

When 'Circumstances' Give Us Pause: What Should Be Reported to Insurers?

We used to learn, when the virtues of the law were discussed openly, that for every wrong there was a right. At times now, litigants seem more motivated by a search to shift a loss rather than try to right any actual wrongs. Attorneys are faced with situations where they fear potential liability before a claim is actually made, often from unfounded worry about their work. Horror stories abound of the increases in liability and the amount of verdicts against law firms. Anecdotal and empirically there may be little to sustain the fear of such liability.



Patrick A. Cathcart

Nevertheless attorneys often feel uneasy about an act or a "judgment call" made in the course of representing difficult clients. Judgment calls are, we know, the result of careful analysis and prudent reasoning in light of our experience. But when we lose, the deal does not close, the transaction goes awry, or the initial

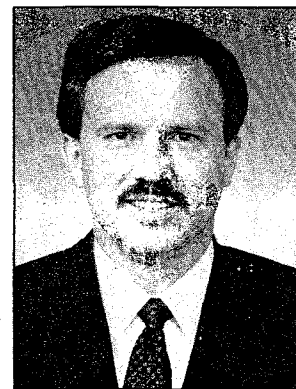
offering results in a bad investment, the public — client and non-client — claims that we did not meet our applicable standard of care. This article will explore a few practical aspects of reporting or tendering malpractice claims when there are no real coverage issues (and assuming without discussion that a "joint defense" privilege applies).

What is a "circumstance" as opposed to a claim? When should a "circumstance" be tendered to the firm's insurer? What hap-

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Section 473 and Mandatory Relief From Default: An Ethical Minefield

For more than 100 years, California courts have been empowered to give discretionary relief from defaults, dismissals, and virtually any other order entered in the course of litigation. Obtaining such relief has traditionally required the moving party to act promptly (under a long-recognized diligence and timeliness requirement) and to demonstrate that the challenged order was the *excusable* result of mistake, inadvertence, surprise, or excusable neglect. If the moving party failed on either the timeliness or the excusability prongs, relief would be denied, and the injured client would be relegated to a malpractice claim against the attorney involved. Extensive case law interpreting and applying the discretionary relief provisions of Section 473 of the Code of Civil Procedure developed over the years, and the relatively narrow boundaries for relief became well known.



Geoffrey L. Bryan

All of this changed, beginning in 1988. In that year, with little fanfare and seemingly little notice from the bench and bar, the Legislature amended Section 473 to add provisions for *mandatory* relief from a default judgment. In subsequent amendments, defaults (prior to default judgment) and dismissals were added to the mandatory relief list. Yet, based on both the relative paucity of appellate cases addressing the mandatory relief provisions and this author's own informal survey of judges and practitioners, these mandatory provisions appear to be one of the better kept secrets of California litigation practice.

This is surprising, given the power of these new provisions. Gone from them is any concept of *excusability*; instead, the only requirement is that the attorney of record at the time of the challenged order must submit an "affidavit of fault" acknowledging his or her own blame for the default or dismissal. Provided that a motion based upon an affidavit of fault is filed within the statutory time limit — within six months after entry of judgment — and provided that the Court is satisfied that the attorney's acts or omissions in fact caused the default or dismissal, then the granting of relief is *mandatory*. The tradeoff comes from an array of optional and mandatory penalties to be imposed by the court on the attorney who submits such an affidavit of fault.

This article will briefly survey the new mandatory-relief provisions of Section 473. It will then pose a thought-provoking

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question: In a situation where a California lawyer is eligible to request mandatory relief, can he or she ever seek only discretionary relief?

The Statutory Provisions

The basic mandatory-relief language appears in the middle of the third paragraph of Section 473:

Notwithstanding any other requirements of this section, the court shall, whenever an application for relief is made no more than six months after entry of judgment, is in proper form, and is accompanied by an attorney's sworn affidavit attesting to his or her mistake, inadvertence, surprise, or neglect, vacate any (1) resulting default entered by the clerk against his or her client, and which will result in the entry of a default judgment, or (2) resulting default judgment or dismissal entered against his or her client, unless the court finds that the default or dismissal was not in fact caused by the attorney's mistake, inadvertence, surprise, or neglect.

The balance of the third paragraph, together with the fourth paragraph, sets out the "quid pro quo" accompanying mandatory relief:

The court shall, whenever relief is granted based on an attorney's affidavit of fault, direct the attorney to pay reasonable compensatory legal fees and costs to opposing counsel or parties.... Whenever the court grants relief from a default, default judgment, or dismissal based on any of the provisions of this section, the court may: (1) impose a penalty of no greater than one thousand dollars (\$1,000) upon an offending attorney or party, (2) direct that an offending attorney pay an amount no greater than one thousand dollars (\$1,000) to the State Bar Client Security Fund, or (3) grant other relief as appropriate.

Finally, the fifth paragraph of Section 473 makes clear that the mandatory relief is not conditional upon *compliance* with these sanctions:

However, where the court grants relief from a default or default judgment pursuant to this section based upon the affidavit of the defaulting party's attorney attesting to the attorney's mistake, inadvertence, surprise, or neglect, the relief shall not be made conditional upon the attorney's payment of compensatory legal fees or costs or monetary penalties imposed by the court or upon compliance with other sanctions ordered by the court.

Basic Application of the Statute

Although only a handful of appellate decisions have considered the mandatory relief provisions of Section 473, a number of fundamental principles have been established. Here are some of the most important:

If the Statutory Requirements Are Met, Relief Is Mandatory. Although the original, discretionary provisions of Section 473 provide that the court "may" relieve a party from a judgment, dismissal, order, or other proceeding taken against him, the mandatory provisions state that the court "shall" grant relief if the conditions are met. Case law affirms the mandatory nature of this relief. *E.g., Billings v. Health Plan of America*, 225 Cal. App.3d 250, 256 (1990); *Beeman v. Burling*, 216 Cal. App.3d 1586, 1605 & n.14 (1990). Legislative materials quoted in the above cases reflect a strong view by legislators that (a) courts with crowded calendars were overly reluctant to grant relief from defaults, and (b) the remedy of a malpractice claim by a client against his or her own lawyer was unsatisfactory and only added to the burdensome civil case load.

Only Defaults, Default Judgments, and Dismissals Are Covered. The courts have construed the mandatory relief provisions quite strictly, and have refused to apply them by analogy to anything outside of the enumerated events of defaults, default judgments, and dismissals. Thus, for example, the failure to make a timely request for trial *de novo* following judicial arbitration was held not to be eligible for mandatory relief under Section 473, even though the result was an unfavorable judgment. *Ayala v. Southwest Leasing & Rental, Inc.* 7 Cal. App.4th 40 (1992); *see also Tackett v. City of Huntington Beach*, 22 Cal. App. 4th 60, 65 (1994) (mandatory relief provisions of Section 473 do not carry over to Government Code Section 946.6). Accordingly, an attorney dealing with situations outside the three enumerated grounds for mandatory relief must continue to rely on the traditional discretionary grounds for relief, requiring satisfaction of the timeliness and excusability standards.

