TADC ETHICS AND PROFESSIONALISM NEWSLETTER

Fall 2010 Edition

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INTRODUCTION

This newsletter seeks to bring you information about topics of interest regarding ethics and professionalism.

The Case Law Updates summarize cases of interest. There are numerous cases involving legal ethics and malpractice, making it infeasible to report about all the potentially relevant cases. [The Ethics Opinion Updates in this newsletter summarize the opinions of note that have been released by the Professional Ethics Committee for the State Bar of Texas since our Fall 2009 newsletter.]

I.

TEXAS CASE LAW UPDATES

A. Texas Supreme Court adopts an additional element of damages in legal malpractice cases.

***Akin Gump Strauss Hauer & Feld, L.L.P. v. National Development & Research Corporation,* 299 S.W.3d 106 (Tex. 2009)**

Akin Gump represented National Development in the jury trial of a case in which a judgment was recovered against National Development. Subsequently, National Development sued Akin Gump for legal malpractice based on its handling of the underlying suit. National Development alleged that Akin Gump negligently failed to request jury questions that might have exonerated National Development from liability in the underlying case. The jury in the legal malpractice suit against Akin Gump found that Akin Gump was negligent in its representation of National Development in the trial of the underlying case.

The trial court entered a judgment awarding damages in favor of National Development. While Akin Gump did not appeal the negligence finding against it, it did appeal a portion of the trial court's damage award. The Court of Appeals reversed in part and affirmed in part, resulting in petitions for review being filed by both Akin Gump and National Development which were granted.

Most of the Supreme Court's opinion deals with issues specific to the adequacy of the evidence in the malpractice trial to sustain the jury's damage award that are of little jurisprudential significance. However, the Court was also required to grapple with an issue unresolved in prior Texas law, *i.e.*, whether National Development was entitled to recover from Akin Gump the fees paid to that law firm in the defense of the underlying case where, as here, the law firm was found to be negligent in the conduct of National Development's defense.

The Court acknowledged the general rule that a party may not recover attorneys' fees for litigation in which it is involved unless the recovery is authorized by statute or contract, as stated in *Turner v. Turner*, 385 S.W.2d 230, 233 (Tex. 1964). However, National Development urged the Supreme Court to adopt the "tort of another" exception set out in RESTATEMENT (SECOND OF TORTS SECTION 914(2) 1977) which allows a party to recover attorneys' fees when that party must, as a result by some tort committed by another, bring or defend an action against a third party. National Development contended that it was compelled to sue a third party, Akin Gump, due to the tort committed by Akin Gump, *i.e.*, its negligence in the trial of the underlying suit.

Akin Gump responded that National Development was seeking fee disgorgement, a remedy available only if Akin Gump's attorneys breached a fiduciary duty to National Development, an issue as to which National Development did not either plead or request jury questions.

[1] Kathy Owen is a member of the Board of Disciplinary Appeals appointed by the Supreme Court of Texas. Any opinions herein are those of Kathy Owen in an individual capacity and do not reflect any opinion of the Board of Disciplinary Appeals.

In response to that and Akin Gump's other arguments, the Supreme Court stated:

> "We disagree with Akin Gump that attorneys' fees paid in an underlying suit can only be recovered through forfeiture for breach of fiduciary duty. For the reasons set out below, we conclude that the general rule as to recovery of attorneys' fees from an adverse party in litigation does not bar a malpractice plaintiff from claiming damages in the malpractice case for fees it paid its attorneys in the underlying suit."

After acknowledging that the American Rule and the Texas Rule has long been that attorneys' fees paid to prosecute or defend a lawsuit cannot be recovered in that suit absent a contract or statute allowing such recovery, the Supreme Court concluded that the rule did not apply to National Development's claim for the recovery of attorneys' fees it paid to Akin Gump for the law firm's negligent representation in the underlying suit.

After analyzing additional precedent, the Supreme Court announced a "better rule", as follows:

> "We see little difference between damages measured by the amount the malpractice plaintiff would have, but did not, recover and collect in an underlying suit and damages measured by attorneys' fees it paid for representation in the underlying suit, if it was the defendant attorneys' negligence that proximately caused the fees. . . . <u>The better rule, and the rule we adopt, is that a malpractice plaintiff may recover damages for attorneys' fees paid in the underlying suit to the extent the fees were proximately caused by the defendant attorneys</u>' negligence (citing multiple authorities; emphasis added).

