



Attorneys in Hot Water When Prosecutors Turn Up the Heat

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By: Michael C. Miller & Jill C. Maguire

I. Introduction

Headlines in the legal and mainstream press have been dominated recently by high profile prosecutions of lawyers in New York. Most notably of late, Cyrus Vance and his team at the Manhattan District Attorney's Office have been prosecuting former leaders of the Dewey & LeBeouf LLP law firm for allegedly defrauding insurance companies and financial institutions out of hundreds of millions of dollars. With pre-trial motions to dismiss the Dewey indictment denied, the Dewey case has been cleared for trial in 2015. In an effort to better understand this spate of prosecutions, we have conducted an informal survey into the criminal cases that have been brought in New York federal and state courts, or against New York-licensed attorneys outside of New York, over the last few years. We have also looked at the civil and regulatory actions brought against law firms and their lawyers in the wake of these criminal prosecutions. This article discusses the results of our limited survey, considers the collateral consequences for lawyers and their law firms caught up in these cases, discusses steps law firms can take to diminish the risks of their lawyers getting into trouble, and reviews some of the key provisions in legal malpractice insurance policies that are directly implicated by criminal prosecutions of lawyers.

II. Our Survey of Criminal Convictions of Lawyers

Our survey focused on criminal convictions of lawyers in New York between January 2009 and September 2014. We also looked at instances where New York-licensed attorneys were convicted of crimes in other states or countries, during the same time period.

To conduct our survey, we took three basic steps. First, we reviewed decisions issued by the Department Appellate Division courts (which review disciplinary proceedings instituted by the New York Department Disciplinary Committees) over the last five years to identify attorneys who were subject to discipline as a result of criminal convictions. Second, we canvassed the Internet for media reports of other attorney convictions. Finally, we reviewed press releases issued by federal prosecutors in New York and the Manhattan District Attorney's Office.

A. Survey Results

Our research revealed that, over the last five years, 224 New York-licensed attorneys have been convicted of a variety of federal and state criminal offenses, with 128 convictions occurring in state courts (principally in New York State), 95 convictions obtained in federal court, and 1 conviction from the courts of the United Kingdom. Using our own informal classification of the offenses for which convictions were obtained, here are the results broken out by state and federal courts.

First, the state convictions, with larceny/theft-related convictions leading the way. We have further broken out the larceny-related convictions as to the type of crime:¹

¹ The larceny/theft-related convictions includes convictions for attempted larceny, theft, shoplifting, criminal mischief/petite larceny, larceny, grand theft, burglary, material misrepresentation, criminal facilitation, scheming to defraud, defraud, residential mortgage fraud, identity theft, forgery, bribery, criminal impersonation, perjury, and false instruments. The other convictions category includes convictions for crimes committed in connection with professional functions (e.g., sharing compensation with a non-lawyer, participation in pay-to-play schemes, removal

Conviction category	Number of convictions (128)
Larceny/theft-related convictions	80
➤ Misappropriation of funds	38
➤ Mortgage-related	22
➤ Securities	2
➤ Insurance	2
➤ Identity theft/forgery	10
➤ Other	6
DUI/drug-related convictions	12
Tax-related convictions	11
Sexual offense convictions	8
Assault-related convictions	5
Other convictions	12

Second, the federal convictions, with fraud-related convictions in the lead. We likewise have broken out the fraud-related convictions as to the type of crime:²

Conviction category	Number of convictions (96)³
Fraud-related convictions	74
➤ Mortgage fraud	25
➤ Securities fraud	16
➤ Immigration fraud	12
➤ Misappropriation of funds	7
➤ Defrauding the U.S. Government	4
➤ Other	10
Tax-related convictions	10
Bribery/obstruction of justice-related convictions	7
Sexual offense convictions	3
Other convictions	2

of public records, and official misconduct) and non-professional activity (e.g., endangering the welfare of a child, criminal trespass, criminal contempt, harassment/stalking, and criminal possession of a weapon).

² Federal fraud-related offenses include convictions such as bank fraud, wire fraud, securities fraud, immigration fraud, visa fraud, healthcare fraud, consumer fraud, and related conspiracy and attempt offenses. The tax-related convictions include failure to pay taxes, filing false tax returns, and the like. The other convictions category includes convictions for disclosure of classified information and violating probation.

³ We included the foreign conviction in our tally of federal convictions.



B. Fraud and Theft Cases

Not surprisingly, fraud and theft-related offenses dominate the mix of criminal convictions revealed in our survey. For example, 80 of the 128 state court convictions we reviewed involved larceny and theft-related crimes. Similarly, 74 of the 95 federal convictions we surveyed were fraud-based crimes. When criminal tax cases are added to the mix, the prevalence of fraud-based criminal cases becomes even more pronounced.

A closer look at the data reflects that mortgage fraud predominates the convictions in federal and state courts over the last five years. Indeed, mortgage fraud accounts for 25 out of 74 fraud-related convictions in federal court and 22 out of 80 larceny-related convictions in state courts. Federal court convictions also included 16 convictions for securities fraud and 12 for immigration fraud. Reflecting a more traditional emphasis on larceny-based crimes, almost half of the state fraud and larceny convictions were related to the misappropriation of funds, typically client funds.

