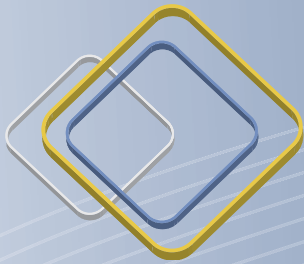

Lawyers' Professional Liability UPDATE

May 2010 Issue 5

Statute of Limitations

Continuous Representation Rule Applied to Former Firms

Waggoner v. Caruso, 68 A.D.3d 1, 886 N.Y.S.2d 368 (2009)

In *HNH Intern., Ltd. v. Pryor Cashman Sherman & Flynn LLP*, 63 A.D.3d 534, 881 N.Y.S.2d 86 (N.Y.A.D. 2009), the court applied the continuous representation to a predecessor firm and the successor firm "because the attorneys who initially handled the matter continued to represent plaintiffs in the matter, albeit at different law firms." In *Waggoner*, citing *HNH*, the court held that the statute of limitations remained tolled during the time the lawyer left his prior firm. The court was concerned that the prior firm could seek indemnity or contribution from the lawyer, interfering with his ongoing representation.

Insurance

Notice to Departed Lawyer Was Notice to the Law Firm for Coverage

Berry & Murphy, P.C. v. Carolina Cas. Ins. Co., 586 F.3d 803 (10th Cir. 2009)

In March 2006, Murphy left Berry & Murphy, P.C., taking with him the Ciri lawsuit. A motion to dismiss for failure to prosecute was subsequently granted. With new counsel, the case was reinstated. In January 2007, the new counsel put Murphy on notice of an intended legal malpractice action, which Murphy reported to Carolina Casualty. The demand was not sent to Berry, who continued to practice in his own name as a professional corporation, also insured by Carolina Casualty. In January 2008, Murphy, Berry, and Berry & Murphy were sued for legal malpractice. Berry was not served, however, until July 2008. His request for coverage was denied by Carolina Casualty.

The court deemed that the letter and lawsuit alleged related wrongful acts under the policy, constituting a single claim first made at the time of letter. The court then observed that under the policy, "[a] Claim shall be deemed to have been first made at

Editor

Terrence P. McAvoy
222 North LaSalle Street
Suite 300
Chicago, Illinois
312-704-3281

Randal N. Arnold
Milwaukee, Wisconsin
414-276-6464

Thomas L. Browne
Chicago, Illinois
312-704-3576

Anthony E. Davis
New York, New York
212-935-1100

David A. Grossbaum
Boston, Massachusetts &
Providence, Rhode Island
617-213-7003

Peter R. Jarvis
Portland, Oregon
503-243-7696

Ronald E. Mallen
San Francisco, California
415-362-8112

Thomas P. McGarry
Chicago, Illinois
312-704-3506

Michael E. O'Neill
Schererville, Indiana
219-864-4522

Victoria L. Orze
Phoenix, Arizona
602-337-5524

Thomas P. Sukowicz
Ft. Lauderdale, Florida
954-375-1142

Philip Touitou
New York, New York
212-471-6211

www.lawyeringlaw.com

HINSHAW
& CULBERTSON LLP

the time notice of the Claim is first received by any Insured." Under Berry's policy, the definition of "insured" included a former stockholder, although it was limited to one acting within the scope of his or her duties for the named insured. Here, Murphy was a co-shareholder in Berry & Murphy, P.C. and the subject conduct implicated his conduct while with that law firm.

Consequently, the claim was not first made during Berry's policy. The court acknowledged that its holding led to a harsh result because Berry had no knowledge of the claim or lawsuit until after he acquired the present policy. A dissenting judge disagreed, observing that the policy was ambiguous as to whether the definition of "insured" also applied for the purpose of notice. The judge accused the majority of conflating two inquiries "coverage and notice," a result inconsistent with Colorado law.

