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WHAT'S INSIDE

COMMENTARY

Malpractice risks in alternative fee arrangements

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AUDITOR

Pa. federal judge nixes auditor's bid to dismiss malpractice suit

A federal judge in Philadelphia has ruled that an accounting firm failed to support its argument that the theory of *in pari delicto* bars a bankruptcy receiver's professional malpractice claims against the firm.

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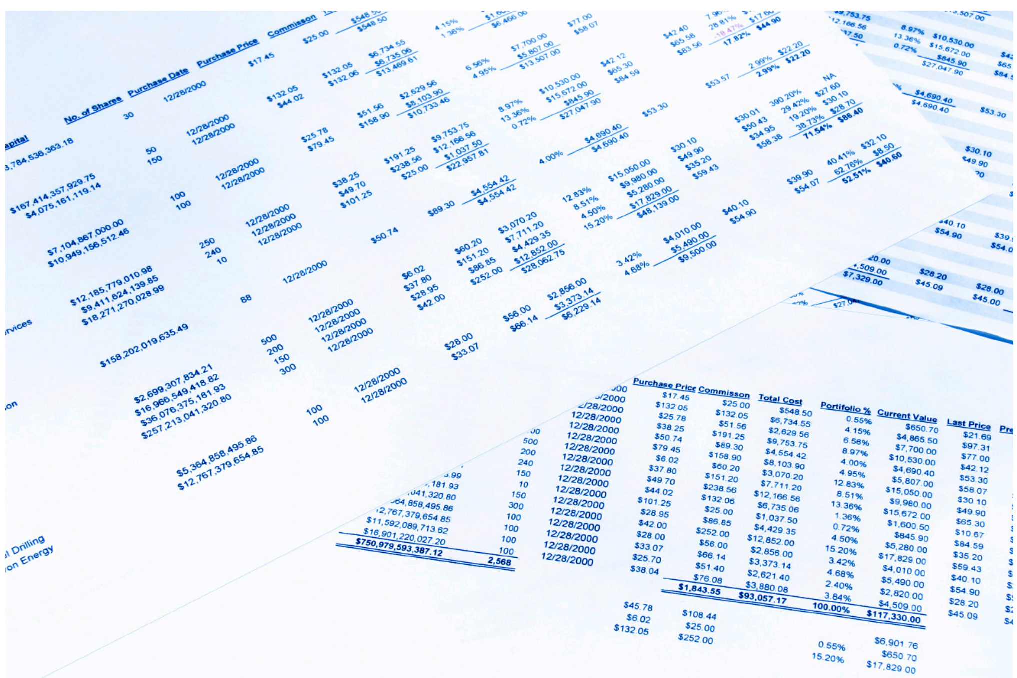

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Malpractice risks in alternative fee arrangements

By Andrew Nicely, Esq., and Elisa Kantor, Esq.
Mayer Brown LLP

The recent global economic downturn has led many clients to look for ways to reduce their annual spending on legal services. As result of this trend, law firms have faced increased pressure to discount their billing rates and to offer a variety of alternative fee arrangements including volume discounts, fee caps and fixed fees.

Alternative fee arrangements can provide cost-conscious clients with tighter cost control, price predictability and greater price-value alignment, among other advantages. Outside counsel also can benefit from alternative fee arrangements, both financially and in terms of building relationships with clients that seek a sense of shared commitment to the attainment of the client's goals.

Despite these virtues, alternative fee arrangements are not suitable for every client, and they are not appropriate for every matter that a client may have. A careful evaluation of the potential risks is critical to ensure that an alternative fee arrangement does not result in an ethics complaint or, worse, a malpractice lawsuit.

A CHANGING ECONOMIC LANDSCAPE

Client dissatisfaction with the billable hour is not new, and the most common alternative fee arrangement — the contingency fee — has been in widespread use, at least among the plaintiffs' bar, for decades. A more recent innovation, which emerged during the "dot-com" boom of the 1990s, is the practice of accepting an equity stake in the client in lieu of a conventional hourly fee structure. Such arrangements were attractive to startup Internet businesses that desired the services of premier law firms but lacked sufficient cash flow to pay substantial fees on an hourly rate basis. Many law firms were glad to accept stock or options as payment for their services, anticipating that the potential profits might exceed the fees collected on an hourly basis if the client's business proved successful.

But these arrangements were not without risk. As the American Bar Association cautioned in formal opinion 00-418, "circumstances may arise that create a conflict between the corporation's interests and the lawyer's economic interest as a stockholder" where the attorney's legal and business judgment conflict.[1]

The ABA urged lawyers considering an equity-for-services agreement to fully inform their clients in writing about the terms of the deal, to advise the clients to seek independent counsel before accepting the proposed terms and to ensure that the arrangement is fair and reasonable under the circumstances.

Although equity-for-services arrangements appear to have fallen into disuse, the economic crisis of the past several years has created renewed interest in other types of nonconventional fee arrangements. Recent surveys reveal that more than 90 percent of U.S. law firms offer one or more types of alternative fee arrangements to clients, and these arrangements may account for as much as 16 percent of law firms' revenue on average.[2]

> Alternative fee arrangements can provide cost-conscious clients with tighter cost control, price predictability and greater price-value alignment.

In fact, some observers estimate that corporate spending on alternatives to the billable hour increased by as much as 50 percent in recent years.[3]

This trend shows no sign of slowing.

Below, we summarize the more common forms of alternative fee arrangements and discuss the potential risks they may pose for lawyers who enter into them.

MODERN TYPES OF ALTERNATIVE FEE ARRANGEMENTS

At present, the most common alternative fee arrangements in use by leading law firms include flat fees, contingency fees, blended hourly rates, capped fees and volume discounts. Although the features of specific agreements are subject to negotiation and may vary, each type has certain essential characteristics.

A flat fee is an all-inclusive fee that the law firm agrees to accept as payment for a particular service, such as the handling of a transaction or the defense of a lawsuit.

Contingency fees, most commonly used by plaintiffs' lawyers, allow the lawyers to retain a percentage or a fixed amount of the proceeds of a successful outcome. If the case does not resolve on favorable terms, the lawyers do not collect a fee.

A blended hourly rate is a fixed rate that the firm agrees to charge for the time of all lawyers who work on a matter, regardless of their actual hourly rates.

A capped fee is an arrangement in which the law firm agrees that its total fees to complete a matter, billed by the hour, will not exceed the agreed-upon cap, even if the lawyers are required to provide additional services after the cap is reached.

Finally, a volume discount, also called bundled-fee arrangements, is an agreement in which the law firm reduces its hourly rates in return for the promise of a certain volume of legal work from the client.

