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Recent Developments in Risk Management

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Aiding and Abetting the Unauthorized Practice of Law — Conducting a Due Diligence Background Check for Incoming Lawyers and Lateral Hires

***Commonwealth of Pennsylvania v. Kimberly Marie Kitchen*, Case No. CR-74-15, Court of Common Pleas of Huntington County, Pennsylvania**

Risk Management Issue: What due diligence should law firms undertake to verify that each incoming lawyer and lateral hire is licensed to practice law?

The Case: Kimberly Kitchen began working at BMZ Law PC part-time in 2005. She started working full-time in January 2014 and was promoted to partner in April 2014. She handled estate planning matters for roughly 30 estates. Prior to beginning work as an attorney, she worked as a paralegal at Reed Smith LLP. According to Kitchen's resume, she taught estate planning classes at Columbia Law School. Kitchen had also previously served as the President of the Huntingdon County Bar Association.

After her promotion to partner, in winter 2014, a fellow lawyer noticed that Kitchen was using the bar number of another lawyer from Delaware. Shortly thereafter, BMZ Law received a court order prohibiting Kitchen from continuing to practice law. When Kitchen was asked for proof that she was an attorney, she provided an email confirming that she graduated from Duquesne University's law school as well as exam results showing that she passed the Pennsylvania bar exam in February 2005. She also provided a photograph of her purported attorney's license. However, Kitchen never went to law school, had not passed a bar exam, and was not licensed to practice law. According to the criminal complaint filed against Kitchen in March 2015, a review of her computer and cellphone showed that the documents she had provided were fictitious. In order to perpetuate the fraud for a decade, Kitchen had attempted to handle contentions matters outside the courtroom.

In July 2016, Kitchen was convicted on charges of unauthorized practice of law, forgery and felony records tampering and sentenced to two to five years in prison. BMZ Law Firm indicated that it would be undertaking a thorough review of each and every file she had handled.

Risk Management Solution: This case is significant because it illustrates the need for law firms to verify that incoming attorneys and lateral hires have a law degree and that their license to practice law is in good standing. Firms should verify directly with the state's attorney regulatory agency that the licensing information comes from a reputable source as opposed to documents that could easily be manipulated by a dishonest applicant. Verifying the attorney's bar number with the state bar association is another way to ensure the new hire is licensed. Background checks will help ensure that the person actually has the credentials they claim. Having these procedures in place will help avoid possible malpractice claims, demands for disgorgement of fees, the potential for professional discipline for aiding the unauthorized practice of law, and any other resulting liability should a non-lawyer slip through the review, be hired by the law firm and held out as a lawyer.

For current comments on issues of professional ethics see our blog: www.lawyersfortheprofession.com.

HINSHAW & CULBERTSON LLP

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 Noah D. Fiedler

Contributors:
Charles G. Brackins, Anthony E. Davis and Alyssa A. Johnson

Waivable and Non-waivable Conflicts of Interest Involving Representation of Multiple Parties — Timely Identification of Conflicts and the Meaning of Adequate Disclosure to Support Waivers

***State Comp. Ins. Fund v. Drobot,* No. SACV 13-0956 AG (JCGx), 2016 BL 205454 (C.D. Cal. June 24, 2016); *US v. DeCinces*, No. SACR 12-0269(B)-AG (C.D. Cal. July 21, 2015); *Bryan Corp. v. Bryan Abrano*, Case No. SJC-12003 (March 8, 2016 - June 14, 2016)(slip opinion)(Mass.)**

Risk Management Issue: What do firms need to do to avoid conflicts, and to obtain effective waivers for conflicts?

The Cases: Three recent cases involve the disqualifications of law firms in connection with the representation of multiple parties.

