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Conflicts of Interest, Fee Claims and 'Bad Press'

by Marian C. Rice, Esq., L'Abbate, Balkin, Colavita & Contini, LLP

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

Mark Your Calendar

April 20-22, 2005

Spring 2005 National Legal Malpractice Conference
Fairmont Copley Plaza
Boston, MA

September 14-16, 2005

Fall 2005 National Legal Malpractice Conference
Grand Hyatt
Seattle, WA

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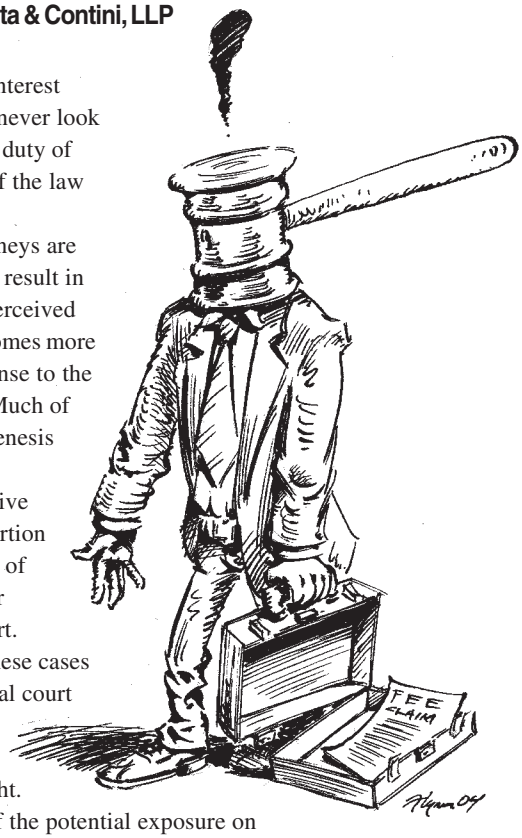

Legal malpractice claims based upon conflicts of interest are by far the most problematic to defend. Juries never look kindly upon a law firm charged with breaching its duty of undivided loyalty to a client, whether in pursuit of the law firm's own interests or that of another client.

At the same time, fee claims asserted by attorneys are often disfavored by the triers of fact and regularly result in the assertion of malpractice counterclaims.[1] The perceived egregiousness of a claimed conflict of interest becomes more pronounced when the conflict is asserted in response to the law firm's suit for fees against the former client. Much of the adverse public perception of lawyers has its genesis in the fees lawyers charge for their services.

The effect of combining an attorney's affirmative action against a former client with the client's assertion that the fees reflect services constituting a conflict of interest is illustrated in two cases involving similar factual allegations decided more than a decade apart. Because of the nature of the allegations, both of these cases received front page treatment at the time of the trial court decisions, as well as at the time the appellate decisions were issued.[2] None of the articles presented the law firms involved in a favorable light.

Presumably, plaintiff law firm was unaware of the potential exposure on the conflict cross-claim asserted by its original client, Leo, when the decision was made to assert a claim for legal fees against its subsequent client, Chan, in *Milbank Tweed Hadley & McCoy v. Chan Cher Boon.*[3] In response to the claim for fees incurred in helping Chan buy the stock of a bankrupt company, Chan impleaded his former principal, Leo, on an indemnification theory. Mrs. Leo, who the law firm had originally represented, asserted a breach of fiduciary duty claim based upon the law firm's representation of Chan to Leo's detriment. From the decision, it is apparent that the law firm felt that Leo's inability to fund the purchase negated the existence of a conflict in representing Chan in finalizing the transaction, despite the written representation that the firm would not undertake to represent either Chan or Leo after the agency relationship terminated. The failure to properly analyze this conflict within the law firm at the time it arose led to a result the firm clearly did not anticipate. Rather than collecting on its fee claim, the law firm found itself the subject of a scathing opinion as the Second Circuit affirmed the jury award of $2,000,000 against it, holding that in light of the "serious breach of fiduciary duty," it would apply the lesser "substantial factor" standard of proof rather than the more stringent "but for" standard in enforcing a "prophylactic rule intended to remove all incentive to breach—not simply to compensate for damages in the event of a breach."[4]

More recently, in *Weil, Gotshal & Manges, LLP v. Fashion Boutique of Short Hills, Inc.*,[5] Fashion Boutique asserted two counterclaims against Weil, Gotshal predicated upon breach of

