Don't Become a Statistic:
Law Firm Risk Management in
Real Estate Development Practice

Mark J. Fucile

Fucile & Reising LLP
115 NW First Ave., Suite 401
Portland, OR 97209
503.224.4895
mark@frllp.com
www.frllp.com

2009 Oregon Eminent Domain Conference
May 28, 2009
Portland

Mark J. Fucile of Fucile & Reising LLP focuses on legal ethics, condemnation litigation and product liability defense. In his legal ethics practice, Mark handles professional responsibility, regulatory and attorney-client privilege matters and law firm related litigation for lawyers, law firms and legal departments throughout the Northwest. Mark is a former member of the Oregon State Bar Legal Ethics Committee, is the past chair and a current member of the Washington State Bar Rules of Professional Conduct Committee and is a member of the Idaho State Bar Professionalism & Ethics Section. Mark is a contributing editor-author for the Oregon State Bar's Ethical Oregon Lawyer and the Washington State Bar's Legal Ethics Deskbook. He is also the ethics columnist for the Multnomah Bar's Multnomah Lawyer and the Washington State Bar News and is a regular contributor on law firm risk management to the Oregon State Bar Bulletin, the Idaho State Bar Advocate and the Alaska Bar Rag. In his condemnation practice, Mark represents property owners in direct and inverse condemnation cases in state and federal court and also has significant experience representing agencies and utilities as condemners. He is a contributing editor for condemnation/inverse condemnation for the Oregon State Bar's Real Estate & Land Use Digest and wrote a series on Oregon condemnation procedure and valuation for the Oregon State Bar's Litigation Journal. Mark is admitted in Oregon, Washington, Idaho, Alaska and the District of Columbia. Mark received his B.S. from Lewis & Clark College and his J.D. from UCLA.

I. INTRODUCTION

Each year, the Oregon Professional Liability Fund publishes a report that both reflects the previous year's malpractice claims involving Oregon lawyers and also contains a 10-year moving average of claims experience by practice area.[1] The statistics track both the frequency of claims by practice area and also the severity. The former reflects the percentage of total claims received by practice area regardless of disposition. The latter reflects the percentage total actually *paid* on claims by practice area. With both, all real estate related areas are aggregated into a single category called "real estate." For the 10-year period ending December 31, 2007, real estate practice generated 11 percent of the malpractice claims filed against Oregon-based lawyers in private practice who (as required by statute) are covered by the PLF. By contrast, for the same period real estate practice generated 15 percent of the claims paid.

There is an inevitable time lag with the statistics reported given Oregon's two-year statute of limitation for malpractice claims (which can be extended further by the "discovery rule") followed by still more time between claim-filing and disposition. In short, presently available statistics reflect historical trends rather than "real time." In light of current economic conditions in the real estate development industry generally, it would not be surprising to see both the statistical frequency and severity of claims increase. If such increases occur, it will not necessarily mean that lawyers practicing in that area suddenly became less competent. Rather, it may reflect a more fundamental

[1] The PLF's annual reports are available on its web site at www.osbplf.org. The Oregon State Bar's Office of Disciplinary Counsel also publishes an annual report that reflects bar regulatory complaints by practice area. Those reports are available on the Bar's web site at www.osbar.org.

fact of practice life that when deals go bad and fingers are pointed lawyers can find themselves convenient targets simply by virtue of having insurance.

In this paper and the accompanying presentation, we'll look at two primary ways from the perspective of law firm risk management of trying to avoid becoming a "statistic." The first will focus on potential claims by clients and will outline the risk management benefits of consistently using engagement agreements when taking on new work. The second will focus on potential claims by nonclients for alleged assistance in supposedly aiding clients in breaching fiduciary duties to nonclients and an important set of decisions from Oregon's appellate courts over the past 10 years in this area.

II. AVOIDING POTENTIAL CLAIMS BY CLIENTS[2]

Subject to limited exceptions, only a client (current or former) of a lawyer has standing to bring a malpractice claim. *See generally Stevens v. Bispham*, 316 Or. 221, 227, 851 P.2d 556 (1993) (outlining the elements of a legal malpractice claim); *see also Caba v. Barker*, 341 Or. 534, 145 P.3d 174 (2006) (discussing the limited exceptions). Similarly, only a client (current or former) of a lawyer generally has standing to bring a claim for breach of fiduciary duty. *See generally Kidney Association of Oregon v. Ferguson*, 315 Or. 135, 144-48, 843 P.2d 442 (1992) (addressing breach of fiduciary duty claims against lawyers); *see also Roberts v. Fearey*, 162 Or. App. 546, 552-56,

---

[2] This section is drawn from my July 2005 article in the Oregon State Bar Bulletin, "Starting Right: Using Engagement Letters as a Risk Management Tool." The article is available in the Bulletin archive on the Oregon State Bar's web site at www.osbar.org/publications/bulletin/05jul/toc.html. For additional discussion of this area when representing entities in particular, see my December 2006 article in the Bulletin, "Drawing a Bright Line: The 'Who Is the Client?' Question," which is available at www.osbar.org/publications/bulletin/06dec/toc.html.

