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Recent Developments in Risk Management **March 2018** | Volume 23 | Issue 2

Lateral Hires – Screening – Moonlighting – Due Diligence by Hiring Firm – Vicarious Liability because of Lawyer's Apparent Authority

***McFarland v. Niekamp, Weisensell, Mutersbaugh & Mastrantonio, LLP*, 2017-Ohio-8394, 2017 Ohio App. LEXIS 4774 (November 1, 2017)**

Risk Management Issue: When a law firm hires a lateral attorney, what due diligence must it undertake in connection with the business introduced by the lateral attorney?

The Case: The plaintiff-clients (the "clients") engaged a law firm (the "first firm") to prosecute a claim against their former stockbroker, and their case was assigned to an associate attorney. The attorney met with the clients, reviewed documents and drafted a complaint which he claimed to have filed on their behalf. The attorney then left the first firm to open his own law firm and the clients agreed to continue their representation with him. The attorney subsequently closed his law firm and joined a second law firm without informing his clients.

The clients learned the attorney had joined the second firm when they performed an internet search and confirmed with a receptionist employed by the second firm. Thereafter, the clients met with the attorney and received his new business card identifying him as an employee of the second firm. Over the next several months, the clients called and left messages with the attorney's assistant, other administrative employees and partners of the second firm regarding the status of the case and requesting a document. The clients also communicated with the assistant and firm employees to schedule meetings. Ultimately, the attorney ceased communicating with the clients.

The clients subsequently discovered that he never filed the complaint and that the statute of limitations for filing suit had expired. The clients sued the second firm alleging that it was vicariously liable for the attorney's alleged malpractice, as the attorney had apparent authority to represent clients on the firm's behalf.

The trial court granted summary judgment in favor of the second firm on the issue of apparent authority, finding there was no evidence to suggest that the second firm did anything to make the clients believe they were clients of the firm or that the attorney had authority to represent them. The clients appealed the trial court's decision. On appeal, the second firm argued that the attorney's legal representation of the clients was outside the scope of his employment because he failed to comply with the firm's policies for bringing a new client to the firm and because the lawyer was "moonlighting."

The appellate court reversed, determining that a question of material fact on the issue of apparent authority existed. Specifically, the court found that the volume of messages combined with statements regarding the status of the case, copies of a letter, and scheduling a meeting is evidence of knowledge by the office staff regarding the clients that was imputable to the attorneys/principals for which they worked. The incoming phone messages, outgoing calls, and scheduling of meetings handled by the second firm's staff were "indicia of firm involvement or representation of the

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client's interests." Additionally, the attorney was identified on the law firm's website which likewise indicated apparent authority to act on behalf of the firm.

Risk Management Solution: This case serves as a cautionary example of the risks a law firm undertakes when hiring a lateral attorney with portable business, the dangers that arise when lawyers engage in "moonlighting," and the importance of support staff in managing a law firm's risk. This decision indicates that a firm faces exposure for a lateral attorney's acts or omissions in representing a client, even where the attorney's representation violates the firm's policies and procedures, (e.g., where the matter is not formally transferred and/or new client intake process is performed). It is critical that law firms implement due diligence procedures to ensure that: the lateral attorney identifies and reports to the firm all existing clients and/or matters that the lateral attorney is bringing to the firm; the client has consented to the firm's representation; that the proper intake process has been performed for every new client; the firm agrees to the scope of representation; a responsible partner is assigned to each incoming matter to supervise the lateral attorney's work; and sufficient file management procedures (e.g., docketing statutes of limitation and issuing timely status reports) are followed. In addition, the case illustrates the value of training support staff in risk management, including expressly supporting a culture to encourage staff to identify and report violations of the file intake and management process, and other anomalies. Indeed, this decision shows that the staff's knowledge may be sufficient to create a duty on the part of the firm towards "clients" of which it had been unaware.

Partners and Officers – Personal Liability – Tax Liability

Alex Spizz v. USA v. Todtman, Case No. 15-CV-2361 (S.D.N.Y. December 4, 2017)

Risk Management Issue: When do officers and shareholders or partners of law firms bear personal liability for the firm's failure to pay trust fund taxes to the Internal Revenue Service?

The Case: Between 2009 and 2012, New York lawyers Spizz, Todtman and Nachamie conducted business through their law firm: Todtman, Nachamie, Spizz & Johns, P.C. Todtman, Spizz, and Nachamie were each one-third owners of the firm.

