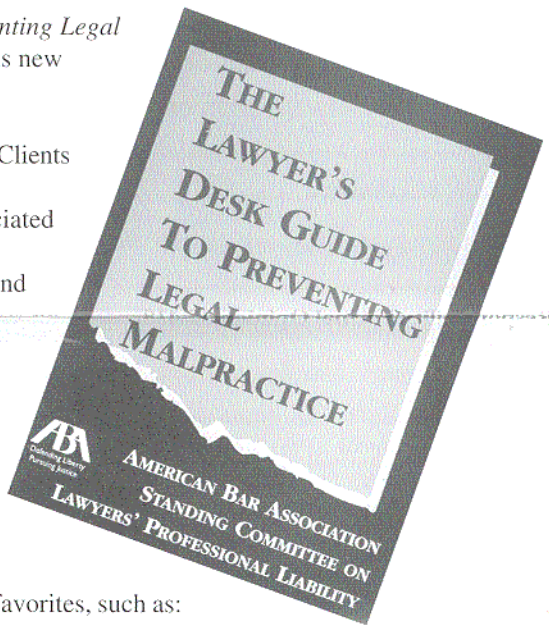
The winner of the annual award receives a cash prize of $5,000 and an all-expense paid trip to the ABA Spring National Legal Malpractice Conference in Washington DC on April 18-20, 2001. The deadline for submissions is January 15, 2001. See www.abanet.org/legalservices/levit.html for complete contest details.

This annual competition is co-sponsored by the ABA Standing Committee on Lawyers' Professional Liability and the San Francisco firm of Long & Levit LLP.

Do you have your 2nd edition...

of the *Lawyers' Desk Guide to Preventing Legal Malpractice*? The 2nd edition contains new sections on:

- ❑ Electronic Communications with Clients
- ❑ Working with Legal Assistants
- ❑ Ethical and Liability Issues associated with "Temping" Lawyers
- ❑ Special Considerations for Sole and Small Firm Practitioners
- ❑ Imputation and Screening of Lawyers for Conflicts of Interest
- ❑ Entrepreneurial Activities
- ❑ Loss Prevention for Trial Lawyers
- ❑ How-to's on Handling the Initial Stages of a Claim



Updates are included on the familiar favorites, such as:

- ❑ The Top Ten Malpractice Traps and How to Avoid Them
- ❑ Sample Client Relations Letters
- ❑ Checklists and Sample Forms for Routine Practice Management Issues

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Taking Stock In Lieu of Fees: A Rapidly Changing Landscape

by William Freivogel

Many readers will recall *Who Wants to Be a Millionaire?* by Debra Baker in the February 2000 American Bar Association Journal (pp. 36-43). The article described the ways in which law firms were reaping profits by taking stock in high-tech startups. The economic and legal environments have changed since that article appeared.

The Economic Environment.

Since February, the NASDAQ, where almost all high-tech stocks are listed, has become demonstrably more volatile. Investors have become increasingly concerned about companies that have no apparent plan to make profits at any foreseeable time and appear to be running out of cash. As a result, some investors' portfolios have eroded dramatically. Lawyers who deal with malpractice cases know that such an environment can spell danger for lawyers.

The Legal Environment

American Bar Association Standing Committee on Ethics and Professional Responsibility Formal Opinion 00-418, July 7, 2000.

For the first time, the Committee has addressed the ethical issues surrounding the practice of taking stock in lieu of fees. Before exploring the substance of the opinion, it is worth noting that courts cite the Committee's opinions regularly. Moreover, a lawyer's compliance, or non-compliance, with legal ethics rules can impact a malpractice case. Section 74(2) of the *Restatement (Third) The Law Governing Lawyers* codifies what many malpractice lawyers know: courts in many jurisdictions will allow juries to consider the ethics rules in making their decisions. The Reporters' Note to that section cites a number of such cases.

The Committee opines that taking stock in a client in lieu of fees is not an inherent violation of Model Rule 1.7. However, a lawyer who does it must consider whether she satisfies the material limitation, adverse effect, and consent provisions of Rule 1.7(b).