The Supreme Court did not cite any prior on point authority for its decision. Nonetheless, it is clear for future legal malpractice cases that a plaintiff suing its former law firm can recover the legal fees paid to that law firm that were proximately caused by the defendant's attorneys' negligence.

B. Lawyer's "alleged" allegation that opposing counsel suborned perjury at trial results in unique sanctions order.

***Oscar Rodriguez, a Partner of Fulbright & Jaworski L.L.P. v. MumboJumbo*, No. 5-10-00361 – CV, Court of Appeals for Fifth District of Texas (Dallas)**

A video game developer, MumboJumbo, won almost $4.6 million in damages against a rival developer, PopCap, for fraud, business relationship interference and breach of contract. Following a hearing in the 193rd Civil District Court in Dallas County, Judge Carl Ginsberg was to issue an order requiring PopCap to pay $2.1 million in attorneys' fees to MumboJumbo, including $525,000 for post-verdict appeals. The court did not stop there when it further issued a sanctions order against counsel for PopCap, an attorney with Fulbright & Jaworski, LLP.

The events that led to the sanction order against the attorney occurred a few days before trial concluded. PopCap filed a motion to determine whether the attorney-client privilege had been waived by the crime-fraud exception under Texas Rules of Evidence Rule 503(d)(1). Judge Ginsberg denied the fraud motion the same day it was filed, and MumboJumbo sought sanctions against PopCap and its counsel for accusing counsel of assisting MumboJumbo's officers in the provision of alleged false testimony at trial. After the trial court posed a question to PopCap's counsel about what he had meant about what he had said at a prior hearing, the court announced that "[t]o the extent that the motion for sanctions asks for relief . . . from Mr. Rodriguez of accusing counsel of suborning perjury, that portion is granted."

On March 19, 2010, the trial court signed an order granting the sanctions motion "concerning Counselor Rodriguez's baseless accusations, made in open court, that opposing Counsel had suborned perjury." Invoking its "inherent power to discipline an attorney's behavior," the court ordered Rodriguez to submit for publication to the Texas Lawyer "no later than April 16, 2010" a half-page advertisement stating "verbatim" the apology language that MumboJumbo's counsel had scripted:

> "BE IT KNOWN:
> During the trial between MumboJumbo, LLLC [sic] and PopCap Games, Inc., which occurred before the 193rd Judicial District Court in Dallas, Texas, I improperly accused Rose Walker, LLP and its attorneys, Martin Rose, Mike Richardson, Ross Cunnigham [sic], Bryan Rose & Elizabeth Lemoine, of suborning perjury. I was wrong. I apologize [sic]

Sincerely,
Oscar Rey Rodriguez
Fulbright & Jaworski, LLP"

The order otherwise denied MumboJumbo's motion for sanctions and imposed no sanctions on PopCap or any of its other counsel. The ad is on hold while the 5th Court of Appeals in Dallas reviews Ginsberg's sanction order.

C. Sanctions order prior to final judgment could result in "death penalty" sanction and abuse of discretion.

***In re Michelle Spence*, 02-09-00392-CV, Court of Appeals for Second District of Texas (Fort Worth)**

Before the 415th Judicial District Court in Fort Worth, Spence filed suit against the defendant, Coalson, for false imprisonment, malicious criminal prosecution, defamation, private nuisance, intentional infliction of emotional distress, and conspiracy. In response, Coalson filed counterclaims against Spence for fraud, action on a debt, and defamation.

After attempts at discovery, Coalson later filed a motion to compel and for sanctions regarding Spence's failure to sufficiently respond to discovery as well as a motion to compel and for sanctions for Spence's failure to appear for her deposition. In his motion to compel discovery and for sanctions regarding Spence's failure to respond to discovery, Coalson asked the court to order Spence to reimburse Coalson for attorneys' fees in the amount of no less than $25,000 incurred in attempting to obtain discovery from Spence.

