A Tennis Match of Ethical Issues Between Litigators and Transactional Lawyers

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Summary of the Presentation

Imagine an ideal tennis match between litigators and transactional lawyers: who has the most difficult ethical issues? It is a touch match. Let's compare some issues.

A. *Use of Limited Engagement Agreements.*

Rule 1.8(h) prohibits certain conduct of a lawyer aimed at limiting his liability. In particular, the rule provides that

> A lawyer shall not:
> (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or
> (2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

As it is evident, it is not an absolute ban on limitation of liability. It does not forbid, for example, arbitration agreements (even if an arbitration agreement maybe favorable to the lawyer), and it does not forbid lawyers from limiting the scope of their representation.

Limitation of the scope of representation – through a so-called "limited engagement agreement" – is not only permitted but it is also advisable for both transactional lawyers and litigators. A limited engagement agreement is one that specifies the legal tasks that the lawyer will handle and excludes all other activities. An engagement agreement that simply specifies what the lawyer will do without excluding other activities might be considered to be ambiguous and insufficient to limit the scope of the lawyer's representation.

The relevant ethical provision is Rule 1.2(c): "A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent". Comments 6-8 discuss when a limitation of representation is reasonable. Courts have often evaluated what it is unreasonable by making reference to the duty of competence.

Barnes v Turner, 606 S.E.2d 849 (Ga. 2004) is an example of a case where a transactional lawyer could have, but failed to use a limited engagement agreement. *Barnes* was a malpractice action by the seller of his business against his lawyer (Turner) who handled the closing. The client had sold his company partially for cash and partially for a ten-year promissory note secured by a blanket lien on the buyer's assets. Turner filed a financing statement to protect his client's security interest, but he did not inform him that financing statements are only effective for five years, although their renewal for another five years is expressly provided for in the statute. Nor did Turner file an extension of the financing statement at the end of the five years. The result of these two omissions was that when the buyer did not pay on the note the client could not obtain satisfaction on the lien because his interest became subordinate. The Georgia Supreme Court held that the lawyer was subject to malpractice liability because he failed either to file the renewal statement or inform his client of the need to do so. As the court put it, Turner failed to protect Barnes's security interest. Had Turner used a limited engagement agreement making it clear to the client that his representation was limited to the closing and did not extent to future activities such as renewal statements, he would have avoided liability.

The lesson for transactional lawyers is that the engagement agreement can limit the lawyer's responsibility to the closing of transaction (and nothing else) but it is necessary for the enagagement to be clear about this limitation.

By contrast, *Flatow v Ingalls*, 932 N.E.2d 726 (Ind. Ct App. 2010), is an example of the successful use of a limited engagement agreement by a litigator. The client complained that his lawyer had failed to file a response to defendant's motion for summary judgment. The lawyer had limited the scope of representation to the preparation of a motion for summary judgment and to an answer in response to motion. Even if I personally think that the limitation of representation was unreasonable (how can you carve out activities like that?), the Indiana Court of Appeals held that the agreement was reasonable. Another example in which a litigator had his limited engagement sustained by a court was *Lerner v Lerner,* 819 A.2d 471 (N.J. Super. App. Div. 2003). The client, without the assistance of a lawyer, had entered into a divorce settlement agreement through mediation. The client asked the lawyer to review the agreement without doing any factual investigation. The lawyer undertook the representation pursuant to a limited engagement agreement. Later the client discovered that the value of a marital asset, the husband's business, was much higher than the client (and the lawyer) had expected, and the

client had sued his lawyer in malpractice. The court dismissed the action finding no duty of investigation of the value of a business because the limited engagement agreement excluded this factual investigation and the limitation was reasonable.

B. *Identification of the client.*

Both litigators and transactional lawyers face client identification issues. Transactional lawyers will want to identify the client in situations like the incorporation of an entity. It is advisable for the lawyer to make it clear whether the lawyer represents all of the promoters, or only some of them, and whether the lawyer represents the entity to be formed. If lawyer fails to specify, courts are likely to find that he represents all of them pursuant to the reasonable expectation principle. Another case in which a transactional lawyer will want to identify carefully his client or clients is when she assists in the closing of a real estate transaction. Let's imagine that the lawyer represents the buyer and at the closing the seller comes unrepresented. Even if the lawyer can explain documents to the seller and can even draft documents for the seller that might not amount to a representation. If it is the case, the lawyer is better to make it clear that she does not represent the seller otherwise a court might find that she does.