C. Landmark Criminal Cases

Buried in this data is the fact that the scale of criminal cases brought against attorneys has become staggering. Here are some of the landmark criminal convictions we observed during our survey:

- ❖ The longest sentence handed down in an insider trading case—12 years—against an attorney, Matthew Kluger, who worked for a number of prominent Manhattan law firms (including Skadden, Arps, Slate, Meagher & Flom LLP and Wilson Sonsini Goodrich & Rosati).⁴
- ❖ Attorney Marc Dreier used his law firm to run a \$700,000,000 lending scam and to misappropriate over \$400,000,000 in client funds.⁵ Mr. Dreier pleaded guilty to securities and wire fraud, among other charges.
- ❖ The Galleon Group insider trading probe has resulted in convictions of four attorneys.⁶
- ❖ A Crowell & Moring LLP associate fled to Hong Kong where he was extradited back to the United States and pled guilty in New York State court on charges of larceny based on his misappropriation of more than \$10 million in client funds.⁷

⁴ Matthew Kluger, a New York-licensed attorney, pled guilty in the District of New Jersey to passing along confidential information (which he learned from his position as an attorney at law firms including Wilson Sonsini Goodrich & Rosati PC) to a professional stock trader. See U.S. Attorney's Office, District of New Jersey, *Lawyer Gets Record Prison Sentence – 12 Years – In Insider Trading Scheme That Used Information Stolen From Preeminent Law Firms* (June 4, 2012), <http://www.justice.gov/usao/nj/Press/files/Kluger,%20Matthew%20and%20Bauer,%20Garrett%20Sentencing%20News%20Release.html>; see also *In re Kluger*, 102 A.D.3d 168 (N.Y.A.D. 1 Dept. 2013).

⁵ U.S. Attorney's Office for the Southern District of New York, *Marc Dreier Pleads Guilty to Fraud* (May 11, 2009), <http://www.justice.gov/usao/nys/pressreleases/May09/Dreier,%20Marc%20Plea%20PR.pdf>; see also *In re Dreier*, 69 A.D.3d 43 (N.Y.A.D. 1 Dept. 2009).

⁶ U.S. Attorney's Office for the Southern District of New York, *Attorney Sentenced in Manhattan Federal Court to 30 Months in Prison for Insider Trading Scheme* (June 30, 2011), <http://www.justice.gov/usao/nys/pressreleases/June11/cutilloarthursentencingpr.pdf>; see also Federal Bureau of Investigation, *New York Field Office, Former Attorney and Wall Street Professional Michael Kimelman Sentenced in Manhattan Federal Court to 30 Months in Prison for Insider Trading* (Oct. 12, 2011), <http://www.fbi.gov/newyork/press-releases/2011/former-attorney-and-wall-street-professional-michael-kimelman-sentenced-in-manhattan-federal-court-to-30-months-in-prison-for-insider-trading>; see also *In re Cutillo*, 86 A.D.3d 1 (N.Y.A.D. 1 Dept. 2011); *In re Santarlas*, 80 A.D.3d 20 (N.Y.A.D. 1 Dept. 2010); *In re Goldfarb*, 96 A.D.3d 12 (N.Y.A.D. 2 Dept. 2012); *In re Kimelman*, 94 A.D.3d 148 (N.Y.A.D. 2 Dept. 2012).

⁷ Press Release, District Attorney, New York County, DA Vance: *Attorney and Former Fugitive Pleads Guilty to Stealing Millions from Clients* (Oct. 2, 2012), <http://manhattanda.org/node/3203/print>; see also Matt Chiappardi, *Convicted Ex-Crowell Atty Disbarred by DC Court of Appeals*, Law360 (Feb. 27, 2014),

- ❖ Attorney John Ioannou was convicted of stealing client funds. He is reported to have had more bar complaints filed against him in Manhattan and the Bronx over the last forty years than any other attorney or law firm.⁸
- ❖ Attorney Michael Levitis was convicted in the first fraud-related case referred by the newly minted Consumer Financial Protection Bureau to federal prosecutors.⁹
- ❖ The harshest sentence in our survey—40 years meted out by a Texas state court—against attorney Anthony Chiofalo for misappropriating over \$9 million from his employer.¹⁰

D. Other Findings

Other findings that we derived from our survey include the following.

First, state convictions outpaced federal convictions in every year except for 2012.

Second, criminal convictions of lawyers (at least in our survey) fell from 51 in 2009 to a low of 34 convictions in 2011, before spiking back up with 43 convictions in 2013.

Third, the significant number of criminal convictions of attorneys for theft, failing to file tax returns, sexual assault, other acts of violence, and drug or alcohol-related crimes supports the view that attorneys who get in trouble with the criminal justice system are often “at risk” individuals. They may be struggling with issues that include drug and alcohol abuse, and personal financial troubles.

Fourth, in the vast majority of our survey cases, the attorney’s unlawful conduct related to his (and it usually is a male attorney) work as an attorney. For example, many of the convicted attorneys were accused of using their legal skills to commit the crime, e.g., by drafting false legal documents in schemes to commit either mortgage fraud or immigration fraud. Others used their unique access to information or funds to carry out their crimes. This marriage of skill set/access and criminal conduct has not gone unnoticed by the courts. For example, in upholding Mr. Kluger’s 12-year insider trading sentence, the Third Circuit Court of Appeals found “good reason” to impose a longer sentence on Mr. Kluger: he was the longtime source of corporate secrets from his firms’ clients and, as an attorney, he “took an oath to uphold the law.”¹¹

<http://www.law360.com/articles/514067/convicted-ex-crowell-atty-disbarred-by-dc-court-of-appeals>; see also *In re Arntsen*, 106 A.D.3d 17 (N.Y.A.D. 1 Dept. 2013).

⁸ Press Release, District Attorney, New York County, DA Vance: *Personal Injury Lawyer Sentenced to 2 1/3-To-7 Years in Prison for Stealing Clients’ Funds and Fraudulently Negotiating Settlements* (Sept. 12, 2013), <http://manhattanda.org/node/4230/print>; see also *In re Ioannou*, 116 A.D.3d 178 (N.Y.A.D. 1 Dept. 2014).

