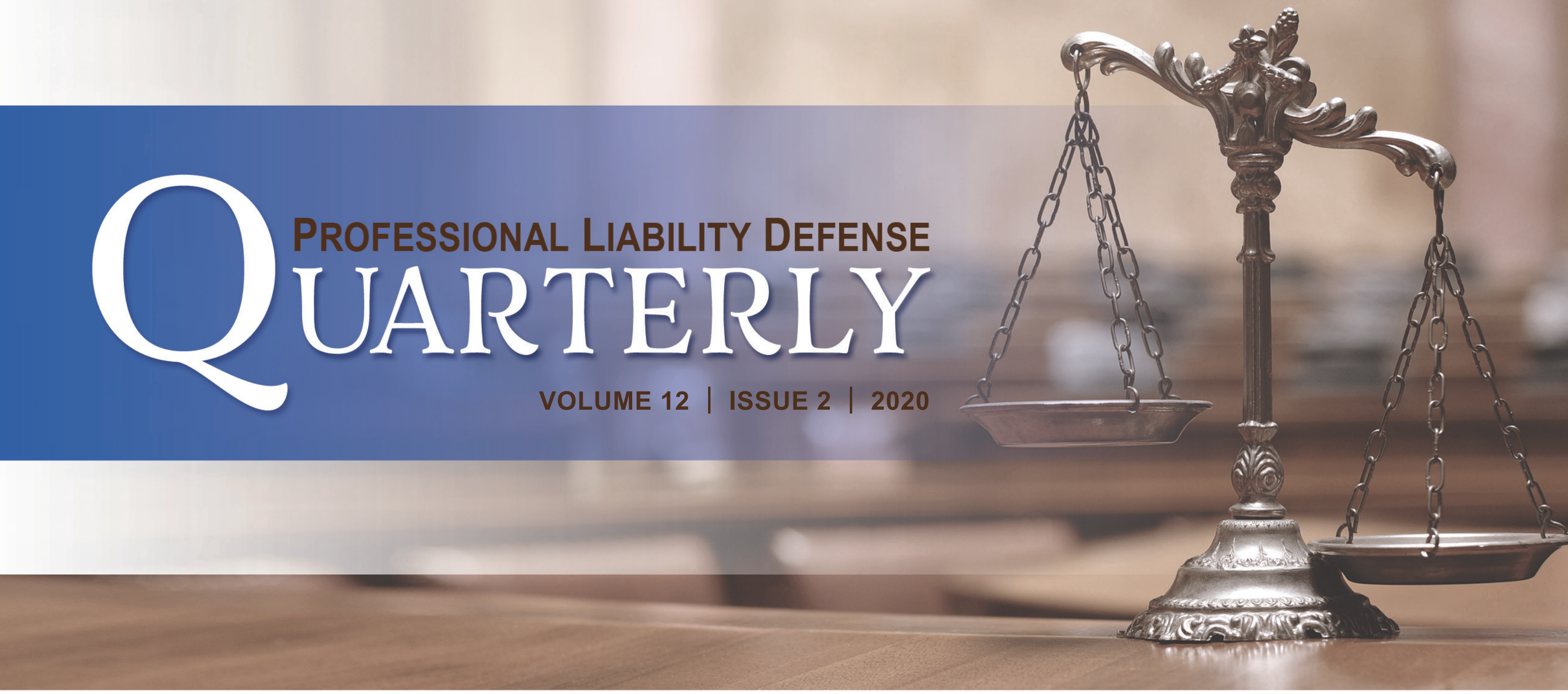

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Choice of Law: State-Specific Pitfalls for the Unwary

Michael D. Handler | *Forsberg & Umlauf, P.S.*

Choice of law questions necessarily arise at the beginning of a claim for insurance coverage of liability claims. There are often significant differences between how multiple states with interests in the policy may resolve questions of whether there is a duty to defend, how to interpret the policy's provisions for defense or indemnity obligations, the parties' settlement-related duties, and whether or when insurers can recoup payments for costs not within the scope of the policy's coverage. These conflicting rules may add to or subtract from the insurer's defense or settlement-related obligations.

The parties to the insurance policy have mutual risks in an underlying lawsuit, which they in turn rely on defense counsel to assess and develop recommendations about. The contracting parties' initial, justified expectations may ultimately prove incorrect regarding what state's laws will be applied to the policy and their related responsibilities, and location(s) of claim handling may contin-

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Letter from the President

Lisa Tulk | *Kessler Collins, P.C.*

The Professional Liability Defense Federation exists to support and benefit its members, each of us sharing a common purpose in upholding the highest standards in managing claims which substantially impact the livelihoods of our clients and insureds. The work we each do day-to-day protects professionals and mitigates damage to their businesses and careers. With this year's world-wide uncertainty stemming from the novel coronavirus, the Board of Directors of the PLDF has turned that same focus inward, trying to find ways we can protect our members and mitigate damage to the PLDF in these uncertain times.

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ue to evolve as claims become litigation, or even become multi-state litigation.

Considerations Governing Choice of Law Determinations

In order to resolve choice of law in an insurance coverage lawsuit, the party seeking a ruling demonstrates to the court that:

(1) an actual conflict exists between the potentially applicable states' laws on relevant issues; and
(2) the forum's choice of law test results in a determination that a particular state's law applies to those issues.

(1971) ("*Restatement*") § 187 generally enforce insurance policies' choice of law clauses.

But *Restatement* § 187 also provides for exceptions. One is when the chosen state has no "substantial relationship" to the parties or their transaction. The other is when the chosen state's law is contrary to a "fundamental policy" of another state with materially greater interest in determination of the particular issue, a consideration further requiring that the other state would be chosen under the "rule of" *Restatement* §188 (further detailed below). If an express insurance policy choice of law clause is not enforceable on these grounds, it constitutes a state-specific pitfall for counsel to be aware of. Examples include states with enactments by statute, or that enunciate contractual unconscionability principles, as where Louisiana, Texas, and Washington neutralize clauses applying any other state's laws to policies issued for delivery there.

> When parties to a contract have chosen the laws of one state to apply to their contract, most states will enforce an unambiguous clause that makes an unambiguous choice.

Defense counsel join last into the insurer and insured's "magic circle" of mutual interest under an insurance policy, and they typically remain focused on underlying evaluations. *In re Rules of Professional Conduct*, 2 P.3d 806, 820 (Mont. 2000). They are usually on the sidelines during any choice of law dispute. However, defense counsel could potentially benefit from an awareness of variances in controlling insurance law that may significantly influence decision making for their client(s).

Express Clauses

When parties to a contract have chosen the laws of one state to apply to their contract, most states will enforce an unambiguous clause that makes an unambiguous choice. States that follow Restatement (Second) of Conflict of Laws

When there is a choice of law clause in the policy, another important initial question is whether its scope is limited. For example, the clause may state that it addresses matters that arise under the contract, or disputes about the policy's meaning, interpretation or operation. Either clause could leave room for argument that it does not prescribe governing law if pressing questions arise during the course of an underlying litigation that relate to (1) how the insurer must perform its defense obligation, or (2) the extent of the insurer's settlement-related obligations. In several jurisdictions, the default assumption is that the contracting parties would have intended for the clause to apply to all causes of action that are related to their contract, instead of leaving matters undesignated. *Nedlloyd Lines B.V. v. Superior Court* (1992) 3 Cal.4th 459, 469-470.

Only a few jurisdictions have held that the same state's law used to interpret an insurance agreement must also be used to interpret claims of insurance bad faith because such claims stem from the policy and are therefore "inextricably intertwined" with the contract claim. *Home Ins. Co. v. Serv. America Corp.*, 654 F.Supp. 157 (N.D.Ill. 1987). Where many other jurisdictions hold that "bad faith" lawsuits are torts independent from breach of contract claims, a different result is foreseeable based on the specialized assessment of choice of law factors applicable to tort claims (prescribed by *Restatement* §145). *Panthera Rail Car LLC v. Kasgro Rail Corp.*, 985 F.Supp.2d 677, 694-96 & 700-01 (W.D. Pa. 2013).

Statutory Directives

Several states impose statutory requirements, impacting insurers that underwrite policies for multiple-state businesses. *Restatement* § 6 notes, preliminarily, that «[a] court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.»

The most protective statutes direct the application of a particular state's law to insurance policies. For example, South Carolina Code § 3861-10 provides that «all contracts of insurance on property, lives, or interests in this state are considered to be made in the state ... and are subject to the laws of this state.» Texas Insurance Code's "Article 21.42 Texas Laws Govern Policies", has a title succinctly stating its intent: insurance policies are governed by Texas laws if issued to a Texas "citizen or inhabitant" by a company doing business in Texas. In practice, there may be more exceptions than meet the eye, if courts requested to apply a statute narrowly construe threshold requirements so as to avoid giving it undue extraterritorial effect. *Austin Bldg. Co. v. Natl. Union Fire Ins. Co.*, 432 S.W.2d 697, 700-01 (Tex. 1968). Other caveats include when a surplus lines insurer is involved, state insurance departments may regulate them indirectly or to a limited extent (Texas controls little more than eligibility to do surplus lines business).