986 P.2d 690 (1999) (noting that a lawyer's fiduciary duty generally runs only to the lawyer's client).

As a result, an often-critical aspect of preventing potential claims by clients (beyond competently performing the work involved) is to define and delineate the relationship at the outset. It is at this early stage that engagement agreements can play two key roles.[3]

First, an engagement agreement allows the lawyer to define who the client will be for a project. Although the identity of the client is often clear, many times it is not. Examples of the latter include situations where a lawyer may have met initially with several family members, a developer and a property owner, potential joint venture partners or representatives of an affiliate of a larger corporate group. In these kinds of scenarios, it is important to make clear to whom the lawyer's duties will run—and to whom they will not—so that the nonclients will not claim later that the lawyer was also representing them and didn't protect their interests. *See, e.g., Lord v. Parisi*, 172 Or. App. 271, 19 P.3d 358 (2001) (family member/property owner involved in a development project with another family member sued the latter's lawyer for malpractice over the project). In Oregon, whether an attorney-client relationship exists in a particular circumstance is governed by the "reasonable expectations of the client" test set out in *In re Weidner*, 310 Or. 757, 770, 801 P.2d 828 (1990); *accord Tinn v. EMM Labs, Inc.*, 556 F. Supp.2d 1191 (D. Or. 2008) (applying *Weidner*). The test is twofold:

[3] Engagement agreements can also serve other important functions such as documenting conflict waivers and incorporating mechanisms to change hourly rates as a representation progresses over time. An engagement agreement, of course, will not have any of its intended effects if the lawyer or firm then does not act consistent with the agreement (absent an intentional, rather than an "inadvertent," modification).

(1) does the client subjectively believe you are the client's lawyer? and (2) is that subjective belief objectively reasonable under the circumstances? Engagement letters allow you to set out clearly who your client will be in a given circumstance. Depending on the setting, polite "nonrepresentation" letters to those you will not be representing may also offer a useful supplement to an engagement agreement to let the nonrepresented parties know which side you are on. In the face of an engagement agreement with your client, conduct consistent with that agreement, and depending on the circumstances, nonrepresentation letters, it will be difficult for another party to assert later that you were his or her lawyer too, under either element of the *Weidner* test.

Second, engagement agreements are an excellent way to define the scope of a representation. Many times in real estate development work, a firm may only be handling one discrete portion of a project, such as wetlands permitting, environmental remediation or land use approvals. In that situation, it is important to document that limited role to lessen the risk that if another aspect of the client's work that your firm was not responsible for doesn't turn out to the client's liking your firm will not be blamed as well. Oregon RPC 1.2(b) allows a lawyer to "limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent." An engagement agreement that outlines the scope of the services to be provided will go a long way toward meeting this requirement.

III. AVOIDING POTENTIAL CLAIMS BY NONCLIENTS[4]

When disputes arise in development projects, they can often involve litigation between joint venture partners or limited liability company shareholders claiming that one partner supposedly breached a fiduciary duty toward the other. Although, as noted above, Oregon has generally limited the ability of a nonclient to bring a legal malpractice or lawyer breach of fiduciary duty claim, there has been significant litigation in the past 10 years over whether lawyers could be targeted by nonclients under a theory that the lawyer was liable to a nonclient if the lawyer assisted the lawyer's *client* in breaching a fiduciary duty to the nonclient.

In *Granewich v. Harding*, 329 Or. 47, 985 P.2d 788 (1999), the Oregon Supreme Court held in the context of an internal dispute among the owners of a small, closely-held corporation that the company's law firm, which was alleged to have taken sides in the dispute, could be held liable for assisting in the asserted breach by two of the company's owners of their fiduciary duties to the third. The Supreme Court based its decision largely on Section 876 of the Restatement (Second) of the Law of Torts (1979), which deals with liability for "aiding and abetting":

> "There is no Oregon law directly addressing whether someone can be held liable for another's breach of fiduciary duty. Legal authorities, however, virtually are unanimous in expressing the proposition that one who knowingly aids another in the breach of a fiduciary duty is liable to the one harmed thereby. That principle readily extends to lawyers." 329 Or at 56 (footnotes omitted).

In *Reynolds v. Schrock*, 197 Or. App. 564, 107 P.3d 52 (2005), the Court of Appeals applied *Granewich* in the specific context of a real estate joint venture.