Insurance

Personal Injury Coverage Trumped Willful Acts Exclusion

***Liberty Ins. Underwriters, Inc. v. Camden Clark Memorial Hosp. Corp.*, 2009 WL 4825199 (S.D. W.Va.2009)**

A federal district court in West Virginia held that an insurer was obligated to indemnify a malicious prosecution claim. The insuring agreement provided coverage for personal injury, which expressly included "false arrest, humiliation, detention or imprisonment, wrongful entry, eviction or other invasion of private occupancy, abusive litigation (criminal or civil), abuse of process, malicious prosecution." The court stated that this more specific coverage grant prevailed over the general exclusion for fraudulent, criminal, malicious and deliberately wrongful conduct. The court did not discuss public policy considerations of whether a malicious prosecution claim could be indemnified.

Evidence

Alleged Misuse of Confidential Information in a Divorce Must Be Supported by Evidence of Disclosure or Misuse

***Brown v. Green*, 302 S.W.3d 1 (Tex. App. Hous. (14 Dist. 2009)**

Plaintiff sued defendant for representing his wife in their divorce and allegedly using confidential information gained over 12 years of prior representation. The court examined the evidence presented regarding the lawyer's motion for summary judgment. To the extent financial information had been disclosed as to subjects on which the parties agreed, there was no causation of injury. As to the claimed knowledge of the disparity in the parties' financial position, there was no evidence that defendant had actually used such information in an effort and strategy to wear down plaintiff "financially and emotionally." Regarding claims that the information was used to create dissension in the family so as to create an incentive to sue plaintiff concerning a charitable foundation, the evidence that a lawsuit concerning the foundation was filed did not establish that confidential information was used or disclosed. As to an alleged breach of the duty of loyalty, plaintiff failed to show a continuation of the attorney-client relationship.

Damages

Indiana Federal Court Crafts a Remedy to Avoid Awaiting Future Damages Regarding a Trust

***Kern v. Radez*, 665 F. Supp. 2d 982 (S.D. Ind. 2009)**

A lawyer was instructed by his clients, a husband and his wife, to provide that the sole residual beneficiary of a trust of the husband's assets would be his daughter by a previous marriage if he predeceased the wife, but only upon the wife's death. Instead, the irrevocable trust divided the property equally among all of the couples' children, so that the daughter would receive only a one-sixth share. When the husband died, there was $1 million in assets. A certified public accountant offered evidence as to the probable value of the assets at the end of the wife's projected life expectancy. Conceding uncertainty of the measure of the daughter's loss, especially because the wife could withdraw assets for her own use, the court was concerned about the practical considerations in delaying resolution of the damage claims until the wife's death. Rejecting the approaches offered by the parties, the court crafted a remedy:

> The solution would be to require Radez [the attorney] to fund at this time a second "shadow" trust for Ann's [the daughter's] benefit. That trust should be funded at a value of five-sixths of the current value of the trust created with Ted Holland's assets. Ann would be the sole remainder beneficiary of that shadow trust. Radez (and/or his malpractice carrier) would be entitled to withdraw from the trust each year exactly five-sixths the amount that Barbara [the wife] withdraws from the

real trust. Upon Barbara's death, Ann would receive one-sixth of the real trust and all of the assets of the "shadow" trust. The two sums should total 100 percent of the residual value of the real trust. By this method, Ann would not receive any money any earlier than she would have received if Radez had not made his mistake, but she would receive upon Barbara's death as nearly as possible the amount that Ann would have received if Radez had not made his mistake.

Statutory Liability

FTC Lacks Authority to Regulate Lawyers Under the Fair and Accurate Credit Transactions Act

***American Bar Association v. Federal Trade Commission*, 671 F. Supp. 2d 64 (D.D.C. 2009)**

In summary, the statutory authority of the United States Federal Trade Commission (FTC) to regulate "creditors" in order to combat identity theft does not include the power to regulate lawyers. The power of a federal agency to regulate lawyers in the lawyer-client relationship would require evidence of clear congressional intent and consideration of a lawyer's ethical duties and the essential aspects of the attorney-client relationship.

