The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

September 2012 | Volume 17 | Issue 3

Unauthorized Practice of Law — Federal Practice — Disclosure Obligations When Lawyers Practice in States Where They are Not Admitted

***Attorney Grievance Commission of Maryland v. Jude Ambe,* Misc. Docket AG No. 6, Sept. Term 2011**

Risk Management Issue: In the context of federal practice, what constitutes permissible practice in locations where the lawyer is not admitted, and what constitutes the unauthorized practice of the law? Is the attorney required to disclose that his or her practice is limited to federal matters?

The Case: Respondent lawyer was admitted to practice in New York, but was not and had never been a member of the Maryland Bar. Since his admission to the New York Bar, the attorney maintained a law office in Maryland. According to the attorney, the office was maintained solely for the practice of immigration law. The lawyer had a "virtual" law practice and did not maintain a law office in New York.

In December 2009, Maryland Bar Counsel received a complaint, separate from the present matter, against the attorney. Bar Counsel wrote to the lawyer and stated:

> Since you are not a member of the Maryland Bar, if your practice is limited only to immigration matters then your letterhead and any signs must indicate that you are a member of the New York Bar, specifically state that you are not a member of the Maryland Bar, and that your practice is limited only to federal immigration matters. Therefore it may be that you are holding yourself out as able to practice law in Maryland without restrictions, and therefore, it may be necessary to investigate whether you have been engaged in the unauthorized practice of law . . . .

The attorney wrote back and assured Bar Counsel that he was aware of the restrictions on his practice, that his practice was limited to immigration matters, and that his letterhead would comply with disclosure requirements. Bar Counsel closed the original complaint against the lawyer on May 3, 2010.

In June 2010, an insurance company contacted Bar Counsel and provided copies of several documents received from and sent to the attorney relating to claims received by the insurer from three claimants. These documents included "demand letters" on the original letterhead of the lawyer's firm concerning the attorney's "clients." None of the letters sent to the insurer on the firm's letterhead contained language noting practice limitations, stating "admitted in New York," or stating "not admitted in Maryland."

Bar Counsel also received documents from a second insurance company pertaining to a separate demand letter on the original letterhead of the firm concerning "our client" Daisy Epie. The letter confirmed that "we are counsels" for the claimant. The attorney acknowledged that it was his intent to act as legal representative for Epie for purposes of communicating with the second insurance company.

On March 17, 2011, the Attorney Grievance Commission of Maryland filed the instant Petition for Disciplinary Action asserting that the lawyer had violated Md. R. Prof'l Conduct R. 5.5, 7.1, 8.1, and 8.4.

Unauthorized Practice of Law, continued on page 2

HINSHAW

& CULBERTSON LLP

Judge Steven G. Salant held an evidentiary hearing on September 15, 2011. After the conclusion of the proceedings, the court found that the attorney had violated Md. R. Prof'l Conduct R. 5.5(a) by representing clients in Maryland state tort law cases while not licensed to practice law in the state. Maryland's Business, Occupations, & Professions Article, Section 10-206(a)(1) establishes that "before an individual may practice law in the State, the individual shall . . . be admitted to the Bar." Md. Code Ann. Bus. Occ. & Prof. 10-101 (h)(2) defines the following acts as "practicing law": "preparing or helping in the preparation of any form or document that is filed in a court or affects a case that is or may be filed in a court; or giving advice about a case that is or may be filed in court." The lawyer was found to have drafted demand letters seeking to settle cases arising from four separate state tort claims that could be filed in court and gave legal advice about the state tort claims. Those acts constituted the practice of law and thus the attorney was held to have violated Md. Code Ann. Bus. Occ. & Prof. § 10-206(a)(1) and Md. R. Prof'l Conduct R. 5.5(a). He was also found to have violated Md. R. Prof'l Conduct 5.5(b)(2) by failing to clearly indicate on his business cards that he was not licensed to practice law in Maryland.

