LAW FIRM RISK MANAGEMENT IN HARD TIMES

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TABLE OF CONTENTS AND PRESENTATION OUTLINE

The Idaho RPCs and comments noted in this paper are available on the Idaho State Bar's web site at www.idaho.gov/isb. The ABA materials cited are available on the ABA Center for Professional Responsibility's web site at www.abanet.org/cpr.

I. Introduction

It's no secret that many law firms and their clients are under great financial stress in the current economy. Both the national and regional legal press have included stories about law firm layoffs of both staff and lawyers, the outright collapse of firms and occasionally tense relationships between lawyers and their clients. Most of us are not 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. Some of those steps are proactive, while others are "defensive" in the sense of trying to avoid situations that have "hard dollar consequences" at a time when margins are already thin.

In this paper and the accompanying presentation, we'll look at three primary areas of law firm risk management for hard times. *First*, we'll survey the status of lateral-hire screening at a time when there is a marked increase in lawyer and staff movement between firms. *Second*, we'll examine the primary Idaho 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.

II. Lawyer (and Staff) Movement and Lateral-Hiring Conflicts

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 economic storm. Others, quite frankly, are a result. With both, conflicts can present a practical barrier to hiring. When a lawyer leaves a firm, the lawyer's clients that remain at the "old" firm become the lawyer's former clients for

purposes of the former client conflict rule, RPC 1.9. Under RPC 1.9, former client conflicts occur in two circumstances. First, under RPC 1.9(a), a former client conflict arises when a lawyer handles a matter against a former client that is either the same or substantially related to a matter the lawyer handled for the former client. Second, under RPC 1.9(c), a former client conflict also arises when a lawyer handles a matter against a former client that would require the lawyer to use the former client's confidential information that the lawyer obtained in representing the former client. When a lawyer changes firms, a lawyer's former client conflicts are imputed to the lawyer's new firm as a whole under RPC 1.10(a)—the "firm unit rule." Therefore, absent waiver (or where applicable timely screening), the new firm may be disqualified from an ongoing matter if the firm hires a lawyer who is representing an adverse party. *See generally Foster v. Traul*, 145 Idaho 24, 32-33, 175 P.3d 186 (2007) (discussing disqualification in the hiring context in a case applying RPC 1.12's judicial screening rule to a law clerk who moved from a court to private practice).[1]

Although former client conflicts are waivable in theory, obtaining a waiver from a former client can be difficult in practice if the same lawyer who represented the former client proposes to be involved in the new representation. Even if the same lawyer will not be involved with the new representation, however, some clients may still withhold consent for reasons ranging from bona fide concerns about confidentiality to less wholesome motives rooted in litigation strategy. If a former client conflict exists, the former client is not required to articulate any reason for denying a waiver.

[1] For similar considerations with in-house counsel moving to private practice, *see* ABA Formal Ethics Op. 99-415 (1999).

When the revised Idaho Rules of Professional Conduct took effect in 2004, they largely reflected the then-current ABA Model Rules of Professional Conduct and, therefore, did not include a screening rule applicable to lateral movement between firms in private practice. Earlier this year, however, the ABA approved an amendment to Model Rule 1.10 allowing screening for lateral movement in private practice. ABA Model Rules 1.11 and 1.12, like their Idaho counterparts, already permitted screening for movement from, respectively, governmental and judicial positions to private practice. With screening, a former client's consent is not required if the screen is effectively and timely implemented to insulate the lawyer involved from the matter otherwise giving rise to a disqualifying former client conflict.

Several neighboring states have already adopted screening for lateral movement in private practice, including Washington, Oregon, Montana, Nevada and Utah. *See* ABA Standing Committee on Ethics and Professional Responsibility, Report on Proposed Amendments to Model Rule 1.10 (2009) at 1. Barring a similar amendment here, however, conflict checks should be run on all potential hires to identify possibly disqualifying conflicts (and, if so, to determine whether a waiver is a practical solution) *before* a final hiring decision is made.[2, 3] Because lawyers are responsible for the conduct of non-lawyer staff under RPC 5.3, similar considerations apply to staff hires. *Id*. at 13.

[2] Even at present, waivers can be conditioned on voluntary screening. For a discussion of voluntary screening, *see Spur Products Corp. v. Stoel Rives LLP*, 142 Idaho 41,122 P.3d 300 (2005).

