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A RISK MANAGEMENT NEWSLETTER FOR LAWYERS FROM TRAVELERS BOND & FINANCIAL PRODUCTS

IN THIS ISSUE

REDUCING RISK IN A REAL ESTATE LAW PRACTICE

By Joe Kingma, Partner, Carlock, Copeland, Semler & Stair, LLP Atlanta

Editor's note: *The current mortgage crisis and related stress on the real estate and lending markets has put real estate lawyers in the spotlight. Here are some practical tips from a seasoned attorney who for many years has defended commercial and residential real estate lawyers against malpractice claims.*

Residential Real Estate Risks

Foreclosure issues.

When real estate transactions slow due to market conditions, real estate lawyers often become work-out or foreclosure lawyers. Foreclosure lawyers draw more than their fair share of malpractice claims. Predatory lending is a hot topic with jury appeal, and in many states is governed by statute. If you are involved in loan work-outs or foreclosure, be very familiar with the Fair Debt Collection Practices Act as well as the cases thereunder. If you have direct contact with a borrower facing foreclosure, meticulously document your contacts. Beware of conflicts -- foreclosing out the interests of one unknowing lender client on behalf of another lender client is a recipe for malpractice litigation.

Mortgage fraud.

Mortgage fraud is the source of many catastrophic claims against innocent residential real estate lawyers. Avoid being unwittingly drawn into real estate fraud by watching out for: (1) transactions involving exorbitant fees or points; (2) suspicious borrowers; (3) strangely structured transactions; (4) unusual

volumes of business from strange sources; (5) flips; (6) payoffs of strange or poorly documented liens at closing; or (7) sellers who justify a vast and abrupt increase in value by alleged improvements to the real estate.

Remember that real estate fraud is often facilitated by crooked loan officers, and that your obligation is to the lender rather than the loan officer or mortgage broker. Sometimes real estate fraud is foisted upon an unsuspecting lawyer by staff at the law firm. A criminal background check before hiring key staff members is a very good idea.

Clients, non-clients and conflicts.
In some states, lawyers are allowed to represent all parties to a residential transaction. In others, the lawyer may only represent the lender. Make sure everyone at the closing knows who you represent, and always give written notice of who you represent and who you don't. Do not take on liability to additional parties unless you have carefully weighed the risks, including problems raised by conflicts of interest.

Escrow accounts.
Make sure your escrow account is balanced monthly and that you can account for even small amounts of money contained therein. Small overcharges multiplied by hundreds or thousands of transactions can result in a very large lawsuit. Consider bringing in an outside accountant on a regular basis to make sure all amounts in the escrow account are properly tied down. Wire transfers that mysteriously "appear" in your account should be researched carefully before being disbursed. Too many lawyers end up appearing complicit in fraud or money laundering when funds simply "pass through" their escrow accounts.

Title examination risk.
If you use an outside title examiner, make sure that the examiner has current insurance with appropriate limits for your practice. A detailed master agreement between you and an outside title examiner can be very helpful if a problem arises. If you use an employee as a title examiner, make sure that employee is well trained and not overworked. Discuss close title questions with your title insurer. Remember, however, that title insurance company guidelines may differ from the standard of care for an attorney. For example, a title insurer may allow an examiner to rely on an existing loan as a basis for a title search, but the lawyer may still face a malpractice claim alleging failure to conduct a full search.

Read and follow instructions.
Review a lender's closing instructions before any loan is closed. Don't assume these instructions are just like all the others. If there are blanket agreements with warehouse lenders or others governing a particular transaction, review them as well.

Title agents.
Many residential real estate lawyers are also title agents. Review the Title Agency Agreement periodically to ensure that your obligations are met. Agency Agreements are often ignored until a problem arises, but they will be strictly enforced against you. Waivers or amendments to a lender's or insurer's instructions must always be in writing. If you are sued two years after the closing, you will probably remember nothing and the paper trail may be all that saves you. Do not let competitive pricing pressures cause you to fail to do your job.

