Imagine a situation where one has lawyer status—simply maintains State Bar membership—but does not engage in the practice of law. Rather, this imaginary person is a well-known real estate developer with an established place of business and track record for the development of land and sale of residential building sites. A long-time childhood friend of the developer owns a tract of Northern Michigan realty. For years this friend has unsuccessfully tried to sell the land. The friend solicits the aid of the developer. The two form a joint venture for residential site development and sale of lots. The project needs money. The developer arranges a bank loan. The loan is secured by a mortgage on the land. The project flounders. The lender forecloses. The developer is the successful bidder at the mortgage foreclosure sale and becomes the ultimate property owner. The friend feels cheated and sues the developer (lawyer) for legal malpractice alleging professional misconduct. Did the friendly developer-lawyer establish an attorney-client relationship with the former landowner? Does there exist a legal duty owed by the developer-lawyer to the putative client?

By Angus G. Goetz, Jr.

BETTER BUSINESS

Avoiding malpractice suits and ethical conflicts when forming business

Problems are likely to arise when lawyers engage in ancillary occupations, or totally independent enterprises, providing products or services to others. When that other person is also the lawyer's client, the problems become compounded. This article will focus on a lawyer's business transactions with others be they clients, former clients, or nonclients.

Clients: The Contours of MRPC 1.8(a)

Ethics rules regulate but do not forbid lawyers from doing business with clients. Since October 1, 1998 the Michigan Rules of Professional Conduct (MRPC) are the ethics rules that govern the relationship between attorneys and clients. In particular, Rule 1.8(a) protects client interests by requiring that business transactions between client and lawyer be objectively fair and reasonable to the client.

The purpose of MRPC 1.8(a) is to safeguard the client's interests against the lawyer's superior knowledge of the intricacies of the deal and the lawyer's frequent familiarity with the client's business and personal affairs, both of which are said to give the lawyer an unfair advantage over the client. Moreover, in business dealings between a client and a lawyer, the attorney has the burden of proving the fairness of the transaction or it will be set aside by the courts. *Kukla v Perry*, 361 Mich 311, 105 NW2d 176 (1960).

MRPC 1.8(a) also obligates the lawyer to give the client a written explanation of the details of the proposed business transaction in language the client may reasonably understand. This advice should identify the risks and disadvantages to the client in the proposed transaction. Moreover, the lawyer must give the client an opportunity to seek the advice of independent counsel on whether to go forward with the deal.

There is no requirement that the client actually consult a lawyer. The client may decide to consult another trusted advisor such as an accountant, tax specialist, or business person. An opportunity to obtain competent independent advice is what is required since an independent advisor may lend objectivity to the proposed business arrangement. The lawyer may proceed only after the client has been given a reasonable opportunity to consult with disinterested counsel and the client consents to the proposed transaction in writing.

deals outside the practice of law

FAST FACTS:

A lawyer should always advise laypersons to seek independent counsel before going forward with a deal with the lawyer.

Courts and disciplinary agencies closely scrutinize business transactions between clients and lawyers.

In recent years, courts have recognized several exceptions to the rule that lawyers are not liable to nonclients.

Rule 1.8 Conflict of Interest: Prohibited Transactions.

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner that can be reasonably understood by the client;

(2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and

(3) the client consents in writing thereto.

Prudence suggests asking a client to confirm receipt of this admonition in writing. In most routine matters involving products or services the client regularly sells, this suggestion should not be necessary. The commentary to this rule points out that the standard does not apply to everyday commercial transactions between the client and the client's lawyer for services or products the client routinely markets to others such as medical or banking services since under those circumstances the lawyer is said to have no special advantages.

Since a showing that the client suffered no economic disadvantage in the transaction is unnecessary to find that MRPC 1.8(a) has been violated, business dealings by lawyers with their clients are very dangerous. If the deal sours, lawyers inevitably become the targets of a malpractice suit, attorney grievance proceeding, or both. Regardless of the wording used in applicable ethics rules, courts and disciplinary agencies closely scrutinize business transactions between clients and their lawyers. Thus the admonition against and wisdom of proceeding with such transactions must be very carefully considered.

A common example of a business transaction with a client requiring application of MRPC 1.8(a) is the lawyer's taking of a mortgage on client-owned real estate or a security interest in client personalty. MRPC 1.8(j) allows for a lien "granted by law" to secure the lawyer's fee and advances for costs. See *Proctor: Clarifying Liens*, 73 MBJ 690 (July 1994) and *George v Gelman*, 201 Mich App 474, 506 NW2d 583 (1993) for a discussion of this topic.

