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Recent Developments in Risk Management

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Engagement Agreements – Mandatory Fee Arbitration Provisions – Malpractice Arbitration Provisions

District of Columbia Ethics Opinion 376

Risk Management Issue: What are the requirements to make agreements to arbitrate malpractice claims and fee disputes in engagement letters enforceable?

The Opinion: The Legal Ethics Committee for the D.C. Bar issued Ethics Opinion 376 to resolve a conflict between prior Opinions and the February 2007 amendments to the D.C. Rules of Professional Conduct. Opinion 376 reflects a growing trend favoring the enforceability of arbitration provisions in fee agreements as long as the firm obtains informed consent.

Before Opinion 376, mandatory arbitration provisions between lawyer and client were not permitted in D.C. unless the client actually consulted with independent counsel. D.C. Ethics Op. 211. As it related to mandatory fee arbitration through the D.C. Bar's Attorney-Client Arbitration Board ("ACAB"), D.C. imposed a specific requirement that "the client be advised in writing that counseling and a copy of the ACAB's rules are available through the ACAB staff and further that the lawyer encourage the client to contact the ACAB for counseling and information prior to deciding whether to sign the agreement and that the client consent in writing to mandatory arbitration." D.C. Ethics Op. 218.

Inserted in 2007, and conflicting with the Opinions, Comment [13] to Rule 1.8 made fee agreements containing mandatory arbitration provisions generally permissible as long as the client is "fully informed of the scope and effect of the agreement."

The Committee reasoned that it was time to revisit these Opinions given the 2007 amendments and the proliferation of arbitration as a means for dispute resolution since the Opinions were first issued. The Committee determined "In light of Comment [13]…that the more onerous requirements imposed by Opinion 211 are no longer required. The same is true for Opinion 218, which deals with a narrow subset of arbitration provisions – those limited to fee arbitrations before the ACAB." The Committee reiterated "that these more narrow agreements (i.e., those limited to the arbitration of fee disputes) should not have different, more burdensome requirements related to obtaining client consent."

The Committee clarified that agreements between lawyers and clients to arbitrate only fees claims (not malpractice claims) do not fall within the scope of the additional safeguards required under Rule 1.8(a). The Committee found that fee arbitration provisions are "ordinary fee arrangements" within the meaning of Comment [1] to Rule 1.8(a), thus exempting informed consent as a pre-condition to the enforceability of such agreements.

As it relates to provisions mandating arbitration for malpractice claims, the Committee found that although the phrase "informed consent" is not defined in the Comments to Rule 1.8, Rule 1.0(e) summarizes the information that must be shared in order for a client to be "fully informed." Rule 1.0(e) defines "Informed Consent" as "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct."

Risk Management Solution: When drafting fee agreements, provisions mandating arbitration of fee disputes are enforceable in most states and do not require informed consent or a recommendation to the client to seek the advice of independent counsel. However, some states impose varying requirements on mandatory arbitration provisions. Contract provisions requiring mandatory arbitration of malpractice claims, on the other hand, usually require at least informed consent, consistent with Comment [13] to Rule 1.8 and Rule 1(e). Best practices include advising the client both orally and in writing that the client can seek the advice of independent counsel regarding the arbitration of potential malpractice claims. Some states require that informed consent be confirmed in writing, so it is important to check each state's rules.

Conflicts of Interest – Future Conflict Waivers – Attorney Disqualification – Simultaneous Adverse Representation of Current Clients

***Southern Visions, LLP v. Red Diamond, Inc.,* 2:18-cv-02039-RDP (N.D.Ala. 2018)**

Risk Management Issue: Can a law firm convert a current client into a former client in order to take on a new client adverse to the now former client without falling foul of the "hot potato" rule?

The Case: The U.S. District Court for the Northern District of Alabama disqualified an Alabama Law Firm from representing a new client against a current-turned-former client. Law Firm began representing Red Diamond, Inc., in January 2009. Law Firm provided legal services to Red Diamond from 2009 through 2018, including in employee benefits matters, divorce proceedings, tax audits, and debt collection matters. In the course of Bradley's representation of Red Diamond, Bradley received various confidential, nonpublic information about Red Diamond.

