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THE RISK MANAGER

A QUARTERLY NEWSLETTER BY LAWYERS MUTUAL INSURANCE COMPANY OF KENTUCKY

DEBT COLLECTIONS ARE A DRAMATICALLY INCREASING MALPRACTICE RISK FOR LAWYERS

From the inception of the federal Fair Debt Collection Practices Act to the advent of the Consumer Financial Protection Bureau, debt collections rose from routine boilerplate demands on debtors to a multiple of technical requirements. The omission of any one can result in strict liability, statutory damages up to $1,000, and reasonable attorney's fees.

The Consumer Financial Protection Bureau in CFPB Bulletin 2013-07 gave this warning to debt collectors:

> In addition to the prohibition of UDAAPs *(Unfair, Deceptive, or Abusive Acts or Practices)* Collection of Consumer Debts under the Dodd-Frank Act, the Fair Debt Collection Practices Act (FDCPA) also makes it illegal for a person defined as a "debt collector" from engaging in conduct "the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt, to "use any false, deceptive, or misleading representation or means in connection with the collection of any debt," or to "use any unfair or unconscionable means to collect or attempt to collect any debt." The FDCPA generally applies to third-party debt collectors, such as collection agencies, debt purchasers, and attorneys who are regularly engaged in debt collection. **All parties covered by the FDCPA must comply with any obligations they have under the FDCPA, in addition to any obligations to refrain from UDAAPs in violation of the Dodd-Frank Act.** *(emphasis added; footnotes omitted)*

Can You Answer These Questions About the FDCPA?

- What type of debt is covered by the FDCPA?
- Which lawyers are regularly engaged in debt collection as defined by the FDCPA? All lawyers? Only lawyers whose primary area of practice is debt collection? Lawyers who from time-to-time act as a debt collector?

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TEST YOUR TITLE SEARCH EXPERTISE

Do purchase money mortgages have priority over judgment lien creditors irrespective of timing and notice?

The answer to this question was yes until the recent Kentucky Court of Appeals decision in *Hays v. Nationstar Mortgage LLC*, No. 2015-CA-000121-MR, 1/6/2017. The case concerned whether the lien of Nationstar was superior to a prior judgment lien filed by Hays for child support arrearages.

In reaching its decision the court considered the inconsistent holdings of *Kentucky Legal Sys. Corp. v. Dunn*, 205 S.W.3d 235 (Ky. App. 2006) and the Kentucky Supreme Court case *Mortg. Elec. Registration Sys., Inc. v. Roberts*, 366 S.W.3d 405 (Ky. 2012):

> ***Dunn:*** [A] purchase money lender does not need to search for judgment liens, as purchase money liens automatically have priority whether the purchase money lender had notice of any other interest. *Dunn*, 205 S.W.3d at 237.

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DEBT COLLECTIONS

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- What is the FDCPA Mini-Miranda notice that is required in a collection letter? What happens if you leave out any of the statutory required notice information? Do additional written communications require a repeat of the notice requirements?
- What is the standard for determining whether a dunning letter could mislead an unsophisticated consumer?
- What is the "bona fide error" defense to a violation of the FDCPA?

What acts are required or prohibited under the FDCPA and by the Consumer Financial Protection Bureau?

Examples of FDCPA required or prohibited debt collector acts are:

- Validation of the debt requirement.
- Prohibition against harassing or abusive practices:
  1. Contacting consumers at atypical times, usually before 8 a.m. or after 9 p.m. in the consumer's time zone.
  2. Using obscene or profane language; threatening or using violence; or falsely stating or falsely implying an affiliation with the United States or a state government.
  3. Contacting consumers at their place of work if the consumer has notified the debt collector that they cannot receive calls at work.
  4. Telling a consumer's co-workers or friends about the consumer's debt.
  5. Abusing or harassing a consumer by, for example, repeatedly calling their telephone or letting it ring continually.
- Prohibition against providing false or misleading information.
- Prohibition against using unfair or unconscionable means to collect a debt.
- Payments must be applied in accordance with the consumer's instructions in the event of multiple debts.
- Prohibition against furnishing deceptive forms.

