

Summary of Meeting of ABA BLS Professional Responsibility Committee

November 17, 2007

Washington, D.C.

Expanding Liability Exposures

The primary purpose of this meeting was to explore the dynamics of law firm liability arising in corporate practice and possible ways for law firms to protect themselves from these exposures. John Villa, a partner at Williams & Connolly, was invited to the meeting as a special guest. Mr. Villa has defended several of the largest claims against law firms, including Vinson & Elkins in the Enron matter. Also attending was Geoffrey Hazard, currently the Thomas E. Miller Distinguished Professor of Law at Hastings College of Law. Professor Hazard is an Advisor to the committee. Participants included a number of distinguished members of the Business Law Section, a bankruptcy judge, a recognized authority on transactional legal opinions and liabilities arising from them, a plaintiff's lawyer, and loss prevention lawyers from ALAS and Aon. An additional number of lawyers participated by means of conference telephone. Much of the discussion came as a result of remarks by Mr. Villa.

The Chair emphasized that purpose of the meeting was to facilitate free and open exchange of views on the topics to be considered by those with experience or interest in the subject matter. It was not intended that the meeting, or any subsequent meetings on the topics, result in any recommended course of action for participants or their firms.

The Concern. U.S. law firms with significant corporate practices maintain malpractice insurance with limits ranging from \$20 million per claim up to \$250 million, and, perhaps, in some cases more. Yet a number of these firms are regularly handling transactions that involve \$1 billion or more. Thus, there is a concern among some that a claim arising from one of these large transactions could exceed available coverage. Claims can come from clients alleging the firm made a mistake, from trustees in bankruptcy purporting to "stand in the shoes" of a former client, or from non-clients alleging aiding and abetting fraud, aiding and abetting breach of fiduciary duty, conspiracy, and other third-party liability theories.

Examiners' Reports. It has long been recognized that corporate insolvencies can produce substantial exposure for firms that represented the entity pre-bankruptcy. Claims against the former counsel to Enron, Adelphia, DVI and Refco were all brought by the trustees in bankruptcy of those corporations. Mr. Villa stated that some of his most difficult cases arose from "findings" and/or "recommendations" set out in reports issued by examiners who had been appointed by bankruptcy judges. He stated that these reports are based on investigations by examiners possessing broad discovery powers who routinely obtain a waiver by the trustee of the bankrupt's attorney-client privilege. The result is that the examiner has largely completed extensive discovery on behalf of the trustee before the case is filed and that, in such circumstances, a law firm defendant can find itself at a tremendous disadvantage in mounting an effective defense. He said that the "findings" in these reports are frequently sufficiently detailed to permit the trustee, and third parties

using the reports, to successfully oppose motions to dismiss and for summary judgment. There is no obvious mechanic to “level the playing field” in the context of a bankruptcy, but the issues arising when a corporate client files for bankruptcy should be well understood by all law firms with significant corporate practices.

Due Diligence Reports and other Foreign Developments. It is common in Europe, and increasingly in the U.S., for non-clients in transactions to seek to rely on due diligence reports prepared by law firms for their clients. European firms frequently deal with such attempts by obtaining liability limitations from various parties to the transaction. The committee discussed the current U.S. practice and ways that firms have implemented to attempt to limit liability to non-clients in those circumstances.

Limiting Liability to Clients. The Committee Chair distributed copies of ABA Model Rule 1.8(h) (1) and a variation in effect in numerous jurisdictions. ABA Model Rule 1.8(h) (1) permits a lawyer to obtain an agreement from a client limiting the lawyer’s liability to the client for malpractice if the client is independently represented in making the agreement. The variation, which is a carryover from the Code of Professional Responsibility, prohibits a lawyer from limiting his liability to a client for malpractice. Although a number of states have adopted Model Rule 1.8(h) (1), some commercially important jurisdictions, including California, New York, and D.C., continue to provide for an absolute prohibition on limitations of liability to clients for malpractice. The chair advised that his information from New York was that a change in the New York rule would be politically impossible. The situation in California, which is in the process of adopting a new set of rules, was less clear. D.C. recently overhauled its rules, retaining the outright prohibition. Professor Hazard and others present expressed concern that a law firm with lawyers in states having both kinds of provisions could not necessarily rely on the application of one version or the other.

Limiting Liability to Non-Clients. There was a consensus at the meeting that no ethics rule prohibits limitations of liability to non-clients. This would include non-clients who sought to rely on due diligence reports. The big issue for such limitations is how they can be made effective as a matter of contract. All agreed that obtaining a signed agreement from the non-client should be effective. It is less clear whether a “self-executing” provision contained in a report or opinion would be effective. One member present said his firm’s research suggested that such a provision might be effective in the U.K. but probably not in at least some U.S. jurisdictions.

Insurance. An insurance broker specializing in transactional insurance (i.e., coverage for liability arising from representations and warranties made in acquisition agreements) had planned to attend the meeting, but he had to cancel for health reasons. He has offered to attend a future meeting and discuss what types of insurance may (or may not) be available to address the concerns of lawyers handling large transactions.

Plaintiff’s Lawyer’s Perspective. One lawyer present had represented plaintiffs in claims against law firms arising from a failed transaction or failed business. He said that, in his experience, these cases are very hard to bring and are very hard for plaintiffs to win.

William Freivogel
Chair