State Compensation Insurance Fund vs. Drobot is a 2016 decision of the U.S. District Court for the Central District of California involving a law firm that was representing the California State Compensation Insurance Fund ("SCIF") in a civil suit seeking recovery of monies alleged to have been wrongfully paid to doctors, clinics and marketers, who had participated in a conspiracy to defraud the SCIF with fraudulent billings. Concurrently, the same firm was defense counsel for a health care marketer ("Randall") in a criminal prosecution involving this same conspiracy. Randall was named as a third-party defendant in the SCIF civil suit and was a defendant and co-conspirator in the criminal prosecution. Both the civil litigation and the criminal prosecution involved the same alleged fraudulent billing scheme and were being litigated concurrently. One of the defendants in the civil suit filed a motion to disqualify the firm from representing SCIF based on an alleged conflict of interest. The firm opposed the disqualification on the grounds that the conflict had been waived by Randall and SCIF in writing on more than one occasion.

The Court side-stepped a standing argument by holding that its authority to disqualify an attorney derived from its inherent judicial powers over its cases and the attorneys who practice before it, since the Court could order disqualification *sua sponte* in the interest of administering justice. With respect to the waiver issue, after a lengthy and detailed discussion, the Court held that since the conflict was actual, adverse and involved representation in concurrent litigation, the conflict could not be waived. In fact, the Court noted that the conflict was so pervasive that it could be the only explanation for why Randall had not been named by SCIF as a Defendant and had only been brought into the civil litigation on a Third Party Complaint.

The Court granted the Motion for Disqualification and refused to allow the firm to continue to represent either Randall or the SCIF.

The Court's decision in the *Drobot* case was authored by Judge Andrew Guilford, who also authored another recent case on this subject, the 2015 Central District case of *United States vs. DeCinces*. The *DeCinces* case involved representation by Skadden, Arps, Slate, Meagher & Flom of both an entity and its former CEO in concurrently pending matters, including an insider trading prosecution of the former CEO.

Contrary to the holding in *Drobot*, Judge Guilford held that the waiver in *DeCinces* was sufficient to overcome the conflict. In *DeCinces*, Judge Guilford placed great reliance on the former CEO's Sixth Amendment right to freely choose his own legal counsel in a criminal prosecution.

In a reference to the *DeCinces* case in his *Drobot* decision, Judge Guilford noted that the waiver used in the *DeCinces* case "was one of the best and most complete the Court has ever seen". What made the wavier particularly effective was the extensive disclosure which preceded the waiver. The Court noted that the client was thoroughly informed of the ramifications which could result from the conflict by an outside, independent attorney engaged specifically for that purpose.

The third case, is the Massachusetts Supreme Court's decision in *Bryan Corporation vs. Abrano*, which dealt with attorney disqualification due to a conflict which should have been foreseen by the attorney. The conflict involved the concurrent representation of a closely held family owned corporation and three of the individual principals. Subsequently, a dispute arose between the three individuals and the corporation. The attorney ceased representing the corporation and sought to continue representing the three individuals. However, the Court disqualified the attorney from representing the individuals in their dispute with the corporation on the grounds that when the attorney had previously represented the corporation, he should have foreseen that the interests of the three individuals "were likely soon to become adverse" to those of the corporation.

Risk Management Solution: As a first step, law firms must have in place a client intake system that gathers adequate information about new matters, and that provides independent assessment of whether conflicts exist; if actual conflicts are then waivable; and if the proposed waiver contains adequate disclosure as required by the ethics rules. Even when the conflict is waivable, any meaningful waiver must be based on adequate disclosure. In the *DeCinces* case a model disclosure of information regarding the conflict and its ramifications was made to the client, and reviewed by an independent outside attorney engaged for that purpose. While that might not be practical or cost-effective in all cases, it does provide a standard that optimizes the likelihood that a court will uphold a waiver.

