##

MALPRACTICE CONSIDERATIONS IN A LAW PRACTICE

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INTRODUCTION

Malpractice liability is a specter that haunts or should haunt every attorney. The knowledge that an attorney could be sued by a client or at the very least lose is his or her job should prompt every attorney to do as good a job as possible for the client. Unfortunately, attorneys are only too human and as such, they, as much as any else, can make mistakes. Mistakes by attorneys can often have disastrous results for the client. Unlike medical malpractice in many states, for legal malpractice there is no limits on the damage awards for pain and suffering as a result of an attorney's malpractice. Judgment awards against attorneys for both compensatory and punitive damages have been steadily increasingly.

Statistics on malpractice suits showed that from 1978 to 1980, the number of malpractice suits filed against attorneys increased by two and a half times (250%). One of the most important reasons for the increase of malpractice suits against attorneys has been the huge explosion in the number of attorneys. In California, for instance from 1974 through 1995, the number of practicing attorneys nearly tippled to over 110,000 attorneys. While the number of attorneys nearly tippled during this period, the population did not even double in California. The effect of this explosion of attorneys in California is simply a reflection of the accepted rule

of supply and demand. The increased number of attorneys has resulted in increased competition. In addition, to cutthroat competition, a new de facto subspecialty of law has developed, the legal malpractice specialist. This is not a recognized specialty of law but nonetheless there are now attorneys whose entire practice is devoted to suing other attorneys.

Malpractice suits are interesting. Usually to obtain a recovery the client must prove that as a result of the attorney's malpractice the client lost a case or did not receive as much as the client was really entitled to receive. This is a hard burden on the client. Nonetheless, a malpractice against an attorney is much like a suit against an insurance company. Many attorneys or their insurers will settle a case to avoid notoriety and will almost settle a case which can a meritorious claim rather than risk a bigger judgment being awarded at trial.

The course itself is designed to address the most common and pressing concerns of attorneys regarding the most common elements or causes of malpractice. It begins with the discussion of the management of the office so as to minimize procedural malpractice, malpractice caused by the operation of the office such as missing filing dates. As such, the delegation of authority, supervision, administration of the office will be discussed to avoid malpractice not related to the furnishing of legal services or advice. The book will then go into some of the most common types of malpractice

caused by the attorney's practice of law and will point out areas of special concern for attorneys. Finally, the books will deal with defenses to malpractice.

In discussing malpractice, it is important to understand the different codes of professional responsibility which apply to attorneys. In 1969, the American Bar Association promulgated its ABA Model Code. This Model Code dealt primarily with the conduct of attorneys. Several states have since patterned their Canons of Professional Responsibility on this ABA Model Code. In 1977, the ABA upgraded its rules for professional conduct and instituted the Model Rules of Professional Conduct. These Model Rules have since been adopted, in the entirety or with modification, by almost all of the states. Regardless of whether they have adopted the Model Code or Model Rules, the states have almost always added their own individual interpretations or additions as relates to the attorney-client relationship. When referring to a "disciplinary rule" the book is referring to the ABA Model Code of 1969. Likewise, when reference is made to the "Model Rules" the book is referring to the Model Rules of Professional Conduct that were subsequently promulgated. It is easier for an attorney to maintain compliance with the Model Rules than with the Model Code. For a particular state, an attorney will have to comply with the professional canons of responsibility that were adopted by that particular state.

CHAPTER ONE

MALPRACTICE DERIVED FROM OFFICE MANAGEMENT

INTRODUCTION

Probably the most common source of malpractice actions against an attorney derives not from what the attorney did but from what the attorney failed to do. Many malpractice suits are based upon negligence in missing filing deadlines, a support person giving the client wrong information, or a support person or otherwise doing an act which results in prejudice to the client's case. Law office management with the view of avoiding malpractice is a relatively new concept. Yet, given the fact many malpractice suits derive from mismanagement of an office, an attorney should implement polices and procedures to limit the potential of malpractice from errors resulting from office management.

A. MANAGEMENT OPERATION

(1) THEORY OF OPERATION

It is often stated that there are two competing theories for the effective management of a law office. In point of fact, there is no one-correct manner in which to operate an office. While all offices share many similarities, such as the type of law practiced, the number of employees, the types of employees and such, each office is nonetheless unique. The human factor often makes adherence to a predetermined management scheme inefficient. The effective law office will adopt the management most closely

associated with the management style and philosophy of its owner or partners and then adapt it to the individual human nature of the office. The point for any manager to remember is that there is no one ultimately correct form of management. The organization should adopt the form of management, or develop one of its own which works best under the individual circumstances of the organizations. The first management theory is the organization's operation by system whereas the second theory is operation by management. The theories are not mutually exclusive and tend to overlap a great deal but they are two different theories.

Operation by system involves management by established procedures. Under this theory, everything is supposed by a procedures manual, the famous book. Whenever an issue comes up, the matter will be looked up in the book and the proscribed response will be implemented. When another question comes up, it is resolved in same way. The effective operation system will have procedures for virtually every type of reasonable expectancy. With operation by management, the manager at every level will have previously formatted answers and responses for any problems as they arise that related to the manager's delegated field of authority. The quintessential example of management by operation is the United States military. Nearly all conduct by military personnel is government by well-defined rules and regulations. The average military officer is given very little is actual discretion to act independently from the group. Nearly all military operation sand

management is directed through the interconnected operations systems governing every particular action of its personnel.

The second theory is operation by management. This theory stresses the independence and problem solving of the individuals to whom management authority is vested. Under this theory, it is the managers, through the exercise of their individual judgment based upon their training and expertise, who handle the problems as they arise and conduct the decision making for the organization. Under this system, the manager is delegated certain authority to manage and administer certain organizational affairs. Within the scope of the delegated authority, the manager may make certain decisions without the need of obtaining permission form superiors. The organization will be bound by the decisions made by the manager that were within the scope of the granted authority or for which the organization were held to have subsequently ratified under the ordinary rules of agency. An example of such management is the scheduling supervisor of a business whose job it is to set the delivery schedule for both goods to be shipped and received. While there are usually general guidelines as to how to conduct such operations, the supervisor is vested with great discretion in the operation so as to address new circumstances as they arise and therefore work more efficiently.

Most law offices, depending on their size and complexity of operation, will use both types of managerial systems to some extent. As the office staff grows, the office management will

become more and more systematic in how it is operated. This is due simply to fact that there are more people involved the operations who must be administered. In the small office of the sole practitioner, the administration is usually performed through direct management rather than procedure. The reason for this is that the attorney-owner or managing partner of the small office is the one most familiar with all of the aspects of the office and what is going on throughout the office. In such a situation, it is easiest for the person to simply handle any problems as they come up. If the small law office should happen to have a secretary, it is, likewise, very easy for the manager to direct generally how any particular matter ought to be handled. Thereafter, it becomes easy then to refer back to those particular procedures or practices that have been set up.

(2) **DEFENSIVE PRACTICES**

The most common instance of malpractice arises from the missing of filing dates or missing important information which prejudices the client's case. This is the biggest concern any attorney has regarding malpractice, i.e., that the attorney will miss something that can't be cured. Attention to detail will greatly reduce with fear but it will not alleviate it altogether. The potential of malpractice will always exist.

One way to limit the potential of malpractice is in the choice of area for which the attorney practices. There are some

areas of law, such as bankruptcy or probate work, in which it is relatively difficult to commit malpractice. The simple reason for the reduced potential of malpractice in these areas is that nothing is final in such areas until the court says so. As such, the court supervises virtually everything that is being done in the case. The court review of the attorney's action makes it more likely that mistakes will be spotted and thereby cured before they can injure the client. In addition, in such fields, an attorney usually can also reopen a matter, such as estate in bankruptcy, if mistakes have been made, to correct them. Likewise, in a probate, the attorney will usually have the court's supervision on virtually every major step. When the court grants permission for an attorney to do an act, after notice to all of the heirs of the proposed action was given, unless the notice deceived the heirs, their failure to object to action will normally relieve the attorney of any malpractice claim. As such, in both probate and bankruptcy, it is relatively difficult for an attorney to negligently commit malpractice.

In litigation, however, it is a whole other ball game. An attorney can misstate positions, lose evidence, not follow up on particular clues that another attorney would have along with other things that will give rise to malpractice liability. As such, it is obvious that there are a lot of things that can happen in a litigation matter that can result in a malpractice award. To help lessen the potential for a malpractice claim, the conscience

attorney will adopt good management and filing procedures so as to be able to both follow up and keep track of what is expected to be done in a case. An attorney must always be ready and able to prove that the case was handled it correctly. The implementation of case and client management procedures are necessary to lessen the potential of malpractice.

Documentation of all communication, both written and verbal with a client, is an extremely useful tool in avoiding a malpractice claim. Generally, once a client loses a case, it is only human nature for the client to blame the attorney. Occasionally, the client will take the frustration of losing the case one step further and proceeds to sue the attorney. In many malpractice cases, the client claims that the attorney had misled the client in some fashion. The client, usually alleges in the complaint, that had there been no misrepresentation the client would not have lost the case or would have done something differently. The attorney, in such a case, is, in the situation of proving a negative act, that he or she did not tell the client the client what the client claims to have been told. There is only one way for an attorney to protect himself or herself from such a situation, which is to document all client communications. For oral and telephone communications, the attorneys should immediately thereafter send confirming letters of the conversation's content simply to prove what was discussed and agreed.

It is quite popular nowadays to sue attorneys for malpractice,

on sometimes, the most flimsy excuse. When an innocent attorney has not protected himself, through the keeping of strong records, that attorney may be unable to defend himself against a meritless malpractice action. There is no doubt that many attorneys have, in the past, settled malpractice claims, which they did not commit, simply because they could not prove that they did not give the advice which the client claims to have been given.

In addition to the above discussion, one of the best defensive practices to malpractice actions is simplicity itself. It is for the attorney to carefully screen a person before taking the person on as a client. There are some people, who will immediately sue an attorney if they lose their action. An attorney needs to be able to recognize these types of individuals before taking them as clients and thereby avoid them. Simply taking as a client, everyone who enters an office exposes the attorney to such individuals and thereby increases the risk of a malpractice claim.

(3) BOOKKEEPING

State bars consider the accounting and bookkeeping practices of an attorney extremely important. The most common source of disciplinary action against an attorney is failure to maintain proper bookkeeping records and accounting practices for clients' trust accounts. Every attorney is required to establish bookkeeping and accounting procedures for the office. The office must still also set up its personal accounts for payroll, operating account

and the like. The new sole practitioner and the small office of two or more attorneys might initially want to look into a computerized bookkeeping and computerized payroll service. If so, the law firm will probably find it will to be less expensive in the long run to use these services initially rather than going out and buying computer equipment and programs and doing it by itself. As the firm grows, it would eventually decide to do its own bookkeeping in-house but until that time it could be a good idea to have it done outside. In the small practice while such bookkeeping tasks are being done, valuable attorney time is not being utilized to generate business and make money. Another consideration is that it might be less expensive initially for the sole practitioner to do such work, but once the attorney gets busy with clients as business increases, it will become increasing less cost effective for the attorney to personally keep the books and records up to date rather than simply review a bookkeeper's monthly product. A small law office may decide to turn over such tasks to a computerized bookkeeping service for a relatively small amount. One advantage that these computerized bookkeeping services do is that they can handle all payroll matters. Their computer programs can write the checks, for the attorney's signatures, compute the necessary state and federal withholdings and prepare all state and federal employees’ withholding tax forms which are a great time savings for the small law office. The charge for such work is usually quite reasonable and, of course, it is a legitimate tax

deductible expense.

All law firm checks should be signed by the sole practitioner or in the case of multi-attorney law firm by the managing attorney or partner. All checks should be signed only one attorney, and all bank statements are received by the managing partner unopened. In addition, a monthly review of all the accounts, and the ledgers should be in the hands of the managing attorney or partner for the firm and not in the hands of a lay person. In this way, each check can be seen by the managing person as he signs it, and each check was not prepared out of the purview of the managing partner. These are common, basic steps, but if they are taken the chances of an embezzlement ever taking place decreases greatly.

(4) OFFICE STAFF

Many law offices employ a lay person to handle the day-to-day administration of the office, such as paying the regular bills, delegation of authority to different secretaries as to what they do. Such delegation is good for most professional offices and absolutely necessary for large offices. An office manager frees the attorney to do what the attorney to practice law without wasting time on tasks which are necessary for the office's management but do not, in themselves, earn money for the office. Generally, once the law office has more than three secretaries or paralegals, the office is going to need someone who has some kind of authority for the day-to-day business affairs other than the practice of law.

This person is usually given the title, office manager.

An important element for any office which often is overlooked is that of an office manual. Whenever a law office is going to going to have more than one employee, then the law office should formulate an office manual. The implementation of the policy manual, except for the filing of employees, should be the initial purview of the office manager. The policy manual should state how the office is to be run, the job descriptions of each person what each person is expected to do. The significance of a law manual is to clarify what each employee does so that important tasks are not missed. In a notable Ohio malpractice lawsuit, an attorney missed the date for filing an answer. The answer hand been prepared and could have been filed in time. The problem was that a new secretary in the office did not know that she had the responsibility to file the answer. There was an inadequate tickler system in use for the office to verify such filings. As a result, the attorney was sued for malpractice as a result of the default taken against the client and the attorney settled the case. The attorney, in this instance, did nothing wrong in the actual practice of law. The attorney's liability arose from the improper management of the office which resulted in the harm, in the form of the default judgment, to the client.

Many sole practitioners and small law offices do not have the need for a full time secretary. With today's computer automation of the office, there are certain types of law practices for which

secretaries are no longer needed. In these practices, most of the drafting is done by the attorneys, directing on the computer and therefore, there is little for a secretary to type. The secretary, in such an office, becomes a receptionist and file clerk. In such an office, when a secretary is needed, the attorney can always call a temp service to have someone come in and help on that line. Many attorneys are solo practitioners and are in this same situation and save a great deal of money by not having a secretary.

Whether staff is hired on a full time or part time basis, the attorney is responsible for their conduct and the result of their work. For this reason, an attorney must pay close attention as to how the staffs perform their work. This is especially important with part-time staff who do not have or envision having a long term relationship with the office. Part time staff are often the source of malpractice actions against an attorney because they often lack the training to understand the importance of their work. In addition, a part time staff member may intentionally, for not being full time or for being let go, may deliberately sabotage the office product. The disgruntled employee who attempts to sabotage the office is not limited to law practice but nonetheless they do appear. The problem for law firms is that employees in a law office, more than any other profession, have the ability to by either accident or intent to disrupt its operations without being caught. An employee's misconduct or mistake, in a law office, may not surface for months or even years. This is the problem with

using employees in a law office. Nevertheless, a law office must have employees therefore it is vital for the office to have detailed procedures in place to regulate, administer and oversee each employee's performance of their jobs. Without such regulation of the employee's, a law office will never, with certainty, know if the work is being done correctly and therefore the sword of a malpractice suit will always hang uncertainly over the law office.

(5) FILING SYSTEMS

A very frequent source of malpractice suits against attorneys are based upon the attorney losing documents or files. It is not uncommon for clients to sue attorneys because the attorney is alleged to have lost important evidence. In addition to suits deriving from lost evidence, there are suits which have their origin in lost files. In large lawsuits, it is not uncommon to have entire boxes or file cabinets to be devoted to the case. When the information in these files or boxes are lost or misplaced, the law firm is liable for the damages which thereon occur.

Every law firm must adopt and implement a filing system to keep track of the cases handled by the law form. Most law offices simply have a filing system where each client in given a number and each case handled for that client is identified by the client's number and a particular letter relating to that particular case. There are some law firms who have their filing system segregated as to what type of law is being practiced by the attorneys. Such

firms, for instance, could have all their probate files in one area of the file room and their bankruptcy, corporate, etc. in a different area. These can generate huge amounts of paperwork. The average probate usually fills up an entire carton and files can be a foot thick with all that as to be done in terms of the accounting, property being sold, inventory and appraisals. It can take up a large percentage of area in a room, so many firms tend to segregate probate. That requires a very good filing system in order to be able to split client files up among various filing cabinets in order to make sure that the files are always documented and that the individual cases can be found they are needed. The complexity of such an arrangement, means that more can go wrong than in the basic filing system. Nevertheless the convenience in being able to find case quickly may override this concern. In point of fact, this is how most courts handle their pleading. Many courts will color code their pleadings, family law, criminal, civil, injunctive, etc. The file is then given a number and filed in the area of the file room allotted to that type of case. A particular plaintiff may have several cases in the court file room scattered about under the separate segregated files.

Whenever a file is removed from a file drawer, a record of who has that file should be made somewhere. Some firms utilize a check out a file which is often colored and has a lined sheet of paper inside. On the sheet is written the file number, date and name of the person who has the file. Some firms put this file in place of

the retrieved file. A practice of other firms is to have this colored file separately located apart from the file drawers. Instead of having a separate checkout list for each retrieved file, only one is used with each retrieved file identified along with a return date as well. However, a law firm does it, there must be a procedure is pace for always keeping track of the files. Once a case reaches the point that it has more than one file folder, then the possibility exists that information may be misfiled or that folders may be lost. A checkout system will not guarantee that such will not happen, but it will lessen the possibility.

It is not uncommon for a malpractice suit to be based upon the attorney not using evidence in the attorney's possession in trying to win the case. In almost every such situation, the attorney did not know that such information or evidence existed because the file containing it was improperly filed in the office. A misfiled file is basically lost forever unless found by error. The attorney, as stated above, is responsible for the actions of the employee. The attorney cannot allege as a defense that the employee misfiled the file or evidence therein. The filing of documents or the maintenance of files are non-delegable duties owed by the attorney. This means that the attorney cannot avoid malpractice liability for damages arising from an employee's misfiling of documents.

The fact that attorneys are liable for the damages which the client suffers as the result of an employee's misfiling of

documents should be the motivating factors for attorneys to careful set up a filing system and monitoring procedure to assure that it is properly administered.

B. MALPRACTICE SUITS AND MALPRACTICE INSURANCE

There has always been malpractice liability imposed on attorneys for their actions. What has become new, however, is that there are now attorneys who specialize only in suing other attorneys for alleged malpractice. One of the reasons for the large number of increases in attorney malpractice suits is that many attorneys carry malpractice insurance. As with any other insurer, a malpractice insurer, is more apt to settle a marginal case that risk a higher judgment at trial. As a result, the insurer will be likely to settle the case and thereafter either raise the insurance premiums of the attorney or cancel the insurance altogether.

An attorney, without an insurance policy, will have to either hire another attorney to defend the action or the attorney will defend the action himself. In either event, the defense in the action will cost the attorney dearly, win or lose. If the attorney hires a defense attorney, the attorney will have to pay the defense attorney. If an attorney conducts his or her own defense, the attorney loses income by working on his or her case for free instead of earning a living.

