Halloween Issue
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The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

TRICK OR TREAT!

The editors of the Halloween edition of the *Lawyers' Lawyer Newsletter* invite you to enjoy ghoulish tales of a lawyer who thought he escaped a dastardly trap only to realize – too late – that he hadn't done quite enough. You will not be able to look away from the gruesome results of an insufficiently specific engagement agreement horrifyingly combined with a suit for fees against client and non-client alike. View with terror and disgust what can happen when a lawyer receives inadvertently disclosed information, later held to be privileged. Finally, gaze upon the terrible results of shortcutting due diligence to speed up a transaction. We hope these horror stories will frighten and delight just in time for All Hallows' Eve.

Trick or Treat Editors' Note: We've gone all the way to jolly England for this delicious treat for some lawyers, and dastardly trick for others: avoid the trick and collect your well-deserved treat by implementing your own due diligence, and confirming to a reasonable extent the identity of your client and the facts surrounding the transaction.

Client Intake – Due Diligence – Liability to Parties Other than Client – Holding Funds in Trust

***P&P Property Ltd. V. Owen White & Catlin LLP, et al.* 2016 WL 05484797 (English High Ct. of Justice, Chancery Div. 2016)**

Risk Management Issues: What steps should a law firm take to confirm the identity of a new client and the details of the underlying transaction? How can the law firm protect itself from liability to other parties in the transaction when the client or the transaction turns out to be fraudulent?

The Case: The purchaser of a London property sued the seller's attorneys after a fraudulent real estate transaction, alleging breach of warranty of authority, negligence and breach of trust and undertaking, fell apart. The attorney had originally been contacted by the purported owner of unoccupied real property located in London for the purpose of negotiating bridge financing with respect to the property, but the client ("seller") changed the scope of the representation to encompass selling the property. Allegedly contacting the attorney while in Dubai, the seller claimed that he needed cash on an urgent basis to complete the purchase of a different property in Dubai.

While most of the communications between the attorney and the seller were by e-mail or telephone, the attorney and seller met in person at the law firm's office in London. At that time, the seller presented a passport which the attorney later claimed was a good likeness of the seller. In connection with the law firm's practices and to comply with UK anti-money laundering statutes and regulations, the law firm arranged for an anti-money laundering search regarding the seller to be conducted which came back marked as "referred" – meaning that further inquiry about the seller was required. The attorney requested and obtained additional information from the seller to confirm his identity and address, including bank statements and the completion of documents by a local Dubai solicitor confirming the seller's identity.

The sale closed and the purchase price was sent to the law firm to be held on behalf of the seller. Following the seller's instruction, the funds were then transferred from the law firm's account to the seller's bank account in Dubai. The purchaser then began to repair and renovate the property. As the work on the property progressed, the true owner of the property turned up and accused the purchaser of trespass. It was only then recognized that a fraud had occurred, and the seller could not be located to attempt a return of the transaction proceeds.

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The purchaser claimed that the law firm was liable for breach of warranty of authority, in that through words and conduct, the firm represented that it had authority to act for the owner of the property and was hired by the true owner of the property. In reliance upon those warranties of authority, the purchaser agreed to purchase the property. The court disagreed, concluding that the law firm could only be held to have acted upon authority conferred by its client – the fraudulent owner – and no warranty was implied that the firm also had the authority of the property's true owner.

The purchaser further claimed that because it relied upon the representations and actions of the law firm, a duty of care should be imposed even though it had not been a client. The court concluded that absent special circumstances, attorneys in real estate conveyancing transactions are to be understood as acting on the instructions of their client when making representations. The purchaser contended that special circumstances existed and a duty of care should be imposed because the law firm accepted direct responsibility to the purchaser. Relying on its earlier conclusion that the law firm's representation of authority only applied to its client and was not a representation of the *bona fides* of ownership, the court disagreed.

Consequently, the court concluded that the law firm had no duty to the purchaser to take reasonable care to ascertain the identity of the seller or to ensure that it was the true owner of the property. That duty fell to the purchaser's own counsel, who did not independently confirm seller's identity and instead relied upon his belief that seller's attorneys – because they were a reputable law firm – would have carried out identity checks.

The purchaser's final claims – breach of trust and breach of undertaking – were based upon its allegations that the law firm received the sale proceeds in trust and the proceeds were distributed to the seller in breach of that trust. The law firm contended that the funds were not held in trust for the purchaser, or if they were, the terms of the trust were not breached. The court agreed with the law firm – the funds were held by the law firm as agent for the seller, and they had been authorized by the purchaser's attorney to release the funds upon his confirmation of completion of the sale. While all claims were dismissed against the law firm, the court also opined that the attorney's due diligence fell short of the high standard expected from a trustee; the documents provided by the seller raised questions and red flags that should have been followed up.

