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The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

Attorney-Client Relationship – Engagement Letters – Standing to Sue Corporation's Law Firm Denied to Individual Shareholders Based Upon Written Engagement Agreement With Corporation

***Kurre v. Greenbaum, Rowe, Smith, Ravin, Davis, and Himmel, LLP*, 2010 WL 2090092 (N.J. Super. Ct. App. Div. Apr. 16, 2010)**

Risk Management Issue: What can lawyers do to avoid representing unintended clients?

The Case: Two large shareholders for Labriola Motors, Elizabeth Labriola Kurre and Michael Labriola (Plaintiffs) sued the law firm of Greenbaum, Rowe , Smith, Ravin, Davis, & Himmel and its partners (Greenbaum) for individual malpractice damages. The trial court concluded that plaintiffs lacked standing to sue, and the Appellate Division affirmed.

Labriola Motors, a Nissan franchisee, experienced financial difficulties causing Nissan to urge it to sell the franchise and avoid termination. Labriola Motors retained Greenbaum to represent it in the proposed sale. The retainer letter specifically advised plaintiffs and the other shareholder, Joseph Labriola, that because their "interests and concerns as shareholders of the Company differ in connection with the proposed transaction," each "should retain independent legal counsel." Further, the retainer agreement required Plaintiffs to acknowledge "that (i) this firm will represent only the Company in connection with the proposed transaction, and (ii) this firm has advised you of your right to obtain independent legal counsel." Plaintiffs retained their own separate counsel.

After a first proposed sale fell through, Greenbaum continued to represent Labriola Motors in connection with another possible sale, and Plaintiffs continued to have independent counsel. Then, Nissan gave Labriola Motors 60 days' notice of its intent to terminate the franchise. Labriola Motors could have appealed the notice, but Greenbaum failed to advise it or Plaintiffs of Nissan's notice. Labriola Motors therefore sought bankruptcy protection instead of appealing the notice.

Plaintiffs sued, claiming that the appeal process would have provided them sufficient time to sell the dealership at market price. The court dismissed Plaintiffs' claims, concluding that the retainer agreement precluded Plaintiffs from asserting that Greenbaum represented them personally. Plaintiffs attempted to sidestep this argument by arguing that the retainer agreement applied only to the first proposed sale. But the court rejected their narrow interpretation after looking at the totality of the circumstances and the context of the agreement, which discussed the survival of the dealership as a whole.

Comment: The court distinguished this case from other cases where courts have allowed third parties to sue because the plaintiffs were constituents of the law firm's corporate client. The court concluded that Plaintiffs could rely on the lawyers' advice as shareholders, but could not assert malpractice claims as individuals. The case did not address whether Plaintiffs could maintain a derivative action for the losses resulting from Labriola Motors' bankruptcy.

Risk Management Solution: The effort put into a well-drafted retainer agreement, clearly identifying who is and is not a client and setting out the scope of the representation at the outset, is invaluable in avoiding difficult and costly consequences down the road. Retainer agreements should mean what they say and say what they mean. Such agreements that properly describe the scope and set for the limitations of an engagement, and are countersigned by the client, are especially useful in establishing that the law firm endeavored to represent the corporate client only, and did not intend to represent the shareholders or their individual interests.

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Attorney-Client Relationship – Advocate Witness Rule and Former Client Conflict – Court Denies Motion to Disqualify Where Former Client Fails to Establish Present Attorney-Client Relationship

***Worldhill Ltd. v. Sternberg et al.*, 2009 WL 3805610 (N.Y. Sup. Ct. Nov. 2009)**

Risk Management Issue: What can lawyers do to avoid being the target of a disqualification motion based upon the movant's claim of prior related representation?

The Case: Plaintiffs sued to recover on a promissory note. Defendants filed a motion to, among other things, disqualify plaintiff's attorney, Moskovitz, based upon defendants' allegations that Moskovitz had represented both parties in the negotiation of the note and in the underlying corporate transaction to transfer Oz Equities. Defendants also alleged that Moskovitz was a necessary witness in the dispute, in that he would have to testify as to whether he represented that the transfer of defendants' interest to plaintiffs would serve to satisfy the note at issue.

No one disputed that Moskovitz spoke directly with defendants throughout the negotiations. Defendant Sternberg testified that he felt that Moskovitz had acted as attorney for "all parties to the Transfer Agreement" at all times. Sternberg claimed that he had not hired separate counsel because Moskovitz led him to believe the parties had a common goal of "maximizing the assets of Oz," and that "Moskovitz was protecting everyone." Plaintiffs and Moskovitz argued that Moskovitz had not represented defendants. In support of that position, Moskovitz submitted evidence that he had previously represented both Oz and Sternberg in an unrelated matter. But in that case Moskovitz had a written engagement letter, which Sternberg had signed, disclosing the joint representation and waiving the conflicts that arose from it.

