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Weathering the Storm: Law Firm Risk Management in Hard Times

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It's no secret that many law firms and their clients are under great financial stress in the current economy. We've read of layoffs of both lawyers and staff and the outright collapse of firms from coast-to-coast. We're equally aware from local small talk of the less publicized but real belt-tightening that is going on at firms large and small in our own communities. Most of us aren't in a position to influence the course of the storm that is blowing through our economy right now. But, there are steps that all of us can take to weather its impact. In this column, we'll survey three. *First*, we'll look at how Oregon's innovative lateral hire screening rule can ease lawyer and staff mobility. *Second*, we'll examine the principal Oregon authorities addressing both rights and responsibilities when firms dissolve or split. *Third*, we'll outline key considerations when economic tensions fray relationships between lawyers and their clients.

Lawyer and Staff Mobility

Increased lawyer and staff mobility—both planned and “unplanned”—is a very real consequence of the current economic times. Some moves are an effort to find more secure shelter from the storm. Others, frankly, are a result. With both, Oregon's lateral hire screening rule, RPC 1.10(c), can make a significant contribution in hiring someone who may have been on the other side of ongoing

litigation or other work. When a lawyer leaves a firm, the “old” firm’s clients for whom the lawyer worked become the lawyer’s former clients for conflict purposes. The lawyer is prevented by the former client conflict rule, RPC 1.9, from taking on a matter at a new firm adverse to the former client if the new matter is the same or substantially related to the matter the lawyer handled at the “old” firm or would require the lawyer to use the former client’s confidential information in handling a new matter at a new firm. Moreover, under RPC 1.10(a), the “firm unit rule,” a disqualifying conflict brought to a firm by a new hire will (absent screening or waiver) be imputed to the new firm. That’s where Oregon’s screening rule can make a difference.

Under RPC 1.10(c), a new lawyer can be screened at the new firm from the matter that would trigger the otherwise disqualifying conflict. This will allow the new firm to both hire the lawyer and continue to represent its client in the matter concerned. Oregon State Bar Formal Ethics Opinion 2005-120 and Chapter 12 of the *Ethical Oregon Lawyer* both discuss the mechanics of lateral hire screening in detail. Although RPC 1.10(c) is framed in terms of lawyers, we have a duty under RPC 5.3(a) to ensure that staff “conduct is compatible with the professional obligations of the lawyer[.]” Screening, therefore, should also insulate a hiring firm from a conflict it might otherwise have from a staff hire. Screening won’t create jobs in and of itself, but it is a very practical tool that

allows firms to continue to meet their obligations to their clients while at the same time removing a sometimes significant impediment to lawyer and staff hiring.

Firm Dissolutions and Splits

Law firms have been dissolving and splitting for a long time for reasons ranging from personality clashes to arguments over firm revenues. As a result, well before the current economic storm Oregon already had a body of law addressing lawyers' rights and responsibilities in dissolutions and splits.

On the business side, the firm's partnership or shareholder agreement along with corresponding statutory law will generally control the division of firm revenue, expenses and other liabilities. *See generally Gray v. Martin*, 63 Or App 173, 663 P2d 1285 (1983) (partnerships); *Hagen v. O'Connell, Goyak & Ball, P.C.*, 68 Or App 700, 683 P2d 563 (1984) (professional corporations). Moreover, the fiduciary duties partners and shareholders owe each other continue while their firms are being wound-up. *See Platt v. Henderson*, 227 Or 212, 361 P2d 73 (1961) (accounting for firm revenues and files during dissolution).

On the professional side, it is paramount that the firms' clients be protected. OSB Formal Ethics Opinion 2005-70 addresses many facets of lawyers changing firms. Although it is framed in terms of individual lawyer departures, it provides equally ready guidance when applied to larger groups of lawyers. The opinion weaves together three primary threads. First, the lawyers involved need to inform their clients of impending firm changes so the clients can

assess who they want to handle their work going forward. Second, both the departed firm and the departing lawyers share responsibility for ensuring that clients' work is not substantively affected by the lawyers' changes in circumstance. Third, the clients affected have an absolute right to choose whether to retain their work at the "old" firm, move it with the departing lawyers or move it still further to an entirely different firm.

Economic Tensions Between Lawyers and Clients

In a down economy, avoiding mistakes that have "hard dollar consequences" can be critical. Three areas in particular can become flashpoints between lawyers and clients when economic pressures mount.

First, economic conflicts among clients can quickly translate into conflicts under the professional rules and underlying fiduciary standards for their lawyers. The economic conflicts can come in many forms, including internecine disputes over corporate control (see, e.g., *In re Kinsey*, 294 Or 544, 660 P2d 660 (1983)), fights over assets in business dissolutions (see, e.g., *In re Phelps*, 306 Or 508, 760 P2d 1331 (1988)), and dueling bankruptcy claims (see, e.g., OSB Formal Ethics Op 2005-40). In those circumstances, firms need to carefully assess potential conflicts, obtain waivers where appropriate and decline work that would put them in nonwaivable conflicts. The consequences of failing to monitor conflicts can range from regulatory discipline to potential claims for breach of fiduciary duty.

Second, trying to obtain security for fees once a client falls behind can create both regulatory risks and enforceability problems. On the former, OSB Formal Ethics Opinion 2005-97 emphasizes that RPC 1.5, which governs fees, requires a firm to obtain client consent based on a complete explanation to modify a fee agreement in the firm's favor. On the latter, a modification which doesn't meet that standard may create enforcement problems later. The Washington Supreme Court, for example, held in *Valley/50th Ave., L.L.C. v. Stewart*, 153 P3d 186 (Wash 2007), that a firm couldn't foreclose on a deed of trust obtained to secure fees that were in arrears because the firm had not satisfied the RPCs for what amounted to a business transaction with a client over a past debt. Although Oregon has not gone that far yet, that argument is no stranger here and, in fact, the Court of Appeals in *Welsh v. Case*, 180 Or App 370, 43 P3d 445 (2002), did not rule it out categorically. Therefore, if a firm considers security for fees necessary, the safest time to get it is at the outset of the representation when it can bargain at arms length with a potential client unencumbered by the fiduciary duties that attach with the formation of an attorney-client relationship.

Third, although withdrawal for nonpayment of fees is clearly permitted by RPC 1.16(b)(5), it is not without risks of its own. OSB Formal Ethics Opinion 2005-1 addresses withdrawal for nonpayment and Formal Ethics Opinion 2005-90 deals with the related issue of "file" liens. The former counsels that in

withdrawing lawyers must provide clients with reasonable notice, must take care to withdraw with the least practical impact on the client and must obtain permission if required by court rule. The latter notes that a lawyer's fiduciary duties to a client can "trump" the lawyer's possessory lien over the client's file and require the lawyer to provide the file to the client notwithstanding the lien if the client needs the file. The underlying message with both opinions is don't make a bad situation worse by giving a now former client grounds to claim that the client's case was damaged by the lawyer's improper withdrawal.

Summing Up

Hard economic times create pressures for both lawyers and clients. There are, however, some simple steps we can all take affirmatively to weather the storm and, perhaps even more importantly, to avoid making expensive mistakes when the margin for error is already thin.

ABOUT THE AUTHOR

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