Oregon Business Lawyer

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Risky Business: Ethical & Risk-management Issues for Business Lawyers

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Disciplinary and claims statistics published annually by the Oregon State Bar and the Professional Liability Fund reflect that, although business lawyers are relatively infrequent targets of bar complaints and civil claims, when claims occur they are typically larger and more complex than their counterparts in other practice areas. These findings suggest structuring risk-management efforts by business lawyers to lessen the particular threats they and their firms face.

This article is based on my presentation at the Business Law Section's CLE conference this past fall. Like the presentation, this article looks at three comparatively simple approaches to risk management for business lawyers:

- Know your client.
- Define your client.
- Stick with one client.

As in the CLE presentation, this article includes Northwest cases as illustrations of each point. The approaches discussed will not prevent all claims, but, if followed consistently, may at least temper some of the principal risks in today's business practice environment.

Know Your Client

> "'[The mastermind] was so charismatic and his Ponzi scheme so sophisticated that he duped everyone, including [the lawyers].'" *Norton v. Graham and Dunn, P.C.*, 2016 WL 1562541 at *11 (Wn App Apr 18, 2016) (unpublished).

The law firm involved in *Norton* had the unfortunate experience of discovering that a seemingly astute and celebrated chief of a client corporation had actually used the corporation to perpetrate a multi-million-dollar Ponzi scheme. Commonly in this scenario, once the Ponzi scheme unravels, the mastermind is inevitably on the way to jail, the company the mastermind used as the investment vehicle is often in bankruptcy or similar receivership, and there are a host of duped investors who want their money back.

Often, the professionals that provided services to the company—including law firms—become magnets for lawsuits by the defrauded investors and bankruptcy trustees or receivers. The former frequently allege that the lawyers involved aided the mastermind through their legal work and the latter often contend that the lawyers did not prevent the mastermind from looting the company. The gist of each is usually a variant of "the lawyers must or should have known." Claimants often point to asserted case-specific "red flags" that may only appear to be such in hindsight.

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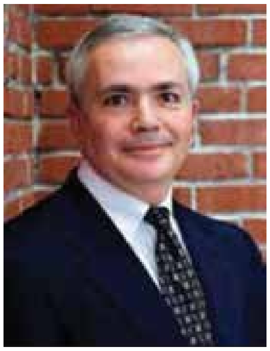

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He is a past member of the OSB Legal Ethics Committee and is also a past chair of the WSBA Committee on Professional Ethics. He is a co-editor of the OSB Ethical Oregon Lawyer, *the WSBA* Law of Lawyering in Washington *and the WSBA* Legal Ethics Deskbook.

Before co-founding his own firm in 2005, Mark was an in-house ethics counsel for a large Northwest regional law firm. He also teaches legal ethics as an adjunct for the University of Oregon School of Law at its Portland campus.

The specific legal theories claimants assert vary and can often be potentially quite broad. The dollar amounts sought are usually large—sometimes even exceeding available insurance coverage.

The nature of typical claims in this setting suggest three approaches law firms can take proactively to lessen their risk.

First, specify what the firm has been hired to do in a written engagement agreement—and generally stick to it unless modified by a later amendment. Oregon RPC 1.2(b) encourages lawyers to specifically define what they have been hired to do. A firm that has been retained to undertake a specific task for a client—and has defined that task in an engagement agreement—will have a better argument later that the nature of its work was sufficiently limited that it neither could have nor should have anticipated that the principal manager of a seemingly successful business was actually the mastermind of a Ponzi scheme.

Second, avoid using terms like "general counsel" in firm marketing. Although not defined in the RPCs, the term "general counsel" implies that a firm is involved in a client's daily operations. Having advertised yourself as being intimately close to company management, it is difficult to "unring that bell" when it turns out that the mastermind has used the company in a massive fraud.

Third, evaluate co-marketing with clients carefully. On some occasions, it is the client that is using the law firm in its advertising—for example, touting that it "partners" with successful professional service firms. Again, having allowed a client to describe your firm as its "partner" makes it more difficult to distance the work performed from what the mastermind was doing unbeknownst to you. This does not mean that a law firm should never engage in co-marketing with clients. But, if you do, make sure that you really know your client.

Define Your Client

> "During oral argument, [Law Firm] could not explain why an engagement letter was not executed at the outset of the . . . representation. Similarly troubling to the court was the fact that [Law Firm] could not advise the court as to whether [Client] was identified as a firm client in [Law Firm's] conflicts check system."
> *Atlantic Specialty Insurance v. Premera Blue Cross*, 2016 WL 1615430 at *13 (WD Wash Apr 22, 2016) (unpublished).

