The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

Halloween Issue - October 2019

TRICK OR TREAT!

As Halloween approaches, and the Great Pumpkin readies itself to visit, the editors of the Halloween edition of the *Lawyers' Lawyer Newsletter* invite you to enjoy -- if you have the stomach for it -- the blind panic of a wire transfer procured by fraud and the resulting frenzied struggle over coverage. View the terrible consequences for a lawyer who enters into a business arrangement with a client in violation of the rules of professional conduct. Share our gut-wrenching horror as we contemplate the loss of attorney-client protections for communications with public relations professionals. Finally, watch as your colleagues struggle mightily to see and control a bleak future in which a client turns against them. We hope these horror stories will frighten and delight just in time for All Hallows' Eve.

Trick or Treat Editors' Note: Does anything cause deeper mortal terror than the prospect of an uncovered loss? In a tale that has an all-too-infrequent happy ending (at least for the insured), there's a lesson for all of us to beware of emails that suddenly appear late on Friday afternoon and demand immediate, and sizable, wire transfers.

Insurance Coverage – Computer Fraud – E-Mail "Spoofing"

***Medidata Sols., Inc. v. Fed. Ins. Co.*, 729 Fed. Appx. 117 (2d Cir. 2018), 2018 U.S. App. Lexis 18376, 2018 WL 3339245**

Risk Management Issue: Is e-mail "spoofing" covered under the computer fraud provision in an insurance policy?

The Opinion: On September 16, 2014, an employee in Medidata Sols., Inc.'s finance department received an email purportedly sent from Medidata's president stating that Medidata was close to finalizing an acquisition, and that an attorney named Michael Meyer would contact the employee. The email advised the employee that the acquisition was strictly confidential and instructed her to devote her full attention to Meyer's demands. On that same day, the employee received a phone call from a man who held himself out to be Meyer and demanded that the employee process a wire transfer for him. The employee explained that she needed an email from Medidata's president requesting the wire transfer and approval from Medidata's Vice President and Director of Revenue.

Thereafter, the employee, the Vice President and the Director of Revenue received a group email purportedly sent from Medidata's president stating: "I'm currently undergoing a financial operation in which I need you to process and approve a payment on my behalf. I already spoke with Alicia, she will file the wire and I would need you two to sign off." The email contained the president of Medidata's email address in the "From" field and a picture next to his name. In response, the employee initiated a wire transfer for $4,770,226.00, which the Vice President and Director of Revenue approved. The money was then wired to a bank account that was provided by Meyer. Medidata later realized that the company had been defrauded when Medidata's president was asked about the transfer and he indicated that he had not requested the transfer.

Medidata submitted a claim for the loss under its insurance policy issued by the Defendant Federal Insurance Company ("Federal"). The policy included a Computer Fraud Coverage provision, which covered "direct loss of Money, Securities or Property sustained by an Organization resulting from Computer Fraud committed by a Third Party." The policy defined "Computer Fraud" as "the unlawful taking or the fraudulently induced transfer of Money, Securities or Property resulting from a Computer Violation." In turn, "Computer Violation" included both "the fraudulent: (a) entry of Data into . . . a Computer System; [and] (b) change to Data elements or program logic of a Computer System."

Despite this language, Federal denied coverage of the claim. Thereafter, Medidata filed a coverage action against Federal in the United States District Court for the Southern District of New York. The trial court ultimately concluded that the losses were covered under the policy and granted Medidata's motion for summary judgment.

On appeal, the Second Circuit rejected Federal's argument that the spoofing attack was not covered and affirmed the lower court's ruling. In particular, the Court held that "the spoofing code enabled the fraudsters to send messages that inaccurately appeared, in all respects, to come from a high-ranking member of Medidata's organization. Thus the attack represented a fraudulent entry of data into the computer system, as the spoofing code was introduced into the email system. The attack also made a change to a data element, as the email system's appearance was altered by the spoofing code to misleadingly indicate the sender." Id. at 118-119. The Court further concluded that spoofing attack "clearly amounted to a violation of the integrity of the computer system through deceitful and dishonest access, since the fraudsters were able to alter the appearance of their emails so as to falsely indicate that the emails were sent by a high-ranking member of the company." On this basis, the Court concluded that Medidata's losses were covered by the terms of the computer fraud provision. Id. at 118.