The court denied defendants' motion to disqualify. It held that defendants failed to establish a present attorney-client relationship with Moskovitz, notwithstanding Sternberg's belief that Moskovitz was protecting everyone's interest in the transaction. The court also found that Moskovitz could not testify to the terms of the parties' agreement on the note because of the parol evidence rule.

Comment: The court followed prevailing authority that a party's belief that an attorney is protecting the party's interest is not, in itself, sufficient to establish an attorney-client relationship. Defendant Sternberg never claimed that he had intended to retain Moskovitz as his attorney, only that Moskovitz was advancing both sides' common interests. It helped defeat the motion that Moskovitz could point to the written engagement agreement in the earlier representation where he had represented both plaintiffs and Sternberg, and the absence of such an agreement here. It would have been preferable, however, that Moskovitz explicitly communicated to Sternberg in writing that Moskovitz was not acting as Sternberg's attorney or representing defendants' interests.

Risk Management Solution: This case illustrates the value of using written engagement agreements for each new matter, even if the client is an established one, and of preparing non-engagement letters when dealing directly with unrepresented parties. An explicit communication disclaiming an attorney-client relationship is particularly important when the law firm previously represented a now opposing, nonrepresented party. Such engagement and non-engagement letters can be quite simple, but should make clear who is and is not a client, and describe the scope of the representation undertaken. Also, where appropriate, written communications with nonrepresented parties should begin with a statement that the lawyer is not representing that party. A lawyer dealing with an unrepresented party may want also to recommend that the party consult with his or her own attorney as appropriate.

Engagement Letters – Nonrefundable Fees – Fixed Fees – Handling Advance Fee Payments

***Missouri Supreme Court Advisory Committee, Formal Opinion 128,* May 18, 2010 (Nonrefundable Fees)**

Risk Management Issues: May a lawyer charge and retain client funds as a "nonrefundable" fee? Into what account should a lawyer place client funds paid in advance as a fixed fee? What language should a lawyer use in an engagement letter when receiving client funds in paid advance of services received?

The Opinion: The Missouri Supreme Court Advisory Committee (Advisory Committee) issued Formal Opinion 128 to address three issues.

First, Missouri does not allow "nonrefundable" fees. Advisory Committee Formal Opinion 128 cautions lawyers that Missouri does not allow fees that are truly nonrefundable. The Advisory Committee explained that regardless of the "terminology used to describe the fee, if the ultimate fee is unreasonable, taking into consideration the eight factors listed under [Mo. Sup. Ct. R.] 4-1.5(a), the unreasonable portion must be refunded." In reaching this conclusion, the Advisory Committee relied on the prohibition against unreasonable fees contained in Mo. Sup. Ct. R. 4-1.5, as well as the requirement in Mo. Sup. Ct. R. 4-1.16(d) to refund unearned fees at the end of a representation.

Formal Opinion 128 then examined two specific types of representations where lawyers often attempt to use "nonrefundable" fees, and offered guidance as to how lawyers can better manage fees in such representations. First examined were domestic relations cases "where the client pays a flat fee or makes an advance deposit on fees against which the attorney will bill on an hourly basis," and where the attorney describes "all or part of the flat fee or initial payment as a 'nonrefundable' or 'minimum' fee." In such representations, Formal Opinion 128 advises that it may be appropriate for a lawyer to take a portion of the fee as an intake fee. This intake fee represents the fact that having the intake meeting will create a "conflict in a situation in which the attorney may have to decline representation of others involved in the case." Because this portion of the fee would be earned upon intake, it would ordinarily not need to be refunded if the representation were terminated before completion.

The other example discussed was the criminal case where the attorney "charges a flat fee and describes the entire fee as nonrefundable." The Advisory Committee noted that in these circumstances, a lawyer terminated before completion of the representation may owe a refund. "The amount of the refund should be based on the reasonable value of the legal services actually provided, taking into account all of the factors listed in [Mo. Sup. Ct. R.] 4-1.5(a)."

The second issue addressed was where flat fees paid in advance should be deposited. Formal Opinion 128 alerted lawyers that, at least under Missouri law, a flat fee paid in advance should be deposited into the lawyer's trust account, not in the attorney's operating account. Portions of the fixed fees should then be "promptly removed [from the trust account] when actually earned, similar to prompt removal of earned hourly fees." The portion earned may be based upon "reaching a particular stage of a case or based on some other reasonable criteria, depending on the nature and circumstances of the representation."

