The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

Halloween Issue - October 2018

TRICK OR TREAT!

As Halloween nears, and the Great Pumpkin readies itself to visit, the editors of the Halloween edition of the *Lawyers' Lawyer Newsletter* invite you to enjoy the suspenseful but hair-raisingly narrow escape of a firm from the painful fate of disqualification. Share our gut-wrenching horror as we contemplate lawyers found personally liable for the firm's failure to pay trust fund taxes. View with terror and disgust what can happen when a lawyer is not sufficiently clear in terminating an engagement. Finally, gaze upon the terrible results of incomplete lateral hire screening. We hope these horror stories will frighten and delight just in time for All Hallows' Eve.

Trick or Treat Editors' Note: We begin our Halloween celebration with a delicious and richly-deserved treat—the success of a well-crafted engagement agreement and a timely termination letter. Lawyers who carefully describe the scope of engagement and consistently document termination of the client relationship avoid dastardly and hurtful tricks like disqualification and civil liability.

Conflict of Interest – Termination of the Attorney-Client Relationship – Avoiding the "Hot Potato" Rule – Former Client Conflicts

***Regal Cinemas v. Shops at Summerlin,* 2017 U.S. Dist. LEXIS 149497 (E.D. Cal. Sept. 13, 2017)**

Risk Management Issue: How can firms, through the proper structuring of engagement agreements and termination letters, protect their ability to take on new clients in matters related to the representation of former clients?

The Case: Regal Cinemas, Inc. (the "Plaintiff") sued Shops at Summerlin North, LP, Elk Grove Town Center, LP and the Howard Hughes Corp. ("HHC") (collectively, the "Defendants") for breach of contract and related claims. The Defendants moved to disqualify Plaintiff's counsel (the "Firm") on the basis that the Firm had terminated its representation of HHC for the purpose of engaging Regal Cinemas as a client in the litigation.

In California, like every state except Texas, the Rules of Professional Conduct prohibit an attorney from representing a new client where the new client's interests are adverse to the interests of a current client, even in unrelated matters. By contrast, an attorney may represent a client against a former client except where the subject of the new matter is the same as, or substantially related to, the subject of the previous matter. Thus, the issue was whether HHC was the Firm's current or former client at the time the Firm sought to represent the Plaintiff.

According to the Defendants, HHC and the Firm entered an "ongoing" attorney-client relationship pursuant to an engagement letter executed in 2015 and the Firm provided legal advice to HHC as late as June 2016. In October 2016, the Firm informed HHC that it had hired a new partner who represented a client (the Plaintiff) that intended to sue HHC. The Firm asked HHC for a conflict waiver, which HHC declined to provide. Shortly thereafter, the Firm sent a letter to HHC terminating the attorney-client relationship "effective immediately," and filed the litigation on behalf of the Plaintiff. The Defendants argued that the Firm could not engage in a "classic hot potato maneuver" in order to avoid the rule against concurrent representations by terminating an existing client for the purpose of taking on a representation adverse to that client.

In response, the Plaintiff argued that the Firm's attorney-client relationship with HHC was not ongoing because the matter that was the subject of the 2015 engagement letter concluded in January 2016 and that the legal advice that the Firm provided to HHC in June 2016 was nothing more than follow up. As evidence that the 2015 engagement was discreet, the Plaintiff pointed to the 2015 engagement letter, which stated that the Firm would perform additional legal services as the parties "may agree upon from time to time." The Plaintiff further argued that the termination letter was directed to HHC as a former client and was only sent out of an abundance of caution.

Although the Firm announced its new attorney-client relationship with the Plaintiff on the same day that the Firm sent HHC the termination letter, the court determined it was reasonable that the Firm sent the termination letter out of an abundance of caution and that the "effective immediately" language was boilerplate from a prior termination letter. The court agreed that the engagement letter language that the parties would agree to additional work from "time to time" indicated that 2015 representation was discreet and not ongoing. Finally, the court ruled that the June 2016 follow-up communications that the Firm had with HHC regarding the concluded matter did not mean that the matter was ongoing. On this basis, the court ruled that (1) HHC was a former client and (2) the subject matter of the litigation did not substantially relate to the subject matter of the Firm's representation of HHC.