The most significant finding of the Committee is that taking stock in lieu of fees is subject to the requirements of Model Rule 1.8(a). Many experts have thought that was the case, and that is the *Restatement's* position at Comment a to §126. ABA Opinion 00-418 makes such a finding in disciplinary and malpractice cases even more likely. The requirements of the rule are tough: the terms of such an arrangement must be in writing; the terms must be "fair and reasonable to the client;" the client must consent to the arrangement in writing; and the client must be afforded an opportunity seek the advice of other counsel.

The Committee compares the "fair and reasonable" requirement of Rule 1.8(a) with the Rule 1.5(a) requirement that fees be "reasonable." A "lawyer-friendly" aspect to the opinion is the Committee's view that the fairness analysis of the arrangement should be as of the time the inception of the relationship. At inception, the riskiness of taking stock in lieu of fees is more apparent, and a finding of reasonableness is arguably more likely.

Failure to comply with Rule 1.8(a) can be devastating. In *Passante v. McWilliams*, 62 Cal. Rptr. 2d 298 (Cal. App. 1997), failure to comply with California's version of Rule 1.8(a), in part, cost the lawyer his ability to collect $32 million worth of stock from a client. Likewise, in *DiLuglio v. Providence Auto Body, Inc.*, 2000 R.I. LEXIS 159 (R.I., June 30, 2000), the court held that a lawyer's failure to comply with Rule 1.8(a) in contracting with a client could entitle the client to rescind the contract. (The court denied rescission in *DiLuglio*, because the client waited six years to raise the issue.)

Loss Prevention Recommendations

1. Taking stock in lieu of fees and investing in clients should not be done at the whim of individual lawyers but rather under supervision of the firm's management group or special committee set up for that purpose.
2. All firms should have an insider trading policy and take steps to ensure that all lawyers and staff are periodically reminded of it.
3. Be constantly mindful of Model Rule 1.8(a) – in particular its requirement that the client be urged to seek other counsel, and its requirement that the

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Taking Stock. . .

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client's consent to the arrangement be *in writing*.

4. Ensure that these practices do not run afoul of the firm's malpractice insurance policy.
5. Try to ensure that each position not be a large percentage of the client's securities or a large percentage of the firm's investment portfolio.
6. Avoid shady clients. If the enterprise fails – and many high-tech enterprises have begun to fail – the risks of being involved in an aiding and abetting claim, or a claim that the firm was a principal violator of SEC Rule 10b-5, are substantial.

William Freivogel is a consultant on legal ethics and professional liability. He publishes Freivogel on Conflicts, *an online guide to conflicts of interest: http://www.freivogelonconflicts.com.*

Message From the Chair

by G. Michael Bourgeois

On behalf of the Standing Committee on Lawyers' Professional Liability, welcome to Tuscon and the Fall 2000 National Legal Malpractice Conference. We look forward to sharing an exiting conference with you.

The Fall conference marks the beginning of a new year for the Committee. It is with great pride and not a little trepidation that I chair the Committee for this year. My first official act is to thank Joe McMonigle for his outstanding job as chair for the last three years.

My second official act is to share briefly with you my vision of the Committee. We are unique in the ABA. This Committee affords the Bar and the insurance industry a special opportunity to engage in an ongoing, never ending but endlessly fascinating dialogue. Since the first conference I attended in South Carolina fifteen years ago, we've seen LPL policy terms sharpen and soft markets turn hard and revert.

The market again hardens again as I write. But the damage of the long soft market will probably be with us for some time to come. Through it all, this Committee is the meeting place to spare common concerns.

We progress with the National Data Collection Project. Due to the wonderful response of the insures, both NABRICO and publicly owned, we will be able soon to afford another snapshot of the state of the claims experience over the past four years. In this business as in many others, trust may be the coin of the realm but the common language is credible information. The ABA Standing Committee will again provide the common language.

Annually, the Standing Committee sponsors the Levit Essay contest. This year's topic set in the technology environment treats the issue of disciplinary code violations, and the deadline for submission of the essays is January 15, 2001. We look forward to another year of robust participation and know that you will encourage the younger members of your firm to reach for this special brass ring.

-G. Michael Bourgeois

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