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ARTICLES

Engagement Letters: Four Key Terms to Reduce Risk

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Recent statistics from the ABA's Standing Committee on Lawyers' Professional Liability reveal that legal malpractice claims are becoming more expensive to defend and settle. Therefore, it is beneficial for practitioners to take steps to reduce the likelihood of claims for legal malpractice. One of the best tools an attorney can use to minimize the likelihood and severity of a later claim is a well-drafted engagement letter entered into at the beginning of a representation.

Engagement letters are one of the most reliable indicators of whether an attorney or firm has systems in place to effectively reduce the risks of malpractice claims. That is why many law firm audits, often conducted by insurers to assess a firm's risk management processes, begin with a review of the engagement letter. Indeed, an effective engagement letter not only guides the representation, including its scope, but it can provide the first line of defense against a future legal malpractice claim.

To ensure that engagement letters are always used, some firms do not allow new matters to be opened or billed until an engagement letter is approved. Inevitably, it is the one new client for which a firm did not use an engagement letter that later causes problems.

Below are some, but not all, terms that law firms should consider including in their engagement letters to reduce overall risk.

Define the Client

Attorneys owe duties to their clients. Generally, attorneys do not owe special duties to parties outside the attorney-client relationship, even those who pay the bills. It is the unique relationship between the attorney and the client that gives rise to potential malpractice suits. Thus, by using the engagement letter to define who the client is, the attorney limits the class of persons to whom the duties of the representation are owed and therefore also limits the potential plaintiffs who could later bring suit.

Sometimes this requires a simple designation. In other circumstances, it may be more complicated. For example, it may behoove the attorney to specify that she represents the officer of a corporation but not the corporation itself (or its shareholders). Or, in a case involving wills, the attorney can specify whether she represents the executor, the heir, or some other party.

This approach is important because courts reviewing the existence and scope of an attorney-client relationship will typically review the facts from the perspective of the potential client. If an attorney is not clear regarding the identity of the client, she may find herself defending a claim from someone she did not intend to represent. Cutting off the potential for nonclients to infer a special relationship is important. Some attorneys consider using an exclusion in the engagement letter for any person or entity not specifically identified: "No duties have been undertaken or assumed for any person or entity that has not been specifically identified as a client."

Confirm the Scope and Duration of Representation

The best evidence of what an attorney agrees to do for her client is the engagement letter. Indeed, the engagement letter can also be used to confirm the type of services to be provided as well as the expected length of the representation. The key is to

clearly define exactly what the attorney has been hired to do and make clear that the attorney has not been retained for anything more. Courts have dismissed legal malpractice lawsuits in which the client alleged the attorney should have done more than what was contained in the engagement letter. In short, an attorney can rely on her engagement letter to defend against legal malpractice claims—but this requires her to include helpful, limiting language in the letter itself.

Absent a definition or limitation in the engagement letter, a court may later infer that the representation is a general one for multiple purposes. This inference is dangerous from both a statute of limitations perspective and a liability perspective. An open-ended representation that continues indefinitely may be viewed as preserving the statute of limitations for any client wishing to bring a claim. A broad representation could also be held against an attorney who could be viewed as agreeing to do tasks that are assumed by the client but never confirmed in writing by the attorney.

Even specifying the task in the engagement letter can create complications. A client hiring an attorney to represent him for a traffic ticket could have varied expectations for the advice received in the representation, including on the hearing itself, the potential liabilities arising from the accident, the applicable statute of limitations for claims relating to the accident, insurance issues, and others. A narrowly drawn engagement letter will help specify the attorney's obligations. The language could be as simple as specifying that the attorney is responsible for the trial but not the appeal. If the representation continues or expands, the attorney can enter into another engagement letter or a modification.

In addition to confirming the scope of the representation, the attorney can use the engagement letter to confirm the duration of the representation. Such a limitation could be tied to a specific length of time or a specific event (such as settlement, a real estate closing, or execution of a document). Because tying the representation to a specific event could also support the drafted limitation on the scope, this may be the stronger approach.