[4] This section is drawn from my Fall 2006 article in the Oregon State Bar Litigation Journal, "Lawyer Liability for Assisting in Breach of Fiduciary Duty." The article is available in Litigation Journal archive at www.osblitigation.com/lj2006-fall.pdf.

Reynolds and Schrock purchased two parcels—one was commercial timber and the other was recreational. They had a falling-out and later entered into a settlement agreement to wind-up the joint venture. Under the settlement, Reynolds conveyed his interest in the recreational parcel to Schrock and, in return, Reynolds was to receive all proceeds from the sale of the timber. Reynolds had invested $500,000 in the joint venture by that point. To make Reynolds whole, the settlement provided that if the timber sale did not net him at least $500,000, Schrock would pay Reynolds any deficiency and Reynolds would have a lien on the recreational parcel to secure the deficiency.

After Reynolds had deeded his interest in the recreational parcel to Schrock, Schrock asked her lawyer if the settlement agreement required her to keep the recreational property pending the timber sale. Schrock's lawyer concluded that the settlement agreement contained no such obligation (the lien was never perfected) and advised Schrock accordingly. Schrock then sold the recreational parcel with the lawyer's assistance. Schrock later prevented the timber sale—leaving Reynolds without either his interest in the recreational property or his share of the timber sale proceeds.

Reynolds sued Schrock. Reynolds framed the primary claim against Schrock as breach of fiduciary duty. He argued that Schrock had a fiduciary duty to wind-up the joint venture as contemplated by the settlement agreement and that her failure to do so—notwithstanding the apparent loop-hole in the settlement agreement allowing the sale of recreational property—constituted a breach of that duty. Reynolds also sued Schrock's lawyer. Reynolds did not contend that Schrock's lawyer had an independent fiduciary duty to him. Rather, he argued that the lawyer was jointly liable with Schrock for the breach of Schrock's fiduciary duty to Reynolds by providing the advice and assistance in implementing that advice to Schrock. Schrock settled with Reynolds. Her lawyer moved for summary judgment, which the trial court granted. The Court of Appeals reversed.

Relying principally on Section 876 and *Granewich*, the Court of Appeals concluded that a lawyer advising a client to act contrary to a fiduciary duty may be liable to a nonclient to whom that duty is owed *even if* the act would otherwise be permitted by an associated contract: "[I]f the attorney knows that the fiduciary relationship imposes a higher standard of conduct than the agreement, then the attorney who advises the client that he or she may do an act that the contract permits but that is incompatible with the fiduciary relationship may be liable for the breach of fiduciary duty." 197 Or. App. at 577.

The Supreme Court then reversed the Court of Appeals in *Reynolds v. Schrock*, 341 Or. 338, 142 P.3d 1062 (2006). The Supreme Court began by distinguishing *Granewich* on the ground that the law firm there had exceeded its role as corporate counsel and began offering advice and assistance to the two majority shareholders who were not its clients as opposed to *Reynolds* where the advice was given directly by the lawyer to his client. The Supreme Court then created a shield from liability in this circumstance *if* the lawyer was providing otherwise lawful legal advice to a client. The Supreme Court conceded that it was doing so on policy grounds to protect the attorney-client relationship and again relied on the Restatement (Second) of Torts—this time Section 890, which recognizes a narrow band of privileges on public policy grounds.

Although the Supreme Court's decision in *Reynolds* creates a shield when advising clients, the Supreme Court's treatment of *Granewich* underscores that the risks identified in that more common situation remain. *See, e.g., Miller v. McDougal Bros. Investments*, No. 08-6110-fra, 2008 WL 4224504 at *3 (Bankr. D. Or. Sept. 15, 2008) (unpublished) (applying the *Reynolds* privilege but noting that it would have been otherwise had there been evidence that the lawyer involved was acting outside the scope of the attorney-client relationship). Lawyers advising closely held corporations, family groups, partnerships and other joint ventures are often put in situations which invite them to step beyond their role as lawyers for the entities involved to give advice to individual shareholders, family members or partners as was the case in *Granewich*. Under *Reynolds*, they would not have the protective shield of privilege for advice beyond their clients.

Granewich and *Reynolds* heighten the importance of clearly spelling out in an engagement agreement who the lawyer is representing and then acting in conformance with that agreement. In situations like *Granewich*, if a law firm confines its role to entity counsel only it will lessen the risk of being accused later of having "taken sides" and, in doing so, assisting one camp in an internal dispute in breaching fiduciary duties to the other.

IV. CONCLUSION

Engagement agreements aren't an insurance policy. Nonetheless, at a time when economic pressures can quickly turn "deals" into "cases," engagement agreements can play a critical role in keeping lawyers out of litigation or providing them with defenses if they are drawn in.