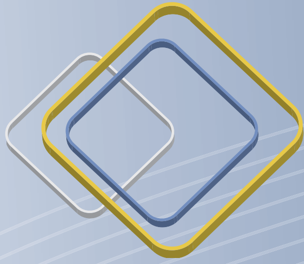

Lawyers' Professional Liability UPDATE

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Statute of Limitations

Dismissal of Claim Based on Statute of Repose Improper Because Plaintiff Did Not Suffer Injury Until Husband Died

***Snyder v. Heidelberger*, 403 Ill. App. 3d 974, 933 N.E.2d 1235 (2d Dist. 2010)**

Plaintiff surviving wife sued an attorney for malpractice in drafting a deed to real property that the surviving wife's late husband allegedly intended to convey to her as his joint tenant. Two months after the husband's death, the surviving wife's stepson filed a forcible entry and detainer action against the surviving wife. A judgment was entered for the stepson on the basis that the decedent had previously amended the land trust, which (rather than the decedent) actually owned the property and which provided that upon the decedent's death, the entire beneficial interest would go to the stepson. The surviving wife alleged that she was a third-party beneficiary of the professional relationship between the decedent and the lawyer. Dismissal of the claim on the basis of the six-year statute of repose (735 ILCS 5/13-214.3) was improper because the surviving wife suffered no actual injury until her husband died. The husband could have, at any time before his death, remedied the attorney's error by drafting a deed or other conveyance that effectuated his intent. The surviving wife timely filed suit within two years after her late husband's death.

Fee Agreements / Fees

Eighth Circuit Invalidates Fee-Splitting Agreement Based on Technical Violations of Ethical Rule

***Eng v. Cummings, McClorey, Davis & Acho PLC*, 611 F.3d 428 (8th Cir. 2010)**

In summary, the U.S. Court of Appeals for the Eighth Circuit held that a fee-splitting arrangement between law firms was unenforceable because the client did not agree to the arrangement in writing and because the agreement did not indicate that the firms would be jointly responsible for the matter.

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A child with a wrongful death claim sought the representation of a Michigan law firm. The Michigan firm referred the case to a Missouri law firm. The two firms ultimately agreed that the Missouri firm would share one-third of its fees with the Michigan firm. The Michigan firm then sent a letter to the client detailing the firms' fee-splitting arrangement.

After the case settled, a dispute over the amount to be shared arose and the Missouri firm sought a declaratory judgment that the fee-splitting agreement was unenforceable. The Michigan firm counterclaimed for bad faith breach of duty, breach of contract, fraud, misrepresentation and unjust enrichment. The district court granted the Missouri firm's summary judgment motion.

The Eighth Circuit affirmed, holding that absent a written agreement between the Michigan firm and the client indicating that the firm would be jointly responsible for the matter, the fee-splitting arrangement was unenforceable. Although the fee-splitting agreement likely would have been valid under Michigan law, the court applied Mo. R. Prof'l Conduct 4-1.5(e), which imposes, *inter alia*, the written agreement and joint responsibility requirements. The court noted that the Michigan firm's letter to the client did not meet the former requirement because the client never agreed to it in writing. Although current Rule 4-1.5(e) does not require the client's written consent, the court noted that the rule in effect during the relevant time did.

The court held that even if the client had agreed in writing to the arrangement, the Michigan firm's letter did not indicate that it would share joint responsibility as required by Rule 4-1.5(e). The court further acknowledged that the Michigan firm had taken some responsibility by occasionally conferring with the client, but held that:

> Nothing that [the Michigan lawyer] did rises to this level [of joint responsibility]. He did not file an appearance in the wrongful death action; he did not pay any portion of the court fees; he did not take depositions (although it appears at one point he offered to); and he did not assist [the Missouri firm] in formulating a trial strategy.

Finally, the court held that the unenforceability of the fee-splitting arrangement precluded the Michigan firm's counterclaims. On this point, one judge dissented, stating that the Michigan firm had a triable tort claim for fraudulent inducement, which was independent of the validity of the fee-splitting agreement.