Without a limitation on duration, for example, an attorney could be found responsible for renewing security filings long after a real estate closing or for advising a client on changes in estate law long after the execution of the will. Specifying a limitation on the duration of the representation typically goes hand in hand with a file-closing letter upon the terminating event, confirming the end of the relationship and, therefore, any other duties to the client.

Confirm the Fee

Most attorneys include fee information in the engagement letter as well. Pursuant to ABA Model Rule of Professional Conduct 1.5(a), "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses." What makes a fee "unconscionable" under California's rule, for example, depends on several factors, including the amount of the fee in proportion to the value of the services performed; the relative sophistication of the attorney and client; the novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly; the amount involved and results obtained; time limits imposed by the client or circumstances; the experience and reputation of the attorney; whether the fee is fixed or contingent; and the amount of labor involved.

It is axiomatic that clients who are dissatisfied with the bill typically claim dissatisfaction with the representation. Attorneys can help reduce the likelihood of this event by confirming the fee arrangement in the engagement letter, whether it's an hourly fee, a contingency fee, or an alternative fee arrangement. Although attorneys are generally permitted to make some adjustments to fees after the representation has begun (such as for reasonable, annual increases in rates), attorneys may have less flexibility to make major changes to the fee arrangement after the representation has begun.

Because Model Rule 1.5(b) requires the attorney to communicate, preferably in writing, "the basis or rate of the fee and expenses for which the client will be responsible," the engagement letter is an appropriate place to do so.

Include Nonassignability Language

As discussed above, typically a malpractice claim is only owned by the person to whom the attorney owed a duty. Courts often recognize that the relationship between attorney and client is unique, both as a professional relationship and as to the specific terms of the representation. Although many courts or states have expressly stated that malpractice claims against an attorney are not assignable to third parties, some jurisdictions are ambiguous or even permit assignments in certain circumstances. Thus, it is recommended that attorneys include nonassignability language in the engagement letter, agreed to by the client. Because the potential for abuse is great, a "no assignment" clause will help ensure that attorneys are held only to those duties implicated by the unique attorney-client relationship.

Conclusion

Although there is no way to remain completely immune from receiving a claim for legal malpractice, a fortified engagement letter can help defend against such a claim. Because an engagement letter that lays out the points recommended above also explains the relationship and expectations to the client, it may also make future misunderstandings (that can lead to claims) less likely to occur. By anticipating some of these issues at the outset of a representation, attorneys can improve their relationships with their clients and lessen the likelihood of a future claim.

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LAW PRACTICE MANAGEMENT: Engagement Letters: Beginning a Beautiful Relationship

Marian C. Rice

The ABA Standing Committee on Lawyers' Professional Liability recently released data on a cross section of legal malpractice claims from 2008 to 2011, reporting that nearly 16 percent of all claims had been caused by poor client communications. To avoid such an outcome, lawyers should start their relationship with a client by having a full and frank discussion about the goals and terms of the engagement and the responsibilities of both the attorney and the client. Shortly after, the oral agreement needs to be accurately committed to paper.

Many jurisdictions mandate the content of written engagement letters in certain situations, and lawyers must consult the local rules before settling on the form of engagement letter to use as a guide. The ABA Model Rules of Professional Conduct "prefer" written engagement letters but require written agreements only where a contingency fee is permitted (Rule 1.5(c)) or where the fee charged may be considered entering into a business transaction with a client (Rule 1.8(a)). Even where a jurisdiction does not mandate the use of a written engagement letter, however, maintenance of office procedures

requiring that all engagements be reduced to writing is a sound risk management policy and promotes compliance with the Model Rules.

Identify the client. As an initial matter, the engagement letter should identify the client whose interests are being represented. Equally as important is a definition of those whose interests are not being represented. In representing a business organization, particular care should be taken to explain to the constituents of the organization that the organization is the attorney's client where the interests of the organization may not be aligned with those of the constituents. Engagement letters in the trust and estates field should also clearly identify the attorney's client in order to avoid the common misconception by relatives of the client that the attorney is the "family" lawyer.