Source: IBS, DCPA Compliance: 5 Debt Collection Basic and a Checklist; Experian, FDCPA Compliance

The following are examples of Consumer Financial Protection Bureau Unfair, Deceptive, or Abusive Acts or Practices included in CFPB Bulletin 2013-07:

> "Depending on the facts and circumstances, the following non-exhaustive list of examples of conduct

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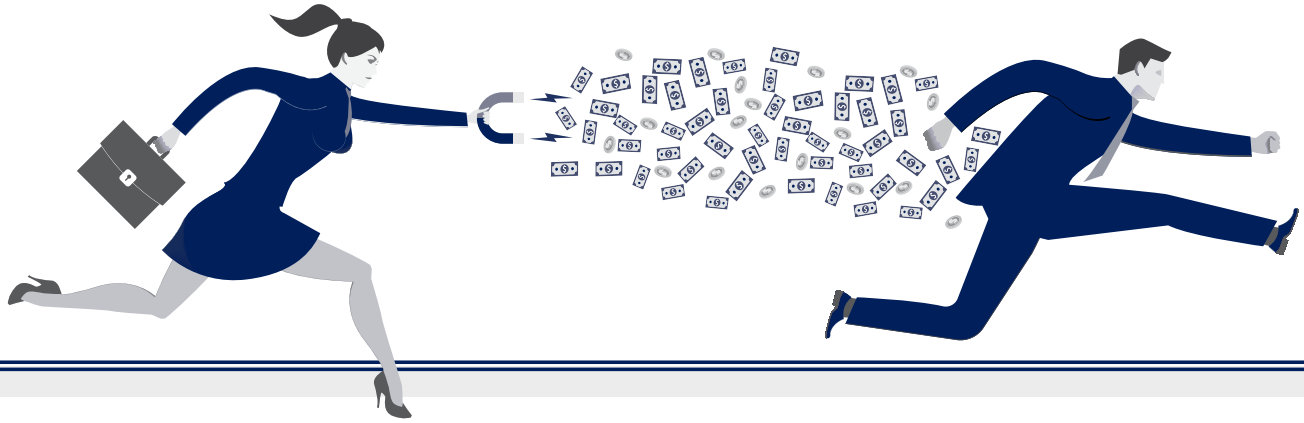
FROM THE INCEPTION OF THE FEDERAL FAIR DEBT COLLECTION PRACTICES ACT TO THE ADVENT OF THE CONSUMER FINANCIAL PROTECTION BUREAU, **DEBT COLLECTIONS ROSE** FROM ROUTINE BOILERPLATE DEMANDS ON DEBTORS TO A **MULTIPLE** OF **TECHNICAL REQUIREMENTS.**



"THE **OLDER WE GET**, THE **FEWER THINGS** SEEM **WORTH WAITING** IN LINE FOR." *Will Rogers*

DEBT COLLECTIONS

PROHIBITED DEBT COLLECTOR ACTS INCLUDE ABUSING OR HARASSING A CONSUMER BY REPEATEDLY CALLING THEIR TELEPHONE OR LETTING IT RING CONTINUALLY.

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related to the collection of consumer debt could constitute UDAAPs. Accordingly, the Bureau will be watching these practices closely.

- Collecting or assessing a debt and/or any additional amounts in connection with a debt (including interest, fees, and charges) not expressly authorized by the agreement creating the debt or permittedby law.
- Failing to post payments timely or properly or to credit a consumer's account with payments that the consumer submitted on time and the charging late fees to that consumer.
- Taking possession of property without the legal right to do so.
- Revealing the consumer's debt, without the consumer's consent, to the consumer's employer and/or co-workers.
- Falsely representing the character, amount, or legal status of the debt.
- Misrepresenting that a debt collection communication is from an attorney.
- Misrepresenting that a communication is from a government source or that the source of the communication is affiliated with the government.
- Misrepresenting whether information about a payment or nonpayment would be furnished to a credit reporting agency.
- Misrepresenting to consumers that their debts would be waived or forgiven if they accepted a settlement offer, when the company does not, in fact, forgive or waive the debt.
- Threatening any action that is not intended or the covered person or service provider does not have the authorization to pursue, including false threats of lawsuits, arrest, prosecution, or imprisonment for non-payment of a debt.

Again, the obligation to avoid UDAAPs under the Dodd-Frank Act is in addition to any obligations that may arise under the FDCPA."

CONCLUSION

We hope that we have left little doubt in your mind about the complexity of debt collections. The irony is that actual damages in FDCPA malpractice claims are usually minor, but lawyers' fees can be a multiple of the actual damages. For this reason, a cottage industry developed for making claims against debt collection lawyers that often have little or no merit. Even if you are not covered by the FDCPA because you are not a lawyer regularly engaged in debt collection, you may get a claim for failing to comply with the FDCPA. The nuisance value of defending such a claim often leads to a grudging decision to just pay it.