Risk Management Solution: This case illustrates the dual importance of clearly articulating the scope of a representation in an engagement letter and timely drafting and sending termination letters closing the file and ending the representation. If a firm intends a representation to be limited to a discreet matter, the engagement letter should specifically define the parameters of that matter and indicate that additional representations outside the scope of the engagement will be covered by separate engagement letters. Where, out of an abundance of caution, a firm elects to send a termination letter sometime after the representation has concluded, the letter should state that the representation ended at the completion of the matter and that the letter is intended only to confirm the prior termination. If it becomes necessary to end the ongoing representation, the termination letter should specifically indicate when the relationship terminates (e.g., "effective immediately"). In all cases, whether the attorney-client relationship is structured as a series of discreet representations or as a single ongoing representation, firms should tailor their engagement letters and termination letters to the particular representation at hand. It is also critical that confirmation of termination be completed before the commencement of representation in a matter adverse to the now former client. Failure to do so could lead to disqualification. See, e.g., *McClain v Allstate Prop. & Cas. Ins. Co.*, Case No. 3:16CV843-TSL-RHW (S.D. Miss. Northern Div., April 25, 2017) (lawyer disqualified when termination letter sent one day after execution of engagement agreement with new client).

Trick or Treat Editors' Note: From treat to terrifying trick—no matter how you try, you cannot avert your eyes from the horror of lawyers' personal liability for unpaid firm trust account taxes. These lawyers fell prey to the courts' expansive definition of "responsible person" and "willful." On All Hallows' Eve, and every other day of the year, do not forget that lawyers cannot escape the long, bony fingers of the IRS simply by delegating authority to handle tax payments.

Partners and Officers – Personal Liability – Tax Liability

***Alex Spizz v. USA v. Todtman*, Case No. 15-CV-2361 (S.D.N.Y. December 4, 2017)**

Risk Management Issue: When do officers and shareholders or partners of law firms bear personal liability for the firm's failure to pay trust fund taxes to the Internal Revenue Service?

The Case: Between 2009 and 2012, New York lawyers Spizz, Todtman and Nachamie conducted business through their law firm: Todtman, Nachamie, Spizz & Johns, P.C. Todtman, Spizz, and Nachamie were each one-third owners of the firm.

Between 2009 and 2012, the firm was in financial difficulty, and periodically failed to pay its quarterly trust fund taxes. The failures occurred when the firm was controlled by first one partner, then another, although the third partner apparently righted the ship and paid taxes for a time. Its non-payment of taxes eventually ran the firm afoul of the IRS. In 2012, the IRS assessed $1.3 million in penalties against the three shareholders personally, representing the amount of funds unremitted by the firm from June 2009 through March 2012.

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In 2015, Spizz sued to abate the IRS penalties against him in the Southern District of New York. The government responded with a counter-claim against Spizz and a third-party complaint against Todtman and Nachamie, seeking recovery of the outstanding tax liabilities. The court granted summary judgment on the claims against Spizz and Todtman, relying on 26 USC §6672, which permits the IRS to impose direct liability on the person responsible for the delinquency, and shifts to the accused the burden of proving that he or she is not a "responsible person," and that the failure to pay was not "willful." The partners, including the partner who took control of the firm and successfully paid taxes for a time, ended up being personally liable for the $1.3 million assessment.

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Comment: This case highlights the grave risk of personal exposure faced by partners or shareholders when the law firm fails to remit trust fund taxes. While liability is ostensibly limited only to the partner or shareholder who exercises authority over financial affairs, the court's decision takes a very expansive view of who qualifies as a "responsible person." So long as a partner or shareholder has the ability "exert influence" to avoid a tax delinquency, liability potentially attaches even though such a partner or shareholder does not actually exercise the authority and even though actual responsibility for tax payments has been delegated to another partner or shareholder.

The definition of conduct deemed "willful" is equally broad, including a failure to investigate or to follow up after notice of a deficiency. The greater the control over the finances, the more likely the court will find an omission willful even though the partner or shareholder can show lack of knowledge.

The import of the holding is that every partner and shareholder, especially of a smaller law firm, may be personally liable. Indeed, as the court observed, it would be hard-pressed to "find a circumstance where one of three shareholders in a small law firm would be a responsible person under §6672, while the other two would not."