The attorney's contention that he did not know such actions constituted the practice of law did not affect the analysis as to whether he had violated the rule. Under Maryland law, "[c]laimed ignorance of ethical duties . . . is not a defense in disciplinary proceedings." *Attorney Grievance Commission v. Awuah*, 346 Md. 420, 435 (1997).

The court also found that the lawyer had made false and misleading communications in violation of Md. R. Prof'l Conduct R. 7.1 by failing to disclose the limitations on his practice. Rule 7.1 requires out-of-state attorneys practicing federal law in Maryland to disclose that the lawyer's practice is limited to federal matters and the attorney is not authorized to practice law in Maryland. The attorney failed to make such disclosures.

The lawyer's representation of claimants in state tort matters and known failure to disclose the limitations of his practice was also held to have constituted a violation of Md. R. Prof'l Conduct R. 8.4(b) (committing acts reflecting adversely on his honesty, trustworthiness, or fitness as a lawyer), Md. R. Prof'l Conduct R. 8.4(c) (engaging in "conduct involving dishonesty, fraud, deceit, or misrepresentation"), and Md. R. Prof'l Conduct R. 8.4(d) (engaging in "conduct prejudicial to the administration of justice.")

The court, however, found no clear and convincing evidence that the attorney knowingly made false statements of material fact in violation of Md. R. Prof'l Conduct R. 8.1(a).

In the end, a suspension by the Maryland Bar would have no effect because the attorney had no right to practice law in Maryland. Instead, the Bar reprimanded him.

Comment: This seems to be a remarkably lenient sanction.

Risk Management Solution: Lawyers engaging in a federal practice, such as immigration law, or otherwise maintaining a law office in a state while not licensed to practice law in its state courts should carefully review local rules of professional conduct, particularly as they relate to disclosure requirements and the regulation of unauthorized practice of the law. Claimed ignorance for failure to strictly adhere to ethical duties is no defense in disciplinary proceedings.

Lateral Movement — The Unfinished Business Rule

***Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld, LLP, et al.*, No. 11-cv-5994 (S.D.N.Y.) (Mem. order granting defendants' joint motion to withdraw the bankruptcy reference and denying defendants' joint motion for abstention, filed Nov. 2, 2011)**

Risk Management Issue: What are the special financial risks potentially faced by law firms seeking to hire lawyers laterally from firms that dissolve? What is the meaning and scope of the "unfinished business" rule? What can hiring firms do to manage the risks of the application of the rule in connection with attorneys whom they hire – and what can firms generally do to prevent the issue from arising?

The Case: The case arises from the bankruptcy of Coudert Brothers (Coudert). The administrator of the firm's estate sought to recover profits from various law firms to which former partners of Coudert had moved as a result of that firm's collapse, based on the unfinished business doctrine. The doctrine has developed based on the decision in *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1984), and springs the longstanding rule in partnership law that when a partnership dissolves the former partners are responsible for winding up the business of the partnership for the benefit of that partnership. The *Jewel* court significantly extended the rule by holding that, following dissolution, no partner of a defunct law firm is entitled to extra compensation for completing unfinished business and that "income generated through the winding up of unfinished business is allocated to the former partners according to their respective interests in the partnership." The case expressly determined that this rule extends to all of the legal fees collected on matters begun at the old firm.

Here, the "unfinished business" claims arising from the dissolution of Coudert were removed to the U.S. District Court for the Southern District of New York based on the recent U.S. Supreme Court decision in *Stern v. Marshall*, -- U.S. --, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), limiting the jurisdiction of the bankruptcy court in connection with claims based on state law. In a very carefully reasoned opinion in that case, Judge Colleen McMahon concluded that the unfinished business rule does indeed represent the law of New York. First, she summarized the New York Partnership Law and interpretive case law, concluding that:

> A departing partner is not free to walk out of his firm's office carrying a Jackson Pollack painting he ripped off the wall of the reception area, simply because the firm has dissolved. Partnership property remains partnership property, dissolution notwithstanding, and a former partner of the dissolved firm must account for any benefit he derives from his use of a partnership asset, even if he is not among the "winding up partners" charged with winding up the firm's affairs.