⁹ U.S. Attorney’s Office for the Southern District of New York, *Debt Relief Company And Its Owner Plead Guilty In Manhattan Federal Court To Multimillion-Dollar Scheme That Victimized Over 1,200 Financially Struggling Consumers* (April 8, 2014), <http://www.justice.gov/usao/nys/pressreleases/April14/MichaelLevitis.php>; U.S. Attorney’s Office for the Southern District of New York, *Manhattan U.S. Attorney Charges Debt Settlement Company And Six Individuals For Multi-Million Dollar Scheme That Targeted Debt-Ridden Consumers* (May 7, 2013), <http://www.justice.gov/usao/nys/pressreleases/May13/MissionIndictmentPR.php>.

¹⁰ *In re Chiofalo*, 993 N.Y.S.2d 21 (N.Y.A.D. 1 Dept. 2014).

¹¹ *United States v. Kluger*, 722 F. 3d 549, 568 (3d Cir. 2013); see also Jacob Gershman, *Appeals Court Upholds Longest Insider Trading Sentence*, Wall St. Journal Law Blog (July 9, 2013, 3:41 PM), <http://blogs.wsj.com/law/2013/07/09/appeals-court-upholds-longest-insider-trading-sentence/>.

III. Collateral Consequences for Lawyers and Their Firms

Individual attorneys who are convicted of criminal conduct clearly face the potential for incarceration, restitution and/or fines. They also face a very real prospect of being named in disciplinary proceedings or sued in civil litigation. Their employers and/or partners share this risk, and have been named in criminal prosecutions and law suits.

A. Disciplinary Proceedings

For New York-licensed attorneys, a conviction will almost certainly result in professional discipline in the form of public censure, suspension, or disbarment. Indeed, a recently published and thoughtful analysis of the New York State disciplinary process for lawyers concluded that approximately 25% of all public discipline imposed by the New York courts stems from criminal convictions of New York-licensed attorneys.¹²

Some convictions will most certainly end (or substantially derail) a lawyer's career. For example, a felony conviction under New York law automatically triggers disbarment. See *In re McLean*, 113 A.D.3d 89 (N.Y.A.D. 1 Dept. 2013). A felony conviction under the law of another jurisdiction (federal or state) may trigger disbarment where the felony is "essentially similar" to a New York felony. *In re Briggs*, 115 A.D.3d 1149 (N.Y.A.D. 3 Dept. 2014). However, a felony conviction under federal law does not necessarily constitute a felony under New York law for disbarment purposes. *In re Lam*, 960 N.Y.S.2d 1, 2 (N.Y.A.D. 1 Dept. 2013). An attorney's conviction of a "serious crime" (meaning crimes not deemed a felony under New York law or misdemeanors with one or more of the elements listed in Judiciary Law §90(4)(d)¹³) results in immediate suspension, pending a final determination by the Appellate Division. See *In re Briggs*, 115 A.D.3d 1149. Following the interim suspension, the attorney is typically either censured, further suspended, or disbarred.

Professional discipline may not be limited to the lawyer. There is a risk of disciplinary actions against firm management and other partners for not fulfilling their supervisory duties under N.Y. Disciplinary Rule 1-104. See DR 1-104(A) ("A law firm shall make reasonable efforts to ensure that all lawyers in the firm conform to the disciplinary rules."); DR 1-104(B) ("A lawyer with management responsibility in the law firm or direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the disciplinary rules."); DR 1-104(C) ("A law firm shall adequately supervise, as appropriate, the work of partners, associates and non-lawyers who work at the firm.").

B. Regulatory Proceedings

Parallel proceedings with regulators almost always flow from the indictment and/or criminal conviction of an attorney, particularly where the alleged (or established) misconduct relates to the attorney's regulated or professional conduct.

Three examples from our research include the following.

¹² Hal R. Lieberman, *Lawyers Who Commit Crimes: Disciplinary Consequences*, New York Law Journal (Aug. 22, 2013), available at <http://www.newyorklawjournal.com/id=1202616430483/Lawyers-Who-Commit-Crimes-Disciplinary-Consequences>.

¹³ These elements include "interference with the administration of justice; false swearing; misrepresentation; fraud; willful failure to file income tax returns; deceit; bribery; extortion; misappropriation; theft; or an attempt, conspiracy, or solicitation of another to commit a serious crime." Hal R. Lieberman, *Lawyers Who Commit Crimes: Disciplinary Consequences*, New York Law Journal (Aug. 22, 2013), available at <http://www.newyorklawjournal.com/id=1202616430483/Lawyers-Who-Commit-Crimes-Disciplinary-Consequences>.

First, before attorney Louis Zehil pleaded guilty to securities fraud and conspiracy to commit securities fraud for selling unregistered shares of several energy companies, the SEC brought civil charges against Mr. Zehil based on the same conduct.¹⁴

Second, the Consumer Financial Protection Board not only referred attorney Michael Levitis to federal prosecutors for criminal prosecution (and eventual conviction), the Board also sued Mr. Levitis, alleging violations of federal consumer protection statutes.¹⁵

Finally, attorney Maurizio Lancia pled guilty to wire fraud for submitting false information on borrowers' loan applications. Prior to his convictions, Connecticut state officials sued Mr. Lancia under the state's Unfair Trade Practices Act.¹⁶

C. Civil Litigation against the Lawyer

Similarly, almost every significant criminal indictment and/or conviction spawns related civil litigation. Several examples of this pattern were evident in our survey.

