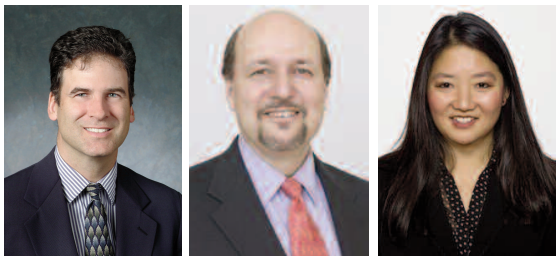


Committee News



Summer 2009

PROFESSIONALS', OFFICERS' AND DIRECTORS' LIABILITY COMMITTEE



TOXIC CLIENTS: HOW TO IDENTIFY AND MANAGE DIFFICULT CLIENT RELATIONSHIPS

By David Marseille, Glen R. Olson and Helen M. McFarland*

Who lied to me about his case, And said we'd have an easy race, And did it all with solemn face? It was my client.

INTRODUCTION

Client screening is one of the most critical steps in the process of managing attorney legal malpractice risk. Of course, new clients are very positive and no one would or should discourage attorneys and law firms from expanding their horizons. However, understanding the risks that new and existing clients can pose

is vital to the safe practice of law. This article addresses one aspect of that process - recognizing and dealing with potentially "toxic" clients.

What is a toxic client? A "toxic client" is one who is harmful, dangerous, and destructive. She¹ can interfere with your practice of law by occupying an inordinate amount of your time, energy, and firm resources, which in turn can harm your other clients, your colleagues, and even your emotional health. She has unreasonably high expectations from you and can

Continued on page 10

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¹ For ease of reference, we use the masculine and feminine forms interchangeably herein.

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LETTER FROM THE CHAIR



By [Glen R. Olson](#)

Dear Committee Members:

This is my last letter to the Professionals, Officers & Directors Liability (PODL) Committee before I pass the reins on to our Chair-Elect, Mach Millett. Mach will become our Committee Chair at the 2010 ABA Annual Meeting in San Francisco and Rick Bale of Larson King LLP will become our Chair-Elect.

I have enjoyed working with the Committee this past year and am proud of what PODL has accomplished in terms of our publications and Annual Meeting CLE program. Much work remains to be done, however, and we strongly encourage folks interested in serving on a subcommittee to step up and help Mach and Rick in the next two years. We are looking for Committee members interested in leadership positions in the following areas: Membership/Diversity, Annual and Spring Meeting CLE Programs, CLE Teleconferences and Committee Publications.

If you will be at the 2010 Annual Meeting, please make sure to attend PODL's CLE program entitled *Financial Fraud Litigation: The Issues Confronting Professionals, Directors and Officers and Their Insurers*, which will take place on Saturday, August 7, 2010 from 8:30 a.m. to 10:00 a.m. at the CLE Program Center. The program will be moderated by Rick Bale and we have a great panel of speakers including Fiona A. Philips of Howrey LLP, Richard M. Heimann of Lieff Cabraser Heimann & Bernstein, Kim Hogreth of Chubb Insurance and Paul M. McGowan, Jr. of Matson Driscoll & D'Amico. Please spread the word about the program to others and we hope to see you there.

Immediately prior to CLE program on August 7 we will hold our PODL Committee Business Meeting, from 7:30 a.m. to 8:30 a.m. at the CLE Center. We need your ideas for the upcoming year and we encourage you to attend and participate.

We could still use your involvement in the next newsletter! Please send your ideas for articles to Cecelia Lockner at clockner@eapdlaw.com.

Finally, we are once again looking for Committee members willing to contribute to the TIPS Journal Annual Survey of the Law. The survey article will run about 40 double-spaced, typed pages, and we are looking for 8-10 page pieces surveying recent case law developments affecting accountants, lawyers, directors and officers, architects and engineers and insurance brokers. If you are interested in participating, please contact me or John Rogers of Carlock Copeland Semler & Stair, jrogers@carlockcopeland.com.

Thank you, and I hope to see you at the San Francisco meeting or a future TIPS meeting. 

Best regards,

[Glen R. Olson](#)

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CALIFORNIA CLARIFIES INDEMNITOR'S DUTY TO DEFEND

By: Mary Pat Cormier & Alexander G. Henlin *

In late April 2010,¹ the California Supreme Court denied petitions for further review and to decertify the Sixth Appellate District's decision in *UDC-Universal Development, L.P. v. CH2M Hill*.² In so doing, the court let stand a California Court of Appeal decision holding that a design professional had a contractual duty to defend the general contractor that had retained it, against non-particularized negligence claims.

Some commentators have described the decision as nothing less than a sea-change in the developing body of California law on an indemnitor's duty to defend.³ While perhaps distressing to indemnitors, who now find themselves in positions similar to those long held by general liability insurers, *UDC* simply extends the reasoning of the California Supreme Court in its 2008 decision in *Crawford v. Weather Shield Mfg., Inc.*⁴ The purpose of this article is to offer a brief overview of the two decisions and to provide some perspective on the direction California law appears to be taking on the duty to defend in the noninsurance context.