Between 2009 and 2012, the firm was in financial difficulty, and periodically failed to pay its quarterly trust fund taxes. The failures occurred when the firm was controlled by first one partner, then another, although the third partner apparently righted the ship and paid taxes for a time. Its non-payment of taxes eventually ran the firm afoul of the IRS. In 2012, the IRS assessed $1.3 million in penalties against the three shareholders personally, representing the amount of funds unremitted by the firm from June 2009 through March 2012.

In 2015, Spizz sued to abate the IRS penalties against him in the Southern District of New York. The government responded with a counter-claim against Spizz and a third-party complaint against Todtman and Nachamie, seeking recovery of the outstanding tax liabilities. The court granted summary judgment on the claims against Spizz and Todtman, relying on 26 USC §6672, which permits the IRS to impose direct liability on the person responsible for the delinquency, and shifts to the accused the burden of proving that he or she is not a "responsible person," and that the failure to pay was not "willful." The partners, including the partner who took control of the firm and successfully paid taxes for a time, ended up being personally liable for the $1.3 million assessment.

Comment: This case highlights the grave risk of personal exposure faced by partners or shareholders when the law firm fails to remit trust fund taxes. While liability is ostensibly limited only to the partner or shareholder who exercises authority over financial affairs, the court's decision takes a very expansive view of who qualifies as a "responsible person." So long as a partner or shareholder has the ability "exert influence" to avoid a tax delinquency, liability potentially attaches even though such a partner or shareholder does not actually exercise the authority and even though actual responsibility for tax payments has been delegated to another partner or shareholder.

The definition of conduct deemed "willful" is equally broad, including a failure to investigate or to follow up after notice of a deficiency. The greater the control over the finances, the more likely the court will find an omission willful even though the partner or shareholder can show lack of knowledge.

The import of the holding is that every partner and shareholder, especially of a smaller law firm, may be personally liable. Indeed, as the court observed, it would be hard-pressed to "find a circumstance where one of three shareholders in a small law firm would be a responsible person under §6672, while the other two would not."

Risk Management Solutions: All law firms need to have in place a system of financial controls that regularly and routinely distributes critical financial information to all the owners, thereby creating oversight that all laws and rules relating to the firm's finances are complied with. It almost goes without saying that each partner and shareholder has the personal responsibility to review relevant financial information, but this case demonstrates that sometimes even lawyers need to be reminded of what ought to be obvious.

Former Client Confidentiality – Exceptions – When is "Generally-Known Information" Confidential?

***American Bar Association Formal Opinion 479*, December 15, 2017**

Risk Management Issue: May a lawyer use information related to the representation of a former client to the former client's actual or potential disadvantage if the information has become "generally known"?

ABA Formal Opinion 479: Model Rule of Professional Conduct 1.9(c) sets forth the duty of confidentiality owed to former clients. The "generally known" exception to the duty of former-client confidentiality is limited. It only permits (1) the use—***not disclosure or revelation***—of former-client information and (2) only if the information has become widely recognized by the public in the relevant geographic area or widely recognized in the former client's industry.

The "generally-known" exception was introduced in the 1983 Model Rules, but there has not been a consensus on when information actually is "generally known." Commentators in New York, Massachusetts, and Illinois agree that "generally known" means "more than publicly available or accessible. It means that the information has already received widespread publicity." For example, a lawyer working on a merger cannot discuss the possibility while the parties negotiate, but may comment after the *Wall Street Journal* reports on the merger and the client is no longer a client.

Information may become widely available through traditional media sources such as newspapers, magazines, radio or television or through publication on web sites and social media. Information is considered widely available in a trade or profession if it has been announced or discussed in a leading print or online publication in the field. In addition to publications like the *Wall Street Journal*, social media and internet sites may publish information such that it is "widely recognized." On the other hand, the fact that information has been discussed in court or may be available in public records does not make the information widely recognized for purposes of Model Rule 1.9(c) because information that is publicly available is not necessarily widely recognized. If it would be necessary to search through court records or library shelves to find it, the information is not widely recognized.

Risk Management Solution: Although the Opinion, and the Rules of Professional Conduct contemplate lawyers having the right to use (but not disclose or reveal) "generally known" information even when doing so may disadvantage a former client, lawyers and firms should always think at least twice before doing so. The better course, with respect to using any information about both present and former clients—including the mere fact of having provided legal services to the client—is always to obtain client consent in advance.

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