First, attorney Benjamin Turner, who was convicted of bank fraud, conspiracy to commit bank fraud and wire fraud, and aggravated identity theft based on his role in a mortgage fraud scheme, was found liable in a private civil predatory lending lawsuit for over \$1 million in damages.¹⁷ The suit was brought by home buyers whose allegations against Mr. Turner included fraud, conspiracy to commit fraud, and legal malpractice.

Second, attorney Ted Doumazios, along with others, engaged in a \$92 million mortgage fraud in which lenders (including Washington Mutual Bank) issued mortgages based on false information provided by Mr. Doumazios. He was convicted in federal court of wire fraud and conspiracy to commit bank fraud. The FDIC (for Washington Mutual) brought suit against Mr. Doumazios and his title company involved in the fraud, seeking \$1.2 million in damages.¹⁸

Finally, attorney Anthony Chiofalo's former employer in Texas sued him for fraud, conversion, breach of fiduciary liability, and for violating the Texas Theft Liability Act.¹⁹ Tadano America Corp., where Mr. Chiofalo previously headed the Legal and Human Resources Departments, sued to recoup \$8 million that Mr. Chiofalo was convicted of stealing from the company to spend on valuable comic books and other collectibles. As mentioned above, Mr. Chiofalo is now incarcerated for up to the next 40 years.

¹⁴ Erik Larson, *SEC Sues McGuireWoods Lawyer*, Law360 (Feb. 28, 2007), <http://www.law360.com/articles/19543/sec-sues-mcguirewoods-lawyer>; see also Complaint, No. 07-cv-1439 (S.D.N.Y. Feb. 28, 2007); see also U.S. Attorney's Office for the Southern District of New York, *Florida Lawyer Pleads Guilty In Manhattan Federal Court To \$17 Million Securities Fraud In PIPE Transaction* (Mar. 15, 2010), <http://www.justice.gov/usao/nys/pressreleases/March10/zehillouispleapr.pdf>; *In re Zehil*, 78 A.D.3d 25 (N.Y.A.D. 1 Dept. 2010).

¹⁵ Martha Neil, *New Federal Agency Sues 2 Law Firms Over Debt-Relief Fees; One Attorney Is Also Criminally Charged*, ABA Journal (May 7, 2013), http://www.abajournal.com/news/article/new_federal_consumer_agency_sues_debt-relief_law_firms_one_attorney_is_also/.

¹⁶ Gerri Hirshey, *Promises Left Buyers Destitute*, N.Y. Times (Oct. 14, 2007), available at <http://www.nytimes.com/2007/10/14/nyregion/nyregionspecial2/14Rsubprimenj.html?pagewanted=all>; see also *In re Lancia*, 102 A.D.3d 165 (N.Y.A.D. 2 Dept. 2012).

¹⁷ *In re Turner*, 121 A.D.3d 313 (N.Y.A.D. 2 Dept. 2014); see also Legal Services New York City, *Court of Appeals Upholds Jury Verdict in Landmark Predatory Lending Lawsuit* (Jan. 29, 2014), http://www.legalservicesnyc.org/index.php?option=com_content&task=view&id=795&Itemid=98; see also Amended Complaint, No. CV-04-087 (E.D.N.Y. Dec. 8, 2005).

¹⁸ *In re Doumazios*, 88 A.D.3d 442 (N.Y.A.D. 2 Dept. 2011); Iulia Filip, *New FDIC Suit Looks for a Piece of the \$92M Mortgage Fraud Pie*, Courthouse News Service (Sept. 27, 2011), <http://www.courthousenews.com/2011/09/27/40080.htm>; see also Complaint, No. 1:11-cv-04610-ENV-RML (E.D.N.Y. Sept. 22, 2011).

¹⁹ Brenda Sapino Jeffreys, *Former In-Houser Faces Up to Life in Prison if Convicted*, Texas Lawyer (Jan. 14, 2013), available at http://www.pauldoylelaw.com/files/former_in-houser.pdf.

Notably, we have seen an increased use by civil litigants of New York State Judiciary Law Section 487, which exposes an attorney who “is guilty of any deceit or collusion, or consents to any deceit or collusion, with intent to deceive the court or any party” to criminal liability and to “**treble damages to be recovered [by the injured party] in a civil action.**” N.Y. Jud. Law § 487 (emphasis added). Section 487 claims present unique challenges to plaintiff’s counsel because they require proof that the attorney was acting in her capacity as an attorney, engaged in a “chronic and extreme pattern” of legal delinquency or intentional misconduct, and did so with the intent to deceive the Court. See, e.g., *Amalfitano v. Rosenberg*, 903 N.E.2d 265, 268 (N.Y. 2009); see also *Englert v. Schaffer*, 61 A.D.3d 1362, 1364 (N.Y.A.D. 4 Dept. 2009); *Kaminsky v. Herrick, Feinstein LLP*, 59 A.D.3d 1, 13 (N.Y.A.D. 1 Dept. 2008); *Jaroslawicz v. Cohen*, 12 A.D.3d 160, 161 (N.Y.A.D. 1 Dept. 2004). Section 487 claims nonetheless create enormous headaches for law firms because they give rise to exposure to treble damages and, as discussed in greater detail below, they raise questions about whether malpractice insurance will cover the defense of the lawyer and any eventual loss.

D. Civil Litigation against Law Firms

Law firms are often viewed as the deep pocket in civil litigation arising out of the criminal conduct of a former partner or employee. These cases can be costly and time consuming, and can tarnish the reputations of the firms involved. In our survey, we have identified a few case studies.

