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IN PRACTICE

Transactional lawyers in the crosshairs

To reduce malpractice exposure, know who your clients are and avoid 'project creep'



Tyler Gerking, Matthew S. Kahn and John B. Sullivan

Tyler Gerking is a partner at Farella Braun + Martel LLP, where his litigation practice focuses on recovering insurance policy proceeds for policyholders. Matthew S. Kahn is a partner at Gibson, Dunn & Crutcher LLP, where his practice focuses on law firm defense, securities and derivative litigation, and class action defense. John B. Sullivan is a partner at Long & Levit LLP, where his litigation practice emphasizes the defense of lawyers.

Legal Malpractice

The severity of legal malpractice claims arising out of business transactions is on the rise. Lawyers can take the following steps to avoid claims arising out of transactional work. If they are the target of a claim, however, or believe a storm may be on the horizon, they should carefully consider when and how to give notice of it to their insurer.

DO NOT UNINTENTIONALLY CREATE ATTORNEY-CLIENT RELATIONSHIPS

Transactional attorneys must be aware of who their clients are at all times and avoid unwittingly creating attorney-client relationships that could create duties to third parties. When an attorney represents an organization, the client is the organization itself. Cal. Rule of Prof. Conduct 3-600(A). An attorney who represents a corporation does not represent the shareholders. *Skarbrevic v. Cohen, England, & Whitfield* (1991) 231 Cal.App.3d 692. Similarly, a lawyer who represents a partnership generally owes no duty to the individual partners. *Johnson v. Sup. Ct.* (1995) 38 Cal.App.4th 463.

However, courts have recognized the following factors that determine whether in a particular case a partnership attorney has established an attorney-client relationship with the individual partners: (1) the size of the partnership; (2) the nature and scope of the attorney's engagement; (3) the kind and extent of the contacts between the attorneys and individual partners; (4) the attorney's access to financial information related to the individual partners' interests; and (5) whether the totality of the circumstances, including the parties' conduct, implies an agreement to represent the individual partners. *Johnson*, 38 Cal.App.4th at 476-477. Attorneys should keep these factors in mind to avoid unintentionally creating an attorney-client relationship with partners.

REMAIN VIGILANT ABOUT NOT REPRESENTING CONFLICTING INTERESTS

California Rule of Professional Conduct 3-310 precludes a lawyer from representing conflicting interests. When deals involve multiple parties, an attorney must clearly define who he or she is representing. If the attorney is representing multiple parties on a transaction, the attorney must analyze the parties' interests to determine if any actual or potential conflicts of interest exist. Attorneys who form partnerships for multiple partners or a corporation for multiple shareholders must be particularly aware of the conflict of

interest rules, including the disclosures that must be made and consents that must be obtained before the representation begins. Attorneys representing multiple parties in a complex transaction must also be aware of their clients' interests and continue to analyze whether conflicts exists as the transaction progresses.

KNOW THE LIMITS OF YOUR COMPETENCE AND AVOID PROJECT CREEP

Lawyers have a duty to provide "competent" representation, which means "to apply the 1) diligence, 2) learning and skill, and 3) mental, emotional, and physical ability reasonably necessary for the performance of such service." Cal. Rule of Prof. Conduct 3-110(B). Obviously, this suggests that a family law practitioner should think twice before handling a multi-billion dollar cross-border merger. But the line is not always so clear, particularly because lawyers may feel capable of practicing in areas that are close to their core competence—even if, ethically, they are not close enough to satisfy the rule.

A common way for attorneys to stray outside their competence is through "project creep"—for example, when an attorney is hired for one task on a complex deal, but ends up, as the deal evolves, providing input on other aspects of the deal outside of his or her expertise. To combat the natural tendency to assist in any way a client may ask, attorneys must clearly define what their roles are, and then stick to those roles. Business & Professions Code section 6148(a)(2) requires an attorney fee agreement to define the scope of the engagement by describing the general nature of the legal services to be provided to client. Likewise, while California Rule of Professional Conduct 3-400 precludes a lawyer from contracting with a client to prospectively limit liability for professional malpractice, the discussion following the rule makes clear that the rule is not intended to prevent a member from reasonably limiting the scope of representation. By maintaining a clear delineation of what work a lawyer has—and has not—agreed to perform, a lawyer can mitigate the risk of later being sued for performing legal services he or she was not qualified to render.

DOCUMENT THE ADVICE YOU PROVIDE

When legal malpractice cases turn into "he said/she said" fights between clients and their former attorneys, the outcome rarely is good for the lawyer. Lawyers can protect against malpractice claims by providing legal advice in writing or, if doing so is not feasible, creating an internal written record of advice. It can be hard to recall who made one of a thousand decisions that happened regarding a given transaction. Keeping a written record of what has been advised, when, why and how can help avoid a later fight about what really happened by providing contemporaneous evidence and potentially refreshing diminished recollections.

IN THE EVENT OF A CLIENT DISPUTE, PROMPTLY AND CAREFULLY CONSIDER INSURANCE COVERAGE

Failing to properly report a "claim" in a timely fashion to the insurer can eliminate coverage for it, or at least create an unnecessary and potentially costly dispute.

Lawyers' professional liability insurance policies are overwhelmingly written on a "claims made and reported" basis. In other words, the policies cover claims "made" during the policy period, and then only if that "claim" is reported to the insurer during (or very shortly after) the policy period.

Attorneys should pay close attention to their policies' definitions of "claim," which vary significantly from policy to policy. Some definitions include not just complaints filed in court, but also "written demand for monetary or non-monetary relief." Others encompass both oral and written demands, or even demands for free services. The definition of "claim" can significantly affect an attorney or law firm's reporting obligation under the policy.

A related challenge is determining whether, short of a "claim," the lawyer should report a "circumstance"—a mistake or situation which he or she might reasonably expect to result in a "claim." Professional liability policies generally expire annually, so lawyers and law firms usually renew their policies with the same insurer or buy insurance from a different insurer every year. The expiring policy will allow the lawyer or law firm to report a "circumstance" and will treat a "claim" made after the policy's expiration as one made during its policy period. This protects the lawyer from a key exclusion often found in the renewal or newly issued policy, which bars coverage for "claims" based on or arising from mistakes or events that the lawyer knew about or reasonably should have known would lead to a "claim." As a result, if the lawyer or law firm is aware of a circumstance during the expiring policy's life and fails to report it, there may be no coverage for a claim under either the expiring or renewal/new policies.

There are many nuances to consider in light of policies' differing language, but lawyers and law firms should pay very careful attention to whether and, if so how, an actual or potential claim should be reported whenever a client representation or relationship appears to be heading south.

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