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An Integrated Law Firm Loss Prevention Matrix

Peter J. Winders

He who flees from the noise of the fear shall fall into the pit; and he who comes up out of the midst of the pit shall be caught in the snare: Isaiah 24:18, plagiarized in Jeremiah 48:44[1]

As if a man fled from a lion, and met a bear; escaped into the house . . . and a snake bit him:
— Amos 5:19

A combination of circumstances creates the serious professional liability claim; and a combination of measures can protect against it. The guy in *Amos* may have been negligent in provoking the wildlife, but with better pest control, he would have been okay.

Large Claims Against Lawyers

Almost all very large claims against law firms in the past 25 years have involved a convergence of several of a group of specific factors listed in the table below. The large claim tends to be a "perfect storm" situation where not just one thing goes wrong but several things coincide to make the situation worse. This observation was true of the savings and loan scandal cases, the recent corporate accounting collapses, the "dot com" cases, and the aiding and abetting claims – in which the plaintiff contends that the defendant's transaction lawyer on various theories became a participant in defendant's schemes. It is rare that a really big claim involves only one or two of these factors. Some of these factors allow problems in the door, while other factors allow problems to grow undetected or unaddressed until they cannot be contained.

Comprehensive Loss Prevention

The loss prevention structure for a law firm involves a combination of elements - policies, programs, systems and aspects of firm culture. Done right, they are complementary and can provide layers of protection. The components can be classified as follows:[2]

Gatekeeping Systems – These are systems that can be enforced by strict application of procedures as part of a process that everyone has to do. An example is the Business Intake System: to open and record time to and bill a matter, certain steps have to be accomplished, and the firm can protect itself by adding steps with loss prevention value. Because everyone wants to record time and bill, this is an occasion to impose other tests before that can be accomplished. Another example is the Lateral Hire procedure, which similarly may have imposed on it certain checks and requirements providing loss prevention information and requiring loss prevention or risk decisions. If mechanical steps are required before something can be accomplished, that also provides an opportunity for application of the additional judgment of a particular person or group.

A number of things can be guarded against at the gate by a Business Intake System that requires signoff by one or more persons of trusted judgment *other than the originating lawyer*:

- **Unworthy or undesirable clients.** By requiring signoff from a person of trusted judgment other than the originating lawyer, and by providing client background information through appropriate research to aid such judgment, the unwitting acceptance of a client with a history of changing lawyers, fraudulent activities, or other undesirable traits, is diminished.
- **Dabbling.** If the business intake review includes the leader of the department in whose specialty the matter falls (not the head of the originating lawyer's primary depart-

Peter J. Winders is General Counsel, Carlton Fields, Tampa, Florida.

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ment unless that is the nature of the matter) then proper staffing of the matter can be assured. Traps exist in every practice area, and it is common for one specialist to underestimate the complexity of another specialty. The litigator cannot open a patent matter without the signoff of the head of the IP Practice Group. This can be guarded against at the gate.

- **Inadequate or inappropriate fees.** Closely related, the appropriate fee agreement for an assignment is best determined by the group or department that specializes in the work. Approval by the group or department head avoids the problems of disappointed expectations. This not only protects the firm's economics, it protects against the temptation to neglect unprofitable work, and the increased risk such neglect carries with it.
- **Conflicts – including positional or "blocking" conflicts.** The basic conflicts issues arising from a standard data base search can be reviewed, which is vital. As important, the leader of the practice area in which the engagement falls is better positioned to know if a positional conflict is implicated, or if the acceptance of the business might interfere with another more desirable engagement that is in process.
- **Inadequate engagement letters.** Involving the right practice group leader helps assure that specific issues to that area of the law are properly addressed in the engagement letter. A signoff by the leader of that area provides this safeguard.

Policies on Specific Products – Certain risks can be managed by requiring that certain functions must be performed with safeguards. Examples are an Opinion Letter policy that requires approval by two lawyers, or by a department head, or by a member of a panel. This is an important safeguard, but it is not always self-enforcing. Unlike the Business Intake Policy where the lawyer wants to obtain the account numbers that will allow him to bill and record his time, but cannot get them without following procedures, the lawyer who wants to fire off a letter answering a complex question off the top of his head can do it – he has just violated policy and made a serious judgment error. The lawyer can get the firm in trouble by forgetting to follow policy, and there is no gatekeeping opportunity to assure he does not make that mistake. Some firms have an Opinion step in the Business Intake procedure, asking if the engagement involves an Opinion of the firm, and if it does, triggering the review process from the outset. This will not catch the Opinion requests that often arise during the course of the engagement, but it should catch those present at the outset and serve as a frequent reminder of the policy. Education and enforcement are required to assure that compliance with such safeguards.