Former Clients: Confidences

When a lawyer contemplates entering into a business investment with a former client, arguably MRPC 1.8(a) does not apply because the lawyer is not expected to exercise independent professional judgment on behalf of a person with whom the lawyer has no current attorney-client relationship. However, the use of confidential client information to the detriment of that former client or to promote the lawyer's own personal interests is prohibited by ethics rules unless the former client gives advance consent to the lawyer's use of the former client's confidences and secrets. MRPC 1.6(C)(1) and MRPC 1.8(b).

Some lawyers mistakenly believe that client confidentiality ceases at the conclusion of the lawyer-client relationship. Confidentiality continues indefinitely—even after the client's death or the lawyer's discharge—unless client consent is given or one of the other permissible exceptions itemized in MRPC 1.6(c) exist or disclosure is triggered by MRPC 3.3. See Michigan Informal Ethics Opinion RI-72 (1991) and JI-31 (1990). Thus, while MRPC 1.8(a) may not apply to lawyer business transactions with former clients, this activity is subject to challenge if the lawyer takes advantage of knowing the former client's confidential information.

Nonclients: The Limits of Tort Liability

Transactions between a lawyer and nonclients are in a similar way not generally protected by MRPC 1.8(a). The same may be said for MRPC 1.7, which is the general conflict rule. MRPC 4.1–4.4 deal with lawyer truthfulness in transactions with nonclients. However, these sections of the MRPC also presume that the lawyer is dealing in a representative capacity on behalf of a client.

Generally, lawyers are not liable to nonclients for professional malpractice—violations of the standard of care and ethics rules. The traditional rationale for this rule rests on the lack of (1) "privity" of contract between lawyer and the nonclient and (2) breach of any duty owed by the lawyer to a nonclient except for the confidentiality of information received from a prospective client. RI-123 (1992). Moreover, the idea that lawyers are liable to nonclients is thought to be inconsistent with the legal and ethical duties of undivided loyalty, zealous representation, avoidance of conflicts of interest, and confidentiality issues that lawyers owe to their clients.

Malpractice liability is predicated upon liability for breach of contract or negligence, with the latter being the most common theory of liability. However, either claim involves an attorney-client relationship giving rise to the lawyer's duty to the client and an act or omission in violation of that duty. In Michigan, the four elements of a legal malpractice claim are (1) the existence of a client-lawyer relationship; (2) negligence in the legal representation (breach of duty); (3) causation; and (4) damages. See *Pontiac School District v Miller, Canfield, Paddock & Stone*, 221 Mich App 602, 563 NW2d 693 (1997).

In recent years, courts have recognized several exceptions to the rule that lawyers are not liable to nonclients. Legally recognized exceptions consist of the following matters:

Third-party Beneficiaries

One exception is when the purpose of the client-lawyer representation is for the benefit of third parties. For example, if a lawyer is retained to prepare testamentary documents to benefit third parties on client's death, this third-party beneficiary exception to the privity of contract rule means the nonclient must show that he was an intended, not merely an incidental, beneficiary. In *Ginther v Zimmerman*, 195 Mich App 647, 495 NW2d (1992), the court ruled that beneficiaries, not named in the will, did not state a claim for malpractice against the drafting attorney.

Detrimental Reliance

This occurs when the lawyer advises nonclients under circumstances where the lawyer intends that the nonclient will rely upon the lawyer's counsel. One example is negligent misrepresentation coupled with justifiable reliance. Opinion letters are a typical setting in which this kind of liability arises. Michigan law creates liability in favor of those persons the lawyer knows will rely on the information in the opinion letter and to those third parties the lawyer should reasonably foresee will rely on the information. *Molecular Technology Corp v Valentine*, 925 F2d 910 (CA 6, 1941).

Intentional Torts

Another exception is when the lawyer intentionally misbehaves, such as by committing fraud. Here, the lawyer makes a false material representation of a past or existing fact with knowledge or reckless ignorance of its falsity made to induce some action or inaction and upon which the nonclient relied to the client's detriment. Similarly, the liability may follow if the lawyer commits acts of malicious prosecution or abuse of process. *Friedman v Dozon*, 412 Mich 1; 312 NW2d 585 (1981).

Lawyer immunity against liability to nonclients is significantly important in the litigation context.

