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Recent Developments in Risk Management

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Joint Clients — Confidentiality — Right to See Clients' File

New York State Bar Association Committee on Professional Ethics Opinion 1070 (10/9/15)

Risk Management Issue: In a joint client representation, if one co-client requests a copy of the client file from the lawyer and directs the lawyer not to disclose the request to the other co-clients, may the lawyer provide the requested client file without advising the other co-clients?

The Opinion: This ethical opinion involves Lawyer A, who represented four Defendants in a matter. One of the joint clients requested that Lawyer A provide Lawyer B (who was separately advising the requesting client) copies of the client file, including billing records. The request also directed Lawyer A to keep the request in confidence and not to disclose the request to the other joint clients.

The New York Rules of Professional Conduct provide that a lawyer may represent multiple clients in the same matter as long as the representation will not require the lawyer to represent differing interests (unless each client consents to the conflict under Rule 1.7(b)). The lawyer has an equal duty of loyalty to each client, and each client has the right to be informed of anything bearing on the representation that might affect that client's interests. (Rule 1.4). In a joint representation, there is a presumption that information disclosed by one co-client will be shared with all other co-clients. (Rule 1.7, Cmt. 31).

However, the presumption that confidences will be shared among co-clients is subject to exceptions, including where disclosure would violate an obligation to a third party or where the lawyer has promised confidentiality with respect to a disclosure. Thus for example, in a prior opinion, the Committee found an exception applicable where disclosure would violate a duty undertaken by the lawyer to another client in the same representation. In that case, the lawyer jointly represented two clients, A and B, in connection with partnership affairs. Client B advised the lawyer that Client B would be breaching the partnership agreement, but preceded this disclosure with the statement that he proposed to tell the lawyer something "in confidence." The Committee therefore found that the lawyer had a duty of confidence with respect to the disclosed information.

In the present case, Lawyer A did not warn the clients either orally or in the retainer agreement or in a separate consent to joint representation that all confidences would be shared with the other clients before the client asked Lawyer A to treat his request to see the client file as confidential. Consequently, the Committee concluded Lawyer A was obligated to maintain the confidentiality of the request.

As to how to deal with the request for the client file, Rule 1.15(c)(4) provides that "a lawyer shall . . . promptly . . . deliver to the client . . . the funds, securities or other properties in the possession of the lawyer that the client . . . is entitled to receive." Under Sage Realty *Corp. v. Proskauer Rose Goetz & Mendelson*, 91 N.Y. 30, 34 (1997), an exception to the general rule of full access to the file arises when the attorney can make "a substantial showing . . . of good cause to refuse." For example, the lawyer "should not be required to disclose documents which might violate a duty of nondisclosure owed to a third party, or otherwise imposed by law," or "firm documents intended for internal law office review and use." *Id*. at 37.

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However, the Committee concluded that if the lawyer in good faith believes that the request for the file is information that would be material to the remaining co-clients (so that non-disclosure would entail a breach of loyalty to those clients), then the requesting client is not entitled to receive a copy of the file. Acting on this request without telling the other clients would entail a breach of a duty to those clients to keep them informed of material developments. Thus, the Committee concluded Lawyer A was not obligated to comply with the request for the file if the request was conditioned on the lawyer's not disclosing the request to the other clients.

Risk Management Solution: It is critical that law firms include express language in the engagement letter in all joint or multiple client representations explaining how confidential information will be treated as between or among the clients, and explaining the duty to keep all clients informed of material developments in the engagement, pursuant to Rules of Professional Conduct 1.4. Normally, the letter will explain that while all information will be confidential as to third parties, each or all of the clients will be entitled to all confidential information. If a different treatment is intended, it must be clearly expressed. Failing to include the appropriate language leads to the kind of situation addressed in this Opinion. When such a problem arises, precisely because the lawyer has information he should otherwise share but now cannot, an unwaivable conflict of interest exists and the lawyer or firm may have no choice but to withdraw, probably from representing both or all of the clients in the matter, pursuant to RPC 1.16.