In 2006, the FTC took the first steps in creating what is commonly referred to as the Red Flags Rule under the Fair and Accurate Credit Transactions Act (FACTA). The rule requires financial institutions and creditors to establish policies targeted at preventing identity theft. After multiple delays in implementation to clarify which individuals and entities were covered, and shortly before the rule was scheduled to take effect, the FTC issued a press release in April 2009 indicating — for the first time — the agency's policy that attorneys who bill clients after services are rendered would fall under the rule's definition of "creditor," and thus be subject to FACTA's provisions. A "creditor" is defined by the law here as someone who regularly extends the right of a debtor to defer payment.

A firestorm of criticism from the legal profession ensued, and the American Bar Association (ABA) sought declaratory and injunctive relief, arguing that application of the rule to attorneys exceeded the FTC's statutory authority. The U.S. District Court for the District of Columbia, granted the ABA summary judgment, supplementing the court's oral ruling.

The court held that Congress neither explicitly nor implicitly, in language or in purpose, granted the FTC authority to regulate attorneys under FACTA. The court noted that the terms used to describe the entities regulated by FACTA and the population that the Act sought to protect did not correspond with terms applicable to the legal profession. Regarding the former, the terms "financial institution" and "creditor" do not squarely describe law firms or the relationships law firms have with their clients. Regarding the latter, FACTA sought to protect "account holders" and "customers," which are terms that do not squarely describe clients or the relationships clients have with their attorneys.

The court found that nothing in the legislative history or the administrative record, which never considered the subject of regulating lawyers, indicated that FACTA or the Red Flags Rule applied to the legal profession. The court held that Congress unambiguously did not intend FACTA to apply to attorneys. The court also noted that even if Congress' intent was ambiguous, the FTC's construction of FACTA was unreasonable, completely arbitrary, post-hoc without any inquiry or fact-finding, and thus impermissible and entitled to no deference. The FTC argued that monthly billing of clients constituted deferred payment. But the court noted that ethical constraints prevent a lawyer from taking ownership over client funds before they are earned, and that as a practical matter, lawyers generally must bill on a periodic basis. The court found that the commission failed to demonstrate the need to redress identity theft in the legal profession, citing a number of ethical rules that already give lawyers incentive to prevent identity theft, namely Model Rules 1.1, 3.3, 4.1(b), 4.4(a) and 7.1. In addition, the court distinguished *Heintz v. Jenkins*, 514 U.S. 291 (1995) (regulating lawyers as "debt collectors" under 15 U.S.C. § 1692a(6) if they regularly collect or seek to collect debts), and *Goldfarb v. Va. State Bar*, 421 U.S. 773 (1975) (the practice of law constitutes "commerce" subject to Section 1 of the Sherman Act).

Finally, the court held the FTC's construction impermissible based on federalism concerns. The court noted that regulation of attorneys is traditionally a state prerogative and cited precedent indicating that if Congress' language is ambiguous, it is unreasonable for a federal agency to decide that Congress has chosen to regulate lawyers without a clear statement of congressional intent to do so.

Here, the federal court refused to defer to an agency's post-hoc policy implementing an administrative rule that would alter the federal-state balance of power in regulating lawyers, without a clear statement of congressional intent and lacking any administrative record to support the agency's position.

Conflicts

Joint Defense Agreements Give Rise to Unique Conflicts and Imputation Issues

***District of Columbia Bar Legal Ethics Comm. Op. 349* (Sept. 2009)**

In summary, a lawyer in a law firm who has participated in a joint defense agreement on behalf of a client may have contractual and fiduciary duties to the non-client parties to that agreement, which may give rise to conflicts of interest on subsequent substantially related matters. Such conflicts may be imputed from the lawyer to a firm unless there is an adequate screening mechanism.