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Conflicts of Interest

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fiduciary duty and legal malpractice in response to the law firm's fee claim. Fashion Boutique, which had rejected the law firm's advice to accept a $1.4 million settlement offer, asserted that an "irresolvable conflict of interest" arose as a result of the dual representation of Prada, the parent of Fendi, Fashion Boutiques' former adversary, and Fashion Boutique, which resulted in the law firm's failure to adequately utilize the testimony of a former Fendi officer in opposing the dismissal of claims based upon the Lanham Act. The trial court granted Weil, Gotshal's motion to dismiss the legal malpractice counterclaim but sustained the breach of fiduciary duty claim on the basis that "the purportedly less vigorous representation may have been a substantial factor in the failure to obtain a more favorable result in the Fendi Action." The law firm was in the spotlight again when the Appellate Division reversed the trial court and dismissed the breach of fiduciary duty claim while reinstating the legal malpractice counterclaim. Although the appellate decision reaffirmed that a breach of fiduciary duty claim based upon the same facts and alleging the same damages as a legal malpractice claim would be dismissed as duplicative, in light of the reinstatement of the legal malpractice counterclaim it is unlikely that the decision was met with much enthusiasm by the law firm involved.

The decisions in these cases highlight the importance of conflict checking and resolution as well as firm policy on instituting suit to recover fees. The proper application of internal firm procedures related to both these areas may have avoided the devastating liability in *Milbank, Tweed,* as well as the adverse publicity.

No one denies the tediousness of the process of checking for conflicts of interest on new retentions and updating databases and conflict checks. It is a task that cannot be performed by even the most effective law firm manager alone. The dedication of every professional and non-professional in a law firm is necessary to implement and maintain an effective conflict procedure. It is the job of every law firm manager to educate every person in the firm on the importance of effective conflict searches, the role every party plays in the process and the consequences that may flow from cutting corners or turning a blind eye when a potential conflict is identified.

In both of the above cases, the conflict causing the law firm's problems may not have been evident upon intake of the new matter. This fact highlights the importance of individual participation in the conflict practices and procedures throughout the life of every representation. In *Milbank Tweed*, the attorneys assuming Chan's representation when the agency relationship between Chan and Leo ceased, should have recognized the potential problem presented by the written representation that the firm would represent neither Leo nor Chan after the agency relationship terminated and addressed it with Leo at that time. Whether or not that representation could cause damages is not part of the conflict analysis. Similarly, in *Weil, Gotshal*, even if the issue was missed upon intake, once it became apparent during the course of the litigation that Prada was the parent of Fendi, the issue should have been addressed and resolved with Fashion Boutique at that time.

While every person in a firm must participate in the conflict process, the resolution of identified conflicts, whether by waiver or disengagement, should only be permitted by attorneys well-versed in the professional rules involving conflicts.

Similarly, before any decision is made to institute suit for legal fees, the representation should be rigorously reviewed, by a partner other than the attorney handling the representation, to ensure value was given for the fees outstanding, to ascertain whether the benefit of collection outweighs the risk of a counterclaim or other adverse reaction, and whether, if a judgment is obtained, it would be collectible. The attorney who handled the representation and expended his or her efforts on behalf of the client lacks the balanced perspective needed to make the final decision. However, serious consideration should be given to the opinion of the attorney handling the representation, particularly if the recommendation is against suit.

While law firms are becoming better educated about the significant civil exposure that may arise due to the failure to identify and resolve conflicts at the onset of a representation and the likely institution of retaliatory counterclaims in the event fee suits are maintained, the publicity of adverse decisions should also act as powerful deterrent. Prominently reported assertions of ethical violations or conflicts of interest are the exception to the adage that "there's no such thing as bad publicity." If potential civil responsibility for conflicts constituting breaches of fiduciary duty is insufficient to encourage rigorous adherence to conflict procedures, the prospect of being tomorrow's headline, for however fleeting a period, should certainly provide further incentive for compliance.

Footnotes

1 American Bar Association Standing Committee on Lawyers' Professional Liability, *The Lawyer's Desk Guide to Legal Preventing Legal Malpractice, 2nd Edition*, p. 248 (American Bar Association 1999) "Claims experience suggests that the correlation between the number of malpractice actions filed and the number of lawsuits filed to collect fees is on the rise. In 1997 some insurers reported that as much as 20% of the malpractice claims filed against lawyers was a direct reaction to the filing of civil lawsuits to collect unpaid fees."

