The Risk Manager

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"I am a man of fixed and unbending principles, the first of which is to be flexible at all times."

Everett Dirkson

Taking Disputed Fees from a Client Trust Account Earns Lawyer 18 Month Suspension

The D. C. Court of Appeals in *In Re Midlen* (D.C. No. 04-BG-808, 11/10/05) is instructive on a problem often encountered here in Kentucky – a lawyer reasonably believing funds held in a client trust account are earned fees withdraws the funds ignoring what is seen as a frivolous or manipulative client dispute over the lawyer's entitlement to the fees. The D. C. professional responsibility rules applicable to *Midlen* are virtually identical to Kentucky's SCR 3.130 (1.15) Safekeeping Property, making this decision an instructive one for our Bar.

This case concerned Midlen's representation of the Jimmy Swaggert Ministries (JSM) from 1991 to 1998 for the purpose of collecting cable royalties for JSM. The fee agreement in pertinent part provided that Midlen would receive the royalty payments, deduct his fees and costs, and distribute the balance to JSM. Over the course of the representation Midlen paid JSM $341,000 and retained $123,000 in fees and costs.

In 1994 JSM began questioning Midlen's fees and later asked for an accounting which was not rendered for over 18 months. JSM terminated Midlen in 1998 asking that the file be sent to a succeeding lawyer. Midlen did not comply with this direction for seven months and then only after a bar complaint was filed.

The eye-catching facts of the case are that Midlen's ultimate entitlement to the deducted fees is not questioned. There was no evidence that Midlen ever withheld more in fees and costs than were due. Furthermore, the Court found that it was reasonable for Midlen to believe that JSM's protestations about billing were merely a tactic to avoid paying Midlen his earned fees because JSM was struggling financially and delaying payments to vendors. Ironically, JSM later made further payments to Midlen in settlement of his suit against it for fees.

Notwithstanding the strength of Midlen's entitlement to the funds withheld from JSM, he was held *inter alia* to have misappropriated disputed fees by failing to segregate them until the dispute was resolved in violation of Rule 1.15 (c), and to have breached his duty to promptly render the requested full accounting in violation of Rule 1.15 (b).

The Court found while there were inconsistent actions by JSM concerning fee payment, that by late 1998, when Midlen withdrew fees from a distribution, there could be no doubt that they were in dispute. In these circumstances Rule 1.15 (c) "…is unambiguous that: an attorney may not withdraw that portion of … deposited funds when the attorney's right to receive that portion is 'disputed' by the client." The Court "rejected the notion that any dispute over fees has to be 'genuine': '[T]here is no requirement that the dispute be 'genuine,' 'serious,' or 'bona fide' … [T]he word 'dispute' means [merely] to argue about; to debate; to question the truth or validity of ; [or] to doubt." …. "The fact that, as it turned out, he was contractually entitled to more than the amounts he withdrew 'does not change the nature of the disagreement … because at the moment [he] withdrew [the funds, the client] had not acknowledged he had earned and was entitled to at least that amount.'"

Poor Midlen was suspended from practice for 18 months and only other aspects of the case not reported here keep one from having a certain amount of sympathy for him. It appears that Midlen made the crucial error of relying on his contractual right to fees and ignoring his fiduciary duty to his client imposed by Rule 1.15. In this regard the Court observed "[A]ny supposed failure of a client to fulfill a retainer agreement is no defense to a disciplinary charge against an attorney."

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Midlen is a good object lesson for Kentucky lawyers. Our Rule 1.15 is as unambiguous as the D.C. rule – it is clear that if a dispute arises between lawyer and client over disbursement of client funds, the disputed amount must be left in the client trust account until the dispute is resolved. KBA Ethics Opinion 293 (1985) provides:

> "… in the absence of an agreement with the client on these matters (the right of the attorney to a specific claimed fee, the amount to which the attorney is entitled, and the time at which payment is expected) a reasonably prudent attorney should not assume that he may withdraw funds …."

Disputes may be resolved by persuasion, negotiation, private mediation or arbitration, mediation or arbitration under SCR 3.815, and appropriate court proceedings.

For a quick refresher on client trust account professional responsibility we suggest *"Client Trust Account Principles & Management for Kentucky Lawyers."* This 56 page guidebook covers the fundamentals of client trust account management and includes the complete text of key KBA Ethics Committee Opinions on client trust accounts. It is yours for the asking by contacting Lawyers Mutual (502.568-6100 or 800.800-6101) or the IOLTA Fund (502.564-3795 or 800.874-6582).