Litigators have a similar situation in an insurance defense practice. Identification of the client or clients in this case is very important. Why? The traditional approach is the multiple representation approach, i.e. the lawyer represents both the insured and the insurance company. If defense counsel wants to adhere to the traditional approach, the lawyer should disclose that there are the situations in which the harmony between insurance company and insured can be broken and the lawyer may not be able to continue the multiple representation. The lawyer may prefer an alternative approach; for example he might want to represent only the insured. If it is so, the engagement agreement must specify that the lawyer only represents the insured and that the insurance company is only a third party payor, which is ethically permissible under Rule 1.8(f)). The latter approach solves possible conflicts of interest between insurer and insured, but it may be unacceptable to insurance companies, which have the contractual right to control the defense and which may require objective analysis.

C. *Restriction on right to practice under Rule 5.6(a)*

Rule 5.6(a) provides that

A lawyer shall not participate in offering or making:

> (a) a partnership, shareholders, operating, employment, or other similar type of agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement; or
> (b) an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a client controversy.

Both transactional lawyers and litigators must carefully consider this rule in their practice. The rule prohibits direct restrictions on the practice of law for both litigators and transactional lawyers. For litigators, for example, an agreement settling a case cannot prohibit the plaintiff's lawyer from representing future clients against the defendant. See ABA Formal Op. #93-371. Similarly, a partnership agreement cannot prohibit a lawyer from practicing with another firm when the lawyer leaves the first firm.

The rule applies also, however, to indirect restrictions on the practice of law, but the application of this principle is unclear for both litigators and transactional lawyers. For litigators some indirect restrictions are permissible. ABA Formal Op. #00-417 opined that while an agreement that prohibits a lawyer from revealing information relating to representation is permissible, an agreement in which the lawyer is precluded to use the information is not permissible. The rationale for distinction between use and disclosure is the following: if the lawyer is prohibited from disclosing, this is nothing more than an extension of the duty of confidentiality that the lawyer due to the client.

In South Carolina Ethic Opinion, #10-04 (revised), the Committee opined that a settlement agreement could not contain a provision prohibiting a lawyer from advertising for clients against defendant. I personally disagree with this opinion: an indirect restriction on the practice of law should be narrowly construed because society has to balance the value of promoting settlements and the restriction on the practice of law. My view is that an indirect restriction should be considered presumably proper, unless strong reasons appear. Anyway for now agreements limiting advertisements seemed to be improper in South Carolina, although a court has not passed on the issue. By contrast, there are other permissible agreements that litigators may consider in their settlements, such as agreements that require a return of material obtained in discovery and agreements not to disclose settlement amounts.

Similarly, the application of indirect restrictions to transactional lawyers is also unclear. Partnership agreements may condition retirement payments on the lawyer actually retiring from the practice of law, but what amounts to retirement payment and what restrictions are permissible when the lawyer is not retiring are unclear.

D. *Disclosure obligations in connection with contract negotiations*

Rules 4.1 Truthfulness In Statements To Others provides that

> In the course of representing a client a lawyer shall not knowingly:
> (a) make a false statement of material fact or law to a third person; or
> (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Rule 4.1 represents a limit for both transactional lawyers and litigators. Litigators, however, have also a duty of candor both in court and in an arbitration proceeding. The duty of candor does not apply in mediations. Thus, both litigators and mediators are allowed to puff in mediation or transactional negotiations since "puffing" is not consider a statement of fact.

Rule 4.1 is worth some explanation because, in my opinion, it covers more than it appears. While the language of the rule provides only for a duty to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by client, the duty to disclose, in my opinion, is not limited to that. Why? Comment 1 provides that sometimes the failure to speak is equivalent to misrepresentation. Therefore, a lawyer has a duty to disclose not only when a criminal or fraudulent activity is at stake but also when a failure to disclose on his side would be equal to misrepresentation.

Based on the case law, I think that there are four situations that call for disclosure: (i) corrective disclosure (the duty to supplement in discovery is an example of that); (ii) a scrivener's error, i.e. when a lawyer discovers that a material error has been made in the writing, and takes advantage of it; (iii) the existence of a fiduciary relationship (for example, when the lawyer represents multiple parties); and (iv) when there is a basic fact that is unknown to the other party and a disclosure would be required by good faith and fair dealing.

This latter category is obviously the most controversial. I am talking about those facts or procedural developments of the case that are unknown to the other side, such as a recantation by a witness, a mistake regarding insurance coverage by the other party, the existence of fee agreements when fees are part of negotiations, or a denial of a pending dispositive motion.

We may ask: What is the rationale for a lawyer to be allowed to violate confidentiality to comply with Rule 4.1? The rationale is dual: First, the duty not to engage in misrepresentation trumps the duty of confidentiality. Second, when the client authorized his lawyer to enter into negotiations, he has impliedly authorized him to reveal information necessary to avoid making misrepresentations in the negotiations.