Risk Management Solution: This case highlights the risks confronted by lawyers in independently communicating with third parties who are doing business with their clients other than to pass on information clearly provided by the client. Even when limiting their statements in that way, lawyers should state that they are not acting as attorneys for the third parties, and that the third parties should seek independent legal advice if necessary. Given that the case may be viewed as enlarging firms' liability to third parties, firms may wish to do some training on these topics to alert their lawyers to this exposure.

Trick or Treat Editors' Note: This case is an unfair trick for lawyers and clients alike when inadvertently disclosed information, which the lawyer has obtained and as to which the lawyer reasonably believes that privilege has been waived, is used without first seeking the court's approval.

Attorney-Client Privilege – Waiver – Inadvertent Disclosure by Third Party – Disqualification for Use of Inadvertently Disclosed Privileged Information

***McDermott Will & Emery LLP v. The Superior Court,* 10 Cal. App. 5^{th} 1083 (2017)**

Risk Management Issue: What are the obligations of an attorney who receives information inadvertently disclosed, which is later held to be attorney-client privileged, when the attorney reasonably believed that the privilege holder waived the privilege?

The Case: Dick Hausman, a director and officer responsible for managing the investments of M. Hausman, Inc. (MHI), hired McDermott Will & Emery LLP (McDermott) to provide a variety of estate planning services for his family. Over the years, McDermott formed several trusts for family members, and also represented MHI on corporate, employment, and other matters.

Dick's personal attorney, Mark Blaskey, sent Dick a lengthy email providing legal advice to Dick about his options for resolving a dispute with other MHI officers. Dick forwarded the Blaskey email to Ninetta, his sister-in-law, who then forwarded the email to her husband, who in turn gave it out to Dick's children, a McDermott lawyer, and others.

Thereafter, Dick filed two malpractice lawsuits against McDermott alleging conflicts of interest involving the firms' representation of various members of the Hausman family. McDermott was represented by Gibson Dunn, who received a copy of the Blaskey email from McDermott.

Over the objections of Dick's counsel, Gibson Dunn used the Blaskey email in the defense of McDermott, taking the position that any claimed privilege had been waived, because Dick sent the email to nonlawyers. Gibson Dunn also argued that the email came directly from the file of McDermott, not via discovery, and was therefore outside the conventional scope of attorney duties relating to the inadvertent disclosure of privileged information.

Dick filed a motion seeking a judicial determination that the Blaskey email was a privileged attorney-client communication that Dick had inadvertently disclosed, and a motion to disqualify Gibson Dunn from representing McDermott based on its use of the Blaskey email and its refusal to return it.

The trial court granted both of Dick's motions, disqualifying Gibson Dunn from continuing to represent McDermott in the malpractice actions.

A divided appellate court upheld the disqualification of Gibson Dunn. The court first held that substantial evidence supported the trial court's conclusion that Dick inadvertently forwarded the Blaskey email to Ninetta with no intention of waiving the privilege. Ninetta's subsequent disclosure of the email to others could not support a waiver of the privilege because Ninetta was not the holder of the privilege.

The court next considered whether Gibson Dunn's use of the email violated the rule set forth in*, State Compensation Insurance Fund v. WPS, Inc.,* 70 Cal.App.4th 644 (1999), the seminal California decision defining a lawyer's ethical obligations upon receiving another's privileged materials. It established the following standard: "When a lawyer who receives materials that obviously appear to be subject to an attorney-client privilege or otherwise clearly appear to be confidential and privileged and where it is reasonably apparent that the materials were provided or made available through inadvertence, the lawyer receiving such materials should refrain from examining the materials any more than is essential to ascertain if the materials are privileged, and shall immediately notify the sender that he or she possesses material that appears to be privileged. The parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified."

The court here found substantial evidence that supported the conclusion that the Blaskey email was a confidential communication made in the course of an attorney-client relationship, and therefore it was presumptively privileged. Therefore *State Fund* required Gibson Dunn to return the email. The court affirmed the disqualification because Gibson Dunn had improperly used the privileged material and because it determined that disqualification was required to prevent future harm and to protect the integrity of the judicial system.

The California Supreme Court declined McDermott's appeal petition on June 16. McDermott's request for the court to depublish the decision, which would bar any use or reference to the case, was also denied.