Tripping Up Over Pro Hac Vice Procedures

In *Brozowski v. Johnson* (Ky. Ct. App. No. 2004-CA-000256-MR, 11/18/05) an Illinois lawyer filed a medical malpractice complaint for the Brozowskis in the McCracken Circuit Court. That same day a Kentucky lawyer filed a motion pursuant to SCR. 3.030(2) for the Illinois lawyer's admission *pro hac vice*, but did not include a proposed order for the motion as required by local rules. This led to a dismissal of the case with prejudice. On appeal the Kentucky Court of Appeals made it clear that strict compliance with SCR. 3.030(2) is required:

> "The Brozowskis nevertheless urge that their substantial compliance with SCR 3.030(2) compels a different conclusion. We disagree. SCR 3.030(2) provides as follows:
>
> A person admitted to practice in another state, but not this state, shall be permitted to practice a case in this state only if he subjects himself or herself to the jurisdiction and rules of the court governing professional conduct, pays a per case fee of $100.00 to the Kentucky Bar Association and engages a member of the association as co-counsel, whose presence shall be necessary at all trials and at other times when required by the court. No motion for practice in any state court in this jurisdiction shall be granted without submission to the admitting court of a certification from the Kentucky Bar Association of receipt of this fee.
>
> Moreover, the McCracken Circuit Court's local rule 5G provides as follows:
>
> Except for motions for summary judgment, no motion shall be filed without the tender of a proposed order in conformity therewith, excluding such orders that require findings of fact and conclusions of law. Such orders shall be by separate styled instruments and not on the same page as the motion in sufficient number for all parties.
>
> Both of these rules use the mandatory directive "shall", and there is no indication that the drafters intended anything less than absolute compliance. Thus, the Brozowskis' substantial compliance is inadequate to fulfill the mandates of these rules." *(footnotes omitted)*

"There is no exception to the rule that every rule has an exception."

James Thurber

The risk management teaching points of *Brozowski* are that to avoid negligence when moving for the admission *pro hac vice* of an out-of-state lawyer a Kentucky lawyer must assure that:

- The out-of-state lawyer is a member in good standing of a state bar;
- The KBA fee is paid;
- A certification is submitted to the admitting court that the KBA fee, in fact, has been paid; and
- There is compliance with all local rules applicable to the *pro hac vice* motion.

In our Winter 2005 newsletter we offered this additional advice in risk managing local counsel arrangements with out-of-state lawyers:

- Confirm that the out-of-state lawyer has malpractice insurance and in what amount. Be sure that you are not the deep pockets in the case. Note that there is the anomaly that a Kentucky co-counsel practicing in a limited liability form of practice is required to have insurance, while the out-of-state lawyer may have no similar requirement (SCR 3.024). Check it out.
- Be sure that the out-of-state lawyer is aware of the new per case fee requirement of $100.
- Document thoroughly with a letter of engagement signed by the out-of-state lawyer and the client exactly what the scope and limits of your engagement are and how you will meet your co-counsel duties.

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- Throughout the representation document telephone calls, meetings with the out-of-state lawyer, and all other aspects of co-counsel activities on behalf of the client.
- Be sure that fee sharing arrangements comply with Kentucky Rule of Professional Conduct 1.5. (e). If you trip over this rule, you could be found to be jointly responsible for the matter in spite of efforts to limit the scope of the representation.

The U.S. D. C. Circuit Court of Appeals Rules Gramm-Leach-Bliley Act Does Not Apply to Lawyers

The Federal Trade Commission made an unprecedented attempt to subject the legal profession to federal regulation by defining lawyers as 'financial institutions' to comply with the Gramm-Leach-Bliley Act provisions on sending clients annual privacy disclosure notices. This regulation was challenged in court by the ABA and the New York Bar. They argued that the FTC exceeded its authority in applying the law to lawyers because Congress had not intended in the Act to alter state regulation of lawyers. The D.C. Federal District Court agreed. The FTC promptly appealed to the U.S. D. C. Circuit Court of Appeals. In *American Bar Association v. Federal Trade Commission* (D.C.Cir., No. 04-5275, 12/6/05) the Circuit Court emphatically ruled that lawyers are not financial institutions and that the FTC had indeed exceeded its authority. Even a hard case bureaucrat ought to get this message. This issue should not trouble the profession again.