Risk Management Solutions: All law firms need to have in place a system of financial controls that regularly and routinely distributes critical financial information to all the owners, thereby creating oversight that all laws and rules relating to the firm's finances are complied with. It almost goes without saying that each partner and shareholder has the personal responsibility to review relevant financial information, but this case demonstrates that sometimes even lawyers need to be reminded of what ought to be obvious.

Trick or Treat Editors' Note: Just when he thought he was out, this poor unfortunate soul was dragged back in. Continued contact with a former client or replacement counsel regarding the matter can lead to the most wretched of outcomes. Courts will examine an alleged attorney-client relationship from the client's point of view, which is likely to end in terrifying and expensive tricks for the lawyer.

Attorney-Client Relationship – Termination of Representation – Implications of Assisting Successor Counsel

***Cesso v. Todd*, 82 N.E.3d 1074 (Mass. App. 2017)**

Risk Management Issue: What are the risks of continuing liability if a lawyer withdraws from representation of a client, but continues to work with successor counsel and the client on the matter?

The Case: Thomas Cesso met with Attorney Gary Owen Todd to discuss the possibility of Todd taking over the representation of Cesso in a divorce action. Todd introduced Cesso to another attorney at Todd's firm, John Quigley, who would assist in the representation. Shortly after Cesso's prior attorney withdrew, Cesso requested a representation agreement from Todd and Quigley, who then filed appearances in the divorce action.

Within the month, Quigley left Todd's firm to start his own firm, and Todd and his firm filed a notice of withdrawal of appearance in the divorce action. Todd sent Cesso a letter that informed Cesso of Quigley's departure from Todd's firm, and stated that "[a]ltough Quigley and I will continue to work together and consult on your case, your hard files will need to be transferred to Quigley's office in Newburyport." The letter was hand delivered to Cesso, who signed it, agreeing to the transfer the file to Quigley.

After notice of withdrawal was filed, Cesso had no verbal communication with Todd and Todd did not bill Cesso. Todd sent a final bill with entries only through the date of the notice withdrawal, but the bill included form language stating that any unused retainer would be applied to future fees.

Cesso emailed Quigley several times after Todd withdrew, copying Todd. Cesso requested that Todd appear with Quigley at hearings, requested a conference call with both attorneys to discuss strategy, and also questioned what the roles were between Quigley and Todd. Todd never responded to these emails or spoke to Cesso.

Todd did not appear at the trial, and Cesso emailed Todd directing that any unused retainer be sent to Quigley. After the divorce concluded, Cesso filed suit against Quigley and his new firm for legal malpractice, and later added claims of legal malpractice and misrepresentation against Todd.

The lower court granted summary judgment in favor of Todd, and Cesso appealed. Todd argued that there was no legal malpractice because there was no attorney-client relationship after Todd withdrew from the action. The appellate court disagreed, reasoning that an attorney-client relationship can be based on an express contract or be implied-in-fact. It also noted that an attorney-client relationship is implied (1) when a person seeks advice, (2) the advice relates to matters within the attorney's professional competence, and (3) the attorney expressly or impliedly gives advice or assistance. Express or implied advice can be established by demonstrating that the person seeking legal services relies on the attorney and the attorney, who is aware of the reliance, does nothing to repudiate the client's reliance.

The appellate court looked past Todd's formal withdrawal of his appearance and concentrated on the facts that demonstrated that a reasonable person would think Todd was still working on the case: the client copied Todd on emails; Todd provided a final bill stating that any amount left in his retainer would be applied to future costs; all while Todd took no action to negate Cesso's belief that Todd was working on his case, albeit in the background.

The court determined that the attorney-client relationship ended between Todd and Cesso only when Cesso asked Todd to forward any unused retainer to Quigley. On that basis, the appellate court reversed the lower court, holding that a reasonable trier of fact could conclude that the attorney-client relationship continued after Todd formally withdrew.

Risk Management Solution: Continued contact with a client regarding a matter after the representation has concluded can create an ongoing implied attorney-client relationship. In order to avoid this outcome, it is essential to clearly and unequivocally withdraw from any attorney-client relationship and representation and have no further involvement except to assist successor counsel in the orderly transfer of files. The letter informing the client of the withdrawal should use language that explains unequivocally to the client that the lawyer is no longer representing the client. If a former client takes actions consistent with continued representation, it is the lawyer's responsibility to disabuse the client of the mistaken notion that the relationship continues. Plain speaking can make the difference between a successful dispositive motion and an expensive settlement in a legal malpractice claim.