First, Mr. Zehil was employed by McGuireWoods LLP when he engaged in the criminal conduct leading to his convictions. McGuireWoods denied any wrongdoing in connection with Mr. Zehil’s conduct. The firm discharged Mr. Zehil and reported him to authorities when it discovered his scheme.²⁰ Nonetheless, at least two lawsuits were filed against McGuireWoods based on Mr. Zehil’s unlawful conduct. In one of the cases, the plaintiff, one of the several energy companies which shares Mr. Zehil traded illegally and which subsequently declared bankruptcy as a result, alleged violations of federal and state securities law, fraud, tortious interference with business expectancies, negligent supervision, and breach of fiduciary duty against the firm.²¹ The energy company sought actual and punitive damages and attorney’s fees. After five years of litigation, the case ultimately settled.²²

Second, Doug Arntsen was convicted in state court of committing grand larceny and engaging in a scheme to defraud after embezzling \$10 million from client escrow funds.²³ Prosecutors began an investigation after one of Mr. Arntsen’s clients, Regal Real Estate, was unable to account for the money in its escrow accounts. Crowell & Moring LLP, where Mr. Arntsen worked, first learned of the criminal probe from the prosecutors.²⁴ Clients whose funds were stolen sued the law firm. Regal Real Estate, for example, brought a \$5.5 million suit against the firm alleging professional negligence and breach of contract due to Crowell’s purported failure to maintain adequate checks and controls over their accounts to prevent diversion.²⁵ Crowell has since settled the Regal Real Estate and other suits.²⁶

²⁰ Sindhu Sundar, *Ex-McGuireWoods Atty Can’t Cut 3-Year Fraud Sentence*, Law360 (Oct. 9, 2012), <http://www.law360.com/articles/385404/ex-mcguirewoods-atty-can-t-cut-3-year-fraud-sentence>.

²¹ Jesse Greenspan, *Suit Against McGuireWoods Stays In Kansas*, Law360 (July 23, 2009), <http://www.law360.com/articles/112898/suit-against-mcguirewoods-stays-in-kansas>; see also Complaint, 2:08-cv-02638-CM-DJW (D. Kan. Dec. 17, 2008).

²² Scott Luck, *Bankrupt Company Settles With Fraudster’s Law Firm*, Missouri Lawyers Weekly (June 3, 2009), available at <http://www.edgarlawfirm.com/News-Investigations/Bankrupt-company-settles-with-fraudsters-law-firm.pdf>.

²³ See *supra* n.9.

²⁴ Joseph Ax, *NY Lawyer Pleads Guilty To Stealing \$10 Million From Clients*, Reuters (Oct. 2, 2012), <http://www.reuters.com/article/2012/10/03/us-newyork-arntsen-plea-idUSBRE89200G20121003>.

²⁵ Complaint, *Regal Real Estate, LLC v. Crowell & Moring, LLP*, No. ___, N.Y. Sup. Ct. (Sep. 23, 2011) available at <http://nylawyer.nylj.com/adgifs/decisions/092611regal.pdf>.

²⁶ Martha Neil, *Crowell & Moring Settles \$5.5M Client Suit re Ex-Counsel Awaiting Extradition in Hong Kong*, ABA Journal (Dec. 12, 2011), http://www.abajournal.com/news/article/crowell_moring_settles_5.5m_client_suit_re_ex-counsel_awaiting_extradition/.

Third, plaintiffs brought a putative securities class action against Mayer Brown LLP and its former attorney, Joseph Collins, asserting that that the firm and its lawyer aided and abetted the securities fraud that felled Refco. Mr. Collins was in charge of the firm's Refco account. Claims against them were dismissed.²⁷ Mr. Collins, however, was later convicted of securities fraud, wire fraud, conspiracy, and filing false statements with the SEC.²⁸

Finally, former clients brought suit against attorney Jonathan Bristol and his former law firm, Winston & Strawn LLP. Mr. Bristol pleaded guilty to conspiracy to commit money laundering for his role in helping Kenneth Starr (a convicted financial advisor) misappropriate client funds.²⁹ The former clients claimed that Winston & Strawn had breached its fiduciary duty and engaged in legal malpractice, negligent misrepresentation, fraud, and negligent supervision, among other claims. The bulk of these claims were dismissed by the district court, and the case was dismissed by stipulation.³⁰

Law firms do not face just the prospect of long and potentially expensive litigation when their partners and employees get into trouble. Some firms, like Jenkens & Gilchrist, P.C., simply collapse. For this firm, it all began (and arguably ended) with an attorney, Paul Daugerdas, who was the mastermind behind a 20-year fraudulent tax shelter scheme. According to federal prosecutors, his unlawful conduct "generated over \$7 billion in fraudulent tax losses and yielded approximately \$95 million in fees to [Mr.] Daugerdas personally."³¹ Faced with civil suits, the firm agreed to pay \$81.6 million to clients who had sued over its tax-shelter advice.³² Later, the firm reached a non-prosecution agreement with prosecutors that included an admission that the firm had developed and marketed tax shelters that generated more than \$1 billion in false losses.³³ The firm later collapsed. Mr. Daugerdas was ultimately convicted by a federal jury for conspiracy to defraud the IRS, to evade taxes, and to commit mail fraud and wire fraud, among other charges.³⁴

²⁷ Christin Caulfield, *Mayer Brown Escapes Refco Securities Fraud Action*, Law360 (Mar. 18, 2009), <http://www.law360.com/articles/92171/mayer-brown-escapes-refco-securities-fraud-action>.

²⁸ U.S. Attorney's Office for the Southern District of New York, *Joseph Collins, Principal Attorney For Former Commodities Firm Refco, Sentenced In Manhattan Federal Court To One Year And One Day In Prison For Securities Fraud* (July 15, 2013), <http://www.justice.gov/usao/nys/pressreleases/July13/JosephCollinsSentencingPR.php>.