Only the Actual Attorney of Record Can Sign the Affidavit of Fault. The statute does not allow a successor attorney to point the finger of blame at his or her predecessor, under oath or otherwise. Rather, only the actual attorney of record at the time of the default or dismissal can invoke the mandatory relief provisions by submitting an affidavit of fault. *See Rogalski v. Nabers Cadillac*, 11 Cal. App.4th 816, 821 n.5 (1992). When a new attorney comes in to pick up the pieces, therefore, it will often be critically important to track down the previous attorney and use whatever persuasion is necessary to get that attorney to execute the affidavit of fault. Otherwise, in the discretionary relief realm, the prospects for relief are far less certain.

The Court Is Not Concerned With the Reason For the Attorney's Mistake or Neglect. Because the mandatory provisions do not call for the court to inquire into whether the attorney's acts or omissions were excusable or not, there is really no occasion to examine the attorney's conduct, *except* to satisfy the statutory requirement that the attorney's conduct actually caused the default, default judgment, or dismissal. *Billings, supra*, 225 Cal. App. 3d at 256. This causation requirement is said to address the possibility that an attorney might be "covering up" for his or her client, *see, e.g., Rogalski, supra*, 11 Cal. App.4th at 821, although no court has yet managed to articulate what such a "cover-up" might actually involve.

There Is No Diligence Requirement. Assuming the other requirements are met, the statute provides for mandatory relief "whenever an application for relief is made no more than six months after entry of judgment." This phrase is introduced by the statement, "[n]otwithstanding any other requirements of this section," which presumably overrides the requirement for discretionary relief that an application "shall be made within a reasonable time." Thus, so far as anyone can see, there is no diligence requirement for mandatory relief.

The Weil & Brown treatise, *Civil Procedure Before Trial*, has lamented this apparent legislative oversight for several years, and has hinted that "corrective legislation is likely." R. Weil & I. Brown, *Civil Procedure Before Trial* (The Rutter Group 1994) 5.300.1. The legislature has ignored this hint so far, however, and at the present time, mandatory relief under Section 473 appears to be available on an open-ended basis until six months after entry of judgment. A recent case, *Caldwell v. Methodist Hospital*, 24 Cal. App.4th 1521, 1525 (1994), seems at first blush to suggest that a diligence requirement might apply to mandatory relief, but a close examination of the case shows that the attorney seeking relief from default apparently based his request on a claim of excusable neglect, not an affidavit of fault. *Id.* at 1524.

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The Ethical Dilemma

Given the relative certainty of the mandatory relief provisions, why would an eligible attorney (that is, one whose own conduct "caused" the entry of a default, default judgment, or dismissal) hesitate to invoke these provisions? Some may not know about it. For those who do, the answers are not hard to figure out. First, when the mandatory relief provisions are invoked, the attorney at fault is subject to a variety of sanctions, including compensatory legal fees to the opponent, penalties payable to the State Bar Client Security Fund, and "other relief as is appropriate." Second, the attorney's own reputation may suffer, and his conduct may be referred to the State Bar or other agencies if the judge so chooses. Thus, even though the lifting of a default or the reinstatement of a dismissed plaintiff's case may protect the attorney at fault from more serious malpractice liability, the cost may nonetheless be significant.

In the face of these considerations, an attorney who believes he or she has good grounds to demonstrate excusability may wish to invoke the discretionary provisions of Section 473 (requiring both timeliness and excusability), rather than invoking the mandatory relief provisions. The problem is, of course, that there can be no assurance that a judge will exercise favorably his or her discretion under Section 473, no matter how strong the facts supporting the application for relief may be. If the trial court rules unfavorably, there can be no assurance that an appellate court will view the judge's ruling as an abuse of discretion, and it is certainly cold comfort for a client to wait one or more years for such an appeal to be prosecuted (especially if a supersedeas bond must be posted in the face of a default judgment). Thus, in the view of this author, serious ethical problems would arise whenever an attorney failed to invoke mandatory relief provisions if they were available.

On the other hand, it seems unduly harsh to require an attorney to fall on his own spear in a situation where the likelihood of discretionary relief is high: that is, where the excuse is a good one, the attorney moves promptly to seek relief, and the opposing party will suffer no meaningful detriment from the granting of relief. There are two possible strategies.

Strategy one would involve filing for discretionary relief first and, if such relief was denied, filing a follow-up motion for mandatory relief. Although there appear to be no cases saying this cannot be done, this strategy smacks of gamesmanship, and may run a risk that the second motion will be denied on the grounds that it is based on matters that could have been presented in the first motion. Cf. *Wyoming Pacific Oil Co. v. Preston*, 171 Cal. App.2d 735, 742 (1959); Code of Civil Procedure § 1008.

Strategy two seems less risky, if more cumbersome, and this author believes it will emerge as the more standard procedure in cases of this kind. In this strategy, the attorney would seek discretionary relief in the first instance, but request mandatory relief in the alternative if the court finds, for whatever reason, that the requirements for discretionary relief have not been met. Thus, an attorney seeking relief would submit an affidavit outlining the factual basis leading up to the default, default judgment, or dismissal, setting forth facts to support the necessary findings of diligence and excusability for purposes of discretionary relief. The affidavit would go on to say, however, that the attorney accepts full responsibility for the default, default judgment, or dismissal, and that if the court finds that discretionary relief is not available, then the attorney requests and is

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The Retainer Agreement: The Ethics and Practicalities of Getting Paid

I know of a lawyer who swears that he can tell within ten minutes of the first meeting between a lawyer and a new client whether their relationship will end in a fee dispute. While this may be boastful talk, it is true that what transpires at the very outset of the attorney/client relationship will have a definite bearing upon how smoothly the relationship will proceed thereafter, and especially upon one of the most important aspects of the relationship for the attorney — getting paid.

This past year, the California State Bar Committee on Mandatory Fee Arbitration has been teaching a course at the Section Institutes and the State Bar Convention entitled: "The Retainer Agreement and Good Client Relations — The Keys to Getting Paid." What follows is a personal distillation of some of the pearls of wisdom from this course, and some other important fundamental, yet all too often overlooked, keys to getting paid the fees you so justly deserve.



Joel Mark

The Retainer Agreement

The first and most important key to getting paid is the initial retainer agreement. Business and Professions Code §§ 6147 and 6148 specify when an attorney must have a written retainer agreement with the client and what must be included in the agreement. The failure to obtain a written agreement at the outset of the relationship will result in the limitation of the attorney's compensation to a "reasonable fee" which, as the attorney will find out usually too late, like beauty, is something which exists in the mind of the beholder (which most often will be a fee arbitration panel or, worse yet, a jury of your client's peers).

The conscientious attorney (aren't we all?) will want to obtain the client's informed written consent to the terms of the representation at the very outset of the relationship. The failure to explain the terms of the representation and to obtain the client's consent in the beginning may subject the attorney who later attempts to obtain the client's written consent to a charge of violating California Rules of Professional Conduct, Rules 3-300, *et seq.*, respecting attorneys entering into contracts with their clients.

Section 6148 has a number of exceptions which seem to excuse the attorney from ever having a fee agreement (i.e., with corporation, in emergencies, etc.); but, the better practice is to have a written fee agreement in all cases. Many collection agencies will not take on a fee collection assignment without a retainer agreement and, in the absence of a written fee agreement, the fee arbitration panel usually will supplant the agreed upon charges with their own estimation of a "reasonable fee" in any event.

A good resource for form fee agreements is CEB's Fee Agreements Forms Manual or the State Bar's model fee agreements pamphlets. It is recommended strongly, however, if you use any form agreements, that you tailor them specifically to each mat-

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ter rather than copying them verbatim. With modern word processing technology, it should be no trouble to tailor your agreement to the specifics of each matter; and, it almost always is a good idea to do so.