At the outset of most of these matters, Red Diamond signed an engagement letter which purported to provide consent to Law Firm for the undertaking of future representations of other clients. This consent applied to "any matter that is not substantially related" to Law Firm's work for Red Diamond, "even if the interests of such clients in those other matters are directly adverse" to Red Diamond, and "even if such representations would be simultaneous." Law Firm did not advise Red Diamond to seek, and Red Diamond did not retain, independent legal counsel with respect to these advance conflict waivers.

In 2018, Southern Visions, LLP, a competitor of Red Diamond, filed a patent infringement action against Red Diamond. On December 18, 2018, Southern Visions' owner contacted Law Firm, seeking to have it represent Southern Visions in the suit against Red Diamond. At that time, certain debt collection matters remained pending in which Law Firm represented Red Diamond. Red Diamond learned Law Firm was considering representing Southern Visions in the suit on December 19, 2018.

On December 21, 2018, Red Diamond informed Law Firm that Red Diamond did not consider itself to have waived any conflict created by Law Firm's representation of Southern Visions and, regardless, Red Diamond revoked any alleged consent, effective immediately. Despite its relationship and pending matters with Red Diamond, on December 23, 2018, Law Firm's representation of Southern Visions was approved by Law Firm's

business review committee, and Law Firm attorneys began to bill time for work on the suit against Red Diamond. The court later concluded that Law Firm's representation of Southern Visions began on December 23.

Law Firm's general counsel sent an email to Red Diamond on December 26, 2018, withdrawing from its current representations of Red Diamond and stated, in its view, Law Firm could represent Southern Visions based on the advance conflict waivers. Forty-three minutes later, Law Firm filed its appearance for Southern Visions in the suit against Red Diamond.

Red Diamond moved to disqualify Law Firm from representing Southern Visions, claiming that Law Firm violated Alabama Rule of Professional Conduct 1.7(a). The rule generally forbids the simultaneous representation of one client in direct adversity to another client, unless: (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and (2) each client consents after consultation. The court sought to resolve two issues: (1) whether Law Firm violated Rule 1.7(a) by undertaking representation of Southern Visions against Red Diamond; and (2) if so, whether disqualification was an appropriate sanction. The court concluded that Law Firm violated Rule 1.7(a) and disqualification was warranted, despite the fact that the court did not find significant prejudice to exist as to Red Diamond.

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In granting Red Diamond's motion to disqualify, the court determined the following:

- Law Firm represented two clients directly opposed to one another in pending litigation for three days;
- Red Diamond did not consent to Law Firm's representation of Southern Visions; and despite the broad language, the advance waivers did not permit Law Firm to undertake the representation of Southern Visions because there was no consent "after consultation" and Red Diamond unequivocally revoked any alleged consent before Law Firm began representing Southern Visions; and
- Law Firm could not have reasonably believed suing Red Diamond on behalf of its competitor, Southern Visions, would not adversely affect its relationship with Red Diamond.

The rules of professional conduct in this instance provided clear guidance to the effect that where an "impermissible conflict of interest" exists before representation is undertaken, "the representation should be declined." Ala. R. Prof. Conduct 1.7, cmt [Loyalty to a Client]. Thus, the court reasoned, Bradley could have declined the representation of Southern Visions, or could have withdrawn from representing Red Diamond *before* accepting the representation of Southern Visions.

The court cautioned that an attorney-client relationship, while it often includes a contractual element, is not merely contractual, because lawyers "owe their clients greater duties than are owed under the general law of contracts," one of which is the "duty of loyalty that precludes lawyers from suing a current client." Finally, the court stressed Law Firm itself created the conflict of interest: "[I]t 'abandon[ed] its absolute duty of loyalty to [Red Diamond] so that it [could] benefit from a conflict of interest' it created by its own actions."