The District of Columbia Bar Legal Ethics Committee addressed conflicts of interest issues that arise when a lawyer in a law firm enters a joint defense agreement on behalf of a client. In such circumstances, some members of the defense group are not the lawyer's clients. The committee assumed that the lawyer had received confidential information from the non-client members and that the lawyer and firm were no longer involved in the joint representation.

The committee first addressed whether the conflicts rules apply to non-client parties to a joint defense agreement, and if so, whether such conflicts will be imputed to the firm. The committee noted that the current client and former client conflicts rules generally only apply to conflicts between clients, which was not the case here. Rule 1.7(b)(4), however, prohibits a lawyer from representing a client when the attorney's judgment may be adversely affected by his or her responsibility to a third party. Based on this rule, the committee opined that a lawyer's contractual or fiduciary obligations to a non-client member of a joint defense group could give rise to a conflict with a client in a subsequent matter.

In addressing imputation of such conflicts, the committee first pointed to Rule 1.10(a)(1), which states that Rule 1.7(b)(4) conflicts will only be imputed in certain circumstances. Namely, if the lawyer's third-party interest under Rule 1.7(b)(4) presents a significant risk of adversely affecting the representation of a client by other lawyers in the firm, the other lawyers will be barred from such representation. The committee addressed this imputation rule in two different contexts, both involving substantially related matters after the matter with the joint defense agreement had concluded: (1) where the lawyer has switched firms, and (2) where the lawyer has remained at the same firm.

Regarding the former, the committee opined that the new firm could represent a client against a joint defense member by timely and effectively screening the lawyer, thus effectively eliminating any appreciable risk of an adverse effect on the representation. Regarding the latter, the committee noted that two factors complicate the imputation issue. First, the firm itself might be a party to the joint defense agreement. Second, given the possibility that other members of the firm came into contact with confidential information from the joint defense members, enacting a retroactive screen could be quite difficult. The committee therefore concluded that the firm likely could not represent a client against a joint-defense member unless the firm and its other lawyers were not bound by the joint defense agreement, and the other lawyers were not exposed to any confidential information related to the joint defense agreement.

The opinion draws an important distinction between the ethical duties owed to current and former clients, on the one hand, and contractual and fiduciary duties that may be owed to non-client members of a joint defense group, on the other. The reasoning in the opinion presumably would apply equally to any common interest agreement, not only "joint defense agreements."

Hinshaw & Culbertson LLP prepares this newsletter to provide information on recent legal developments of interest to our readers. This publication is not intended to provide legal advice for a specific situation or to create an attorney-client relationship. We would be pleased to provide such legal assistance as you require on these and other subjects if you contact an editor of this publication or the firm.

Lawyers' Professional Liability Update is published by Hinshaw & Culbertson LLP. Hinshaw is a national law firm with approximately 500 lawyers in 24 offices. We offer a full-service practice, with an emphasis in litigation, business law and corporate transactions, environmental, intellectual property, labor and employment law, professional liability defense, estate planning and taxation matters. Our attorneys provide services to a range of for-profit and not-for-profit clients in industries that include alarm and security services, construction, financial services, health care, hospitality, insurance, legal, manufacturing, real estate, retail and transportation. Our clients also include government agencies, municipalities and schools.

Hinshaw was founded in 1934 and is headquartered in Chicago. We have offices in 12 states: Arizona, California, Florida, Illinois, Indiana, Massachusetts, Minnesota, Missouri, New York, Oregon, Rhode Island and Wisconsin.

Copyright © 2010 Hinshaw & Culbertson LLP, all rights reserved. No articles may be reprinted without the written permission of Hinshaw & Culbertson LLP, except that permission is hereby granted to subscriber law firms or companies to photocopy solely for internal use by their attorneys and staff.

ATTORNEY ADVERTISING pursuant to New York RPC 7.1