The large claim tends to be a "perfect storm" situation....

Another example is a policy on Audit Letter Responses. The policy may be clear that the firm does not give oral updates to auditors, but it is possible to do so anyway.

Policies Against Bad Ideas – As examples, firms should have policies against investment with clients, against serving on the Board of a client, against insider trading. There can be requirements for seeking exceptions to some such policies, but there is no true gatekeeping opportunity to catch all of them before they arise. Some of these can be uncovered by requiring a response annually to a question to the lawyers about board memberships, often required for insurance applications. Perfect enforcement of policies such as this is hard. A typical young litigator will read and immediately forget a policy that prevents his acting as a trustee or a director without certain conditions and safeguards, because he cannot foresee that it applies to him. When a grateful client offers him the position several years later, he sees it as an honor, and thinking as litigators do about business matters, "How hard can it be?" accepts without thinking about checking policy. Education and re-education are required.

Policies and Systems to Assure Access and Reporting – These are important whether you can appropriately call them systems or not. What happens when, despite the sentries, the problem matter got through the gate despite the fluttering red flags and the foul smell, or when the problems arose after the matter was already in the door? There should be clear paths that allow peers, associates, paralegals and secretaries to let appropriate people know if they observe an irregularity or are worried about something. Many of the firm's staff members will be quite savvy (especially if the firm includes them in its education efforts). The policies encouraging reporting might be called an Open Door policy, an Ombuds Policy, a Safe Harbor Policy, or a combination – but they should both encourage, and remove impediments to reporting matters that may be important. If the Ombuds Policy allows a secretary anonymously to report that Lawyer X is not following the Opinion Policy, or is showing signs of a substance abuse problem, or is investing with a client contrary to policy, the firm is way ahead. The requirement to report claims or circumstances that might conceivably result in claims to a designated person as soon as possible should be crystal clear, and the reporting itself should be as painless as possible – a means to marshal the firm's resources for damage control, not discipline.[3] Any decision about whether the existence of a problem is a symptom of inadequate performance by an individual lawyer must be separated from reporting. Reporting a problem to the General Counsel should have a positive result - immediate assistance in solving the problem or minimizing the damage. If there was misconduct on the part of the lawyer, that is a different problem that will be addressed later by management.

Education Programs - A firm whose lawyer population

has a high average sensitivity to ethical issues has a built-in early warning system as important as any policy or procedure. The higher the level of sophistication the lawyers have in general, the more likely they are to recognize issues early and engage the firm's machinery for resolving them. A program of regular and frequent highlights distributed in the firm (including to staff) to remind everyone of ethical issues, illustrations of the consequences that can result from ignoring ethical problems, new developments in the law, firm policies and their bases, etc., in addition to more formal in-house CLE programs and discussions at department or practice group meetings, can help increase the firm's ethical sensitivity and sophistication. Education is essential to achieve compliance with the above stated firm policies because compliance depends to a large extent on the individual lawyer, except in the case of the gatekeeping systems.

Cultural Aspects - It helps enormously if it is recognized that the firm expects adherence to high ethical standards and the policies helping to assure it. It helps even more if the compensation system does not reward improper behavior but penalizes it. The prospective lateral hire who has heard of conflicts but has never actually seen one must understand and agree that he must buy in to the culture of the firm that takes conflicts very seriously. If the firm already has a culture of openness and teamwork, the firm can be more confident that its Ombuds policy will be even more successful in assuring prompt reporting of problems and concerns. The firm that addresses internal personnel problems directly consistent with its values and goals, rather than wishing them away, is avoiding losses just by being itself. The firm that recognizes that time spent in management of the loss prevention policies (such as those involved in business intake) is valuable to the firm, and therefore pays for it, will be money ahead of the firm that appoints department heads as a matter of seniority but compensates only billable time.

Reporting a problem to the General Counsel should have a positive result.