The need for a written communication to the client is no less immediate when the representation is declined by the attorney. Failure of the attorney to advise the rejected client of his, her or its rights with respect to the running of the statute of limitations, for instance, may result in malpractice liability to the attorney in the event that the client does not find alternate counsel before the statute runs out. See, *Miller v. Metzinger*, 91 Cal. App.3d 31 (1979).

Know Thy Client

The first thing the attorney must determine prior to preparing the retainer agreement is just who is the client and who will be paying the bill. Problem areas are juveniles, and criminal and family law cases, where a guardian, spouse or friend will be responsible for the bill. The attorney must clarify that the third-party payor will be responsible to pay the bill yet will have no influence over the case strategy. If the payor insists, then it also may be necessary to advise the client to seek independent advice as well.

Probate and estate planning work also requires care in specifying who is the client and who is and who is not an intended beneficiary of the attorney's services.

Corporations and other business entities also present the need for the attorney to clarify to whom the professional duty will be owed. This is a two-fold issue. First, is the attorney being hired to render an opinion for the corporation or other business entity that will be relied upon by third parties? Second, who within the corporation will be benefitting from the attorneys services (such as individual employees and minority shareholders, etc.)?

Thus, while the attorney's duty to the corporation is set out in California Rules of Professional Conduct, Rule 3-600, the careful practitioner will want to anticipate potential problems which may arise. The practitioner should specify in writing any limitations made necessary because the representation may involve third parties, individual employees, or directors or shareholders (especially in small corporations or limited partnerships), including just what will happen in the event that a conflict later may arise between the entity and an employee or shareholder.

The Scope of Services

The next part of a good retainer agreement will describe in detail the matter for which the lawyer is hired, the scope of the services to be performed, the charges applicable to such services and any limitations upon the scope of services.

Contingent fee matters are governed by Business and Professions Code § 6147. In addition to the specific requirements of the statute, the contingent fee attorney also will want to specify the case to be filed and the court in which it is to be filed, and clearly explain who will become responsible for any additional fees in the event that a cross-claim is filed or an appeal becomes necessary. Where the client's version of the facts is important to the attorney's decision to take the case, it also may be helpful to specify in the scope of services section of the retainer agreement the precise facts which have influenced the attorney's decision to take on the matter and to have the client confirm the

accuracy of these facts when executing the agreement as well.

The agreement also should spell out how the recovery is to be calculated and distributed when it is received and who will be responsible to pay the costs in the event that no recovery is obtained. To the extent that the advance of costs may be construed as a "loan" to the client, a review of Rules of Professional Conduct Rule 3-300 and *Ritter v. State Bar*, 40 Cal.3d 595 (1985), will be helpful. Additionally, if the case involves a suit related to a contract with an attorneys' fees provision, the client should be alerted to the potential liability which he, she or it may face in the event that the case is lost.

Any claims which the attorney intends not to pursue also should be referenced, such as where a workers' compensation or bankruptcy specialist should be brought in to handle a claim which otherwise arguably the attorney should have pursued on behalf of the client.

It seems superfluous to remind the readership of the *ABTL Report* that, if the attorney does not maintain errors and omissions coverage or a qualifying substitute, that fact must also be disclosed in the agreement; but, we do so gratuitously nonetheless.

In an hourly contract, governed by Business & Professions Code § 6148, the rates to be charged should be specified, together with a statement, if applicable, that they may be subject to future adjustment. See, *Severson, Werson, et al. v. Bolinger*, 235 Cal. App.3d 1569 (1991). Discuss with the client and record in the retainer agreement any budgets or estimates requested by the client. Be sure, also, to specify that such estimates are not guarantees of the cost of services or the outcome of the case.

Conflicts of interest governed by Rules of Professional Conduct Rules 3-310 and 3-320 should be disclosed at the initial client meeting and in the retainer agreement. It also is appropriate to confirm in the retainer agreement the attorney's advice to the client that he, she or it has a right to seek independent counsel before deciding to waive the conflict.

Finally, it is imperative to set forth any other limitation upon the scope of services clearly in writing in the retainer agreement as well. Failure to limit the scope of services will almost always result in a finding that the attorney is liable for the failure to perform any services which had any reasonable relationship to the problem at hand.

Cover all the Details

Other charges and aspects of the billing process also should be covered in the retainer agreement, such as who will pay for travel time, expert witnesses, copying, computer research, and secretarial and staff costs and overtime. The billing cycle and the client's obligation to pay the bill when rendered or from funds held by the attorney in trust also should be covered.

A major nettle which infects far more fee arbitrations than one would think possible is charges for attorney conferences and client telephone calls. It therefore is wise, in the event that the attorney contemplates receiving assistance from other attorneys in representing the client, to recite in the agreement that there will be attorney and staff conferences for which the client will be billed. If the attorney's usual practice is to bill in minimum increments for telephone calls or other events, such as .2 hours minimum for each telephone call, that practice should be set forth in the retainer agreement as well.

A current list of rates and charges for costs (i.e., cost per page for copying, etc.) also should be attached to the initial fee

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agreement and updated to all clients thereafter when any changes or increases are made.

Also, if working with another attorney who is not a partner or employee is contemplated, language should be inserted in compliance with Rules of Professional Conduct Rule 2-200.

Limitations on Liability

The question often arises whether the attorney may limit his or her liability to the client in the retainer agreement such as by an arbitration clause or outright waiver of future malpractice claims. Rules of Professional Conduct Rule 3-400, of course, flatly prohibits an attorney from limiting liability to the client for future malpractice claims.

Arbitration Clauses

Arbitration clauses may address two aspects of the relationship — fee disputes and malpractice claims. Fee disputes are governed by Business and Professions Code §§ 6200, *et seq.*, which provide that fee arbitration thereunder is mandatory for the lawyer and voluntary for the client. Additionally, State Bar Formal Ethics Opinion No. 1981-56 states that it is unethical for an attorney to condition employment on a client's acceptance of binding arbitration in advance of a dispute arising over fees.

Pending legislation is in the works which if passed will make it permissible for the attorney to contract that fee arbitration under Business and Professions Code §§ 6200, *et seq.*, is mandatory for the client as well, provided that the client is not also asked to agree in advance of the dispute that such mandatory arbitration will be binding.

Arbitration of malpractice claims, on the other hand, presents a different question. Twenty years ago, the California Committee on Professional Responsibility and Conduct (COPRAC) took the position that it was unethical to condition employment upon the client's acceptance of binding arbitration of malpractice claims as well. In State Bar Formal Ethics Opinion 1989-116, however, COPRAC concluded that there is nothing ethically improper with including a malpractice dispute arbitration provision in the initial retainer agreement.

Although not ethically improper, whether a malpractice dispute arbitration clause will be enforceable, however, will depend upon the attorney being able to establish that the agreement to arbitrate is fully disclosed to and voluntarily agreed to by the client without undue influence being exerted by the attorney. See, *Lawrence v. Walzer & Gabrielson*, 207 Cal. App.3d 1501 (1989). See also, CCP § 1295, requiring at least ten point type in medical arbitration clauses, and *Lynch v. Cruttenden & Co.*, 18 Cal. App.4th 802 (1993), involving the duty of a stock broker affirmatively to bring the clause to the attention of the customer.