Each structure can be modified to include a bonus or success premium payable to the lawyers in the event of a successful outcome, as defined in the fee agreement.

AVOIDING POTENTIAL PITFALLS

Despite their possible benefits, alternative fee arrangements can become a source of friction between lawyer and client if they are entered into hastily, without consideration of the impact that the agreement may have on the provision of legal services and the ultimate cost of the representation over the course of the engagement. A comprehensive and unambiguous fee agreement is essential, but not sufficient.

The law firm and the client should be aligned in their expectations about how the agreement will be implemented. Indeed, fee-related disputes have long been the primary genesis of ethical complaints, and many malpractice actions involve, at least in part, disagreements about fees. Thus, it is imperative that counsel be particularly aware of the issues that can arise in this context.

Excessive fee claims

Lawyers are ethically required to charge no more than a "reasonable fee" for their services, regardless of the type of fee arrangement involved.[4] Whether a fee is "reasonable" is a fact-specific inquiry that depends in large measure on the point in time at which the determination is made.

At the outset of an engagement, a 10 percent contingency fee may sound like it is on the low end of what may be available to clients. But what if the matter settles for $50 million after the preparation of a draft complaint, a few phone calls and a full day of mediation? A fee of $5 million may seem high to a client in relation to the amount of effort expended. This question also may arise with flat fees and any other arrangement that results in the law firm collecting a larger fee than it would have received had it billed for its services at its standard hourly rates.

The general rule is the reasonableness of a fee arrangement should be determined as of the date when the agreement was made, in light of the facts known or knowable by the lawyer and the client at that time.[5] That approach seems logical and fair. The mere fact that a contingent or flat fee arrangement produces a large fee — one in excess of what the firm would have charged at its hourly rates — does not make it unreasonable per se. Alternative fee arrangements involve risk for the lawyers, who may expend significant effort without recovering any fee (contingent fee) or recover a fee far below the value of the services provided if billed at hourly rates (flat fee). Sometimes the law firm comes out ahead, sometimes not. There is little to commend a rule treating alternative fee arrangements as voidable at the election of a client that, with the benefit of hindsight, concludes that a traditional hourly fee arrangement would have better met its needs.

Yet, some courts have shown a willingness to "look back" at the conclusion of a matter to determine whether the agreed-upon fee was reasonable in light of the work required.[6]

For example, one court held that a $50,000 contingent fee was excessive because the plaintiff's lawyer was able to settle the claim without filing a lawsuit and the underlying issues were not particularly complex.[7] Similarly, a court rejected a one-third contingency agreement where the plaintiff's lawyer secured a settlement after expending minimal effort on the case.[8]

Fee agreements that provide for a bonus or "success fee" also may be challenged by clients who believe, in hindsight, that the total fee is high relative to the results achieved. In a recent Pennsylvania case, for example, a corporation retained counsel to represent it in a patent dispute and agreed to pay its legal bills in full, based on agreed hourly rates, within 18 months if it did not prevail in the patent case. In the event of a favorable verdict, the client agreed to treble the base amount of the law firm's fee and to pay that amount immediately. A favorable verdict was obtained, and the law firm requested payment of the trebled fee, which was more than double the amount of the judgment. After threatening to sue for the full amount, the law firm brought suit to recover only its actual fees and expenses, and it won a jury verdict in that amount.[9]

> There are a number of steps lawyers can take to limit the risk that an alternative fee will be found to be excessive in hindsight.

There are a number of steps lawyers can take to limit the risk that an alternative fee will be found to be excessive in hindsight. It may be helpful to state in the fee agreement that the agreed upon fee arrangement may, in the fullness of time, prove to be higher or lower than what the client would pay if it were billed on an hourly basis. A tiered structure can be built into both contingent and flat fee arrangements, in which the firm's percentage or the flat fee amount increases at each stage of the litigation.

In the interest of avoiding disputes, the law firm may choose to do its own quick "look back" at the conclusion of an engagement to assess whether the fees earned under an alternative billing arrangement far outstrip what would have been earned under an undiscounted hourly rate agreement. Although a significant premium above standard rates may well be justified in light of the risks shouldered by the law firm, the facts and circumstances of a particular engagement may weigh in favor of rebating a portion of the fee to the client.

Disputes about the value of the legal services delivered

Most lawyers work tirelessly for their clients and would scoff at the notion that an alternative billing arrangement would affect their work ethic. Some clients, however, fear that certain fee arrangements, particularly fixed fees and fee caps, could result in a misalignment of interests between client and counsel by creating the incentive to maximize profits by doing as little work as possible. They wonder how zealously the law firm will continue to pursue their matter once the firm is effectively working for free, having reached the fee cap or having accrued time charges equal to the amount of the flat fee.

These concerns, if left to fester, could lead to allegations that counsel:

- Breached the duty to competently and diligently represent the client[10];
- Failed to perform the necessary legal services thoroughly and in a timely fashion; or
- Put undue pressure on the client to settle a matter early in order to earn a larger fee.

Allegations along these lines are likely to pose more of a threat if it appears that the firm has significantly underestimated the total cost of the representation, such that the actual value of the services invested by the firm greatly exceed the flat fee or the fee cap.

Client concerns about quality and value also may arise in volume-discount arrangements. If the law firm is being paid a flat fee to manage a portfolio of cases, the client may come to believe cases are being settled too quickly, when a more aggressive defense might yield a lower settlement amount. If the arrangement calls for the firm to handle a portfolio of cases at a significant discount from the firm's standard rates, the client may question the number of hours being charged to the engagement or the extent to which the cases are being staffed with droves of junior associates.

To avert these sort of client-relation issues, lawyers must, at the outset, carefully assess the client, the proposed matter and the anticipated cost of handling the engagement before entering into an alternative fee arrangement. These arrangements require trust on both sides and may not be advisable for use with new clients. Flat fees and fee caps can produce large losses for law firms that do not make a realistic projection of the total cost to handle a matter through completion. On the corporate side, prior, comparable transactions may provide a fairly accurate benchmark for the fees necessary to complete a new transaction.

In litigation, because so much depends on how aggressive the opposing party is and how the court manages the discovery process, budgeting is more difficult. The complexity increases if the flat fee or fee cap relates to the handling of a portfolio of litigation. It may be difficult or impossible to renegotiate the fee or to withdraw as trial counsel once the litigation is underway. Thus, the safest course is to take into account the most costly scenario that is foreseeable when setting the budget for the engagement and to set the flat fee or fee cap with that potential scenario in mind.