To illustrate a protective choice of law statute with restricted reach, the Oregon Environmental Cleanup and Assistance Act has provided since 1999 that Oregon law shall apply to all cases involving contaminated property in Oregon. Its controlling definitions have notable carve outs, including its application to a so-called "general liability insurance policy" but not to "claims-made policies". ORS 465.475(2) & 465.480(2)(a).

Less intrusive statutes prescribe the choice of law test, but not its result. For example, California Civil Code § 1646 states that "[a] contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made." However, this test remains subject to considerations such as whether there was an "understanding of the parties at the time they entered into the contract" regarding the intended place of performance by "mounting and funding" the insured's defense and/or by paying indemnity to resolve liabilities. *Frontier Oil Corp. v. RLI Ins. Co.* (2007) 153 Cal.App.4th 1436, 1461-62.

Restatement Considerations—Most Significant Relationship

In the absence of choice of law clauses or statutes, several states have retained the predictable *lex loci contractus* rule, whereby the law of the "place of contracting" applies to govern the contract application and interpretation. Although states like Florida have long applied this doctrine for insurance contracts, some rulings have made exceptions to the general rule. *LaFarge Corp. v. Travelers Indem. Co.,* 118 F.3d 1511, 1515-16 (11th Cir.1997).

Most states with no such "bright line" common law rule begin from the proposition that they intend to apply the *Restatement*'s tests, aimed at determining what state has the most "significant relationship" to the transaction and the parties. The level of complexity increases for analysis of a forum state's choice of law test when legal analysis is required of various *Restatement* factors in that state's common law. There is still more complexity when the insurance agreement being analyzed involves a wide variety of multiple-state risks, such as a large corporation's management liability policy.

To resolve conflicts of laws for insurance policies, *Restatement* § 193 states that the "principal location of the insured risk" is the most important factor with respect to choice of law decisions for fire, surety or casualty insurance contracts. However, some states regard *Restatement* § 193 as inapplicable to general liability policies that are not specifically tied to the location(s) of insured properties, because they have no "principal" location of the risks insured.

If *Restatement* § 188 applies, the following five contacts are used to determine choice of law:

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a) Place of contracting,

b) Place of negotiation of the contract,

c) Place of performance,

d) Location of the subject matter of the contract,

e) Domicile, residence, nationality, place of incorporation, and place of business of the parties.

These factors are not to be applied mechanically, but qualitatively to determine which state has the most significant relationship to the parties and their contracting transaction. This can involve increasing (or conversely, reducing) the weight of certain factors given the existence of specifically relevant contacts, and also addresses the permissibly-considered interests of conflicting, involved states. Ultimately, in the absence of an effective choice of law by the parties, these § 188 contacts are required to be evaluated in light of the pertinent principles of *Restatement* § 6, which are considered in the absence of statutory directives or constitutional restrictions.

Even states that apply § 193 will also address the relevant above-listed § 188 contacts, due to an exception in § 193 when another state has a more significant relationship with respect to the particular issue. The majority of states continue to develop their choice of law test and apply them to new contracts and new scenarios, which may newly create effective or actual "bright line" rules.

Traps for the Unwary May Vary from State to State

Resolving what law initially applies to analysis of an insurance policy's enforceability and interpretation may not prevent state-specific challenges from arising during the life cycle of a claim and its related litigation. Choice of law issues can present a "moving target" when defense funding and provision of settlement, judgment and post-judgment assistance are issues that may eventually arise. Unforeseen traps can lurk in each new, potentially applicable state's laws.

Acceptance, Performance and Conclusion of Defense Duties

An insurer or insured's alleged right to select counsel can present a time-sensitive issue, with short-term deadlines to file an answer and looming threats of default. This early question may be uncertain for insurers, defense counsel and their clients, simply because the performance of an insurer's defense obligation is not necessarily subject to the same law as interpretation of the insurance policy provisions. Jurisdictions may favor the location of contracting as supplying consistent governing law because contractual duties anchor the insured's and insurer's rights. Conversely, some courts seem untroubled that disputes arising out of one liability insurance policy may be governed by the laws of 50 states nationwide. California has reduced doubts by codifying in Civil Code § 2860 the insured's rights to select independent "*Cumis*" counsel, when California is where the underlying case proceeds and a possible ethical conflict of interest is created by the insured's reservation of rights to deny coverage, among other statutory requirements.

Whether a policy provision is enforceable that defense costs incurred will reduce the total policy limits could also influence choice of counsel, particularly the insured's acceptance of panel counsel subject to budget projections and other guidelines. Where limits-reduction provisions appear in a medical professional's liability policy, their enforceability may depend on whether applicable law imposes statutory restrictions (as in New York, pursuant to 11 CRR-NY 71.2 & 71.3), or freely allows the policies to so contract (as over the border, in New Jersey). Surplus lines insurers' policies may be exempt from such restrictions, in a jurisdiction that exempts the surplus lines market (e.g., New York's Nonadmitted and Reinsurance Reform Act) from claims-made policy standards or the state's defense-within-limits statutes.

These threshold issues can yield more pervasive questions of whether defense counsel's duties are initially owed, or may become no longer owed, to the defending insurer. *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*, 24 P.3d 593 (Ariz. 2001) (when insurer assigns attorney to represent insured, the assigned attorney has a duty because the services are ordinarily intended to benefit both insurer and insured when their interests coincide). Moreover, the defending insurers may eventually consider whether to conclude their defense funding based on (1) an underlying ruling that ends the potentially covered claims, (2) their prosecuting rescission/voiding of the policy due to an insured's material misrepresentations, or (3) "exhaustion" of their policy's limits. Each right to conclude the defense would be state law-dependent. After providing the defense, the insurer may consider whether to obtain cost recoupment. Re-reading this author's "Reimbursement to Insurers for Defense of Non-Covered Claims", PLD Quarterly Vol. 10, #2 (Spring 2018) demonstrates that each issue warrants its own article to track the nuances nationwide.

Indemnity Obligations and "Mixed" Obligations

Technical requirements in California include the insurer's requirement to state written coverage positions with a notice, accompanying denial or rejection, of the insured's right to California Department of Insurance review. Cal. Code Regs. Title 10 § 2695.7(b)(3). However, in practice, insurers often state such notices in reservation of rights letters, after scrutinizing available facts for clear California connections. California also statutorily bars coverage under liability insurance policies for punitive damage awards. Cal. Ins. Code § 533. Without such enactments, several other states (e.g. Illinois and New York) have held that it frustrates the punitive award's deterrence of wrongful conduct if the penalized defendant simply passes such penalties along to an insurer. For defense counsel to weighs the risks of proceeding to judgment, it is proper to consider whether punitive damages, if awarded, will be paid by their client and not by its insurer.

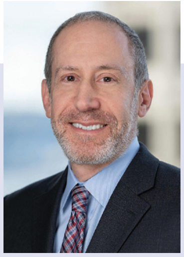
Duties to address an insured's settlement options are described in some states as part of the insurer's defense obligations, and elsewhere as indemnity obligations. This distinction alone may lead to unpredictable application of states' laws to the so-called "duty to settle". One common issue is whether sufficient limits remain available for settlement, after their reduction due to enforceable defense-within-limits provisions. Electronic settlement discussions, including "virtual" mediations conducted by video conference or in states other than the underlying suit's forum state or the parties' home office state(s), may yield further risks: the "duty to reasonably explore settlement" in the state where discussions are "deemed" to take place can newly be considered.

At this point, defense counsel may need a scorecard to keep up with all of the possibly applicable states' laws.

Conclusion—Choose Your Own Law Adventure, But Choose Wisely

Choice of law consultations probably should happen more often than they do. If early (and ongoing) check-ins with supportive coverage counsel isn't possible, published resources include state-specific lists of procedural timelines for the insurer's decision-making and other controlling law. As to some above-specified issues, like punitive damages insurance coverage, 50-state surveys have become reliable online resources. Deskbook reference manuals are published on nationwide liability defense practices and insurance coverage, with their subscribers receiving periodic updates. Finally, localized coverage counsel with expertise in each state may have proprietary "resource guides" to make available, if requested. ■

NOTE: *Any opinions expressed are the author's own, rather than being issued on behalf of Forsberg & Umlauf, P.S., or their clients.*



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Litigation Funding: Will This Glittering Investment Bring on a Malpractice Gold Rush?

Andrew P. Carroll | *Goldberg Segalla, LLP*

An old concept, third-party litigation funding, has been modernized in a way that has serious implications for professional liability. Historically, lawsuit funding involved loans to personal injury plaintiffs. An accident victim files a lawsuit and, while the lawsuit is pending, borrows money that is repaid out of any settlement proceeds. Although the lending terms are typically harsh, the market for such traditional litigation financiers remains robust.