Neither a Borrower Nor a Lender Be

Can the attorney charge interest on past due accounts? According to State Bar Opinion 1980-53, the answer is "yes" provided that certain conditions are met, including the informed consent of the client at the outset of the relationship. Traps for the unwary in charging interest include, however, usury questions, Unruh Act compliance where the services are primarily for personal, family or household matters, compounding interest without a clear written agreement providing for such charges, and charging interest based upon the statement date rather than the date the statement actually is mailed to the client.

Liens on Future Recoveries

Although less than clear, it appears to be the law that a contingent fee agreement vests the attorney with an equitable interest in part of the client's cause of action subject to the imposition of a constructive trust but that the attorney has "no special or charging lien, unless it has been specifically contracted for." *Jones v. Martin*, 4 Cal.2d 23 (1953).

The amount of the lien must be established by an independent action. *Valenta v. Regents*, 231 Cal. App.3d 1465 (1991). A discharged attorney is entitled to the reasonable value of services rendered up to the time of discharge, not the full contingency fee. *Fracasse v. Brent*, 6 Cal.3d 784 (1972). An attorney who abandons the client, however, is not entitled to participate in the fee recovery. *Hansel v. Cohen*, 155 Cal. App.3d 563 (1984).

The attorney's lien never extends to the client's files or papers. *Weiss v. Marcus*, 51 Cal. App.3d 590 (1975).

Attorneys' Fees in Fee Actions?

Provided such clauses are fairly negotiated at the outset of the attorney-client relationship, it is permissible for an attorney to provide for the recovery of attorneys' fees in the event of a future action arising out of the agreement.

Business & Professions Code § 6203(a) provides that such clauses are unenforceable in fee arbitrations under that title; but, there appears to be no other statutory prohibition affecting such clauses in other actions or alternative dispute resolution forums.

Note well that, in *Trope v. Katz*, 94 Daily Journal D.A.R. 14061 (Oct. 5, 1994), *review granted*, it was held that such provisions do not extend to cases where the law firm appears pro se.

Billing Practices

Billing statements are another area where the attorney can end up on the losing end of a fee dispute. The requirements for what must be included in attorney billing statements are set forth in Business and Professions Code § 6148. These include the amount, rate, basis for calculation or other method of determination of the attorney's fees and costs. Failure to comply will result in the attorney being entitled only to the dreaded "reasonable fee," which these days quite often ends up being woefully smaller than the "reasonable monthly Mercedes lease payment" to which so many practitioners obligated themselves during the Eighties.

Although many attorneys fear sending regular statements to clients (for fear that the client will be frightened away by the receipt of such bad news), the better practice is to bill at intervals no less often than monthly, if at all possible. This forces the attorney to communicate more often with the client and provides the client and the attorney with an early warning of potential billing problems so that they might be confronted and resolved when they are still small and when a good and continuing client relationship still can be salvaged.

Client Communication — The Real Key to Getting Paid

The real key to getting paid is regular communication with the client. Ethically, the Rules of Professional Conduct, Rules 3-500 and 3-510 require only that the attorney (1) keep the client reasonably informed about significant developments, (2) promptly comply with reasonable requests for information and

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pens if the matter is not tendered to the insurer?

When an actual claim is made, can the firm defend itself?
What right does a policyholder have to settle a claim?

Tendering the "Circumstance"

A "circumstance" for reporting purposes is an act or omission that may never result in a malpractice claim. Circumstances range from an attorney's "gut feeling" that something is wrong to a realization that, unbeknownst to the client, a mistake was made. Virtually all professional liability insurance policies issued today are claims-made policies requiring that the claim be made against the attorney and reported to the insurance company during the policy period. (Some policies specify a short period after the policy expires to permit year-end reporting.) Most such policies also include language similar to the following provision concerning acts or omissions:

Provided always that such act or omission occurs:

1. During the Policy Period or
2. Prior to the Policy Period, provided...
 - (b) Prior to the first Inception Date of this policy, if continuously renewed, or the date Insured first becomes a member of the Named Insured, whichever is later, the Insured had no basis to believe that any such act or omission might reasonably be expected to be the basis of a Claim...

Some policies vary the language, requiring that the insured have "no reasonable basis to believe that the Wrongful Act was a breach of professional duty or might result in a claim." In trying to decide whether and when to report such circumstances, the policyholder should obviously read the policy to see exactly how the "circumstance" is defined and whether that alone answers the question.

Reporting the "Circumstance" That Might Give Rise to a Claim

If a policyholder is concerned about whether a circumstance should be reported, there is probably a sufficient concern with the act or omission involved that it should be reported to the insurer.

The danger in not reporting such a circumstance is that the coverage would be lost if the policy expires, a claim is then made based upon that prior circumstance, and the circumstance is found "likely to have given rise to a claim." In a coverage action, the court or jury will determine whether a circumstance was "reasonably" likely to give rise to a claim in the context of a claim that did in fact arise.

Does the reporting of a circumstance adversely affect the policyholder at renewal? Early reporting should not have a detrimental effect on renewal. Nevertheless, attorneys should know their insurers and consult with them to determine the effect of early reporting on renewal. If your insurer disfavors early reporting or early reporting is likely to adversely affect renewal, I would recommend consideration of alternative cover. Most insurers recognize that early reporting is beneficial: You can take the necessary precautions to prevent an eventual claim or, if a claim arises, to prevent serious deterioration of the claim into a real disaster. Some insurers provide a "hotline" number which can be called to obtain an attorney or claims adjuster's advice concerning reporting as well as steps to take to prevent the circumstance from becoming worse.

What effect does reporting circumstances have on the "frequency" of claims? Many insurers look at the frequency of claims against a law firm in the underwriting and renewal process. Frequency, from the standpoint of most insurers, relates

to the frequency of actual claims. In most cases insurers are more critical of severe claims and look at the ultimate dollar amount of loss payments in evaluating a firm for renewal. In any case, through continual dialogue with insurers, the policyholder and insurer can reach an understanding that early reporting of circumstances is part of an effort to prevent claims from materializing or deteriorating. The awareness of such circumstances, and the sensitivity of attorneys in the policyholder firm to such circumstances, ought to provide some comfort to the insurers that the policyholder is being more careful in handling its relationships with its clients. Insurers should understand (and, if properly guided, will understand) that early reporting permits better control over the development of claims and more efficient and economical resolution of those claims that eventually materialize.

The "Circumstance" Not Tendered

Claims-made policies specifically require that the claim, and, if included in the definition of covered act or omission, the circumstance be reported during the policy period in which the claim was made against the policyholder or the circumstance became known (or within a specified number of days of the end of the period). Failure to tender or report timely a claim or circumstance will result in a loss of coverage for the circumstance. See *Pacific Employers Ins. Co. v. Superior Court*, 221 Cal. App. 3d 1348 (1990); *Burns v. International Ins. Co.*, 929 F.2d 1422 (9th Cir. 1991). Contrary to general liability or other policies, the tender of a matter under a claims-made policy after the policy expires is not a "late notice" issue measured by the existence or non-existence of "substantial prejudice" to an insurer.

What Should Be Reported?