Even if the attorney wins a malpractice case, the win is often a pyrrhic one. Winning the suit means that the attorney will not have to pay any judgment to the client. However, unless the

attorney can prove that the suit was a malicious prosecution action or an abuse of process the attorney cannot sue the losing plaintiff and former client. As such, the attorney is not compensated for the damages suffered by having the suit brought against the attorney for the attorney's loss of reputation or business as a result of the suit.

If the attorney had a clause in the fee agreement that awarded attorneys fees to the prevailing party in the event of a lawsuit, if the attorney wins, the attorney would get his or her attorney fees if a defense attorney had been retained. Many states, such as California however, will not award attorneys' fees to an attorney who acts as his or her own attorney in a malpractice action. In such states, to get attorney fees, the attorney must actually hire a defense attorney. Of course, if the attorney loses the malpractice case, the attorney must pay the client's attorney's fees along with the judgment. In most states, if any money is awarded, even as part of a settlement, to a plaintiff in a malpractice action that person is the prevailing party and is entitled to attorney fees unless the settlement agreement states otherwise. Bearing all of the above, in mind, it is very important, that attorneys design their practice and their case management procedures to minimize the potential of any malpractice claims.

For the most complete piece of mind and protection, an attorney should consider malpractice insurance. As a result of the plethora of malpractice suits occurring in the last few years,

malpractice insurance premiums have skyrocketed. In some states, malpractice insurance is offered by insurance companies formed by attorneys themselves. Many state bars also have established relationships with insurance carriers to help provide insurance to their members.

The value of an insurance company is not only that the company will pay the judgment, up to the policy amount but that the insurance company will defend the action and thereby free the attorney to continue to earn a living. An insurance company is under the obligation to defend that attorney regardless if the claims are groundless, false or even fraudulent. The obligation to defend the attorney is a separate independent obligation from the obligation to indemnify the attorney. Insurers have increasingly been found to be bound by a duty of good faith toward their insureds. Under **Comunale vs. Traders & General Ins. Co.** (1958) 50 Cal2d. 654, this duty has been defined as requiring the insurance company to do nothing that will interfere with the insured's right to receive benefits under the insurance contract. In **Crisci vs. Security Ins. Co.** (1967) 426 P.2d 179, an insured company may be liable for punitive damages for acting in bad faith. Liability for bad faith include the refusal to settle a policy within policy limits or denying coverage when there is an absolute obligation to defend or acting unreasonably with respect to action or its defense.

Just as the insured has duties imposed upon him by the insurance contract, so too are duties imposed upon the insured’s attorney. The attorney is usually required by the terms of the insurance contract to give notice to the insurer of any acts or potential claims which the attorney reasonably foresees as being made against the attorney. If the attorney fails to provide such notice to the insurer, the insurance company may be able to deny coverage even though it would otherwise be obligated to cover and defend the attorney. In addition to the notice requirement, all policies require that the attorney participate with the insurer in the defense of the action. The insurance company cannot, settle the action without the consent of the insured. The insured is not permitted, by the terms of most policies, from making payments, assumption of any obligations or the incurrence of any expense related to the defense of an action without the insurer's consent. When the insurance company makes a payment or settlement of a malpractice action, the insurance company becomes subrogated to the insured's right of recovery against any other person. The right of subrogation does not, obviously does not extend to recovery from the insured except for breaches of the insurance policy or for fraud or other acts of dishonesty.

There are different types of malpractice policy for which the attorney should be aware. The first type of insurance policy is that of the occurrence policy. This type of policy will cover the attorney for any claims which arise from actions during the period

of time the policy was in effect even if the attorney is not insured by the company at the time the claim was made. This type of insurance policy is not always available.

Many insurance companies now require that the attorney not only be a client at the time of the incident but also when the claim was made. Under this situation the attorney is required to be a client for life. This is one of the reasons that the insurance companies like this policy. The rationale behind this policy is that the insurance does not want to insure a client for the potential liability of one big risk and not receive proceeds for the other years when the risks are low. There is also what is called "tail" insurance. This is particular coverage which persists after policy termination. Many insurance companies limit tail coverage only for retirement. Some companies will offer tail coverage even though a client is moving to another carrier.

One type of policy seldom available nowadays is the blanket policy which covers the attorney for claims made when the policy is in effect. The attorney is not required to have been a client at the time the incident arose. The attorney is only required to be an attorney when the claim was filed. This type of policy was popular with new attorneys who did not have assets when starting up. A malpractice by an attorney early in the practice would collect little because the attorney had little to lose. As the practice grew and the attorney acquired assets, a blanket policy would thereafter protect the attorney for malpractice performed in the

early years. Of course, there was the trade off in premiums. The insurance would charge an attorney more for the blanket policy because it was insuring for past work along with the work being conducted during the term of the policy.

Professional liability insurance is a legitimate business expense and thus the premiums for the insurance are tax deductible. The amount any attorney pays for premiums is based upon the type of law an attorney practices. An attorney, in a bankruptcy practice, will pay different premiums than an attorney who primarily engages in real restate litigation. Insurance companies base their premiums and coverage on the types of law and percentages in which an attorney practices. Some insurance companies offer attorneys the option of choosing only for claims arising in certain areas of law. In this situation, for example, the attorney could elect to be covered for any real estate malpractice claim but not any social security malpractice claims.

When shopping for malpractice insurance, the old adage of “buyer beware” applies. Insurance policies, by their very nature, must be read closely along with all riders so that he fully understands what is in them. Because of an attorney's knowledge of the law and legal training, an attorney would be less likely to win an action based upon misunderstanding of the policy than a lay person. For this reason, the attorney, must understand what is and is not covered by the policy.

CHAPTER TWO

ATTORNEY ADVERTISING

INTRODUCTION

There are two types of malpractice. The first type is called practice malpractice and is related to the handling of a client's legal matter. For an instance of practice malpractice, the attorney may be sued for the damages suffered thereby to the client. The second type of malpractice is called procedural malpractice and pertains to the method by which the attorney operates the practice. In a procedural malpractice situation, the attorney might not be subject to a suit by a client but will nevertheless be subject for disciplinary action by the state bar. One of the most common type of this procedural malpractice relates to attorney advertising. Every state bar has adopted disciplinary or ethics rules to govern the attorney advertising. The violation of these rules may not, in themselves, give rise to a suit for malpractice against the attorney. However, the violation of these rules can and often do result in disciplinary action which can result in punishment up to and including disbarment.

Until very recently, it was considered a breach of professional ethics to advertise. The reluctance for attorneys to advertise is a throw back to the middle ages. From then forward, English barristers have had a large pocket sewn on the back of the robes which barristers wear into Court. The Barristers, at the

conclusion of the case, would turn their backs to their clients who would place into the pocket whatever compensation they felt the attorney deserved for the representation rendered. The barrister could not sue the client over the fee received or not received. It was considered not appropriate for a gentlemen to solicit or argue over payment for services of his profession. The reluctance on the part of state bars to permit an attorney to advertise or solicit work has continued up to this date. Although, by virtue of rulings by the United States Supreme Court, some attorney advertising is now permitted, attorney advertising and marketing activities are still among the most regulated aspects of an attorney's practice.

Historically, no attorneys advertised. For generations it was considered inappropriate for attorneys to better themselves and did ordinary trades people. To enforce this prohibition, up through the 1970's most states had adopted disciplinary codes to specifically forbid attorney advertising. The prohibition against attorney advertising did not seriously impede an attorney's ability to earn a living up to 1970's because there was more than enough work to go around. Beginning in the 1970's, however, the days of being a success merely because the person was, an attorney came to an abrupt end. From the 1970's onward, the legal profession suffered a population explosion. In California, for instance, the number of practicing attorneys increased from 46,000 in 1976 to 115,000 active practitioners in 1995, which represents a threefold increase. The population in California, in comparison did not

nearly triple during that period of time. The effect of this huge increase in the number of attorneys has been to foster competition to an extent never before experience in the profession.

A by-product of competition, regardless of the profession involved, is the necessity to advertise. With many attorneys from which to choose, an attorney needs to explain to a potential client why that attorney whether than any other should be selected. Attorneys practice the law and the law of supply and demand is now, more than ever, being practiced by and on the legal profession. Traditionally, new attorneys would get a job as an assistant district attorney or public defender for a few years before entering private practice. This allowed the attorney to develop the legal skills necessary go into private practice. Today, these jobs are simply no longer available in the number in which they once were. Even most entry level government attorney jobs, today, require several years experience. While exceptions are sometimes made for minority attorneys, especially where affirmative action may apply, absent that, unless the attorney has experience, there are few attorney jobs available. Competition and the large growth in the number of attorneys has forced new attorneys to enter private practice, in higher numbers, than ever before. In addition. the competition with the new attorneys forces older attorneys into price competition to greater extent than ever before. As a result, it becomes necessary for attorneys to market themselves and their skills as never before.

I. ADVERTISING

Marketing a practice involves advertising in all of its various forms. The right of an attorney to advertise is a recently won right and is still highly regulated. Before an attorney undertakes any advertising campaign, regardless of how innocent it may appear, he should understand the limitations on advertising and the case law that has developed on the subject.

The areas of solicitation and advertisement embroil many attorneys with their state bars. Yet these are not areas that lead to malpractice actions against the attorney unless there has been some kind of misstatement about qualifications. Most restrictions on advertising imposed against attorneys are the result of a feeling that it is unseemly (not very professional) for an attorney to advertise. In point of fact, a blanket restriction against advertising works to the disadvantage of the public. Unless an attorney advertises, it is difficult for most lay people to discover whether or not the attorney is qualified to handle a case. It is also difficult to determine who is a good attorney and who is not. It is acknowledged that advertisements can go too far and they can be misleading, but in most instances advertising is correct and a blanket prohibition on advertising would work as a disservice to the public in general.

Prior to the mid-1970's, the 1908 ABA Canons of Professional Ethics absolutely forbade attorneys to advertise or solicit clients in any form whatsoever. This began to change in the 1970's when

both public interest groups and the attorneys themselves began to question the wisdom and merit of having such prohibitions. The first case that went to the United States Supreme Court regarding attorney solicitation was **Bates vs. State Bar of Arizona**, 433 U.S. 350, 1977. It involved the use of print advertising directed to the public. The U. S. Supreme Court used a premarket analysis in rendering its decision and held there is a first amendment right to advertise, but a state can adopt reasonable regulations to assure that the advertising is not false or misleading.

The **Bates** case was the first time the first amendment rights of free speech were extended to attorneys in their right to commercial speech. The **Bates** case involved two attorneys who were prosecuted for having published a list of their services in a legal newspaper with the term "reasonable rates." They didn't give any amount, they just said "reasonable rates." Nonetheless, the State Bar of Arizona prosecuted them for violation of the restrictions on attorney advertising. The court found that the restriction on attorney advertising did not violate the Sherman Anti-Trust Act; however, the court did find it violated the first amendment stating, "It prevented publication in a newspaper of a truthful advertisement concerning the availability and terms of routine legal services." Since the court found that the first amendment protection extended to commercial speech and specifically to attorneys, restriction was held to be unconstitutional.

Almost immediately following the decision in the **Bates** case in 1977, came the Ohio case of **Ohralik vs. Ohio State Bar Asso.**, 436 U. S. 447. In that case the attorney visited two teenage girls who were injured in an automobile accident. The attorney solicited their employment. That was a violation of the Ohio Canons of Professional Responsibility that forbade lawyers' soliciting clients with whom they did not have a preexisting attorney-client relationship. **Ohralik** relied upon the **Bates** case of commercial free speech, and argued that he had a free speech right to solicit clients. The Supreme Court rejected that argument and ruled that a state could enact rules against solicitation and forbid in-person solicitation in circumstances that were likely to result in overreaching or misleading a lay person.

This is significant because this Supreme Court decision effectually stated a corollary that an attorney could have solicitation for nonprofit purposes. It is possible and professionally permitted for an attorney to contact a person with whom he does not have a previous relationship and offer his services for free. In that situation, he is not attempting to realize any kind of profit. As a result of the **Ohralik** decision, such contact would be permitted because the attorney does not have a profit motive for doing so.

If profit does, in fact, derive to the attorney in some direct fashion from a representation, that may or may not taint the

solicitation. **Ohralik** made it clear, however, that states do have the power and authority to ban solicitation by attorneys in the profit situation. In 1978, there was also an important case: In re Primus 436 U.S. 412 (1978). In this situation, the lawyer named Primus had contacted some black women who were allegedly sterilized as a condition to receive Medicaid benefits. Primus had offered to represent the women for free as part of the services of the ACLU. The attorney was disciplined for this solicitation. The Supreme Court, following the **Ohralik** case, held that such sanctions were improper because the attorney was acting on behalf of the public, i.e., she was working for the ACLU and was not seeking any personal benefit. The court found that the attorney's actions were praiseworthy and of the highest ethical standard. The court recognized that there is nothing wrong in representing poor people for free to protect their rights, especially in a situation where the government has infringed upon their rights, such as forcing sterilization.

The next important case was **In re RMJ**, 455 U.S. 191, 1982 which involved the Missouri bar. If a lawyer wanted to advertise his expertise in specific areas of the law in Missouri, state law required that the advertisement be limited to an exclusive state list of areas and specific language had to be used. An attorney was not permitted, for example, to advertise personal injury law but was permitted to advertise "tort law," which was on the state's

authorized list. Missouri also required that an advertisement state that listing the areas of law that the attorney practiced did not mean certification by the state bar in those areas. Moreover, if the attorney was licensed in another state besides Missouri, he could not list that fact in the ad. This restriction in particular made no legitimate sense. It would seem quite beneficial for a client to know there is a certain attorney who can handle matters in another state, especially if the client lives close to the state boundary and may have legal matters in both states.

In the **RMJ** case, the United States Supreme Court established the guidelines for regulating attorney advertising. The court made it clear that the information being advertised must not be misleading, false or deceptive, i.e., the **Bates** situation. Such information or advertising can be banned outright. Secondly, in order to restrict acceptable and non-misleading information, there must be a substantial interest in the state involved and regulation must be in proportion to the interest served. Now, state bars must employ a balancing test. They can no longer say, "We do not want our clients deceived, therefore you shall not do it." They can regulate, but they have to ensure the regulation is in proportion to what they are trying to prevent or protect. The Supreme Court held as follows:

> "Truthful advertising relayed to lawful activities is entitled to the protection of the First Amendment. But when the particular content or method of the advertising suggests that it is inherently misleading or when experience has proved that

> in fact such advertising is subject to abuse, the States may impose appropriate restrictions. Misleading advertising may be prohibited entirely. But the States may not place an absolute prohibition on certain types of potentially misleading information, e.g., a listing of areas of practice, if the information may also be presented in a way that is not deceptive....
>
> Even when a communication is not misleading, the State retains some authority to regulate. But the State must assert a substantial interest and the interference with speech must be in proportion to the interest served."

The United States Supreme Court specifically struck down the restrictions on the lists of fields of practice and the jurisdictions where the attorney was listed, neither of that were inherently misleading in any way, shape or form, because the court found there was no real justification behind it. The lists of fields of practice can in itself be misleading. In the same vein, it can be totally valid. The courts can restrict composition of those lists as long as it is not a complete ban or there is some manner that is related to what they are trying to prevent happening.

After the Supreme Court ruling in **RMJ**, the ABA revised some of its model rules in order to comply with the Supreme Court's holding in that case. Under the Model Rules, if any information is false or misleading, it is prohibited outright. That is simply a restatement of the **Bates** position. Under the prior Disciplinary Rule 2-101(A), communications concerning legal services was prohibited and read as follows:

"A lawyer shall not prepare, cause to be prepared, use or

> participate in the use, of any form of self-laudatory statements calculated to attract law clients; as sued herein, "public communication" includes, but is not limited to, communication by means of television, radio, motion picture, newspaper, magazine or book."

This restriction is no longer required now under the new Model Rule 17.1. The definition of false and misleading information is information that is a misrepresentation of a fact, or law, or omits a fact necessary to make a statement considered as a whole not materially misleading, or "is likely to create an unjustified expectation about results the lawyer can achieve." What the state bars are attempting to accomplish here is prevent the situation where the attorney guarantees he is going to win or uses similarly situated former clients in an advertisement to essentially convey the message that "I got $100,000 for this person, I can do the same for you." Such conduct is improper and in violation of virtually every state's canons of professional responsibility. Such endorsements by former clients really treated the viewing public as idiots. Most attorneys have very high degrees of professionalism and let their work product speak for themselves by the fact that they win their cases.

Following the **RMJ** case came **Zauderer vs. Office of Disciplinary Council**, 471 U.S. 626, involving a lawyer's advertisement that was directed to specific people in a group. The attorney sent printed material and solicitations to women who had been injured by the Dalcon Shield, the birth control device that resulted in toxic

shock syndrome for many of the women who used it. The Office of Disciplinary Council for the Supreme Court of Ohio instituted disciplinary actions against the attorney for solicitation. Ohio was claiming that the attorney breached his professional ethics by targeting too narrow a group. He had reached a point where he was really soliciting a very narrow group of women in violation of state law as opposed to simply advertising to the public at large.

The other issue they were talking about was dignity. One of the main attributes in the earlier Model Code of Professional Responsibility, Disciplinary Rule 2-102, required that all advertisements be dignified, i.e., hold the legal profession to the highest standards. The information in the ad could be totally correct, but if the bar association believed it was not dignified, they could sanction the attorney. As a result, some attorneys were disciplined for what they considered undignified advertising. The Supreme Court in this case strikes the use of dignity as a standard for determining whether or not there can be an advertisement. The court specifically states:

> "Although the state undoubtedly has a substantial interest in assuring that attorneys maintain their dignity and decorum in the courtroom, we are unsure that the state's desire that attorneys maintain their dignity in their communication with the public is an interest substantial enough to justify their abridgment of their first amendment rights."

In addition, the court in **Zauderer** stated the advertisement directed to a narrowly favored group was permitted, but that the advertisement in question was misleading in that it had the line,

"If there is no recovery, no legal fees are owed by our client." That phrase was considered to be misleading to the public because it didn't mention the fact that clients still have an obligation to pay litigation costs, court costs, etc. as required by the canons of professional responsibility. Attorneys can properly only give limited and specifically defined financial support to their clients. They can advance litigation costs or fees, but the client must repay them. Therefore, any statement that they will take a case on contingency and absorb all fees is improper because it is a violation of the canons of professional responsibility.

Technically, the attorney in that case was sanctioned not for the advertising and not for having it directed to a narrow group (which was the big issue the Supreme Court in Ohio wanted to have addressed). He was sanctioned for a minor thing: simply having a misstatement that the plaintiff would not have to pay any legal fees if the case was not a winner. The importance of this case is that it permits an attorney to advertise directly to a narrow group of persons as long as the group is not so narrow as to be effectively on a one-to-one basis.