Statements by Lawyer Relating to Investments — Liability to Third Parties for Negligent Misrepresentation

***Chanin, et al. v. Machcinski, et al.*, 139 A.D.3d 490 (2016)**

Risk Management Issue: Is a lawyer liable for representations made by the lawyer to a third-party investor who relies on the representations, thereby losing his investment?

The Case: Plaintiffs were investors in a hedge fund owned and controlled by Dr. Walter Gerasimowicz and two of his companies. The hedge fund, the two companies and Dr. Garasimowicz were all represented by Defendant Victor Machcinski. In 2011, Plaintiffs made a series of investments in the Fund. Plaintiffs complained that unbeknownst to them, by the time they were induced to invest in the Fund, Gerasimowicz had already wrongfully diverted $2.65 million from the Fund in purported loans to another of his companies.

In late 2011, Plaintiffs were contacted by the SEC inquiring about their investment in the Fund. Concerned, Plaintiffs considered withdrawing their investment and seeking counsel to compel its return. Before doing so, they sought an explanation from Gerasimowicz for the SEC inquiry. On Gerasimowicz's behalf, his lawyer Machcinski assured the Plaintiffs that the SEC inquiry was routine, stating:

> The SEC has vigorously implemented its new oversight responsibilities under Dodd-Frank, and its communications with you regarding the Fund resulted from this new and very expansive authority. Please be assured that there has been no suggestion or insinuation by the SEC that there is or has been any impropriety regarding Meditron's services to the Fund.

Plaintiffs claim they relied on this representation and took no action to seek the return of their investment. In fact, a year later, the SEC found Gerasimowicz and his companies in violation of numerous securities laws including misappropriation and misuse of the Fund's assets, ordered them to disgorge $3.1 million and pay civil penalties of over $1.9 million. As a result, Plaintiffs lost their entire investment in the Fund.

Plaintiffs instituted suit against Machcinski and his firm, asserting a lone cause of action for negligent misrepresentation. They sought recovery of the investment they allegedly lost because of their reliance on Machcinski's false and misleading statements.

The trial court dismissed the complaint on Machcinski's motion, finding that the "pleadings fail[ed] to allege the existence of privity, or a privity-like relationship between Plaintiffs [and Defendants]" supportive of a negligent

misrepresentation claim. The court noted that the complaint contained no allegation that "Plaintiffs solicited the explanation from Machcinski" or that Machcinski knew that Plaintiffs were going to rely on the letter to "determine whether to withdraw their invested funds." On these facts, the court concluded that "Plaintiffs fail[ed] to assert facts giving rise to a special relationship of confidence and trust between them and Defendants."

The Appellate Division, First Department reversed. The court opined that the requisite "privity-like" relationship existed where Plaintiffs alleged that they requested a letter from Machcinski regarding the implications of the SEC inquiries and that Machcinski responded with a letter directly addressed to Plaintiffs and specifically answering their concerns. On the other hand, Defendants failed to establish as a matter of law that there were no false statements in the letter, that Plaintiffs' reliance was unreasonable, or that the alleged false statements did not proximately cause Plaintiffs' alleged losses.

Comment: This case should be considered in light of *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994). In that case, the United States Supreme Court addressed the scope of attorneys' liability in investment matters through its holding that private actions for aiding and abetting claims against secondary actors like attorneys and accountants involved in securities transactions are prohibited under Rule 10(b) of the Securities Exchange Act of 1934.

However, in the course of that opinion, the Court stressed that assuming all of the requirements for primary liability under Rule 10(b)-5 are met, secondary actors like attorneys remain liable under the Securities Acts as primary violators if they employ any manipulative device or make a material misstatement or omission which is relied upon by a purchaser or seller of securities.

This case portends an expansion of the scope of an attorneys' potential liability to third-party investors when the attorneys themselves make representations on behalf of but independently of their clients in connection with securities matters.

The decision provides a third-party investor with an alternative theory for relief against lawyers and other secondary actors to the claim under Rule 10(b). Under *Chanin*, a lawyer can be liable to a third party for negligent misrepresentation even in the absence of privity so long as "privity-like circumstances" exist.