In tendering a claim to an insurer, and especially in tendering or reporting a *circumstance*, attorneys should include as much factual information as possible. Too often, the policyholder tendering the matter will seek to minimize the event. The tender asserts that the matter is nothing. It will never materialize into a claim, or does not involve malpractice. Clarence Darrow has been quoted as saying that there is no such thing as justice — in or out of court. Malpractice is the finding at the end of the day of culpability, irrespective of whether "justice" would dictate a contrary result. No matter worth reporting is inconsequential. Policyholders should avoid any statements that might be construed as an admission. Nevertheless the tender should include as much factual detail as possible.

Insurers and brokers need to report matters within the principal insurance organization to other insurers, to excess insurers and to reinsurers. This is often done through the use of a *bordereau*, which in the insurance industry is a true art form: Each claim is represented in a data-base format, sorted by specific fields for such information as the name of the claimant, date of act or alleged omission, the scope of the loss (or alleged damage), the nature of the transaction, and a host of other facts deemed important by those to whom the information is reported. The gathering of the information is difficult when the tender letter is one sentence, or contains an oblique reference to a possible event. If there are any questions about what information to include, the particular insurer should be contacted. Most insurers either have or can provide a tender or reporting "protocol" that delineates the information they seek when a claim is tendered.

In reporting any claim or circumstance, the act of reporting itself can be a major step in the process leading to renewal of coverage. Insurers feel a greater degree of comfort, and there-

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fore less concern about a policyholder's claims or circumstances, if the information reported is complete, and if the follow-up is frequent and diligent. If a policyholder feeds an insurer as little as possible, either out of fear or from inadvertence, then the policyholder is damaging his or her renewal prospects. However, complete disclosure of facts will enable insurers to see that the claim is in fact benign, or the matter is being handled well, or the policyholder has a "one-off" situation and is taking steps to prevent recurrence. When insurers or their representatives request further information, that should be provided in complete form. Keeping an insurer supplied with complete information will help prevent the claim from becoming an obstacle to renewal.

Solving the Problem In-House

Once a circumstance or claim has been tendered to the insurer, it is essential that the insurer and the policyholder determine the appropriate point when counsel should be retained. In most cases that would not be until a suit has been filed. However, firms faced with potential malpractice exposure should consider at least two alternatives.

Outside counsel to evaluate the case: First, in a case in which the client is still being represented, it may be prudent to have outside counsel investigate the facts and provide an opinion concerning the potential for a claim to be asserted. For example, the client may later charge that subsequent acts or omissions were motivated more to protect the firm and in derogation of the duty owed to the client. An outside opinion to the effect that there is no merit to the concern will obviate that problem, and an outside opinion that there is a problem will permit a withdrawal and substitution of counsel who can then either cure the problem or share in the exposure. Also, in the event the firm withdraws from representation, the outside firm can, as well, aid the firm in preserving the record in anticipation of a defense effort.

Should the Policyholder retain independent defense counsel when actual suit is filed? When actual suit is filed, it is imperative that the firm obtain defense counsel. In the past decade, I have heard at least four arguments to justify requests by policyholders that they be permitted to defend themselves in a malpractice lawsuit:

No other firm is as competent as the policyholder's firm: The arrogance of the position alone should resolve the issue. One could suggest that if the firm were that good, there would be no lawsuit against the firm. Some argue that the firm possesses a special expertise in the subject matter of the claim. Yet it is difficult to conceive of any area of special expertise in which no other law firm participates.

The policyholder can save a lot of money defending itself: The argument that it is cheaper to defend oneself is wrong and also ignores a powerful lesson that can be learned from retaining outside counsel. A firm representing itself will lose the revenue produced by the lawyers and paralegals who represent the firm. No matter what the firm says, unless it short-changes itself in its representation of itself, it will spend the same amount of time preparing the litigation and defending itself. The lawyers who did the transaction or handled the litigation will not try the case, so new litigators and paralegals will work the case up, do the discovery, and try the case. The expense would be the same as well-selected outside counsel. Also, if outside counsel are retained, the lawyers who would have done the case will work on revenue-producing business. The net effect on the "bottom line" should be that the firm will be in the same place

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A Case of Shrinking Attorney Liability: Is There Life after *Bily*?

The California Supreme Court's opinion in *Bily v. Arthur Young & Co.*, 3 Cal.4th 370 (1992), has had a major impact on accountants' liability litigation. It has narrowed the group of third parties who may assert claims against financial statement auditors and limited the legal theories which can be asserted by third party claimants.

The question addressed by this article is whether *Bily* applies to third party claims against attorneys and, if so, how?

No one can reasonably argue that *Bily* expands the scope of attorney liability. The questions which remain open are: (1) whether the case will reduce the universe of third parties who may assert claims against attorneys; and (2) whether third parties who have standing to sue may be limited to asserting claims for negligent misrepresentation — not simple negligence.

Auditor Cannot Be Liable to a Third Party for Simple Negligence

The *Bily* Court held that:

"An auditor's liability for general negligence in the conduct of an audit of its client's financial statements is confined to the client, i.e., the person who contracts for or engages the audit services. Other persons may not recover on a pure negligence theory." *Id.*, at 406.



Michael L. Cypers

The Court based its ruling on policy grounds, observing that it would be unfair to hold an auditor liable to an unlimited universe of third parties on a simple negligence theory when the auditor would have no reason to be aware of the third party's existence or reliance on the audit report. The Court also observed that an auditor's client is ordinarily the primary wrongdoer. By the time suit is filed against the auditor, that client is ordinarily insolvent. The hapless accountant becomes the remaining solvent bystander.

Negligent Misrepresentation

The *Bily* Court held that there is a narrow class of non-clients who may sue the auditor under a theory of negligent misrepresentation: "Such persons are specifically intended beneficiaries of the audit report who are known to the auditor and for whose benefit it renders the audit report." *Id.* at 407.

The Court based its decision on the Second Restatement of Torts, providing that a supplier of information who intends to influence the conduct of a specific third party may be liable to that third party. The *Bily* court synthesized the Restatement rule by stating that an information supplier has liability to a third party "only if he or she intends to supply the information for the benefit of one or more third parties in a specific transaction or type of transaction identified to the supplier." *Id.* at 392.

The Significance of Limiting Third Party Claims to Negligent Misrepresentation

The theory of negligent misrepresentation focuses on the specific report issued by the auditor on its client's financial

(Continued on page 8)

statements. This is ordinarily a one page report in which the auditor issues its conclusion as a result of the audit process. The audit report either takes the form of a "clean report" on the client's financial statements — stating that the financial statements are fairly presented in accordance with applicable accounting rules — or the auditor's qualification or disclaimer on the client's financial statements. The *Bily* decision thus eliminates the third party's ability to sue for negligence, which focuses on the auditor's process of performing the audit. Instead, the third party must focus on the audit report, the end product of the audit process.

The *Bily* Court stated: "Nonclients of the auditor are connected with the audit only through receipt of and express reliance on the audit report. Similarly, the gravamen of the cause of action for negligent misrepresentation in this context is actual, justifiable reliance on the representations in that report. Without such reliance, there is no recovery regardless of the manner in which the audit itself was conducted." *Id.*, at 413.

The claim for negligent misrepresentation focuses on whether the auditor had a reasonable basis for believing the statements made in the audit report. *Bily*, 3 Cal.4th 370, 407; California Civil Code § 1710(2). The focus of this tort is narrower than the focus of an auditor negligence claim, in which the auditor's planning, testing and sampling techniques, and the auditor's professional judgments, are attacked, ordinarily with the wisdom of hindsight. Thus, the *Bily* decision narrows the group of third parties who have standing to sue the auditor, and it further narrows the grounds of attack compared to a claim for professional negligence.