Modern litigation funding similarly started by finding potential plaintiffs, only this time focusing on the commercial litigation space. Funders began targeting litigants who are low on funds but hold a plausible claim for recovery. For example, a small company that owns a patent allegedly being infringed upon by a large corporation may be unable to afford the legal fees necessary to protect its intellectual property. In such cases, modern litigation financiers provide the necessary capital to fight the proverbial goliath in exchange for a cut of the judgment or settlement.

The biggest difference between this form of litigation funding and its predecessor is the concentration of investment in only a few sophisticated matters. Rather than extend 1,000 loans of $5,000 per plaintiff, modern financiers are lending millions for a single case in the hope of a multi-million dollar judgment and commensurate return on investment. This new form of third-party funding has quickly gained traction in the

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corporate world, with two financiers taking their companies public. As publicly traded entities, these companies show exorbitant profits that are drawing significant attention from the investing world. Burford Capital ("Burford"), for example, touts its increase in assets under management from $541 million in 2016 to a jaw dropping $2.3 billion in the first half of 2019. Burford proudly advertises various investment performance metrics north of 30%, and claims that in-house counsel is becoming more and more comfortable with third-party litigation financing. At the Litigation Finance Dealmakers Forum in Manhattan in 2019, one panel described this "explosive growth" in the field as an indication that the increase in high end litigation funding will not be slowing down anytime soon. Financiers believe that as lawsuits are increasingly viewed as an asset, they will prove to be among the highest yielding investments in the market. But is this growing perception leading too many to overlook what happens when billions of dollars is suddenly injected into the civil litigation system by non-litigant stakeholders?

> The biggest difference between this form of litigation funding and its predecessor is the concentration of investment in only a few sophisticated matters. Rather than extend 1,000 loans of $5,000 per plaintiff, modern financiers are lending millions for a single case in the hope of a multi-million dollar judgment and commensurate return on investment.

The Burford Capital Short Attack and Investment Expectations

Only two litigation-funding companies have gone public thus far, but the risks associated with public capital markets have already been revealed. A clear example is Burford's confrontation last summer with a common but unwanted beast in the world of publicly traded companies—short attackers. A short attacker analyzes the disclosures of public companies, and if it finds what it believes to be a significant weakness, will place a bet that the company is overvalued. However, a short attacker only profits if the company's stock value is driven down significantly. To ensure this price drop occurs, a short attacker may attempt to trigger a sell-off of the company by publishing its analysis explaining why the company is overvalued. The more the public agrees with the short attacker's position, the more the stock price falls, and the more money it makes on its bet. The first of such short attacks on litigation financiers occurred to Burford, and the arguments alone reveal an unfamiliarity with operating on a contingency fee basis and, with it, the likelihood that more and riskier claims are sure to come.

Short attacker Muddy Waters Research ("Muddy Waters") completed its deep dive of Burford and concluded that its "operating expenses, financing costs, debt, and funding commitments . . . put it at a high risk of a liquidity crunch." Muddy Waters further described Burford as "a fund that invests in an illiquid and esoteric asset class, which few investors can understand well." Specifically, Muddy Waters points to the supposedly creative accounting benchmarks used by Burford, known as Return on Investment Capital ("ROIC") and Internal Rate of Return ("IRR"), to paint a misleadingly rosy picture for investors. The critiques supporting this claim, however, seem to mostly describe predictable risks involved in contingency-based litigation.

For example, Muddy Waters analyzed the case of *Napo Pharmaceuticals Inc. v. Salix Pharmaceuticals Inc.* that Burford categorized as concluded in 2013 and booked as a 100% ROIC in favor of Napo. In reality, Burford's client *lost* this case in 2014, and then converted its investment into a $30 million debt. Since Napo was essentially worthless, it merged with a different company using financing from one of Burford's largest investors. As a condition of the merger, Napo had to immediately pay $8 million to Burford, and trade the remainder of the debt for the merged entity's stock. Burford put a value on this stock that actually increased the ROIC on the case, only for it to eventually yield about $600,000 in liquidation. Muddy Waters noted that it was only in 2019 that Burford finally conceded the stock was worth far less than it was booked as in public disclosures. So while Burford may have seen this as a creative response to an uncollectible judgment, Muddy Waters called it fraud.

Muddy Waters also pointed out various judgments or settlements that were highly speculative in their valuation and ultimately proved uncollectible. In one case, the value obtained was dependent on the continuing operations of a patent holder who died unexpectedly. Another investment in a divorce judgment was also questioned, as the oligarch husband undertook significant asset-hiding and actually sued the wife for impounding one of his yachts. Finally, Burford took a large judgment against a company that soon after filed for bankruptcy, leaving Burford behind a very long line of secured and unsecured creditors who are themselves unlikely to ever collect on their claims. In sum, Muddy Waters brings up these various examples of "paper wins" to support its argument that Burford inflates returns to raise funding, despite knowing that many judgments were unlikely to be monetized.

Muddy Waters also questioned the overall performance of the fund after evaluating individual case figures pulled from large portfolios. As is increasingly true in litigation finance, Burford takes a cross-collateralization approach to investing. Rather than link one investment to one case, capital is raised for an entire portfolio, and the returns are gauged based on the overall performance. According to Muddy Waters, this covered up the reality that just four cases accounted for 66% of Burford's ROIC over the past 7.5 years. Muddy Waters claims that this overconcentration of risk tied to just a few cases is a recipe for disaster, particularly if an entire group of investments ends up failing.

Those familiar with the operation of a plaintiffs' side firm will find these allegations to be hardly surprising. While the involvement of an investor in the *Napo* case may seem unusual, creative judgment collection is not out of the ordinary. Particularly with large cases, creativity in ensuring collection is sometimes necessary. Converting an uncollectible judgment into a partially collectible one can be a strategic part of bringing the lawsuit. In fact, some firms have even taken a large if uncollectible verdict at trial at least partially for marketing purposes, rather than accept a negligible settlement amount. Furthermore, it is common for many plaintiffs' side firms to have a few big hits, a few total losses, and a whole lot of cases in the middle that mostly break even. This is often the cost of doing business in the world of contingency fees, and while these and other discoveries may surprise some investors, practicing attorneys are likely to shrug their shoulders. Given the recent withdrawal of a shareholders' suit against Burford based on the Muddy Waters allegations, it appears investors are already beginning to understand this is the nature of the beast.

Idle Capital Is the Devil's Playground

The Muddy Waters findings may currently have Burford's stock trading lower than before its report, but the fund and its brethren still have billions of dollars in capital and do not plan on turning investors away any time soon. In the first half of 2019 alone, Burford received $751 million in new investment commitments, up from a mere $81 million in the first half of 2015, and deployed $448 million in litigation financing. Such dramatic increases in capital infusion in unique investment vehicles is not unprecedented, however, and one prior comparator suggests the result will be more and riskier litigation across the board before any reduction in litigation funding.

Much like Burford, in 1994, Long-Term Capital Management ("LTCM") was formed to take advantage of an untapped investment market. In the case of LTCM, the focus of investing was fixed-income arbitrage, which in the simplest terms, sought to turn profits on discrepancies in the valuation of government bond securities. LTCM's use of complex mathematical models yielded tremendous success, with annualized returns of 21% in its first year followed by returns of 43% and 41% the next two years. These outsized profits led to garish praise from the market and an exponential increase in investment. Starting with a few hundred million dollars in late 1993, by 1998 LTCM had $4.7 billion in equity and had borrowed over $124.5 billion to stake out its positions in the market.

This precipitous rise preceded a dramatic downfall, but the process in getting there sheds light on what will likely occur in litigation finance. Investors flocked to LTCM so quickly that it had more capital than it knew what to do with. Needing to employ its capital while faced with narrowing anomalies in the fixed-income arbitrage market, LTCM started looking outside of its specific area of expertise. This lack of familiarity, combined with models that did not account for black swan events, led LTCM to be caught completely off guard by economic crises in both Russia and Asia in 1998. Losses started mounting, and by the end of the year, LTCM had lost a staggering $4.6 billion that required a bailout and, eventually, the complete liquidation of its positions.

The availability of such unjustified levels of capital is precisely where Burford found itself, and in an economy that encouraged riskier trading every day. Critics of the current Federal Reserve's low interest rates before the onset of COVID-19 often pointed to the level of speculation that naturally results from low rates. When interest rates are at moderate or high levels, institutional investors are happy to blend portfolios with safe havens like U.S. Treasury bonds. By contrast, interest rates at the current level have the opposite effect, encouraging investors to look for returns in companies that otherwise might be deemed a bit too risky. This became evident in the quick stock price fall of several companies after their Initial Public Offerings ("IPO"), and the cancellation of the WeWork IPO altogether. In the case of WeWork, its most recent private capital raise valued the company at $47 billion and its IPO was planned at a similar valuation. However, critics noted that WeWork lost

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$900 million in the first six months of 2019 and is saddled with leases that last up to fifteen years, even though it rents out space on much shorter terms. In a recession economy, the company could therefore find itself on the hook for obligations based on the currently high real estate prices, without the ability to turn around and lease space at a profitable rate. The market ultimately determined the valuation was at least twice as high as it should have been, dashing investors' grandiose expectations.