Much work will be required to assure that there is no fear that a messenger will be shot. This is an area like many others in which a written policy is easy, but making sure the firm both means what it says and is perceived to mean what it says is hard. When the suspicious young securities lawyer is reassured by her boss that the client can be trusted because the boss has known the client's grandfather for 40 years, the young lawyer needs to be able to take the concerns to a different part of management, and she must see that as not only her duty but a rational option. Nothing should make her believe that her best course is to transfer to the construction department or seek another firm. Creating the right culture is difficult not only because it places a burden on the young lawyer, but also because it places a burden on management to do something. Everybody's reaction to such a problem is to wish it wasn't there or that it would resolve itself. In firms where management is part time, the press of client work may not only take precedence, but also provide an excuse not to address the problem. Confidence that reporting concerns is of value to the firm must be demonstrated by promptly investigating, and by promptly addressing the problem. The task is made more difficult because often it is inappropriate to report the results of the investigation to the person who reported it. This is worth a separate article, as it is a difficult set of issues with many different aspects.

Management - It takes time and attention to make the loss prevention systems work. Operational managers such as Practice Group Leaders or Department Heads must be given the time and resources to do what is expected of them. The managing board and the full time CEO must support the loss prevention policies and support the General Counsel or equivalent person charged with administering them. Full time leadership, not just administration and crisis management, is a necessity in a large firm. Besides leadership and top management, paying attention to the business aspects of the firm can provide another early warning system. What is the reason the file remains unbilled? Is there a problem that the lawyer believes will resolve itself with time, or that sending a bill will exacerbate? Why hasn't the client paid the bill? Is there dissatisfaction that should be addressed now? Or that the billing lawyer doesn't know how to handle? Following up on the finances will uncover problems if they are there. It should be assured that the problems will then be addressed.

Core Values - Agreed and sincerely held core values are a guide for maintaining the helpful culture that supports wise loss prevention policies, and a basis for backing up the policies. If a firm's core values include a dedication to ethical behavior, teamwork, and the practice of law rather than individual entrepreneurial adventures, it is easier to expect the reporting of claims or concerns, compliance with the policies against outside directorships or investments, and similar polices.

With the foregoing as an introduction, here is the matrix and how it can work:

Components of Large Claims vs. Firm Policies and Safeguards

The following table shows how various loss prevention systems, policies, and programs may be effective to (a) identify, (b) prevent, or (c) assure speedy response and damage control to the presence of the various factors that in combination make up the large claim. The protection of the firm lies not only in the attempt to prevent the original danger or mistake, but also to avoid the concurrence of aggravating factors and thus prevent the basic problem developing into a category 4 or 5. I hope this display of the interactive relationship of the policies and systems in response to known factors will help loss prevention officers communicate the reasons behind the policies and programs, and thus to enhance compliance, alertness and the corresponding utility of the combination.

FACTOR CONTRIBUTING TO CLAIM	PROGRAM, SYSTEM OR POLICY TO IDENTIFY, LIMIT, PREVENT LOSS
• The claim is not made by a client, but by a person who dealt with the client (stockholder, investor, lender, customer, etc.).	• **Business Intake** (PGL[4] must approve client, staffing, etc.). Matters involving possible 3d party reliance and OPM[5] are given special attention. • **Opinion Letter and Audit Response policies.** Knowledgeable additional shareholder must sign off on opinions. • **Practice Group Organization.** Lawyers aware of special dangers of their practice area involved in the matter.
• The claim involves a lawyer with a personal stake or personal relationship with the client (maybe an investment, maybe a friendship, maybe a system of compensation that rewards client relationship).	• **Policy against investment with client.** No such investment except with Firm permission. • **Policy against service on client Board,** or as client officer, to prevent confusion of lawyer obligations and director/officer obligations. • **Policy preventing lawyer with interest in client handling client business** in the few instances that a lawyer has such an interest. • **New Business Intake** – staffing approved by PGL for the area of law, not originating lawyer. • **Ombuds Policy and Firm Culture** – enabling junior lawyer or staff member to report matters of concern anonymously or without adverse consequence – see below. • **Compensation System** - see below
• Lawyer inexperienced in the area of the law fails to recognize trap or to appreciate risk.	• **New Business Intake** – staffing: PGL for the type of matter must approve staffing. • **Practice Group Organization-** organization of firm by areas of law helps assure discovery of inappropriate staffing.
• Some red flags or knowledge that client might be misbehaving, and failure of responsible partner to recognize or believe it. ("I have been representing client for 20 years – they would never do anything improper"). Failing to consider change in corporate client's personnel or financial circumstance.	• **Ombuds Policy** – and firm culture enabling junior lawyer or staff member to report matters of concern anonymously or without adverse consequence – the junior lawyer or staff member can make concern known to disinterested members of the Firm - clear lines of communication. • **Clear Loss Prevention Policy** - obligation to report any "circumstance" to the GC, etc.
• Some red flags or knowledge that client might be misbehaving, or that misbehavior is not addressed by responsible lawyer - junior lawyer or staff member who sees it does not know what to do.	• **Clear Loss Prevention Policy** – obligation to report any "circumstance" (situation that could result in a claim) to General Counsel or equivalent • **Ombuds Policy and Culture** – enabling junior lawyer or staff member to report matters of concern, etc. as above, through several routes.