Model Rule 7.1(C) prohibits an attorney from comparing his services with that of services provided by other attorneys unless the comparison can be factually substantiated. An exception exists when statements that a lawyer's fees are reasonable can be verified by reference to objective standards and tend to be valid. Model Rule 7.4 permits an attorney to list fields of practice, but claims

of expertise are prohibited under this rule unless the attorney has actually completed some type of state specialization requirement. In addition to listing fields of practice, comments on Rule 7.4 suggest the attorney also should not use the phrases "limited to" or "concentrated in" because they tend to imply that the attorney is a specialist. This is only a comment, not the actual rule.

In most states, attorneys are still permitted to state that an attorney's practice emphasizes a particular field, even if not a specialist, simply to show that the attorney practices in those particular areas. In most advertisements, such as the telephone book, attorneys do not have sufficient space to put the words emphasizing specialties. They would rather use that space to list the specific disciplines of their practice. Often, for example, is seen such listings as: "Estate Planning" or "PI or Real Property" or "General Practice" rather than the complete words simply because there is insufficient room.

The Kentucky case of **Shapiro vs. Kentucky Bar Association**, 486 U.S. 466 followed the **Zauderer** case in 1988. This case involved sending letters or advertisements to potential clients who each faced a similar legal problem. The common denominator was foreclosure on their homes for failure to pay debts. The state bar refused to sanction sending letters. The state bar considered it to be improper solicitation because the attorney was going to receive a benefit from it. The state bar determined from the **Ohralik** case

that the attorney was going to receive a private benefit from being retained by clients receiving his letter. This was an area the bar could regulate, and they prohibited sending the letter. The United States Supreme Court distinguishes its **Ohralik** decision from this case. **Ohralik** was a face-to-face solicitation; **Shapiro** was a letter. The Supreme Court finds that a solicitation through personal act or contact (**Ohralik**) creates more likelihood of overreaching and the state can bar it. On the other hand, a letter directed to a group (**Shapiro**), has less likelihood of overreaching. The Supreme Court, however, did rule (in **Shapiro**) the states do have a right to institute regulations that are reasonable to oversee advertisements and solicitations to private individuals for profit.

Consequently, most states have enacted a requirement that such advertisements or solicitations state on the printed material that it is in fact an advertisement and that the sender is required to verify the accuracy of the facts stated. To put this into perspective, in 1990 the United States Supreme Court in **Peel vs. Attorney Regulatory and Disciplinary Commission** held that an attorney cannot be disciplined for simply listing his certification as a trial specialist by the National Board of Trial Advocacy (NBTA). The state had objected to the advertisement because the state believed it gave the impression that the state itself was the certifying entity when the state was not; the NBTA was not a state

agency. The Supreme Court held that the attorney's statement of certification as a trial specialist was true and verifiable rather than a claim of quality and the statement included objective facts supported by the inference of that quality.

It is important to stress again that in attorney advertising or solicitation an attorney is not permitted to pay any money or give anything of value to a person for recommending his services to another person. This is Model Rule 7.2(C). This rule does not prohibit the attorney from paying the reasonable cost of advertising. Obviously, the attorney has to pay for advertising. No one is going to do it for free. One situation where this comes into play is where an attorney is recommended by a client to a third party. The attorney in gratitude might believe he should reduce the bill of the client who made the recommendation. That, of course, is illegal. One clear exception: The nonprofit lawyer referral services established by state bars in which attorneys have memberships and get referrals from the service and pay a certain amount to be a member; the situation is different because it is covered by statute itself; otherwise, it probably would be illegal.

II. **SOLICITATION**

Solicitation will be discussed separately. Refer to ABA Model Rule 7.3 that was enacted in response to the cases discussed above: **Ohralik**, **Primus** and **Shapiro**. The general rule is that an attorney is not permitted to seek for-profit work through a personal or live

telephone contact with a prospective client with whom the attorney has had no prior professional dealing and is not related to the person in a family way. If the person is a family member related by blood in some fashion, the attorney can contact them because the attorney has the right to contact family members. There is no real statement on how distant the family relationship must be to be too distant. He could be a cousin seven times removed. At some point, however, the family relationship does terminate or else we would all be related to everyone else because we all came from Adam and Eve. Absent that, the attorney can contact people as long as the attorney stays within the guidelines of the cases discussed above and the state law of the attorney's licensing state.

Written materials that are sent and labeled as advertisement would usually be permitted under most state law under their canons of professional responsibility. However, it is always necessary to be familiar with the state law of each state which the attorney advertises. For example, there is a significant difference between Nevada's and California's regulations for attorney advertisement. Consequently, it would be prudent to obey the more stringent Nevada regulations on California advertising because those advertisements might reach Nevada and might cause an unintentional violation.

III. RUNNER AND CAPPERS

Under Model Rule 7.2(c) an attorney cannot and is not permitted to pay anything of value or give anything of value to a

person for recommending that lawyer's services to another person. This rule does not prohibit the attorney from paying the reasonable cost of advertising. Obviously, an attorney is expected to have to pay for the cost of advertising. No one is going to do it for free. One situation where this tends to come into play is where an attorney is recommended by a client to a third party. The attorney in gratitude might reduce the bill for the client who made the recommendation. Such conduct would, of course, be a violation of ethics rules. The one clear exception to the above prohibition involves the nonprofit lawyer referral services set up by the state bar and the like in which the attorney has membership and gets referrals from the service and pays a certain amount to be a member. This situation is different because it is covered by statute itself, otherwise it probably would be prohibited, however, that is not the case.

Disciplinary Rule 2-103 prohibited the use of runners and cappers under the Model Code as follows:

> "(B) Except as permitted under DR 2-103(C), a lawyer shall not compensate or give any thing of value to a person or organization to recommend or secure his employment by a client, or as a reward for having a recommendation resulting in his employment by a client.
>
> (C) A lawyer shall not request a person or organization to recommend employment, as a private practitioner, of himself, his partner, or associate, except that he may request referrals from a lawyer referral service operated, sponsored, or approved by a bar association representative of the general bar of the geographical area in which the association exists and may pay its fees incident thereto.
>
> (D) A lawyer shall not knowingly assist a person or

> organization that recommends, furnishes, or pays for legal services to promote the use of his legal services or those of his partners or associates..."

The Runner and Capper prohibitions were restated in Model Rule 8.4(A) which prohibits an attorney from using an agent (runner or capper) to do contact potential clients in situations which the attorney cannot. These rules prohibit an attorney from using an agent to do what the attorney cannot do. If an attorney cannot contact a person directly, it makes sense that the attorney would not be able to pay a runner or capper to do it for the attorney. In fact, payment is not even a requisite factor for a disciplinary violation. If, for example, an attorney asked someone to go out and find business for him and that person does attempt to get clients for the attorney, then the attorney could be liable for the personal contacts of made that person. If someone does it on their own, that is by word-of-mouth and is perfectly legal, and there is nothing wrong with that. It is understandable that if an attorney is good attorney, then people are going to recommend the attorney's services to others. The only question is whether the attorney has asked for the solicitation or has or hired people to get business for the attorney. The answer has to be "No" or else the attorney has violated the runner and cappers rules of most state bars. Such contacts or use of runners and cappers violates Rule 7.3.

There are exceptions to the rule. Rule 7.3(A) applies only when there is a significant motive of profit involved in the lawyer's solicitation. If the attorney is not trying to make money

but are trying instead to do a nonprofit pro bono service, there is no problem with direct contact because the attorney is not getting any benefit out of it personally. Many attorneys do a lot of pro bono work, and occasionally they will have a case where they will be handling several people pro bono. It often is a good idea to have others join as parties to have a better class or to preserve rights; so the attorney will contact a person and inform him, "I am handling such-and-such in a case and am handling it pro bono, and your issues are quite similar. Do you want to join? If so, I will handle you as well for free. If not, you can get your own attorney or not file at all." After a full and complete discussion, the person often does not join because he does not want to be involved in a lawsuit. Occasionally someone joins. Again, it is free work as a part of public service, representing indigent people who cannot represent themselves to preserve their rights. There is nothing wrong with an attorney conducting such work.

One area that the runner and capper situation does not apply is the contacting family members or former clients who are current clients about legal representation. Attorneys are allowed to do that. In addition, attorneys are allowed to talk to family members. Attorneys can offer their services to former clients and are allowed to talk to current clients without fear of violating Rule 7.3. Once the potential client however, declines the offered representation, in essence says "No," then the attorney is not supposed to continue contacting the person. After a "No," the

attorney would be in violation of Rule 7.3(B) that prohibits the attorney from using "coercion, duress or harassment" in an effort to get clients. There are situations where attorneys continue to call a client until they exhaust the client or the client threatens to get a restraining order. Often this arises in a class-action or some horrific automobile or airline accident where there are a lot of plaintiffs involved and liability is clear cut; having the client sign is sort of like money in the bank for the attorney. Nearly everyone has seen those characterizations of attorneys parachuting into a city following an airline disaster in an effort to acquire clients within a few days and therefore control the litigation. While this is illegal, it nonetheless happens all too frequently. In fact, this is one of the most cited instances which blackens the reputation of all attorneys. The attorney is permitted to send personal letters to solicit clients, but he is not allowed to contact people personally if they do not already have a relationship. Nonetheless, that seems not to be the situation in most of these cases.

All attorneys should remember that Rule 7.3 requires that all written or recorded communication with prospective clients who are being targeted by the attorney include the words "advertising material" on them. This must appear on the outside of the envelope and on the first page of the communication. Recorded communication must also both begin and end with the "advertisement" announcement especially when an attorney is using a taped telephone

solicitation. The purpose of that regulation is to ensure everyone knows this is a solicitation and that they have the right to disregard the advertisement or not listen to the phone message instead of thinking they are listening to something important or even that they are talking to the attorney.

IV. TELEPHONE BOOK

The most important and effective means of advertising and marketing for an attorney is the phone book. Most attorneys get their new clients from the phone book. A new client usually does not have an existing attorney, although occasionally the person is changing attorneys for any of a variety of reasons. The new client usually will select the attorney out of the phone book and call for an appointment. Generally, a potential client will only call one attorney at a time. Few clients really shop around. They may call the attorney and ask what type of law he handles and the price for a consultation.

Advertising in a phone book is the least expensive type of advertising for the attorney. A monthly ad in the yellow pages that is approximately four square inches (about 2 columns by 2 inches) tends to run about $50 per month. In this space, an average attorney can place a lot of information such as office location, phone number, states of practice, fields of practice and special licenses. It is also possible to buy white pages advertising. The determining factor is the amount of money that the attorney wishes to spend. In addition, most yellow pages have divided their yellow

pages into specialty sections as well. The attorney can place an ad or just the name, address and phone number under each section. An attorney might have a 2-column ad twice in the specialty sections under the most important fields of practice and also have the attorney's name listed under the other major filed in which the attorney sometimes practice. An attorney should avoid running the columns on the same pages or on facing pages. One ad on a facing page is distinctive enough to be eye-catching. This amount of advertising is about $115 per month. This is very inexpensive when compared to newspaper advertising: $175 each time an ad the size of a business card runs.

Attorneys will come to realize the importance of a phone ad early in the success of a legal practice. After an attorney has moved his office a couple of times, he will realize that advertising in anything other than the phone book is usually not very effective. Not being in the phone book can be the "kiss of death" because most people locate their attorneys from the phone book. As a practical matter, attorneys will find that whenever they are not in the phone book, either as a result of opening a new office or moving an existing office, that they really will get very little new business from people who do not already know of the attorney. Most people hire their attorneys through the phone book and attorneys not in the phone book operate at a severe disadvantage.

It is important to know the deadlines for getting into a phone

book. If a deadline is missed, an attorney might have to wait as long as a year before getting an ad in the phone book. As a result, the attorney might have to engage in other more costly forms of advertisement to keep his name before the public.

V. RADIO AND TELEVISION ADVERTISING

Everyone has seen television ads for attorneys and attorneys are advertising more frequently on radio as well. For the sole practitioner, television advertising is usually cost prohibitive. To be effective on television, the attorney must advertise on prime time, and that is the most expensive slot. There is a run of program rate where a television station will run the ad during the day whenever it has a spot available. For business ads this is usually a waste because they tend to run late at night and do not generate sufficient business to recover their cost. There is one advantage in television advertising. Cable companies often develop local stations and expand the coverage of the station over a much larger area. In this situation, the advertiser's ad is shown to a larger marketplace.

Radio advertising can also be valuable for an attorney. A one-minute ad in many markets is around $20 for the major syndicated shows. A general ad twice a week on RUSH LIMBAUGH, PAUL HARVEY and DR. DEAN EDELL, national shows with high audiences, will cost about $40 per show. It would serve its purpose of introducing the attorney to the public.

The most effective radio advertising is for the attorney to be

a guest on a radio talk show where clients can telephone their legal questions and the attorney answers them. Most state bars will not permit the attorney to take any of the callers as a client as they view this as a form of solicitation. It is, however, permitted for attorneys to answer legal questions of the public on the air. The advantage of doing this is that the attorney has more than a mere minute of paid advertising to demonstrate his legal knowledge and reasoning ability. If the attorney is lucky, the station might invite him to appear on a regular basis. This type of marketing works for attorneys quite well.

VI. LEGAL WRITING

An often overlooked means of marketing a law practice is to write a legal column. Nearly every city or town has a local free newspaper. Most such newspapers are looking for articles. A very good way to receive free exposure is for an attorney to write a free legal column for the paper. For example, in northern Nevada there is a free popular newspaper called the SIERRA SAGE. The editors readily agreed to have a free legal column written. The column is approximately 1200 words per month, that is approximately four questions from the public and their answers or general advice. The paper comes out once per month and has a circulation of 30,000. In contrast, the local newspaper is printed only twice a week; so the SIERRA SAGE is a relatively well-read paper. A normal ad covering this space would cost over $200. The best part about it is that an attorney is able, through the article, to demonstrate

his proficiency and knowledge on a topic or field rather than merely stating that he possesses it.

In addition to writing a column for a local paper, an attorney might consider writing a column for specialty managers or newsletters. Many attorneys offer to write legal columns on the areas in that they practice in monthly magazines. For example, an attorney practicing environmental law might contribute an article to an environmental magazine. The result of this is that the attorney begins to be perceived as an expert or specialist in the area by the public. A person reading the article might therefore use the attorney because of the developed name recognition. As a practical matter, except for national magazines that have a permanent staff, most magazines would greatly appreciate the receipt of a well-written article by an attorney.

An attorney might also write a column or article for the state bar publication. This generally will not yield much in the way of employment; although there might be some referrals generated from it. The main advantage from writing such articles is that it improves the attorney's professional resume and standing. This can be important if the attorney ever seeks a judgeship or other appointed position.

VII. SEMINARS

A common marketing strategy that has developed in the past few years is for attorneys to conduct seminars for prospective clients. This is most often done in the estate planning area. Attorneys will

rent a room and run an ad in the newspaper and often on the radio as well. At the seminar, the attorney presents an overview of the specific area of law and gives examples of how the law works.

Seminars are also given by non-attorneys. The result has been that attorneys have had to give their own seminars just to compete. Many state bars have been remiss in their obligation to prevent the unauthorized practice of law by non-attorneys. This is especially true in the estate planning area. Most of the so-called "financial planners" are not attorneys. Yet these "financial planners" prepare complex estate plans often without the use of attorneys. Insurance salesmen have created their estate planning designation called a Certified Life Underwriter (CLU) so they can engage in estate planning. A CLU is not recognized as equivalent to a legal degree and the holder of the designation is not legally permitted to practice law. Nonetheless, since the state bar does not enforce the unauthorized legal practice of these non-attorneys, attorneys in these areas must conduct seminars to educate the public. Most of these non-attorney seminars charge far more than attorneys. Some people have reported fees quoted as high as $4000 to do a revocable trust that an attorney might do for $600.

Seminars can be given by attorneys on any subject. They might be on social security, worker's compensation or taxation. An attorney must comply with state regulations regarding attorney advertisements, but nonetheless they can be done. Seminars can become an important marketing tool, especially for new attorneys.

Many attorneys create a working relationship with a senior center or community organization to give regular seminars to their members. This usually works out to be beneficial for the attorney. It is not uncommon for an attorney at a large seminar to get 10 or more clients, that in the estate planning fields could be $10,000 or more of legal fees.

VIII. REFERRALS

One of the most successful forms of marketing is the courting of referrals. It is a unique aspect of the human personality that if asked to make a referral most people will attempt to do it even if they really do not know anyone. In such an instance, referrals are simply based upon the attorney's reputation. People may want to help a person when such help can be easily given, or they may simply not want to appear ignorant or "out of the loop." In any event, people try to give referrals whenever they can do so. An attorney can generate a fair amount of new clients by developing enough name recognition that he will be referred simply because of that name recognition.

All attorneys have heard the cliche that they should join social organizations. In reality this does not generate business for new attorneys. Most social organizations have specific prohibitions against discussing or conducting work on their premises. There are two reasons behind these prohibitions. If the organization is a private club, conducting business in it might expose the club to a discrimination law suit. Many women and

minorities have successfully sued private clubs claiming that they were really business organizations. In such instances where it has been shown that business has been conducted in the club, the courts have found discrimination in not allowing minorities to join.

A more common reason for denying business to be conducted on the premises is for the comfort of the members and to prevent them from being pestered. In any event, joining an organization does not usually result in the attorney getting access to the members for the purpose of marketing.

The best way for the attorney to obtain referrals is to introduce himself to persons who can pass on the referrals. For example, an attorney who has served in the military has an automatic "in" with the various veterans' groups that are very good about referring work to veterans. Even if the person is not a veteran, a relationship can be courted with the organization, such as through doing seminars for the group that will translate into eventual referrals.

Another source of referrals is through bartenders, especially for drunk drivers. Bartenders hear a lot of problems relating to the human condition. Bartenders have been referred to as the poor man's psychiatrist, that might be true. In any event, when a patron has a problem, such as a drunk driving charge, a bartender is usually among the first to know. The bartender is often among the first people to be able to recommend an attorney. It is not uncommon for attorneys to give a stack of their business cards to

the bartender for distribution to patrons. There is nothing wrong with a bartender recommending an attorney as long as the attorney does not pay for the recommendations. Many bartenders make the recommendations, as stated above, because they want to be helpful to the patrons. Bartenders realize that if they appear unresponsive or uncaring to their patrons, they will lose business.

IX. PART-TIME PUBLIC WORK

It used to be that an attorney just out of law school would enter public service, such as assistant district attorney or public defender, for several years before entering private practice. Opportunities for these jobs have disappeared. The large increase in the number of attorneys, competition for work in the private sector and affirmative action have resulted in fewer and fewer public attorney jobs becoming available each year. Most public attorneys view their jobs as a career, not as a stepping stone into private practice, with the result that there are few permanent jobs available for the new attorney.