This is significant because, unlike a federal securities fraud claim under Rule 10(b)-5, which requires the misrepresentation to have been made in connection with the purchase or sale of securities, the *Chanin* opinion allows a negligent misrepresentation claim to proceed where the investor has not bought or sold securities but has merely maintained his or her investment in reliance on a lawyer's representations.

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.

Receipt of Third or Opposing Parties' Confidential Information Deliberately (and Not Inadvertently) Provided — The Receiving Lawyer's Duties

***In Re: Joel B. Eisenstein*, 2016 SC95331 Mo.**

Risk Management Issue: What are the risks when lawyers receive a third party's confidential information that is delivered deliberately and not inadvertently?

The Case: Respondent represented Husband in a marital dissolution action. Husband obtained his Wife's payroll documents and a list of direct examination questions prepared by Wife's attorney (Opposing Counsel), by illegally gaining access to Wife's email account. Husband provided Respondent with the improperly obtained documents. On the second day of trial Respondent handed opposing counsel a stack of exhibits that included the direct examination questions. Prior to this time, neither the Wife nor Opposing Counsel was aware that Husband had improperly accessed Wife's email and delivered the documents to Respondent.

Opposing Counsel requested a conference with the trial judge and a hearing on the record. At the hearing, Husband admitted to improperly obtaining the documents from Wife's email account and providing them to Respondent. At the hearing, Respondent admitted to reading a portion of the direct examination questions and realizing it was improper, but failed to inform opposing counsel he was in possession of the documents until the second day of trial. A few days following the hearing, Respondent sent Opposing Counsel a threatening email to dissuade her from publicly discussing the events of the hearing.

The Office of Chief Disciplinary Counsel charged Respondent with several violations of the Rules of Professional Responsibility. The Supreme Court of Missouri found that by utilizing the payroll information and direct examination questions that were improperly procured by Husband, Respondent had violated Rule 4-4.4(a), which prohibits a lawyer from using methods of obtaining evidence that violate legal rights of a third party.

Respondent admitted to reviewing the information and failing to immediately disclose his receipt of the information to Opposing Counsel. The fact that Respondent did not obtain the information himself did not negate the fact that Respondent received the information, realized it was improperly obtained but failed to disclose these facts until the second day of trial. Rule 4-4.4 requires the lawyer to promptly notify the sender in order to permit that person to take protective measures.

Respondent's violation of Rule 4-4.4(a) also constituted a violation of Rule 4-8.4(c), which prohibits a lawyer from engaging in conduct involving dishonesty, fraud deceit or misrepresentation, and of Rule 4-3.4(a), which prohibits a lawyer from unlawfully obstructing another party's access to evidence or unlawfully altering, destroying or concealing a document or other material having potential evidentiary value. In addition, the Supreme Court found that by sending a threatening email to opposing counsel, Respondent violated Rule 4-8.4(d), which prohibits a lawyer from engaging in conduct that is prejudicial to the administration of justice. Respondent was suspended for six months.

Comment: The entire topic of the duties of lawyers who receive information or material to which they are not entitled — whether inadvertently or deliberately sent — is extraordinarily confused. Numerous Rules of Professional Conduct are or may be implicated when these situations arise, including Rules 4.4(b), 3.3, 4.1 1.6, 8.4 and, possibly, 1.15. In addition, in many situations the applicable law and rules of evidence may be implicated. Not only are outcomes determined within each jurisdiction based upon the interplay of these various rules (often themselves the subject of case law), but the outcomes and resolution vary widely by state. The literature on this topic is voluminous.

Risk Management Solution: There is no one-size-fits-all solution that firms may apply to shield them and their lawyers from these problems. Because these situations can arise in every conceivable area of law practice — whether transactional or litigation — and to any lawyer at any time, we recommend that law firms educate their lawyers in the intricacies of the subject or, at a minimum, that when such a situation arises lawyers should immediately consult their firm's general counsel or ethics committee for advice and instruction on how to proceed.