In our risk management program we now place debt collection along with bankruptcy, trusts and estates, and taxation as areas of law you should never dabble in – you must know what you are doing. A cardinal principle of lawyer risk management is:

Malpractice Avoidance: Steps taken to evaluate substantive areas of practice or methods of practice and to make decisions about whether to avoid or eliminate certain areas of law because of the malpractice risks and exposure involved.

"SOME PEOPLE **TRY TO TURN BACK** THEIR ODOMETERS. NOT ME; I WANT PEOPLE TO KNOW 'WHY' I LOOK THIS WAY. **I'VE TRAVELED A LONG WAY**, AND SOME OF THE ROADS WEREN'T PAVED." *Will Rogers*

RISK MANAGING MIXED BUSINESS AND LEGAL ADVICE

What is a Lawyer's Obligation to Provide Business Advice?

A panel at the 2016 Legal Malpractice Risk Management (LMRM) Conference discussed the increasing risk of transaction malpractice claims. The panelists pointed out that transactional practice generates the highest percentage of incurred losses compared to reported claims (4% of claims, 8-9% of losses). Additionally, transactional claims typically result in double the payments of other practice areas. Cost of defense is more than double other practice areas (complexity, documentation, multiple parties, multiple experts). Failure to provide appropriate advice constitutes almost 25% of claims and 30% of losses.

The panel used the case of *Peterson v. Katten Muchin Rosenman LLP*, (792 F.3d 789 (2015)) to develop the emerging law on the malpractice standard of care for advising on business transactions. Katten was sued for malpractice for its advice on how to structure the Trustee client's loan transactions with entities controlled by an individual who turned out to be running a Ponzi scheme. The client alleged that Katten owed them a duty to tell them that the arrangement posed a risk that the other party was not running a real business. The client claimed that part of this duty requires advising what contractual devices are appropriate to the situation. Katten was, therefore, negligent in not recognizing the fraud risk the arrangements entailed and should have advised the client to take additional protections. The district court dismissed the case ruling that the client "knowingly took a risk and cannot blame a law firm for failing to give business advice." The 7th Circuit reversed and remanded the case for further proceedings.

The 7th Circuit opinion began by observing that the district court "does not identify any principle of Illinois law that sharply distinguishes between business advice and legal advice. It is hard to see how any such bright line could exist, since one function of a transaction lawyer is to counsel the client how different legal structures carry different levels of risk, and then to draft and negotiate contracts that protect the client's interests." The Court then ruled:

- Advising clients how best to maintain security for their loans using legal devices is a vital part of a transactions lawyer's job.
- An attorney in a counseling situation must advise a client of the risks of the transaction in terms sufficiently clear to enable the client to assess the client's risks. The care must be commensurate with the risks of the undertaking and tailored to the needs and sophistication of the client.
- We take the point that a transactions lawyer's task is to propose, draft, and negotiate contractual arrangements that carry out a client's business objective, not to tell the client to have a different objective or to do business with a different counterparty.
- A lawyer is not a business consultant. But within the scope of the engagement a lawyer must tell the client which different legal forms are available to carry out the client's business, and how (if at all) the risks of that business differ with the different legal forms.
- The Trustee alleges that Katten did not offer any advice about how relative risks correspond to different legal devices, and its complaint states a legally recognized claim for relief. Whether the law firm has a defense and whether any neglect on its part caused injury – are subjects for the district court in the first instance. *(citations omitted)*

The LMRM panelists advised:

- A letter of engagement (LOE) is the first opportunity for a lawyer to carefully delineate the nature of the advice to be provided – what is the scope of the legal advice covered by the retention.

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A LAWYER **MUST TELL THE CLIENT** WHICH DIFFERENT LEGAL FORMS ARE AVAILABLE TO CARRY OUT THE CLIENT'S BUSINESS, AND **HOW THE RISKS** OF THAT BUSINESS **DIFFER** WITH THE DIFFERENT LEGAL FORMS.

"I DON'T KNOW HOW I GOT **OVER THE HILL** WITHOUT GETTING **TO THE TOP.**" *Will Rogers*

MIXED BUSINESS

A LETTER OF ENGAGEMENT (LOE) IS THE FIRST OPPORTUNITY FOR A LAWYER TO CAREFULLY DELINEATE THE NATURE OF THE ADVICE TO BE PROVIDED.

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- Update the LOE as circumstances change to assure that the distinction between business advice and legal advice is not compromised.
- Document the file to indicate whether legal advice or business advice was given in a given meeting.
- Remember that a lawyer is often responsible for putting the transaction together and the last stopgap before execution. If the deal goes bad, the lawyer is a lucrative target to blame. Tight LOEs and careful documentation of the nature of advice given is the best defense.