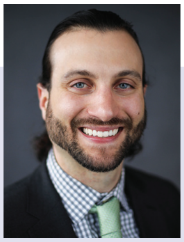
The Wave of Trickle Down Litigation is Coming

So where does that leave Burford, which went from $378 million in 2016 to $2.3 billion in 2019? While the overall market took a dramatic turn for the worse due to COVID-19, Burford still holds billions in assets and litigation funders have gone on record to say that plenty more investments have come in since. Furthermore, much like LTCM in the 1990s, the extensive publicity of Burford's investment returns has also increased competition in the field. With their own investment commitments growing exponentially, and competition from various angles, Burford will surely see a shortage of multi-million dollar commercial cases and look for new and creative ways to deploy its capital.

In late 2019, Burford appeared to already be venturing outside of its traditional model when it expressed a desire to explore the insolvency and bankruptcy field while touting increasing investments in asset recovery, post-settlement actions, and adverse cost indemnities. The COVID-19 economic downturn provides litigation funders with fertile ground to pursue this area, as legal industry analysts have pointed out that during the 2008 recession, there was a massive spike in both bankruptcies and professional malpractice claims. In other words, we have a perfect storm brewing wherein a natural spike of professional malpractice claims from the downturn will now be combined with increased resources to fund such lawsuits through third party financiers. Burford may also look to continue stepping up its cross-collateralized strategy by aggregating a greater amount of smaller claims into one large portfolio. In combination, it becomes very likely that mid-size or even small professional firms will find themselves in the cross hair of litigation finance in the coming years.

However, even if Burford itself does not drive the gold rush toward middle and small market professional malpractice claims, it is almost certain that others will. Burford is just the most public company in what has become a $9.5 billion U.S. litigation finance market. While it began as loans to accident victims, companies like Burford have shown that money can be made by funding many types of lawsuits. It should be no surprise if smaller private investment funds continue to crop up and increase funding of professional malpractice lawsuits. As this occurs, the landscape of professional malpractice litigation will change for *all* claims, and attorneys and insurers alike must be prepared for the impending shift in underwriting and defense strategy.

All is not lost, however, and in Part Two I discuss how litigation finance will increase both the volume and value of claims, as well as the methods available for evening the playing field for malpractice carriers and defense attorneys alike. ■



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Use of Federal Law in Defense of State Legal Malpractice Claims

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A couple of years ago we wrote on the use of *Rooker-Feldman* and *res judicata* in federal cases against lawyers that arose out of underlying state litigation. See *"Unusual Names, Powerful Doctrines: Use of Rooker-Feldman and Res Judicata in Defending Federal Lawsuits Brought Against Attorneys Arising from Litigation in State Court,"* PLDF Quarterly, Vol. 10, No. 4, Alice Sherren, James J. Sipchen, and Donald Patrick Eckler. Two recent cases, *Zander v. Carlson*, 2019 Il App (1st) 181868 and *Ritchie Capital Management, LLC v. McGladrey & Pullen, LLP*, 2020 IL App (1st) 180806, show how federal law can be used to defeat legal malpractice claims filed in state court.

Zander v. Carlson

Courts across the country have repeatedly looked to *Atkinson* and *Peterson* to hold that an attorney hired by a union to defend a union member covered under a collective bargaining agreement is an agent of the union and is therefore immune from suit.

In a case of first impression, the Illinois Appellate Court, First District in *Zander v. Carlson* ruled in favor of a labor union and a union attorney in a legal malpractice lawsuit arising out of an arbitration hearing in which the plaintiff challenged his termination as a police officer. *Zander*, 2019 IL App (1st) 181868, ¶ 1. The plaintiff, Zander, alleged legal malpractice against the attorney, Carlson, and negligence against the union. *Id*. The court affirmed the dismissal of Zander's complaint against Carlson on the ground that he was immune from suit. *Id*. The court also held that the Illinois Labor Relations Board (ILRB) had exclusive jurisdiction over Zander's claims against the union. *Id*.

Zander alleged that he was placed on administrative leave by the police chief and that eventually formal charges were filed against him recommending that he be terminated. *Id*. ¶ 3. Zander requested counsel from the union and the union assigned Carlson to represent him. *Id*. There was no retainer agreement executed and Carlson was paid only through Zander's union dues. *Id*. Pursuant to the collective bargaining agreement Zander could challenge his discharge either before the police board or through the collective bargaining agreement's ordinary grievance arbitration procedure. *Id.* ¶ 4. Upon Carlson's advice, Zander chose the arbitration procedure and after a two-day hearing the arbitrator upheld the decision to terminate Zander. *Id*.

Zander alleged that Carlson had inadequately represented him because he advised him to waive his right to a hearing before the police board and inadequately represented him at the arbitration hearing. *Id*. ¶ 5. Zander also alleged that the union was liable to him because it assigned him inadequate representation and was vicariously liable for Carlson's alleged malpractice. *Id*. The trial court dismissed the complaint against Carlson finding him immune and dismissed the claims against the union finding that the ILRB has exclusive jurisdiction over those claims. *Id*. ¶ 6.

The *Zander* Court premised its ruling in favor of Carlson on the United States Supreme Court decision of *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238 (1962), in which the Court held that union officers and employees are immune from personal liability for acts undertaken as union representatives on behalf of the union. *Id*. ¶ 11. In *Atkinson*, the Supreme Court held that the Taft-Hartley Act, which amended the National Labor Relations Act, provided that "a union's agents may not be held individually liable for actions taken on behalf in the collective bargaining process." *Id*.

This has become known as the *Atkinson* Rule. Courts across the country have subsequently applied the *Atkinson* Rule to bar legal malpractice claims brought by union members against union attorneys for acts performed in the collective bargaining process.

For example, in *Peterson v. Kennedy*, 771 F.2d 1244 (9th Cir. 1985), the Court held that the *Atkinson* Rule applies to a union's in-house counsel, as well as to its retained outside counsel:

> When the union uses its regular outside counsel, the services are sometimes covered under an overall retainer agreement, and there is no additional fee or charge to the union for the law firm's handling of the matter. In any event, whether it be house counsel or outside union counsel, where the union is providing the services, the attorney is hired and paid by the union to act for it in the collective bargaining process. *Peterson*, 771 F.2d at 1258.

Courts across the country have repeatedly looked to *Atkinson* and *Peterson* to hold that an attorney hired by a union to defend a union member covered under a collective bargaining agreement is an agent of the union and is therefore immune from suit. *Montplaisir v. Leighton*, 875 F.2d 1, 5-7 (1st Cir. 1989); *Best v. Rome*, 858 F. Supp. 271, 274 (D. Mass. 1994); *Mamorella v. Derkasch*, 276 A.D.2d 152, 716 N.Y.S.2d 211, 213 (App. Div. 2000); *Sellers v. Doe*, 99 Ohio App. 3d 249, 650 N.E.2d 485, 487-88 (Ohio Ct. App. 1994); *Collins v. Lefkowitz*, 66 Ohio App. 3d 378, 584 N.E.2d 64, 65 (Ohio Ct. App. 1990) (holding that an attorney who is handling a labor grievance under a collective bargaining agreement has not entered into an attorney-client relationship with the union member). This also holds true in the context of a local government employee where a state public labor relations act applies. *Weiner v. Beatty*, 121 Nev. 243, 248-250 (2005) (holding that Nevada Employee Management Relations Act immunized

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lawyers supplied by unions from legal malpractice claims).

The Court rejected Zander's argument that the protection should not extend to union lawyers. *Id*. ¶ 14. The Court, relying on *Arnold v. Air Midwest, Inc.*, 100 F.3d 857 (10th Cir. 1996 and *Carino v. Stefan*, 376 F.3d 156 (3rd Cir. 2004), stated that courts "have uniformly concluded that *Atkinson* prohibits claims made by a union member against attorneys employed by or retained by the union to represent the member in a labor dispute." *Id*. ¶ 16.

Zander attempted to avoid *Atkinson* by asserting that he had an attorney-client relationship with Carlson, but this failed as well because he did not have a retainer agreement with Carlson, he did not directly pay for Carlson's services, and his mere acquiescence of the relationship was foreclosed by *Peterson*. *Id*. ¶ 17. In *Peterson* the court recognized an exception where the employee and the lawyer "specifically agreed … to provide direct representation to [the union member] as an individual client" and was not merely "acting pursuant to [his] obligation to provide representation for or on behalf of the union," but those were not the facts in this case. *Id*. ¶ 18.