²⁹ U.S. Attorney's Office for the Southern District of New York, *Former Attorney Sentenced In Manhattan Federal Court For Laundering Nearly \$19 Million In Connection With Financial Adviser Kenneth Starr's Fraud* (Dec. 18, 2012), <http://www.justice.gov/usao/nys/pressreleases/December12/BristolJonathanSentencing.php>.

³⁰ Carolina Bolado, *Winston & Strawn Ducks Part Of \$2M Starr Fraud Suit*, Law360 (Jan. 17, 2012), <http://www.law360.com/articles/300930/winston-strawn-ducks-part-of-2m-starr-fraud-suit>. See also *Stipulation & Order Voluntarily Dismissing the Case*, No. 2:10-cv-06608-JLL-MAH (D.N.J. June 4, 2012).

³¹ Department of Justice, Office of Public Affairs, *Former Jenkens & Gilchrist Attorney Sentenced to 15 Years in Prison for Orchestrating Multibillion Dollar Criminal Tax Fraud Scheme* (June 25, 2014), <http://www.justice.gov/opa/pr/former-jenkins-gilchrist-attorney-sentenced-15-years-prison-orchestrating-multibillion-dollar>.

³² Patricia Hurtado & Chris Dolmetch, *Chicago Lawyer Daugerdas Found Guilty in Tax Shelter Trial* (May 24, 2011), <http://www.bloomberg.com/news/2011-05-24/chicago-lawyer-paul-daugerdas-found-guilty-of-selling-phony-tax-shelters.html>.

³³ *Id.*

³⁴ U.S. Attorney's Office for the Southern District of New York, *Jenkins & Gilchrist Attorney Found Guilty In Manhattan Federal Court Of Multibillion-Dollar Criminal Tax Fraud Scheme* (Nov. 1, 2013), <http://www.justice.gov/usao/nys/pressreleases/November13/DaugerdasGuiltyVerdict.php>. Note that Mr. Daugerdas was first convicted in 2011 and then re-tried, and convicted again, in 2013.

IV. Prevention Steps: What Can a Firm Do to Limit the Likelihood of Fall-Out from an Attorney Conviction

A. Managing Internal Risk

Faced with this breadth of scenarios, what can a law firm do to prevent attorney misconduct, and limit its own risk of criminal, regulatory, and civil exposure if misconduct nonetheless occurs?

Some firms have found it prudent to promptly investigate allegations of criminal conduct by its attorneys and then report the results to law enforcement. For example, Baker & McKenzie uncovered a partner's money laundering scheme through an internal investigation and turned over the fruits of its inquiry to federal prosecutors.³⁵ Likewise, Mr. Zehil's actions at McGuireWoods were first discovered by a firm associate, who reported the matter to the firm's managers. Partners at the firm investigated these allegations, and then informed clients about Mr. Zehil's conduct, forced Mr. Zehil to resign, and reported him to the SEC.³⁶ Moreover, in some instances, New York Disciplinary Rule 1-103 *requires* an attorney to disclose such information to a tribunal or similar authority empowered to investigate violations of the Disciplinary Rules. Failing to make such a disclosure is itself an ethical violation.

While these steps may help firms avoid *criminal* and regulatory liability, they do not necessarily protect firms from civil liability. The civil cases against law firms tend to raise issues of fraud, breach of fiduciary duty, and negligence—with the root problem being the firm's failure to stop—or even notice—the unlawful conduct. In other instances, of course, the law firm is accused of being an active participant in the unlawful conduct.

So what can firms do? After seeing these cases and the issues that arose, a few bedrock suggestions, set forth below, come to mind:³⁷

- ✓ Stay current on trends in unlawful conduct.
- ✓ Educate attorneys (and staff) as to their duties and obligations.
- ✓ Develop policies and procedures about maintaining the confidentiality of client information and avoiding insider trading.
- ✓ Conduct outreach to attorneys (and staff) to ensure they not only have the policies, but understand what they mean.
- ✓ Educate attorneys (and staff) as to red flags indicating questionable conduct and regularly remind all personnel to report aberrant or troubling behavior.

³⁵ Dan Stater, *Indicted Former Baker McKenzie Partner Hit With More Charges*, Wall St. Law Blog (May 27, 2009, 11:38 AM), <http://blogs.wsj.com/law/2008/05/27/indicted-former-baker-mckenzie-partner-hit-with-more-charges/>; see also Martha Neil, *Ex-Partner of Baker & McKenzie Indicted in \$1.3M Client Theft Case*, ABA Journal (May 27, 2008), http://www.abajournal.com/news/article/ex_partner_of_baker_mckenzie_indicted_in_13m_client_theft_case/. Mr. Weisberg pled guilty as to the money laundering charge and as to a separate securities fraud conspiracy charge. See U.S. Attorney's Office for the Southern District of New York, *Corporate Lawyer Sentenced To 24 Months' Imprisonment On Convictions For Money Laundering And Securities Fraud Conspiracy* (Aug. 7, 2013), <http://www.justice.gov/usao/nye/pr/2013/2013aug07.html>.

³⁶ Mark Hamblett, "A Little Nervous," *Ousted NY BigLaw Partner Admits Swindling Clients for \$10 Million*, New York Law Journal (Mar. 16, 2010), <http://www.newyorklawjournal.com/id=1202475523261/A-Little-Nervous-Ousted-NY-BigLaw-Partner-Admits-Swindling-Clients-for-10-Million?slreturn=20140811173209>.

³⁷ In drafting this section of the article, we have happily supplemented our own practical experience with some very useful ideas set forth in materials prepared by various professional liability carriers.