The Right of Law Firms to Assert the Attorney-Client Privilege when Ethical Issues Arise in Connection with a Client Engagement

***Stock v. Schnader Harrison Segal and Lewis LLP*, 35 N.Y.S.3d 31 (N.Y. App. Div. 2016)**

Risk Management Issue: Are lawyers and law firms protected by attorney-client privilege when advice is sought from and given by in-firm general counsel in circumstances when the advice relates to a continuing, current client of the firm?

The Case: In *Stock v. Schnader Harrison Segal and Lewis LLP, the Court decided that communications between lawyers and their law firm's in-house General Counsel are protected by the attorney-client privilege. The decision is consistent with similar rulings in a number of other states, and rejects several theories that had greater success in some earlier cases in several federal courts.*

Stock had retained the Schnader Harrison firm to represent him in his departure from MasterCard International, Inc. Stock subsequently sued the firm for malpractice, blaming the failure of the arbitration — that the firm had advised him to bring — on the fact that Schnader Harrison had failed to advise him that his termination by MasterCard triggered the acceleration of the ending dates of the exercise periods of certain stock opinions granted to him by MasterCard, worth $5 million. In the course of discovery, Stock sought 24 documents relating to communications his former Schnader Harrison attorney had with the firm's General Counsel. The trial court held that Stock had a right to compel disclosure under the "fiduciary exception" to the "intra firm" attorney-client privilege. This supposed exception to the normal rules of attorney client privilege rests on the argument that law firms are fiduciaries with special obligations to their clients that override the firms' right to claim the privilege.

The Appellate Division reversed the lower court's ruling and held that the fiduciary exception does not apply, and that the communications between the firm's attorneys and the firm's General Counsel were privileged. The Court reasoned that when the Schnader Harrison attorneys sought the advice of the firm's General Counsel, they did so only to receive appropriate legal advice about their ethical responsibilities and potential liabilities, and that the privilege was not lost because of the firm's fiduciary duties to Stock. The Court noted that the General Counsel never worked on any matter for Stock, and that Stock was not billed for any time spent on the in-firm consultation. The Court further held that for the purposes of the in-firm consultation on the ethical issue, the attorneys seeking the General Counsel's advice, as well as the firm itself, are the General Counsel's "real clients". The Court also declined to adopt the "current client" exception to the attorney-client privilege, which, as in the case of the fiduciary exception, some federal courts had found should bar firms from asserting the privilege on the ground that the duty of loyalty to current clients overrode the right to claim the privilege. The Court ruled that the "current client" exception would create unworkable results for both the client and the law firm.

Comment: This case follows earlier cases on the same topic, discussed in prior issues of the *Lawyers' Lawyer Newsletter*. See Volume 19, Issue 4, September 2014 (discussing *Crimson Trace Corp. v. Davis Wright Tremaine LLP*, (2014) 355 Or. 476 (May 30, 2014)); Volume 18, Issue 4, September 2013 (discussing *RFF Family Partnership, LP v. Burns & Levinson, LLP*, 991 N.E.2d 1066 (Mass. 2013) and *St. Simons Waterfront, LLC v. Hunter, MacLean, Exler & Dunn*, P.C., 746 S.W.2d 98 (Ga. 2013); Volume 20, Issue 2 (discussing *Palmer v. Superior Court*, 231 Cal. App. 4th 1214 (2014)). and Volume 20, Issue 4 (discussing *Moore v. Grau*, No. 2013-CV-150 (Sup. Ct. N.H. Dec. 15, 2014).

Comment: A contrary decision would have created serious problems for law firms in New York when the firms or their lawyers are confronted with an ethical dilemma. If there were no in-firm privilege, in order to obtain advice and keep it confidential and privileged the firm would likely have to withdraw from the matter immediately, which often would not otherwise be necessary, and which might very well prejudice the client. Accordingly, this case is of great importance, and should encourage those firms that have not already done so to appoint a General Counsel.