A. CRAWFORD

Crawford arose out of a residential construction contract. J.M. Peters Co. was the developer, builder, and general contractor for a new complex in Huntington Beach, California. Weather Shield Mfg., Inc., contracted with J.M. Peters to manufacture and supply wood-framed windows for the project. In the contract, Weather Shield promised to "indemnify and save [J.M. Peters] harmless against all claims for" damages, loss, or theft "growing out of the execution of [Weather Shield's] work" and "at [its] own expense to defend any suit or action brought against [J.M. Peters] founded upon the claim of such" damage, loss, or theft.⁵

In the fall of 1999, the owners of over 200 finished homes in the project sued J.M. Peters and Weather Shield, along with numerous other contractors, alleging a host of construction defects. With respect to Weather Shield's windows, the homeowners alleged that their improper design, manufacture, and installation caused the windows to leak and fog, leading to extensive damage.⁶ In April 2000, J.M. Peters cross-claimed against Weather Shield, demanding that Weather Shield defend and indemnify J.M. Peters against the homeowners' complaints.⁷

All of the defendants except Weather Shield and another subcontractor settled before trial. In October 2002, a jury returned a general verdict in favor of Weather Shield, finding that it had neither breached its warranty nor been negligent and declaring that it had no liability.⁸

Later, in March 2003, J.M. Peters' cross-complaint was tried against Weather Shield. The trial court declared that the jury's finding in favor of Weather Shield was dispositive, absolving it from any duty it may have had to indemnify J.M. Peters.⁹ It concluded that the duty to defend, however, was a separate issue. There, the contract obligated Weather Shield to defend J.M. Peters against the homeowners' claims, insofar as those claims concerned Weather Shield's windows, regardless of any ultimate finding on negligence.¹⁰

The Court of Appeal affirmed, relying upon case law drawn from the vast body of law regarding a liability insurer's duty to defend. Agreeing with the trial court that the duty to defend implied an immediate service, the appellate court held that the duty to arise at the time the suit was brought. The duty to defend,

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¹ See 2010 Cal. S. Ct. Minutes 739 (Apr. 28, 2010).

² 181 Cal.App.4th 10, 103 Cal.Rptr.3d 684 (2010).

³ See, e.g., Jean A. Weil, *Are You Defended Against the Duty to Defend?*, AIA California Council (2010).

⁴ 44 Cal.4th 541, 187 P.3d 424, 79 Cal.Rptr.3d 721 (2008).

⁵ See 44 Cal.4th at 547-48.

⁶ See *id.*, at 548.

⁷ See *id.*

⁸ See *id.*, at 549.

⁹ See 44 Cal.4th at 549.

¹⁰ See *id.*

according to the appellate court, could not “depend upon the outcome of issues to be litigated in the very action Weather Shield was obligated to defend.”¹¹

Reviewing familiar concepts from the liability insurance context, the California Supreme Court unanimously affirmed the lower courts’ decisions. Its opinion opened with a recitation of the basic rules on a duty to defend:

Standard comprehensive liability insurance policies provide that the insurer must both indemnify and defend the insured against claims within the scope of the policy coverage. The insurer’s duty to defend is broader than its duty to indemnify. The latter duty runs only to claims that are actually covered by the policy, while the duty to defend extends to claims that are merely potentially covered. The insurer’s defense duty is a continuing one, arising on tender of defense and lasting until the underlying lawsuits is concluded, or until it has been shown that there is *no* potential for coverage.¹²

The court went on to note that it was addressing “issues concerning the contractual duty to defend in a *noninsurance* context,” but the concepts it explored were not themselves new.¹³

After reviewing of the basic principles of contract construction (*e.g.*, courts are to construe contracts so as to give effect to the parties’ mutual intent, as ascertained from the contract’s clear and explicit language).¹⁴ The court noted that indemnity agreements resemble insurance contracts — albeit with some significant differences. Unlike an insurance contract, where ambiguities are construed against the insurer, for example, the court recognized that it is typically the *indemnitee* who has disproportionate bargaining power in an indemnification agreement. The result is that there are some statutory (and possibly equitable) limitations on what may be included within the scope of an indemnity agreement.¹⁵

Whatever those limits may be, the court turned to Section 2778 of the California Civil Code for the proposition that the obligations set forth in an indemnity contract are generally to be performed, unless forbidden by another, more specific statute.¹⁶ According to the court, any indemnity promise includes within its scope the costs of defending against claims that fairly fall within the subject matter of the indemnity, insofar as they are incurred reasonably and in good faith.¹⁷ The statute goes on to require the indemnitor to defend actions or proceedings brought against the indemnitee, with respect to matters within the scope of the indemnity agreement, upon demand.¹⁸

Turning next to the substantive portions of the contract between J.M. Peters and Weather Shield, the court noted that Weather Shield assumed two separate and distinct obligations. First, Weather Shield had agreed to indemnify and hold J.M. Peters harmless against all claims for damages arising out of Weather Shield’s work.¹⁹ Second, and more critically, Weather Shield made a separate and specific promise to defend any suit brought against J.M. Peters “founded upon” that claim of damage.²⁰

On that reasoning, the court declared that the duty to defend “clearly connotes an obligation of active responsibility, from the outset, for the promisee’s defense against such claims.”²¹ The duty, according to the court, “arises immediately upon a proper tender of defense by the indemnitee, and thus before the litigation to be defended has determined whether indemnity is actually owed. This duty, as described in the statute, therefore cannot depend on the outcome of that litigation.”²²

Significantly, the court expressly disapproved prior court decisions that suggested that the duty to defend was essentially a duty to reimburse, which arose only upon a finding that the indemnity obligation was triggered.²³

¹¹ See *id.*, at 550.

¹² See *id.*, at 547 (internal citations and punctuation omitted, emphasis in original).

¹³ See *id.* (emphasis in original).

¹⁴ See *id.*, at 552.

¹⁵ See *id.*

¹⁶ See 44 Cal.4th at 553.

¹⁷ See *id.*

¹⁸ See *id.*

¹⁹ See *id.*

²⁰ See *id.*, at 554.

²¹ See *id.*

²² See *id.*, at 558.

²³ See *id.*, at 564-65.