The *Zander* decision has application for the defense of union lawyers in actions brought by union employees and should be explored wherever such a claim is made.

Ritchie Capital Management v. McGladrey & Pullen, LLP

Though an accounting malpractice case, the *Ritchie Capital Management, LLC v. McGladrey & Pullen* decision may have impact across professional liability claims, including legal malpractice claims. The Ritchie plaintiffs wanted to pursue malpractice claims against the McGladrey defendants, who were accountants who performed audit work for an entity in which they invested, but did not bring their claims until more than two years after they knew of them. *Ritchie, LLP*, 2020 IL App (1st) 180806, ¶ 1. The *Ritchie* court dismissed the claims as time barred, despite an automatic stay in the bankruptcy of the investment entity, after determining that the time to file was not tolled. *Id.*

The plaintiff unsuccessfully argued for the application of one of Illinois' statute of limitations tolling provision, 735 ILCS 5/13-216, which states:

> When the commencement of an action is stayed by injunction, order of a court, or statutory prohibition, the time of the continuance of the injunction or prohibition is not part of the time limited for the commencement of the action.

Identical language is found in statutes in California (Code of Civil Procedure Section 356), Virginia (§ 8.01-229), North Carolina (G.S. 1-23), Idaho (§5-234), Wisconsin (§ 893.23), Utah (§ 88-12-41) , and South Dakota (§ 15-2-25). It is likely that other states have similar statutes or doctrines.

The Ritchie plaintiffs invested in Lancelot Funds which purported to invest in short term trade notes and purchase order financing, principally with Petters Company, Inc. (Petters). *Id*. ¶ 3. On October 20, 2008, Petters filed for Chapter 11 bankruptcy following the arrest of Thomas Petters on federal fraud and money laundering charges; Lancelot then filed for Chapter 7 bankruptcy. *Id*. Following the filing of the Lancelot bankruptcy, several investors (though not the Ritchie plaintiffs) sued McGladrey, but the bankruptcy trustee obtained the application of the automatic stay under Section 362(a)(3) of the Bankruptcy Code against those claims asserting that the claims against the McGladrey defendants were the property of the Lancelot bankruptcy estate. *Id*. ¶ 5.

The Ritchie plaintiffs were not subject to the stay, in part, because they had not filed a lawsuit against McGladrey defendants at that time. *Id*. In July 2009, the bankruptcy court enforced the stay against another investor, McKinley, who sought to pursue McGladrey. *Id*. ¶ 6. The bankruptcy court also entered an injunction against McKinley under Section 105 of the Bankruptcy Code, which prevented McKinley from pursuing its claims against McGladrey. *Id*. ¶¶ 6-7. The injunction was dissolved on September 15, 2015. *Id*. ¶ 7.

On May 12, 2017, nearly nine years after Petters filed for bankruptcy, the Ritchie plaintiffs filed their complaint against the McGladrey defendants alleging that Lancelot had contracted with the McGladrey defendants to perform audits and prepare financial statements. *Id*. ¶ 9. The Ritchie plaintiffs alleged that there was direct communication between their representatives and the McGladrey defendants, that the audited financial statements were used to solicit investors, and that the McGladrey defendants knew that the audits would be used in this fashion. *Id*. ¶ 10. The Ritchie plaintiffs claimed negligent misrepresentation, fraudulent misrepresentation, common law fraud, fraudulent concealment, aiding and abetting, conspiracy for one of the auditors having pled guilty to federal charges, breach of contract, and violation of the Illinois Consumer Fraud Act. *Id*. ¶¶ 11-15.

The McGladrey defendants moved to dismiss the case arguing that the Ritchie

> "[C]ourts will likely view the effect of a stay or injunction on a case by case basis after a determination of what is 'necessary or appropriate.'"

plaintiffs had violated the two-year statute of limitations and the five-year statute of repose. *Id*. ¶ 17. The trial court granted the motion finding that the plaintiffs were required to have filed their claims when they knew of them in 2008, and rejected the plaintiffs' argument that the automatic stay provision of the Bankruptcy Code applied because the McGladrey defendants were not the party who had filed bankruptcy. *Id*. ¶ 18.

In the appellate court, the Ritchie plaintiffs claimed that the statutes of limitations and repose were tolled between October 20, 2008 and September 15, 2015. *Id*. ¶ 20. In rejecting this argument, the Court held because the Ritchie plaintiffs were not subject to the injunction they were not prevented from pursuing their claims and, as held by the Seventh Circuit in *Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998), neither did the automatic stay order preclude them from filing their claims against the McGladrey defendants. *Id*. ¶¶ 23-24. The plaintiffs relied on 735 ILCS 5/13-216, which tolls the statute of limitations when claims are stayed or enjoined. *Id*. ¶ 24.

In *Ritchie,* the non-debtor McGladrey defendants were allegedly liable for the scheme to defraud. To aid in its analysis in determining whether the claims against the McGladrey defendants were time barred, the *Ritchie* court turned to *Fisher*, in which the Seventh Circuit held that an injunction under Section 105 precluded claims against non-debtors who were allegedly involved in the scheme to defraud (like McGladrey was in the *Ritchie* case), but that the automatic stay under Section 362 did not apply. *Id*. ¶ 25. Applying the reasoning of *Fisher*, the *Ritchie* court held that the tolling provision of Section 13-216 was not triggered by the stay. *Id*. ¶ 25. The court then reviewed the injunction and found that it did not apply to the plaintiffs and therefore could not trigger tolling of the statute of limitations. *Id*. ¶¶ 26-30. As a result, the plaintiffs' lawsuit, which was not filed until nine years after they knew of potential wrongdoing, was not timely and the dismissal was affirmed. *Id*. ¶ 33.

A further explanation of the power of a bankruptcy court is seen in *Cappuccilli v. Lewis*, 2010 U.S. Dist. LEXIS 119658, *16-17 which cited to *Fisher*, *In re Mountain Laurel Resources Co*., 2000 U.S. App. LEXIS 6137 (4th Cir. 2000), and *In re Philadelphia Newspapers, LLC*., 407 B.R. 606 (E.D. Pa. 2009). In *Cappuccilli*, which dealt with claims against a lawyer, the court stated:

> A bankruptcy court's jurisdiction to stay actions in other courts extends beyond claims by and against the debtor to include suits to which the debtor need not be a party but which may affect the amount of property in the bankrupt estate or the allocation of property among creditors. To protect this jurisdiction, [t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title . . . including a stay. (citations and internal quotations omitted)

Given this explanation of bankruptcy court jurisdiction, courts will likely view the effect of a stay or injunction on a case by case basis after a determination of what is "necessary or appropriate."

Conclusion

Most legal malpractice claims will not involve the invocation of federal law as a defense. However, defense practitioners should be on the lookout for situations in which the invocation of federal law may provide an appropriate defense. The *Zander* and *Ritchie* cases provide two examples where the potential is more likely: labor and bankruptcy. ■

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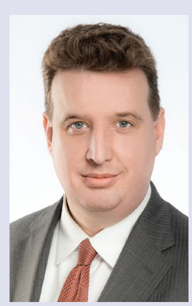

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Court Continues Plain Meaning Approach to Statutory Interpretation

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In a pair of opinions dealing with federal anti-discrimination statutes, the United States Supreme Court continued to emphasize that, when the words of a statute are unambiguous, the Court's analysis begins and ends with the words of the statute itself. The Court declined argumentative appeals toward inapposite case law and other statutes worded markedly different than the ones being considered. Instead, the Court looked to dictionary definitions of the words themselves and applied basic principles of grammatical syntax to parse meaning.

> [W]hen the words of a statute are unambiguous, the Court's analysis begins and ends with the words of the statute itself.

In *Comcast Corporation v. National Association of African American-Owned Media, et al.*, No. 18-1171, 589 U.S. ___ (2020), the Court determined whether a plaintiff suing under 42 U.S.C. § 1981(a) had to show but-for causation to trigger liability. Section 1981(a), among other things, guarantees, "[a]ll persons . . . the same right . . . to make and enforce contracts . . . as is enjoyed by white citizens." Here, Entertainment Studious Network (ESN), an African American-owned media company, negotiated with Comcast, one of the nations largest cable television providers, to carry several of its channels. Comcast ultimately refused to carry the channels, citing a lack of consumer demand. ESN sued under Section 1981(a) and alleged Comcast systematically disfavored 100% African American-owned media companies. After three rounds of motions and amendments, the district court entered final judgment for Comcast, holding that ESN failed to show but-for causation. The United States Court of Appeals for the Ninth Circuit reversed and held that a Section 1981 plaintiff need only plead sufficient facts to show that race played some role in the defendant's decision-making process. The Supreme Court granted certiorari to resolve a circuit split.