As its third and final issue, Formal Opinion 128 clarified the use of the term "retainer." Formal Opinion 128 cautions lawyers that the word "retainer" has "taken on many meanings which are inconsistent with one another and which are confusing to clients." The Advisory Committee encouraged attorneys to "avoid using the term retainer when the attorney actually means an advance fee deposit, flat fee, initial deposit, etc. Attorneys best fulfill their duty of communication about fees under [Mo. Sup. Ct. R.] 4-1.4 and 4-1.5 when they use plain language that clients are likely to clearly understand."

Risk Management Solution: Lawyers should monitor what fee arrangements are permitted in the jurisdictions where they practice, and how client payments should be handled. They should also heed Formal Opinion 128's warning that commonly used terms such as "retainer" may be ambiguous, or at least unclear, to clients and seek to "use plain language that clients are likely to clearly understand" to describe fee and payment arrangements.

Continuous Representation – Statute of Limitations for Malpractice Actions – Effect of Failure to Give Clear Writing Terminating Engagement

[Editors' Note: We take this opportunity to provide an update on a case discussed in the January 2009 issue of *The Lawyers' Lawyer Newsletter* in conjunction with a new case that presents related risk management issues.]

***Laclette v. Galindo*, 184 Cal. App. 4th 919 (Cal. App. 2 Dist. May 17, 2010)**

***Gotay v. Breitbart*, 2008 WL 4821764 (N.Y.A.D. 1 Dept.), 2008 N.Y. Slip Op. 08432, Nov. 6, 2008, *Reversed* 2009 NY Slip Op. 05209, June 25, 2009 (N.Y. 2009)**

Risk Management Issue: What can lawyers and law firms do to avoid application of the "continuous representation" doctrine, and thus prevent losing the statute of limitations defense to malpractice claims?

***Laclette* Case**: Plaintiff Ramirez sued Laclette and Elite on claims that they had induced her to forego inspecting property she purchased. The matter settled for $350,000 during trial, with Laclette and Elite each agreeing to pay half the settlement. Laclette then sued her attorney Galindo and his law firm (Galindo) for legal malpractice and breach of fiduciary duty, claiming that Galindo had a conflict of interest in representing both Laclette and her co-defendant Elite against Ramirez's claim.

Galindo moved for summary judgment on the grounds that the lawsuit was barred by the one-year limitations period. Attorney Galindo claimed that the representation of Laclette had ended prior to that statutory period and that he had no contact with Laclette after the earlier suit ended. In resisting summary judgment, Laclette acknowledged that she had had no contact with Galindo since the conclusion of the underlying trial. She argued, however, that the limitations period had not yet expired on her action against Galindo because "[t]here are still potential issues that may arise," for example "whether all payments have been made, the amounts of payments, the date of payments, whether Ramirez [was] entitled to an entry of judgment, or Laclette [was] entitled to a dismissal with prejudice," and that "Galindo would be directly involved in resolving any such disputes."

The trial court granted Galindo's motion, finding that the statute of limitations had expired. Neither the fact that Galindo had failed to formally withdraw after the trial, nor the fact that the court retained jurisdiction over some issues after the trial, was sufficient to constitute "continued representation," where Galindo had not performed any services.

The appellate court disagreed and vacated the summary judgment. It relied on *Gonzalez v. Kalu,* 140 Cal. App. 4th 21 (2006), where the court held that an attorney's representation does not end until the client actually did not and reasonably could not expect that the attorney would provide further services. Notice to the client may be made expressly by the attorney, or the client may infer it from circumstances. But "***[a]bsent actual notice to the client that the attorney will perform no further legal services or circumstances that reasonably should cause the client to so conclude, a client should be entitled to rely on an attorney to perform the agreed services and should not be required to interrupt the attorney-client relationship by filing a malpractice complaint."*** (*Gonzalez v. Kalu,* 140 Cal. App. 4th 21, 30 (2006), emphasis added).

***Gotay* Update:** *Gotay* similarly involved the trial court's denial of a motion for summary judgment where the law firm argued that its attorney-client relationship with plaintiff had ended more than three years before she filed her legal malpractice case. The issue turned on the sworn affidavit testimony of attorney Hankin that, in January 1999, he met with plaintiff and her father and advised that his present firm would not take on her medical malpractice case. Hankin testified that in response to his advisement, plaintiffs' father demanded immediate return of the file. Hankin's sworn account of that meeting was not contradicted by plaintiff. Yet the trial court and intermediate appellate court found that a triable issue of fact existed as to whether the attorney-client relationship was terminated at that time. **The New York Court of Appeals reversed and granted the motion to dismiss, dismissing the case, in a memorandum decision without an opinion.**

Comment: Although the claims against the lawyers in *Gotay* were ultimately dismissed, considerable effort had to be expended over a course of years to achieve that result. While the lawyers relied on testimony to establish the end of the attorney-client relationship, the *Galindo* defendants argued that the end of the litigation, coupled with the lack of further contact, was sufficient to prove that the attorney-client relationship had terminated. In either case, a simple letter would have sufficed to put plaintiff on notice that the relationship had terminated, allowing the firms to avoid years of litigation over the single issue of whether the attorney-client relationship had or had not been concluded.