Crawford represented a significant expansion of the duty to defend under California law. Construing California statutes, the court essentially imported into noninsurance cases the duty-to-defend rules developed in the context of insurance coverage. *Crawford*, however, was a typically straightforward case, where the alleged tortfeasor had been named as a defendant. Until *UDC*, it remained unclear how specific the allegations in a complaint had to be to trigger the indemnitor's duty to defend.

B. UDC

Like *Crawford*, the *UDC* case arose out of a California home construction project. UDC-Universal Development hired CH2M Hill to provide engineering and environmental planning services in connection with the development of a residential condominium complex.²⁴ As part of the construction contract, CH2M agreed to:

indemnify and hold Owner, Developer, and their respective officers, directors, employees and agents free and harmless from and against any and all claims, liens, demands, damages, injuries, liabilities, losses and expenses of any kind, including reasonable fees of attorneys, accountants, appraisers and expert witnesses, to the extent they arise out of or are in any way connected with any negligent act or omission by [C2HM], its agents, employees or guests, whether such claims, liens, demands, damages, losses or expenses are based upon a contract, or for personal injury, death or property damage or upon any other legal or equitable theory whatsoever. *Consultant agrees, at his own expense and upon written request by Developer or Owner of the Subject Property, to defend any suit, action, or demand brought against Developer or Owner on any claim or demand covered herein.*²⁵

In October 2001, the homeowners' association sued UDC for property damage arising from defective conditions at the condominium complex, due in part to "negligent planning and design of open space and common areas."²⁶ Discovery produced further evidence

of drainage problems, soil instability, erosion, settling, and other geotechnical concerns at the site.²⁷

In November 2006, UDC filed a cross-claim for indemnity against its various subcontractors, including C2HM. UDC also tendered its defense of the homeowners' association lawsuit in the cross-complaint, which C2HM rejected. During trial, but before the submission of the case to the jury, UDC moved for a directed verdict against C2HM on the duty to indemnify, citing the California Supreme Court's decision in *Crawford*.²⁸ The court reserved to itself any decision on the indemnity portion of the contract and submitted to the jury the factual questions of negligence and breach of contract.²⁹

The jury returned a unanimous verdict for C2HM, finding that it had not been negligent and had not breached its design contract. The court, however, found that the duty to defend was not dependent on the jury's finding with respect to indemnity. Holding that the parties' contract required C2HM to provide a defense "upon an allegation of some negligence in the manner in which the work was conducted," the court concluded that "a separate duty to defend must occur before the duty to indemnify arises."³⁰ The court ordered C2HM to reimburse UDC for the defense costs that UDC had incurred in defending the homeowners' association's claims related to C2HM's work.³¹

The Court of Appeal unanimously affirmed the trial court's decision, holding that C2HM's duty to defend was separate and independent from its duty to indemnify and that the Supreme Court's decision in *Crawford* compelled the result below.³² The court wrote:

[T]he indemnity and defense clauses pertained to separate obligations. If any "claim or demand covered herein" refers back to claims and demands identified in the indemnity clause, it obviously cannot be premised on a proven "negligent act or omission" by CH2M Hill unless there is first a finding of such negligence. As the trial court pointed out, requiring such a determination would render meaningless the defense obligation and contravene *Civil Code*

²⁴ See 181 Cal.App.4th at 14.

²⁵ See *id.*, at 18-19 (emphasis added).

²⁶ See *id.*, at 14.

²⁷ See *id.*

²⁸ See *id.*, at 14-15.

²⁹ See *id.*, at 15.

³⁰ See *id.*

³¹ See *id.*, at 16.

³² See 181 Cal.App.4th at 20-21.

section 2778 and the Supreme Court's admonition that a duty to defend arises out of an indemnity obligation as soon as the litigation commences and regardless of whether the indemnitor is ultimately found negligent.³³

In response, C2HM took the position that the homeowners' association's complaint was insufficient to trigger its duty to defend. C2HM argued that the plaintiffs in *Crawford* had at least asserted claims against the indemnitor itself; in contrast, here, the association made no allegations of defective performance against C2HM.³⁴

The court was not persuaded, noting that there was no requirement in the indemnification clause that claims against UDC arising "out of or in any way connected with" a negligent act or omission by CH2M explicitly name CH2M, before the defense obligation attached. Rather, the duty to defend applied to *any* "suit, action or demand brought against" UDC on *any* "claim or demand covered herein."³⁵

In a construction project involving multiple consultants and subcontractors, any of them might have been negligent. An indemnitee should not have to rely on the plaintiff to name a particular subcontractor or consultant in order to obtain a promised defense by the one the indemnitee believes is responsible for the plaintiff's damages.³⁶


In other words, the generalized allegations in the homeowners' association's complaint were sufficient to implicate CH2M's work, and UDC's subsequent cross-

claim was sufficient demand to trigger CH2M's duty to defend.³⁷

C. CONCLUSION

Viewed through the prism of *Crawford*, the UDC court's decision is understandable and, indeed, appears to be a logical evolution of what is now settled law in California.

Consistent with the *Crawford* court's recognition that indemnification contracts are different from insurance contracts, it seems reasonable to infer that indemnification contracts are unlikely to be construed against the indemnitor as strictly as insurance contracts are against carriers. Parties that expressly limit their "duty to defend" to reimbursement of defense costs, for instance, in cases where the indemnitor has been found negligent, are far more likely to have their agreement honored, even in a post-UDC world – provided that they clearly evidence that intention in contract wording. The reason is that the mutual intent of the parties should still govern, and that intent must be derived from the clear and unambiguous meaning of the words that the parties employed to define their agreement.