In a prior newsletter we offered this risk management advice on transaction matters contained in a New Jersey Superior Court unpublished opinion.* It is well worth repeating.

> "When a malpractice claim is brought against an attorney retained to represent a client in the drafting and review of written agreements, with respect to complex transactional matters, involving, as here, significant financial issues, depending upon the particular facts and the expert testimony presented, we perceive several actions which may be considered by a jury in determining whether the attorney breached the standard of care.
>
> - First, did the attorney ascertain the client's business objectives through appropriate consultation?
> - Was reasonable advice provided to the client on the various legal and strategic issues bearing on those identified business objectives? (An attorney in a counseling situation must advise a client of the risks of the transaction in terms sufficiently clear to enable the client to assess the client's risk.)
> - During the drafting process, did the attorney scrutinize the proposed agreement to ensure that the writing effectuates the business objectives defined by the client?
> - Did the attorney review the written agreement with the client, to determine that the client understood the material terms that might reasonably affect the client's decision to execute it (attorney is obligated to inform the client promptly of any known information important to him [or her]); (attorney should review all important provisions with the client before proceeding to an agreement)?
> - Were the various provisions to accomplish each of the client's stated objectives pointed out or, if they were not, did the attorney ensure that the client assents to the omission of any such objective?

We do not suggest that all of these actions are always required. However, if the scope of representation includes one or more of these activities, failure to perform an included act in a reasonably competent manner may indicate a breach of the standard of care." *(citations omitted)*

* *Cottone v. Fox Rothschild LLP**2014 BL 240874, N. J. Super. Ct. App. Div., No. A-0420-12T4, 9/2/14, (unpublished).*

"ONE MUST WAIT UNTIL THE EVENING TO SEE HOW SPLENDID THE DAY HAS BEEN." *Will Rogers*

BEWARE OF COMPROMISING ATTORNEY-CLIENT PRIVILEGE WHEN GIVING MIXED BUSINESS AND LEGAL ADVICE.

Is advice that includes both business and legal advice covered by the attorney-client privilege or has it been waived?

Many Kentucky lawyers will remember that during the massive tobacco litigation some tobacco companies attempted to shield business and email documents from discovery by channeling them through their lawyers thereby claiming attorney-client privilege. This thinly veiled manipulation did not work, but did highlight the risk of losing the privilege by mixing legal advice with business advice. We found no Kentucky authority on point, but the recent Connecticut Supreme Court case *Harrington v. Freedom of Info. Comm'n** is something of a clinic on when mixed business and legal advice is privileged. What follows is a short review of the case with emphasis on the risk management guidance the decision contains. We recommend it for your professional reading as well as placing a copy in your precedent file.

The plaintiff, Harrington, appealed the Commission's denial of his Freedom of Information request to the Connecticut Resources Recovery Authority. The denial was justified on the basis that the information was protected by the attorney-client privilege. The Supreme Court reversed because the Commission failed to apply the proper standard for evaluating communications containing a mix of business and legal advice.

The Court adopted the 'primary purpose' test as the proper standard by noting that "There is broad consensus in other jurisdictions that if the non-legal aspects of the consultation are integral to the legal assistance given and the legal assistance is the primary purpose of the consultation, both the client's communications and the lawyer's advice and assistance that reveals the substance of those communications will be afforded the protection of the privilege."

The Court then developed this structure for how to apply the standard:

> "The communication must be made by the client to the attorney acting as an attorney and not, e. g., as a business advisor. . . . In sum, attorneys do not act as lawyers when not primarily engaged in legal activities. . . . [Moreover], it would seem obvious that business communications cannot be insulated from discovery by virtue of the mention of an attorney's name, or their being directed to an attorney."
>
> "The line between legal advice and business advice, however, is not always clear. Fundamentally, legal advice involves the interpretation and application of legal principles to guide future conduct or to assess past conduct. It requires a lawyer to rely on legal education and experience to inform judgment. . . . But it is broader, and is not demarcated by a bright line. . . . The modern lawyer almost invariably advises his client upon not only what is permissible but also what is desirable.... [T]he privilege of nondisclosure is not lost merely because relevant nonlegal considerations are expressly stated in a communication which also includes legal advice."
>
> "In classifying the character of the communication, the crucial inquiry is whether the intent of the client, in deciding to approach the lawyer, is to obtain legal counsel, even if other dimensions of a matter are addressed as well."
>
> "[I]t is not enough for the party invoking the privilege to show that factual information might become relevant to the future rendering of legal advice. Instead, the communication must also either explicitly or implicitly seek specific legal advice about that factual information."
>
> "[C]lient communications intended to keep the attorney apprised of continuing business developments, with an implied request for legal advice based thereon, or self-initiated attorney communications intended to keep the client posted on legal developments and implications may also be protected."
>
> "[I]f the protected and nonprotected purposes of the communications are inextricably linked, thus precluding any separation of the communications into the privileged and non-privileged categories, the communications will be protected."
>
> "When the legal aspects of the communication are incidental or subject to separation, the proponent of the