Atlantic Speciality involved a law firm whose Seattle office was disqualified from a major piece of litigation for a long-time client because the firm's Portland office had taken on a corporate affiliate without an engagement agreement —and apparently without including the names of the affiliate's other corporate family members in the firm's conflict system.

The Portland matter was an insurance-coverage case in federal court. Although the firm's Portland office had not sent an engagement letter, the client had forwarded a set of "case handling guidelines" to the firm that essentially defined the client to include its entire corporate family. While the Oregon case was still active, the firm's Seattle office was retained by a long-standing client to defend it in a coverage action in federal court there.

The Seattle litigation was being pursued by an affiliate of the same carrier the firm was representing in Oregon. When the law firm filed its appearance in the Seattle case, the carrier moved to disqualify the firm on the ground that it had an unwaived conflict. The federal district court in Seattle agreed and disqualified the firm. Being disqualified for a conflict a law firm should have anticipated can lead to both the forfeiture of fees on the matter concerned and potentially a civil claim for breach of fiduciary duty.

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Law firms can—and generally should—define in an engagement letter the exact corporate entity they represent and limit their representation to the specific entity involved. The information then must be carefully and consistently put into the firm's conflict database. If you do not do that as a law firm, someone else—like another member of the client's "corporate family" or a court as in *Atlantic Specialty*—may do it for you. As in *Atlantic Speciality*, the failure to define the client in an engagement agreement may lead to a disqualifying conflict.

When acting as corporate counsel for a closely held corporation, law firms should generally stick to that role and not attempt to also advise feuding shareholders involved in internal disputes.

Stick With One Client

> "The complaint, however, alleges that the corporation hired the lawyers, that the corporation had no interest in the dispute between plaintiff and [Other Directors] and that the work that the lawyers performed was outside the scope of any legitimate employment on behalf of the corporation." *Granewich v. Harding*, 329 Or 47, 58–59, 985 P2d 788 (1999).

In *Granewich*, a law firm had taken on a closely held start-up with three founders who were also its directors. Later, two of the founders had a falling-out with the third and forced him out of the company.

The third then sued the other two—and the law firm. The former director contended that the other two directors had breached their fiduciary duties to him. He also asserted that the law firm had assisted in this alleged breach by, in essence, siding with the two majority shareholders in their intramural dispute and assisting them in pushing him out of the company.

The Oregon Supreme Court concluded that the founder who had been forced out had stated a legally viable claim against the law firm for assisting in the breach of the two directors' fiduciary duty to the third.

On the limited record before it because the case had reached the appellate level following a dismissal on the initial pleadings in the trial court, the Supreme Court noted that—at least as alleged—the law firm had exceeded its role as corporate counsel and taken on the two majority shareholders against the third.

Granewich highlights that, when acting as corporate counsel for a closely held corporation, law firms should generally stick to that role and not attempt to also advise (either formally or by letting events transpire) feuding shareholders involved in internal disputes.

If shareholders do devolve into conflict, the most prudent course is for the warring camps to obtain their own lawyers while the company's lawyer remains just that—corporate counsel. To the extent that corporate counsel implements any aspect of a resolution of the intramural dispute, it is prudent to document that this is done on behalf of the corporation rather than the warring parties.[1] ◆

Endnote

1. *Reynolds v. Schrock*, 341 Or 338, 142 P3d 1062 (2006), discussed—but did not limit—*Granewich*. Rather, *Reynolds* addressed the separate issue of whether a lawyer could provide a client with otherwise lawful legal advice that, if followed, would potentially constitute a breach of fiduciary duty by the client to a third party. The Oregon Supreme Court in *Reynolds* concluded that a lawyer could do so as along as it did not amount to assisting a client with fraud or other unlawful conduct.

Bar Seeks Comments on Proposed Changes to Rules of Procedure

The OSB Board of Governors has approved several changes to the rules of procedure that govern Oregon's attorney regulatory system. These changes, which will be proposed to the Oregon Supreme Court following a 60-day comment period, involve: (1) enhancements to the role, jurisdiction and functioning of the adjudicator; (2) clarifications pertaining to investigations and formal proceedings; (3) modifications to reinstatement rules, and to Form A and Form B resignations; and (4) housekeeping and error corrections since the rules were amended in 2018.

Details of the proposed changes are available on the Oregon State Bar website at https://www.osbar.org/_docs/resources/ProposedChangestoBRs.pdf

Members are welcome to submit comments and questions in writing. Direct them to ropcomments@osbar.org by April 29, 2019.