Furthermore, the Court rejected Federal's argument that Medidata did not sustain a "direct loss" as a result of the spoofing attack, within the meaning of the policy. Specifically, the Court concluded that "[t]he chain of events was initiated by the spoofed emails, and unfolded rapidly following their receipt. While it is true that the Medidata employees themselves had to take action to effectuate the transfer, we do not see their actions as sufficient to sever the causal relationship between the spoofing attack and the losses incurred. The employees were acting, they believed, at the behest of a high-ranking member of Medidata." Id. at 119.

Accordingly, the Court affirmed the entry of summary judgment in favor of Medidata.

Risk Management Solution: This case highlights the need for all organizations, including law firms, to establish fraud prevention policies, such as dual authentication of all instructions to transfer funds. Before wiring money to anyone, always verify – by phone call, not email – the authority to make the payment and the destination of the funds. To supplement fraud prevention policies, it is equally important to have insurance with limits sufficient to make good a reasonable range of losses that could occur. To ensure access to that protection, it's vital to understand that the language in your policy covers and does not cover. Firm policies and procedures to prevent computer fraud should be designed with the language of the firm's insurance policy in mind.

Hinshaw & Culbertson LLP
151 North Franklin Street
Suite 2500, Chicago, IL 60606
312-704-3000
www.hinshawlaw.com

Editors: Anthony E. Davis and Noah D. Fiedler

Contributors: Robert M. Buchholz, Michael G. Ruff, Jessica Watkins, and former Hinshaw attorney, Aji Abiedu

Trick or Treat Editors' Note: "Put it in writing," the lawyer said. But that's not enough when the lawyer runs afoul of the rules of professional conduct. Consider your steps carefully and tread lightly when entering into any kind of agreement with a client—the consequences could be disastrous.

Doing Business with a Client – Rule 1.8 Conflicts Arising from Transactions with Clients – Enforceability of the Transaction

***Calvert v. Mayberry,* 2019 CO 23**

Risk Management Issue: What are the risks for an attorney who enters into a contract to engage in a business transaction with a client in violation of Rule 1.8?

The Case: Based on the corresponding Model Rule, Colorado Rule of Professional Conduct 1.8 ("Rule 1.8") governs specific conflicts of interest, including business transactions between lawyers and clients. In this case, the Supreme Court of Colorado held that a contract between a lawyer and a client that violates Rule 1.8 is presumptively void, although an attorney can rebut the presumption.

On the facts of *Calvert v. Mayberry*, the plaintiff-attorney ("Calvert") was unable to rebut the presumption and summary judgment was entered against him, voiding the contract he sought to enforce.

Mayberry initially engaged Calvert to help secure title to her home in her name, which Calvert successfully accomplished. Later, Calvert gave Mayberry approximately $193,000 in various increments to help renovate the house. Calvert then attempted to secure the loan using Mayberry's house as collateral. The repayment and security agreement were never put into writing and Calvert never advised Mayberry to seek independent legal counsel in connection with the transaction. The Colorado Supreme Court found Calvert's conduct to be a violation of Rule 1.8 and disbarred him before this case commenced.

Following his disbarment, Calvert sued Mayberry for breach of the oral agreement that was the subject of his disbarment proceeding. Mayberry moved for summary judgment, arguing the oral agreement violated public policy and was therefore void. Summary judgment for defendant Mayberry was granted and affirmed by both Colorado's Court of Appeals and Supreme Court.

The Colorado Supreme Court held the oral agreement clearly violated Rule 1.8, and therefore was presumptively void as a matter of public policy. The court stated that an agreement reached in violation of Rule 1.8 is unenforceable unless the lawyer can demonstrate that it did not "offend the public policy goals underlying the Rule." Calvert was unable to meet this burden.

Risk Management Solution: Violation of a Rule of Professional Conduct can have both expected and unexpected consequences. In Colorado, violation of a Rule can result not only in disciplinary action, but may also void a contract. This is not true in all jurisdictions, so lawyers should consult the law of the state in which they're licensed. In any event, a lawyer should take great care when entering into any business relationship with a client. Such arrangements carry multiple risks for claims of conflicts, breaches of duty, and claims of undue influence by the lawyer, which can give rise to civil liability or disciplinary consequences, or both.

Trick or Treat Editors' Note: Lawyers and clients alike rely on the protections of attorney-client privilege to ward off the prying eyes of ill-intentioned adversaries. The privilege, though, is both powerful and fragile. If not carefully tended and cared for, the privilege may wither and fade, leaving lawyer-client communications exposed for all to see.