[3] For a discussion of related considerations involving job negotiations with counsel for an adverse party from the perspective of both the lawyer negotiating for a position and the hiring firm, *see* ABA Formal Ethics Op. 96-400 (1996).

III. Law Firm Dissolutions and Splits

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

On the business side, the firm's partnership or shareholder agreement, along with corresponding statutory law, will generally control the division of firm revenues, expenses and other liabilities. *See generally Howard v. Perry*, 141 Idaho 139, 106 P.3d 465 (2005) (law firm dissolution). In this context, it is important to underscore that law firm partners and shareholders owe fiduciary duties to their fellow partners/shareholders and their firms. *See generally Anderson v. Anderson, Kaufman, Ringert and Clark, Chartered*, 116 Idaho 359, 775 P.2d 1201 (1989) (discussing internal law firm fiduciary duties).

On the professional side, it is paramount that the firm's clients be protected. ABA Formal Ethics Opinion 99-414 (1999) addresses many facets of lawyers changing firms. Although the opinion 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 in a timely fashion 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 circumstances. 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.

IV. 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 for their lawyers under the professional rules and underlying fiduciary standards. The economic conflicts can come in many forms, ranging from internecine disputes over corporate control to fights over assets in business dissolutions. *See, e.g., Blickenstaff v. Clegg*, 140 Idaho 572, 97 P.3d 439 (2004) (illustrating both). In those circumstances, firms need to carefully assess potential conflicts, obtain waivers where appropriate and decline work that would put them in non-waivable conflicts. The consequences of failing to monitor conflicts can range from regulatory discipline to potential claims for breach of fiduciary duty. Firms should also carefully document who their clients are at the outset of a representation in an engagement letter so that it will be clear to whom the firm's duties do—and do not—run. *Id*.[4] Firms should be equally careful not to take on duties to third parties that put them into conflict with their clients or which may open themselves to the claims that they knowingly assisted a client in breaching a fiduciary

[4] For more on engagement letters and definition of the client, see my articles in *The Advocate*: "Defensive Lawyering: Why Engagement Letters are a Lawyer's Best Friend" (Sept. 2004); and "The 'Who Is the Client?' Question" (Feb. 2009). Whether an attorney-client relationship exists in a particular circumstance is a question of fact. *See Warner v. Stewart*, 129 Idaho 588, 593, 930 P.2d 1030 (1997). The test generally turns on (1) the client's subjective belief and whether that subjective belief is objectively reasonable under the circumstances and (2) whether there is some clear assent to the representation by both the client and the lawyer. *Id*. at 593-94; *accord Balvi Chemical Corp. v. JMC Ventilation Refrigeration, LLC*, No. CV-07-353-S-BLW, 2008 WL 313792 at *2 (D. Idaho Feb. 1, 2008) (unpublished) (discussing and applying *Warner*).

duty to a third party. *See, e.g., Jones v. Runft, Leroy, Coffin & Matthews, Chartered*, 125 Idaho 607, 873 P.2d 861 (1994) (claimed duty to third party based on funds held in escrow); *Davis v. Keybank Nat. Assn*., No. CV-05-198-E-BLW, 2005 WL 2847239 (D. Idaho Oct. 26, 2005) (unpublished) (claimed duty to third party based on role as trustee on deed of trust); *Taylor v. Maile*, 142 Idaho 253, 127 P.3d 156 (2005) (claimed assistance with breach of fiduciary duty).[5]

Second, trying to obtain nonmonetary security for fees (such as a trust deed or similar lien on the client's real property)[6] once a client falls behind can create both regulatory risks and enforceability problems. On regulatory risks, *In re May*, 96 Idaho 858, 538 P.2d 787 (1975), classified a modification of an existing fee agreement to take nonmonetary security as a business transaction with a client that triggered the heightened disclosure and consent standards now found in RPC 1.8(a). Those increased requirements include: (1) the transaction must be "fair and reasonable to the client"; (2) the client must be advised to seek independent counsel; and (3) the agreement (including the disclosure) must be in a writing signed by the client.[7] On enforceability problems, the Idaho appellate courts have not yet determined whether a lawyer's failure to comply with RPC 1.8(a) also constitutes a defense to enforceability. Other courts, however, have held that it can. *See, e.g., Valley/50th Ave., LLC v.*

[5] Claims for legal malpractice, by contrast, generally require a direct attorney-client relationship as a prerequisite. *See generally Harrigfeld v. Hancock*, 140 Idaho 134, 90 P.3d 884 (2004); *Becker v. Callahan*, 140 Idaho 522, 96 P.3d 623 (2004).