This much is clear: Understanding the basic contours of duty-to-defend law is now a necessity for those who would advise businesses and individuals that enter into indemnification agreements or whose contracts include contractual rights of indemnity. No longer is the broad scope of the duty to defend an issue reserved for the insurance context. 

³³ See *id.*, at 21-22.

³⁴ See *id.*, at 20.

³⁵ See *id.*

³⁶ See *id.*, at 21.

³⁷ See *id.*

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PROFESSIONALS: DON'T KNUCKLE UNDER WHEN A TRUSTEE WANTS TO CLAW BACK YOUR FEES

By Joe Kingma and John Bunyan*

The landscape is littered with bankrupt clients and those who may be about to become bankrupt. These are dangerous clients who pose special risks for professionals, especially lawyers and accountants. However, you do not want to abandon a client just because they may have been mortally wounded. Thus, many professionals end up doing work for clients who ultimately become insolvent.

Professionals with failing clients must keep in mind:

- (1) You don't want to facilitate or participate in any fraudulent conveyances;
- (2) You may not get paid for your work; and
- (3) Your litigation risk is growing dramatically and you may want to terminate your engagement to avoid further risk.

Often, professionals actually are paid at least some of what they are owed shortly before a bankruptcy filing. Once a bankruptcy is filed, you face an unusual decision tree. If you are owed money, you have to decide whether or not to file a proof of claim in the bankruptcy court. The debtor's schedule of liabilities and assets is often available online and you may be able to evaluate your chances of recovery while sitting at your desk. Filing a proof of claim may have the effect of ensuring that any malpractice claims brought against you will be brought in the bankruptcy court and not in a state or federal district court. Many defense lawyers would tell you that you are better off in a "regular" court than a bankruptcy court if you are defending malpractice claims. This is obviously a consideration you should take up with your lawyer. You need to evaluate your claim for fees, as well as your risk for a malpractice claim.

Even if you decide not to pursue recovery of unpaid fees, and even if no malpractice claim is brought by the trustee, you are not yet out of the woods. Trustees must recover assets of the debtor to repay creditors, and

many are very aggressive in their attempts to do so. Professionals, and others who have been paid by the debtor prior to bankruptcy, need to be concerned about actions claiming that:

- (1) Payment to the professional was an avoidable preference; or
- (2) Payment to the professional constituted a fraudulent transfer.

AVOIDABLE PREFERENCES

The rule against preferential payments is intended to keep debtors on the verge of bankruptcy from paying off favored creditors at the expense of other, usually unsecured, creditors. The trustee's burden of proving that a payment to a professional was an avoidable preference¹ requires a showing that:

- (1) The payment was made to or for the benefit of the professional;
- (2) The payment was made on account of a previous debt;
- (3) The payment was made while the debtor was insolvent;
- (4) The payment was made within 90 days of the filing of the bankruptcy petition (or within one year if the creditor was an insider); and
- (5) The payment allowed the professional to receive more than he would have if the debtor's estate was liquidated in Chapter 7 bankruptcy.²

The trustee does not have to prove the specific date when the debtor became insolvent because the debtor is presumed to be insolvent for the 90 days preceding the filing of a bankruptcy petition.³ This allows a trustee to make a broad claim that any payment from a debtor to a professional for services made in the 90 days before a bankruptcy petition is filed was a preference payment that belongs to the bankruptcy estate.

* Mr. Kingma and Mr. Bunyan are attorneys at Carlock, Copeland, Semler & Stair in Atlanta.

¹ 11 U.S.C. § 547(g).

² *Id.* § 547(b); *In re Globe Mfg. Corp.*, 567 F.3d 1291, 1296 (11th Cir. 2009).

³ 11 U.S.C. § 547(f).

If the trustee makes this initial showing, he does not automatically recover the payments. The burden then shifts to the professional to prove that the payments were not avoidable preferences. The most common defense for professionals who are trying to keep payments for services provided is to show that either:

The payment was made in the ordinary course of business; or

The payment was made according to ordinary business terms.

The “ordinary course of business” defense requires the professional to show that the alleged preference payments were no different than other payments received from the debtor.⁴ This is easier to show when the parties have an extensive history of dealing with each other. For example, imagine that the debtor and professional had been doing business with each other for 10 years and that the debtor paid every invoice from the professional within 30 days. If the debtor similarly made the alleged preferential payments within 30 days, then the professional has a strong defense that these payments were made in the ordinary course of business. But if the debtor waited 90 days to make these alleged preferential payments, then this argument is much tougher to make.⁵ As the Eleventh Circuit has explained, “[a] creditor who tolerates unusual delays in payment from a debtor on the verge of bankruptcy may be dependent on the debtor and aiding the debtor in forestalling the inevitable to the detriment of less dependent creditors.”⁶

The “ordinary course of business” defense can be used even where the parties do not have an extensive history of transactions together. The parties’ engagement agreement is the best evidence of what they intended an ordinary transaction to be.⁷ So if a professional can show that the parties agreed that invoices would be paid within 30 days and the alleged preferential payments complied with this agreement, then the professional may still prevail on the “ordinary course of business” defense.

The other common defense for a professional is to show that the payments were made according to “ordinary business terms.” For this defense, the professional must show that its transactions with the debtor were consistent with the way things are done in the industry.⁸ Instead of focusing exclusively on the history of dealings between the parties, this defense requires specific, objective data on payment practices in the industry.⁹ This often results in a battle of the experts on industry standards that creates a question of fact for the bankruptcy court to decide.