Comment: This is an extremely troubling decision, at least as it relates to Gibson Dunn's disqualification. While states' rules regarding waiver of privilege vary widely, few states go as far as California in imposing the draconian consequence of disqualification where a lawyer in good faith makes an objectively reasonable determination that privilege has been waived. The consequence of this outcome for McDermott – loss if its counsel of choice – does not seem in any way proportionate to what happened. It is hard to see how the plaintiff (or the legal system) would be harmed by permitting Gibson Dunn to continue as McDermott's counsel, subject to being precluded from making any further reference to the email.

Attorneys must be mindful that the duties under *State Fund* (or applicable rules in other jurisdictions) may not be limited to the inadvertently disclosed but privileged documents received from opposing counsel, but also may apply to documents the attorney receives from a client or other third parties. Regardless of how the attorney obtains the documents, whenever a reasonably competent attorney would conclude the documents appear to be privileged and are inadvertently disclosed, the *State Fund* rule requires the attorney to review the documents no more than necessary to determine whether they are privileged, notify the privilege holder, and refrain from using the documents until the parties or the court resolve any dispute about their privileged nature. The receiving attorney's reasonable belief that the privilege holder waived the privilege will not vitiate the attorney's duties. The receiving attorney assumes the risk of disqualification when that attorney elects to use the documents before the parties or the court has resolved the dispute over the privileged status. Note that rules governing obligations upon receiving inadvertently disclosed privileged material vary from state to state, and few states' rules are as draconian as California's.

Risk Management Solution: When there is the slightest doubt as to the propriety of using an inadvertently received document, lawyers should consider requesting the direction of the court before making use of it.

Trick or Treat Editors' Note: **This case is a trick for lawyers who tempt fate by writing engagement agreements that don't specify who is – and who is not – the client, among other things. There's an added trick here for lawyers who sue clients – and non-clients – for fees.**

Representing Constituents of Entity Clients – Suing for Fees – Legal Malpractice Counterclaims by Non-Client Entities

***Exeter Law Group LLP v Wong*, 2016 NY Slip Op 32425(U), 12/9/ 2016, Supreme Court, New York County**

Risk Management Issue: To what extent may an ambiguous engagement agreement with the constituents of an entity client expose lawyers to malpractice and fiduciary breach claims by the non-client entity?

The Case: Two individuals engaged a law firm to assist with transactions involving two corporations in which the individuals held shares, over an approximate three-year period. The law firm eventually sued both its clients (the individuals) and the corporations to recover fees. The clients and corporations asserted counterclaims in response, including claims for legal malpractice and breach of fiduciary duty, among others. The firm moved to dismiss the counterclaims.

As to the legal malpractice claim, the firm argued the shareholders had no standing to bring a direct action for injuries allegedly suffered by the corporations. The firm also argued that the corporations lacked standing to bring a legal malpractice claim because neither corporation engaged the firm and no privity existed.

The Court permitted the claims of both the shareholders and the corporations to proceed to trial. The Court explained that to the extent that the shareholders were bringing claims as individuals who were harmed when they relied on alleged negligent representation in structuring and forming their business ventures, they could state a claim for legal malpractice. With respect to the corporations' claims, the lack of a retainer agreement was not dispositive on the issue of whether there was an attorney-client relationship. Further, the Court found it significant that, despite the fact that the corporations were not parties to an engagement agreement, the firm asserted claims against the corporations for unjust enrichment and quantum meruit and sought to recover fees.

As to the breach of fiduciary duty claim, the shareholders and corporations argued the firm and one of its attorneys disclosed confidential and privileged information with another attorney outside the firm in order to coerce payment to the firm. The firm and attorney moved to dismiss on the grounds that the engagement letter explicitly authorized the firm to confer with the outside attorney. In addition, they argued the claim should be dismissed because New York Rule of Professional Conduct ("NYRPC") 1.6(b)(4) and 1.6(b)(b)(ii) authorized them to reveal client confidences in consulting with other lawyers. Finally, they argued counterclaimants failed to state a claim because there is no private right of action for a violation of the NYRPC.

The Court permitted the fiduciary breach claim to proceed to trial as well. The Court found that while the engagement letter might have permitted the attorney and firm to consult with the outside lawyer on certain matters, it did not "flatly contradict" the shareholder's allegations that this lawyer may have disclosed confidential communications without authorization. Further, the Court explained that the alleged coercive nature of the communication may rise to the level of a breach of a fiduciary duty. Finally, the Court determined that a claim for breach of fiduciary duty can be stated where the defendant lawyer is alleged to have used confidential information to disadvantage a former client.