2 *See,* Wise, Daniel, *Milbank Tweed Seeks Reversal of $2 Million Verdict Against It*, 12/15/92 NYLJ 1, (col. 3); Pines, Deborah, Panel Upholds Jury Award Against Milbank, 2d Circuit Court Finds "Serious Breach," 1/4/94 NYLJ 1 (col. 6); Lin, Anthony, "*Single Claim Against Weil Goes Forward*," 12/9/03 NYLJ 1, (col. 3); Lin, Anthony, "*Malpractice Action Against Weil Gotshal Reinstated By Panel*," 8/9/04 NYLJ 1, (col. 5).

3 13 F.3d 537 (2nd Cir. 1994).

4 *Id.,* at *543.

5 10 A.D.3d 267, 780 N.Y.S.2d 593 (1st Dep't 2004).

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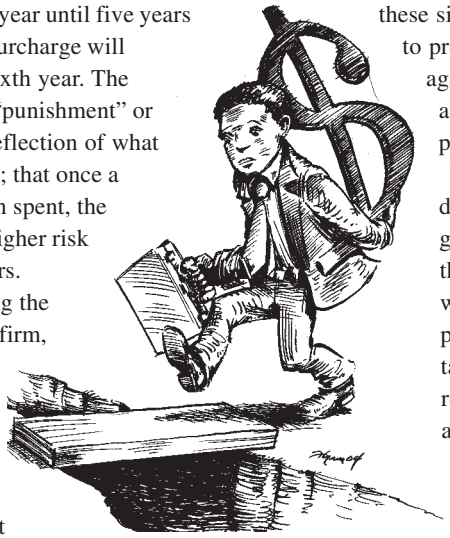
Impact of Claims on Premium—One Company's Point of View

by Stacey K. Smith, Esq., ALPS Corporation

What is going to happen to my premiums if I report this situation to my malpractice carrier? Often, this is one of the very first questions raised when an insured calls to discuss a circumstance (a potential claim situation) or a claim or lawsuit that has just arisen. As is so often the case in a legal setting, the answer is, "it depends." This article will attempt to generally outline the impact of reporting a claim or circumstance on premium. Insurers will each treat the report of a claim or circumstance differently. However, this article will provide some guidance in addressing the subject with an insurer.

If a client, or anyone else, has demanded that the law firm either work for free, refund its fees, or pay money damages, the situation will usually fall within the definition of a claim and it will be addressed as such. The claims attorney will then work with the insured to determine how to handle that particular claim. Issues that will be discussed include whether it is appropriate to retain defense counsel, whether the matter is really more about fees and the availability of fee arbitration in that jurisdiction, or whether the claim is brought by a former client or an individual who has also sued various State personnel alleging various wrongdoings by all, etc. Claims situations vary greatly and underwriters will view each claim on a case-by-case basis trying to determine whether a specific claim impacts the firm's risk profile. *See* ALPS 4/29/04 risk management article, "*Look for the Learning with Claims"* for exploration of this issue in greater detail.

Generally, at ALPS, if more than a given sum has been spent on a claim, whether on defense expenses, paid on a loss, or some combination of the two, a claims surcharge will attach upon the firm's renewal. Other insurers may address this situation very differently so it is best to direct questions to your own insurer. The actuaries who assist ALPS in setting fair rates to reflect a firm's risk, have determined that once this sum has been spent on a claim, the firm is moved into a higher risk bracket for the next five years. Due to the loss/expense expenditure, the firm is more likely to experience additional claims over the next five years. Therefore, the firm's premium will reflect that higher risk bracket. If no additional claims arise, the surcharge will decrease each year until five years have passed. The surcharge will disappear on the sixth year. The surcharge is *not* a "punishment" or "penalty". It is a reflection of what the numbers tell us; that once a given sum has been spent, the firm represents a higher risk for a period of years.



After discussing the surcharge with the firm, a question often posed is whether the firm can pay a settlement out of its own pocket to keep the amount spent by ALPS under the given sum. While we appreciate the offer, unfortunately, because the surcharge is a reflection of the increased risk, once that amount has been paid, it does not matter *who pays* the amount, only that that amount has been spent. Therefore, whether the firm pays or the insurer pays, the surcharge will remain the same.

Often firms call to discuss a circumstance that could lead to a claim, but in fact, no demand for money or services has been made upon the firm. There are many questions as to whether the firm should wait to report these situations or whether it is better to promptly advise the insurer; again, out of concerns over how a report will impact the firm's premium.

