

The Lawyers' Lawyer Newsletter – Recent Developments in Risk Management – September 2020 Edition

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Expand each of the topics below to learn more about the risk management issues and solutions covered in this edition of *The Lawyers' Lawyer Newsletter*.

Protection of Client Funds – Wire Fraud – Confirmation of Destination Account

Sorenson Impact Foundation and James Lee Sorenson Family Foundation v. Continental Stock Transfer & Trust, Tassel Parent and Holland & Knight, D. Utah Case No. 2:2020-cv-00521

Risk Management Issue: What steps should lawyers and law firms consider to protect against fraud when facilitating a transfer of client funds?

The Case: This ongoing lawsuit was filed against *among other defendants* the law firm, alleging that it failed to prevent the transfer of \$3.1 million to a fraudulent account in Hong Kong. The firm was hired as lead legal counsel to effectuate a merger agreement and document the acquisition of plaintiffs' stock.

According to the complaint, plaintiffs emailed wire instructions to the firm regarding the conveyance of funds to plaintiffs' domestic bank accounts. Plaintiffs allege that a "malicious third-party" accessed the emails between the parties, and that, on January 31, 2020, the third party fraudulently sent an email to the firm requesting to change the wire destination to a foreign bank in Hong Kong.

On the same day that the firm received the request to change banks, the handling attorneys emailed plaintiffs requesting clear wiring instructions. That email was purportedly intercepted by the third party and never received by plaintiffs. The third party—pretending to be plaintiffs—sent the firm wire instructions for the Hong Kong bank.

The funds were ultimately transferred to the foreign accounts. Plaintiffs allege they have not yet been able to recover the funds.

Plaintiffs claim that the firm breached its fiduciary duty to them and also breached the engagement contract. According to the complaint, the firm did not require adequate documentation and verification of the change to the destination account. Further, the complaint alleges that the firm failed to investigate whether the Hong Kong bank account was actually owned by plaintiffs and to conduct a multifactor authentication for the wire transfer.

Risk Management Solution: As referenced in NYC Bar Op. 2015-3, common “red flags” of an internet scam include an email sender based abroad or the use of awkward phrases and poor grammar, both of which are alleged here. This complaint highlights the need for lawyers and law firms to establish fraud-prevention policies—such as multifactor authentication and call-back verification—to authenticate and verify wire instructions prior to transferring funds. Before wiring money to anyone, always confirm by phone call, not email, the authority to make the payment and the destination of the funds. Additionally, lawyers and law firms should consider implementing a system to flag suspicious email accounts, particularly those from outside the United States, as potential spam.

Attorney-Client Relationship – Settlement with Clients – Withdrawal – Stopping Work

Caper v. Foley & Lardner, LLP, et al., 2020 Mass. Super. LEXIS 22 (Mass. Super. Ct., Jan. 16, 2020)

Risk Management Issue: How may an attorney appropriately stop work when the existence of a conflict may necessitate withdrawal?

The Case: This legal malpractice case arose out of the firm’s representation of Adam Caper, Synchrony Venture Management, LLC (SVM), and Synchrony Innovations, Inc. (SI) (collectively, “plaintiffs”). In July 2013, Caper and SVM retained the firm and its attorney, Gabor Garai, for advice regarding a corporate restructuring of SVM, which resulted in the formation of SI.

In August 2013, plaintiffs hired Dowling as chief operating officer. Plaintiffs did not have sufficient funds to pay Dowling’s requested salary, so Caper consulted with the firm regarding whether Dowling’s salary could legally be deferred, pending the attainment of certain financial benchmarks by SVM and SI. The firm opined that the arrangement was permissible. Relying on that advice, Dowling’s employment agreement with SVM and SI stated that his annual salary would be deferred until SI obtained an initial round of financing.

Dowling resigned from SVM and SI early in January of 2014, and demanded \$42,300 in back salary, which he claimed he was owed. Caper contacted the firm regarding the demand and was informed that the salary deferral arrangement violated one or more statutes. Dowling later sued plaintiffs for violations of the Massachusetts Wage Act. The firm declined to represent plaintiffs in the employment claim “due to the significant unpaid balance” of legal fees; Caper eventually hired a different firm.

In early July 2014, Caper, his new firm, and the first firm, discussed the first firm’s potential liability for plaintiffs’ legal exposure as a result of the advice regarding Dowling’s salary arrangement. No agreement was reached, but the initial firm made it clear that any resolution would necessarily include plaintiffs’ release of potential claims

against the firm. Then, in late July 2014, Dowling offered to settle the employment litigation for \$60,000. Caper informed the first firm of Dowling's offer, and asked the firm to contribute up to \$40,000 for the settlement.

While these discussions were occurring, other attorneys from the first firm continued to work on other matters for Caper, including the preparation of preparing documents regarding an investment in SI from an outside investor. The investor pledged to invest \$50,000 and raise an additional \$200,000 in capital from other investors. Upon learning of Caper's request that the initial firm contribute \$40,000, Garai sent an email to Caper and the firm attorneys working on the outside investment, stating, "[Oven [sic] the demand for damages we cannot continue to represent you. Mike, please put pens down." Garai testified that he did not intend to terminate the attorney-client relationship, but only to persuade Caper "to pick up the phone and call." However, the firm never resumed work for plaintiffs.

According to plaintiffs, the first firm's unwillingness to complete the necessary documents for the investment caused the investor to walk away, and plaintiffs were never able to raise additional investment. SI eventually failed for lack of sufficient funds.