FACTOR CONTRIBUTING TO CLAIM	PROGRAM, SYSTEM OR POLICY TO IDENTIFY, LIMIT, PREVENT LOSS
• Conflicts of interest	• **Clear conflict of interest policy,** supported by good and accurate database, quick turnaround, and procedure to resolve questions. • **Continued education** in-house to assure Firm employees are sensitive to conflicts issues, need for waiver or consent, etc.
• Compensation systems that ignore loss prevention or ethical issues.	• **Subjective compensation system** that takes into account intangible contributions to the Firm and actions or attitudes adverse to the best interests of the Firm.
• Firm culture or failure of THE FIRM AS A WHOLE to recognize or address the problem – e.g.: * one lawyer recognizes the problem but "it is not my business, it is Joe's client" * officers of firm too busy with practice of law to do any management other than crisis management * "eat what you kill" or similar system, where compensation is based not on firm welfare but individual "production" * "lone wolf" lawyers, not integrated into the firm, not taking advantage of resources, not keeping others advised of their work	• **Responsible Practice Group Organization,** responsible & accountable for operations. • **Strong organization**, agreed core values, dedication to Firm as an entity. • **Strong leadership** – Firm management & loss prevention, are full time, not sidelines • **Strong commitment to loss prevention,** continued loss prevention education, etc. Clear lines of communication: **Claims, Loss Prevention, Ombuds Policies.** • Strong culture of professionalism and teamwork • **Ombuds Policy** – to enable expected cooperation, communication from all employees. • **Staff of knowledgeable employees**, encouraged to take a team attitude for the benefit of the Firm. • **Attention in Recruitment** to lawyers with compatible philosophy to that of the firm. • **Compensation system** with a strong subjective element allowing for consideration of overall contribution to/ damage to the organization. • **Firm culture** of professionalism, service, and that includes all the above.
• "Unworthy client" – the person or corporation we should not represent – an unsavory or dishonest past, a questionable venture, a person who might want to use the Firm's respectability more than its legal advice; such persons tend to spread blame when a scheme goes bad, and to insist on more involvement than appropriate by their lawyers.	• **New Business Intake** requirement that Practice Group Leader approve new client or search for information on new client. • **Oversight** of various "badges" of an unworthy client by other Firm officers and staff – accounting and Treasurer re late paying client; Practice Group Leader, General Counsel re complaints, concerns, etc. • **Frequent education**, encouragement to identify and terminate "unworthy" clients. • **Firm culture** that recognizes advantage of eliminating dangerous clients
• Failure of a lawyer to recognize a problem until a number of the factors have converged.	• **Education.** Frequent reminders and explanation to lawyers and staff of known dangers, policies and their reasons. Parables from hard cases. Reminders about access and reporting. Accessibility for help.

So what? There are ways to guard against various risks. That is obvious. Why take six pages to tell somebody that?

The point is the mathematics behind a good loss prevention matrix. If you accept the proposition that *several* things must go wrong in order to turn a mistake into a catastrophic claim, then improving the odds that each of the necessary factors will not occur improves the odds against a catastrophic loss. The math looks like this: the probability of a situation that occurs as a result of several factors is the product of the probability of the occurrence of each factor.

So if X (the catastrophic claim) occurs when a, b, c, and d coincide, the probability of X occurring is calculated by multiplying the probabilities of a, b, c, & d. If the probability of a, b, c, & d occurring is 50% (.5) for each of them, then the probability of X occurring is .5 x.5 x .5 x .5 = .0625 = 6.25%. If the probability for each of a, b, c, & d occurring is reduced to 10%, then the probability of X occurring is .1 x .1 x .1 x. 1 = .0001 = .01%. Thus X is 625 times more likely to occur when the odds are 50% that each of a, b, c & d will occur than when the odds are 10% that each of them will occur. If even one of the factors is reduced from 50% to 10%, the probability of X occurring is reduced from 6.25% to 1.25%.