Although every situation is different and handled as such, in general, reporting one situation that could give rise to a claim will not adversely affect your premium. Again, insurers may take a different approach to reporting matters out of caution and it is worth discussing this topic with your carrier prior to the situation actually arising. In fact, most, if not all, claims-made policies *require* firms to report situations that could reasonably be expected to give rise to a claim. Failure to timely report situations such as a missed deadline for instance, can jeopardize coverage for a claim or suit later brought as a result of that missed deadline. Further, failure to *timely* report matters can adversely impact the firm's risk rating. When a firm fails to report one situation until much later when a claim is made, underwriting becomes very concerned that other situations exist that the firm has not reported and has greater difficulty

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Levit Essay Contest Seeks Entries!

Submissions are now being accepted for the annual Levit Essay Contest on Lawyers' Professional Liability. The winner of the contest will receive a cash prize of $5,000.00 and an expense-paid trip to the Spring National Legal Malpractice Conference in Boston on April 20-22, 2005.

This contest encourages original and innovative research and writing in the areas of legal malpractice law, professional liability insurance and loss prevention.

The topic is "Mandatory Legal Malpractice Insurance—What Are Its Implications for the Profession?" Submissions should address the pros and cons of mandatory legal malpractice insurance, as well as the problems presented by requiring lawyers to maintain professional liability coverage.

The Levit Essay Contest is open only to law students and young lawyers.

The deadline for submissions is February 17, 2005.

The competition is co-sponsored by the ABA Standing Committee on Lawyers' Professional Liability and the law firm of Long & Levit, LLP of San Francisco. Contest rules and the entry application are available at www.abalegalservices.org/levit.html. Please address any inquiries to Edna Driver, ABA StC Lawyers' Professional Liability, 321 N. Clark St., Chicago, IL 60610, 312/988-5763, drivere@staff.abanet.org

Message From the Chair

I hope you found the Fall 2004 National Legal Malpractice Conference to be a great way to learn about developments in our profession and to network with your colleagues. With your ongoing involvement and the contributions of our speakers, not to mention the support of the Conference's sponsors, we thought the Conference was a great success.

As this was my first Conference as Chair of the Standing Committee, I find it appropriate to draw your attention to the many accomplishments that took place during the term of my immediate predecessor, Ed Mendrzycki. The Committee flourished with Ed at the helm, with attendance at the Conferences growing to record numbers, and the launch of the Members' Only Web Pages for the National Legal Malpractice Data Center. I would like to continue to build upon Ed's and the Committee's prior success.

During my term, I plan to continue to guide the Committee in a way that keeps it toward the forefront of the ABA and the profession, since professional liability issues and legal malpractice insurance affect all lawyers. And, we will continue to take the Committee's work beyond loss prevention and risk management, by providing information and advocacy on related topics such as ethics and professional responsibility, as well as the intricacies of the insurance market. I am committed to having the Committee remain accessible, and we will look for new ways to expand our reach and connect more people and organizations to this important work. You are an integral part of that commitment.

On that note, I invite you to participate in the process. If you have interest in a particular area in the law of lawyering, or think that a certain topic should be addressed in some way, do not hesitate to provide your input. The Committee has at its disposal many resources and tools to convey your message, such as conferences, teleconferences, and publications (both print and electronic). Please do not hesitate to get in touch with ABA staff, either Jane Nosbisch or Glenn Fischer, with any proposals you have. Also, if there is something that the Committee is already doing that you think can be done better, let us know that too.

Be sure to mark your calendars for the Spring Conference in Boston on April 20-22. We hope to see you there.

Impact of Claims

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assessing the risk of that particular firm.

Generally, it is better to report out of caution when a firm is unsure whether a situation necessitates reporting. Call your insurer and discuss such situations with a claims attorney or risk manager who can assist you in working through the issues and, most importantly, address the potential for an actual claim. One common example is when a client has made it clear that he or she is unhappy with the firm but the firm, after careful file review, determines that it did not commit any errors. Discussing the particulars of this type of situation can be helpful in determining whether to report the circumstance.

Given the variety of claims and situations that we regularly address, it is not possible to discuss how one particular claim or circumstance will affect that particular firm's premium. However, hopefully, this brief general overview has helped to address some concerns often voiced when discussing circumstances and claims and their impact on the firm's premium.

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Standing Committee on
Lawyers' Professional Liability
American Bar Association
321 North Clark Street
Chicago, IL 60610-4714

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