

FAVORS CAN BE EXPENSIVE

Angie's family members were elated when they learned that she had passed the bar exam. The fact that she had just been hired by a prestigious corporate firm only added to the excitement. This was a first. At last the family had a lawyer in its midst.

It was not too long before family members commenced soliciting advice from Angie concerning various matters of a legal nature. "Can I get my deposit back when my apartment lease expires?" "Do I have to pay an overdraft charge because I bounced a check?" "Can I take defensive driving again, if I took a defensive driving course six months ago?" Angie was only too happy to field questions of this nature. After all—what are family members for?

It wasn't long before Angie's cousin Harry called. Harry was a gas. Everybody's favorite. But, Harry never could keep his eye on the ball. He partied a little too much in college and dropped out in his second year. He always intended to go back, but never did. He was such an affable guy. It was only natural for him to gravitate towards a career in sales.

When he called, Harry told Angie that he was setting up a little business to produce and sell Harry's Deluxe Hair Gel—a growth stimulant for men with receding hairlines. He advised that he was looking for financial partners and, in fact, was running ads for prospective investors in the Green Sheet, the local newspapers, and on the Internet. Since he was starting to attract some investor interest, he asked Angie if she would give him some forms he could use to more or less formalize the investments.

Angie was happy to oblige Harry, especially since her firm kept a stock of sample forms for use in many different types of commercial transactions. She sent those to Harry along with a memorandum she had prepared on firm letterhead while she was on a lunch break. She mentioned in the memo that Harry needed to be mindful of the requirements of federal and state securities laws when selling securities to the investing public. She told him that limited partnership interests are normally viewed as securities and implicate the rules on registration.

Time passed and Angie heard through family circles that Harry's little venture was really catching on. Because of investor interest, his operations had grown substantially. And, from time to time, Harry would call Angie for advice on small issues that cropped up—questions about a lease—or perhaps about an employment issue. He never mentioned that he had failed to seek registration of the securities he was selling. Harry, being such a good guy, wanted to show his appreciation for the advice Angie afforded him while he was getting his operation off the ground. And so it was that he bought and gave her a \$5,000 David Yurman necklace as an expression of his appreciation for her advice.

Sadly, over time, Harry's gel proved ineffective and actually exacerbated male hair loss. As you might expect, the fallout was awful. First came the product liability suits. Then came the suits by investors. The investors formed a class and then did what they normally do—started looking for money. Angie's memorandum on her firm letterhead was produced in discovery. So too were notes Harry had made when he from time to time talked with Angie about general legal matters.

It was a shock to Angie's firm's management when the firm was sued for aiding and abetting securities fraud. A quick check by the firm's general counsel revealed nothing in the firm's records concerning a client doing business as Harry's Deluxe Hair Gel. No new client memo. No engagement letter. Nothing. But, because her memorandum was referenced in the investors' pleadings, Angie soon found herself in a meeting attended by the firm's managing partner, its general counsel, and a representative of the firm's professional liability insurer.

It was an uncomfortable meeting. Angie explained that she was just being nice and trying to help a family member. The general counsel explained, that fact notwithstanding, the firm had exposure. But at least it had coverage for the \$5 million claim. Angie despaired—how could we be liable for such a sum—we really didn't represent Harry and the advice she gave was correct. The general counsel explained that because there was no engagement letter the plaintiffs could effectively argue that Angie and the firm represented Harry on all matters. The firm should have known he was selling unregistered securities. By not stopping him Angie and the firm could be alleged to have aided and abetted his illegal operations.

In passing Angie mentioned how sad it was for Harry. He was such a nice fellow—and had given her a \$5,000 David Yurman necklace as a manifestation of his appreciation for her work. With that disclosure a paled look came upon the general counsel's face. So too was the interest of the insurance representative suddenly piqued. Both instantly recognized that a serious coverage issue had presented itself. Pro bono work by a firm's lawyer is covered. But, if a firm lawyer performs legal services and receives a fee that is not shared with the lawyer's firm, then coverage is abrogated. Could it be that Angie had placed her firm in a position of facing a \$5 million claim with no coverage? Absolutely.

What lessons do we learn from this?

First: remember that no good deed goes unpunished. If you are going to provide legal services and give legal advice, then always run a conflicts check and go through the normal file opening process your firm employs. Always prepare an engagement letter that specifically identifies the legal task you intend to perform for the client. Had Angie properly opened a new file and drafted an appropriate engagement letter specifying that she was only giving advice as to the necessity of registration, all would have been fine. By not doing so, she left her firm vulnerable to a claim that it was serving as Harry's corporate counsel on all of his business affairs and an aider and abettor in his illegal operations.

Second: remember that any fee you receive for legal services must be shared with your firm. As noted, pro bono services are covered by most professional liability policies. But, if a fee is paid, it must be shared with the firm to trigger coverage. Arguably, Angie's necklace did not constitute a fee. But, it had substantial value that inured to her benefit and not to that of her firm. Thus, a very significant coverage issue presented itself.

texasbar.com/transition