Setting an appropriate fee generally requires careful due diligence. But it is important to recognize that in the course of evaluating a potential representation, the law firm may become aware of confidential information about the client that could disqualify the firm from handling other matters, even if the proposed representation is declined. Accordingly, if the firm has significant doubts at the outset about the client, the specific matter or the general terms of the proposed alternative fee arrangement, it might make sense to decline the engagement without further inquiry or request that the potential client agree that any information provided is non-confidential.

The California bar has estimated that more than 90 percent of all fee disputes result from counsel's failure to adequately explain the fee structure at the outset.[11] This is particularly important with alternative fee arrangements. In the case of flat fees and fee caps, the fee agreement should state very clearly what is and is not included in the fee.

For example, if a $400,000 flat fee is offered to handle a case through trial, the budget likely will not accommodate 30 or more depositions, the retention of five expert witnesses, a jury consultant and a mock trial. And the budget will not include post-trial motions, an appeal and a petition for *certiorari*. The more information the client has up front about the services it will receive, the less likely a dispute will arise later about the nature of the fee agreement.

CONCLUSION

Alternative fee arrangements undoubtedly will continue to be widely available to clients who ask for them. Although their use poses certain risks for lawyers, most issues can be avoided through careful due diligence, close communication with the client to manage expectations and proper documentation of fee-related discussions. Used wisely and within accepted parameters, many lawyers may find that alternative fee arrangements enhance their ability to attract new business without creating undue risk. WJ

NOTES

[1] Am. Bar Ass'n. Comm. on Ethics & Prof'l Responsibility, Formal Op. 418 (2000).

[2] *See Karen Sloan, Billing Blues: Continued Pricing Pressure From Clients Means Firms Are Limited to Modest Yearly Rate Increases,* Nat'l L.J., Dec. 6, 2010.

[3] *See* Nathan Koppel & Ashby Jones, *'Billable Hour' Under Attack,* Wall St. J., Aug. 14, 2009, at A1.

[4] *See* ABA Model Rules of Prof'l Conduct 1.5(a).

[5] *See* ABA Formal Ethics Op. 00-418 at 4 & n.9.

[6] *See, e.g., Holmes v. Loveless*, 94 P.3d 338 (Wash. Ct. App. 2004); *In re Swartz,* 686 P.2d 1236 (Ariz. 1984) (*en banc*); *Anderson v. Kenelley,* 547 P.2d 260 (Colo. Ct. App. 1975); *In re Sullivan*, 494 S.W.2d 329 (Mo. 1973) (*en banc*).

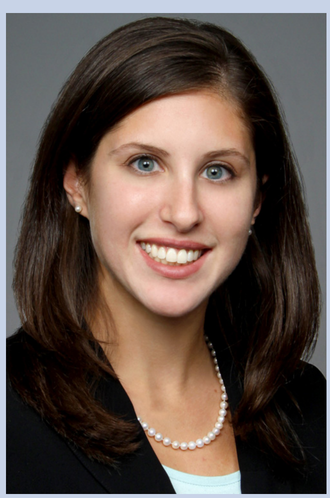
[7] *See In re Swartz*, 686 P.2d at 1243-44.

[8] *See Anderson*, 547 P.2d at 261.

[9] *Drinker Biddle & Reath v. AgriZap Inc.,* No. 080401453 (Pa. Ct. Com. Pl. Feb. 18, 2010).

[10] *See* ABA Model Rules of Prof'l Conduct 1.1, 1.3

[11] *See* Douglas G. O'Brien, *Civility: Moving Beyond the Code,* 23 Law Prac. Mgmt. 34, 36-37 (October 1997).



Andrew A. Nicely (left) is a partner in the commercial litigation and professional liability defense group at **Mayer Brown LLP**. **Elisa Kantor** (right) is an associate in the firm's litigation and dispute resolution group, with a focus on commercial litigation and complex civil litigation.

Pa. federal judge

CONTINUED FROM PAGE 1

Bechtle v. Master Sidlow & Associates, No. 10-5195, 2011 WL 476535 (E.D. Pa. Feb. 8, 2011).

In pari delicto, Latin for "equally at fault," relieves a defendant of liability where the plaintiff was "an active, voluntary participant in the wrongful conduct or transactions and bears substantially equal or greater responsibility for the illegality claimed," the judge said.

U.S. District Judge John Padova of the Eastern District of Pennsylvania denied accounting firm Master Sidlow & Associates' motion to dismiss the malpractice claims of Louis Bechtle, the court-appointed receiver for various Acorn entities, including Acorn Capital Management.

Bechtle alleges that while acting as auditor for Acorn from 2003 to 2007, Master Sidlow "cast a blind eye" to numerous signs that Acorn Capital partner Donald Young was conducting a Ponzi scheme by using investments from new, limited partners to pay previous investors.

Young also used investor funds for personal expenses, and Master Sidlow failed to report suspicious activities such as the 36 transfers Young made from an Acorn account to his personal account over a nine-month period, Bechtle alleges.

In addition, Young opened an account and subsequently withdrew 75 percent of its contents within three months. On another occasion, he opened an account and withdrew more than the amount invested in it within six months, Bechtle claims.

According to the complaint, Master Sidlow negligently relied on monthly account statements from CRESAP, a company that was Acorn's custodian and that held the brokerage account for Acorn's investments. The statements listed contributions and withdrawals from investor accounts but did not indicate which partner had contributed or withdrawn the funds.

The firm also unreasonably relied on Young to provide details on the contributions and withdrawals and it failed to question or verify false information he provided to the firm, Bechtle says.

"By proceeding in this fashion, defendants failed to rely on proper supporting documentation and failed to exercise professional skepticism and independence," which enabled Young's fraud, Bechtle asserts.

In April 2009 the Securities and Exchange Commission sued Young and the Acorn entities for running a Ponzi scheme. Two months later Judge Padova appointed Bechtle as receiver for the Acorn entities in order to "maximize the recovery available to investors defrauded during Young's operation of the Ponzi scheme," the opinion says.

> The complaint says the auditor should be held liable for "casting a blind eye" to signs of a Ponzi scheme.

Young pleaded guilty in July 2010 to criminal charges stemming from his involvement with the Ponzi scheme, according to the opinion.

Bechtle sued Master Sidlow in the District Court in 2010, alleging professional negligence, breach of contract, unjust enrichment, aiding and abetting fraud, and aiding and abetting breach of fiduciary duty.

The firm moved for dismissal, arguing that the claims are barred by doctrine of *in pari delicto* because Bechtle stands in the shoes of the Acorn entities.