- ✓ Implement tools to detect possible misconduct, such as:
 - ✓ Requiring daily time submissions;
 - ✓ Running edits to pro forma bills through accounting staff;
 - ✓ Issuing bills from, and receiving payments in, the accounting department;
 - ✓ Requiring administrative review and approval of expense reports;
 - ✓ Implementing systems that flag excessive or irregular lawyer billing patterns;
 - ✓ Requiring two signatures for disbursement of firm or client funds;
 - ✓ Developing clear guidelines on what expenses are reimbursable and the procedures for reimbursement;
 - ✓ Monitoring for suspicious changes in client addresses;
 - ✓ Implementing mandatory vacation policies for employees in accounting and other sensitive areas.
- ✓ Conduct periodic outside audits of internal controls to ensure that they are effective.
- ✓ Utilize technology aids to monitor the comings and goings of attorneys (and staff).
- ✓ Remove attorneys from and insert administrative staff (particularly accounting staff) into procedures, where feasible. For example, require approval by an administrator and a second partner (such as a loss prevention partner or practice group leader) for all trust account transactions. Have the requesting partner sign a written request specifying the reason for the transaction and certifying that the described purpose is proper and authorized.
- ✓ Determine reporting obligations (to law enforcement, to disciplinary committees, to clients) and which attorneys are best suited to make those determinations.
- ✓ Distribute client surveys to keep open the lines of communication.

B. Professional Liability Coverage or Lack Thereof

Even with the best of internal controls and internal investigations to ferret out attorney wrongdoing, allegations of attorney misconduct will arise and civil litigation will follow. Typically, faced with such a suit, a firm will pull out its professional liability policy to see what is, and what is not, covered.³⁸ It is not uncommon that criminal cases create special headaches for law firms in connection with their professional liability coverage. Here are some of the issues to watch out for.

1. Business Enterprise v. Law Practice

When liability arises from a lawyer's business activities outside his law practice, insurers may point to the so-called "business enterprise" exclusion, which bars coverage for claims arising from a lawyer's non-firm activities. Here is a sample of this type of language taken from a malpractice insurance policy, where the policy **excludes** from coverage:

[A]ny CLAIM arising out of any INSURED'S activities as an officer, director, partner, manager or employee of any company, corporation, operation, organization or association **other than the NAMED INSURED** or PRIOR LAW FIRM except as a

³⁸ We neither pretend nor intend that this section be deemed exhaustive on the types of coverage and/or exclusions applicable to a given situation. We merely cite some of the coverage issues that we discovered in the course of reviewing the criminal convictions comprising our case survey.

member, director or officer of any Bar Association, its governing board or any of its committees[.]³⁹

In one case that we reviewed, the Appellate Court of Connecticut upheld the insurers' denial of coverage based on such an exclusion.⁴⁰ The court determined that the insurers had no duty to defend attorney Maurizio Lancia based on alleged breach of fiduciary claims. He had operated both a law practice and mortgage broker business, and he faced civil liability based on his alleged role in a mortgage fraud scheme. He sought coverage under the policy issued to his law firm. The insurers countered that they were not obligated to defend Mr. Lancia in any of the underlying actions because all of the claims at issue were alleged to have arisen out of his activities as the owner or principal of his mortgage business—not with respect to the operation of his law firm, the named insured. The Connecticut court agreed with the insurers.⁴¹ While the coverage litigation proceeded, Mr. Lancia pled guilty to wire fraud for his involvement in the mortgage fraud scheme.⁴²

2. Prior Knowledge

Insurers may deny coverage when the law firm had “prior knowledge” of the misconduct that gives rise to the claim. In other words, when the policy was issued or renewed, the law firm knew that misconduct that might create a claim was underway. In this regard, an insurance policy might contain language such as the following:

Policy Exclusion ___ **excludes coverage** for “claims” arising out of any error, omission, negligent act or “personal injury” occurring prior to the inception date of the policy **if any insured prior to the inception date knew or could have reasonably foreseen that such error, omission, negligent acts or “personal injury” might be expected to be the basis of a “claim” or “suit.”**

In practice, this language can put coverage very much at risk. For example, in one case we reviewed, an insurer sought to avoid coverage following the convictions of two attorneys, David Reback and Eileen Potash, for their roles in a mortgage fraud scheme. Mr. Reback pled guilty to all counts in July 2010 and Ms. Potash was convicted on one count in November 2010.⁴³ The insurer alleged that the policy's equivalent of the “prior knowledge” exclusion barred coverage as to the underlying litigation relating to the mortgage fraud because the attorneys knew or should have known that their conduct would likely give rise to a claim against them at the time the policy was issued (and subsequently renewed).⁴⁴ Additionally, the insurer sought to rescind the policies, alleging that the insured law firm falsely stated it was unaware of any criminal conduct that could lead to professional liability claims in its initial application for the policy in 2005 and in three subsequent renewal applications. The parties ultimately settled the coverage litigation.⁴⁵

3. Material Misrepresentation

Similar to the misrepresentation allegations made in the Reback/Potash case, under New York law, an insurance company is entitled to the rescission of a policy if the company issued the policy in reliance on

³⁹ *Lancia v. State Nat. Ins. Co.*, 41 A.3d 308, 317 (Conn. App. 2012) (emphasis added).

⁴⁰ *Id.* at 318 (emphasis added).

⁴¹ *Id.* (“underlying complaints are devoid of any allegations against Lancia that are not predicated on his role as a mortgage broker”).

⁴² *In re Lancia*, 102 A.D.3d 165 (N.Y.A.D. 2 Dept. 2012).

⁴³ *In re Reback*, 86 A.D.3d 128 (N.Y.A.D. 2 Dept. 2011); *see also In re Potash*, 91 A.D.3d 184 (N.Y.A.D. 2 Dept. 2011).