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"NEVER SLAP A MAN WHO'S CHEWING TOBACCO." *Will Rogers*

ATTORNEY-CLIENT PRIVILEGE

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privilege may be entitled to redact those portions of the communication…. When such separation is not possible, both may be protected, as long as the primary purpose is legal advice." (*citations omitted*)

** 2016 BL 281220, Conn., No. SC 19586, 9/6/16*

In the article *Legal vs. Business Advice: Knowing When Your Advice Is Privileged** the authors offered these guidelines for when advice is legal and when business:

"Courts have found the following to be primarily legal functions:

- Advising the company on existing law;
- Performing and reporting legal research;
- Analyzing conduct for conformity with law;
- Advising on imminent litigation; and
- Opining on applicable law."

"Courts have found the following to be primarily business functions, and thus not typically privileged:

- Negotiating a contract
- Attending business meetings;
- Attending product liability review meetings;
- Soliciting advice from outside professionals;
- Performing duties of another office – e.g., corporate secretary; and
- Acting as a scrivener."

The article emphasized that in-house counsel may be subjected to a heightened standard when their documents are reviewed for privilege. It included the following in-house counsel best practices suggestions for preserving the privilege:

- When possible, separate legal and business advice by starting a new email chain;
- Designate requests for or discussions regarding legal advice as legal and/or privileged;
- When serving dual functions, use titles as appropriate, segregate legal files from non-legal files, and emphasize and maintain a written record of the legal aspects of any communication;
- When appropriate, use words/phrases like "privileged," "attorney advice," "legal," and "work product" and reference cases, statutes, or rules;
- Do not overuse labels/designations when clearly providing only business advice;
- When in meetings or on conference calls, (1) take clear notes of who is present; (2) if only portions of discussions are privileged, label them as privileged; and (3) exclude from the conversation anyone that may waive privilege;
- Limit the recipients of privileged information; and
- When appropriate, advise recipients that they should not forward privileged information to others.

** Legal vs. Business Advice: Knowing When Your Advice Is Privileged, Jennifer Poppe, Chris Popov, and Amy Tankersley, State Bar of Texas, Corporate Counsel Section, Newsletter, Winter 2014.*

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PUBLISHED BY LAWYERS MUTUAL INSURANCE COMPANY OF KENTUCKY

DEL O'ROARK
Newsletter Editor

TITLE SEARCH

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Roberts: "Kentucky is a race-notice jurisdiction" and that "a prior interest in real property takes priority over a subsequent interest that was taken with notice, actual or constructive, of the prior interest." *Roberts*, 366 S.W.3d at 407-08.

The Court of Appeals ruled: "When examining these issues de novo, we conclude that *Roberts* effectively overrules *Dunn* by implication. Accordingly, the race-notice provisions reaffirmed by *Roberts* must be applied to the facts before us."

RISK MANAGEMENT ALERT:

Prior to *Hays* title examiners relying on *Dunn* often did not check the borrower's name for pre-existing liens. It is now critical that they do so. Update your title examination checklist to include this requirement. Be sure that everyone in your practice knows of this significant change in real estate law.

"NEVER MISS A GOOD CHANCE TO SHUT UP." *Will Rogers*

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ANNOUNCEMENT

2017 ANNUAL POLICYHOLDERS' MEETING

The Annual Policyholders' Meeting of Lawyers Mutual Insurance Company of Kentucky is scheduled for 8:00 am, Wednesday, June 21 in the Executive Meeting Room, Holiday Inn Owensboro, 701 West 1st St., Owensboro, KY 42301. Included in the items of business are the election of a class of the Board of Directors and a report on Company operations. Proxy materials will be mailed to policyholders prior to the meeting. The Annual Report can be downloaded from the Web site, **LMICK.com**. We urge all policyholders to return their proxies and to attend the meeting.

WEDNESDAY, MAY 11, 2016
8:00 A.M.
EXECUTIVE MEETING ROOM
HOLIDAY INN OWENSBORO
701 WEST 1ST ST.
OWENSBORO, KY