Commercial Real Estate Risks

Time pressures.
Often mistakes happen in commercial real estate transactions because of unreasonable time pressures created by the client. If there simply is not time to get the deal done correctly, don't do the deal. Surveys reviewed hurriedly at the closing table for the first time generate claims, and ill-considered changes to loan documents jammed in at the last minute are also a frequent source of trouble. If a deal goes awry, your client will typically not take into account your time pressures. The client expects an A+ job regardless of time considerations. You must make sure you take the time to do an A+ job.

Title insurance binders.
Marking up a title insurance binder or commitment correctly is critical. In some states this becomes such a standard operating procedure that it is not really nailed down at closing. When problems arise this can result in significant claims.

Applying residential procedures to commercial deals.
Occasionally residential real estate lawyers take on commercial transactions and in doing so fail to fully appreciate the differences between commercial and residential deals. While a residential real estate lawyer may have plenty of expertise to do a commercial deal, too often they inappropriately follow residential standard operating procedures. It is critical to manage and memorialize a client's expectations and the lawyer's obligations by means of a solid, comprehensive engagement letter.

CHOOSING THE RIGHT CLIENTS – GOOD BUSINESS AND GOOD RISK MANAGEMENT

By, Joseph W.E. Schmitt, Senior Claims Counsel, Travelers

Poor client selection is a recurring source of legal malpractice claims – and one you can control. This article offers tips for developing the right business while minimizing malpractice risk.

Before we review these tips, it important to understand what **you can't control** – No matter how good you are at lawyering, a disappointed client may one day sue you for malpractice, whether the action is merited or not.

These tips have everything to do with **what you can control.** Among the most important risk variables within an attorney's control is the decision to accept or decline the representation of a new client. Done right, it can also be a sound risk management approach that is good for the firm's bottom-line.

The key to making the right client selection decision is to **develop and adhere to an effective client-screening policy.** In designing the policy, consider the factors below and any others you feel are important, and which are in keeping with the nature of your practice, desired clientele, and business goals. Unless you are a solo practitioner, the policy should include some form of peer review.

Here are some specific questions to consider, based in part on the ABA's *Desk Guide to Preventing Legal Malpractice*, as well as our independent claims experience.

1. **Has the potential client gone through previous lawyers?**
   A client who comes to you dissatisfied with more than one set of attorneys may be the cause of their own problems. Perhaps the client doesn't pay bills or isn't straightforward with his or her attorney. Expectations on the merits of their position may be unrealistic. When clients who go through multiple attorneys on the same matter bring suit, they frequently include all of the lawyers in the chain. The last one in line sometimes bears the brunt for what has come before.

2. **Are you dealing with a reasonable potential client?**
   Unreasonable and unduly litigious individuals, who act on impulse or for vengeful motives, have a certain "cash-cow" attraction if you are hungry for business. Often their adversaries are those with whom they once enjoyed productive relationships. If the results of your representation are not to their liking, do you have reason to believe that they will behave differently toward you?

3. **Does the potential client have a difficult background?**
   Learn what you can about the potential client's background: financial problems, serious legal problems, chemical or gambling issues, etc. Pay attention to factors that may indicate instability or obsessiveness.

4. **Does the potential client require immediate action?**
   Beware of the intake interview that occurs at the last minute. If a pleading has to be filed before you have a chance to get up to speed on a case, any omission or error may in hindsight seem frighteningly obvious. The lawyer who fails to timely identify a potential source of offset, misses a critical appellate issue within a jurisdictional deadline, or who substitutes in on the eve of trial without time to thoroughly prepare, runs significant risk. Even if excusable, these are just the sort of standard-of-care issues that can turn into "battle of experts" malpractice litigation.

5. **Does the potential client expect more than legal advice?**
   Business clients, especially the promoters of closely held corporations, may select a firm believing that the firm's contacts will be good for business. Networking is good, and you want to help. Be aware that fact-driven claims arise when, for example, clients think you actually undertook to arrange financing for them. The lawyer who, in the eyes of the client, wears more than one hat in regard to a transaction greatly increases the risk of a thorny claim.

6. **Is this a personal favor?**
   Your qualifications and obligations as an attorney don't change when the client, or the person referring the client, is someone close to you. Sadly, kind-spirited lawyers who do "favors" outside their area of expertise do get sued, even when the disgruntled client suing them is a friend or relative. And the personal relationship tends to sour as well.