Estate Planning Malpractice Traps

The Ohio Bar Liability Company in its newsletter *Malpractice Alert* (June 2004) alerted lawyers doing estate planning to beware of three situations that often lead to claims:

- ***Clients that instruct that the tax consequences of estate planning are secondary.*** In such cases the lawyer should document the client's guidance in a letter that includes advice given and confirmation of the client's position on taxes. If an alternative approach to the one decided upon by the client would accomplish the client's goals and avoid taxes, it should be included in the letter. The client should be asked to acknowledge receipt of the letter by signing a copy.
- ***Title or ownership of property conflicts with an attempt to bequest it in a will.*** Testators often do not appreciate that property they wish to pass by will is titled in such a way as to pass by law instead of by will. This can result in a different disposition of the property than the testator's intent and lead to malpractice claims by disappointed beneficiaries. Testators should be informed in writing about the distinction between property passing by will and by law. They should be advised to assure that property to pass by will is not titled in a way to frustrate their intent.
- ***Estate planning for married couples when there are children of prior marriages involved.*** In these circumstances there is a high risk that the lawyer may later be accused of favoring one spouse over the other or that incomplete advice was given about the possible outcomes for beneficiaries of a deceased spouse. It is often prudent to represent only one of the spouses in these circumstances. A Kentucky case illustrates this risk. In *Bohlinger v. O'Hara* (Ky. Ct. App. No. 2003-CA-001670-MR, 10/29/04) a lawyer prepared a prenuptial agreement and, after the marriage, wills for the husband and wife, both of whom had children by previous marriages. The effect of these arrangements was for each spouse to waive any claim upon the other's estate at death and to leave their respective estates to their children from the previous marriage. Later the lawyer prepared a general power of attorney granted by the husband to the wife because of his failing health. Subsequently, the wife with the assistance of her son sold $200,000 of Procter & Gamble stock owned by the husband. Some of the proceeds were used to pay taxes and upkeep for the couple, but $160,000 was placed in an account in the name of the wife and son. After the husband's death, his children questioned the stock sale leading to the allegation that the lawyer malpracticed by failing to adequately explain to the husband that the wife could use the power of attorney to sell assets, make gifts, and thereby circumvent his intention for his assets to go to his children. The lawyer was saved from contesting this claim by the malpractice statute of limitations.

"It infuriates me to be wrong when I know I am right."

Moliere

Ineffective Screening Can Be Costly

Kentucky allows screening by a firm to avoid disqualification for a conflict of interest when the only reason for disqualification is a former client conflict by a current member of the firm. The disqualified member must be screened, receive no part of fees from the representation, and the client must be notified in writing (SCR 3.130 (1.10 (d)).

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Two cases in other states show how ineffective screens can lead to a malpractice claim or disqualification:

- In Idaho a firm screened a conflicted lawyer with the client's waiver and the understanding that the screened lawyer would receive no confidential information. Subsequently, a memorandum was circulated in the firm involving settlement issues. This memorandum was received by the screened lawyer. After settling the case for $3.5 million, the client sued the firm for malpractice for $6.3 million. In the course of discovery the client found out about the violated screen and moved for an additional malpractice claim. The Idaho Supreme Court held that the facts alleged a viable claim. The client asserted that it would not have settled the claim had it known that confidentiality was breached and was thereby damaged by the lost opportunity for arbitration. *Spur Products Corp. v. Stoel Rives LLP*, Idaho, No. 30433,9/30/05; *ABA/BNA Lawyers' Manual On Professional Conduct, Current Reports*, Vol. 21, No. 21, page 518 (10/19/05).

> ***"Life is easier than you think; all that is necessary is to accept the impossible, do without the indispensable, and bear the intolerable."***
>
> ***Kathleen Norris***

- In Pennsylvania a lawyer changed firms resulting in him switching sides in a case in which he had been lead counsel. The firm immediately screened the lawyer, but the opposing party still moved for disqualification. In granting the motion for disqualification the court pointed out deficiencies in the screen to include:
  - no absolute prohibition on conversations with, around, near, or in the presence of the screened lawyer concerning or related to the matter;
  - no guidance that violators would be terminated and disciplined;
  - no guidance that the screened lawyer was to receive no part of the fees from the representation.

Norfolk Southern Railway Co. v. Reading Blue Mountain & Northern Railway Co., M.D. Pa., No. 3:03cv736,10/25/05; *ABA/BNA Lawyers' Manual On Professional Conduct, Current Reports,* Vol. 21, No. 23, page 574 (11/16/05).

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