FRAUDULENT TRANSFERS

If a trustee cannot show that a payment to a professional was an avoidable preference, it can also claim that a payment or debt is avoidable as fraudulent. Payments made or debts incurred within two years of filing for bankruptcy may be recovered by the Estate as fraudulent.¹⁰

There are two ways for a trustee to make this claim. He can argue that the debtor made the payment or incurred the debt with an actual intent to defraud its creditors.¹¹ This type of claim can succeed only where the trustee has evidence of a fraudulent intent. In most situations, it is unlikely that the trustee will have this “smoking gun.”

Professionals are more likely to face a claim of “constructive” fraud, which means that a payment made or debt incurred is assumed to be fraudulent under certain circumstances.¹² A payment to a professional can be constructively fraudulent if the debtor is, or is about to be, insolvent and the value the debtor received in the exchange is too low.¹³

This burden is not quite as easy for a trustee to meet as the initial burden for preferences. There is no presumption that a debtor was insolvent for a certain time period for a fraudulent payment claim, so the trustee must actually show that the debtor paid after the debtor became insolvent. Also, the trustee must show that the debtor did not get its money’s worth out of the transaction. This may be easy if the debtor paid an

⁴ *In re Globe Mfg. Corp.*, 567 F.3d at 1298.

⁵ *Id.* (“[U]ntimely payments are more likely to be considered outside the ordinary course of business and avoidable as preferences.” (quoting *In re Craig Oil*, 785 F.2d 1563, 1567-68 (11th Cir. 1986)) (alteration in original)).

⁶ *In re Issac Leaseco, Inc.*, 389 F.3d 1205, 1212 (11th Cir. 2004).

⁷ *In re Globe Mfg. Corp.*, 567 F.3d at 1298.

⁸ *Id.*; *In re Issac Leaseco, Inc.*, 389 F.3d at 1210.

⁹ *In re Globe Mfg. Corp.*, 567 F.3d at 1298.

¹⁰ 11 U.S.C. § 548(a).

¹¹ *Id.* § 548(a)(1)(A).

¹² *In re Chase & Sanborn Corp.*, 813 F.2d 1177, 1180 n.2 (11th Cir. 1987).

¹³ 11 U.S.C. § 548(B).

accountant \$50,000 to print a tax document from the IRS's website and mail it to him. While most transactions are not so obviously fraudulent, a trustee often can present enough evidence on this ground to create a question of fact that will survive summary judgment.¹⁴

If the trustee can show insolvency and inadequate value, the professional has the burden of showing that a payment received or debt owed is not fraudulent. The most common defense is that the professional (1) received the payment or obligation to pay, (2) for value and in good faith, and (3) in exchange for value it gave to the debtor. Again, this defense centers around the question of "value." For purposes of these types of fraud claims, "value" means property or satisfaction of a present or existing debt of the debtor.¹⁵ In simple terms, a professional should be able to succeed in defeating a fraudulent transfer claim if he received the payment in exchange for services provided to the

debtor at a reasonable price. Professionals should try to show a lengthy history of similar payments for similar services before the debtor became insolvent. They might also show similar charges to other clients who were not insolvent.

CONCLUSION

Professionals must be wary of clients in failing financial circumstances. Once a client goes into bankruptcy, you are unlikely to receive payments for fees that were owed at the time the Petition was filed. That does not mean, however, that you must give in to a trustee who would like to assert claims for avoidable preference or fraudulent transfer. Just because a trustee asserts the claim does not mean that he or she will prevail. Particularly if the amount of fees sought in the claw back is substantial, you should consider fighting back to protect the fees that you have earned. ⚖️

¹⁴ *In re Chase & Sanborn Corp.*, 904 F.2d 588, 593 (11th Cir. 1990).

¹⁵ 11 U.S.C. § 548(d)(2)(A).

TOXIC CLIENTS...

Continued from page 1

demand an unwarranted amount of attention. Further, she can cause financial problems for you and your firm by refusing to pay bills or by presenting a looming threat of a legal malpractice action. Although malpractice claims appear to be statistically unavoidable,² increased legal malpractice claims lead to higher insurance premiums, which impinge on the firm's financial success, reputation, and overall well being.

We focus below on how to identify and avoid a toxic client before it is too late, and how an attorney can extricate herself from difficult situations with an existing toxic client when problems arise after a relationship has been formed. Handling these delicate issues with finesse and caution may avoid future litigation with the toxic client related to collection of fees and legal malpractice claims.

RED FLAGS HELP IDENTIFY A TOXIC CLIENT BEFORE RETENTION

Toxic clients tend to have several common characteristics, which immediately should present as "red flags" to an attorney engaged in the pre-client screening process. "Red flags" include a potential client who:

(1) is a professional litigant; (2) has a demonstrated history of problems with attorneys; (3) is coming to you presenting an imminent deadline or an immediate emergency; (4) plays on your sympathies; (5) comes to you with unrealistic expectations; (6) is being controlled by a third party; (7) acknowledges the existence of a disadvantageous factual or legal position but professes not to care; (8) skimps on legal research, motion practice or important tasks in a quest to save money; (9) won't listen to professional advice when it is given; (10) demonstrates a pattern of refusing to take responsibility for his or her previous decisions; and (11) wants to engage in multiple representation. Another significant red flag is the client who immediately engages the attorney in a dispute over the terms of the representation, such as a retainer to be paid or the hourly fee to be charged.

In order to effectively identify these potentially dangerous and demanding clients, it is important to have effective screening prior to accepting the representation in question. The initial interview is extremely valuable and should not be overlooked or minimized. It needs to be handled by an attorney, and it should be in person. The potential client should be asked to bring all pertinent documents related to her case, and if she was formerly represented by a different attorney, you should

² On average, an attorney is sued for legal malpractice approximately three times during his or her legal career. James M. Fischer, *External Control over the American Bar*, 19 GEO. J. LEGAL ETHICS 59 (Winter 2006).

contact the former counsel to discuss the case and the client. This can be an invaluable, eye-opening process that will identify the dynamics of the representation before problems arise. It allows the attorney to objectively gauge whether the potential client may become problematic.