Risk Management Solution: In order to sustain the right to assert the privilege, firms need to be able to demonstrate compliance with these prerequisites:

- The establishment of a formal position of "in-house" General Counsel by a lawyer within the firm, either generally or at least to deal with the matters in question
- The purpose of the communications with law firm General Counsel should be clearly identifiable and the advice sought should relate to the lawyer's or the firm's own ethical or legal obligations
- The time spent communicating with in-house General Counsel should not be charged to the client
- The in-house General Counsel providing the legal advice should be someone who is not directly involved in the underlying client-matter and who has not previously billed any time to the matter
- In the event the advice sought relates to a malpractice claim, the law firm should refrain from putting the communications with the in-house General Counsel "at issue"
- The use of segregated filing for "in house" communications so that these are kept apart from the underlying matter out of which the risk management issue has arisen. This will commonly be accomplished by the use of "risk management" or equivalent "firm matter" billing codes for matters addressed by in-house General Counsel. Those files should, of course, be kept confidential, especially from the client, so as to avoid a waiver.

Duty to Disclose Malpractice to Clients — Duty to Disclose Co-counsel's Malpractice

New York State Bar Association Committee on Professional Ethics Opinion 1092 (May 11, 2016) (Opinion 1092)

Risk Management Question: When lawyers become aware that either they themselves or their co-counsel have committed malpractice, what is the duty of disclosure to clients?

The Opinion: Opinion 1092 succinctly sets out both the applicable rules of professional conduct and governing New York case law on lawyers' duties to inform clients of their own as well as co-counsel's errors and omissions.

The facts that gave rise to the issuance of Opinion 1092 are summarized in the opinion as follows:

> The inquirer was engaged to represent a client on the eve of trial. The client's prior counsel is serving as co-counsel. In preparing the case, the inquirer has learned that co-counsel conducted virtually no discovery and made no document requests, although the inquirer believes correspondence and emails between the parties could be critical to the case. The inquirer believes this was a significant error or omission that may give rise to a malpractice claim against co-counsel. The outcome of the case, however, has yet to be decided. The inquirer is concerned about disclosing this situation to the client because it would undermine inquirer's relationship with co-counsel, but the inquirer also believes it is in the client's best interests to disclose the facts as soon as possible.

The relevant New York Rules of Professional Conduct ("RPCs") on which Opinion 1092 is founded are 1.4, governing the ethical obligations of a lawyer regarding communication with the client; RPC 1.7, governing conflicts between the lawyer's own and the client's interests; and RPC 1.16, governing the lawyer's duty to withdraw from representation.

RPC 1.4 provides:

> (a) A lawyer shall (1) promptly inform the client of…(iii) any material developments in the matter…; (3) keep the client reasonably informed about the status of the matter; and
>
> (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Opinion 1092 notes that Comment [3] to this provision "requires that the lawyer keep the client reasonably informed about the status of the matter, such as significant developments affecting the timing or the substance of the representation."

Rule 1.7(a)(2) provides that:

> Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that…there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.

And Opinion 1092 further notes that, should such a conflict arise because of a lawyer's error or omission, Rule 1.16(b) may require the lawyer to withdraw.

Most helpfully, Opinion 1092 sets out extensive references to case law, both from New York and other states, other states' ethics opinions, law review articles, and the pertinent reference to the Restatement of the Law Governing Lawyers. These materials can be found in footnotes 3, 4 and 5. (For readers interested in accessing these materials, the following is a link to the opinion: https://www.nysba.org/CustomTemplates/Content.aspx?id=63834)

Although not every error rises to the level that requires reporting to the client, where a lawyer commits an error or omission that has a real possibility of causing the client harm, it must be reported to the client.

What is novel in Opinion 1092 is that it addresses the questions as to how this principle applies when the error or omission was made by a lawyer's co-counsel.