7. **What does your gut tell you?**
   Trust your instincts. If something doesn't seem right, the best time to avoid a bad surprise is before you undertake an attorney-client relationship.

MANAGING PERCEIVED PROBLEMS AND POTENTIAL CLAIMS

By, Joseph W.E. Schmitt, Senior Claims Counsel, Travelers

Lawyers manage problems for their clients every day. But they're not always sure how to manage situations that might turn into malpractice claims against themselves. Here are thoughts, based on our experience, which may lower the risk that potential claims will ripen into lawsuits, and help you sleep better at night if they do.

First, most problems don't turn into malpractice claims. But over the course of your career, no matter how excellent the quality of your lawyering, you (and staff for whom you're vicariously liable) likely will face at least one malpractice claim. In a generation, claims for legal malpractice have gone from something of an anomaly to a virtual subspecialty of the practice of law. Mallen & Smith observe that, while the 1977 first edition of their *Legal Malpractice* treatise covered about 800 cases (many of which applied to legal malpractice by analogy), the 2007 edition reports over 17,000 published legal malpractice decisions. They further state that today's law school graduate has a statistical likelihood of facing at least three claims of malpractice in his or her career.

The prospect of a malpractice claim can arise from, among other things, a question from a client or other party, a threatening letter or phone call, a response to an invoice for legal fees, or even simply the unilateral belief that a mistake has been made.

The potential claim may or may not have merit. But whether or not the concern is well founded, the situation generally calls for action of some sort. The circumstances sometimes give rise to an ethical obligation of disclosure toward your client. And in any event, failing to act or hoping problems will go away can, and too often does, turn innocent and curable issues into more complicated claims to defend.

If a lawyer anticipates a claim, the law firm should determine whether it has a contractual obligation to place its liability insurer on notice. Because policy forms vary, the law firm should review the specific terms of the policy, which govern its rights and obligations. Failure to abide by notice requirements can result in the loss of otherwise available coverage.

In addition, strategies for resolving problems early and appropriately tend to evolve out of the interplay between the insurer's experience with legal malpractice matters and the law firm's expertise in its chosen substantive field of law. Our group at Travelers is in the business of handling claims against lawyers and in helping you navigate the pitfalls inherent in such claims. That includes an ability to recognize when practice area, law firm size, or other variables generate special considerations and when they do not. When appropriate, working with us early on can and often does prevent claims from ripening into full-blown lawsuits.

The law firm's initial communication to the carrier is ordinarily a concise, written statement containing information required to satisfy the insurance policy's notice provisions. Well written notice letters present the information objectively and without unnecessary editorializing. When appropriate, they may refer to

brief self-explanatory attachments, such as a demand letter from a client or other party criticizing how a matter was handled. A notice letter will often indicate that it is being provided in an abundance of caution, to satisfy the insurance policy's notice provisions.

The carrier typically will acknowledge receipt of the law firm's notice in writing. The claim handler, who may be a lawyer with relevant background in private practice, will contact the firm and, if appropriate under the terms of the policy, will discuss the notice and determine whether and to whom the matter should be referred for assistance or defense. It may be that no action is called for at this stage, and the matter will simply remain on file. Or, if action is called for, the law firm and the insurer will discuss the approach and the wisdom of obtaining outside counsel.

Sometimes, the plan may be to do nothing, unless and until the matter ripens. This approach is often taken after some due diligence regarding other options. Alternatively, the plan may be to "repair" the claim, if an opportunity exists to cure or reduce the impact of the perceived harm that may have been caused. If so, early action may eliminate or reduce the risk of the matter ripening, or at least prevent the harm from escalating.

If it is appropriate to settle the matter, an early understanding of the issues can lead to better and more flexible prospects for negotiation, before the parties' positions have become entrenched or the procedures governed by court rules. And for those potential matters that ultimately do result in formal litigation, the early preparation can pay off in the form of a better considered defense and a better night's sleep.

SUING FOR FEES? THINK TWICE

By Tom Ascher, Claim Counsel, Travelers

Many of the legal malpractice claims we see are counterclaims to an attorney's suit against the client for fees. The counterclaims often lack merit, but they cost time, money, and tooth enamel to defend and resolve. Sometimes the deductible payments for defending the counterclaim wind up costing more than the fees at issue.

