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Recent Developments in Risk Management

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Fee Splitting – Enforcement of Undisclosed Agreements – Need for Specificity

***Marin v. Constitution Realty, LLC,* 2017 N.Y. Slip. Op. 01019, 2017 WL 521504**

Risk Management Issue: Is an attorney fee-splitting agreement that is undisclosed to the client nevertheless enforceable?

The Case: After Jose Marin sustained severe injuries in the workplace, he and his wife, Ada, retained attorney Shirley Menkes to pursue a personal injury action on their behalf.

The Manheimer Agreement. In February 2009, Menkes hired Jeffrey Manheimer to serve as co-counsel. Menkes and Manheimer agreed in writing that Manheimer would receive 20% of net attorneys' fees if the case settled before trial and 25% upon commencement of jury selection. In June 2009, this agreement was amended to limit Manheimer to a purely advisory role, with no authority to contact the clients, the defendants, experts or the court unless Menkes first gave her consent. The fee arrangement under the amendment remained the same. In contravention of Rule 1.5(g) of the New York Code of Professional Responsibility, the Marins were not informed of Manheimer's involvement or the agreed division of fees.

In August 2009, Menkes discharged Manheimer, advising him that his portion of the fees would be determined on a quantum meruit basis. Manheimer did no further work on the case and did not object to Menkes' statement.

In August 2012, Menkes obtained partial summary judgment for the Marins on liability. The case was scheduled for mediation on May 20, 2013 and thereafter, a trial on damages.

The Golomb Agreement. In March 2013, before the scheduled mediation, Menkes enlisted the assistance of David Golomb, another attorney, for the upcoming mediation and trial.

Golomb agreed to handle the mediation in exchange for 12% of "all attorneys' fees whenever the case is resolved, whether by settlement, verdict after trial or appeal, calculated after the attorneys have been reimbursed for all expenses." If, on the other hand, the case "does not resolve at the mediation presently scheduled for May 20, 2013," then Golomb agreed to prepare the case for trial and try the case. "After such mediation [Golomb] will be entitled to [40%] of all attorneys' fees…"

The mediation session on May 20, 2013 did not conclude in a settlement. However, the mediator maintained contact with both Golomb and the carriers, negotiations continued, and on May 31, 2013, a settlement of $8 million was reached.

The Manheimer/Menkes Fee Dispute. After the settlement, Menkes moved to set Manheimer's fees on a quantum meruit basis, arguing that since the agreement had not been disclosed to the Marins in violation of Rule 1.5(g), it was unenforceable. Manheimer objected, seeking to enforce his 20% of net attorneys' fees agreement. Manheimer argued that Menkes repeatedly led him to believe that the Marins had been advised of his role and consented to his assistance. Moreover, Menkes rejected all his attempts to meet with the Marins himself and in fact, revised his agreement to altogether deny him access to the clients.

The New York Court of Appeals found in Manheimer's favor, finding that both the February and June 2009 agreements were prepared by Menkes and unequivocally and unambiguously entitled Manheimer to 20% of net attorneys' fees.

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For current comments on issues of professional ethics see our blog: www.lawyersfortheprofession.com.

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While illegal contracts are normally unenforceable, this general rule does not always apply. If the law or rule governing the contract does not expressly deprive the parties of their right to sue for a breach of the contract and the denial of relief is wholly out of proportion to the requirements of public policy, the right to recover will not be denied. *Rosasco Creameries v. Cohen*, 276 NY 274, 278 [1937]. Hence, the general rule was held inapplicable in this case. The court condemned Menkes' position as an attempt to "use the ethical rules as a sword to render unenforceable…" an agreement that Menkes herself drafted. Quoting its prior decision in *Benjamin v. Koeppel*, 85 N.Y.2d 549, 556, 626 N.Y.S.2d 982, 650 N.E.2d 829 [1995], the court said, "it ill becomes defendants, who are also bound by the Code of Professional Responsibility, to seek to avoid on 'ethical' grounds the obligations of an agreement to which they freely assented and from which they reaped the benefits." This, the court held, was particularly true where Menkes led Manheimer to believe that the Marins were informed of the contract, impeded his access to the clients, and the clients were not harmed by the ethical breach.

The Golomb/Menkes Fee Dispute. As to Golomb, Menkes moved for an order fixing his fee at 12% of net attorneys' fees. Menkes argues that the Golomb agreement provided for a 12% fee if the case settled at the mediation and 40% if Golomb had to prepare for trial and try the case. Golomb, meanwhile, contended his fees were 40% of net attorneys' fees.

The lower court found for Golomb, reasoning that the agreement referenced the May 20, 2013 mediation, not the "process" of mediation, and since the matter was not resolved on the day set, the 40% fee was applicable. Nothing in the Golomb agreement, the lower court added, conditioned Golomb's entitlement to the higher fee upon his taking any steps to prepare for trial.

The Court of Appeals disagreed. Applying principles of contract interpretation, the Court observed that the plain language of the Golomb Agreement provided for 12% of net attorneys' fees to Golomb if the matter resolved through the mediation that was scheduled to begin, but did not need to conclude, on May 20, 2013. It was within the Agreement's contemplation that the mediation may require multiple sessions or follow-up conversations before settlement can be reached. The 40% fee, on the other hand, was not triggered until the matter moved past mediation into trial preparation.