Plaintiffs asserted five claims against the first firm: (1) negligence/malpractice for erroneously advising Caper that SVM and SI could properly defer Dowling's salary; (2) breach of fiduciary duty for the "pens down" email; (3) intentional misrepresentation for advising plaintiffs that they could defer payment of the firm's invoices; (4) negligent misrepresentation regarding the firm's knowledge of the Massachusetts Wage Act; and (5) an unfair or deceptive act or practice by forcing plaintiffs to settle the dispute with the firm regarding the Dowling litigation.

In response to the firm's summary judgment motion, the court found a genuine issue of material fact regarding all counts except count four, which the court found to be duplicative of count one. The court also determined there was a genuine question as to whether Garai's "pens down" email was a legitimate effort to terminate the attorney-client relationship, or whether it was an attempt to force Caper to resolve the dispute on terms favorable to the firm. The court noted that Caper was in a vulnerable position. However, even if Garai's email was a legitimate attempt to withdraw, it was unclear whether the firm's withdrawal was accomplished "at a time and in a way that was 'a substantial cause of injury' to its clients and whether [the firm] gave [p]laintiffs adequate notice of its intention to withdraw."

Risk Management Solution: An attorney may not terminate or threaten to terminate the attorney-client relationship to coerce a settlement with a client. Even if a lawyer is required to withdraw due to a conflict of interest or for another reason, he or she must always protect the client's interests and effectively communicate to the client the intent to withdraw. Halting work without adequate notice prior to the withdrawal—and without ensuring that the client's interests are protected despite withdrawal—may be a breach of the attorney's fiduciary duty.

Prospective Clients – Duty of Confidentiality – Potentially Harmful or Disqualifying Information

ABA Formal Opinion 492 (June 9, 2020)

Risk Management Issue: When dealing with prospective clients, what steps can a lawyer take to insulate against disqualifying conflicts of interest?

The Opinion: The American Bar Association (ABA) Standing Committee on Ethics and Professional Responsibility issued Formal Opinion 492 on June 9, 2020. The Opinion provides guidance on Model Rule 1.18 regarding “Prospective Clients.” Specifically, it discusses the following in detail:

- Rule 1.18(a)’s definition of a “prospective client”
- The duty of confidentiality imposed even if an attorney-client relationship is not formed, as outlined by Rule 1.18(b)
- The potential for disqualification arising from consultation with a prospective client, provided in Rule 1.18(c)

A “prospective client” is defined in Rule 1.18(a) as “[a] person who consults with a lawyer about the possibility of forming a client-lawyer relationship with respect to a matter.” The ABA Opinion refers to Comment [2], which identifies the type of conduct constituting a “consultation” that would create an attorney-client relationship and additional duties to the client. Not all contact between an attorney and individual relating to a specific legal matter creates ongoing duties. As Comment [2] explains, a person who engages in unilateral communication to an attorney, “without reasonable expectation that the lawyer is willing to discuss the possibility of forming a client-lawyer relationship, [] thus is not a prospective client.”

According to the ABA Opinion, Rule 1.18(b) imposes a duty of confidentiality relating to information obtained during the course of a consultation—even if an attorney-client relationship is not formed. The prospective client may, however, consent to disclosure of information shared in the consultation. The ABA opinion refers to Comment [5], which states that “[a] lawyer may condition the consultation with a prospective client on the person’s informed consent that no information disclosed during the consultation will prohibit the lawyer from representing a different client in the matter.”

Finally, Rule 1.18(c) provides guidance relating to the potential for disqualification when the lawyer receives “significantly harmful” information during the course of a consultation. The Rule states that an attorney should not “represent a client with interests materially adverse to that of a prospective client in the same or substantially related matter if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter.”

The ABA Opinion provides some guidance on what might be considered “significantly harmful,” including settlement positions, opinions on legal theories, sensitive personal information, and financial information. Further, the ABA Opinion also states that the potentially harmful information need not be utilized by the attorney to trigger Rule 1.18 protection. Rather, the fact that information *could* be potentially harmful is sufficient to trigger disqualification under Rule 1.18.

In order to guard against a potential disqualifying conflict, the ABA Opinion recommends that attorneys “warn prospective clients against disclosing detailed information.” By limiting the consultation to information necessary

to determine whether or not the lawyer wishes to take on the representation, it is less likely that the attorney will receive disqualifying “significantly harmful information” from the prospective client.

For attorneys using websites to attract potential clients, the committee suggests that this protection can be achieved by placing an “explicit caution on a website intake link saying that sending information to the firm will not create a client-lawyer relationship and the information may not be kept privileged or confidential.” Alternatively, the prospective client and attorney can explicitly agree that information learned during the consultation may subsequently be used by the attorney.

Even if an attorney has received disqualifying information during the consultation with a prospective client, the ABA Opinion outlines protective steps that law firms can take.

If these suggested defenses cannot be implemented, and the prospective client attempts to invoke the protection of Rule 1.18 in a disqualification motion, courts and disciplinary organizations will conduct a fact-specific investigation to determine if “significantly harmful” information was relayed about the new matter. According to the ABA Opinion, that inquiry will consider the “duration of the discussion, the topics discussed, whether the lawyer reviewed documents, and whether the information conveyed is known by other parties, as well as the relationship between the information and the issues in the subsequent matter.”

Risk Management Solution: In order to avoid disqualifying conflicts of interest resulting from consultation with prospective clients, law firms should “condition a consultation with a prospective client on the person’s informed consent that no information disclosed during the consultation will prohibit the lawyer from representing a different client in the matter.” Additionally, attorneys should structure the initial consultation with a prospective client to obtain only the information necessary to determine if a subsequent attorney-client relationship should be formed. Despite these protections, if significantly harmful information is obtained, attorneys may seek the informed written consent of both parties.