While there may not be permanent jobs available with the public, there occasionally are part-time or contract jobs available with public agencies. These jobs generally pay a straight hourly rate and are without benefits. The two advantages of these jobs are that they provide a small but steady source of income for the attorney and they provide a degree of visibility to the attorney that translates into name recognition.

Two examples of how this works are as follows. Alpine County,

California has a contract for an assistant attorney to provide 1800 hours of legal services per year. The contract is bid and there are no benefits beyond the contract payment. The attorney to whom the contract is given sets his own schedule and is paid $40,000 per year. The attorney is permitted to maintain a private practice on the side. In Douglas County, Nevada, the county's education attorney has a contract for 20 hours per month at $1,100 without benefits. The attorney charges $150 per hour for his private clients. The $1,100 per month from the county covers the office rent and operation expenses, other than secretarial. Therefore, the attorney is able to maintain himself during months of low income.

X. CONCLUSION

Attorneys can no longer assume that simply because they are attorneys they are in demand. The fact is that paralegals are often paid more than starting attorneys. For example, the Judicial Assistant (legal secretary) for the District Court of Douglas County makes $48,000 per year; that is more than the county pays its starting assistant district attorneys.

To survive as an attorney, it has become necessary for attorneys to look upon their practice as a business and to market it as such. To paraphrase Abraham Lincoln, the only thing an attorney has to sell is his time that means himself. To sell anything, the item must be marketed. This chapter's purpose is to acquaint the attorney with some of the different marketing avenues available to the sole practitioner in order to maximize his income.

CHAPTER THREE

ESTATE PLANNING

INTRODUCTION

The purpose of an attorney in estate planning is to help a client build a large estate during life and to pass as much of it as possible to the loved ones upon death. This section attempts to educate and remind attorneys, who do not ordinarily practice in the filed, of the various types of available estate planning. Much of the advice which an attorney gives to a client will affect the client's estate. Such advice might well result in higher probate costs or increased estate taxes upon the client's death. Attorneys have been held liable on the theory of malpractice for those increased costs and taxes when the attorney failed to fully apprize the client of the risks or of available estate planning alternatives.

An estate plan is the procedure by which a person attempts to preserve the assets of his estate during life and distribute them after death. The main considerations in estate planning are avoiding probate, reducing estate and inheritance taxes and quickly distributing the estate to the designated heirs.

A complete estate plan will consider methods for preservation of the estate during life by maximizing income while reducing income taxes that must be paid. The costs of probating a Will are

large. An old joke: If the person was not already dead, the cost to probate his estate would kill him.

Probate costs include court fees, appraisal fees, attorney fees and executor fees. Court costs and appraisal fees are modest: a couple of hundred dollars for an average estate. The real costs are the attorney and executor fees. The maximum amounts of attorney and executor fees are set by statute and approved by the court. They are based upon the size of the estate (value of the property to be probated) and increase as the estate increases. In California, for example, attorney and executor fees are calculated as follows:

1. 4% of the first $15,000; maximum $600.
2. 3% of the next $85,000; maximum $2,550.
3. 2% of the next $900,000; maximum $18,000.
4. 1% of the next $15,000,000 and .5% thereafter.

For example, a $100,000 estate probated in California would have to pay maximum attorney and executor fees of $6,300: $3,150 each to the executor and attorney. The attorney and executor can agree to take less or no fee at all.

Avoidance of probate fees is a major inducement for implementing an estate plan. When a revocable trust is used, there are no probate fees. The estate passes immediately to the designated beneficiaries of the trust. No court proceeding is needed to transfer the property of a trust, so no attorney is needed. There are several means to avoid having to probate

property. The probate avoidance vehicles are:

1. Summary probate proceedings in the decedent's state. A summary probate is an abbreviated procedure for small estates or for transferring the entire estate to a surviving spouse. Many states have adopted special procedures to bypass the expense and long delay in probating such estates.
2. Giving the estate away while alive.
3. Placing the property into joint tenancy with the proposed heirs. Upon death, title for the property passes immediately without probate to the surviving joint tenants. Real property held in joint tenancy passes to the survivors without a probate by recording a notice of the death of a joint tenant.
4. Placing the estate into a revocable trust that passes the estate to the designated beneficiaries immediately upon the decedent's death.

In order to determine the type of estate planning best suited to an individual, the attorney must fully understand and appreciate the size and makeup of the estate, how the client wishes to distribute the estate and the amount of control which the client wishes to give up in order to effectuate the estate plan. Toward these ends, this chapter is structured in such a way as to provide a concise summary of estate planning law and its application.

This is the most popular form of estate planning. It is fast and

bestows the maximum amount of control and property over the estate.

In order to structure the best type of estate plan, for a client, an attorney must fully understand the size of the estate, how he wishes to distribute it and the amount of control he wishes to relinquish to effectuate the estate plan.

I. CONSIDERATIONS IN ESTATE PLANNING

A. **A WIFE'S DOWER RIGHTS**

Some states still have the ancient common law right of "dower." Under the concept of dower the law gives an interest to the wife in the real property of the husband owned by him at any time during the marriage. The wife's right (dower) was contingent upon her surviving him, and it became an absolute right after she did so. The dower interest was a life estate in one-third of the real property that the husband owned during the marriage.

The wife's dower could not be defeated by the husband during his life or by his Will, and her interest was not subject to the claims of her husband's creditors. The dower terminates upon divorce. Many states have abolished dower and replaced it with statutory shares in the deceased husband's estate.

B. A HUSBAND'S CURTESY RIGHTS

Some states still have the ancient common law doctrine of "curtesy" governing the husband's statutory share of his wife's estate. Curtesy grants the husband an interest in the real

property of the wife owned by her during the time of the marriage. The husband's curtesy was contingent upon him surviving her, and it became an absolute right when he did so, provided a child was born during the marriage.

Curtesy entitles the husband to a life estate in all of the wife's real property owned by her during the marriage. The husband's curtesy could not be defeated by the wife during her life or by her Will and was not subject to the claims of her creditors. Curtesy terminates upon a divorce. Most states have replaced the doctrine of curtesy with statutory shares for the surviving husband in the deceased wife's estate (between a third and a half).

C. COMMON LAW STATES

The following are the states that follow the common law marital property rules. In these states a person owns separately and apart from the spouse everything titled solely in his name and everything purchased by his own property, income, or salary. The titles to property actually control who owns. This is different from the law in community property states, which hold that all property acquired by gift, devise, or bequest belongs to both husband and wife. The common law states are:

ALABAMA	ALASKA	ARKANSAS	COLORADO
CONNECTICUT	DELAWARE	FLORIDA	GEORGIA
HAWAII	ILLINOIS	INDIANA	IOWA
KANSAS	KENTUCKY	MAINE	MARYLAND
MASSACHUSETTS	MICHIGAN	MINNESOTA	MISSISSIPPI
MISSOURI	MONTANA	NEBRASKA	NEW JERSEY
NEW HAMPSHIRE	NEW YORK	N. CAROLINA	N. DAKOTA
OHIO	OKLAHOMA	OREGON	S. CAROLINA

PENNSYLVANIA	RHODE ISLAND	S. DAKOTA	UTAH
TENNESSEE	VERMONT	VIRGINIA	W. VIRGINIA
WYOMING			

Every common law state has its own laws determining the statutory share that a surviving spouse receives from a deceased spouse's estate. In the following states the surviving spouse receives a one-third life estate. This is the right to use the property to obtain income but not the right to sell it:

Connecticut Kentucky Rhode Island Vermont

In the following states, the surviving spouse's percentage varies, depending on whether the deceased spouse had children. The surviving spouse usually gets at least one-half of the estate, one-third if there are children.

Alabama	one-third of the augmented estate.
Alaska	one-third of the augmented estate.
Colorado	one-half of the augmented estate.
Delaware	one-third of the estate.
District of Columbia	one-half of the estate.
Florida	30% of the estate.
Hawaii	one-third of estate.
Iowa	one-third of estate.
Maine	one-third of the augmented estate.
Minnesota	one-third of estate.
Montana	one-third of augmented estate.
Nebraska	one-third of augmented estate.
New Jersey	one-third of augmented estate.

New York	one-third of augmented estate.
North Dakota	one-third of augmented estate.
Oregon	one-fourth of the estate.
Pennsylvania	one-third of the estate.
South Dakota	one-third of the augmented estate.
Tennessee	one-third of the estate.
Utah	one-third of the estate.
W. Virginia	up to one-half of the augmented estate.

In the following states, the surviving spouse's percentage varies depending on whether the deceased had children. If there are no children the surviving spouse usually gets one-half of the estate but only one-third if there are children.

Arkansas	Illinois	Indiana	Kansas
Maryland	Massachusetts	Michigan	Missouri
New Hampshire	N. Carolina	Ohio	Oklahoma
S. Carolina	Virginia	Wyoming	

Georgia is unique. Instead of a fixed share, Georgia requires the deceased spouse's estate to support the surviving spouse for one year. This might or might not exceed the one-third of the estate usually given in other states.

Most states base the statutory share on the augmented estate of the deceased spouse. The augmented estate consists of everything owned by the decedent: joint-tenancy property, trust property, etc. The amount of the statutory share is calculated

from the augmented estate. The probate court has the power to cancel joint tenancies and trusts created by the deceased spouse in order to give the surviving spouse a statutory share.

The purpose of using the augmented estate is to ensure the deceased spouse passes a statutory share of the estate to the surviving spouse. Not all states, however, use the augmented estate. Instead, other states simply rely on the property actually undergoing probate.

D. STEPPED-UP BASIS ON PROPERTY RECEIVED FROM A DECEDENT

The basis (value for tax purposes) of property received from a decedent through a trust or through probate is its fair market value on the date of the decedent's death. Example: A person bought a home for $10,000. On his death it was worth $40,000. The basis of the property when heirs receive it will be $40,000. If the heirs sell it for $40,000, there will be no capital gains taxes due. If the heirs sell the house for $60,000, they will have to pay capital gains taxes on $20,000 (selling price $60,000 minus stepped-up basis $40,000).

Community property is considered owned by both spouses and is given special tax treatment. Under federal law when one spouse dies, the basis of both halves of the community property will be increased to fair market value. This is a great tax advantage. Example: A couple bought a home for $20,000 that had increased to $500,000 upon the husband's death. The basis for the husband's

share in the community property is increased to fair market value $250,000. Under the special treatment for community property, the wife's share is also increased to fair market value $250,000. The surviving wife can sell the house for $500,000 without having to pay any capital gains taxes. If, however, the spouses held the house as joint tenants, only the husband's half would have been increased to fair market value. The wife's basis for her half would have remained at $10,000. If the wife later sold the house for $500,000, she would have to pay capital gains tax on $240,000 ($500,000 - $260,000 total basis). The stepped-up basis for community property is a great tax advantage over mere jointly-held property between spouses.

E. ESTATE AND INHERITANCE TAXES

A common misconception is that probate exists as a means for the state or federal government to collect taxes. That is not the case. Estate and inheritance tax rates are based on the size of the estate and the relationship of the heirs to the deceased. It is irrelevant to the taxing entities whether or not a probate is conducted when determining the tax liability.

For example, assume that a person gives $800,000 at his death to his children. It makes no difference if the $800,000 comes to the children from probate or through a revocable trust. There is greater cost if the estate is probated rather than passing it through a trust, but the tax rates are the same. The tax is on the

money and property distributed after death, not whether or not it comes from probate.

Some states will freeze jointly-held property (such as bank accounts, real estate and brokerage accounts) until the taxing entities have time to assess the value of the decedent's interest in the property. In particular, New Jersey and South Carolina require 10 days' written notice to taxing agencies before securities, deposits or assets of a decedent may be transferred outside of probate. In the states that freeze the assets pending a tax determination, a limited amount may, none-the-less, be transferred to a spouse or children without having to give the required notice. New Jersey permits $5,000 to be transferred to the surviving spouse without having to wait the required 10 days.

The purpose of permitting limited transfer for use by the family is to keep the spouse and family from destitution while the taxing authorities determine what amount of tax is owed. It is markedly unfair to seize the joint property of one person merely because the other joint tenant died. Consequently, the notice period is usually small.

There is a lifetime federal unified credit of $600,000 for gift and estate taxes. This means that no federal estate taxes will be owed unless an estate exceeds $600,000 (including the value of lifetime gifts). Under the Internal Revenue Code a personal representative can file a request with the IRS (and sometimes the state taxing agency) for a final assessment of the taxes owed by

the estate. The IRS has three years in which to assess additional taxes. If the personal representative makes a request for a prompt assessment, the IRS has to complete the assessment within 18 months. After the assessment is done, the personal representative can pay the tax, distribute the remaining estate to the heirs and be discharged without any liability for future taxes.

F. PROBATE

"Probate" is the name for the entire legal proceeding in a probate court to determine how to distribute the estate of a deceased. Probate is the legal mechanism whereby a court states who gets the estate. Probate of a deceased's estate is necessary when the decedent did not plan his final affairs beyond preparing a Will. Appropriate estate planning avoids probate altogether while providing for the immediate transfer of the estate to the designated heirs.

Probate proceedings are long, cumbersome and expensive. They are avoidable with proper estate planning. In recognition of the difficulties and expense of probate many states have enacted laws waiving probate or streamlining procedures for small estates (usually under $60,000). These summary probates usually involve nothing more than filing petitions with the court stating that the estate is too small to be managed effectively and that it should be distributed without administration to the heirs. Summary probate procedure is available only for small estates. Above a certain

value, usually $60,000, a regular probate is required. A person whose estate exceeds $60,000 should develop a simple estate plan and avoid probate.

G. THE PROBATE COURT

The probate of a deceased person's estate is handled through a probate court. It is a special department or court under a court of general jurisdiction. The probate court oversees the administration of the probate estate. The probate court is responsible for performing the following functions:

1. Appointing the legal representative of the estate.
2. Supervising the representative.
3. Receiving and evaluating the inventories, accountings and other reports of the representatives.
4. Assuring that all bills, taxes and claims against the estate are paid by the representative.
5. Overseeing the distribution to the heirs.
6. Closing the estate and releasing the representatives from further responsibility.

The estate remains under the control of the personal representative until the probate court issues the final order of distribution. It can take years for an estate to be closed and the assets distributed to the heirs.

H. THE LAST WILL AND TESTAMENT

A Will is the final testament a person makes to ensure his

earthly possessions go to whom he wants them to go. A Will is totally revocable during one's life. A Will usually must be in writing and witnessed by two or more adult persons. The witnesses usually cannot be heirs mentioned in the Will.

In some states an oral Will made in immediate contemplation of death may be valid to distribution of the estate. The creator of the Will (testator) must be legally competent to make the Will and not be insane or otherwise mentally impaired.

Unless a clause of the testator's last Will specifically revokes all prior Wills, all of the Wills of the testator must be read together. The probate court then will determine how the estate will be distributed. Therefore, all Wills should have a simple clause revoking all of the testator's prior Wills.

A Holographic Will is a Will that is written entirely in the handwriting of the testator. Some states, such as Colorado and California, do not require a Holographic Will to be witnessed. Most states require a Holographic Will to be witnessed. Many states will not accept a Holographic Will as valid if there are any preprinted or typed portions of the Will. Some states will permit preprinted language in the Will if the material provisions are entirely in the testator's own handwriting. To be safe a Holographic Will should have two or more witnesses. That means, however, that it is no longer a Holographic Will, but an ordinary Will. Generally, Holographic Wills should not be used because they raise the potential issue of forgery. A case in point was the

alleged Holographic Will of HOWARD HUGHES. The distribution of his estate of several billion dollars hinged on a purported unwitnessed Holographic Will. After years of legal wrangling, the court ruled that the Will was a forgery, but there are still some experts who believe it wasn't. If it was real, however, the issue of competency then exists because most sane people would not give away millions to strangers.

A Will must be signed, dated and, unless typed, be written entirely in the handwriting of the testator or be an approved Statutory Will (a preprinted Will authorized by statute in the testator's state of residence). Many states have created Statutory Wills. These Statutory Wills comply with all of the terms for a valid Will in the state. They are preprinted blank Wills on which the testators simply fill the blanks, sign and have notarized. Nearly all states have approved Statutory Wills for their citizens. Statutory Wills are usually sold in stationery and office supply stores. A Statutory Will must still be probated the same as any other Will.

It is important that whenever a preprinted do-it-yourself Will is used that the person pay particular attention to detail. A telling example of this is an actual case where a woman used a preprinted Will. She was unmarried and had lived for 30 years with a man. She had a child whom she had not seen for over 30 years. She left everything to her male companion in the Will. Unfortunately, the Will she had bought and used was titled "Single

Without Children." Her son filed a claim as a pretermitted heir and was awarded her entire estate. The man who had been with the decedent for 30 years received nothing because the woman chose the wrong preprinted Will.

If a deceased person's Will cannot be found, the general presumption in law is that the person destroyed it. The estate will be distributed in accordance with the state's laws of intestacy. It is next to impossible to prove the existence of a missing Will and what it contained to the satisfaction of a court. If an heir can do so and also convince the court that the Will was inadvertently destroyed, the court might possibly distribute the estate as intended. For example, assume that George made a Will and gave a copy to a friend and placed the original Will in his son's house, which was destroyed by fire. The court might distribute the estate according to the copy. The evidence needed to prove to the court that the deceased did not destroy a missing Will is overwhelming.

The better tactic is for the person to sign two duplicate Wills with a general provision stating, "I have executed this last Will and testament in duplicate with one copy being held by my attorney. On my death if the Will in my possession cannot be found, it is not to be presumed that I revoked it. The Will in the possession of my attorney can be admitted in probate and treated as though it was the Will in my possession."

Because a lost Will is presumed to have been revoked, a

probate court will not accept a copy of a Will into probate unless it can be shown to its satisfaction that the original Will was not destroyed by the deceased. The general presumption is that the decedent revoked the Will if it is missing. Producing a copy of the Will proves the contents of what was in it but does not prove that the deceased did not revoke it. Example: A fire kills the testator and destroys the Will at the same time. It then falls upon the heirs to prove that the testator did not destroy the Will prior to the fire. Therefore, execute the Will in duplicate with a clause that if the Will is not found in the deceased person's possessions, it is not to be presumed to have been destroyed.

I. LEGAL COMPETENCE TO MAKE A WILL

In order to create a Will that is valid, the testator must be legally competent to do so. The issue of competency is critical when determining the validity of a Will. Will contests based upon competency are the most difficult cases in the law to win. The creator of the Will is dead, and the intent of a deceased testator has to be proven by extraneous and parol evidence that:

1. The testator was an adult or emancipated minor.
2. The testator knew the nature and quality of his estate.
3. The testator knew those who were the natural objects of his bounty (must have known his or her family).
4. The testator was mentally competent and not suffering from any insane delusions as pertained to the members of

his family.