[6] Advance fee deposits are governed by RPCs 1.5 (fees) and 1.15 (trust accounting).

[7] The Idaho Supreme Court has not yet ruled on whether a nonmonetary security provision in a fee agreement negotiated at the outset of a representation also constitutes a business transaction with a client. ABA Formal Ethics Op. 02-427 (2002), however, finds that it does. The ABA, in turn, relied, in part, on Comment 16 to ABA Model Rule 1.8, which reads: "When a lawyer acquires by contract a security interest in property other than that recovered by the lawyer's efforts in the litigation, such an acquisition is a business or financial transaction with a client and is governed by the requirements of paragraph (a)." Comment 16 to Idaho RPC 1.8 is identical to its ABA counterpart.

Stewart, 153 P.3d 186 (Wash. 2007). Moreover, it is important to note that the Idaho Supreme Court has cast lawyers' responsibilities to clients in fiduciary terms. In *Blough v. Wellman*, 132 Idaho 424, 426, 974 P.2d 70 (1999), for example, the Supreme Court wrote:

> "The relationship of client and attorney is one of trust, binding an attorney to the utmost good faith in fair dealing with his client, and obligating the attorney to discharge that trust with complete fairness, honor, honesty, loyalty, and fidelity. . . . For a breach or violation of those professional duties, the client may hold the attorney liable or accountable."[8]

Fee forfeiture is a recognized remedy for a disloyal agent. In *Rockefeller v. Grabow*, 136 Idaho 637, 642, 39 P.3d 577 (2002), which involved a real estate agent, the Supreme Court noted: "It is the established law of this jurisdiction that an agent's right to compensation will be affected by a violation of his fiduciary duties." That principle has been applied to lawyers. *See, e.g., In re Larson*, No. 03-04001, 2004 WL 307182 (Bankr. D. Idaho Jan. 30, 2004) (unpublished) (ordering fee disgorgement as a sanction for a conflict). Therefore, it would not represent an extraordinary extension of existing fiduciary law applicable to lawyers to find that an improper nonmonetary security provision was unenforceable.

Third, although withdrawal for nonpayment of fees is clearly permitted by RPC 1.16(d), it is not without risks of its own. In *Defendant A v. Idaho State Bar*, 134 Idaho 338, 342-43, 2 P.3d 147 (2000), the Supreme Court found as a matter of regulatory law a lawyer could not be disciplined for asserting the lawyer's possessory lien to enforce payment when the client moved the work involved to new counsel. In doing so, the Court relied on a provision in former RPC 1.16(d) that is identical to the present version:

[8] For a similar statement in federal court applying Idaho law, *see Damron v. Herzog*, 67 F.3d 211, 214 (9th Cir. 1995).

"The lawyer may retain papers relating to the client to the extent permitted by law." Under the facts involved in *Defendant A*[9], the Court refused to read into the rule a requirement that the lawyer's possessory lien give way in the face of client need. As noted earlier, however, the Supreme Court has also cast lawyers' duties under the professional rules as reflections of underlying fiduciary duties—the breach of which can give rise to civil damage liability. *See Blough v. Wellman*, 132 Idaho at 426. Under RPC 1.16(d), lawyers have a general duty upon withdrawal to "take steps to the extent reasonably practicable to protect a client's interests[.]" Comment 9 to RPC 1.16 also notes that "[e]ven if the lawyer has been unfairly discharged by the client, a lawyer must take all reasonable steps to mitigate the consequences to the client." It would not be hard to imagine, therefore, a former client framing a claim for breach of fiduciary duty around the contention that the former client had been damaged by the lawyer's failure to provide the file (notwithstanding the lawyer's possessory lien rights).

V. Conclusion

Hard economic times create pressure 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.

[9] The underlying case had essentially been concluded and the client had not objected to the lawyer's billing statements at the time they were tendered. On a related point, RPC 1.5(f) gives clients a right to request an accounting for fees—including upon withdrawal. *See Wilhelm v. Idaho State Bar*, 140 Idaho 30, 34, 89 P.3d 870 (2004) (discussing accounting rights under RPC 1.5(f)).