Scope of engagement. Making the scope of the work performed under the terms of an engagement letter as broad as possible is a natural reaction. As outlined in Model Rule 1.2(c), it is perfectly acceptable for a lawyer to reasonably limit the terms of the engagement, provided the client is aware of the limitations and gives his or her informed consent.

A plainly worded provision setting forth the defined scope of the services to be performed is one of the most important risk management tools an attorney can adopt. If the intended engagement does not include appeals, the engagement letter should say so. If the attorney represents the executor but an accounting professional is separately retained by the estate to prepare the estate tax returns, spell it out in the engagement letter. If the ongoing representation expands beyond its original scope, a simple amendment to the original agreement will suffice. It is a sensible idea to set forth in this section of the letter the allocation of responsibility between the attorney and client in order to apprise the client of his or her role in the success of the representation.

Terms of payment. The engagement letter must also set forth the monetary terms of payment and should include the frequency of payment, the definition of the expenses for which the client will be responsible, and a realistic outline of the steps involved in the course of the representation, together with the time frame within which the client may expect to know the outcome of the retention. An estimated

budget of the cost of the representation—subject, of course, to revision as the matter proceeds and unanticipated events occur—will go a long way toward avoiding the misunderstandings that can cause a breakdown in the attorney-client relationship. If an attorney is concerned that a client will not retain the attorney if a realistic cost estimate is provided up front, the attorney should know that the client is never going to be happy with the services rendered as fees mount beyond the client's expectations.

If it is anticipated that the compensation spelled out in the engagement letter will change during the representation, the attorney should advise the client in the engagement letter of the circumstances warranting any increase in fees and the parameters of any projected change. In addition to the fact that Rule 1.5 states that "[a]ny changes in the basis or rate of the fee or expenses shall also be communicated to the client," many jurisdictions will exercise a high degree of scrutiny to changes in the terms of compensation that are not detailed in an engagement letter, particularly where the changes inure solely to the benefit of the attorney.

Additional factors that may negate the ability to change the terms of compensation include the sophistication of the client and the timing of the requested change. Rule 1.5(a) provides that an attorney may not charge "unreasonable" fees or expenses. The key to the reasonableness of the fees provided for in the letter is the client's understanding of the amounts charged and the reasons for the fee structure.

The engagement letter should also spell out the consequences of the failure to pay in a timely manner the legal fees invoiced to the client. The tolerance a law firm may have for unpaid invoices may differ from client to client, but keeping track of troublesome accounts receivable and taking appropriate action if requests for payment are ignored are important functions of law firm management. Suits for unpaid legal

fees will provoke retaliatory claims of malpractice. While the ability of a law firm to extricate itself from an engagement may depend on the jurisdiction and the nature of the representation, the client should be informed that nonpayment will result in withdrawal. Many jurisdictions require attorneys to advise their clients in the engagement letter of the existence of attorney-client fee dispute and conciliation programs.

Client communications. The frequency and means by which the attorney will apprise the client of the status of the proceedings should also be outlined in the engagement letter. Model Rule 1.4 requires that the client be kept reasonably informed of the status of the matter. While e-mail has become a common means of communication, attorneys must caution their clients that no attorney-client privilege will attach to substantive attorney-client communications made under circumstances where there is a significant risk that the communications will be read by a third party.

Also, if it is apparent that an actual or potential conflict of interest exists, the manner in which the conflict is being addressed should be set forth in the engagement letter. Keep in mind that not every conflict can be waived and that the consequences of failing to adequately analyze a conflict can be devastating to both the client and the law firm. Assuming the existence of a conflict, the client's informed consent must be obtained for any waiver to be effective.

Document and file retention. Given the obligation imposed on attorneys to take affirmative steps to ensure a litigation hold is in place and that data is preserved from the moment it becomes reasonably evident a dispute exists, reference to the client's role in the preservation obligation should be spelled out on engagement. Although the details of the client's obligations should be outlined in a separate document, a cursory reference to the need for the client to

safeguard data and cease routine document destruction policies is warranted.

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