Risk Management Solution: In a significant number of jurisdictions, courts will enforce the applicable rules of professional conduct and as a result invalidate an attorney fee-splitting agreement that is not disclosed and consented to by the client. This case represents a different viewpoint. Nevertheless, attorneys would do well to err on the side of prudence and ensure that any such arrangement is disclosed to, understood by, and plainly agreed to by the client. An attorney about to enter a fee-sharing arrangement should check the relevant rules of professional conduct in his or her jurisdiction to determine the pertinent client disclosure and consent requirements for fee sharing arrangements. The case also demonstrates that it is imperative in drafting fee-splitting agreements that hinge on "settlement" that the language used to determine when and in what circumstances the agreement is to be triggered be plain, unambiguous and well-defined.

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.

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: While a client or potential client may insist on the urgency of his or her transaction, firms should avoid shortcutting due diligence to confirm the client's identity and the facts surrounding the transaction. This is particularly vital where the client is in another jurisdiction or country and the bulk of communications occur via e-mail or telephone with little in-person contact. An attorney should take care not to make any express warranties or representations – by words or conduct – concerning the client's identity or other transaction issues to other parties to the transaction. Counsel should undertake their own due diligence with respect to the transaction and the other parties. In particular, lawyers should make clear in writing that they are acting upon the client's instructions and representations.

Confidentiality – Withdrawal for Nonpayment of Fees in Civil Litigation

The Opinion: ABA Formal Opinion 476

Risk Management Issue: What steps are required of a lawyer, when moving to withdraw under Rule 1.16 for nonpayment of fees, to comply with the Rule 1.6 duty of confidentiality?

The Opinion: Judges and lawyers must recognize the ethical constraints on lawyers forced to move to withdraw due to the nonpayment of fees. The duty of confidentiality under Rule 1.6 must be balanced against the court's need for sufficient information to consider a motion to withdraw. In an effort to educate lawyers and judges alike, the American Bar Association Standing Committee on Ethics and Professional Responsibility addressed the proper steps a lawyer should take, and what judges should consider, in order to protect a client's confidential information during a motion to withdraw based on nonpayment of fees.

Model Rule 1.16(a) addresses obligations when the lawyer is required to withdraw and Rule 1.16(b) addresses the permissive reasons for withdrawal. Rule 1.16(b) allows a lawyer to withdraw "if the client refuses to abide by the terms of an agreement relating to the representation, such as an agreement concerning fees or costs" or if "the representation will result in an unreasonable financial burden on the lawyer." Procedurally, most jurisdictions require that the lawyer file a motion to withdraw if another lawyer does not substitute in as counsel of record. The disclosure of information in the motion to withdraw, however, is subject to the duty of confidentiality set forth in Rule 1.6 which applies broadly to "information related to the representation," unless the client provides informed consent. The need to protect the client's information related to representation while moving to withdraw and the countervailing need to provide the court with adequate information to grant the motion has long been described as a problem without a clear solution.

The Opinion cites to *In re Gonzalez*, 773 A.2d 1026 (D.C. 2001) for what *not* to do when moving to withdraw. There, the lawyer was informally admonished for disclosing superfluous and humiliating information about the client in connection with the motion to withdraw for unpaid fees. Specifically, the lawyer attached as exhibits to his motion letters he had sent advising his client of settlement amounts as well as what amount he believed was at stake for his client. The lawyer also informed the court that his client had made misrepresentations to him through the course of representation. This information was irrelevant to the motion to withdraw and disclosed "client secrets." The Opinion advises lawyers to err on the side of caution and not disclose any information about the client or the representation.

Instead, the Opinion advises that citing "professional considerations require termination" should be accepted as sufficient. However, many courts require additional details to decide motions to withdraw. Judges are required to assess the impact of withdrawal on the parties in litigation and the impact on the court's calendar. Withdrawing early in a case may cause no issues, but if the case is complex and the motion comes shortly before trial, a court may need more information to make its decision. Judges, though, should recognize the duty of confidentiality owed to the client and work with the lawyer to get only information relating to the substance of the matter necessary to make a decision.

Comment: There are many other cases where courts required counsel seeking to withdraw to provide specific details related to representation of a client, including the amount of money owed and the nature of the legal services performed. These decisions permitted withdrawal where it was demonstrated that the financial burden imposed was the equivalent of requiring the lawyer or law firm to provide free legal services. These decisions demonstrate that in deciding the motion to withdraw courts are not always willing to accept without at least some additional information the lawyer's bland assertion of "professional considerations".

Risk Management Solution: Law firms should consider establishing a standard procedure when lawyers move to withdraw to prevent inappropriate excessive use of client confidences. First, before moving to withdraw, the lawyer should inform the client that if the fees are not paid, the lawyer will move to withdraw. If that fails to remedy the situation, the lawyer should initially move to withdraw citing only to "professional considerations" and provide no confidential client information at all. If the court requires additional information to make a decision, a lawyer should respond, where practicable, to persuade the court that the motion should be ruled on without additional information, reminding the court of the lawyer's duty to preserve the client's confidences. If that does not satisfy the court, then under the exception in Rule 1.6(b)(5) in place in most states, a lawyer should submit only minimal information that is reasonably necessary to satisfy the court and under restricted means, whether it be *in camera* or under seal. However, it will usually be appropriate to tell the court that fees are unpaid and the amount, if pertinent. If the court orders the lawyer to provide more information, Rule 1.6(b)(6) allows an exception applying to court orders which will allow the lawyer to disclose the information as long as the lawyer has asserted claims of confidentiality and privilege to prevent having to disclose the information, and has timely informed the client about its right to contest the court's order.

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