***Bily's* Discussion of Attorney Liability Cases**

The *Bily* court discussed existing attorney liability cases as being consistent with its decision. In particular, the Court pointed to *Goodman v. Kennedy*, 18 Cal.3d 335 (1976). There, the California Supreme Court affirmed the dismissal of claims by third parties against an attorney. The third parties alleged that the attorney delivered a securities opinion to his client which ultimately turned out to be incorrect. However, the third parties did not (and presumably could not) allege that the legal opinion was ever communicated to them or relied upon by them. The *Bily* court reaffirmed *Goodman v. Kennedy*. *Id.* at 410-411.

By contrast, in *Roberts v. Ball Hunt Hart Brown & Baerwitz*, 57 Cal. App.3d 104 (1976), a lender sued attorneys for a partnership based on an allegedly erroneous legal opinion rendered by the attorneys to the partnership. The plaintiff alleged that the attorneys knew and understood that the legal opinion they gave to their client would be shown to the lender in order to induce it to make a loan to the partnership. *Bily* reaffirmed the correctness of this rule, and contrasted the underlying facts with those in the *Goodman* case, where the attorney did not know that his work product would be given to or used by a third party.

Subsequent Discussion of *Bily* — the (Depublished) *Ronson* Decision

The only appellate attorney liability case citing *Bily* is *Ronson v. Superior Court*, 24 Cal. App.4th 94 (1994). However, the *Ronson* decision was depublished. 94 Daily Journal DAR 3938 (July 14, 1994). *Ronson* is discussed here to illustrate how attorneys may try to use *Bily* to limit their liability and how

courts will grapple with the application of *Bily* in professional liability cases.

In *Ronson*, a limited partner of a partnership sued the attorneys for the general partner, which attorneys also performed some services for the partnership. The plaintiff's claim centered on certain disclosure documents the attorneys drafted for the general partner to supply to the limited partners to satisfy the general partner's fiduciary duty. The general partner edited the draft disclosure documents, eliminated certain of the disclosures suggested by the attorneys and sent them to the limited partners. Plaintiff sued the attorneys for negligence and breach of fiduciary duty (as well as a series of intentional tort claims), claiming that even if the disclosure documents contained all of the disclosures recommended by the attorneys, they would be deficient and the attorneys acted with a conflict of interest and assisted the general partner in attempting to cheat the limited partners out of their valuable partnership interests.

The trial court granted a motion for summary judgment in favor of the attorneys. The Court of Appeal issued a writ of mandate vacating the summary judgment order on the basis that material issues of fact remained.

The attorney defendants argued that *Bily* imposed a privity requirement on malpractice actions against auditors, that it effectively overruled *Goodman v. Kennedy* and that the plaintiff's negligence claim must be dismissed. The *Ronson* court observed: (1) *Bily* did not overrule *Goodman v. Kennedy*; and (2) *Bily* was so fact specific to auditors that it could not be reasonably applied to attorney malpractice claims. 24 Cal. App.4th 94, 112, n.9.

Ronson ruled that triable issues of fact existed on a number of bases. One such basis was that a factual issue existed as to whether the attorneys for the general partner and the partnership may have also occupied an attorney-client relationship to the limited partners. If so, then the plaintiff limited partner had standing to assert claims for negligence and breach of fiduciary duty.

Application of *Bily* to Claims Against Attorneys

A strong argument can be made that *Bily* applies to attorney malpractice cases, in spite of the *Ronson* court's statement to the contrary. This argument is based on the following components.

The California Supreme Court based the *Bily* decision in part on what it believes is existing law in the attorney malpractice area. There appears to be a principled basis on which to distinguish the *Goodman* case from the *Roberts* case. In *Goodman*, the third parties were barred from suing the attorney because the attorney did not know that his work product would be supplied to the third parties. In *Roberts*, the third party was permitted to sue the attorney because that was a case in which "an attorney gives his client a written opinion with the intention that it be transmitted to and relied upon by the plaintiff in dealing with the client." *Bily*, 3 Cal.4th 370, 411, quoting the Supreme Court opinion in *Goodman*.

The existing attorney malpractice cases are consistent with the *Bily* rule, which delineates when a third party has standing to sue a financial statement auditor for negligent misrepresentation.

The *Bily* court adopted the Rule of the Restatement (Second) of Torts regarding the circumstances under which a third party may assert claims for negligent misrepresentation. The pertinent Restatement Section 552 is entitled "Information Negligently Supplied for Guidance of Others." This section is designed for commercial suppliers of information, and is not

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limited in its terms or in its illustrative examples to auditors. Accordingly, a strong argument can be made that the Restatement rule can and should be applied to claims against attorneys.

A strong argument can be made on policy grounds that the liability limits the *Bily* court recognized for accountants should be applied to attorneys as well. The *Bily* court recognized limits on accountants' liability even though it explicitly recognized the public responsibility of financial statement auditors. 3 Cal.4th 370, 383-384. In its discussion of the public responsibility of auditors, the *Bily* court cited both AICPA standards and *United States v. Arthur Young*, 465 U.S. 805, 817-818, 79 L.Ed.2d 826, 835-837, 104 S.Ct. 1495 (1984). While recognizing the public responsibilities of auditors, the *Bily* court limited auditor liability because of its perception that liability is out of proportion to fault.

The auditor-client relationship is one in which the auditor is required by professional standards to remain independent from the client. For this reason, financial statement auditors are ordinarily not considered to occupy a fiduciary relationship to the client. *Painters of Philadelphia District Council No. 21 v. Price Waterhouse*, 879 F.2d 1146 (3rd Cir. 1989); *Franklin Supply Co. v. Tolman*, 454 F.2d 1059 (9th Cir. 1971). The *Bily* court distinguished "lawyers and other professionals who perform services for clients" from auditors who have recognized public functions. 3 Cal.4th 370 at 383. The attorney is ordinarily the advocate of his or her client, is not required to maintain independence from the client and generally occupies a fiduciary relationship to the client. These reasons furnish a basis for a strong argument that the liability of attorneys to third parties should be no broader than the liability of auditors and that the liability limitations of the *Bily* decision should apply to attorneys as well as auditors.

An Open Question

A strong argument can be made that the liability limits of the *Bily* decision will apply to third party claims asserted against attorneys. Assuming that the courts follow this approach, an open question remains as to whether third parties who do have standing to sue attorneys may sue for negligence, or whether their negligence-based claims are limited to claims for negligent misrepresentation.

—Michael L. Cypers

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Sexual Relations with a Client: What's Your Position?

Vivian Bloomberg, the Editor, called.

"We need an article on the State Bar's Rule of Professional Conduct on personal relations."

I replied that I didn't know the State Bar had any personal relations. "You mean sex, don't you?"

Well, yes, she owned up, she guessed she did mean sex.

How can we talk about sex in a family publication, I asked.

"Well we must," she said. "The State Bar has banned it and there is just too much of it." I said I had never found that a pressing problem, but perhaps she was right and I would look into it.

"Where do I find these rules?"

"I believe they were printed as a pocket part to the *Kama Sutra*."