5. The testator was not on mind-altering drugs or alcohol when the Will was executed.

6. The testator knew that he was making a Will.

If these elements are not met, the Will is invalid no matter how many witnesses were present when it was executed. Competency is interesting because it does not have to be permanent. A person can be insane, have a temporary return to sanity, sign the Will and then relapse into insanity. In such an event, the Last Will and Testament, executed during the period of competency will be valid.

The issue of competency most commonly arises when an elderly person creates a Will close to the time of death or while under some type of medical treatment that might cloud judgment. Most Will contests arise by someone claiming the decedent was tricked into signing a Will.

J. INTESTACY

A person is said to have died intestate if that person died without having executed a valid Will. The estate of a decedent whose Will is declared invalid will be treated as if he died without a Will. An unemancipated deceased minor's estate will be treated as though the minor died intestate. Minors cannot write a valid Will. If a Will is declared invalid for any reason (failure to be witnessed, having improper witnesses, being under age, lacking mental capacity, etc.), the decedent's estate will be

distributed as though he died without creating a Will.

Generally, when a person dies intestate, the estate usually is divided among the immediate family as follows:

1. If there is a spouse and a child, the estate is divided evenly between the two.
2. If there is a spouse and more than one child, one third of the estate goes to the spouse, and the rest is divided among the children.
3. If there is a spouse and parents and no children, the estate is split between the spouse and parents.
4. If there are parents and no spouse or children, it goes to the parents.
5. If there are no parents, spouse or children, the estate goes to any brothers and sisters.

The probate court will keep searching for heirs until it finds someone to receive the estate. To find an heir to Howard Hughes' estate the court ultimately found a distant cousin by adoption several times removed.

K. INVALIDATING A WILL

A probate court will declare a person's Last Will and Testament invalid when:

1. The testator was an unemancipated minor, usually under eighteen years of age.
2. The testator did not sign it or have enough witnesses, or

the witnesses were heirs and thus disqualified, or the witnesses were minors. In most states people named in a Will as receiving property cannot be witnesses. Their signatures are invalid. If there are not two, and in some cases three, good witnesses, the Will is declared invalid.

3. The testator was mentally incompetent at the time the Will was executed.
4. The testator was forced to make the Will as a result of fraud, duress or undue influence of another.
5. The oral Will was found invalid because it exceeded the statutory amount that can be passed by an oral Will.
6. A Holographic Will was not entirely in the handwriting of the testator or not signed or not dated.

When a Will is declared invalid, the last valid Will of the decedent will be admitted into probate. If there is no valid previous Will, the decedent's estate will be distributed in accordance with the decedent's state laws.

L. CONSIDERATIONS IN MAKING A WILL

A Will is a final statement of a person about how his estate is to be distributed. A probate court will not employ a Ouija board or seance to determine the testator's intent on issues not covered in the Will. The court will apply the state's law and general equitable principles. One should consider the following

factors before making a Will:

1. What specific bequests (gifts) are to be made?
2. How should the remainder of the estate be distributed?
3. Who should be the executor of the estate?
4. Should a bond be required on the executor?
5. What powers should be given the executor? How much should the court supervise the executor?
6. Should adopted or step-children inherit from the estate?
7. Should a testamentary trust be established?
8. Who should be nominated as guardian for minor children?
9. Should any debts be canceled that are owed by heirs, or will they be deducted from the inheritances?
10. If assets are to be sold to pay debts, is there a priority as to how they will be sold?

It simply makes no sense to leave such important matters to be decided by a judge who has no understanding of the decedent or his wishes.

M. PROBATING COMMUNITY PROPERTY

A small minority of states (California, Arizona, Idaho, Louisiana, New Mexico, Texas, Nevada, Washington, Wisconsin and to an extent Oklahoma) have laws that state all property acquired by either spouse during a marriage (except by gift, devise or bequest) is jointly and equally owned by both spouses. Earnings by both spouses for their work during the marriage along with retirement

benefits earned during the marriage also belong equally to both spouses. Upon death only one half of the community property is placed in the deceased spouse's estate. The other half of the community property remains the sole property of the surviving spouse and is not included in the decedent's probate.

When a spouse dies intestate in some community property states, such as California, the surviving spouse automatically acquires title in the community property without probate. Since community property is considered by law to be owned equally by both spouses, a spouse's estate consists of only one-half of the property. Either spouse can direct through a Will how his half of the community property will be distributed. A surviving spouse is not automatically entitled to the deceased spouse's share of the community property. For example assume that George and Ellen are married in a community property state. George subsequently gives his half of the community property and all of his separate property by Will to his children, not to his wife, Eileen.

If the deceased spouse does not have a Will, his half of the community property will be distributed by state laws. California has a special provision that requires all community property to pass automatically to the surviving spouse if a spouse dies intestate. In the example above, if George died without a Will, then Eileen would inherit automatically, with no probate, all of George's interest in the community property. A probate would still be needed for all of George's separate non-community property.

N. HEIRS

An heir is someone who succeeds by operation of law to the estate of a person who died intestate. Each state identifies those persons that can be heirs under its laws. A living person has no heirs, only "heirs apparent." Heirs must survive a decedent. Generally, heirs are the spouse, parents, children, brothers and sisters (immediate family) of the decedent. If none survive the decedent, the laws will extend heirship to the next-of-kin closest in relationship to the decedent.

Generally stepchildren have no greater rights in a stepparent's estate than those of a total stranger. Unless the stepchildren were adopted, which legally makes them the same as biological children, stepchildren are viewed as strangers for inheritance purposes.

If an heir is to receive property from an estate but can't be found, the probate court will order the property of the heir to be delivered to the county treasurer, county administrator or other designated agent. The agent will hold the property for the missing heir until the heir or a person acting for the heir or his estate applies for release of the property. Payment to the designated agent relieves the personal representative of further responsibility to the heir.

When the property consists of real or personal property other than cash, the court may order the property to be sold, converted

to cash and kept in an interest-bearing account. If the money in the bank account is not claimed within a fixed statutory period, it is transferred to the state as "escheated property."

O. PERSONAL REPRESENTATIVE

The person appointed by the court to act for the estate of a deceased person is the personal representative. There are two types of personal representatives: (1) the executor or executrix and (2) the administrator. The executor (a man) or the executrix (a woman) is appointed by the court to represent the estate when the trustor (creator) of the Will dies. A person nominates an executor or executrix in the Will, but it is the court that does the actual appointment. If the court is not satisfied with the decedent's chosen representative, it will appoint another. An administrator is a man (administratrix, if a woman) appointed by a court to administer the estate of a decedent who died intestate.

The personal representative is given statutory powers to handle the affairs of the estate in most transactions without court approval. Through his Will the decedent can give the executor more powers and authority to act than are normally contained in the statutory powers conferred by the court. Usually court approval must be sought before real estate can be sold. A testator, however, may require in his Will that the real property be sold. If he does, court approval is not necessary.

The personal representative, whether the executor or the

administrator, is responsible for performing the following duties in the probate:

1. Marshals (assembles and inventories) the assets of the estate.
2. Establishes a checking account in the name of the estate.
3. Arranges for appraisal of the assets of the estate, both real and personal property.
4. Seeks payment on any insurance policies owed on the life of the deceased person.
5. Substitutes as the representative of the deceased person in any litigation pending at the time of death.
6. Files any litigation needed to collect debts owed to the estate or to maintain and preserve the estate.
7. Pays all bills, including funeral bills and medical bills for the last illness.
8. Prepares tax returns and pays all federal and state taxes for the estate and the decedent.
9. Submits accounting to the court for review.
10. Petitions the court for authority to distribute to heirs.
11. Distributes to heirs.
12. Applies to the court for final discharge, terminating his authority to act and releasing him from liability.

It usually takes a minimum of six months for a personal representative to do all this. It can take significantly longer. Some estates have been open for years. This is the prime factor in

favor of a revocable trust, which can transfer property immediately subject only to the payment of appropriate estate and income taxes.

The personal representative appointed by the court is responsible for the payment of all taxes owed by the estate from the assets in the estate. If the personal representative distributes the estate before payment of all taxes due and owing, the representative may become personally liable for the taxes to the extent of the property transferred. For example, assume that the representative distributes $50,000 to the heirs, and the IRS then determines that an additional $60,000 is owed in taxes. The personal representative may be responsible for any portion of the $50,000 not recovered from the heirs.

P. AN ACCOUNTING

The personal representative is required to file an inventory with the court when the estate is opened. An inventory is a complete listing of every asset in the estate and its value. While the estate is open, the representative is required to keep track of every penny received or spent by the estate.

Before the estate can be closed, the representative is required to account for every penny that entered and left the estate. There must be a complete accounting for the estate. All of the heirs can agree to waive an accounting. That might be done when the accounting is unnecessary because the heirs trust the executor, or when it will be too costly given the difficulty or

expense in performing it. Unless the accounting is waived, the estate cannot be closed.

Q. LETTERS OF PROBATE

In a probate the court appoints a personal representative. The appointment of a representative is manifested by a court document. The court order appointing an executor in an estate where there is a Will is called "letters testamentary." The court order appointing an administrator in an estate where there is no Will is called "letters of administration."

The letters are the official appointment of the personal representative to act for the estate. Once these letters have been issued, the personal representative is legally entitled and indeed obligated to undertake the management of the affairs of the probate estate. No one should ever deal with a person claiming to be the personal representative of an estate without first seeing the letters of appointment.

R. USE OF JOINT WILLS

Joint Wills are trouble and must be avoided. The problems are obvious. A married couple makes a Joint Will; one spouse dies; the survivor wished to change the Will; the ultimate beneficiaries, usually the children, object. Whether the surviving spouse can alter a Joint Will depends both on the language of the Will and the state law where the Will is probated. If the Will states that after the death of one spouse the survivor cannot amend or revoke,

most states would enforce that provision on contractual grounds. These states take the position that the deceased spouse would not have executed the Joint Will had he known that it could be changed after death.

If the Joint Will does not have the language making it irrevocable and unamendable, the court will try to decide the intent of the parties when they drafted it and base its decision on that determination. There simply is not any real justification for running this type of risk. Individual Wills are relatively cheap, especially Statutory Wills, so cost should not be the determinative factor in deciding upon use of a Joint Will.

S. CHANGING A WILL

A "codicil" is an amendment to a Will. It does not revoke the entire Will, but it does change certain provisions. The probate court will read the Will and all codicils together to determine the final intent of the deceased. A codicil is, in essence, a mini-Will. It is prepared, signed and witnessed in the same manner as an ordinary Will. Particular care must be taken in writing a codicil to define just what changes are to be made in a Will. If an heir is to be removed or added, it must be clearly stated. A codicil should be kept together with the Will to assure that it will not be overlooked when the estate is probated. A codicil is governed by the same rules as a Will. Therefore, if a codicil is missing, it will be presumed to have been previously revoked unless

conclusively proven otherwise.

All changes to the Will must comply with the same formalities as those used in making a codicil or new Will. A person who simply deletes old provisions or inserts new clauses brings the validity of the will into question. A person can revoke his Will at any time by another will or simply by destroying the old will. Some states would consider the writing of the new clauses an effective revocation of the old will yet ineffectual in creating a new will.

A person should never write a change on the face of a will. All changes to a Will should be by a valid codicil or a new Will in accordance with the requirements of the state of domicile. Given the ease with which new Wills can be created, especially Statutory Wills, there is no reason to risk invalidation of an existing Will by writing on it. Just prepare a new Will or a codicil.

T. WHEN A WILL SHOULD BE CHANGED

Unless changed, once a Will is drafted, it is valid forever. As time passes, a person's needs and circumstances change. A Will drafted years earlier may no longer fulfill the current needs and desires of the person. A Will should be changed to reflect the true intent of the person.

The following changes in a person's life should immediately cause a review of the person's Will:

1. A change in marital status. Marriage makes the new spouse a pretermitted heir. A divorce might not cut the ex-

spouse out of the Will.

2. Children are born or adopted. State laws allow unmentioned children to claim a portion of an estate as pretermitted heirs. These children, however, might not receive under state law what the decedent would have given them.
3. Stepchildren. In most states stepchildren of a deceased have no rights to inherit under a stepparents estate. Therefore, if a stepparent wishes to make dispositions to a stepchild, that intent must be specifically stated in a Will.
4. The value of the estate changes and the earlier gifts were too much, too little or there is now enough to give to others as well.
5. The intended heirs, executors, guardians or trustees have died.
6. Changes in estate or inheritance tax laws that make changing the Will advisable to save on taxes.
7. The necessity for testamentary trusts for surviving spouse and children no longer exists.

A Will should be reviewed every few years for possible changes. Tax laws change frequently, and Wills should be reviewed to ascertain their effect on the estate.

U. DISINHERITING A CHILD

Most states permit a parent to disinherit a child: prevent the child from receiving anything from the parent's estate. While possible, the intent to specifically disinherit a child must be detailed in writing. The laws of all states presume that a parent does not intend to disinherit a child unless specifically stated in the Will. If a child is simply not mentioned in the Will, the court will presume it was an error and award the child his intestate share of the estate.

Louisiana has several probate laws different from the rest of the nation. While the rest of the nation derived its basic law from English Common Law, Louisiana derived its law from French Napoleonic Code. Louisiana permits the disinheriting of a child only on one of 12 different grounds. Therefore, in Louisiana a parent cannot disinherit a child, no matter how specifically the intent to do so is stated in the Will, unless one of the 12 grounds are met. These grounds run from a minor marrying without consent to planning to murder a parent.

V. PRETERMITTED HEIRS

A probate court will presume that a parent did not intend to disinherit a child unless the intent is specifically stated in the Will. This comes into play in the pretermitted heir situation. A pretermitted heir is an heir, usually a child, who is not mentioned in the Will, but who would have inherited under a state law if there had been no Will. When the court finds the existence of a

pretermitted heir, the court will award that heir his intestate share of the estate. For example, assume that Mary wrote a Will leaving her estate to her three children. Mary later had a child out of wedlock and died shortly thereafter. Mary's will did not mention the new baby. The court, however, will find the baby a pretermitted heir and award the baby her intestate share of the estate which is one-fourth.

A stepchild is not a pretermitted heir and has no right of inheritance under the law. California has created a novel statutory provision that permits a person to claim a de facto adoption if certain elements are met. California requires there be a parent-child relationship between the people and that an adoption was not possible because of some legal impediment. If these elements are met, the court will treat the person the same as an adopted child and award him an intestate share of the estate.

As with a pretermitted heir, a court will presume that a deceased spouse did not intend to disinherit a surviving spouse unless it is specifically stated in the Will. A pretermitted spouse is a surviving spouse who is not mentioned in the deceased spouse's Will. In all states a surviving spouse Will inherit from a deceased spouse's estate, under each state's laws. It matters not that the surviving spouse is pretermitted or disinherited by a clause in the Will, the state law will provide for inheritance. When the court finds a pretermitted spouse, it will award that spouse the intestate share of the estate. Example: Mary wrote a

Will leaving her estate to her three children. Mary then remarried and died 20 years later. Mary's Will did not mention the husband. The court will find the new husband a pretermitted spouse and award him his intestate share of the estate, usually a third.

W. EFFECT OF A TESTATOR'S DIVORCE ON A WILL

A few states, like California, have enacted laws that specifically prevent an ex-spouse from inheriting under a deceased ex-spouse's Will that had been drafted at the time of their marriage. In most states, however, an ex-spouse will be entitled to share in the estate where the decedent failed to rewrite the Will after the divorce. Most states take the view that the decedent must have wanted to make gifts to the ex-spouse because the Will was not changed. Those courts will honor that perceived intention.

No one should ever assume that a divorce removes the rights of the ex-spouse to inherit under a Will. In cases of divorce, a new Will or a codicil should be drafted to state that the ex-spouse is not inheriting under the Will. A new Will should be written as soon as the divorce papers are contemplated and should certainly be in place when the divorce is filed. Some die during a divorce (in fact it has been the basis of many mystery movies). The marriage is still legal. Thus the surviving spouse receives property under the deceased spouse's old Will even though granting the divorce would have invalidated the Will. For example, an attorney defended

a woman charged with the murder of her wealthy husband whom she had shot six times. The attorney defended her successfully. Because it was not murder, she inherited his estate of $26 million.

X. ANCILLARY PROBATES

An ancillary probate is a proceeding conducted in a state other than the state that was the decedent's permanent residence. Every state is responsible for probating the real and personal property located within it. If a deceased owned property in more than one state, a probate may be required in each such state in addition to the state of the decedent's domicile. Example: Robert died with a home in Georgia and another in Alabama. Probates must be opened in both Georgia and Alabama for the house in each state. If a decedent owns oil and gas leases in six states, there will be ancillary probates in five of the states plus a probate of the majority of the decedent's estate in the state of domicile.

Additional problems arise if the states have differing requirements for a valid Will. For example, assume that the domicile state requires two witnesses, but the state with the ancillary probate requires three witnesses. The Will may be invalid in the ancillary probate state, and the property located therein will be distributed by its law of intestacy.

Y. WILL CONTESTS

A Will contest is a legal proceeding whereby someone, usually an heir or beneficiary, attacks or contests the validity of a Will

or a distribution made under it. A Will contest results in a trial before the court to determine if the Will was validly executed and should be enforced. The main contentions for contesting a Will are:

1. Improper execution.
2. Lack of competency.
3. Lack of intent to make a Will.
4. Pretermitted spouse.
5. Pretermitted heir.
6. Fraud, duress or undue influence.

Generally, only two witnesses are needed for a Will, but a few states have rather eccentric requirements. Vermont requires three witnesses; Louisiana follows the Napoleonic Code requiring three witnesses, one of whom must be a notary public. These factors are important if there is a possibility of an ancillary probate. If the Will might be probated in another state, it must comply with that state's and the decedent's home state's requirements for a valid Will. In the case of an ancillary probate, if the Will does not comply with the ancillary state's requirements for a valid Will, it will be declared invalid and the estate distributed by the laws of intestacy.

All states require that proof be submitted that the decedent actually signed the Will. Some states actually require some or all of the witnesses to come before the court and testify about the signing of the Will. Other states, such as California, permit the witnesses to sign a declaration called a proof of subscribing

witnesses in which the witness swears under penalty of perjury that he actually saw the testator sign the Will.

A few states, like Louisiana, permit witnesses to sign the Will before a notary public. When this is done, the Will is said to be self-authenticating, and the witnesses need not appear in court to validate their signatures. When the witnesses are dead or unavailable and their signatures were not notarized, some states, California for instance, permit handwriting experts to testify that the decedent signed the Will. This is a last resort and is difficult if the decedent had a long illness that affected his signature. It is a good idea to use witnesses who are younger and in better health than the testator.