She then determined that cases commenced at the former firm — the unfinished business — are to be treated no differently than paintings on the wall.

Significantly, Judge McMahon's decision directly addressed — but rejected — the argument made by the hiring law firms, seeking to dismiss the unfinished business claims made against them, that New York's strong public policy in favor of permitting unfettered movement by lawyers should overcome the rules of partnership law that would otherwise apply. Although extensively considering the case law, beginning with *Cohen v. Lord, Day & Lord*, 75 N.Y.2d 95, 96 (1989), to the effect that New York courts "refus[e] to enforce provisions in partnership agreements that might create a financial disincentive for a partner to continue representing a client of his former firm," Judge McMahon concluded that application of the unfinished business rule does not constitute an impermissible disincentive in the specific context of firms that are dissolving. Rather, she determined that "[i]t would be difficult indeed to conclude that the Partnership Law provisions that impose and measure the duty of partners to wind up existing firm business for the benefit of the dissolved firm, adopted as they were by the Legislature, violate public policy [regarding prohibited disincentives]." Additionally, she explicitly stated her belief that: ". . . if faced with the issue, the New York Court of Appeals would apply the same rule to hourly billed cases as its Appellate Divisions apply to contingency fee cases: they are unfinished business assets subject to distribution unless a contrary intention appears."

Judge McMahon also raised — but left open for future resolution — several critical questions: that the actual value of unfinished business can only be determined in an accounting; and whether departing partners are "entitled to deduct from the net profits 'reasonable compensation' for [their] post-dissolution efforts before remitting the balance to [their] former partners for division." Notably, while not finally deciding that question, she expressed significant doubts as to the viability or appropriateness of any such entitlement in quantifying the profits that the hiring firm would owe the estate of the dissolved firm.

Finally, Judge McMahon pointed out several times that under the New York Partnership Law, Coudert's partners could have agreed, in their partnership agreement, to waive the unfinished business rule in connection with partner departures and the dissolution of the partnership, but had not done so.

Comment: While the decision is very thorough, it is likely to be appealed. Also, as Judge McMahon recognized, the issues of New York law may well be referred to the New York Court of Appeal for determination. The critical

Hinshaw & Culbertson LLP
222 North LaSalle Street
Suite 300, Chicago, IL 60601
312-704-3000
www.hinshawlaw.com
www.lawyeringlaw.com

Editors: Anthony E. Davis and David A. Sorensen

Contributors: Daniel Sanchez-Behar and Daniel E. Tranen

issue for the appellate courts to address (and, in the editors' view, the key mistake in the decision) is Judge McMahon's conclusion that New York's public policy in favor of unfettered movement of lawyers will not trump the unfinished business rule in noncontingency fee cases. There are several reasons why it should do so. First, if upheld, the decision amounts to an invitation for departing laterals to race for the exit as soon as there is the slightest concern that their current firm may dissolve, in order to avoid application of the *Jewel* rule (bypassing the bankruptcy rules governing preferences). Inevitably, the *Jewel* rule can serve to destabilize perfectly viable law firms. Second, it may also be unfair in its application as between transactional lawyers and litigators. Frequently, litigators' unfinished business lasts longer and may have greater value than transactions in terms of total billings. Third, the principal of unfettered movement has been critical in shaping the legal profession, leaving the unfinished business rule in place materially limits its future efficacy. Finally, the fact that Judge McMahon accepts that partners *can* agree in advance not to treat unfinished business as an asset of the partnership adds further to the inequity of application of the rule. By making it harder for lawyers to leave firms that have not amended their agreements, and riskier for hiring firms to take on attoneys from such firms, upholding the *Jewel* rule makes for an uneven playing field among lawyers seeking to make a move. It also undermines the ethical rule and established case precedents favoring the unfettered movement of attorneys.