"West's St. Paul *Kama Sutra* or Bancroft Whitney's San Francisco *Kama Sutra*?"

"The one with the most citations."

"Ah, San Francisco."

Well, I looked into it and I'll tell you it would just curl your hair. The very idea that some lawyers are getting more than their fee.

Rule of Professional Conduct 3-120 prohibits a lawyer from "requiring" or "demanding" sexual relations from a client as a condition to representing the client (obviously oblivious to the fact that many of us can't get paid, much less laid). This seems rational and appropriate, although God never felt it necessary to propose it as the Eleventh Commandment. Perhaps, god never used lawyers.

It is Rule 3-120(b)(3) that intrigues me. It says a State Bar member shall not:

"(3) Continue representation of a client with whom the member has sexual relations if such sexual relations cause the member to perform legal services incompetently...."

In other words, a rephrase of the old "keep your mind on your work" rule, and very appropriate it is — don't commit malpractice because of too much sex.

But how will we know?

Suppose the poor lawyer is just dumb. Maybe sex had nothing to do with it. Will there be two standards, "malpractice" and "malpractice with sex," a sort of "special circumstances" of the Civil Bar? Does this mean greater penalties? "The court enters judgment of \$250,000 in damages for failing to file within the statute of limitations, and an additional \$25,000 for all that stuff on the side."

I called Vivian and said, "I read the rules and now I finally understand what they mean by a 'unified' Bar."

"Then you'll do it," she asked.

"Vivian, the last time I did a mild parody on the Los Angeles County Bar's niceness rules, everybody thought I was against niceness."

"Only those who know you personally," she replied.

"Oh."



Thomas J. McDermott, Jr.

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Sexual Relations with a Client

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"Come on, Tom," she said. "This is important. The State Bar is telling us that if we cut out the hanky-panky, we'll have more time to practice."

"Well, I suppose that's right," I replied. "The law is a jealous mistress."

"Can't say that."

"We can't even *talk* about sex?"

"No. Be sensitive to minorities. With this new rule, the mistress is now a minority."

Convinced by her persuasiveness and the State Bar's rectitude, I agreed to aid in the dissemination of this vital message. But how? The rules were clear, needed no explication, so there wasn't much to write about. Besides, no one reads anymore.

How to get the message to the broadest possible public. Would this make a movie? No, lawyers having sex in a movie would hardly be noticed. Could we have a plane pull one of those large signs over the beach this summer: "NO SEX WITH CLIENTS?" No, lawyers don't go to the beach.

Then it hit me! We'll do a TV show featuring lawyers. What an innovation! We'll call it "The Clients' Court" and it will feature no one but clients who have been imposed upon by their lawyers. It will go something like this:

Announcer:

The State Bar of California and American Lawyer Enterprises, presents.... "The Clients' Court." Starring Judge Joe Wopem.

Applause as the Judge takes the bench.

Ann:

Our contestants today, as always, are real clients who are charging their real lawyers with real personal relationships. You will see for the first time that lawyers are capable of personal relationships. But remember, if Judge Wopem finds a single element of humanness in any lawyer, that lawyer must *pay*! (Sotto voce and quickly): All awards paid by the production company, American Lawyer Cashcow, Inc.

Ann:

Today's case: Our client is Henry Hunk who claims he was seduced by his lawyer, Ms. Leslie Abrupt, during protracted and passionate unlawful detainer litigation.

Our guest prosecutor is the famous talk-show host, Oprah Winsome, and our guest defense counsel, who just concluded the four-month trial of the Central Park rapist on the stage of the Radio City Music Hall, is Mr. Allen M. Der Showbiz.

Judge Wapem:

(Slams gavel):

Hunk v. Abrupt. Are the parties ready?

Oprah:

Ready for the Hunk.

Der Showbiz:

Ready for Ms. Abrupt.

Oprah:

Tell us about it, Mr. Hunk.

Hunk:

I-it started when she said she wanted to show me her briefs.

I thought she meant papers.

Oprah:

Show you her authorities?

Hunk:

She was into that too. The handcuffs, the whips....

Oprah:

Let us feel your pain!

Hunk:

Actually, it was kind of fun. I didn't suffer but the case did.

Oprah:

You mean....

Hunk:

Yes. The unlawful detainer held over and over and over. Even the three-day notice was deficient.

Oprah:

My God! We all feel the pain. Did...you appeal?

Hunk:

Over and over again to her. But she was dominant. I was a slave to her body and her law degree.

Oprah:

Clear case, your honor.

Judge Wopem:

Proceed with your attorney, Mr. Der Showbiz.

Der Showbiz:

Ms. Abrupt, did you make any advances to Mr. Hunk?

Abrupt:

Absolutely not. He came on to me, breathing in my ear "unlawfully detain me....unlawfully detain me...." I couldn't resist.

Der Showbiz:

And did the case go well?

Abrupt:

Amazingly so. We completed the three-day notice procedure in 167 days, which I understand is the shortest time ever achieved in Los Angeles County.

Der Showbiz:

We rest, your honor.

Ann:

As Judge Wopem retires to ponder his decision, listen to this announcement.

Second Ann:

Next week, on The Clients' Court, LAWYERS WHO FAIL TO FLOSS AND THE PENALTIES THAT AWAIT THEM!

Judge Wopem's decision was, I understand, Solomonic, but, as with most decisions today, it is unpublished.

If you find all of this somewhat overdrawn, perhaps in questionable taste, a bit manic, and maybe even unnecessary, you get the idea.

—Thomas J. McDermott, Jr.

When 'Circumstances' Give Us Pause

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financially, with outside counsel defending, and will have the benefit of independent counsel.

A policyholder with a large self-insured retention may not relish writing a check to another firm. However, if the firm does indeed have a potential exposure, and a lawsuit is filed, then making the firm write a check can serve as a "wake-up call." There can be a positive learning effect from having to pay another firm, and the net, as pointed out, will be the same financially.

The Policyholder is more motivated to vindicate itself: Too often, a firm defending itself will not understand the exposure to it since it will have been too close to the underlying transaction. We have all had clients who allowed self-righteous indignation to impair their view of the facts. Settlement judges are well aware of the "difficult client" syndrome. Partners view their partner charged with the act or omission differently than independent counsel would view the participants, and the difference

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may be critical in evaluating facts, witnesses and defenses. It is difficult for close friends and colleagues to evaluate themselves. Finally, the policyholder motivated by the abject need to vindicate themselves has already lost any independent capacity and should retain outside counsel immediately. The minor peccadillo in the policyholder's eyes may be the linchpin in plaintiff's case. A policyholder exacerbates the potential for underestimating the strength of the claimant's case if it is blinded by self-righteous belief in its own invincibility.

Settling the Claim: With or Without Consent

Once the claim is made, and a settlement opportunity arises, what latitude does the policyholder have to settle the matter? If the claim can be settled beneath the deductible, few insurers will object to the settlement. Nevertheless, the language of the policy will govern the amount of latitude afforded to the policyholder. Most policies will not permit settlement without the consent of the insured. When the policyholder refuses consent, the result may, under the language of the policy, "cap" the limit of the insurer's liability. The ability of the policyholder to settle the claim is also usually expressly provided in the policy. The following is an example of such language:

The Company shall not settle any Claim without the consent of the Insured. Should the Insured refuse to consent to a settlement recommended by the Company and elect to contest the Claim, or continue any legal proceedings in connection with such Claim, the Company's liability for the Claim shall not exceed the amount in excess of the Insured's Deductible for which the Claim could have been settled, or the applicable Limit of Liability, whichever is less, including costs and expenses,... incurred up to the date of such refusal.