The defendant noted Bechtle's complaint does not allege Master Sidlow had actual knowledge of Young's fraud or colluded with him in misstating Acorn finances.

Judge Padova denied the motion.

Simply because the complaint lacks allegations of collusion does not mean the defendants necessarily acted in good faith, he said.

The judge was "not convinced" based on the pleadings that Bechtle has not stated a valid claim. Further, Master Sidlow cited no ruling from the 3rd U.S. Circuit Court of Appeals on applying the *in pari delicto* defense against a receiver.

Judge Padova declined to rely on a 7th Circuit ruling in deciding the issue. WJ

Attorneys:
Plaintiff: Kevin Kent and Francesco Trapani, Conrad O'Brien Gellman & Rohn, Philadelphia

Defendant: Patrick McGrory, Tighe & Cottrell, Wilmington, Del.

Related Court Document:
Opinion: 2011 WL 476535

The defendants are accused of violating the following generally accepted auditing principles:

- Maintaining professional skepticism and independence.
- Implementing alternative tests for fraud if a company has no internal controls in place.
- Preparing audit documentation that would enable an experienced auditor to understand the results.
- Obtaining sufficient evidence for an opinion about the finances under audit.

AUDITOR

Malpractice action against auditor, actuary filed too late

A pension fund's negligence and professional malpractice claims against an auditor and actuary for allowing $3.5 million in overpayments accrued when the payments were made, not when they were discovered, the 1st U.S. Circuit Court of Appeals has ruled.

Erlich v. Ouelette, Labonte, Roberge & Allen et al., No. 10-1160, 2011 WL 679433 (1st Cir. Feb. 28, 2011).

The pension fund had argued that although the overpayments occurred from 1973 to 2005, it did not have to file suit until it actually discovered the overpayments in 2006.

The appeals court affirmed the trial court's dismissal of the claims accruing before 2003, six years before the complaint was filed.

Maine, where the malpractice action was filed, has a six-year limitations period for civil actions.

The panel explained that Maine courts only rarely depart from the state's "date of injury" rule and only in situations where a fiduciary relationship has been established.

"The complaints here describe arm's-length, contractual arrangements between the board of a sizable pension fund and professionals providing routine, even mechanical financial services," the 1st Circuit said. "These relationships were neither special nor unique.

"Applying a discovery rule to these circumstances would represent a significant step in expanding Maine law that we decline to take," the panel concluded.

According to the opinion, in 2006 the New England Carpenters Pension Fund's auditor looked at a random sample of pension calculations and discovered that one of the fund's predecessors had overpaid some of its pensions.

After checking all the calculations for the years 1973 through 2005, the fund discovered overpayments of more than $3.5 million.

> Maine courts only rarely depart from the state's "date of injury" rule, the court said.

In 2009 the fund sued both auditor Ouelette, Labonte, Roberge & Allen and actuary S.R. Thomas Actuarial Associates Inc. in separate but identical suits in the U.S. District Court for the District of Maine.

The suits alleged breach of contract, negligence and professional malpractice based on Thomas' miscalculations and Ouelette's failure to check the calculations, as required by generally accepted accounting principles.

The District Court dismissed both of the fund's complaints as time-barred with respect to claims accruing before 2003.

The fund appealed, and the 1st Circuit affirmed.

The appeals court said the fund did not cite any Maine decision that applied a discovery rule to claims against an auditor or an actuary, relying instead on analogizing the two defendants to the fiduciary providing financial services in *Nevin v. Union Trust Co.*, 726 A.2d 694 (Me. 1999).

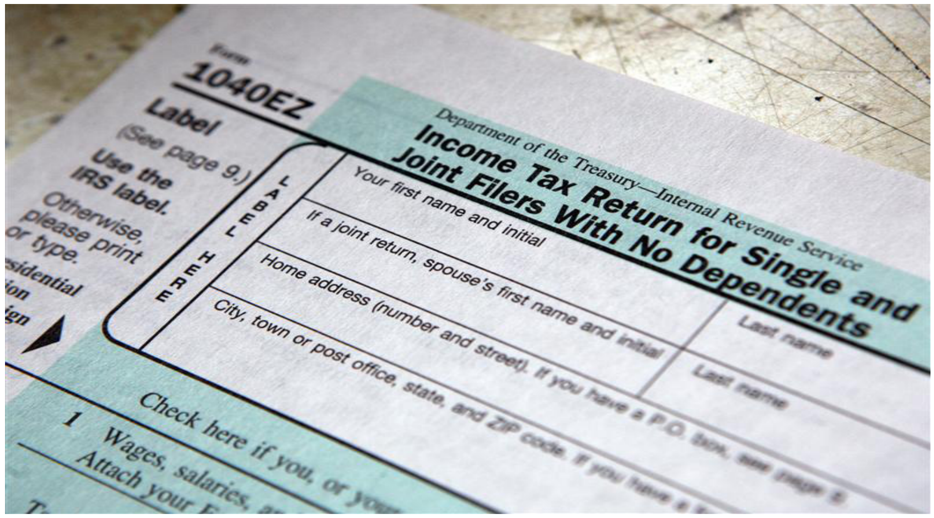
In that case, the Maine Supreme Judicial Court applied the discovery rule because the bank's "acts or omissions prevented the plaintiffs from discovering their cause of action."

Here, the appeals court said, what was missing was an actual placing of trust and confidence by the fund in the defendants and a great disparity of position and influence between the parties, which would have justified applying the discovery rule. WJ

Related Court Document:
Opinion: 2011 WL 679433

Discovery rule cannot save accountant malpractice case

A company suing its accountant for malpractice has failed to convince an Illinois appeals court that the two-year limitations period for professional malpractice should be extended based on the state's discovery rule.



REUTERS/Chip East

The test is whether the plaintiff had a "reasonable belief that the injury was caused by wrongful conduct".

SK Partners et al. v. Metro Consultants Inc., No. 1-09-0695, 2011 WL 636941 (Ill. App. Ct., 1st Dist. Feb. 17, 2011).

The discovery rule delays the start of limitations period until a plaintiff "knows or reasonably should have known of the injury and that it may have been wrongfully caused," the opinion says.

The 1st District Appellate Court rejected plaintiff SK Partners' argument that it did not know about the 1999 accounting errors until 2004, when the Internal Revenue Service sent the company the first of several refund checks after an audit of its amended tax returns.

The test is whether SK Partners had a "reasonable belief that the injury was caused by wrongful conduct, thereby creating an obligation to inquire further on that issue," the court said.