Spence's counsel argued to the trial court that assessing the monetary sanction Coalson was requesting would result in a death-penalty sanction against Spence because he believed she did not have the funds to pay the sanction. At the conclusion of the hearing, the trial court ordered Spence to appear for and pay for her deposition, respond to each and every discovery request propounded, and reimburse Coalson for reasonable and necessary attorneys' fees incurred in the amount of $19,929.19 within thirty days after entry of the order.

Spence filed a petition for writ of mandamus before the Fort Worth Court of Appeals and a motion for emergency stay seeking relief from the trial court's sanctions order. The appellate court held that an order directing that sanctions be paid prior to final judgment is an abuse of discretion unless the court makes express findings as to why the sanctions do not preclude the sanctioned party from continuing the lawsuit. The court of appeals deferred ruling on the discovery issues and amount of the sanctions but held that the order to pay within thirty days was an abuse of discretion because the sanction threatened the plaintiff's ability to continue the lawsuit. The Court stated:

> If a litigant contends that a monetary sanction precludes access to the court, the district judge must either (1) provide that the sanction is payable only at a date that coincides with or follows entry of a final order terminating the litigation; or (2) make express written findings, after a prompt hearing, as to why the award does not have such a preclusive effect.

Therefore, the Court denied the plaintiff's request for mandamus as to the propriety of the sanctions, but granted the petition and ordered the trial court to modify the sanctions order to provide that the sanctions be payable upon termination of the litigation.

D. Former judge and her law firm disqualified as counsel for conflict of interest when judge heard related probate cases.

***In re Brittingham*, No. 04-10-00175-CV, Court of Appeals for Fourth District of Texas (San Antonio)**

The San Antonio Court of Appeals recently disqualified former court of appeals Justice Sarah Duncan and her law firm--Locke Lord Bissell & Liddell LLP. The Justice and her firm represented a Relator in an original proceeding pending before that court of appeals. When Justice Duncan served on the Fourth Court of Appeals, she participated in two separate appeals taken from the underlying probate proceeding. After she left the bench, she made an appearance as counsel in an original proceeding filed in the Fourth Court of Appeals and relating to the same probate proceeding. The Real Party in Interest, Kevin Mackie, moved to disqualify Justice Duncan and her law firm.

Perhaps an obvious result, the court of appeals granted the motion to disqualify. First, the court of appeals discussed the definition of a "matter" under Texas Disciplinary Rule of Professional Conduct 1.11. The court of appeals further rejected a narrow interpretation that would have treated an original proceeding as a separate matter from the underlying

proceeding or from prior appeals taken from the same underlying proceeding. Next, the court discussed what disclosure is required in order for the opposing party to consent to the conflict and held that the mere listing of Justice Duncan on a brief in the original proceeding was not disclosure of the conflict. Third, the court concluded that the Real Party in Interest was not required to show prejudice. Finally, the court held that the disqualification of Justice Duncan required disqualification of the entire law firm under Rule 1.11(c).

E. Attorney recovers for travel time under Chapter 38.

***Dennis Wilkerson v. Atascosa Wildlife Supply,* No. 04-08-00468-CV, Court of Appeals for Fourth District of Texas (San Antonio)**

Attorney's Fees for travel time are potentially recoverable under Chapter 38 of the Texas Civil Practice and Remedies Code. Atascosa sought recovery of attorney's fees inclusive of $5,500 for travel time. Atascosa offered evidence that the travel time was reasonable and necessary considering the distance traveled. Atascosa only billed 50% of his rate for the hours of travel time in which he was driving and could not actively work on the case. The trial court awarded the fees.

After the trial court granted Atascosa's attorney's fees, Wilkerson appealed. The court of appeals observed that it could find no Texas case precluding an award of attorney's fees that includes travel time. Based upon the evidence presented, the court concluded that there was nothing in the record showing the award of attorney's fee for travel time was unreasonable or arbitrary and the court affirmed the judgment. *Wilkerson* has now been appealed to the Texas Supreme Court.