Opinion 1092 unequivocally states that, "[a]s in the case of the lawyer's own malpractice, the inquirer has a duty to inform the client of co-counsel's malpractice if the inquirer concludes that co-counsel's error or omission was significant.…." However, Opinion 1092 suggests, without requiring it, that the lawyer may wish to discuss with co-counsel why co-counsel acted or omitted to act in the manner that gives rise to the lawyer's concerns before deciding to report to the client. The act or omission may, for instance, be strategic rather than negligent. (Or it may have occurred with the client's knowledge and approval.)

Nevertheless, "[i]f the inquirer determines that co-counsel has engaged in a significant error or omission that may give rise to a malpractice claim, then the lawyer must inform the client." Opinion 1092 notes that "[t]his is particularly so because the client needs the information when the lawyer who has committed the significant error or omission is continuing to represent the client." The opinion suggests that this factor is particularly crucial because the client has more options to consider in this circumstance: (i) continuing the attorney-client relationship with co-counsel and reserving any possible malpractice claim for later; (ii) terminating co-counsel while keeping the inquirer (or hiring a different lawyer); or (iii) bringing a malpractice action against co-counsel now. The client may want to seek independent advice regarding these options. Rule 1.4(b) requires a lawyer to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." However, the client can only make an informed choice among those options if the lawyer gives the client the relevant information about co-counsel's past conduct. Accordingly, Rule 1.4(b) requires that the lawyer disclose to the client the facts that the lawyer has learned about co-counsel.

Comment: It should be noted that a client may have to consider how best to proceed even in the situation where co-counsel is not continuing in the representation. Accordingly, the lawyer who learns of the error or omission needs to consider this in determining when to report to the client. Notably, if the duty to report arises because the client may have a claim against co-counsel, the lawyer exposes herself or himself to a claim that she or he aided in the malpractice, or hindered the client in seeking a remedy, if the report is not made promptly after the lawyer learns of the error or omission.

There is, however, one critically important issue that arises when a lawyer is reporting her own conduct that is not addressed in Opinion 1092, namely the manner in which an error or omission should be reported to the client. Whenever a duty to report arises, lawyers need to be mindful of the terms of their lawyers' professional liability (malpractice) insurance contract. Almost universally, those contracts include as a condition of coverage that the insured lawyer not make admissions that may prejudice the defense of a claim made under the policy. Obviously, this is of greatest significance when a lawyer is required under the ethics rules and case law to report the lawyer's own misconduct. However, given that the client may well decide to sue everyone, the issue should not be forgotten even when reporting only the errors of co-counsel.

Risk Management Solution: Where a lawyer commits an error or omission that has a real possibility of causing the client harm, or becomes aware that co-counsel has committed such an error or omission, it must be reported to the client. In order to comply with this ethical duty without compromising the reporting lawyer's right to a defense under her malpractice insurance policy, lawyers should set out all of the material facts — describing the error ("the deadline to file the claim was on [date] but the claim was not filed on or before that [date]") — and also informing the client of the conflict of interest that therefor now exists between the client's own and the lawyer's interests as to how to proceed going forward, and that the client should accordingly consult independent counsel as to the client's rights that may follow from the stated facts and the conflict that has arisen.

Although some cases on the lawyer's fiduciary duty to the clients in these circumstances — which are coterminous with the ethical duties described in the Opinion — go further and suggest a duty actually to admit malpractice, the lawyer is not required under the ethics rules to make an explicit admission that would potentially compromise the lawyer's right to a defense under the insurance policy. Absent local case law to the contrary, the lawyer should not take the extra step of stating "this circumstance gives rise to a claim against me," or "this circumstance constitutes an error or omission on my part," or "I messed up, and you should sue me." See, e.g., Colorado Bar Association Ethics Committee Formal Opinion 113 — Ethical Duty of Attorney to Disclose Errors to Client, Adopted November 19, 2005, Modified July 18, 2015. Provided that lawyers take care in this respect, insurers should not be able to argue that reporting consistent with the ethical duties discussed in Opinion 1092, absent an actual admission of liability, itself constitutes a violation of the insurance contract.