Risk Management Solution: Unless and until this decision is explicitly overturned on appeal, and the unfinished business rule as applied here is abrogated, hiring firms' due diligence efforts will be significantly complicated. Confidentiality obligations generally prevent a potential lateral from revealing the contents of his or her current firm's partnership agreement. But educating a lateral on the issues that the rule presents, both for the lawyer and the hiring firm, and seeking assurances regarding those risks (*e.g.*, that the lateral's current firm is not about to dissolve, and whether or not the current firm's partnership agreement contains an anti-*Jewel* provision) is reasonable and prudent for hiring firms. Once a lateral attorney has given notice to her *solvent* former firm and clients have responded to joint notification letters, it may be worth considering whether there is an opportunity to negotiate a fee division with the former firm to avoid the potentially devastating effects of a *Jewel* claim years later. The opposite, of course, is true when a prior firm is insolvent. Agreements that divert assets from an organization on the verge of bankruptcy are risks arguably not worth taking.

Other due diligence procedures may also be worthwhile, if more uncertain, to avoid or at least limit the possibility of these claims. For instance, careful research of publicly available information about the firm which the lateral prospect wishes to leave may produce useful intelligence about the firm's long-term prospects. Similarly, even firms that resist using "headhunters" to identify potential recruits may wish to consider engaging one or more of these professionals to act as consultants — extra eyes and ears to the marketplace — to identify firms where there are signs, such as a rash of resumes on the marketplace, of incipient problems. Finally, whenever there is the slightest perceived risk that the rule will be applied to work being brought by the lateral to the hiring firm, the financial terms offered to laterally moving lawyers are likely to be significantly circumscribed.

Additionally, law firms generally may wish to give serious consideration to adopting so called "anti-*Jewel*" provisions in order to avoid the problems posed to both partners who leave the firm and the firms to which they seek to move, if the firm subsequently dissolves, as suggested by Judge McMahon (and other commentators). An example of such a provision might be:

> The [*partners/shareholders/principals*] each acknowledge the duty to complete work undertaken for clients while with the firm. However, all [*partners/shareholders/principals*] and [*name of entity/firm*] waive any and all rights to receive payment of legal fees generated from unfinished business

Lateral Movement, continued on page 5

after dissolution or fess generated by any departing lawyer or group of lawyers following their departure in connection with matters that were in-progress at the time of departure. Following dissolution, each lawyer or group of lawyers shall be solely entitled to the post-dissolution fees they generate from the winding up of [*entity/firm name's*] unfinished business.

Law Firms Obligations When Personal Information in Their Control Is Hacked — Data Breach Legislation

Risk Management Issue: What are the implications if (when?) a law firm IT administrator discovers a security breach in the firm computer system such that hackers have accessed financial information of a number of firm clients? How is such a law firm supposed to protect itself and its clients and what must the firm do when it discovers that its computer system has been breached and confidential or personal information has been accessed by third parties?

The Applicable Law: To date, 46 states, the District of Columbia, Puerto Rico and the Virgin Islands, have enacted laws designed to require those who maintain personal information of others to protect that information and to notify the owners of that information of security breaches when they occur. [The only states that currently do not have statutes are Alabama, Kentucky, New Mexico and South Dakota.] The National Conference of State Legislatures lists the statutes of each state that has a security breach notification law. These are largely uniform statutes. These laws and their corresponding regulations are designed to protect personal information and they contain a notification requirement when security breaches occur.

The laws require persons who "own or license" personal information about residents of the respective states to meet minimum standards in connection with the safeguarding of personal information. According to these statutes, one "owns or licenses" personal information if he or she receives, stores, maintains, processes or has access to personal information in connection with the provision of goods or services or in connection with employment. Accordingly, any law firm would "own or license" personal information it stores or maintains in connection both with its clients and its employees. Significantly, the "personal information" to which these statutes apply is limited to government identification numbers such as social security numbers and financial account information.