F. Trial court abuses its discretion if it conditions a trial setting on the payment of sanctions.

***In re Gawlikowski*, No. 14-09-00985-CV, Court of Appeals for Fourteenth District of Texas (Houston)**

The plaintiff and his attorney were sanctioned $45,000 and $5,000, respectively. In addition to awarding sanctions, however, the order set the trial for the "next available trial date following payment of the fees in full as ordered herein." The plaintiff and his attorneys challenged the sanctions order by mandamus.

In its memorandum opinion, the court of appeals began by holding that because the plaintiff and his attorney did not claim that the sanctions threatened their ability to continue the litigation, they had an adequate remedy by appeal and, thus, were not entitled to mandamus relief with respect to the sanctions. Citing precedent, however, the court held that "[a] sanctions award that impedes the prosecution of the case warrants extraordinary relief." Accordingly, the court of appeals found an abuse of discretion and conditionally granted mandamus, ordering the trial court to delete the language in the sanctions order that conditioned the trial setting on the payment of sanctions.

II.

FEDERAL CASE LAW UPDATES

A. Fifth Circuit rules district court has "no inherent authority" to impose sanctions for attorney's conduct occurring in arbitration.

***Positive Software Solutions, Inc. v. New Century Mortgage Corp., et al.,* 2010 WL 3530013 (5th Cir. Sept. 13, 2010)**

The Fifth Circuit Court of Appeals recently held that a district court overstepped the bounds of a court's inherent authority by sanctioning conduct that occurred in connection with an arbitration proceeding.

Positive Software Solutions sued New Century Mortgage for allegedly infringing on certain software patents associated with telemarketing software licensed to New Century. A partner in Susman Godfrey, LLP represented New Century in a court-ordered arbitration. After an award was rendered, the district court vacated the award due to an alleged undisclosed relationship between the partner and the arbitrator. In an initial appeal, the Fifth Circuit reversed the vacatur and remanded the case. Positive Software later settled its dispute with New Century and, as part of the settlement, "New Century waived and assigned to Positive Software its attorney-client and work-product rights." The district court later ordered Susman Godfrey to turn over its files to Positive Software so that it could investigate potential sanctions.

Positive Software subsequently moved for sanctions against the partner and another under, Rules 28 and 37, 28 U.S.C. § 1927, and the district court's "inherent authority." In February 2009, the district

court sanctioned the partner $10,000.00 under the district court's "inherent authority" for conduct that had occurred during an arbitration proceeding. The district court concluded, because it had ordered the arbitration to proceed, it retained the authority to impose sanctions for conduct occurring during the arbitration.

On appeal, the Fifth Circuit expressed its concern that a district court might use its inherent power to sanction as a means to seize control over substantive aspects of arbitration. The Fifth Circuit first recognized that a District Court had the "inherent authority" to impose sanctions in order to (a) control the litigation before it, (b) sanction conduct in direct defiance of the sanctioning court, and (c) sanction conduct which constitutes disobedience to court orders. Nevertheless, the Fifth Circuit noted such "inherent authority" must only be used when essential to preserve the court's authority. The Fifth Circuit further acknowledged that "[p]arties agree to avoid litigation; they voluntarily surrender judicial remedies in favor of an extrajudicial process." Finally, the Fifth Circuit set out two means by which a party could seek redress for wrongdoing during an arbitration proceeding after the conclusion of the proceeding: (1) the grievance process, or (2) reopening the proceedings. Additionally, the Fifth Circuit concluded the sanctions order likely violated the Federal Arbitration Act, 9 U.S.C. §§ 1, *et. seq*., which significantly limits a court's ability to interfere with an arbitration proceeding. The Fifth Circuit overturned the sanctions award and concluded a district court cannot "become a roving commission to supervise private method[s] of dispute resolution and exert authority that is reserved, by statute, caselaw, and longstanding practice, to the arbitrator."

III.

ETHICS OPINION UPDATES

Opinion No. 594, February 2010

Question Presented:

Is it permissible for a lawyer to recoup from a client an amount greater than the amount actually paid by the lawyer for an expense incurred in connection with the representation of the client?