The “Professional Litigant”

“The most important thing in their lives was to have a lawsuit going. It was not a question of winning or losing it, and indeed it was vital to do neither, for otherwise the suit would be over and done with. A lawsuit was part of the personality, if not the only visible sign of it, to such an extent that there was often no real animosity between the litigants, because they both needed each other.” - Salvatore Satta

Typically a “professional litigant” is one who has been involved in litigation on a regular basis for more than five years. He may have been involved in more than one litigated matter, and he is usually inordinately occupied with the facts and details of the litigation. Because the litigant has spent years of his life in litigation, he has experienced trials, appeals, and has been represented by a sequence of different attorneys. This type of client tends to obsessively focus on the details of the case and all players involved. The purpose of the professional litigant’s life has become litigation.

An important question to ask at this stage of the screening process is how the professional litigant client was accepted by a trier of fact in a prior case. Did the judge or jury react poorly to the client? That fact can speak volumes as to why the client is a repeat litigant. The client may be frustrated with the legal process or may feel that the system is out to get him, but he may be the driving force behind his own problems. There is a significant likelihood that the case at hand will end the same way.

A professional litigant also may come to feel that he should be prosecuting his own case. He second-guesses his retained attorney, fails to heed advice to settle from counsel or neutral third parties such as mediators, and generally becomes dissatisfied with any lawyer who does not dedicate her entire life to his case. The professional litigant also tends to become irrational with his expectations for the litigation. He

has intermingled so much of his identity with the fight that he will accept nothing less than a complete victory. He feels certain about the “correct” outcome and believes he can steer the process to a pre-determined result. The professional litigant’s emotions drive his decisions and prevent him from accepting an objective assessment of the case from any source. He will then disregard case law that is contrary to his position as being irrelevant.

A professional litigant abhors his opponents and has such a deep-rooted hatred for them that he may wish to engage in litigation simply to harass the potential opposing party. Rules of Professional Conduct³ preclude an attorney from accepting a client with this type of objective. Common sense also suggests that you should hesitate to represent this type of client.

History of Disputes with Former Attorneys

“To make no mistakes is not in the power of man; but from their errors and mistakes the wise and good learn wisdom for the future.” - Plutarch

Another common characteristic of a toxic client is that she has a demonstrated history of problems with attorneys. This can manifest itself in disputes with former attorneys related to legal fees (the client simply refuses to pay the fees or repeatedly questions the merit of particular fees and services performed by the attorney), in legal malpractice claims, or other disputes with former attorneys regarding strategy.

Somewhat surprisingly, many attorneys who accept such clients fail to ask why the prior professional relationship terminated. If the client retained a number of attorneys, why did she move from one to the next? There is a distinct danger in this area associated with hubris – every attorney thinks she is smarter than the last and able to handle the client/situation when the prior attorney could not. However, what can you do with the client who will never be satisfied with any lawyer? Learn that such people exist and develop skills to recognize them and avoid them. You will likely not succeed in pleasing a toxic client, even if you prevail on their behalf.

While you may not be able to learn in the initial interview that the client is problematic with an issue

³ California Rule of Professional Conduct 3-200 provides:

A member shall not seek, accept, or continue employment if the member knows or should know that the objective of such employment is:

(A) To bring an action, conduct a defense, assert a position in litigation, or take an appeal, without probable cause and for the purpose of harassing or maliciously injuring any person; or

(B) To present a claim or defense in litigation that is not warranted under existing law, unless it can be supported by a good faith argument for an extension, modification, or reversal of such existing law.

such as fees, you may be able to infer that problems have existed if the potential client has cycled through a series of different attorneys. If former attorneys have withdrawn from representation of this client, or if the client has inexplicably fired several various attorneys, you should be wary of representing this type of client. Ask the client why the prior professional relationship ended.

The client has probably set unrealistic and demanding expectations for the attorney, and as she has done in the past, she will likely continue to do so in the future.

Imminent Deadlines And Clients Playing On Sympathy

Sometimes during an initial interview with a potential client, it will become clear that the client has an imminent deadline driven by either a statute of limitations, factual development in the matter, or a legal issue that must be immediately addressed. At other times, a potential client may make an initial contact with you providing a quick summary of the facts through an email or voicemail, and you may not be able to immediately respond.

Be extremely cautious in these circumstances. It is likely the prospective client is omitting negative facts about the matter in a bid to entice you into accepting the case. In a worst-case scenario, the client could miss his deadline, and blame you for failing to take action on his behalf. The client might argue that he was relying on you to act on his behalf, even though it was not clear to you that you had agreed to do anything. Avoid this type of conflict by making clear to the potential client that you are not intending to act on his behalf until you have decided to accept the case and until a fee agreement has been signed. If you do not wish to represent the client, you should immediately notify him of any imminent deadlines you discovered and clearly advise the potential client in writing that you are not choosing to represent him in the matter.

With an imminent statute of limitations deadline, you may believe the potential client is best served if you prepare a Complaint on her behalf to preserve the statute of limitations, and then withdraw from representation after it is filed. However, your subsequent withdrawal as attorney of record may cause more problems, because subsequent attorneys will question the client about reasons for your withdrawal, and the client may still claim malpractice as to the manner in which

the Complaint is drafted. If you feel the potential client is not one you wish to represent, or a red flag appears, you are better served by not performing any legal services on the client's behalf.