Persons who own or license personal information are required to develop and implement a comprehensive, written information security program which is appropriate to the size, scope and type of business, the amount of data stored, the need for security and confidentiality and the amount of resources available to such business. An employee of the business should be designated to maintain the security program and that person should be well-trained, should examine employee compliance with the program, and should be charged with investigation and prevention of security system failures. That person is also responsible for preventing terminated employees from accessing sensitive records, overseeing third-party service providers, and regularly monitoring the plan and the scope of the security measures at least annually.

With regard to computer systems, these statutes and regulations require that owners and licensees of personal information maintain secure user authentication protocols and secure access control measures. This includes encryption of all transmitted records and files containing personal information that will travel across public networks or be transmitted wirelessly, and all personal information stored on laptops or other portable devices. Owners and licensees of personal information are also expected to have reasonably up-to-date firewall protection for systems connected to the internet and reasonably up-to-date security system agent software to address malware and computer viruses. The statutes and regulations also require training of employees on the proper use of computer security systems and the importance of personal information security.

In the event of a security breach, those individuals whose personal information has been breached must be notified as soon as possible and without delay. The notice should include any specific use made of the data, the approximate date of the security breach, and any steps that the owner/licensee of the information has taken or

Law Firms Obligations, continued on back

plans to take relating to the incident. The notification requirement also includes informing the applicable state government, typically the attorney general's office, of these same facts along with the approximate number of state residents affected by the breach.

Risk Management Solution: There is no perfect solution to protecting confidential information as even the most advanced security system has limitations and can be breached by a determined and skillful hacker. According to the 2012 ABA technology survey, approximately 10 percent of all law firms have experienced a data security breach of some type.

It is important that firms designate a senior person to become familiar with the statutes applicable in each jurisdiction where they are operating. Notably, these statutes are not focused on the location of the holder of the information. Instead, they are designed to protect residents of the state, regardless of where the owner or licensee of the personal information is located. Accordingly, data breaches may result in obligations to notify multiple state governments, depending upon the residency of the clients whose data has been taken.

Based upon these statutes, law firms must establish and implement a written plan for addressing the potential risk of security breaches, its complexity depending largely on the size and resources available to the firm. A large firm with a national client base should consider hiring individuals in its IT department to address specifically the requirements in these security breach statutes. Smaller firms or solo practitioners should create a plan depending upon the type practice (i.e. risk of disclosure of personal information) and the breadth of their client base. Fortunately, the regulations do consider the firms resources as a factor for the type of security plan that must be enacted. As law firms generally must protect confidential information of clients beyond the limited types of personal information to which these statutes apply, the protective measures identified should be built on presumably existing polices rather than having to be created from scratch.

If (when?) a security breach does occur, the affected firm must notify its clients regarding any personal information that has been compromised. The notice requirements of security breach statutes are generally limited to the specific personal information identified above (social security numbers and financial account numbers). However, if a security breach does occur, a law firm should consider going beyond the statutory requirements and identify any personal information, and especially confidential or privileged information that has been — or may have been — obtained by third parties.

While these statutes do not provide a private right of action against owners/licensees of this information, there are potentially enormous financial consequences flowing from data breaches. These may include: the costs of finding and fixing the firm's network (which may involve significant "down" time); consequential business interruption; claims by third parties (as well as clients) for harm done to their computer system, and businesses; the cost of notifying the customers of the firm's clients of the breach; the cost of compliance with the regulatory requirements; and reputational harm. Because at least some of these consequences are unlikely to be covered by standard lawyers professional liability insurance, firms should also consider whether it is appropriate to obtain what is commonly referred to as "cyber" insurance to cover these otherwise uninsured risks.

The Lawyers' Lawyer Newsletter is published by Hinshaw & Culbertson LLP. Hinshaw is a full-service national law firm providing coordinated legal services across the United States, as well as regionally and locally. Hinshaw lawyers represent businesses, governmental entities and individuals in complex litigation, regulatory and transactional matters. Founded in 1934, the firm has approximately 500 attorneys in 24 offices located in Arizona, California, Florida, Illinois, Indiana, Massachusetts, Minnesota, Missouri, New York, Oregon, Rhode Island and Wisconsin. For more information, please visit us at www.hinshawlaw.com.