Risk Management Solution: These cases are classic examples of the rule that when representation ends, lawyers and law firms should be assiduous in sending closing letters to their clients. Such termination letters should not be hostile, but instead simply indicate that the engagement has concluded and that unless the client retains the lawyer afresh — which would require a new engagement letter signed by both the firm and the client — the attorney will not be providing additional services on the closed matter. Such letters provide clear evidence that the attorney-client relationship has ended, and can be used to counter any future argument that the statute is tolled by the lawyer's continuing representation. They also present an opportunity to notify the client of the firm's file retention and destruction policy, and serve the purpose of changing a "current client" into a "former client" for disqualification purposes, as illustrated in the next case discussed in this newsletter.

Outside Counsel's Affirmative Duties to Oversee Their Clients' Compliance With Discovery Obligations – Duty to Investigate

UPDATE: *Qualcomm vs. Broadcom Corporation*, 2010 WL 1336937 (S.D. Cal. Apr. 2, 2010)

In the April 2008 issue of *The Lawyers' Lawyer Newsletter*, we discussed the original sanctions order of U.S. Magistrate Judge Barbara L. Major in this case. (*See Qualcomm Inc. v. Broadcom Corp*., 2008 WL 66932 (S.D. Cal. Jan. 7, 2008); 2008 WL 638108 (S.D. Cal. Mar. 5, 2008)).

The magistrate judge had found that Qualcomm intentionally withheld discovery materials and could not have done so without its outside lawyers' assistance. There was no evidence that Qualcomm had told the outside lawyers about the documents, or that the outside lawyers had agreed to conceal them. Nevertheless, the magistrate judge rejected the possibility that the company hid the documents so effectively that the lawyers did not know about them or that outside counsel simply missed the evidence. Instead, she commented, it was most likely that the attorneys, experienced and knowledgeable litigators, suspected that the documents existed but chose to ignore the warning signs of suspicious activity.

Some of Qualcomm's lawyers (Responding Attorneys) filed timely objections to the magistrate judge's order. On March 5, 2008, the district judge ruled on these objections, vacating and remanding the magistrate judge's decision on the basis that the Responding Attorneys should have been able to use communications between outside counsel and Qualcomm to defend themselves. To reach this conclusion, the district court held that the "introduction of accusatory adversity between Qualcomm and its retained counsel regarding the issue of assessing responsibility for the failure of discovery, change[d] the factual basis which supported the court's earlier order denying the self-defense exception to Qualcomm's attorney-client privilege." According to the district judge, the Responding Attorneys had a "due process right to defend themselves under the totality of the circumstances presented in this sanctions hearing where their alleged conduct regarding discovery is in conflict with that alleged by Qualcomm concerning performance of discovery responsibilities."

Update: The magistrate judge conducted further proceedings and examined extensive discovery and evidence. She then concluded that, "while significant errors were made by some of the Responding Attorneys, there is insufficient evidence to prove that any of the Responding Attorneys engaged in the requisite 'bad faith' or . . . failed to make a reasonable inquiry before certifying Qualcomm's discovery responses." Accordingly, two years after her original order, the court declined to impose sanctions on the Responding Attorneys.

Comment: Despite avoiding formal sanctions, the lawyers in question were put through enormously burdensome and stressful proceedings for an extended period before finally receiving what can fairly be described only as lukewarm vindication. Therefore, the editors of this newsletter believe that our original risk management solution, repeated below, remains apposite.

Risk Management Solution: When a law firm takes on complex litigation involving a client, it should, in addition to explaining the rules regarding the requirement of a litigation hold to prevent any document destruction, also seek agreement with the client at the outset regarding the management of the discovery process. The law firm should obtain all litigation clients' written commitment to give the firm full access to the information it deems necessary to comply with discovery requests. If the client is reluctant to provide unrestricted access, the law firm should reconsider whether to accept or continue the engagement.

At a minimum, if the client wants to maintain control over the discovery process and its results, the firm should require the client's in-house lawyers to personally verify all discovery responses before relying on the responses. However, this does not remove the risks, as it will likely not insulate outside counsel from their obligations, as explained in this case and others (*See*, *e.g., Zubulake v. UBS Warburg*, 2004 WL 1620866 (S.D.N.Y. 2004)).