Summary of Opinion:

A lawyer represented a client on her personal injury claim and recovered from the opposing counsel party an award. The fee arrangement between the lawyer and the client allows the lawyer to deduct from any award the expenses paid by the lawyer in connection with the representation. The client had incurred medical expenses relating to the representation, which were intended to be paid out of the recovery, totaling $5,000. The lawyer, however, negotiated a release of these expenses for $500 and paid this amount to obtain a complete release of the amount due. The lawyer then issued to the client a check in an amount equal to the client's gross recovery less legal fees as provided in the engagement agreement and less $5,000 for the medical expenses that had been released, even though this was no longer technically the amount due.

The Texas Disciplinary Rules of Professional Conduct generally require that a client understand and accept the basis on which a lawyer's compensation for legal services is computed. Rule 1.04(c) provides that "[w]hen the lawyer has not regularly represented the client, the basis or rate of the fee shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation." In addition, Rule 1.03(b) provides: "A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."

Absent an agreement to the contrary, a lawyer may not mark up or increase the amount of an expense being recouped from the client, and if a lawyer receives a discount on payment of the expense, the amount of the expense recouped from the client must take into account the discount. The Committee concluded that billing more for expenses than the amount paid by the lawyer without disclosing that fact would constitute a violation of the requirements of Rule 1.04(c) and Rule 1.03(b) in that the lawyer would not have communicated accurately to the client the basis for the billing. In addition, the Committee opined that, in the absence of disclosure and agreement to the contrary, charging, collecting or recouping more for a third-party expense than the amount actually paid by the lawyer would violate the prohibition of Rule 8.04(a)(3) against engaging in conduct involving dishonesty, fraud, deceit or misrepresentation.

The factual situation considered in this opinion did not include the related but distinct subjects of additional charges for general office overhead and charges for the provision of in-house services.

In the absence of disclosure to and agreement with a client to the contrary, charging, collecting or recouping from a client more for a third-party expense than the amount of the expense actually paid by a lawyer would violate the requirements of Rules 1.04(c), 1.03(b) and 8.04(a)(3) of the Texas Disciplinary Rules of Professional Conduct.

IV.

PROPOSED TEXAS DISCIPLINARY RULE UPDATES

On Friday, Oct. 1, 2010, the State Bar of Texas Board of Directors voted to recommend to the Supreme Court of Texas that proposed amendments to the Texas Disciplinary Rules of Professional Conduct and interpretive comments to those Rules be approved, with the exception of Rules 1.06, 1.07, 1.08, and 1.09 regarding conflicts of interest. The Board will consider commentary and recommendations to the excepted rules during its January 28, 2011 meeting. The following is not intended as an exhaustive review but rather is intended only to provide short summaries of some of the key provisions to the amendments.

We suggest visiting www.texasrulescommentary.com for more detailed, additional commentary kindly provided by attorneys Amon Burton, Chuck Herring, and Jim McCormack. Background and explanation has also been provided by Rules Attorney Kennon L. Peterson, which can be found at http://www.supreme.courts.state.tx.us/rules

A. Rule 1.05 – Confidentiality of Information

The rule calls for a lawyer to disclose confidential information if it clearly establishes "that a client is likely to commit a criminal or fraudulent act that is likely to result in death or substantial bodily harm to a person." The term "substantial" has attracted criticism, as comments note that any form of bodily injury is not appropriate.

B. Rule 1.06 – Conflict of Interest: General Rule (Proposed)

Existing Texas Rule 1.06(b) defines a current-client conflict of interest as follows:

> With certain exceptions] a lawyer shall not represent a person if the representation of that person: (1) involves a substantially related matter in which that person's interest are materially and directly adverse to the interest of another client of the lawyer or the lawyer's firm; or (2) reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests.

Proposed Rule 1.06(a) eliminates the "substantially related" requirement in (b)(1) above. Texas is now the only state in which a directly adverse representation must also be "substantially related" in order to constitute a conflict of interest.

Second, the conditions that invoke the "adversely limited" standard in (b)(2) above are changed to read: "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person, or by a personal interest of the lawyer."