Once SK Partners' new accountant had reviewed the affected returns in 2003 and told it about the errors, the company "clearly acquired the obligation to inquire further, starting the clock on the applicable statute of limitations," the panel said.

According to the complaint, defendant Metro Consultants prepared SK Partners' federal income tax returns for 2000, 2001 and 2002.

After that, SK Partners hired the accounting firm CJBS, the suit said.

An accountant from CJBS said his review of past tax returns indicated that the depreciation of the plaintiff's real estate assets was understated and that it had overstated income on its returns, the complaint said.

In November 2003 the accountant told SK Partners it would probably take a year to investigate and to file amended tax returns, according to the opinion.

The IRS conducted an audit after receiving the amended tax returns and issued refund checks between Dec. 13, 2004, and April 21, 2006.

SK Partners sued Metro for accounting malpractice Sept. 21, 2006, in the Cook County Circuit Court. The trial judge dismissed the case on statute-of-limitations grounds in April 2007.

The plaintiff appealed, arguing that the judge incorrectly applied the two-year statute of limitations to their claims.

The appeals court affirmed.

The discovery rule has never been used to delay the start of the limitations period until there is actual knowledge of negligence by a professional, the court said.

Instead, it has been used to delay the start of the limitations period until there is a reasonable belief that the injury was caused by negligent conduct.

SK Partners claimed it did not have actual knowledge of the damages caused by Metro's conduct until the IRS issued the first refund check Dec. 13, 2004.

The appeals court said this position was "entirely irrelevant" because under the discovery rule, "a statute of limitations may run despite the lack of actual knowledge of negligent conduct."

The CJBS accountant explained his investigatory findings to the plaintiff Nov. 11, 2003, and the company told him to "inquire further."

Because all the relevant depreciation figures were available and placed before the plaintiff before the amended tax returns were filed, it was "plainly obvious" that there was a tax overpayment, the appeals court said.

Therefore, the limitations period expired most likely by Nov. 11, 2005, and because the complaint was filed after that date, the trial court properly dismissed it, the panel concluded. WJ

Related Court Document:
Opinion: 2011 WL 636941

A successful professional negligence suit must show:

- A professional relationship.
- A breach of duty.
- Causation.
- Damages .

Discovery under way in broker-dealer insurance coverage dispute

A federal magistrate judge in Kansas has granted a motion by Lloyds of London for documents the insurer requested in connection with a coverage suit filed against it by a securities broker-dealer.

Brecek & Young Advisors Inc. v. Lloyds of London Syndicate 2003, No. 09-2516, 2011 WL 765882 (D. Kan. Feb. 3, 2011).

The plaintiff said it was forced to pay a portion of the damages awarded after an arbitration proceeding before the National Association of Securities Dealers.

U.S. Magistrate Judge Gerald Rushfelt of the District of Kansas rejected plaintiff Brecek & Young Advisors' argument that Lloyds' requests were "overly broad," "ambiguous" or "irrelevant."

"It appears relevant to whether plaintiff was covered, and to what extent, under the insurance policy in question," Judge Rushfelt said.

Because B&Y claims that the underlying case involves "interrelated wrongful acts," Lloyds should be allowed to discover when the first "interrelated wrongful act" occurred, he added.

According to the memorandum and order, B&Y sought a declaration that Lloyds of London Syndicate 2003 was obligated to defend and indemnity B&Y during NASD arbitration proceedings in accordance with the professional liability policy issued by Lloyds. The policy was in effect from Dec. 1, 2006, to Dec. 1, 2007.

The arbitration proceeding filed in May 2007 involved 26 claimants who were found entitled to damages. The claimants said B&Y sold them "unsuitable annuities and/or investments."

Lloyds has paid the damages except for a retention of $50,000 applied to each of the 26 claims.

B&Y says that, since the 26 claims all stem from the same "interrelated wrongful acts," as the term is used in the policy, is it only one claim, and Lloyds should retain only $50,000. The insurer disagrees.

Lloyds sought dismissal of the suit for lack of personal jurisdiction but the court ruled that under the service-of-suit clause in the policy, the insurer agreed to be sued in the state chosen by the plaintiff.

Lloyds sought production of a variety of B&Y documents, including "similar claims" made before the policy went into effect.

Judge Rushfelt said B&Y had failed to support its objections to the discovery request.

The judge did not find that Lloyds' use of the terms "similar to," "pertaining to" and "relating to" created "objectionable ambiguity or uncertainty and an unreasonable burden" for B&Y.

Given B&Y's argument that the claims in the underlying arbitration were similar enough to be treated as one claim, a request for "similar" documents in the discovery request should not be overruled, the judge said.

Judge Rushfelt also found the request relevant on its face because it involves whether B&Y had a "propensity to engage in fraudulent, deceptive or dishonest" acts.

"This information is relevant, because the policy may not afford coverage if plaintiff had knowledge or reasonable basis upon which to anticipate that the wrongful act or any interrelated wrongful act could result in a claim," the judge explained. WJ

Related Court Document:
Memorandum and order: 2011 WL 765882

The claimants in the underlying case alleged the firm sold them "unsuitable annuities and/or investments."

FINANCIAL ADVISER

Claims against financial adviser go to arbitration

An annual arbitration agreement between a financial advisory firm and an investor applies to disputes that began before the date of the most recent contract, the 4th U.S. Circuit Court of Appeals has ruled.

Levin v. Alms & Associates Inc. et al., No. 10-1896, 2011 WL 456328 (4th Cir. Feb. 10, 2011).

The appeals panel rejected defendant Alms & Associates' argument that the arbitration clause in its 2007 advisory agreement with plaintiff Eric Levin did not apply to claims that arose before Jan. 1, 2007.

In so doing, it reversed and remanded a ruling by the U.S. District Court for the District of Maryland.

After reviewing the language of the agreement, the panel found that although the arbitration clause did not state specifically that it applied to claims arising before the 2007 agreement, courts usually apply the phrase "any dispute" retroactively, "especially when combined with language that refers to all dealings between the parties."

The agreement states that it "encompasses and embodies all agreements," which seems to include prior agreements (those in effect during 2004, 2005, 2006 and 2007), the court explained.

In addition, the court reasoned that retroactivity was intended because Alms & Levin had an ongoing business relationship that was "seamlessly renewed on an annual basis."

The underlying claims involve events that are part of the extended financial advising relationship between the parties, the appeals court said.

Alms provided financial advisory services to Levin from 2004 through 2007. Each year, the parties signed agreements that governed the relationship and fees, according to the opinion.