⁴⁴ Complaint, *Liberty Insurance Underwriters, Inc. v. Reback & Potash, LLP*, No. 1:11-cv-02358-ARR-LB (E.D.N.Y. May 16, 2011); Sean McLernon, *Liberty, Law Firm Reach Deal Over Mortgage Fraud Coverage*, Law360 (Nov. 14, 2012), <http://www.law360.com/articles/393853/liberty-law-firm-reach-deal-over-mortgage-fraud-coverage>.

⁴⁵ *See also* Complaint, No. 1:11-cv-02358-ARR-LB (E.D.N.Y. May 16, 2011).

a material misrepresentation made by the insured in the policy application.⁴⁶ A misrepresentation is “material” if knowledge by the insurance company of the misrepresented fact would have resulted in a refusal to issue the same policy.⁴⁷

4. Handling Funds

Policies often exclude coverage for claims arising out of the insured’s inability or failure to pay, collect, administer or safeguard funds held or to be held for others. Thus, where the insured attorney misappropriates or fails to disburse funds held in client trust accounts or escrow accounts, this exclusion may apply. See, e.g., *K. Bell & Assocs., Inc. v. Lloyd’s Underwriters*, 97 F.3d 632, 634-35 (2d Cir. 1996) (exclusion for claims arising out of commingling of monies or accounts barred coverage for claims that insured allegedly failed to forward reinsurance premiums and amounts recovered from reinsurers).

5. Criminal Acts and the Innocent Insured

Professional liability policies often exclude coverage for certain conduct of the insured—criminal, intentional, malicious, or fraudulent acts. Typically, such exclusions are not applicable until it is established that the specified conduct has actually occurred. Some policies provide that such conduct must be established by “final adjudication” to trigger the exclusion, while others provide that the conduct must be established “in fact,” by “admission or plea.” There must also be a factual connection between the criminal acts and the allegations in the underlying claim to preclude coverage. Accordingly, the wording of such exclusions is key because it may determine whether an insurer has an obligation to fund defense costs through trial. Because the impact of these exclusions often cannot be determined until the litigation has progressed significantly, insurers may ultimately seek to recoup defense expenses paid out if the exclusion is shown to apply as a result of an eventual conviction. Thus, insurers often will provide defense costs subject to a reservation of rights, including the right to rescind the policy and the right to pursue recoupment of all defense expenses paid out by the insurer.

Finally, even for policies containing a criminal acts exclusion, coverage may still be available to an “Innocent Insured,” such as the law firm employing the attorney who engaged in the wrongful conduct. An “Innocent Insured” exception typically provides that the criminal acts exclusion does not apply to insureds that did not personally participate in the wrongful acts and that did not “remain passive after having knowledge of any such act or omission.” Such a provision might read like this:

Exclusions: This policy shall not apply to any claim based upon, arising out of, attributable to, or directly or indirectly resulting from . . . any intentional, criminal, dishonest, malicious or fraudulent act, error, omission or personal injury committed by an insured. ***This exclusion does not apply to any insured who is not so adjudged. This exclusion also does not apply to any insured who did not commit, know or acquiesce in such wrongful act which is the basis of the claim.***⁴⁸

A 2012 ABA Journal article pointed out, however, that the “Innocent Insured” exception to the criminal acts exclusion may not be able to save coverage if *another* exclusion applies, such as the “prior knowledge” exclusion. The ABA Journal notes that most professional liability policies “don’t cover claims if *any* insured knew about a potential claim when the insurance policy was purchased. Because a wrongdoing lawyer knows about the potential claim when committing the bad act, everyone else at the firm could be excluded from coverage, as well.”⁴⁹ Further, the “material misrepresentation” provision could bar coverage too: “wrongdoing insureds don’t typically disclose their own dishonesty, so applications frequently contain misstatements in those circumstances.”⁵⁰ The Journal article also

⁴⁶ See N.Y. Ins. Law § 3105.

⁴⁷ See *id.* § 3105(b).

⁴⁸ Ian T. Matyjewicz & David A. Grossbaum, *Protecting the Innocent: Wrongdoing by One Lawyer can Affect Insurance Coverage for Others*, ABA Journal (Feb. 1, 2012), http://www.abajournal.com/magazine/article/protecting-the_innocent_wrongdoing_by_one_lawyer_can_affect_insurance/.

⁴⁹ *Id.* (emphasis added).

⁵⁰ *Id.*

reported that few courts have extended the protection of the “Innocent Insured” exception to law firms. As with any coverage issue, loss prevention partners and firm management should carefully evaluate their policies to determine the coverage they may have.

V. Conclusion

A number of New York-licensed attorneys have landed themselves in hot water over the last five years, some for particularly egregious abuses of their position as an attorney. But mistakes do happen, and truly, these attorneys are the exception to the rule. To put it in perspective, in 2013, 288,965 attorneys were licensed in the State of New York,⁵¹ but our research revealed just 43 convictions—or .015% of New York-licensed attorneys. The price for the mistake—and getting caught—is high, impacting the attorney’s physical freedom, his family, his future employability, his colleagues, his employer, and perhaps beyond. Law firms are often pulled into the fray, but taking some affirmative steps to implement constructive internal controls could alleviate some risk. Even so, litigation is difficult to avoid and firms pay a hefty price—in dollars, distraction, and in terms of their reputation. Coverage may be available to defray the costs of such litigation, but any number of provisions could preclude coverage when you’re dealing with an attorney conviction.

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⁵¹ NYS Unified Court System, Office of Court Administration, Attorney Registration Unit, *Location of Registered NY Attorneys as of the end of Calendar Year 2013* (copy on file with the authors).