How should the lawyer proceed to comply with his disclosure duty? In my view there are three options that might be available depending on the circumstances: (i) disclose the relevant information; (ii) consult with the client and then disclose or not or (iii) consult with the client and then withdraw from representation. In deciding among these options the lawyer should consider various factors: the seriousness of the harm to the other party; the extent of court involvement; his client's interest in nondisclosure; the feasibility and consequences of withdrawal; and the lawyer's philosophy of lawyering. Of course, it is almost never an easy decision because these factors can point to different directions.

Let's see two examples of difficult decisions, one for transactional lawyers and one for litigators.

For the transaction lawyer, let's see an example taken from literature, Louis Begley novel, *Mistler's Exit* (1998). The transaction here is the sale of a business in which a seller agrees to work after the sale. The seller, after the signing the contract, learns that he has terminal cancer. As a result the seller realizes that from a tax perspective the transaction would be much more favorable as a stock rather than a cash sale. Initially the client does not inform the lawyer of his terminal illness, but he finally informs the lawyer of the situation. The lawyer advices his client that he should disclose the illness to the buyer, but the client decides not to do so. If a lawyer faced this situation, what should the lawyer do? The client has not engaged in criminal or fraudulent activity, so if the lawyer has a duty to disclose, the duty flows from the principle that in some circumstances the failure to disclose material information amounts to misrepresentation. Considering the factors above, a lawyer facing such a situation would probably not have a duty to disclose his client's health. The situation would have been different if during the negotiation the parties had discussed the seller's future activities in the company that was being sold; in this case the lawyer would probably have a duty of disclosure because "misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false". In a situation like the one in *Mistler's Exist*, however, a lawyer could perhaps withdraw from representation, depending on the lawyer's philosophy of lawyering.

Consider a similar issue of disclosure that was faced by a litigator. The case is *Spaulding v Zimmerman*, 116 N.W2d 704 (Minn. 1962). Plaintiff Spaulding requested that a settlement from a previous personal injury case, during which plaintiff was a minor, be vacated due to the fact that the defendants and their counsel had information, prior to the settlement, that was unknown to plaintiff and the court that the plaintiff suffered from a potentially life-threatening condition that probably was caused by the accident. The Minnesota Supreme Court held:

> The court may vacate . . . a settlement [made on behalf of a minor] for mistake even though the mistake was not mutual . . . but where it is shown that one of the parties had additional knowledge with respect thereto and was aware that neither

> the court nor the adversary party possessed such knowledge when the settlement was approved.

The critical point here is that there was a minor involved, for which a court approval was required. Had he been an adult, the result would probably have been different, at least in 1959 when the case was decided. With regard to the conduct of defense attorney, the court found that even if there were no rules imposing on him a duty to disclose he should have known that his silence triggered the risk of a reopening the settlement.

In my opinion, if *Spaulding* arose today, even if it did not involve a minor, a lawyer would have a duty to disclose the plaintiff's life-threatening condition because this is a basic fact and good faith and fair dealing would require such a disclosure. Unlike *Mistler*, the factors involved in the case would mandate that the lawyer make the disclosure; withdrawal would not be sufficient.

E. *Misleading advertisement*

Transactional lawyers face a problem when advertising on their websites or other media about the quality of the services that they or their firms perform.

Rule 7.2(f) provides

> A lawyer shall not make statements in advertisements or written communications which are merely self laudatory or which describe or characterize the quality of the lawyer's services; provided that this provision shall not apply to information furnished to a prospective client at that person's request or to information supplied to existing clients.

In my opinion, this rule is unconstitutional based on the *Central Hudson* standard on Constitutional protection of commercial speech, *Central Hudson Gas & Electric Corp. v. Public Service Commission,* 447 U.S. 557 (1980). *Central Hudson* laid out a four-part test for determining when restrictions on commercial speech are constitutional. We must evaluate (i) whether the expression is protected by the First Amendment; (ii) whether the government has a substantial interest in regulating the advertisement; (iii) whether the regulation directly advances the government's interest; and (iv) whether the restriction is no more extensive than necessary.

A similar issue faces litigators with regard to advertisements dealing with results obtained. Comment 1 to Rule 7.1 states: "unjustified expectations would ordinarily preclude

advertisement of results." With regard to the constitutionality of this provision, in my opinion it is also unconstitutional under *Central Hudson* because a disclaimer rather than a blanket prohibition would be sufficient to prevent prospective clients from having unjustified expectations about the results that lawyers could obtain.