Levin sued Alms in 2009 in the District Court, claiming that in 2006 the firm failed to reveal a conflict of interest concerning one of the land deals it advised on as an investment and failed to disclose a commission it had received between 2004 and 2009.

The complaint alleges breach of contract, negligence, negligent misrepresentation, and violation of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1.

Alms moved to stay the case pending arbitration, arguing that the 2007 advisory agreement applies to all of Levin's claims.

The District Court said Levin could pursue claims arising after Jan. 1, 2007, but not those that arose earlier than that date. The court explained that the wording of the 2007 agreement did not support a retroactive application of its terms.

Alms appealed to the 4th Circuit and, because the District Court did not stay the action, asked the panel for a stay pending resolution of its appeal.

The appeals court first determined that Alms' appeal on the issue of arbitrability automatically divested the lower court of jurisdiction over Levin's claims and required a stay pending appeal.

On the merits of the appeal, the panel ruled in Alms' favor, noting the "heavy presumption" in favor of arbitrability that tips the scale in the firm's favor.

The appeals court noted the agreement specified that "any dispute shall be submitted to binding arbitration" and that "any dispute" includes those that began before Jan. 1, 2007.

"The language in the agreement is broad enough to encompass all agreements and any disputes — past and present — especially given that the presumption in favor of arbitrability is particularly applicable when the arbitration clause is broadly worded," the panel said. WJ

Attorneys:
Plaintiff: Steven Kelly and Matthew Sturtz, Miles & Stockbridge, Towson, Md.

Defendant: Christopher Mellott and Viktoriya Shpigelman, Venable LLP, Baltimore

Related Court Document:
Opinion: 2011 WL 456328

See Document Section A (P. XX) for the opinion.

Attorney misconduct cost hospitals millions, suit says

Two Phoenix hospitals have sued their former attorneys in Arizona state court, accusing the law firm and several individuals of self-dealing and fraud that led to hundreds of millions in damages and federal and state antitrust charges against the hospitals.

Mayo Clinic Arizona et al. v. Coppersmith, Gordon, Schermer, Owens & Nelson et al., No. 11-002886, complaint filed (Ariz. Super. Ct., Maricopa County Feb. 4, 2011).

In the complaint filed in the Maricopa County Superior Court, Mayo Clinic Arizona and Phoenix Children's Hospital allege that defendant law firm Coppersmith, Gordon, Schermer, Owens & Nelson and certain others connected with the firm charged them millions of dollars in fees for representation that was substandard at best.

According to the complaint, Mayo hired the attorney defendants in 1998, and Phoenix Children's hired them in 2001.

The representation involved advice on the operation of temporary nurse registries and the defendants' marketing those registries to the plaintiffs and other hospitals in Arizona and in "at least 13 other states," the complaint says.

The defendant attorneys allegedly told the plaintiffs that the temporary nurse registries were "legitimate group purchasing organizations" that met the requirements of federal and state antitrust laws.

Specifically, the complaint says, the defendant attorneys added three illegal components to the registries, a move that state and federal authorities regarded as a violation of antitrust laws:

- Setting maximum wages.
- Requiring exclusivity.
- Allowing almost all Arizona hospitals to participate.

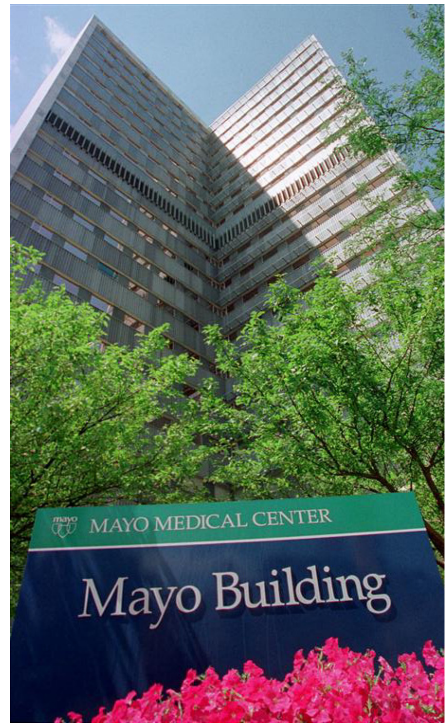
According to the plaintiffs, the defendant attorneys knew about but did not use the safe-harbor information provided by the Justice Department and the Federal Trade Commission for group-purchasing organizations such as the temporary nurse registries.

The enforcement agencies indicated they would not challenge a joint-purchasing-of-services arrangement involving health care workers that accounted for less than 35 percent of the market, the complaint says.

However, in this case, the joint-purchasing arrangements that the defendant attorneys structured resulted in nearly 100 percent of all purchases of temporary nursing services in Arizona, the plaintiffs say.

In addition to setting up registries that violated state and federal antitrust laws, the defendant attorneys responded to but hid a 2002 investigation of the registries by the Antitrust Section of the Arizona attorney general's office, the complaint says.

They did so to avoid jeopardizing their plan to sell their registries to hospitals and associations in other states, the plaintiffs say.



REUTERS/Str Old

The plaintiffs allege the defendant law firm charged the Mayo Clinic Arizona and Phoenix Children's Hospital millions of dollars in fees for substandard representation. The Mayo Clinic in Rochester, Minn., is shown here.

> The attorneys advised the plaintiffs on the operation of temporary nurse registries in Arizona and elsewhere.

The defendant attorneys also hid from the plaintiffs the Justice Department's 2005 investigation of the registries, the complaint says.

Finally, in May 2007 the plaintiffs learned that an affiliate of the defendants, Arizona Hospital & Healthcare Association, had agreed to enter a consent decree that shut down the registries created by the defendant attorneys.

Despite of the consent decree and a 2007 class-action, antitrust lawsuit filed against "almost all" Arizona hospitals by two classes of temporary nurses, the defendant attorneys continued to assure the plaintiffs that analysis and research supported a conclusion that the registries did not violate state or federal antitrust laws, the complaint says.

Nevertheless, the plaintiffs say, they were forced to share in a joint defense agreement structured by the defendant attorneys to shield their "more favored" clients from having to foot the entire bill for defending the class action.

The complaint alleges negligence, breach of fiduciary duty, fraud, negligent misrepresentation, constructive fraud and unjust enrichment.

The plaintiffs are seeking unspecified compensatory and punitive damages, and the return of the fees they paid to the defendant attorneys. WJ

Attorneys:
Plaintiff: Barry Halpern and Dan Goldfine, Snell & Wilmer, Phoenix.

Related Court Document:
Complaint: 2011 WL 827202

See Document Section B (P. 27) for the complaint.