Suppose the bad situation consists of (a) bad client, (b) bad mistake, (c) failure of the firm to react, or failure to notify the firm, and (d) bad motive either present or arguable. The chances of getting a bad client can be reduced by a good intake system, an investigation of the client's background, which is pretty easy by computer. A bad mistake is less likely if the policy against dabbling by non-specialists is enforced. Good staffing and clear lines of pain-free communications will help assure that a problem is recognized early and that the firm is notified of a problem when it begins to arise. And bad motive will be hard to find if the policies against investment with clients are enforced and compensation is not tied by formula to a particular piece of business. With the success of each policy or procedure, the odds of the catastrophic claim go down. That is the point. No program or series of systems can assure that mistakes will not be made. But a good overall program can enormously reduce the chances of catastrophic loss.

The object of loss prevention is to make it easier and safer to practice law. A well thought out loss prevention matrix based not only on the firm's own experience but also on the experience of other firms, can work to reduce risks significantly. And examining the practical workings of the culture, programs and policies should increase the awareness and sensitivity of lawyers to loss prevention and ethical concerns, which by itself increases the safety of the firm.

Endnotes

1. Actually, whether this is earthly plagiarism or divine redundancy depends on who (Who?) wrote it.
2. Writers similarly can be classified into two groups: those who classify things into groups and those who don't.
3. At least one large firm has a Safe Harbor policy allowing a lawyer to self-report a mistake to the General Counsel with no adverse consequence, but promises consequences if the problem is discovered or reported first by others.
4. Practice Group Leader or a designee.
5. Other People's Money.

Recent Decisions, from page 2

4. *Id.* at *5.
5. *Id.*
6. *Id.* at *4 (citing Office of Disciplinary Counsel v. Marcone, 855 A.2d 654, 657 (Pa. 2004)).
7. Office of Disciplinary Counsel v. Marcone, 855 A.2d 654, 657 (Pa. 2004).
8. *Id.* at 658.
9. *Id.* at 658.
10. *Surrick*, 2005 U.S. Dist. LEXIS 6755 at *14 - *15.
111. *Marcone*, 855 A.2d at 661. The Court based its decision on the following: (1) Merely "engaging in general federal practice and advising clients as part of a federal practice necessarily implicates counseling on state law issues;" (2) Diversity actions are based on state law; (3) Many time state law issues are intertwined with federal law issues; (4) The State has an interest in regulating attorney conduct to ensure the public's interest of competent legal representation. *Id.*
12. *Surrick*, 2005 U.S. Dist. LEXIS 6755 at *29 - *38. *See, e.g.*, Sperry v. State of Florida, 373 U.S. 379 (1963) (holding that a licensed attorney before the United States Patent Office who is unlicensed to practice law in Florida is not engaging in the unauthorized practice of law by maintaining in office in Florida for the purpose of practicing patent law); Pennsylvania v. Wheeling & Belmont Bridge Co., 54 U.S. 518, 566 (1851) (asserting that a State can not adversely affect the free use of a license granted under an act of Congress); *In re* Disilets, 291 F.3d 925, 930 (6th Cir. 2000) (finding that when a state licensing law attempts to restrict a lawyer from doing what a federal law expressly entitles the lawyer to do, the state law must heed way). *But see, e.g., In the Matter of* Perrello, 386 N.E.2d 174, 179 (Ind. 1979) (holding that an attorney suspended from the practice of law in Indiana violated his suspension by maintaining a law office in Indiana for federal practice).
13. *Surrick*, 2005 U.S. Dist. LEXIS 6755 at *38.
14. *Id.* at *37 (citing Leslie Miller v. Arkansas, 352 U.S. 187, 190 (1956)).
15. *Id.* at *37.
16. *Id.* at *42.
17. *Id.*
18. *Id.* at *43. *See* Attorney Grievance Commission v. Bridges, 759 A.2d 233, 244-45 (Md. 2000) (holding that an attorney did not engage in the unauthorized practice of law because he did not advertise, have a sign at his office, and in fact limited his practice to federal matters). *But cf. Marcone*, 855 A.2d at 660-61 (Pa. 2004) (finding that a sign stating "Attorney at Law" on office window constituted unlawful practice of law).
19. *Surrick*, 2005 U.S. Dist. LEXIS 6755 at *41 n.1. *See id.* (stat-