Beginning its analysis, the Court reiterated that "textbook tort law" reveals a plaintiff must usually show but-for causation when seeking redress for a legal wrong. This ancient but-for test comprises the default rule against which Congress is presumed to legislate against. ESN argued that Section 1981 provides an exception to this rule and that, to survive the motion to dismiss stage, a 1981 plaintiff need only show that race was a motivating factor in the defendant's decision-making process. Looking to the relevant text of the statute, the Court rejected this approach. Section 1981(a) requires that "[a]ll persons . . . shall have the same right . . . to make and enforce contracts, to sue, be parties, [and] give evidence . . . as is enjoyed by white citizens." 42 U.S.C. § 1981. The Court noted that, while there is no explicit reference to causation, the words of the statute are suggestive. "The guarantee that each person is entitled to the 'same right . . . as is enjoyed by white citizens' directs our attention to the counterfactual—what would have happened if the plaintiff had been white? This focus fits naturally with the ordinary rule that a plaintiff must prove but-for causation." Slip Op. at p. 5.

Given the relevant text, if Comcast would have responded the same way to ESN even if it were a white-owned company, an ordinary speaker of English would say that ESN received the same legally protected right as a white person. On the contrary, had Comcast responded differently but for ESN's racial makeup, ESN would not have received the same right as a white person. The Court found support for its holding in a neighboring section of 1981 that details criminal sanctions, where the government must prove that a defendant's challenged actions were taken "on account of" or "by reason of" race—phrases used to indicate a but-for causation standard. Further, the Court declined ESN's invitation to construe Section 1981 similarly to Title VII (with the latter's motivating factor causation test), noting that these are two distinct statutes with two distinct histories. Finally, the Court noted that the burden-shifting framework set out in *McDonnel Douglas Corp. v. Green*, 411 U.S. 792, 802-04 (1973), in no way supported ESN's argument. Under *McDonnel Douglas*, the Court explained, only the burden of production can shift to the defendant, never the burden of persuasion. A complaint must allege the essential elements of a claim in order to survive the motion to dismiss stage, and for Section 1981, this means but-for causation.

In *Babb v. Robert Wilkie*, No. 18-882, 589 U.S. ___ (2020), the Court had to decide whether the federal-sector pro-

While the type of discrimination outlawed “based on age” indicates a but-for causal relationship, the marriage with the phrase “shall be made” reveals the critical importance of syntax. The Court explained that while “based on age” modifies the noun, “discrimination,” it does not modify “personnel actions.”

vision in the Age Discrimination in Employment Act (ADEA) imposes liability only when age is a but-for cause of the personnel action in question. In *Babb*, a clinical pharmacist employed at a VA medical center alleged age discrimination after the VA removed several of her promotion designations and passed her over for additional training opportunities. The VA offered several legitimate non-discriminatory reasons for the actions taken and the district court granted the VA summary judgment under *McDonnell Douglas*. The United States Court of Appeals for the Eleventh Circuit affirmed.

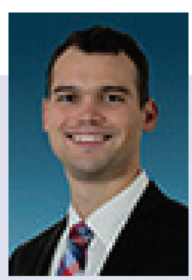
The relevant text of the statute at issue provides that, “[a]ll personnel actions affecting employees or applicants for employment who are at least 40 years of age . . . shall be made free from any discrimination based on age.” 29 U.S.C. § 633a(a). Under the plain meaning of the words themselves, the Court held that, “the statutory text shows that age need not be a but-for cause of an employment decision in order for there to be a violation of § 633a(a).” Relying on dictionary definitions of the words “free from,” the Court reasoned that, under Section 633a(a), a personnel action must be made *untainted* by any discrimination based on age.

While the type of discrimination outlawed “based on age” indicates a but-for causal relationship, the marriage with the phrase “shall be made” reveals the critical importance of syntax. The Court explained that while “based on age” modifies the noun, “discrimination,” it does not modify “personnel actions.” “The statute does not say that ‘it is unlawful to take personnel actions that are based on age’; it says that ‘personnel actions . . . shall be made free from any discrimination based on age.’” Slip Op. at p. 6. Age must be a but-for cause of the discrimination, but not necessarily a but-for cause of the personal action itself. The Court further explained that “free from any discrimination” is an adverbial phrase modifying the verb “made.” The straightforward meaning of Section 633a(a) becomes clear: “If age discrimination plays any part in the way a decision is made, then the decision is not made in a way that is untainted by such discrimination.” *Id*.

The Court noted that the government’s primary arguments rested not on the text of Section 633a(a) itself, but on other case law that interpreted different statutes. Examples include prior precedent affirming a but-for causative standard in a particular provision of the Fair Credit Reporting Act and precedent extrapolating the private-sector provision of the ADEA that requires but-for causation. The problem for the government, however, is that the private-sector and public-sector provisions of the ADEA “are ‘couched in very different terms.’” Slip Op. at p. 10 (quoting *Gomez-Perez v. Potter*, 553 U.S. 474, 488 (2008)).

Even though the Court ruled plaintiffs can show violations of Section 633a(a) without proving that age was a but-for cause of the personnel action, it reiterated that but-for causation is still required for the traditional employment discrimination remedies, such as backpay or compensatory damages. The Court noted that, in cases of violations where but-for causation on the personnel action is lacking, plaintiffs may still be entitled to injunctive or other forward-looking relief, which is appropriately adjudicated by district courts.

Both *Comcast* and *Babb* continue the Court’s heavy emphasis on a plain meaning approach to statutory interpretation. The decisions are emblematic of textually driven judicial decision making. When the words of a statute are unambiguous, practitioners should not waste time appealing to legislative drafting history, inapposite caselaw, or other statutes worded differently than the one at hand. The dictionary is likely your best ally. ■



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Don't Cross the Rubicon: When Do Settlement Tactics Go Too Far?

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"Settle the case or I'll file a grievance against your client." You may have been at the receiving end of this demand. But is threatening to file a disciplinary complaint or criminal action to gain leverage in settlement negotiations a proper tactic? Is it unethical? Is it *illegal*?

As one high profile lawyer recently learned the hard way with a criminal conviction after attempting to extort money from a major athletic apparel company, making threats during settlement negotiations could land an attorney in hot water. Several large jurisdictions have rules that explicitly bar attorneys from threatening disciplinary or criminal action to gain the upper hand in settlement talks. Some states only prohibit threatening criminal action. And some states haven't promulgated any rules covering this subject at all.

Some Jurisdictions Prohibit Threats of Criminal Action and Disciplinary Charges

Several states have rules that explicitly bar attorneys from presenting or threatening to present criminal *or* disciplinary charges solely to obtain an advantage in a private civil matter. See, e.g., *California Rules of Prof'l Conduct*, R. 3.10 ("a lawyer shall not threaten to present criminal, administrative, or disciplinary charges to obtain an advantage in a civil dispute"), *D.C. Rules of Prof'l Conduct*, R 8.4(g) ("prohibiting a lawyer from seeking or threatening to seek criminal charges or disciplinary charges solely to obtain an advantage in a civil matter"), *Louisiana Rules of Prof'l Conduct*, R. 8.4(g) ("it is professional misconduct for a lawyer to threaten to present criminal or disciplinary charges solely to obtain an advantage in a civil matter"), *see also Ohio Rules of Prof'l Conduct*, R. 1.2(e), *Colorado Rules of Prof'l Conduct*, R. 4.5, *Connecticut Bar Association Informal Opinion* 15-01, *Massachusetts Rules of Prof'l Conduct*, R. 3.4(h), *Texas Rule of Prof'l Conduct*, R. 4.04, *Illinois Rule of Prof'l Conduct*, R. 8.4(G), and *Florida Rule of Prof'l Conduct*, R. 4-3.4(h).

This rule is seemingly straightforward. But, as shown in the examples below, its application and interplay with other laws and privileges is nothing but.

California

California Rule 3.10 states, "A member shall not threaten to present criminal, administration, or disciplinary charges to obtain an advantage in a civil dispute." *Cal. Rules of Prof'l Conduct*, Rule 3.10. California's Supreme Court examined that rule (at the time, its predecessor Rule 5-100(A)) in *Flatley v Mauro*. *Flatley v. Mauro*, 139 P.3d 2 (2006). In that case, entertainer Michael Flatley sued an attorney for civil extortion based on a letter from the attorney-defendant threatening to publicize a sexual assault allegation unless Flatley paid millions of dollars. The letter warned Flatley that, unless he settles, "an in-depth investigation" of his personal finances would commence and would "become a matter of public record." The letter went on to say the attorney-defendant would turn over any pertinent information to law enforcement agencies.

The attorney-defendant moved to strike the complaint, arguing that he was exercising his constitutionally protect rights of free speech and to petition to redress grievances, or that he was immune under the litigation privilege. The Supreme Court rejected the attorney-defendant's arguments, holding that his actions constituted criminal extortion as a matter of law. Citing Rule 3.10, the court emphasized that attorneys aren't exempt from the law. Pointedly, the court wrote: "[A] threat that constitutes criminal extortion is not cleansed of its illegality merely because it is laundered by transmission through the offices of an attorney."