CalPERS sues over failed Lehman investments

The nation's largest public employee retirement system has filed a securities fraud lawsuit in California federal court, claiming it was misled into investing hundreds of millions of dollars in now-bankrupt Lehman Bros. Holdings Inc.

California Public Employees Retirement System v. Fuld et al., No. 11-CV-562, complaint filed (N.D. Cal. Feb. 7, 2011).

The suit filed in the U.S. District Court for the Northern District of California seeks to recover losses allegedly suffered by the California Public Employees' Retirement System stemming from its purchases of Lehman common stock and bonds between June 2007 and September 2008.

The defendants include a dozen former Lehman executives and more than 30 underwriters.

Lehman is not a defendant, having filed for Chapter 11 bankruptcy protection in September 2008, the complaint says.

CalPERS claims it made the investments based on allegedly false and misleading offering documents, including prospectuses and SEC filings, that "failed to disclose Lehman's losses and exposure in connection with its subprime … lending activities and the true value of the company's mortgage-related assets."

The false statements led to Lehman's stock and bond prices being artificially inflated, CalPERS claims.

CalPERS claims it made the investments based upon allegedly false and misleading offering documents, including prospectuses and SEC filings.

But when Lehman announced the results for the third quarter of 2008, it reported a net loss of $3.9 billion and $7.8 billion in write-downs, which included $7 billion on its residential and commercial real estate holdings, the complaint says.

The announcement caused the stock price to drop, and four days later Lehman filed the largest bankruptcy in U.S. history. WJ

Attorney:
Plaintiff: Shawn A. Williams, Robbins Geller Rudman & Dowd, San Francisco

Related Court Document:
Complaint: 2011 WL 396033

Pension fund can't amend complaint against Wachovia

A federal judge in New Jersey has refused to allow a pension fund to amend its complaint alleging Wachovia Bank breached its fiduciary duty by investing in mortgage-backed securities and collateralized debt obligations.

Trustees of the Local 464A United Food & Commercial Workers Union Pension Fund et al. v. Wachovia Bank N.A. et al., No. 09-668, 2011 WL 677461 (D.N.J. Feb. 15, 2011).

U.S. District Judge William J. Martini of the District of New Jersey affirmed a magistrate judge's ruling that the plaintiff, Trustees of the Local 464A United Food & Commercial Workers Union Pension Fund, failed to comply with a scheduling order and wrongly asserted the delayed filing would not prejudice the bank.

The pension fund filed suit in February 2009, alleging it suffered losses stemming from Wachovia's heavy concentration in mortgage-backed securities and collateralized mortgage obligations.

U.S. Magistrate Judge Mark Falk issued a scheduling order for discovery and set a Dec. 31 deadline for amending the pleadings.

The pension fund sought leave to amend the complaint Aug. 11, 2010, citing financial evidence produced during discovery.

Judge Falk denied the motion, saying the plaintiffs did not demonstrate "good cause" as required by the Federal Rule of Civil Procedure 16.

The pension fund appealed that decision to the District Court, arguing the magistrate should have applied the Rule 15 standard, which requires the defendant to show it would be prejudiced by an amendment.

The fund contended Rule 16 did not apply because several discovery disputes caused the scheduling order to become stale. In any event, the fund said it should prevail under either standard because it demonstrated good cause for the amendment and that Wachovia would not be prejudiced.

Judge Martini found no error in the magistrate's ruling and rejected the fund's argument that the scheduling order no longer was in effect.

Discovery disputes often lead to delays, the judge said, and "allowing parties to ignore applicable scheduling deadlines every time this occurs would prevent effective case management."

He agreed with Judge Falk that the pension fund lacked good cause for its delay in seeking to amend the pleadings.

Judge Martini noted the fund had the relevant data when it filed the original complaint because Wachovia sent monthly statements showing the allocation of its assets.

If the pension fund did not understand the financial data, it could have retained an expert to analyze it, he said.

The fact that the plaintiff waited to get the information in the format it preferred does not give it a free pass to delay amending the complaint for months beyond the scheduling order's deadline, the judge said.

Acknowledging that Rule 16, rather than Rule 15, applies, Judge Martini nonetheless held that the pension fund did not meet Rule 15's more liberal standard that leave to amend should be freely granted unless motivated by bad faith or doing so would prejudice the opposing party.

REUTERS/Chris Keane

The fact that the plaintiff waited to get the information in the format it preferred does not give it a free pass to delay amending the complaint for months beyond the scheduling order's deadline, the judge said.

Wachovia established it would suffer prejudice because any delay would require additional resources to conduct discovery and prepare for trial, the judge explained. WJ

Attorneys:
Plaintiff: Edward W. Ciolko and Joseph H. Melzer, Barroway Topaz Kessler Meltzer & Check, Radnor, Pa.

Defendant: Diane A. Bettino, Reed Smith LLP, Princeton, N.J.

Related Court Document:
Opinion: 2011 WL 677461

REUTERS/Phil McCarten

OFFICERS AND DIRECTORS

SEC charges ex-IndyMac execs with subprime fraud

Former executives of IndyMac Bancorp defrauded investors in 2007 and 2008 by hiding the now-bankrupt lender's precarious financial condition, the Securities and Exchange Commission has alleged in Los Angeles federal court.

Securities and Exchange Commission v. Perry et al., No. 11-CV-1309, Securities and Exchange Commission v. Abernathy, No. 11-CV-1308, complaints filed (C.D. Cal. Feb. 11, 2011).

In a complaint filed in the U.S. District Court for the Central District of California, the SEC says CEO Michael Perry and CFO Scott Keys authorized the sale of $100 million in new stock in 2008 while hiding the firm's rapidly deteriorating balance sheet.

Perry and Keys should have disclosed the bad news in the firm's 2007 annual report and in 2008 stock offering documents, the suit says.

They allegedly violated the Securities Act of 1933, 15 U.S.C. § 77q(a), and the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b).

Former CFO Blair Abernathy agreed to pay $125,000 to settle similar allegations in a separate complaint. In settling, he neither admitted nor denied the charges.

Abernathy replaced Keys as CFO in April 2008.

According to the agency, Perry and Keys knew in February 2008 that IndyMac's public statements predicting a profitable future were false.

IndyMac continued to sell stock even though Perry knew and failed to disclose that recent credit rating downgrades would force the firm to suspend preferred dividend payments, the complaint says.