Proposed Rule 1.06(c) would permit a lawyer to undertake certain conflicted representations if the lawyer complies with three requirements. One requirement is that the client "provides informed consent, confirmed in writing." Rule 1.00 is the new rule that contains definitions of certain terms. Rule 1.00(k) defines "informed consent" as follows: " 'Informed consent' denotes the agreement by a person to a proposed course of conduct after the lawyer has explained, in a manner that a reasonable lawyer would believe sufficient for the person to understand, the material risks of and reasonably available alternatives to the proposed course of conduct." This is different from the disclosure requirement for consent in current Rule 1.06(c)(2), which requires "full disclosure of the existence, nature, implications, and possible adverse consequences of common representation and the advantages involved, if any." Notably, there is no definition for "confirmed in writing."

C. Rule 1.07 – Conflict of Interest: Intermediary (Proposed)

Rule 1.07 has been rewritten to address a lawyer's obligations relating to the representation of two or more clients (i.e., multiple clients) in the same matter. This rule requires a lawyer to evaluate the situation before undertaking multiple-client representation and reasonably believe that the conditions in subparagraph (a)(2) of the rule are met. Also before undertaking the representation, or as soon as practicable thereafter, the lawyer must disclose to the clients all of the things listed in

subparagraph (a)(3). Finally, under subparagraph (a)(4), the lawyer must obtain the clients' informed consent, confirmed in writing, to the representation. Paragraph (b), however, allows the lawyer to proceed under standards that differ from these standards if the lawyer represents multiple clients pursuant to a court order or appointment that entails different standards.

The rule attempts to clarify that it applies more broadly than many lawyers previously had thought. Instead of being relevant only to situations in which a lawyer acts as an intermediary between clients, such as representing two entrepreneurs working out the financial reorganization of a business, the amendments make clear that the rule applies to all representations in which the lawyer or affiliated lawyers represent multiple clients on the same matter. Therefore, Rule 1.07 will not apply just to litigators (even those who hire contract lawyers) but to all lawyers representing multiple clients in Texas, including companies with subsidiaries. The proposed Rule 1.07(b) prohibits a lawyer from representing two or more clients in a matter unless nine requirements are met, the last four of which must be documented in writing.

D. Rule 1.08 – Conflict of Interest: Prohibited Transactions (Proposed)

Rule 1.08 has been revised to define more clearly the bounds of prohibited transactions. For example, paragraph (b) prohibits a lawyer from soliciting a substantial gift from a client. Paragraph (f) imposes restrictions on aggregate settlements (in civil matters) and aggregated agreements (in criminal matters). The disclosures a lawyer must make to a client before executing such a settlement or agreement are also expanded. Subparagraph (g)(1) now restricts a lawyer's ability to prospectively limit the lawyer's liability to a client not only for malpractice, but also for professional misconduct. Subparagraph (g)(2) sets forth new standards for agreements between lawyers and clients to refer their disputes to binding arbitration.

E. Rule 1.09 – Conflict of Interest: Former Client (Proposed)

Paragraphs (a) and (b) restrict a lawyer's ability to represent a person in a matter in which the person's interests are materially adverse to the interests of a former client if the matter is the same as, or substantially related to, a matter in which the lawyer represented the former client. Paragraph (c), in turn, restricts a lawyer's ability to represent a person in a matter adverse to a former client in which the person questions the validity of the lawyer's services or work-product for the former client. New to Rule 1.09, paragraph (d) makes it explicit that a lawyer's use and disclosure of information relating to the representation of the former client is inappropriate.

F. Rule 1.12 – Organization as a Client.

The amended rule clarifies the lawyer's obligation to protect the organization's best legal interests (as the lawyer is retained to protect those interests), modifies the standard for initiating reasonable remedial measures, and addresses the limited situations in which the lawyer may disclose the organization's confidential information or jointly represent the organization and the organization's constituent or constituents.

G. Rule 1.13 – Prohibited sexual relations with a client (Proposed)

Rule 1.13 prohibits a lawyer from making sex a condition of representing a client and from soliciting or accepting sexual relations as payment of fees. It also states that "a lawyer shall not have sexual relations with a client that the lawyer is personally representing" unless the lawyer and client had a pre-existing consensual sexual relationship. As written, the rule would not apply to a lawyer in a firm who, if he or she begins having sex with a client, could transfer that client to another lawyer in the firm. The proposed rule prohibits a lawyer from soliciting or accepting sex for fees but does not explicitly apply the same prohibition to expenses.