This opinion demonstrates the importance of determining which state's rules of professional conduct govern a fee-splitting arrangement and complying strictly therewith. Notably, although the Eighth Circuit followed settled Missouri law by strictly applying the requirements of Rule 4-1.5(e), other jurisdictions have occasionally upheld fee-splitting agreements despite technical violations of similar rules.

Privilege

No Privilege for In-House Counsel Communications in Europe's High Court

***Akzo Nobel Chemicals and Akcros Chemicals v. Commission*, Case No. C-550/07 P (2010)**

In summary, the European Union's high court, the Court of Justice, held that a corporate client's communications with its in-house attorneys were not privileged because such lawyers are not independent from their clients. The Court of Justice addressed the issue of whether the legal professional privilege (LPP)—Europe's version of the attorney-client privilege—applied to communications with in-house counsel. The LPP protects lawyer-client communications which involve an attorney who is independent from the client. The independence requirement is designed to ensure that the lawyer's role in collaborating in the administration of justice is not overridden by the attorney's role in advancing the client's interests.

The Court held that independence under the LPP requires the absence of an employment relationship between lawyer and client. The Court noted that "an in-house lawyer is less able to deal effectively with any conflicts between his professional obligations and the aims of his client." This holding was not precluded, the Court noted, by the principle of equal treatment, which prohibits comparable situations from being treated differently and different situations from being treated in the same way. The Court held that despite being subject to the same ethical rules as outside counsel, in-house lawyers are in a different situation based on, *inter alia*, their financial dependence on their employers.

This holding may encourage corporations that do business in Europe to utilize outside counsel when seeking candid legal advice. Notably, this decision applies to European Union courts, but not to the courts of the Union's member states. The member states do not have uniform LPP rules, and some states treat communications with in-house lawyers as privileged.

Privilege

Ohio Supreme Court Recognizes Self-Protection Exception to Attorney-Client Privilege

***Squire, Sanders & Dempsey, L.L.P. v. Givaudan Flavors Corp.*, 127 Ohio St. 3d 161, 937 N.E.2d 533 (2010)**

In summary, the Ohio Supreme Court held that exceptions exist to both the attorney-client privilege and work product protection when the attorney-client relationship has been put at issue by a claim for legal fees or a claim that the attorney breached a duty owed to a client.

Plaintiff law firm sued its former client for unpaid legal fees. The client brought multiple counterclaims, including for legal malpractice. The client had decided to stop using the law firm based on the concerns of the client's in-house counsel. During discovery, the client asserted the attorney-client privilege and work product protection to block the law firm from information related to: the law firm's staffing of the case; the resources committed to the litigation; the law firm's strategy and trial preparation; and the client's reasons for terminating its relationship with the law firm. The law firm moved to compel the production of documents as well as the testimony of the client's in-house counsel. The trial court granted the law firm's motion, but the appellate court reversed.

On appeal, the Ohio Supreme Court held that the common law "self protection" exception to the attorney-client privilege applied, and that the discovery was permissible. The Court began by noting that it had recognized a number of common law exceptions to the privilege, including the crime fraud exception and the joint representation exception. The Court then cited its own precedent from 1939, where it recognized that the attorney-client privilege "does not prevent an attorney from testifying to the correctness, amount, and value of the legal services rendered to the client in an action calling those fees into question." The legislature did not supersede this holding, the Court noted, when it later recoded the attorney-client privilege statute. The Court further held that the self-protection exception "also applies when the client puts the representation at issue by charging the attorney with a breach of duty or other wrongdoing."

The client argued that Ohio's attorney-client privilege statute provides the exclusive means of waiving the privilege. The Court acknowledged its prior decisions to this effect, but noted that such decisions applied only to waiver and not to exceptions. Finally, regarding the client's assertion of work product protection, the Court held: "[w]hen the attorney-client relationship has been put at issue by a claim for legal fees or by a claim that the attorney breached a duty owed to the client, good cause exists for the production of attorney work product to the extent necessary to collect those fees or to defend against the client's claim."

Ohio Supreme Court Justice Judith Ann Lanzinger, concurring, took issue with the Court's characterization of exceptions to the privilege as "fall[ing] into the category of situations in which the privilege does not attach to the communications in the first instance. . . ." She opined that exceptions are no different than waivers because both arise as a result of some action taken by the client.