Failure to Suggest Independent Counsel

Failure to suggest independent counsel is when the lawyer becomes personally involved in a business transaction with nonclients and fails to advise the nonclient investors to seek the advice of independent counsel. Here the potential for a conflict of interest is very clear: advice that serves the nonclient (or is it the client?) may not be the same advice that furthers the lawyer's interests.

Violations of Statutory Law

The final exception occurs when a statutory basis exists, i.e. state or federal securities laws (Securities Act of 1933, 15 USC 77a et seq. and the Securities Exchange Act of 1934, 15 USC 78a et seq.), Racketeer Influenced and Corrupt Organization Act, 18 USC 1961 et seq. Absent such special circumstances, lawyers are customarily immune from suit by their client's adversaries. However, the courts are chipping away at this immunity from suit. Courts uniformly find lawyers liable when they commit intentional torts such as fraud, collusion, abuse of process, or malicious acts like mishandling nonclients' money. Lawyer immunity against liability to nonclients is significantly important in the litigation context.

Be careful, courts will routinely find the existence of a client-lawyer relationship when a nonclient reasonably believes a lawyer will provide legal services—a fact apparent to the lawyer—and the lawyer does nothing to inform that person that he or she is not acting as a lawyer for that person in the particular circumstance. The attorney-client relationship contemplates legal services from the lawyer even though the person intends to also receive other services. In Informal Opinion CI-319 (1977), the ethics committee of the State Bar ruled that a lawyer-client relationship may be established simply by providing one party to an agreement drafted by a lawyer with legal advice regarding the document, even though no fee was charged to the person (client) who received the advice. Moreover, neither a formal contract of retention nor financial compensation are required to establish the relationship. Informal Opinion CI-984 (1983).

These prior opinions of the State Bar of Michigan focus upon a nonlawyer seeking and receiving personal advice from a lawyer. The giving of advice may be casual, such as at a social function, or formal, but it is clear that if advice is given, the Michigan approach would treat the relationship as one of lawyer and client. CI-1153 (1986). For a discussion of the establishment of the lawyer-client relationship implied from conduct, see ABA/BNA Lawyer's Manual on Professional Conduct § 31:101 (1984); *Kearns v Fred Lavery/Porsche Audi Co*, 573 F Supp 91 (ED Mich 1983) and *Dalrymple v National Bank and Trust Company of Traverse City*, 615 F Supp 979 (WD Mich 1985).

Procedural Aspects of Nonclient Torts

In litigation, the lawyer's contacts with opposing parties and their counsel is usually adversarial in nature. The policy of the law is to insulate the "other side" from the fear of retribution for hostile adversarial conduct. This concept is particularly true with respect to immunity from malpractice claims brought by the client's adversaries. In *Trepel v Pontiac Osteopathic Hospital*, 135 Mich App 361, 354 NW2d 341 (1984), the court held that attorneys owe no duty of care to opposing parties and therefore cannot be sued in negligence by the opposing party for the attorney's zealous representation of a client. See also *Cramer v Metropolitan Savings Assoc*, 25 Mich App 664, 337 NW2d 264 (1983) and *Gais v Schwartz*, 80 Mich App 600, 264 NW2d 76 (1978).

In Michigan, violations of ethics rules (MRPC) are not a basis for civil liability. The MRPC do not give rise to an independent cause of action for damages caused by failure to comply with an obligation or prohibition imposed by a rule. See MRPC 1.0. In other words, violation of the MRPC *alone* does not give rise to a suit by nonclients for legal malpractice. Jurisdictions are divided on whether a breach of lawyer disciplinary rules can be admitted as supplemental evidence of malpractice.

Michigan holds that violations of the MRPC create a rebuttable presumption that the standard of care has been breached. *Beattie v Firnchild*, 152 Mich App 785; 394 NW2d 107 (1986); *Hart v Comerica Bank*, 957 F Supp 958 (ED Mich 1997). The rationale for the Michigan rule rests on the hypothesis that ethics rules reflect standards of professional conduct expected of lawyers in their relationships with the public and therefore it would be "patently unfair" to deny a client from relying on those standards where there is a client-lawyer relationship. See *Lipton v Boesky*, 110 Mich App 589; 313 NW2d 163, 166 (1981) and *Swabini v Desenberg*, 143 Mich App 373, 372 NW2d 559 (1985).