Attorney-Client Privilege – Waiver – Communication with PR Consultants

***Universal Standard Inc. v Target Corporation, et al.* Case No. 1:2018 CV 0642 (S.D.N.Y. 2019)**

Risk Management Issues: Is the attorney-client privilege lost when a PR consultant, hired by a party to a lawsuit, is included in correspondence between the party and the party's lawyers?

The Case: Plaintiff clothing company filed suit against Defendant retailer alleging trademark infringement and unfair competition under the Lanham Act and related state law claims. During the deposition of Plaintiff's Chief of Staff and in-house counsel, it was revealed that emails between Plaintiff, its attorneys, and a public relations firm hired by Plaintiff, had not been produced during discovery or identified on a privilege log. The emails involved discussions regarding a public relations strategy surrounding the filing of the lawsuit and whether a press release should be issued.

Defendant moved the court for an order deeming the emails non-privileged, arguing Plaintiff had waived any privilege by failing to include the emails on the privilege log and by including the public relations firm on the email chain. The court agreed, holding that attorney-client privilege had been waived and the work product doctrine did not apply. However, the court did not address the question of whether the failure to identify the emails on the privilege log warranted waiver of privilege, as waiver was established on the merits.

The court explained that disclosure of attorney-client communication to a third party typically waives whatever privilege the communication may have originally possessed. However, there are four exceptions to the waiver doctrine, depending on the status of the third party: (1) third party shares a common legal interest; (2) third party is necessary for communication between client and counsel; (3) third party is the functional equivalent of a corporate employee of a party to the litigation; and (4) third party is used by lawyer to aid in legal tasks.

The court found that none of these exceptions applied to disclosure in this case, and therefore the privilege was waived. The first exception was inapplicable because the public relations firm was neither involved in the litigation, nor did it share any common interest with the Plaintiff.

The second exception applies where the third party enables counsel to understand aspects of the client's own communications that could not otherwise be appreciated. This exception did not apply because Plaintiff did not need its public relations firm in order to effectively communicate with the attorneys. Any questions regarding the propriety of a press release could simply have been communicated to the attorneys by Plaintiff without the public relations firm's involvement.

The third exception applies when the third-party is considered the functional equivalent of a corporate employee of a party to the litigation. In determining whether this exception applies, courts have considered whether the third party: (1) exercised independent decision making on the company's behalf; (2) possessed information held by no one else at the company; (3) served as a company representative to third parties; (4) maintained an office at the company or otherwise spent a substantial amount of time working for it; and (5) sought legal advice from corporate counsel to guide work for the company. This exception did not apply because none of the public relations firm's duties related to seeking legal advice.

The final exception applies when the function being performed by the third-party is necessary to achieve a circumscribed litigation goal. In the case of a public relations consultant, courts have generally limited the application of this exception to situations where the consultant was hired by the lawyers to assist them in dealing with media and where communications are made for the purpose of giving or receiving advice directed at handling the client's legal problems. The court found no evidence that the purpose of the communication with the public relations firm was to assist Plaintiff's attorney in performing a legal task.

The court found the emails were not afforded work-product protection because Plaintiff was unable to proffer any evidence to support the conclusory statement that the doctrine applied. It should be noted that many courts have rejected work-product protection for materials relating to public relations activities.

Risk Management Solution: Attorneys should advise their clients to limit third-party involvement in correspondence with attorneys to those necessary to the litigation or who are aiding the litigation. The fact that the third-party has been hired by the client as a result of the litigation is of no consequence. If the third-party's role is outside the scope of legal advice and assistance, or is not for the purpose of directly facilitating legal advice and assistance, there is a risk that attorney-client and/or the work-product privileges will be found to have been waived, or to be inapplicable. However, analysis and outcomes with respect to communications with PR consultants vary by jurisdiction, so attorneys should consult the law of the jurisdiction in which they practice and advise their clients accordingly.

Trick or Treat Editors' Note: **Who can gaze into the crystal ball and see the future? Who can foretell the outcome of a battle between one-time allies and confidantes? When planning for such a distasteful event, it's wise to take extra precautions, and in some states, required.**

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 <u>not</u> 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.

The Lawyers' Lawyer Newsletter is published by Hinshaw & Culbertson LLP. Hinshaw & Culbertson LLP is a U.S. law firm with 450 attorneys located in 11 states and London. Founded in 1934, the firm has a national reputation for its insurance industry work, its representation of professionals and law firms, and its closely coordinated business advisory, transactional and litigation services. We serve clients ranging from emerging and middle-market businesses to Fortune 500 companies, as well as governmental and public sector clients. For more information, please visit us at www.hinshawlaw.com.