Judges in California have been busy distinguishing when protected activity may or may not be unethical (or criminal) since *Flatley*. Recently, for example, a California appellate court held that an attorney didn't violate Rule 3.10 when they sent an email threatening to expose a purported fraud scheme via *civil* litigation if the parties didn't settle because the email didn't threaten *criminal* charges. *J.B.B. Investment Partners Ltd. V. Fair*, 248 Cal. App. 5th 1 (2019).

California's State Bar provides guidance to attorneys who suspect they are on the receiving end of an improper threat. Comments to Rule 3.10 provide that if a lawyer believes *in good faith* that an opposing attorney violated the law, the lawyer may state that if the conduct continues the lawyer will report it to criminal or administrative authorities. On the other hand, a lawyer cannot imply that they will pursue criminal or administrative action unless the opposing party agrees to settle the civil dispute. Attorneys must approach these situations carefully to avoid violating the rule themselves.

> Several large jurisdictions have rules that explicitly bar attorneys from threatening disciplinary or criminal action to gain the upper hand in settlement talks. Some states only prohibit threatening criminal action. And some states haven't promulgated any rules covering this subject at all.

Illinois

Illinois's Rule of Professional Conduct 8.4(g) also prohibits lawyers from presenting, participating, or threatening to present criminal or professional disciplinary charges to obtain an advantage in a civil matter. *Ill. Sup. Ct. R. Prof'l Conduct*, R 8.4. Yet there isn't a great deal of case law applying the rule.

In *Drennan v Susman*, defendants moved to vacate a settlement agreement alleging that opposing counsel violated Rule 8.4(g). In that case, the defendants claimed that the plaintiff's attorneys suggested to one of the defendants that he should settle the case because defendant's daughter, an attorney, had violated the rules of professional conduct. The defendants alleged that plaintiff's attorneys filed an ethics complaint against the defendant's daughter. By raising the disciplinary issue during settlement negotiations, the alleged implication was that if the defendants settled, the grievance would go away. *Drennan v. Susman (In re Estate of Susman)*, 2012 IL App (2d) 110121-U. The plaintiff's attorneys denied bringing up the disciplinary action during settlement negotiations. Instead, they contended that the defendant's *own* attorney brought up the disciplinary action.

The trial court denied the motion to vacate the settlement order. The appellate court agreed, holding that the facts didn't support a finding that any attorney made comments related to disciplinary proceedings to obtain an advantage during settlement negotiations. And the court was persuaded that settlement wasn't coerced due to the threat of ongoing disciplinary action against the defendant's daughter, but rather that trial was going to start the next day and the defendant "want[ed] this over."

The fact-specific holding in *Drennan* doesn't provide a lot of guidance to attorneys regarding the ins and outs of Rule 8.4(g). But it's worth noting that the appellate court didn't outright reject the possibility that a client's own attorney could violate Rule 8.4(g) by interjecting the issue of disciplinary proceedings (or other extraneous actions) that may impact a client's decision to settle.

Texas

Texas Rule of Professional Conduct 4.04 (b) mirrors Illinois's and California's rules discussed above. Comments to Rule 4.04 provide an important public-policy justification for the rule: "Using or threatening to use the criminal process solely to coerce a party in a private matter improperly suggests that the criminal process can be manipulated by private interests for personal gain." The Texas rule also expressly prohibits any such threats in the context of bar disciplinary proceedings. *Tex. R. Disc. Prof'l Cond.* Rule 4.04(b)(2).

As one Texas case shows, scenarios in which an attorney may transgress rules like Rule 4.04(b) aren't limited to the context of settlement negotiations. In *Yetiv v. Comm'n for Lawyer Discipline,* an attorney appealed a trial court's decision to suspend him from the practice of law for several months for violating Rule 4.04(b). *Yetiv v. Comm'n for Lawyer Discipline,* No. 14-17-00666-CV, 2019 WL 1186822 (Tex. App. Mar. 14, 2019). *Yetiv* arose out of an underlying trial in an insurance dispute. In the middle of the underlying trial, the attorney-appellant emailed opposing counsel with a demand: "Announce in open court that you now realize that there was no factual or legal basis for your allegations, and that you are sorry for having made them." In exchange, the attorney-appellant promised to release opposing counsel from liability and that he wouldn't file a grievance. The email concluded: "Choose wisely."

On appeal, the attorney-appellant suggested the Rule 4.04(b) could only be triggered by a monetary *quid pro quo*. He cited past Texas cases examining the rule in the context of settlements and payment of money. Yet the court found it was enough that the attorney-appellant conditioned his threat on opposing counsel taking specific action at trial. If opposing counsel took that action, it would have given the attorney-appellant an advantage in the civil case. The appellate court affirmed the trial court's decision, noting that an attorney must be "exceptionally careful" when communicating a threat of criminal or disciplinary proceedings in the course of litigation.

In sum, attorneys must be cognizant of applicable rules throughout the course of litigation—not just during settlement negotiations. And a financial incentive

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isn't required to trigger discipline under Rule 4.04(b).

Jurisdictions Not Prohibiting Threats or Are Silent on the Issue

While many states have promulgated rules addressing these ethical issues, other states haven't addressed the issue of threatening disciplinary action or haven't issued any rules on the subject at all. Despite the absence of a specific rule, threats during civil litigation can still leave an attorney exposed to liability or discipline.

New York

New York Rule of Professional Conduct 3.4(e) prohibits attorneys from threatening criminal charges to obtain an advantage in a civil matter. But unlike California, Illinois, and Texas, the New York rule stops short of prohibiting threats of disciplinary actions.

The New York City Bar Association's Committee on Professional Ethics issued a formal opinion addressing this discrepancy. *N.Y.C. Bar Ass'n Comm. on Prof'l Ethics*, Op. 2015-5. The opinion warns attorneys to consider whether making threats of disciplinary action would violate the rules of professional conduct. But since Rule 3.4 only applies to criminal charges, the opinion concluded that disciplinary threats don't violate this rule.

This conclusion is in line with New York State Bar Association Ethics Opinion 772, which analyzed the predecessor to Rule 3.4 in a scenario in which a lawyer represented a stock brokerage customer whose funds had been misappropriated by the broker. *N.Y. Bar Ass'n Comm. on Prof'l Ethics*, Op. 772 (2003). The question presented to the ethics committee was whether the lawyer could threaten to file a criminal complaint or a complaint with a regulatory body, like the New York Stock Exchange. The opinion concluded that threatening a criminal complaint would violate the rule if the lawyer's purpose was to obtain a return of his client's funds. But threatening to file a complaint with a regulatory body, administrative agency, or disciplinary authority wouldn't violate the rule.

Michigan

Michigan, on the other hand, doesn't have a specific rule barring threats of either criminal or disciplinary action to seek an advantage in a civil proceeding. It used to. Like New York, Michigan's former rule prohibited attorneys from threatening criminal charges solely to obtain an advantage in a civil case. *Michigan Code of Professional Responsibility* 7-105(A). But that language was dropped when Michigan adopted its current rules of professional conduct. Nevertheless, such conduct can still conflict with Michigan's professional conduct rules.

Various provisions of Michigan's current rules of professional conduct arguably address the abuse the former rule sought to thwart. However, these rules are less broad than the former rule. For example, MRPC 3.1 prohibits lawyers form making frivolous or bad faith assertions. MRPC 4.1 prohibits lawyers from knowingly making false statements. Nor may a lawyer engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.

The State Bar of Michigan addressed this gray area in an informal ethics opinion. The opinion concluded that a lawyer may, when acting in good faith:

> Call to the attention of an opposing party the applicability of a penal statute;
>
> Make reference to a specific criminal sanction; or
>
> Warn of the possibility of criminal prosecution, *even if done in order to assist in the enforcement of a valid right or legitimate claim of a client*.

Mich. Ethics Op. RI-78. The opinion noted, however, that there must be a "reasonable nexus" between the possible criminal conduct and the issues in the civil case, otherwise a lawyer risks conflicting with the criminal extortion statute.

While the opinion references criminal sanctions, there is a lack of guidance regarding threats of disciplinary actions. Other ethics opinions pick up the slack. For example, another informal opinion observed that a lawyer can't use alleged lawyer-misconduct "as a means of obtaining an advantageous resolution of the client's own matter." *Mich. Ethics Op.* RI-88. Nor can a lawyer threaten reporting lawyer-misconduct in exchange for restitution or offer or make an agreement restricting reporting misconduct to the Attorney Grievance Commission.

Bottom line: in the absence of an explicit rule, Michigan attorneys must be wary before engaging in conduct that could conflict with the various rules of professional conduct implicated by threats of criminal or disciplinary action during litigation. While the above informal ethics opinions are merely advisory and aren't binding on the courts, they are instructive. See, e.g., *Evans & Luptak, PLC v Lizza*, 650 N.W. 2d 364 (Mich. App 2002). So, it's likely that threatening criminal or disciplinary action against an opposing attorney simply to gain a strategic advantage in civil litigation would violate multiple ethics rules, raise serious questions about an attorney's professionalism, and could even violate Michigan's criminal extortion statute.