Risk Management Solution: The ruling underscores the critical importance of specificity in engagement agreements particularly as to who is – or is not – the client. Had the agreement specified that it did not create an attorney-client relationship with the corporations, the corporations' claims may have been dismissed. The breach of fiduciary duty claim may also have been disposed of had the agreement detailed what information counsel was authorized to disclose. Finally, the decision highlights the danger of pursuing fees from clients, and especially from non-clients, regardless of the causes of action. Doing so may imply that specific tasks were undertaken for the benefit of the non-client and permit the non-client to state claims notwithstanding the fact that it was never a party to the engagement agreement.

Trick or Treat Editors' Note: **This case is an expensive trick for lawyers who blindly follow suspicious email directions about the disposition of client funds, instead of taking steps to independently confirm the instructions.**

Technology Security — Protecting Client Funds From Outside Interference

***Bile v. RPEMC*, 2016 WL 4487864 (E.D. Va., Aug. 24, 2016)**

Risk Management Issue: If a lawyer receives a suspicious email regarding the transmission of settlement funds, what steps should she take to protect herself, her client and any others with an interest in the funds?

The Case: *Bile* involved the settlement of an employment discrimination claim. *Bile v RREMC, LLC*, 2016 WL 4487864 (E.D. Va, Aug. 24, 2016). Six days after the settlement was reached plaintiff's counsel received an email that purportedly came from his client. Plaintiff's counsel noted, however, that the email had a domain extension ending with "aoi.com" rather than "aol.com." The email contained instructions to wire the settlement to a Barclay's account in the client's name in London. Plaintiff's counsel called his client and confirmed that the client had not sent the email. Plaintiff's counsel then simply deleted the phony email, but did not notify opposing counsel.

Several days later the lawyers discussed how to accomplish payment of the settlement. They agreed that the payment would be made by two checks, one in the amount of $63,000 and a second in the amount of $2,000, less withholding, sent via courier services to plaintiff at his home. Plaintiff's counsel agreed to send to defense counsel an email confirming plaintiff's home address — that confirmation email was sent from plaintiff's counsel's Yahoo.com email account.

Later the same day, defense counsel received another email, also from plaintiff's counsel's email account, this time directing that the settlement payment be wired to a Barclay's account (the same one identified in the first fraudulent email sent only to plaintiff's counsel). Believing that the email was genuine, defense counsel wired the settlement payment to the Barclay's account.

When the fraud was discovered, defense counsel made an unsuccessful attempt to recall the wire transfer. Plaintiff, who hadn't received the settlement payment, demanded that he be paid and refused to dismiss the lawsuit as agreed in the settlement. The defendant refused to make any further payment and demanded the lawsuit be dismissed pursuant to the settlement agreement. Eventually, the dispute was brought to the attention of the District Court. The Court conducted an evidentiary hearing to determine the reasonableness of each side's actions and who should bear the risk of loss.

The Court evaluated the actions of both lawyers under ordinary care principles guided by common-law contract principles and several rules from the Uniform Commercial Code. The Court fashioned a rule from these principles to the effect "that a blameless party is entitled to rely on reasonable representations, even when these reasonable representations are made by fraudsters." *Id.* at *8.

The Court ultimately concluded that the lawyer who was aware of the phony email appearing to be from the client should bear the risk of loss. In reaching that conclusion, the Court found that defense counsel had no reason to suspect the email asking the settlement be wired to an offshore account was fraudulent. *Id.* at *12. Additionally, the Court noted that both plaintiff's counsel and his client were aware that a malicious third party had targeted the settlement for a fraudulent transfer to an offshore account. *Id.* at *3. Finally, the Court found that both plaintiff's counsel and his client knew that the lawyer's email account was implicated in that fraudulent activity. *Id.* The District Court ultimately ruled:

> As technology evolves and fraudulent schemes evolve with it, the Court has no compunction in firmly stating a rule that: where an attorney has actual knowledge that a malicious third party is targeting one of his cases with fraudulent intent, the lawyer must either alert opposing counsel or must bear the losses to which his failure substantially contributed.

Id. at *13.

Risk Management Solution: While email has likely replaced the telephone as the primary mode of communication for many lawyers, this unfortunate circumstance could have been avoided had plaintiff's lawyer picked up the phone to call the defendant's lawyer about the spoofed client email, or had the defendant's lawyer called to ask about the change in the payment method from check to a wire transfer. Because of the immediacy of wire transfers, law firms may want to consider a policy or practice of calling to confirm the accuracy and validity of any wire transfer instructions before the wire is sent, and not rely on emails alone.

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