If the Will is successfully contested, the probate court may invalidate the entire Will or only the challenged portion of it. If the entire Will is invalidated, the last valid Will is reinstated. If there is no such valid prior Will, the estate will be distributed pursuant to the laws of intestacy.

Z. CREDITOR CLAIMS

After a probate is opened a notice of the probate proceeding is published in a newspaper of general circulation in the area where the decedent lived. This publication informs creditors of the decedent that a death has occurred. The publication also informs the creditors that they have a fixed period of time ranging from four to six months to file claims with the probate court for

the amounts they are owed.

If any creditor that was given valid notice, directly or by publication, fails to file a claim within the statutory period of time, he is barred from recovery. The reason for having a cut off period is to close the estate on a certain date. Otherwise, the probate would be open forever while old unpaid claims were being submitted. Once filed, the executor must approve or reject the claim. If the claim is approved, it will be paid from the estate at the closing. If the claim is rejected, the creditor has a fixed time to file a lawsuit to collect the claim. After that time, collection is permanently barred.

This creditor period is the main reason for the delay in closing a probate and distributing the estate. The advantage of a revocable trust is that the property is transferred immediately. The disadvantage is that the creditor claims follow the estate. The claims will be paid. Still it makes better sense to pay them immediately through a trust rather than wait months for the action to work its way through the courts.

Funeral expenses are paid out of the estate. They are granted a priority over other bills. They are among the first bills paid once the estate has been marshaled (assembled). Many people today make their own funeral arrangements by paying for the service ahead of time. Many states, such as Ohio, Nevada, South Dakota and Washington require money paid under a pre-need plan to be placed in a trust fund. In the event the funeral home goes out of business,

the money is returned to the client. Sometimes a person purchases a funeral policy to pay the funeral expenses, and the insurance company can pay insurance proceeds directly to the funeral home. Some states, such as Maryland and Tennessee, require all payments on funeral policies to be made to the estate and forbid funeral homes being named beneficiaries on such policies.

If the estate is not large enough to pay all of the creditors, the personal representative will sell the secured property. The representative will apply the proceeds from the sale of the secured property to the secured creditors: those holding loans secured by designated property. If the proceeds are not enough to cover the claims, the secured creditors will have an unsecured claim for the unpaid balance. Any amount received in the sale that exceeds the amount of the claims is paid to the estate.

After claims of the secured creditors are satisfied, all the unsecured creditors divide the remaining estate according to their percentage of claims against the estate. For example, assume that Ed dies owing George $50,000 secured by a printing press. The executor of the estate sells the press for $30,000 and pays it to George. The remaining $20,000 becomes an unsecured debt of George against the estate. Ed's estate totals $100,000 with $200,000 in unsecured claims. George's $20,000 unsecured claim is 10% of the total unsecured claims. Therefore, George receives 10% of the unsecured estate, which is $10,000.

AA. FAMILY ALLOWANCES

Many states, like California, permit a surviving spouse or minor children to claim a fixed amount from decedent spouse or decedent parent's estate free from all creditor claims. This family allowance can be in addition to anything bequeathed in the Will. In some states if an heir elects to take a family allowance, the heir cannot take under the Will.

The family allowance can also be taken despite the terms of the Will. The Will may specifically give the wife nothing, but the wife may still be entitled to the family allowance under state law. A family allowance was one of the means used by the states to replace dower and curtesy. In a small estate the family allowance is the only way that the family may receive anything from the decedent's estate.

BB. SIMULTANEOUS DEATH

A simultaneous death occurs when both the husband and wife die together so close in time that it cannot be ascertained with certainty who died first. When there is simultaneous death, each spouse's estate is distributed as though the other spouse has died first. The husband's estate passes to his heirs in the manner it would have passed had the husband actually died first. Jointly held property is divided equally among the two estates. Every state except Alaska and Louisiana have adopted the Uniform Simultaneous Death Act, which covers this situation. Many Wills avoid this

problem altogether by simply containing clauses that require the spouse or other heir to survive the testator by a fixed period of time in order to inherit, usually 60 days.

CC. TIME NECESSARY TO PROBATE AN ESTATE

The time required to settle an estate varies from state to state. It depends on whether there is litigation or creditor claims. In California it takes a minimum of six months to close an estate. Four months is the statutory creditor claims period, and the other two are the general period of public notice for opening and closing an estate.

Some states require that an executor actually close the estate within a fixed period of time. In Kansas the mandatory time to close an estate is nine months. In Wyoming one year is the time period. Where litigation is involved years may pass before an estate can be closed. If a revocable trust is used, there is no estate to close because the trust estate passes immediately upon death to those next entitled to receive it under the terms of the trust.

DD. THE FINAL JUDGMENT OF DISTRIBUTION

After the accounting has been performed and either accepted by the court or waived by the heirs, the court will order which creditor claims are to be paid and how the final distribution to the heirs is to be made. The final judgment acts as a deed for real property. Recording the final judgment is the same as having

received a deed from the personal representative for the real property distributed under the final judgment.

EE. AFTER-DISCOVERED PROPERTY

An estate can always be reopened if property not covered by the terms of the final judgments have what is called an omnibus clause that states how such after-discovered property is to be distributed, thereby avoiding reopening the estate. Generally such an omnibus clause states, "The remainder of the estate along with any undiscovered property shall be distributed as follows:..."

When an omnibus clause is used in the final judgment of the probate court, there is usually no reason to reopen the probate because of after-discovered property. Finding after-discovered property may result in additional estate or inheritance taxes. The taxes go with the property. If additional taxes are owed because of the existence of this newly discovered property, the heirs receiving the property will be responsible for the taxes to the extent of the value of the assets received from the estate.

II. REVOCABLE TRUSTS

INTRODUCTION

In planning a client's estate, the attorney must evaluate both the wishes of the client and the size of the estate before making recommendations on the type of estate planning vehicle to be used by the client. Most states have enacted summary probate procedures for estates below a certain dollar amount of value which will pass

the estate quickly with little cost. Also, joint tenancy can be utilized to pass property without a probate but there are tax basis considerations attendant with their use. An attorney may be liable to the client's estate for any increased taxes or administration costs incurred if the use of cheaper estate planning vehicles were not discussed with the client. It is very dangerous for an attorney to do a simple Will for a client with a large estate without having the client sign a statement acknowledging that the attorney discussed the advantages of a revocable trust whose use as rejected. Without such a statement, heirs of the client might sue the attorney for the increased probate costs by claiming that the client would have done a revocable trust had the attorney informed the client of its advantages.

A revocable trust is usually the best means of estate planning. The creator of the trust, called the "trustor" or "grantor," places his entire estate into the revocable trust. The trustor usually is the trustee (the person who manages the estate). There is a beneficiary (the one who will benefit from distribution of the trust). Upon the trustor-trustee's death, the person named in the trust document as successor trustee becomes the trustee immediately without court approval being needed. Depending on the terms of the trust, the new trustee either dissolves the trust and distributes the assets immediately in the manner designated in the trust document or continues to operate the trust in the manner directed by the trust document.

Since there is no probate, there are no probate costs. The savings for the estate with a revocable trust are several times the cost of creating the trust. Because the trust is revocable, the trustor can alter, amend or revoke it at any time. If the trust is revoked, the trust assets immediately return to the trustor.

The standard estate plan that includes a revocable trust, durable power of attorney, living Will, and pour-over Will is usually between $500 and $1,100, depending on the type of trust. There are different types of trusts. Different trusts are tailored to whether or not the grantor is married, has children, or wants a joint trust between the spouses. Special trusts such as life insurance trusts, generation skipping trusts or charitable trusts can also be part of an estate plan.

All fifty states and the federal government accept as valid a revocable trust. If the trust was validly created in the original state, all the other states will honor and enforce it. Provisions can also be placed into a trust document stating that the terms of the trust are to be administered by the laws of a certain designated state. All states will apply the laws of the designated state in administrating the trust. Even if the trustor moves to another state, the trust will still remain valid and in effect.

A. FEDERAL ESTATE AND GIFT TAXES

The federal estate and gift tax rate is graduated and increases as the size of the estate increases over the unified

credit. Example: A taxable estate of $100,000 has a tax of $23,800; a taxable estate of $250,000 has a tax of $70,000; a taxable estate of $500,000 has a tax of $155,000; a taxable gift of $2,5000,000 has a tax of $1,025.800.

1. UNLIMITED MARITAL DEDUCTION

Under federal law there is no federal gift or estate tax on property transferred between spouses. This is an unlimited credit that has only two exceptions:

1. It must be an actual gift. If the gift is in trust, all of the income must go to the spouse.
2. The spouse receiving the gift must be an American citizen. Gifts to a non-citizen spouse are not eligible for the unlimited deduction but are eligible for a $100,000 annual exclusion (Section 2523 of the Internal Revenue Code). Likewise, property passing from an American spouse to an alien spouse after death does not qualify for an unlimited marital deduction either. Special tax rules apply for such transfers, and a tax consultant should be consulted if the estate of the American spouse exceeds $600,000.

Therefore, a person can generally pass his entire estate to a surviving spouse without incurring any federal estate taxes. This may not ultimately be the best estate plan. If the property given to the surviving spouse boosts the surviving spouse's estate over

$600,000, the surviving spouse's estate will have to pay estate taxes upon the death of the surviving spouse. Any gift to a surviving spouse that would boost his estate over $600,000 in value should be made after using the decedent's unified credit.

2. UNIFIED CREDIT FOR GIFTS OR ESTATES

Every person is permitted by federal law to transfer assets totaling $600,000 by either gift or death without incurring a gift or estate tax. Example: A person can give $275,000 in gifts while living and pass an estate of $325,000 after death without the estate paying any federal gift or estate taxes.

About half of the states impose their own estate and inheritance taxes. These taxes should also be a consideration in estate planning. The Internal Revenue Code permits a small credit for state death taxes to be applied against the federal estate. The $600,000 unified credit permits a husband and wife to give to their children a total combined estate of $1,200,000 before incurring any estate taxes. A person giving his entire estate to a surviving spouse is not taking advantage of his spouse's unified credit. It is simply good planning to use the spouse's $600,000 unified credit when the trustor's estate exceeds $600,000.

3. ANNUAL EXCLUSION FOR GIFTS

Under federal tax law every individual may make an annual gift of $10,000 per person without incurring a gift tax or having the gift applied towards the $600,000 unified credit. A parent having

four children can give each $10,000 for a total of $40,000 each year free of gift taxes. The advantage of making these gifts is that they help reduce the size of the estate below $600,000, eliminating federal estate taxes.

An alien spouse does not qualify for the unlimited marital deduction. In place of the unlimited marital deduction an alien spouse is permitted to receive as a gift from the other spouse $100,000 per year tax free.

B. GIFT TAX ON THE CREATION OF A TRUST

If the trust is revocable, there is no gift tax because the trustor can always revoke it. All income is still taxed to the trustor. If the trust is irrevocable with the trustor as the beneficiary, there is no gift tax because the trust is still for the trustor's benefit. Such a trust is called a grantor's trust, and all trust income is taxed to the trustor. If the trust is for the spouse, there is no gift tax because of the unlimited marital deduction. If the trust is for someone other than the trustor or the trustor's spouse, a gift tax is owed. The gift tax must either be paid or deducted from the unified credit or annual exclusion.

C. BASIC TYPES OF REVOCABLE TRUSTS

1. JOINT TRUSTS

A common estate plan is where both spouses create one joint revocable trust. In this joint trust both spouses create one joint revocable trust and place all their property into the

trust. The spouses' property is listed on schedules marked his, hers and theirs. On the death of the first spouse the trust is divided into separate trusts for the surviving spouse and the children or heirs. This joint trust is usually the most economical estate plan because it plans for both estates. The cost for doing the joint estate plan is less than the cost of a separate estate plan for each spouse.

The trust is totally revocable during the joint lifetimes of the spouses; either spouse may terminate it at any time. Upon the death of the first spouse the trust usually becomes irrevocable as to the property of the deceased spouse, but the surviving spouse usually retains full power to revoke the trust as to the property that he contributed to it. This type of trust gives the spouse maximum control over their assets. This flexibility accommodates future changes in the surviving spouse's life following the death of the first spouse.

2. AN A-B-TRUST

The A-B Trust is the common name given to the general type of revocable trust used by a married person with children where the trustor's estate exceeds $600,000. It is also called a "marital trust" or a "bypass trust." The trust exists for the benefit of the trustor during his life. At the trustor's death the trust is divided into two parts: the first $600,000 (or the remaining unused unified credit) is placed into the B trust, and the rest is placed

in the A trust.

The sole beneficiary of the A trust is the surviving spouse. The surviving spouse has ownership of the A trust and usually has the power to terminate it and receive the assets in her (assuming the wife is the survivor) own name. Since the assets in the A trust go to the wife, and since there is an unlimited marital deduction the estate is not subject to federal estate taxes if the spouse is a U.S. citizen. Upon the surviving spouse's death all of the property in Trust A will be included in the surviving spouse's estate for calculation of estate taxes. Example: Upon the husband's death his $2 million estate was divided $600,000 to Trust B and $1,400,000 to Trust A. Upon the wife's death Trust A had grown to $1,700,000. In addition, the wife had $500,000 of her own estate. So, for tax purposes, the wife's taxable estate will be $2,200,000.

The beneficiaries of the B trust are the children. Income may be attributed to the surviving spouse, but the trust does not qualify for a marital deduction. It does qualify for a deduction to the extent of the trustor's unused unified credit ($600,000). Thus it is possible that there will be no federal estate tax on either trust. In the above example, if the assets in Trust B increased to $1,000,000 at the time of the wife's death, no estate taxes are due because the property placed into the Trust was originally tax free. If the $800,000 was originally placed into Trust B, the excess $200,000 would be taxable; after the taxes are paid, no additional estate taxes will be charged against it upon

the death of the wife.

3. A QTIP TRUST

A QTIP trust is a special trust whereby the trustor's spouse is given all of the income from the trust with the principal being distributed to others (usually the children or grandchildren) upon the surviving spouse's death. QTIP stands for Qualified Terminal Interest Property and is a fancy name for property given to a spouse in a certain type of trust.

A QTIP trust gives the option to the surviving spouse to have the trust property treated as a gift to the surviving spouse for estate tax purposes. If the election is made, the value of the trust will be treated as a spousal gift and exempt from tax because of the unlimited marital deduction. On the surviving spouse's death the value of the trust assets will be included in the surviving spouse's estate for the determination of the surviving spouse's estate tax.

Depending on the size of the surviving spouse's estate it may or may not be good financial planning to make the QTIP election and have the value of the trust included in the surviving spouse's estate. For example, assume that the surviving spouse's estate is $100,000, and the QTIP trust is $100,000. The unified credit of the deceased spouse has previously been used. Making the election will save the trust from paying federal estate taxes until the surviving spouse dies. In the meantime the surviving spouse could

draw a higher interest from the investment of the $100,000. If the surviving spouse's estate grows after making the election, tax will ultimately be required on the growth at the death of the surviving spouse.

4. A GENERATION SKIPPING TRUST

A generation-skipping trust is a trust that skips one or more generations (grandparent's trust for grandchildren that bypasses the parents). The exception is when there are no parents surviving the grandchildren; then it is treated as a direct trust. A generation-skipping trust is complicated tax-wise. Although easy to create, it should not be created without first consulting a tax advisor because of the inherent tax consequences. $1,000,000 can normally be placed in a generation-skipping trust without incurring an estate or gift tax (provided the uniform credit has not been used previously).

Any amount placed in the trust over $1 million is taxed at a rate of 50% at the time of any distribution. A distribution occurs when the parents of the grandchildren die or the grandchildren receive money from the trust. The purpose of this law is to avoid amassing huge estates by not paying taxes. These trusts only affect very wealthy people. The tax consequences of a generation-skipping trust are so great that one should not consider funding one with more than $600,000 without professional tax advice.

5. CREATION AND OPERATION OF A TRUST

A trust is created very easily. The trust document is drafted, usually by an attorney, and directs how the trust estate will be administered and distributed. The trustee acts in accordance with the terms of the trust. The trustor and trustee must both sign the trust document. If the trustor is also the trustee, he signs the trust agreement twice: as trustor and or trustee.

The final requirement is that the trust be funded. Funding the trust requires that the trustor place into the trust all of the property the trustor wishes to be in the trust. All of the property of the trustor should be placed into the trust. Anything left out of the trust will have to be probated unless it is joint-tenancy property or insurance policies with designated beneficiaries other that the decedent's estate.

Any property that has a title must have the title specifically transferred to the name of the trust. Merely stating in the trust agreement that such property is to be placed into the trust is insufficient to put the property into the trust legally. For example, assume that the trustor owns a home. Since a home has a title document, the title must be changed to name the trust as the owner. A quitclaim deed by the trustor to himself as trustee must be executed and recorded. This is simple to do and usually is done when the trust is created.

Placing a piece of real property into a trust should not trigger a reassessment of property taxes because the transfer is

not really a sale or conveyance of the property. The property is put into a revocable trust, which the owner can terminate at any time and title to the property reverts to the owner. California law specifically states that merely placing real property into a revocable trust for estate-planning purposes does not trigger reassessment as long as the grantor is alive. This is just common sense. Reassessment occurs when there is a change of ownership. Placing the real property into a revocable trust is not really a change in ownership because the trustor still controls it and can have the property returned to him at any time.

Personal property that does not have a title (such as a television or furniture) is transferred automatically by a statement in the trust document showing the intent of the trustor to put into the trust all personal property wherever located. Property that has a title (such as a house or car) must have the title specifically changed to make the trust the owner. Merely stating an intent to place the house or other property that has a title into the trust is insufficient. The only way to put property that has a title into a trust is to actually change the title on the property so that the trust is listed on the title documents as the owner. Property once placed into a trust is treated like any other property that is not in a trust.

To sell any of the property that has no title (such as a radio or stove), one merely sells it. To sell any property that has a title (such as a car), one sells it by transferring title. All

that is needed to sell real property from a trust is a deed executed by the trustee. The trustee merely signs the deed as the representative for the trust and upon recordation the title is passed. For example, the deed from the trustee will read: "John Doe, Trustee of the John Doe Revocable Trust, hereby deeds, conveys, sells, and transfers to John Smith all right, title and interest in the following property."

A revocable trust is considered for tax purposes a grantor trust. The Internal Revenue Code recognizes a grantor trust as a type of trust created for the benefit of the person creating it: all of the income from the trust is attributed to the grantor for tax purposes. Since all of the income is attributed to the grantor for as long as he is alive, the grantor remains liable for the income taxes. A revocable trust does not save the grantor any money on income taxes because it is not designed to do that. A revocable trust exists to avoid probate and save estate taxes, not to save income taxes.