With planning and foresight, you can minimize the risk of notifying your carrier of a "malpractice" claim that is nothing more than attempted leverage for the client who is unwilling to pay a bill.

Know your clientele.
If your client base is mainly individuals rather than businesses, you are more likely to see malpractice alleged in response to a demand for fees Business clients tend to have more experience with attorneys, and their expectations are more realistic. They are less likely to allege malpractice as an emotional reaction. Their repeat business gives them leverage other than alleging malpractice when fee issues arise. And they are often better able to absorbing high costs. Individual clients may be more emotionally invested in the legal representation and have less realistic expectations as to outcomes and costs. When pressed to pay bills, their only perceived leverage may be an unfounded claim of malpractice.

Good client screening is important.
Many attorneys faced with a fee-dispute malpractice claim have commented they knew the client was "going to be trouble. My gut just told me to stay away, and I should have listened." True. Screen your clients carefully. If you sense that a potential client may be difficult, unreasonable, unrealistic, or not a good bet on paying fees, pay attention to your instincts.

Communicate risks and manage expectations.
At your initial meeting with a potential client, take the time to go over the possible outcomes, good and bad, and your realistic estimate as to the likelihood of each. Make sure the client understands the possibility of adverse results, and the likelihood of such results. Make sure the potential client understands that you are giving an estimate, not a guarantee, and that you are doing so with limited facts and information. Tell the potential client that your opinion is likely to change as the case move forward. Clearly and carefully outline the potential costs involved in proceeding with the representation, and again let the client know that you are providing an estimate, not a guarantee, as to what your fee will be. *Put it all in writing.*

Obtain a retainer from individual clients.
Specify in writing that the retainer will need to be replenished with a specific amount and at specific intervals. If the client balks, that may be a red flag.

Follow up with letters as expectations and the landscape of the representation changes.

Bill regularly and timely.
Your retainer agreement should set forth how often bills will be sent out, and how soon the client is expected to make payment and/or replenish a retainer. Most attorneys choose to send out bills strictly based on the passage of time – monthly, quarterly, when I get around to it – but the better practice is for the agreement/understating with the client to be that bills will go out based on the passage of a certain time period *or the accumulation of a certain amount of fees,* whichever comes first. Most clients actually prefer this method, because then they know they will not get an unpleasant surprise upon opening up a bill (or, at least, they will not get a more unpleasant surprise than they should be prepared for by the retention and billing arrangement). If a client doesn't come current on replenishing a retainer or paying a balance due in full, take note and take action. Follow up with the client and get an understanding as to why the client has not fulfilled his obligation and responsibility to the representation. If the client has an issue with the bill and/or the representation, you need to know that and the sooner you know it the better chance you have of dealing with it effectively.

Consider appropriate withdrawal from representation if delinquent payments appear uncurable.
If you make a follow-up contact, and payment is still not made, you must then make a business decision. Generally you are not *required* to represent anyone (at least almost never, especially with paying clients) and it may be prudent to withdraw. But it is important to do so appropriately. It is not a good idea to tell the client that you are simply going to stop doing any work on the file until the bill/retainer is made current. Doing so may result in a malpractice claim and/or an ethics complaint. Even informing the client that you are going to simply perform "the minimum necessary to meet my professional and ethical obligations to you" until the bill is paid is dangerous. Instead, inform the client that you will have to withdraw unless the bill is brought current. Make sure you consult with and follow your local rules of professional responsibility in this context. Many jurisdictions require that you notify the client, in writing, of this possibility, and allow at least some time (most rules use the very helpful "reasonable amount

of time") for the client to make efforts to get the legal fees paid so that the representation can continue. Depending on the jurisdiction and the type of representation, you might also need court approval before you can withdraw. Follow applicable rules when you withdraw. You have the right to do so in most instances, and you should not be timid about doing so.

If you must pursue a fee claim, explore alternatives to formal litigation. Some jurisdictions offer free or low-cost binding fee arbitration through local or state bar associations. Mediation is also an option. If you provide the client with some options, the client is less likely to feel his hand has been forced.

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