This opinion aligns Ohio with the majority of other jurisdictions to the extent that it denies the protections of the attorney-client privilege and the work product doctrine on claims in which the client has placed the relationship with its lawyer at issue.

Miscellaneous

New York High Court Declines to Broaden Liability of Third-Party Professionals for Client Fraud

***Kirschner v. KPMG LLP,* ___ N.E.2d ___, 2010 WL 4116609 (N.Y. 2010)**

In summary, under New York law, the fraud of corporate insiders will be imputed to the corporate entity regardless of the insiders' intent or the degree to which the corporation benefited from the fraud. There is a limited exception to this rule when the fraud is against the corporation itself. In cases where fraud is imputed, the corporation is barred by the doctrine of *in pari delicto* from shifting responsibility for the fraud to third-party agents such as law firms or accounting firms.

The New York Court of Appeals, in a 4-3 decision, held that the combined principles of *in pari delicto* and imputation prevent corporations from shifting responsibility for insider fraud to third parties unless the fraud was perpetrated against the corporation itself. The Court discussed these principles in response to certified questions from two courts. The Delaware Supreme Court certified the *in pari delicto* question, and the U.S. Court of Appeals for the Second Circuit certified the imputation question.

The former case involved a shareholder derivative action based on insider fraud in which the corporation sued its outside auditor for failure to detect the fraud. The auditor raised the defense of *in pari delicto*, which precludes the court from resolving disputes between two wrongdoers.

The latter case arose on the heels of a corporate bankruptcy that was triggered by insider fraud. A litigation trustee was appointed as part of the Chapter 11 proceeding, and the trustee ultimately sued a group of the corporation's advisers, including its former law firm, alleging that they were partially responsible for the fraud. Those third parties argued that the insiders' fraud could be imputed to the corporation and asserted the rule that a corporation lacks standing to recover from third parties for a fraud that the corporation itself was involved in.

The New York high court held that so long as insider fraud can be imputed to the corporation, the corporation is barred by the doctrine of *in pari delicto* from shifting responsibility to third parties. There is a narrow exception to the imputation rule, the Court held, for instances in which a corporate agent totally abandons the corporation's interest and acts entirely for his or her own, or another's benefit, *i.e.*, when the corporation is actually the victim of the fraud. The Court emphasized the narrowness of this so called "adverse interest" exception by noting that, for the exception to apply, harm to the corporation must arise from the fraud itself, rather than from discovery of the fraud.

In reaching its conclusion, the Court rejected plaintiffs' efforts to expand the adverse interest exception in the context of *in pari delicto*. For example, the Court rejected an idea derived from Second Circuit precedent in which the adverse interest exception applies so long as the insiders intended to, and actually did benefit themselves, and/or if the corporation only received a short-term benefit but suffered a long-term harm. The Court also rejected the approach taken by the New Jersey Supreme Court in which minor corporate shareholders who are deemed innocent and unaware of internal fraud may bring suit against a third-party auditor for negligence. The Court also discussed a similar approach taken in Pennsylvania, and, more generally, the applicability of comparative negligence in this context.

The Court rejected those equitable approaches, noting that the proper balance of equities is difficult to determine. Specifically, the Court stated: "...why should the interests of innocent stakeholders of corporate fraudsters trump those of innocent stakeholders of the outside professionals who are the defendants in these cases?" The Court further noted that as between the corporation and an outside professional entity, the corporation's agents invariably play a bigger role in the fraud and therefore are more culpable.

Three judges dissented, arguing against the majority's strict application of the imputation principle. Namely, they argued that where fraud merely prolongs the life of a corporation, the corporation does not truly benefit, and therefore the adverse interest exception to imputation may apply. The dissent further questioned whether the majority's holding might remove the incentive of third-party professionals to monitor insider agents of the corporation.

This exceptionally important opinion solidifies New York's stance on the doctrine of *in pari delicto* and clarifies the scope of the imputation rule by highlighting the narrow applicability of the adverse interest exception. This decision appears to largely insulate lawyers and other third-party professionals from liability for corporate client fraud under New York law.

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