A trust can be made irrevocable. Sometimes it makes good financial sense to do so. For assets in a trust not to be included in a trustor's estate, the trustor must not have control over the trust and must not have reasonable expectation that the trust will revert back to him. If the trust is revocable, the trustor has a great deal of control over the trust. The fair market value of the assets of the trusts will be included in the trustor's estate upon death for estate tax calculations. If the trust is made

irrevocable, and the trustor has no control over the trust, the assets in the trust and all appreciation in value will not be included in the trustor's estate. This could pass a great deal of appreciation to the trustor's heirs without having it taxed. It is because a life insurance trust is irrevocable that the proceeds of the insurance on the decedent are not included in his estate.

A revocable trust does not need to be recorded. Unlike a will it is a private document. The only documents that need recordation are the deeds transferring real property into the trust. In some states a revocable trust is required to be registered and a copy lodged with the probate court. To register, a short statement is filed listing the trustee and giving some basic information. Registration gives the court jurisdiction to oversee the trust. There are no penalties, however, for failure to register. The states requiring registration are Alaska, Colorado (after the death of the grantor, and no registration is required if there is an immediate distribution to the beneficiaries), Hawaii, Idaho, Michigan, New Mexico and North Dakota. Florida and Nebraska do not require registration with the probate court, but both states allow it and suggest it.

6. THE FEDERAL ESTATE TAX RETURN

Federal estate tax return Form 706 is required to be filed whenever the decedent has an estate greater that $600,000. The requirement to file the estate tax return does not depend on any

taxes being due or probate being required. If the estate is greater than $600,000 the tax return has to be filed.

Form 706 tax return has to be filed even if the entire estate is going to the surviving spouse under a trust and is entirely exempt from estate tax as an unlimited marital credit. Likewise, a Form 706 tax return has to be filed even if the entire estate is given to charities exempt from tax under the Internal Revenue Code.

7. TERMINATION OF THE TRUST

A trust must terminate within twenty-one years after the death of the last person who was alive and mentioned in the trust when it was created. This is known as the Law of Perpetuities. "Terminate" infers all of the assets of the trust are totally distributed. If it appears from reading the trust document that the trust would continue more than 21 years after the death of the person alive that is mentioned, the trust is invalid. Clauses are usually inserted in the trust document to guarantee that the trust will not violate the Law of Perpetuities.

Except for the Law of Perpetuities, a trust terminates whenever the terms of the trust agreement state it will terminate. Usually it terminates on the death of the surviving spouse or the death of the trustor's last child.

8. GRANTOR'S REVOCATION OF THE TRUST

If a trust is revocable, all that is needed for an effective revocation is for the trustor to notify the trustee in writing that

the trust is terminated on a certain date and to demand the trust assets be returned to the trustor. When the trustor is the trustee, he simply affixes a letter to the trust document revoking the trust and executes new deeds from the trust back to the trustor as an individual.

Revocation is simple and quick. That is one of the prime advantages of the trust over any other form of estate plan. Control over the assets of the trust is never lost. Until the trustor dies he retains the ability to immediately revoke and terminate the trust merely by stating that the trust is revoked.

9. A CHARITABLE REMAINDER TRUST

A charitable remainder trust is an inter vivos (living) trust: a trust made during the lifetime of the trustor. Property is placed into an irrevocable trust with a charity as beneficiary. The trustee, who is usually the charity, is instructed to pay a fixed percentage of the trust assets to the trustor for the life of the trustor. The trustor is given a federal tax deduction for the value of the gift to the charity. The trustor pays ordinary income tax on the payments received from the trust.

The gift to the charity is tax free. The charity is tax exempt and can sell the appreciated property without having to pay capital gains. The charity can reinvest the proceeds of the sale and pay the trustor from the interest on the investment. Because the charity can invest the whole amount without paying capital

gains, it can generate more interest income from the sale than the person who transferred it to the trust. For this reason it is better to place highly appreciated property that is not earning a great deal of income, such as idle land, into the trust. The return that the trustor gets from the trust is higher than if the assets are sold and reinvested by the trustor because capital gains taxes on the trustor's sale of the highly appreciated property will take much of his profit.

A living person can make a gift to a qualified charity and receive a federal income tax deduction for the gift. The maximum deduction is 50% of the taxpayer's adjusted income for the year with the balance of the gift being carried over for the next five years. Where the gift is appreciated property the amount of the deductible is 30% rather than 50% unless special elections are made. Because of the complexity of the tax law in this area, any large gifts to a charity should only be made after consulting a tax professional.

Charitable gifts made through a will or trust are allowed full deductions of fair market value from the decedent's estate for federal estate-tax purposes. These estate charitable deductions reduce the taxable value of the estate, reducing the estate tax. Example: A decedent has an estate worth $1,000,000 and gives $400,000 to a charity. The decedent's estate deducts that $400,000 gift leaving an estate of $600,000. The $600,000 equals the decedent's unified credit: there is no federal estate tax owed.

Charitable remainder trusts can be excellent vehicles for estate planning for well-to-do people. Life insurance policies can be bought with the trust payments, thereby replacing the value of the property transferred to the charitable trust.

10. ATTACHMENT OF TRUST ASSETS FOR TRUSTOR'S AND BENEFICIARY'S DEBTS

All states allow creditors to attach any revocable trust created by a trustor. This allows the creditor to get paid for any debts or other obligations owed by the trustor. The rationale for allowing the attachment is that the trustor has effective ownership of the trust assets by the fact that he can revoke the trust and receive the property in his own name. A court has the power to order the trustor to terminate the trust, receive the assets and pay the creditors.

Most trusts have clauses in them that state that the interest of the trust beneficiaries cannot be attached to pay the debts or obligations of any beneficiary. This provision is called a spendthrift clause. Courts will enforce spendthrift provisions and deny any attachments, except in a revocable trust where the trustor is also the beneficiary. Moreover, if there is no spendthrift clause, the trust can be attached to pay a beneficiary's debts. In addition, most states permit a beneficiary's share of a trust to be attached to pay spousal or child support obligations even if there is a spendthrift clause in the trust. In like manner California has

recently passed legislation stating that a spendthrift clause will not shield a trust from attachment for payment of a tort judgment against a beneficiary.

11. THE EFFECT OF A TRUST ON DOWER AND CURTESY LAWS

If the provisions of a trust are in conflict with a state's law regarding how much of a decedent's estate goes to the surviving spouse, the surviving spouse can elect to take a share of the trust or to receive a statutory share of the estate. If the spouse elects to take the statutory share, the trust must pay as necessary to comply before distributing the remainder.

To avoid this conflict and confusion in states with statutory provisions to provide for a surviving spouse, the spouse can disclaim his statutory rights and agree to take only the disposition given by the trust document. Moreover, if the trust does not give the surviving spouse at least his statutory share, the spouse should consult with an attorney for advice on the legal consequences before accepting any offer.

12. INCOME TAX TREATMENT OF A REVOCABLE TRUST

As long as the grantor of the revocable trust is the trustee and treated as the owner of the trust, no tax return for the trust should be filed. The income and deductions for the trust should be listed on the grantor's personal tax return.

A Form 1041 should be filed by the trust when the grantor is not the owner (the trustee). This return should then list to whom

any distributions of income were made and pay the trust income tax on any income not distributed.

13. JUDICIAL REVIEW OF A TRUST'S ADMINISTRATION

A common fear that many people have is that the trust will be mismanaged, and no one will be able to stop it. All states permit concerned persons to petition the court for review of the administration of a trust. A trustee is a fiduciary and owes both the trust and the beneficiaries a fiduciary duty to act reasonably and responsibly. If the court finds that a trustee has breached his duty of care, it will remove the trustee and surcharge him (find the trustee liable) for all of the damages caused by the trustee's misconduct.

Even if the trust document states otherwise, probate courts always have the power to review the actions of a trustee. The court will never permit a trustee to misuse the faith and power of his position and hide behind the trust document to avoid judicial scrutiny. Anyone, not just the beneficiaries, can take their suspicions of abuse to the court, and the court will investigate. In Bakersfield, California, an attorney conspired with a trustee to raid an elderly woman's trust. Concerned neighbors expressed their concern to the court, which ordered an investigation. Ultimately the attorney was sentenced to seven years in prison. The defense that everything was done in accordance with the terms of the trust was not persuasive.

14. TRUSTEE

The original trustee of a revocable trust is usually the grantor. Since the grantor of a revocable trust has unlimited power to alter or revoke the trust, the grantor can do anything he wants with the trust. When the grantor dies or resigns as trustee, a successor trustee takes over. Most trusts contain certain clauses which state who the successor trustee will be and give the grantor power to replace the stated successor or to appoint a successor trustee if none is stated. When there is no successor trustee, the probate court having jurisdiction over the trust will appoint the successor trustee. No trust will ever fail just because there is no trustee.

A trustee can always resign and be replaced just as though he died. Most trust agreements contain a list of proposed successor trustees to replace dying or resigning trustees. If the trust does not provide for a successor trustee and the trustor is dead or did not retain the right to amend or revoke the trust, the probate court will appoint a trustee. Before a trustee can resign, the trustee, unless the trustor is the trustee, will be required to provide a full accounting of the trust business during the time he managed it. All of the beneficiaries together may waive the accounting.

Normally, the trustor waives any bond for any trustee or successor trustee named in the trust document. Such a bond would

be paid by the trust, diminishing the trust estate. If the trustor did not have faith in the named trustees, he should not have named them. The court will require a bond of a court appointed trustee unless all the beneficiaries agree to waive it.

Most trusts require the trustee to make annual accountings of the trust assets unless the grantor is the trustee or all the beneficiaries waive them. In addition, any concerned person who feels that the trust is being mismanaged can seek a court order directing the trustee to perform an accounting. The court can order an accounting even if the trust agreement waives them. A major concern that many people have is that the trustee may mismanage the trust assets and the beneficiaries will be helpless. Such is never the case. The probate court always has the jurisdiction to oversee every trust, whether or not such jurisdiction is spelled out in the trust document. No court will ever let a trustee intentionally mismanage or steal trust assets. Anyone, not just beneficiaries, can raise their concerns to the court, which will order a hearing to investigate the matter.

Most trusts have language that a successor trustee takes over when the trustee becomes unable to perform the duties. This may cause problems when the trustee is the trustor and does not believe he is incompetent. Many agreements permit a trustee to be replaced when two competent doctors determine the trustee to be incompetent. Likewise, if a court adjudges a person incompetent, the successor trustee immediately assumes the responsibility.

Following hereafter is an estate planning questionnaire for completion by a client. Such a form protects an attorney by disclosing all of the client's assets so that a proper estate plan can be structured. Likewise, if a client fails to list assets, the attorney cannot be held liable for malpractice as to any probate fees or costs related to those items.

ESTATE PLANNING QUESTIONNAIRE

A. BACKGROUND INFORMATION

1. Name (include all other names once used, i.e., maiden)

   ____

2. Address and phone number (home and business)

   ____

   ____

3. Employer's name, address and phone number:

   ____

   ____

4. Spouse's employer's name, address and phone number:

   ____

   ____

5. Occupation:____

6. Spouse's occupation:_________________________________

7. Social security number:______________________________

8. Spouse's social security number:_____________________

9. Former military service (branch and dates of service):

   ____

   ____

   ____

10. Date and place of birth:_____________________________

11. Name of spouse:______________________________________

12. Date and place of spouse's birth: ___________________

    ____

13. Date and place of marriage: ______________________________

____

14. Length of residency in the state:________________________

____

15. Previous marriages for each spouse:_____________________

____

____

____

16. Children:____

____

____

17. Children of spouse (stepchildren):_____________________

____

____

18. Deceased children: ____

____

19. Grandchildren:____

____

____

20. Grandchildren of spouse: __________________________________

____

21. Parents and address: ______________________________________

____

____

____

22. Parents of spouse and address: ______________________

____

____

____

23. Last Will:

a. Date executed:________________________________

b . Location of original: __________________________

____

c. Attorney who prepared Will, address, phone: ____

____

____

B. PROPERTY

1. Real property (for each piece of real property state):

a. (1) Type of property: ____________________________

____

(2) Location of property: ___________________________

____

(3) Holder and amount of liens on the property:_____

____

(4) Fair market value of the property not deducting for the liens: ____________________________________

(5) Date of purchase and original amount: _________

____

(6) How is title to the property taken? (What does it say on the deed? separate property, joint tenancy,

tenancy in the entirety, tenancy in common):

____

b. (1) Type of property: ____________________________

(2) Location of property: ________________________

____

(3) Holder and amount of liens on the property:

____

(4) Fair market value of the property not deducting for the liens: ______________________________

____

(5) Date of purchase and original amount: ________

____

(6) How is title to the property taken? (What does it say on the deed? separate property, joint tenancy, tenancy by the entirety, tenancy in common):

____

____

c. (1) Type of property: ____________________________

(2) Location of property: ________________________

____

(3) Holder and amount of liens on the property: ____

____

(4) Fair market value of the property not deducting for the liens: ______________________________

(5) Date of purchase and original amount: __________

____

(6) How is title to the property taken? (What does it say on the deed? separate property, joint tenancy, tenancy by the entirety, tenancy in common): ____

2. Bank Accounts (including savings and loans and credit unions):

a. Name, address, account number: ____________________
____
____

b. Name, address, account number: ____________________
____
____

c. Name, address, account number: ____________________
____
____

3. Stocks and bonds:

a. Type and company ______________________________
issuing:______________________________________
____

b. Amount: ______________________________________

c. Date and manner of acquisition (purchase, gift, or inheritance):__________________________________

d. Fair market value: ____________________________

e. Basis (purchase price or basis on date of gift or

inheritance):______________________________

4. Insurance:

a. Type: ______________________________

b. Group, term or whole life: ______________________________

c. Company and policy number: ______________________________

____

d. Amount: ______________________________

e. Beneficiaries: ______________________________

____

5. Safe deposit boxes:

a. Location: ______________________________

____

____

b. Box number: ______________________________

____

c. Contents: ______________________________

____

____

6. Tangible personal property (list all property worth over $100.00, such as jewelry, tools, cars, boats, etc.):

____

____

____

____

____

____

____

7. Intangible personal property (list all intangible property, such as money owed, royalties, copyrights and other interests not previously listed):

a. Loans:

(1) (a) Name and address of debtor: ____________

____

(b) Amount of loan outstanding: ________________

(c) Security for loan (deed of trust, mortgage, collateral):________________________________

____

(2)(a) Name and address of debtor:_________________

____

(b) Amount of loan outstanding: _______________

(c) Security for loan (deed of trust, mortgage, collateral): _______________________________

____

(3)(a) Name and address of debtor:_________________

____

(b) Amount of loan outstanding: ________________

(c) Security for loan (deed of trust, mortgage, collateral): _______________________________

____

____

b. Other interests:

(1) Type of interest: ______________________________

(2) Date and manner of acquisition (gift, purchase or inheritance): ______________________________

(3) Basis (purchase price or value of basis at time of gift or inheritance): ____________________

8. Pensions, IRA's, SEP's, death and retirement benefits (list location, account number and amount of each plan or account): ____

____

____

____

____

____

____

9. Expectancies (list any property that is expected to be received in the future along with the source, for instance:inheritances, property settlements or insurance proceeds): ____

____

____

____

10. Debts and liabilities (list all debts and liabilities along with whether the obligation is secured):

a. Secured debts:

(1) (a) Creditor and address: ____________________

____

(b) Account number and outstanding balance:

____

(c) Nature of collateral: __________________________

____

(2) (a) Creditor and address: ____________________

____

(b) Account number and outstanding balance:

____

(c) Nature of collateral: __________________________

____

(3) (a) Creditor and address: ____________________

____

(b) Account number and outstanding balance:

____

(c) Nature of collateral:___________________________

____

b. Judgment creditor:

(1) Case number and amount of lien: _______________

____

(2) Property which lien attaches: _________________

____

c. Unsecured debts:

(1) Debts owed under contractual or leasehold agreements: ________________________________

____

____

(2) Pending lawsuits: ____________________________

____

(3) Unsecured loans: _____________________________

____

(4) Damages caused to others: ____________________

____

(5) Other liabilities: ___________________________

____

C. ESTATE PLAN

1. Guardian for children:

a. Name of children: ________________________________

____

b. Name of guardian: ________________________________

c. Address of guardian ______________________________

____

d. Guardian of person____ estate____ or both____

e. Bond waived____ bond required____

f. Name of alternate guardian: ____________________

g. Address of alternate guardian: _________________

____

h. Guardian of person____ estate____ or both____

I. Bond waived____ bond required____

2. Executor:

a. Name:____

Address:____

b. First alternate: ______________________________

Address:____

c. Second alternate: ______________________________

Address:____

3. Establishment of a trust:

a. General intended distribution __________________

____

____

____

____

b. Property included in the trust: ________________

____

____

c. Beneficiaries of the trust: ____________________

____

____

d. Name and address of trustee: ___________________

____

____

D. SPECIAL INSTRUCTIONS

1. Persons to be excluded and disinherited from the Will

and/or trust:

a. Name: ______________________________

Address: ______________________________

____

b. Name: ______________________________

Address: ______________________________

____

2. Payment of all taxes to come from residual of estate (after specific bequest made? (This is normal) Yes______ No____

3. Specific instructions (funeral wishes, anatomical gifts, etc.):

____

____

____

____

E. PROPOSED DISPOSITION

1. Specific gifts of personal property:

a. Description:______________________________

To: ______________________________

b. Description:______________________________

To: ______________________________

c. Description:______________________________

To: ______________________________

d. Description:______________________________

To: ____________________

2. Specific gifts of real property:

a. Description: ____________________

To: ____________________

b. Description: ____________________

To: ____________________

c. Description: ____________________

To: ____________________

d. Description: ____________________

To: ____________________

3. Charitable gifts:

a. Description: ____________________

To: ____________________

b. Description: ____________________

To: ____________________

4. Remainder of estate:

a. Single heir:

Name: ____________________

Address: ____________________

b. Multiple heirs:

Name: ____________________

Address: ____________________

Name: ____________________

Address: ____________________

F. OTHER CONSIDERATIONS

1. Are your intended heirs deeply in debt? ______________

   ____

2. Are the financial affairs of your heirs so bad that they may file for bankruptcy protection? ______________

3. Has a spendthrift trust for the heirs been considered?

   ____

G. BANKRUPTCY

1. Date and court where filed: ___________________________

   ____

2. Type of bankruptcy: Chapter 7____ Chapter 13____

3. If a Chapter 13, has the plan been completed? If not, what remains to complete the plan? ___________________

   ____

   ____

4. If a Chapter 7, are there any debts being redeemed, ratified or affirmed in the bankruptcy action? ______

   ____

   ____

5. If married, has your spouse filed a bankruptcy petition?

   ____

H. DURABLE POWER OF ATTORNEY (DPA)

1. Health care

   a. Do you want a DPA? _______________________________

   b. How long do you want it to last? ________________

   c. Who would be your attorney in fact? _____________

____

d. Who would be your alternate attorney in fact?