Risk Management Solution: Loyalty and trust are of the utmost importance in an attorney-client relationship. Disqualification is a serious remedy that can bring with it consequences, including the loss of clients other than those at issue in the underlying matter and fee disgorgement, among other things. The *Southern Visions* case reminds lawyers that: 1) simultaneous adverse representation of current clients is an automatic conflict in every state (except Texas); 2) advance waivers are unlikely to resolve conflicts of interest in the absence of full disclosure of the actual risks; and 3) if valid grounds exist to withdraw from, or confirm the prior termination of a client, the actual withdrawal notice of termination must occur, or be given, before undertaking the representation of the new client.

Liability for Third Party/Non-Client-Claims – Claims Asserted by Will Beneficiaries Against Estate Administrator

***MacLeish v. Boardman & Clark LLP*, 2019 WI 31, 2019 Wisc. LEXIS 125, 2019 WL 1339035**

Risk Management Issue: What is an attorney's liability to non-client beneficiaries of a will for negligence in the administration of a decedent's estate?

The Case: Plaintiffs–children who were beneficiaries of their deceased father's will–sued the attorney who administered their father's estate for malpractice. The will left the entirety of the father's estate to his wife for her life and, upon her death, the remainder of the assets comprising his estate were to pass to his four children. The father died in 1984 and, per the will, his assets passed to his wife for the duration of her life. When the wife died in 2008, the assets of the father's estate passed to the four children. Plaintiffs contended that the attorney should have deemed the bequest to the wife to have been in the form of a trust, with a remainder interest to the children. Plaintiffs alleged that if the estate had been administered in that manner, it would have saved the estate $261,343 in estate taxes, not including additional avoidable costs which were incurred in the probate administration.

The threshold issue was whether Plaintiffs had standing to sue the attorney since, as beneficiaries of the estate, they were not clients of the attorney. Wisconsin does not follow the Restatement of the Law Governing Attorneys (the "Restatement") but rather has adopted more restrictive case law limiting a non-client's standing to sue an attorney for malpractice. Plaintiffs asked the Supreme Court of Wisconsin to adopt Restatement Secs. 51 and 52, and to overrule *Auric v. Continental Cas.Co*. (1983) 111Wis.2d507, 331 N.W.2d 325.

Auric held that third-party non-clients had standing to bring malpractice actions against an attorney who negligently drafted a will, but only if the attorney negligence actually thwarted the testamentary intent of the decedent. Since Plaintiffs could not establish that their father's testamentary intent had been thwarted, (rather the contention was that excessive taxes and costs were incurred due to the attorney negligence), they urged the Wisconsin Supreme Court to abandon *Auric* and adopt the Restatement's more flexible criteria for establishing standing of a non-client to sue an attorney for malpractice.

The Wisconsin Supreme Court rejected Plaintiffs's argument and upheld the *Auric* rule that third-party non-clients only have standing if the attorney thwarted the testamentary intent of the decedent.

Editor's Note: While the *MacLeish* decision limits the scope of an attorney's liability for malpractice claims asserted by third-party non-clients, the decision is very narrow and may be regarded as jurisdiction-specific. Wisconsin courts have consistently refused to increase the scope of attorney liability to third-party non-clients by adopting the Restatement. However, other states have adopted the Restatement standards. See, e.g., *Klever Investor, LLC v. Buchalter Nemer, P.C*. (2012) 2012 WL 1427361 (unpublished, 2012 Ariz. App. LEXIS 503); *New Hope Methodist Church etc. v. Lawler & Swanson* (2010) 2010 Iowa App. LEXIS 1368. Be sure to check your state's authority on this issue.

Risk Management Solution: Whether controlled by the Restatement or *MacLeish*, claims asserted by third-party non-clients, particularly in the estate planning and administration areas of practice, present significant problems because the risks are difficult to identify, and the issues often become manifest years or decades after the testator or trustor client has died. To protect against these sorts of claims, lawyers should—and should be regularly reminded to—fully document the file with notes of conversations and communications to and from the testator. Regular communication with the client testator seeking review and confirmation of the client's intent can also provide good evidence against a later claim. In addition, rather than have estate planning matters staffed by only one attorney with no review of the work product, firms should establish a policy and practice of having at least two attorneys working on the matter whenever possible and practicable, or alternatively of mandatory review of the work product by another lawyer.