Friedman v Dozorc discusses at length an attorney's responsibility to opposing parties in litigation. In *Dozorc*, the court ruled that an attorney in a negligence action owes no

actionable duty of care to an adverse party in litigation because the finding of a duty to nonclients would create a conflict of interest, which would seriously interfere with the attorney's duties of loyalty and zealous representation owed to the client. The court distinguished cases in which opposing counsel have been held accountable to the adverse party, holding that there can be neither reliance on the quality of services performed by an adversary's lawyer, nor any benefit intended by the attorney to the opposing side, because the relationship is adversarial.

The recent case of *Simko v Blake*, 448 Mich 648; 532 NW2d 842 (1995) says that in Michigan there is no tort liability unless the attorneys owed a duty to the nonclient, and whether a duty of care exists because of the relationship between the parties is a question of law that is "solely for the court to decide." *Beattie v Firnchild* and *Murdock v Higgens*, 454 Mich App 46, 55; 554 NW2d 3 (1997).

A person who is not a client of an attorney has been able to sustain a cause of action in Michigan on a theory of breach of fiduciary duty. To succeed in an action for breach of fiduciary duty, there must be shown a situation in which the nonclient reasonably reposed faith, confidence, and trust in the attorney's advice. *Fassihi v Sommers, Schwartz*, 107 Mich App 509, 515; 309 NW2d 645 (1981). However, it is not reasonable for a nonclient to repose faith, confidence, and trust in an attorney's advice where the interests of the attorney's client and the nonclient are adverse. This conclusion is more pronounced when the nonclient is represented by counsel.

When a person having lawyer status becomes involved in a business arrangement with a nonlawyer, the better practice is to advise the nonclient to seek independent counsel from a disinterested advisor on whether or not to go forward with the transaction in which the lawyer is to become involved. This admonition applies even when the lawyer is acting as an investor or nonlawyer business person since the layperson may believe the lawyer is looking out for the interests of the layperson when in reality there is a basic conflict of interest inherent in the relationship, which prevents the lawyer from doing so.

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While it is generally necessary that a client-lawyer relationship exist between the lawyer and others for a violation of the MRPC to occur, there is no bright line test to determine the existence of the client-lawyer relationship. We do know that a unilateral act is not sufficient to create an attorney-client relationship since this relationship is based in contract. *Fletcher v Board of School District Fractional No 5*, 323 Mich 343, 348; 35 NW2d 177 (1948) and *Scott v Green*, 140 Mich App 384, 400; 364 NW2d 709 (1985).

Conclusion

Business transactions with clients are fraught with the danger of lawyer self-dealing and cannot be undertaken without strict compliance with MRPC 1.8(a). Because of the inherent possibility of lawyer overreaching, all business dealings between client and lawyer will be closely scrutinized for attorney fairness and compliance with MRPC 1.8(a). The best advice is to stay out of business deals with clients.

When a business transaction between a lawyer and a former client occurs, there is a question of whether the attorney's influence over the client's will is still present and therefore the lawyer's duties of loyalty and utmost good faith may still exist. Since the former client may expect the lawyer to continue to exercise independent professional judgment for the protection of his or her interests and the lawyer may have done nothing to signal the termination of the attorney-client relationship, it is best that the lawyer send to the former client a client-lawyer termination of representation letter. If there is any doubt existing over the end of the relationship, the mandates of MRPC 1.8(a) should be followed.

Where there never has been a client-lawyer relationship between a lawyer and a layperson, the courts and disciplinary agencies should not impress the requirements of MRPC 1.8(a) on the parties' economic business relationship. Of course the lawyer must offer no legal advice to the other business partners. Since there is no bright line test between what is considered business advice and legal counsel, when entering into a business deal with a nonlawyer, it is recommended that the lawyer give no advice other than the advice to the laypersons to seek independent counsel of their own choosing before going forward with the deal with the lawyer. ✦

Angus G. Goetz, Jr. is in private practice in Bloomfield Hills, specializing in business law and professional ethics. He is currently a member of the State Bar of Michigan Judicial and Professional Ethics Committee and served as its chairperson from 1977–1983 and from 1988–1994. He is a former member of the American Bar Association Standing Committee on Professional Ethics and a past chairperson of the Michigan Attorney Grievance Commission and State Bar of Michigan Representative Assembly. He currently serves as an Attorney Discipline Board adjudicator and is chairperson of the State Bar Client Protection Fund and the Committee on Arbitration of Disputes Between Attorneys.