Also be aware that a very demanding client who expects you to jump through hoops with very little time may continue to expect you to drop all of your other personal and professional obligations going forward with the representation. Setting the bar early by agreeing to these unreasonable demands will likely lead to continued difficulties in this regard during the representation.

The potential client who plays on your sympathy may be manipulative and misrepresenting facts in order to persuade you represent them. It is important to consider whether there is merit to the case based on documents and communications with his/her former attorneys and to be guarded about tactics to garner your sympathy.

Making misrepresentations to the Court or to other parties on the client's behalf is, of course, a very serious ethical concern. Attorneys should ask when accepting new clients whether this is a person who will cooperate in discovery, including producing documents, appearing at deposition, and responding to written interrogatories. In an era of expanding obligations, particularly as to electronic discovery information, uncooperative clients carry distinct and different risks for attorneys. The bigger the client's fight with the adversary – the bigger such risks can become.

Third-Party Control

Some potential clients come with very involved third parties who attempt to control the course of the litigation.⁴ A typical controlling third party is a potential client's child, spouse, sibling, or partner. In these types of cases, be sure to fully communicate with the potential client outside of the presence of the third party to preserve the attorney-client confidentiality. Evaluate the third party's reaction to this type of meeting and determine whether the third party's relationship with the potential client will create additional problems for you. If the third party insists on intervening, he may destroy the attorney-client privilege and effectively dismantle your case.

You should also be aware of your jurisdiction's disclosure and waiver rules regarding the conflicts inherent in one person paying the costs associated with your representation of another person. In California,

⁴ This is referring to a third party who is not an insurer funding the litigation pursuant to an applicable policy.

Rule of Professional conduct 3-310(F) addresses this situation and precludes such a representation unless: (a) there is no interference with the attorney's professional judgment on the attorney-client relationship; (b) the client's confidential information is protected; and (c) the attorney receives the client's informed written consent.

Also, be aware that when the interests of the third party diverge from the interests of the potential client, the third party may try to steer the course of the litigation, even when it conflicts with the advice you are providing to your client. Assuming the advice you are providing your client is kept confidential (and not shared with the third party), the third party may be evaluating your performance without a full understanding of the facts. If the third party is funding the litigation on the client's behalf, and he disagrees with you, this conflict could prejudice your potential client.

Similarly, when a potential client seeks to have you participate as co-counsel on a matter, communication with the client and decisions relating to the direction of the case may become more difficult. In these multiple representation situations, costs and fees may be significantly increased, creating some potential client resentment. The client may either refuse to pay fees, or ask you to perform limited services or minimize fees, which may reduce your effectiveness on the case. Co-counsel representations may also lead to situations in which the retained attorneys disagree about a course of action, which could also compromise the client's case.

MANAGING EXPECTATIONS AND SETTING THE SCOPE OF THE REPRESENTATION WHEN A RED FLAG IS DETECTED

Following a detailed screening interview in which the attorney encounters a client who raises "red flag" issues, it is important to examine your motives for wanting to proceed with the representation. Determine whether your motives are financial, i.e., the case presents the potential for a large fee; or based on ego (you believe you could perform better than the prior attorneys). If your reasons are wrapped up in your ego, you should reconsider. You risk facing years of problems with a toxic client, with benefits that will be much less than the potential reward.

If you still intend to proceed with the representation, you may limit the scope and severity of potential

problems by clearly and effectively managing the client's expectations prior to engaging in the representation. This should be done verbally as well as in writing. The potential client must understand and agree to the scope of the representation that you are willing to provide.

The attorney-client fee agreement is the more important document in the file!⁵ The initial letter to the client and/or the agreement should clearly set forth the parameters of the representation that you are agreeing to provide to the client. It can be used to explain the uncertainties of litigation, and the terms upon which the representation may end. If the representation could arguably extend to various areas of law that you do not wish to pursue, be sure to explicitly note which tasks you will not be performing. If the representation is for more than one party, conflict waivers are essential.⁶

During the course of preparing these documents, if the potential client refuses to cooperate, or objects to the scope of representation you are willing to provide, you should not agree to represent this client.

AFTER THE RETENTION: MANAGEMENT OF THE TOXIC CLIENT

"Insanity is often the logic of an accurate mind overtaken."- Oliver Wendell Holmes

After you have commenced representation of the client, you may learn that you missed red flags in the screening process. Or, while you may have initially suspected there was a problem, you underestimated the challenges it would create. The situation has now spiraled out of control and the client has become unmanageable and troublesome.

Several types of problems can lead to the conclusion that the client has become toxic: (1) your client refuses to pay your bills or stops paying you; (2) your client wants to re-negotiate the terms of your retention; (3) you learn through the course of the representation that the client is inaccurate or untruthful; (4) your client overburdens you with correspondence, emails, and/or phone messages which mischaracterize your conversations and advice; or (5) your client is trying to out-lawyer you or fails to follow your advice.

If any of these situations arise, you should immediately take control of the situation. Utilize correspondence to detail the problems you are having, the efforts

⁵ California attorney-client fee agreements must comply with either California Business and Professions Code §6147 (for contingency fee agreements) or §6148 (for hourly agreements). Client agreements that provide a lien on fees (including contingent fee agreements) also require that the attorney comply with Rule of Professional Conduct 3-300. The attorney must advise the client in writing that he/she should seek the counsel of an independent attorney.