The Insured shall not admit liability for, or make any voluntary settlement,... except with the written consent of the Company.

The language of professional liability policies varies somewhat, and should be carefully read before any settlement discussions take place. Prudence would dictate, irrespective of the language, that policyholders work with their insurers in providing information to permit a proper evaluation of a claim. If both the policyholder and the insurer understand the scope of exposure presented by claims and circumstances, and cooperate in resolving the matter, then "consent" will not be a barrier to settlements that are reasonable.

Early Communication and Cooperation Can Make a Difference

If a policyholder looks to its insurer as one more adversary in the path of success, then the relationship of insurer-to-policyholder is doomed from the start. If the policyholder or the insurer are unable to work together to defeat, minimize or expeditiously resolve any potential malpractice exposure, the entire process will be distasteful, but more so for the policyholder. The process will be expensive for both as well.

Early communication with the insurer, reporting of circumstances as soon as they are uncovered or become known, and cooperation in providing information, selecting counsel and strategic handling of the claim — **between the policyholder and the insurer as well as between the policyholder and defense counsel** — can make a big difference in whether the defense is successful and in minimizing the detriment to the firm of having to defend against a malpractice claim.

—Patrick A. Cathcart

Securities Fraud

In a significant victory for plaintiffs, the Ninth Circuit ruled that, in pleading securities fraud, plaintiffs can plead scienter generally; it is not necessary to plead facts giving rise to a strong inference of fraudulent intent. *In re Glenfed, Inc.*, 1994 WL 688969, 94 Daily Journal D.A.R. 17350 (9th Cir. Dec. 9, 1994). In so holding, the Ninth Circuit refused to follow the lead of the Second Circuit and vacated a decision by a three-judge panel of the Ninth Circuit.



Denise M. Parga

Summary Judgment

In a marked shift from prior decisions, the Second District Court of Appeal ruled that the burden of proof in a summary judgment motion shifted from the moving party to the non-moving party where the defendant's motion was based on interrogatory responses that contained no evidence to support a theory of liability. *Union Bank v. Los Angeles County Superior Court*, 1995 WL 10458, 95 Daily Journal D.A.R. 597 (Court of Appeal Jan. 12, 1995). The Court of Appeal granted a writ of mandate compelling the respondent court to enter summary judgment against plaintiffs, based on its interpretation of California Code of Civil Procedure 437c(o)(2), as amended in 1992.

After-Acquired Evidence Doctrine

The U.S. Supreme Court ruled that an employee discharged in violation of the Age Discrimination in Employment Act of 1967 was not barred from all relief, even though, after her discharge, the employer discovered evidence of misconduct that would have led to the employee's termination on lawful and legitimate grounds. *McKennon v. Nashville Banner Publishing Co.*, 1995 WL 20463, 95 Daily Journal D.A.R. 976 (U.S. Supreme Court Jan. 23, 1995). At the same time, the Court ruled that "after-acquired evidence" must be taken into account in determining the specific remedy. The Court held that the proper boundaries of remedial relief must be addressed on a case-by-case basis, but the general starting point should be calculation of backpay from the date of the unlawful discharge to the date the new information was discovered. The court can also consider any extraordinary equitable circumstances that affect the legitimate interests of either party. *Id.* at 979.



Vivian R. Bloomberg

Insurance

The Sixth District Court of Appeal ruled that an insurance company was entitled to recoup defense costs of more than \$96,000 from its insured where the insurer provided a defense subject to a reservation of rights. *Gossard v. Ohio Casualty Group of Insurance Companies*, 29 Cal.App 4th 1660 (1994), review granted, 94 Daily Journal D.A.R. 1188 (Jan. 25, 1995). In so holding, the court rejected the insured's argument that an insurer may not "unilaterally reserve the right to recoup defense fees without an explicit agreement with the insured." *Id.* at

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prepared to accept the consequences of mandatory relief. This approach seems to give maximum assurance of a favorable outcome for the client, while reducing the likelihood that an attorney will be unnecessarily penalized.

Thorough Familiarity Will Lead to Sound Decisions

The mandatory relief provisions of Section 473 represent a profound change in California law, bringing improved protection of client interests along with new dilemmas for lawyers. State court practitioners can expect to deal with these provisions, on one side or the other, from time to time in their practices. Thorough familiarity with these provisions will lead to sound decisions when mandatory relief situations arise.

— Geoffrey L. Bryan

The Retainer Agreement

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(3) promptly communicate all written settlement offers.

Getting paid on time and without a fee arbitration, however, requires more than a minimal level of communication. Getting paid also requires:

(1) Returning all client telephone calls within twenty-four hours or less;

(2) Having a clean desk when the attorney meets with the client in the office so the client can appreciate that their matter is the only thing on the attorney's mind during the conference;

(3) Understanding the client's business needs and profit cycles so that payments can be arranged which may be less painful to the client without sacrificing the attorney's own cash flow;

(4) Monthly billing statements with cover letters explaining in actual English what activities are covered, what activities are to be expected on the next billing and a detailed explanation for any deviation from the agreed budget;

(5) Sending copies of all correspondence and pleadings to the client with cover letters explaining what they mean and what additional work they may require for which the client can expect a bill in the future;

(6) Regular status reports even when nothing is happening so the client never loses the abiding feeling that he, she or it truly is loved by the attorney;

(7) Advance notice of any rate increases;

(8) Regular telephone communications between the accounting staffs of the attorney and of the client to insure that the billing statements comply with the client's internal requirements;

(9) Facing up to difficult problems that may arise and strategy decisions that may have to be made immediately, rather than letting them grow hoary from procrastination; and,

(10) Any number of other regular and sincere communications with the client which will overcome the seemingly insatiable desire of most clients to use their attorneys as interest-free banks.

Of course, the readers of *ABTL Report* are well versed in all of these practice points already; but, armed with this reminder to actually go out and do all of these things on a regular basis, each of you will stand a much better chance of fulfilling the unrelenting expectations of our spouses, dependents and creditors — that we actually and even promptly get paid for the services which we otherwise would be happy to render solely for the good of the public.

—Joel Mark

15892. It was sufficient that the insurer sent correspondence expressly reserving the right to seek reimbursement if there was no coverage under the policy.

Usury

In *Ghirardo v. Antonioli*, 8 Cal.4th 791, 35 Cal. Rptr. 2d 418, 94 Daily Journal D.A.R. 16714 (1994), the Court held that usury laws do not apply to a modification of a credit sale. The owners of undeveloped real property sold it to a prospective developer and received a promissory note and deed of trust on the property. The new owner sold the property subject to the note and deed of trust. Ultimately, the parties agreed to a debt restructuring. Under the restructuring, the original note and deed of trust was reconveyed to the original seller in exchange for a partial cash payment and the execution of two new secured notes in favor of the original seller. The ultimate buyer also agreed to pay a \$100,000 fee, which resulted in an effective rate of interest on one of the notes of 17.46 percent. The court held that the modification notes were neither a loan nor a forbearance and were the functional equivalent of a modification to a credit sale that was exempt from the usury law.

—Denise M. Parga and Vivian R. Bloomberg

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