Absent a specific rule, attorneys may hesitate to report attorney misconduct because they aren't sure whether the at-issue conduct is permissible. On the flipside, attorneys who may contemplate using threatening tactics during settlement negotiations should think again. Even in states lacking clear-cut rules, the best practice, is to err on the side of caution and avoid threats of criminal charges simply to gain a strategic advantage in a case.

ABA Model Rules and Practice Points

While many states have promulgated specific rules prohibiting all threats to gain an advantage during civil litigation, the rule in some states is unclear. For example, New York's ethics rules don't address threats of disciplinary action. And Michigan dropped the language addressing this conduct from revisions to its rules of professional conduct. Like Michigan, the ABA Model Rules do not specifically address threats of criminal prosecution or disciplinary action to gain an advantage in civil litigation. In a formal opinion, the ABA Standing Committee on Ethics and Professional Responsibility explained that threatening to bring criminal charges for purposes of advancing a civil claim *would* violate the Model Rules only if the following applied:

> The criminal wrongdoing was unrelated to the civil claim,
>
> If the lawyer didn't believe the potential criminal charges were well-founded, or
>
> If the threat constituted an attempt to exert or suggest improper influence over the criminal process.

ABA Comm. on Ethics and Prof'l Responsibility Formal Opinion 92-363 (1992). The drafters of the Model Rules viewed a general prohibition as overbroad and unjustified unless any of the above factors applied. In sum, the ABA's position is that a lawyer does not subvert the criminal justice system by threatening criminal prosecution when the criminal charges are well founded, stem from the same matter as the civil claim, and are used to gain legitimate relief for the client. Abusive threats, on the other hand, are covered by general prohibitions elsewhere in the Model Rules.

While other rules may regulate the same conduct, the omission leaves a void that can create unnecessary confusion for attorneys, especially those who may wonder whether they have a duty to report potentially offending conduct to regulatory bodies. Absent a specific rule, attorneys may hesitate to report attorney misconduct because they aren't sure whether the at-issue conduct is permissible. On the flipside, attorneys who may contemplate using threatening tactics during settlement negotiations should think again. Even in states lacking clear-cut rules, the best practice, is to err on the side of caution and avoid threats of criminal charges simply to gain a strategic advantage in a case. And, attorneys should also avoid using threats of disciplinary action as weapons to gain an advantage in litigation and reserve those discussions for circumstances in which there is a genuine concern that anther attorney has violated their ethical duties. If the latter is true, then mandatory reporting requirements could apply anyway. ■

About the **AUTHOR**

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Practicing Well: Talk About It!

Patty Beck | *Minnesota Lawyers Mutual Insurance Company*

If you asked me during March 2020 how I felt about COVID-19, I would tell you that it was awful and that I had nothing good to say about it. If you asked me that same question at the end of April, I would tell you that I have seen more beauty, creativity, and courage from people around the world in the last eight weeks than ever before. Not only have I witnessed this in my news feed and around my community, but I've experienced it professionally as well.

> I recently heard the phrase "we may not be in the same boat, but we are all in the same storm." The way I see it, this storm is currently helping lawyers get comfortable talking about their well-being, which is something our profession needs.

Nearly every phone call and video conference I attended during April began with everyone sharing how they were doing, things they were struggling with, and what they were doing to stay physically and mentally healthy. This was not a matter of being polite or going through the motions of asking someone how their day was going. People were genuinely concerned for each other and wanted to know how everyone was doing. That may be one of the greatest things to come out of COVID-19 for the legal profession—lawyers are becoming more interested and willing to talk about their well-being without fear of judgment or negative repercussions.

Lawyers tend to not want to share what they are stressed about. There are a lot of reasons for this, one being there is a perception that lawyers are supposed to be tough and that sharing our struggles can be viewed as a sign of weakness. But COVID-19 seems to be changing that in a way. With this pandemic, we finally have a level playing field where there is absolutely no weakness or negativity associated with talking about how we're doing because *everyone* has been impacted and can relate in some way to what others are going through.

Everyone knows the challenge of not being able to hug their loved ones, the fear of financial uncertainty, or the sheer boredom that we have all undoubtedly faced at some point during our respective lockdowns. There are emotional consequences of social distancing, there is anxiety that can come from reading too much news, and exhaustion from wondering how long this will last.

We don't have to look hard to find statistics about lawyers battling various mental health and well-being issues before COVID-19 (see the *2016 ABA Hazelden Betty Ford Study* for reference). Many lawyers admit there are significant barriers to openly discussing our problems and getting help, most of which have to do with concerns of confidentiality and the potential for professional consequences if our colleagues and clients learn that we are struggling. But given that everyone understands, on some level, the stress associated with COVID-19, there seems to be a greater willingness to share our experiences knowing that suddenly we are not "alone" in our struggles.

I recently heard the phrase "we may not be in the same boat, but we are all in the same storm." The way I see it, this storm is currently helping lawyers get comfortable talking about their well-being, which is something our profession needs. At the end of April, I am encouraged and feel hopeful that when we come out the other side of this pandemic, lawyers will continue to talk about their well-being and help reduce the stigma that has seemingly plagued our profession.

So, talk about it. Ask your colleagues how they are doing. Be willing to share what challenges you are facing, or the great ways you are staying healthy. If you feel nervous about sharing what you're going through, try to find the courage to talk about it anyway—not only will it be helpful for you, but hearing that a peer is going through the same thing may be the push that someone else needs to share their own experience and get the help they need. ■

About the AUTHOR

Patty Beck is a Claim Attorney with *Minnesota Lawyers Mutual Insurance Company*, where she manages litigation involving legal malpractice claims, advises attorneys facing existing and potential ethical dilemmas, and resolves complex pre-suit malpractice claims on behalf of MLM insureds. She is Co-Chair of the MSBA's Well-Being Committee and frequently speaks on topics related to ethics, legal malpractice, and attorney wellness. Ms. Beck may be reached at pbeck@mlmins.com.

While we may not be able to gather together in Nashville this fall to greet old friends and make new professional connections, we are starting planning for the 2021 Annual Meeting and a time when we can hopefully gather together again safely. Though still in the early planning process, with any luck we should be able to head roaring into Nashville in the fall of 2021 instead.

We recognize that there are presently a lot of unknowns facing our membership, their companies, their firms, their colleagues, their families and their communities. Many of these unknowns face the PLDF as well.

The PLDF operates as a non-profit professional organization and has always tried to deliver maximum value to its members at the minimum possible cost. The PLDF Annual Meeting, my favorite professional conference each year, is an area in which this is particularly true. We have strived to keep it on the lower end of being competitively priced with other high-quality CE/CLE options, but to deliver a more connected atmosphere by including cocktail hours, networking field trips, meals and the signature member dinner. In short, we price like other organizations but give you much more for the price of admission.

In order to make this work both financially and logistically, we need to be able to plan around a minimum number of attendees and commit to venues and other vendors based on those numbers. If we fail to meet the minimums, the PLDF has to make up the financial difference. In years where we meet our expected number of attendees, the funds generated by the Annual Meeting cover the costs of the event without much left over. If we were ever to dramatically miss the mark on our estimates, the required vendor commitments could be financially ruinous for the PLDF and compromise its future existence.

This year, in light of unprecedented measures underway to protect the public health against a new threat, the Board of Directors unanimously agreed that we cannot responsibly keep the attendance commitments to vendors necessary for the PLDF to hold an in-person annual meeting this year. The world is too uncertain, the threats to our members and their firms are too unknown, and the financial risk to the PLDF is too great.

That said, while we may not be able to gather together in Nashville this fall to greet old friends and make new professional connections, we are starting planning for the 2021 Annual Meeting and a time when we can hopefully gather together again safely. Though still in the early planning process, with any luck we should be able to head roaring into Nashville in the fall of 2021 instead.

Finally, please know that every PLDF member is a part of our extended professional family and we each face upheaval on an ongoing basis in the present and for the foreseeable future both in our personal and professional lives. I ask not only that each of you take care of yourselves but that you take care of other members and colleagues if you see them struggling, and to let me know if there is any way the PLDF can be of assistance.

Thank you for your continuing support of the PLDF. Be well. ■

About the
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Lisa Tulk of *Kessler Collins, P.C.* in Dallas is the current President of PLDF. Her practice focuses on the counseling and defense of architects, engineers, financial advisory firms and accountants. Ms. Tulk may be reached at ltulk@kesslercollins.com.

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Our committees are vibrant communities of attorneys, claims professionals, risk managers, and insurance professionals who devote their time, energy and expertise to advancing the PLDF mission, "to ehance the stature and effectiveness of professional liability defense professionals through education, training, and the exchange of information."

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