Trick or Treat Editors' Note: This gruesome lateral-hire trick appeared, almost without warning, from the moonlight. Firms that do not exercise sufficient due diligence in lateral hiring may suffer the same horrible, and expensive, fate. The antidotes to this kind of infection are: identification of all lateral-hire current clients and matters, complete intake procedures for each, including review of the scope of representation and docketing of deadlines, and assigning a partner to oversee each incoming matter.

Lateral Hires – Screening – Moonlighting – Due Diligence by Hiring Firm – Vicarious Liability because of Lawyer's Apparent Authority

***McFarland v. Niekamp, Weisensell, Mutersbaugh & Mastrantonio, LLP,* 2017-Ohio-8394, 2017 Ohio App. LEXIS 4774 (November 1, 2017)**

Risk Management Issue: When a law firm hires a lateral attorney, what due diligence must it undertake in connection with the business introduced by the lateral attorney?

The Case: The plaintiff-clients (the "clients") engaged a law firm (the "first firm") to prosecute a claim against their former stockbroker, and their case was assigned to an associate attorney. The attorney met with the clients, reviewed documents and

drafted a complaint which he claimed to have filed on their behalf. The attorney then left the first firm to open his own law firm and the clients agreed to continue their representation with him. The attorney subsequently closed his law firm and joined a second law firm without informing his clients.

The clients learned the attorney had joined the second firm when they performed an internet search and confirmed with a receptionist employed by the second firm. Thereafter, the clients met with the attorney and received his new business card identifying him as an employee of the second firm. Over the next several months, the clients called and left messages with the attorney's assistant, other administrative employees and partners of the second firm regarding the status of the case and requesting a document. The clients also communicated with the assistant and firm employees to schedule meetings. Ultimately, the attorney ceased communicating with the clients.

The clients subsequently discovered that he never filed the complaint and that the statute of limitations for filing suit had expired. The clients sued the second firm alleging that it was vicariously liable for the attorney's alleged malpractice, as the attorney had apparent authority to represent clients on the firm's behalf.

The trial court granted summary judgment in favor of the second firm on the issue of apparent authority, finding there was no evidence to suggest that the second firm did anything to make the clients believe they were clients of the firm or that the attorney had authority to represent them. The clients appealed the trial court's decision. On appeal, the second firm argued that the attorney's legal representation of the clients was outside the scope of his employment because he failed to comply with the firm's policies for bringing a new client to the firm and because the lawyer was "moonlighting."

The appellate court reversed, determining that a question of material fact on the issue of apparent authority existed. Specifically, the court found that the volume of messages combined with statements regarding the status of the case, copies of a letter, and scheduling a meeting is evidence of knowledge by the office staff regarding the clients that was imputable to the attorneys/principals for which they worked. The incoming phone messages, outgoing calls, and scheduling of meetings handled by the second firm's staff were "indicia of firm involvement or representation of the client's interests." Additionally, the attorney was identified on the law firm's website which likewise indicated apparent authority to act on behalf of the firm.

Risk Management Solution: This case serves as a cautionary example of the risks a law firm undertakes when hiring a lateral attorney with portable business, the dangers that arise when lawyers engage in "moonlighting," and the importance of support staff in managing a law firm's risk. This decision indicates that a firm faces exposure for a lateral attorney's acts or omissions in representing a client, even where the attorney's representation violates the firm's policies and procedures, (e.g., where the matter is not formally transferred and/or new client intake process is performed). It is critical that law firms implement due diligence procedures to ensure that: the lateral attorney identifies and reports to the firm all existing clients and/or matters that the lateral attorney is bringing to the firm; the client has consented to the firm's representation; that the proper intake process has been performed for every new client; the firm agrees to the scope of representation; a responsible partner is assigned to each incoming matter to supervise the lateral attorney's work; and sufficient file management procedures (e.g., docketing statutes of limitation and issuing timely status reports) are followed. In addition, the case illustrates the value of training support staff in risk management, including expressly supporting a culture to encourage staff to identify and report violations of the file intake and management process, and other anomalies. Indeed, this decision shows that the staff's knowledge may be sufficient to create a duty on the part of the firm towards "clients" of which it had been unaware.

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