The Federal Deposit Insurance Corp. took IndyMac into receivership in July 2008. The Pasadena, Calif.-based company filed for bankruptcy later that month. WJ

Related Court Documents:
Perry complaint: 2011 WL 549377
Abernathy complaint: 2011 WL 549376

Securities fraud charges against Ruger officers hit the mark

Charges that top officers duped investors about increased orders for Ruger firearms are on target, according to a Connecticut federal judge who allowed shareholders to proceed with a securities fraud suit over a 2007 turnaround plan that backfired.

In re Sturm, Ruger & Co. Securities Litigation, No. 09-1293, 2011 WL 494753 (D. Conn. Feb. 7, 2011).

U.S. District Judge Christopher Droney of the District of Connecticut said the plaintiff shareholders, led by the Steamfitters Local 449 Pension Fund, sufficiently backed up their charges that officers of Sturm, Ruger & Co. knew a reshuffling of inventory to distributors, rather than new orders, was responsible for a 2007 sales spike.

He denied a motion to dismiss the complaint, finding it met the toughened pleading standards of the Private Securities Litigation Reform Act of 1995 by showing the officers knew their turnaround plan was failing.

> The "lean manufacturing" plan had left Ruger with insufficient parts to quickly fill big orders, and the firearms company was losing sales as a result, according to sales managers.

The shareholder plaintiffs said new CEO Michael Fifer told investors that his "lean manufacturing" plan had produced increased sales and reduced inventory in the first half of 2007 even though he knew the spike mainly resulted from stuffing the product distribution channels.

In fact, the "lean manufacturing" plan had left Ruger with insufficient parts to quickly fill big orders, and the company was losing sales in the second half of 2007 as a result, according to testimony from its production managers.

However, Fifer and CFO Thomas Dineen hid the bad news from investors and kept the stock price artificially inflated until they sold off large blocks of their shares, the suit alleges.

When the company announced a 23 percent drop in sales in the third quarter of 2007, the stock price plummeted, and investors were blindsided, the plaintiffs say.

"The court finds that the company had a duty to disclose the negative consequences of the transition to lean manufacturing, and the failure to do so renders several [company] statements misleading," Judge Droney wrote.

He noted specific charges that the officers knew their statements were false when they made them. That alleged reckless disregard for the truth is enough to pass the PSLRA's *scienter* requirement because the officers saw reports that put them on notice that their statements were false and that investors would be injured by relying on them, he added.

REUTERS/Khalid Mohammed

Although the plaintiffs must prove their charges at trial, for now, their specific allegations are sufficient to withstand a motion for dismissal, the judge concluded. WJ

Attorneys:

Plaintiffs: David Rosenfeld, Robbins Geller Rudman & Dowd, Melville, N.Y.

Defendants: Michael Dockterman, Wildman, Harrold, Allen & Dixon, Chicago

Related Court Document:

Opinion: 2011 WL 494753

OHIO SAVINGS PROVISION APPLIES TO REMOVED CASE

An Ohio federal judge has rejected a defendant attorney's attempt to dismiss a malpractice action on statute-of-limitations grounds. U.S. District Judge Edmund Sargus said that, under the state's savings provision, plaintiff TattleTale Portable Alarm Systems could file its malpractice lawsuit within one year of the date an Ohio appeals court affirmed its removal from state to federal court. The dispute involved attorney Lisa Griffith's alleged failure to advise TattleTale about applicable deadlines related to patents. The usual limitations period for professional malpractice claims in Ohio is one year. Here, however, the initial malpractice suit was filed in state court in August 2006 and was dismissed in July 2008 because federal courts have exclusive jurisdiction in patent cases. A state appeals court affirmed the dismissal in March 2009. TattleTale then filed the action in federal court, and Lisa Griffith unsuccessfully moved to dismiss because the filing came more than one year after the malpractice was allegedly discovered in August 2005.

TattleTale Portable Alarm Systems Inc. v. Calfee, Halter & Griswold et al., No. 10-226, 2011 WL 679492 (S.D. Ohio Feb. 14, 2011).

Related Court Document:
Opinion: 2011 WL 679492

FIRM FAILED TO PURSUE CLAIM AGAINST STATE FARM, SUIT SAYS

A Los Angeles law firm breached its duty to follow through on a suit against State Farm Insurance for damages stemming from a 1994 earthquake, according to a complaint filed in California state court. Plaintiff Linda Paduano says attorney Steven Zelig sued State Farm on her behalf to recover on her policy but decided to end his representation just before a hearing on the company's summary judgment motion. Paduano also claims that, unbeknownst to her, the court imposed $30,000 in sanctions for Zelig's failure to comply with court orders in 2008, 2009 and 2010. She says her claim for coverage for earthquake damage was legitimate and that Zelig did not fulfill his duty to keep her informed about the case. She is seeking unspecified compensatory, exemplary and punitive damages.

Paduano v. Zelig et al., No. BC455878, complaint filed (Cal. Super. Ct., L.A. County Feb. 24, 2011).

COMPANY MAY SUE INSURER FOR BREACH OF DUTY

A New York appeals court has found a question of fact as to whether an insurance agency met its duty to respond within a reasonable time to a construction company that allegedly requested construction management professional liability insurance coverage. The appeals court said the trial court found plaintiff Axis Construction Corp. did not specifically ask the O'Brien Agency Inc. for insurance coverage. However, an insurance agent or broker has a common law duty to arrange for the coverage requested by a client within a reasonable time, especially, where there was a "special relationship" with the client. A "special relationship" may exist where there is a continuing "course of dealing" for an extended period that would put an "objectively reasonable" insurance agent on notice that his advice was being sought and would be relied upon, the court said.

Axis Construction Corp. v. O'Brien Agency Inc. et al., No. 038131/2007, 2011 WL 668359 (N.Y. Sup. Ct. App. Div., 2nd Dep't. Feb. 22, 2011).

Related Court Document:
Opinion: 2011 WL 668359

AUTO DEALER SUES ATTORNEY OVER ADVERSE JUDGMENTS

An Illinois Kia dealership has sued an Oak Park attorney for malpractice stemming from two separate default judgments that cost the plaintiff more than $84,000. Evergreen Motors says that, in the first case, it hired James Smith to handle a replevin matter for it, but Smith failed to appear in court and did not answer a counterclaim. In the second case, Smith allegedly did little more than file an appearance with the court after Evergreen was sued. This inaction resulted in two judgments being entered against the dealership and Evergreen's subsequent termination of Smith's services, according to the complaint. In addition to claiming that Smith breached his duty of care to the company, Evergreen says he was not honest about the status of the two cases when he was asked.

Evergreen Motors Inc. v. Smith, No. 2011-002096, complaint filed (Ill. Cir. Ct., Cook County Feb. 22, 2011).

CASE AND DOCUMENT INDEX