⁶ California Rule of Professional Conduct 3-310(C).

you have made to resolve the problems, and what your plan is to resolve the dispute. When corresponding by letter or email, think how your communication might be portrayed to a jury that may later be called upon to evaluate your conduct and professional judgment within the confines of a legal malpractice action. The toxic client poses an acute risk for the eventual manifestation of a malpractice claim. The existence of well-written communication eliminates the potential for a "he-said, she-said" dispute, which tends to be the foundation of many malpractice claims raised by the toxic client. In the case of a client who is bombarding his attorney with letters, they must be responded to in one form or another. If the client correspondence appears intended to set the attorney up for a later malpractice claim, be forthright and professional in your responses, encourage the client to meet or call you to discuss case or transaction strategy, and discourage a letter writing campaign that distracts from your providing the actual legal services that are within the scope of your retention.

If your client is not paying your bills, or appears to be deliberately paying you slowly, politely inquire and document these communications. Provide a schedule outlining your plan to withdraw unless the problem is corrected. It may be time to consider withdrawal from representation.

Also be attuned to clients who are financially self-destructive. They may become "slow pays" by virtue of their litigant approach to business and may be on a downward spiral. If the client's business fails, it is not uncommon for the client (or a subsequent trustee or liquidator) to assert claims against the professionals the client has previously retained. Keep tabs on why the client may not be keeping current with his bills.

If your client wants to re-negotiate the terms of the representation and you agree, be sure to comply with all rules regarding such an amendment. For example, Rule of Professional Conduct 3-300,⁷ which applies to

all contingency fee agreements between an attorney and his/her client,⁸ requires the attorney to advise the client *in writing* to seek the advice of an independent attorney and requires the client to consent *in writing*. Thus, in order to effectively re-negotiate the terms of a contingent fee agreement, the parties must comply with these strict requirements.⁹

If you feel that your client is being untruthful, or mischaracterizing your statements either verbally or in writing, document what actually occurred. Take steps to ensure that your file for this client is complete and that all documentation relating to that client is accurate. Also, if you learn that your client has misled you into believing his/her case has merit, and it actually does not, you have an obligation to withdraw from representation under Professional Rule of Conduct 3-700.

In any situation in which your client makes you feel as if you are being "set-up," be sure to document the facts as they exist, and consider withdrawing from representation of that client. Know what your professional liability insurance policy says with respect to what constitutes a claim, and when and how to report a claim. Your insurer can be an important resource for helping you through a difficult situation. Some carriers even have risk management hotlines you can access on difficult client relations issues.

EXTRACTING YOURSELF FROM THE REPRESENTATION OF A TOXIC CLIENT

When problems persist with the toxic client, the attorney may need to withdraw from the representation.¹⁰ In order to withdraw properly, you must ensure that the client's files are in order, and that no prejudice will result to the client upon your withdrawal. Comply with all rules of conduct related to withdrawal.¹¹ This typically means that you time your withdrawal in a manner which enables the client to obtain new counsel before any substantive action need be taken, and that you advise the client of all pending issues and deadlines.

⁷ Rule of Professional Conduct 3-300 provides:

A member shall not ... knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and

(B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

⁸ *Fletcher v. Davis*, 33 Cal.4th 61 (2004).

⁹ Failure to comply with these rules may render the attorney's lien unenforceable. *Passante v. McWilliam*, 53 Cal.App.4th 1240, 1248 (1997) (Lawyer failed to advise the client to obtain independent counsel prior to entering into a business agreement; client not required to honor oral promise to give attorney 3% of the stock in company).

¹⁰ Pay close attention to your motives for resisting withdrawal, especially if they are related to money.

¹¹ California Rule of Professional Conduct 3-700 applies to withdrawals in California. It states, in pertinent part:

(A)(2) Take reasonable steps to avoid foreseeable prejudice to the client, including giving notice to client, allowing time for employment of successor counsel, complying with 3-700(D) and other laws and rules.

If the client refuses to allow you to substitute out, you must file a motion for withdrawal, providing full notice and disclosure of the reasons for the withdrawal. If your reasons require the disclosure of any confidential attorney-client communications, file the motion for withdrawal under seal with the Court.

Immediately upon completion of withdrawal (either through court order, signing a substitution of attorney,¹² or upon completion of the representation), you should do two things: (1) promptly return all client papers and property to the client;¹³ and (2) promptly refund any part of a fee that was advanced but was not yet been earned.¹⁴ However, particularly when you have a toxic client, you should keep a complete copy of the file for yourself. While this necessarily requires you to incur an additional cost for copying, it is money well spent. The effort should include collecting copies of all emails exchanged, saved text messages from your cellular phone, transcripts of voicemail messages, and any other notes in your possession documenting communications, so a complete record of communication with the client is available for future reference purposes. These documents are invaluable in a malpractice defense.

If you do not have a court document evidencing the date your representation was terminated, send a certified letter to the client clearly stating that you have completed your representation of that client. The letter returning documents, or offering to return documents if the case is over, presents a convenient opportunity to send this type of correspondence. This will commence the applicable statute of limitations without any uncertainty.

Resist the urge to sue for any unpaid fees until more than a year has passed from the last date of your representation. Do not assume that there will be no malpractice action, even if you prevailed on behalf of your client. Although toxic clients are usually appeased by good results, a positive result does not always foreclose a malpractice action against you.

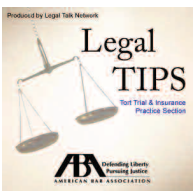
CONCLUSION

In the long run, it is better to avoid the representation of a toxic client rather than to mire yourself in a painful representation and then face certain litigation. Be vigilant in the screening process and you may avoid these dangerous and frustrating clients. These situations can be recognized, and managed, and there are resources available to help you in both areas. ⚖️

¹² Resist the urge to disparage your former client. You may be contacted by potential successor counsel and you should consider carefully what you say about your former client.

¹³ California Rule of Professional Conduct 3-700(D)(1).

¹⁴ California Rule of Professional Conduct 3-700(D)(2).



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