____

e. What special medical care do you want if you are unable to make your wishes known? ______________

____

____

f. Are there some types of medical decisions that you do not want to give the attorney in fact authority to make on your behalf ________________________

____

____

g. Do you want your agent to be able to order an autopsy or make organ donations? ________________

h. Do you want your agent to be able to make the decision to place you in a retirement or nursing home? ____

2. Business affairs

a. Do you want a DPA? ______________________________

b. How long do you want it to last? ________________

c. Who would be your attorney in fact? _____________

____

d. Who would be your alternate attorney in fact?

____

____

e. How do you want your business affairs handled if you are unable to make your wishes known?
____
____
____

f. Are there any special business affairs that you do not want the attorney in fact to handle or become involved in any manner? ________________________
____
____

g. Are there certain acts that you do not wish to give the attorney in fact the authority to do on your behalf ____
____
____
____

I. LIVING WILL DECLARATION

1. Do you want a living will declaration? _____________

2. Do you want extraordinary means to keep you alive if you are unable to make your wishes known? _______________
____

3. Would you consent to the withholding of food and water if you were "brain dead" or in an unrecoverable coma?
____

4. What types of medical treatment would you want and accept

if unable to make a decision for yourself? __________

____

5. Who would you want to make decisions for you if you cannot make them for yourself? _______________________

____

CHAPTER FOUR

BANKRUPTCY MALPRACTICE

A. INTRODUCTION

Bankruptcy is an area of law for which the unwary attorney can fall into the pit of malpractice. Most attorneys did not take coursework in bankruptcy while in law school. In fact, most attorneys will never handle a bankruptcy case. Many attorneys will occasionally come upon a bankruptcy issue while representing a client in another matter. In that situation, the advice given to the client will be held to the same standard as that given by a bankruptcy attorney even though the original reason for the representation was not bankruptcy related.

Whether an attorney intends to regularly practice in the bankruptcy or not, every attorney should have a basic understanding of the elements present in the average bankruptcy action. Often, the advice which an attorney gives to a client will have a financial effect of the client's estate should the person file for bankruptcy relief. As such, if the client, in fact, subsequently files for bankruptcy relief, the advice previously given by the attorney may severely affect the rights of the debtor in the bankruptcy estate. Attorneys who give advice related to bankruptcy will be held to the standard of a bankruptcy practitioner. This means that a non-bankruptcy attorney may be held for malpractice for giving what can be considered bankruptcy advice. For this

reason, attorney should understand the basics of bankruptcy so that, even they will realize when their advice intrudes into the area of bankruptcy law and understand the potential effects of their advice. In such instances, the attorney would understand that he or she must either refer the matter to a bankruptcy attorney or engage in addition training or research so as to be on the par with a bankruptcy attorneys in rendering advice on the matter.

When a client comes to an attorney seeking bankruptcy protection, the attorney must first be satisfied that the bankruptcy will accomplish the desired results of discharging the client's debts while keeping exempt property. The two most common types of bankruptcies are those under Chapter Seven and Chapter Thirteen. This chapter is designed to provide a general overview of these types of bankruptcy proceedings for non bankruptcy attorneys.

1. CHAPTER SEVEN

A Chapter 7 is commonly referred to as a liquidation which is a misnomer. To be more precise, a Chapter 7 proceeding is, at best, a partial liquidation of the debtor's estate. In a Chapter 7 proceeding, the debtor's estate will be sold (liquidated) to the extent of its nonexempt property and the proceeds used to pay the debtor's creditors. To the extent that the debtor's creditors remain unpaid their non-dischargeable debts are thereafter discharged and forgiven which means that the debtor will not have to pay them. There are certain that Congress, as a matter of public

policy, have made non-dischargeable in bankruptcy. There are other debts that are non-dischargeable only in the event that the creditor objects. It is very important for a person considering filing for bankruptcy protection to know what debts are dischargeable and which debts are non-dischargeable. IN THE SITUATION WHERE MOST OF A DEBTOR'S DEBTS ARE NON-DISCHARGEABLE, FILING A CHAPTER 7 PETITION MAY BE OF LITTLE ASSISTANCE. This chapter identifies and explains which debts are non-dischargeable under the bankruptcy code.

A married couple may file a joint bankruptcy petition and in fact in the vast majority of cases a joint filing by married couples provide the following advantages:

1. In many states, there the spouses are permitted to double (claim twice the state's permitted exemption amount) the exemption for specified exemptions;
2. The cost is less than separate filings, and
3. It is usually quicker to have a joint petition decided rather than two separate petitions.

However, there can be situations where filing jointly may not always be best in all situations. The following are some situations when a joint petition may not be advisable:

1. The couple own property in tenancy in the entirety. Such title will be reflected in the deed of title document in the form Jane Doe and John Doe, husband and wife as tenants in the entirety. In about twenty states, property

held as tenants in the entirety will not be included in the estate of a spouse filing separately if the other spouse is not liable for the debt. This can be extremely important if the couple has such property. A consultation on this issue may cost up to $250 but it could save tens of thousands of dollars in exempt property. Even with the consultation fee, it would still be cheaper for a person to their own bankruptcy petition.

2. The couple have ERISA qualified pensions. The United Supreme Court has in recent years made several rulings that seriously affect the exemption for ERISA pensions. Today, ERISA pensions are not part of a bankruptcy estate and therefore will not be lost in a bankruptcy. Non-ERISA pensions, however, are included in the bankruptcy estate and may be lost if not specifically exempt. In some circumstances it might be beneficial for a couple to move to another state so as to utilize the federal pension exemption and the federal homestead exemption.

2. CHAPTER THIRTEEN

A Chapter 13 petition is a reorganization of debts for individuals. The debtor creates a plan which must be approved by the court wherein some of the debts are discharged, in whole or part, and the remaining debts are paid over a period of time usually three to five years. A Chapter 13 proceeding is commonly referred to as a reorganization which is a correct adjective. A

bankruptcy petition filed under chapter 13 of the Bankruptcy Code permits the debtor to establish a payment schedule over a period of time between 3 to 5 years for the payment of unsecured debts. Those unsecured debts that are completely paid off during the term of the plan will have their balances discharged. In comparison, a bankruptcy proceeding filed under Chapter 7 is a liquidation of the debtor's estate with the proceeds being distributed among the debtor's creditors.

What has to be borne in mind, when considering the filing of Chapter 13 petition, is that a chapter 13 petition can only be filed by a debtor with less than $250,000 in unsecured debts and less than $750,000 in secured debts. These restrictions severely limit the number of people who can seek Chapter 13 protection. Debtors, such as those engaged in business, whose debts are greater than those above the stated limits would have to file a full blown Chapter 11 petition if they wanted to reorganize and that of course is generally prohibitive because of its great cost.

In a Chapter 13 proceeding, the debtor's estate is not sold or liquidated. The debtor keeps all of assets of the estate. The debtor is required to pay the unsecured creditors, under the chapter 13 payment plan, a minimum amount, at least, equal to that which would have received had the debtor filed a Chapter 7 bankruptcy petition. To the extent that the debtor's unsecured creditors remain unpaid their dischargeable debts are thereafter discharged and forgiven which means that the debtor will not have

to pay them.

Not all debts are dischargeable in a bankruptcy proceeding regardless of whether a Chapter 7 or Chapter 13 petition is filed. As such, it is important for a debtor to know what type of debts can not be discharged. It is possible that a bankruptcy filing might not help a debtor because the majority of the debtor's debts may not be dischargeable. There are certain debts that Congress, as a matter of public policy, have made non-dischargeable in bankruptcy. There are other debts that are non-dischargeable only in the event that the creditor objects. It is very important for a person considering filing for bankruptcy protection to know what debts are dischargeable and which debts are non-dischargeable. IN THE SITUATION WHERE MOST OF A DEBTOR'S DEBTS ARE NON-DISCHARGEABLE, FILING A CHAPTER 13 PETITION MAY BE OF LITTLE ASSISTANCE.

B. NON-DISCHARGEABLE DEBTS

Congress, as matter of public policy, made ten categories of debts non-dischargeable. Of the ten categories, seven of them represent debts that cannot be discharged unless they fall into narrow exceptions. The remaining three categories of debts are dischargeable unless the creditor timely files objections to their discharge.

1. DEBTS NOT DISCHARGEABLE UNLESS A EXCEPTION EXISTS

a. TAXES

Under section 523(a)(1), a debt is not discharged if it is:

(1) for a tax or customs duty-

(A) of the kind and for the periods specified in section 507(a)(2) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required-

(I) was not filed; or

(ii) was filed after the date on which such return was last due under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

I. INCOME TAXES

Generally, income taxes can be discharged provided the following conditions are met:

1. The taxes are over three years old;
2. The assessment for the taxes was made over eight months prior to filing of the bankruptcy petition;
3. The tax return was timely filed, (for taxes relating to a late return, the tax debt is not excepted unless the required return was due, after any extensions, within two years of the filing); and
4. The debtor did not file a fraudulent return or attempt to willfully avoid paying the taxes.

Under the bankruptcy code, tax assessments made against a debtor within eight months of filing a bankruptcy petition are non-dischargeable even if the taxes are over three years old. In such an event, the debtor must wait more than eight months after any tax

assessment to be able to discharge those back taxes even if the other requirements for a valid discharge are met.

When all of the above conditions are met, the back taxes may be discharged. Penalties assessed for late filing or nonpayment are dischargeable if the taxes to which they relate are dischargeable. If the taxes are not dischargeable neither are the penalties.

ii. PROPERTY TAXES

Property taxes that are less than one year old are not-dischargeable. However, from a practical sense, it makes no difference. Property taxes are almost always assessed against the property and not the owner. The taxing agency usually imposes a statutory tax lien against the property to secure payment of the lien. (See CHAPTER LIEN AVOIDANCE). Therefore, in truth of fact property taxes are not dischargeable because they must be paid if the debtor wishes to keep the property for which they are attached.

b. UNLISTED DEBTS

A creditor's debt will not be discharged, pursuant to section 523(a)(3), unless the creditor either was duly listed as a creditor with the court or had actual notice of the bankruptcy filing. It is the clerk of the bankruptcy court which sends the notice of the bankruptcy filing to the creditors. If a creditor is not properly listed then that creditor will not receive notice of the bankruptcy action and be unable to protect its interest.

The purpose of this exception to a discharge is obvious. There is an affirmative duty on the part of the debtor to notify the

creditors of the bankruptcy. The bankruptcy system will not function as intended if debtors are permitted to exclude creditors and not give to them an opportunity to participate in the proceeding. In addition, the discharge of any unnoticed creditor would probably be unconstitutional as a violation of due process.

If the creditor never had knowledge of the debtor's bankruptcy, then the creditor's debt is not discharged. The debtor then remains liable for repayment of the debt even though the other debts of the debtor have been discharged. In the case of an omitted creditor, the debtor may petition the court the bankruptcy case in order to list the creditor. Reopening the case is rare but it can occur. Absent reopening the case, the debtor remains liable for repayment the debts of any creditor who was omitted on the petition and had no knowledge of the action.

c. SPOUSAL AND CHILD SUPPORT

Under section 523(a)(5), courts ordered payments for the support of a child or former spouse are non-dischargeable. However there are variations on this theme for which a debtor must be aware. WHERE BACK CHILD SUPPORT IS AT ISSUE THE DEBTOR SHOULD CONSULT AN ATTORNEY BECAUSE IT MIGHT BE A CRIMINAL ACT, QUITE APART FROM THE BANKRUPTCY LAW, NOT TO HAVE PAID IT.

Once a court orders a parent to make child support payments, the obligation to make those payments then become non-dischargeable. **In Re Harrell** (1983) 33 B.R. 989. The obligation

to make child support payments, ordered by a court, is not discharged even if it is assigned to a state or governmental agency. In other words, if a county or state agency provides benefits to a family because of the debtor's failure to make court ordered support payments, the state or other governmental agency is assigned the right to receive reimbursement. That right to receive reimbursement for the support payments made by the state for the support of debtor's child cannot be discharged (as it once was) by the debtor's subsequent bankruptcy.

The general rule is that claims of third parties for property or services provided for a child's support are dischargeable by a parent, **In re Lo Grasso** 23 F.Supp. 340. There is, however, case law which holds that where a parent deserts or neglect the children, then the debts for the property or services which have been provided by third parties are not dischargeable, **In re Meyers** 12 F.2d 938.

In order for the debt for child support to be non-dischargeable, there must be a court order requiring the support payments to be made. All states have laws that impose upon a parent the duty to support a child. In addition, the parent can be sued for the value of the child support provided by third parties. However, those debts are dischargeable unless reduced to a judgment prior to the debtor-parent filing for bankruptcy protection. For example, if a mother deserted her children and the

father raised them, then the father would be entitled for reimbursement from the mother for her share of the child support. If the mother files for bankruptcy relief before the father gets a judgment for reimbursement, then the obligation to reimburse the father for the back child support is discharged. However if the father obtained a court order requiring the mother to reimburse the father for the back support, then the debt for back support is not dischargeable.

Spousal support, which is also referred to as alimony, requires either a court order or an agreement obligating the debtor to make support payments to the spouse in order for the obligation to make the payments not be dischargeable. The debtor may agree to make spousal support payments through a marital agreement or a property settlement agreement and such support payments are non-dischargeable. Without either a court judgment ordering a debtor to make spousal support payments or an agreeing requiring them to be made, the debtor's obligation to make support payments can be terminated in a bankruptcy.

Where parties are not married, unless the relationship qualifies as a common law marriage, the debtor may be discharged from any obligation to make support payments to the other party through a bankruptcy proceeding.

THE BANKRUPTCY ACT OF 1994 AMENDED THE AUTOMATIC STAY UNDER SECTION 362 TO PROVIDE THAT COLLECTION OF SPOUSAL OR CHILD SUPPORT

PAYMENTS FROM PROPERTY WHICH IS NOT PROPERTY OF THE ESTATE IS NOT SUBJECT TO THE AUTOMATIC STAY. The 1994 Act also prohibited the Automatic Stay from blocking commencement or continuation of proceedings to enforce alimony and child support during the bankruptcy case. In a Chapter 13 case, property acquired during the life of the Chapter 13 Plan is considered property of the estate. Under the Bankruptcy Act of 1994, child and spousal support claims now have priority over and are to be paid before general unsecured claims and also tax claims. In addition, the Bankruptcy Act of 1994 prohibits both the Trustee and the debtor from the recovery of any property transferred to spouse or a child in connection with a divorce or separation made within one year of the filing of the bankruptcy petition. Before this amendment, The Trustee and the debtor were each permitted to avoid such payments made within a year of the bankruptcy filing as a creditor preference or a payment not supported by reasonable equivalent consideration. Section 522 of the Bankruptcy Code was amended, under the 1994 Bankruptcy Act, to prohibit a debtor from being able to avoid a judgment lien on otherwise exempt property for child or support payments. Regardless if the debts are collected or incurred during the bankruptcy, the obligation survives the bankruptcy and the debtor must still pay it in full.

d. FINES, PENALTIES AND FORFEITURES

Section 523(a)(7) exempts from a discharge those debts

incurred as fines or penalties deriving from the debtor's violation of the law. This exception from discharge is firmly based on the belief that approving the discharge of the above would be an implicit approval of criminal or civil misbehavior. Therefore, all governmental sanctions, whether by a court or agency, for a violation of any rule, statute or law are not dischargeable.

The only penalty not completely excepted from discharge under this chapter are tax penalties if the tax itself can be discharged under section 523(a)(1) as discussed above. Some additional tax penalties can be discharged even if the tax is not dischargeable where the transaction giving rise to the tax occurred three or more years prior to the filing of the bankruptcy petition.

e. STUDENT LOANS

Under section 523(a)(8) student loans made or guaranteed by a governmental agency (which are just about all of them) are not dischargeable unless:

1. the payments on the loan became due more than seven years before the debtor filed for bankruptcy relief; or
2. nor discharging the student loan debt would impose an undue hardship on the debtor.

If the bankruptcy petition is filed more than seven years after the student loan matured (became payable), there is no requirement for the debtor to prove undue hardship in order to have the student loan debt discharged. The seven year period is intended to keep students from discharging the loans prior to starting their

careers.

Most courts will allow the debtor to discharge the entire student when the loan became due more than seven years earlier. Some courts will only discharge those delinquent payments over seven years old, see the California case **In Re Steiner** 55 B.R. 1 (1983). If a debtor is considering discharging student loans over seven years old, the debtor should consult a bankruptcy attorney for determining how they are handled in that state. If the bankruptcy court of that state will only discharge the payments over seven years old, it might be advantageous for the debtor to move to another state whose bankruptcy court would discharge the entire amount.

In order to get a discharge for student loans less than seven years old, the debtor must convince the court that the debtor will suffer undue hardship from being required to make the payments on the student loan, **In re Rice** 4 C.B.C.2d 134 (1981). The second Circuit Court of Appeal in the case, **Brunner vs. New York State Higher Educational Service Corp.** (1987) 831 F.2d 385 stated that to prove undue hardship from being required to make student loan payments, the debtor had to show the following:

1. that the debtor cannot maintain, based on current income and expenses, a minimal standard of living for herself and her dependents if forced to repay the loans;

2. that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment of the student loan; and

3. that the debtor has made a good faith effort to repay the student loans.

When the court is granting a discharge for undue hardship, the court may instead of a compete discharge only grant a partial discharge of the student loans. It is rare that a court will grant a complete discharge based on undue hardship.

A special type of student loan is the Health Education Assistance Loan for use by those obtaining a medical education. This type of student loan was held not to be dischargeable unless the debtor could show a greater burden that just an undue hardship in being forced to repay the loan, **In re Hines** 15 C.B.C.2d 959 and **Columbus College vs. Shore** (1983) 707 F2d. 1337. For all intents and purposes, such loans should be considered and treated by a debtor as non-dischargeable except in the most extreme cases.

f. DEBTS INCURRED FROM DRIVING WHILE INTOXICATED

Debts incurred as a result of an episode of intoxicated driving are not dischargeable under section 523(a)(9). Basically. this means that if a debtor was driving while intoxicated and caused an accident, the debtor could no longer avoid the liability of paying for the damages caused by the escapade by filing a bankruptcy petition. Prior to the enactment of this section, such debts arising from damages caused from intoxicated driving were dischargeable unless the debtor had been driving in such a reckless manner so as to make the conduct almost willful and thus non-dischargeable under section 523(a)(6) discussed below.

Now, the damages caused by a person's intoxicated driving will not be discharged if the following requirements are met:

1. the debt arose from a court decree or judgment against the debtor for damages from the debtor's intoxicated driving;
2. the court found the debtor to be legally intoxicated; and
3. the court rendering the judgment was the court for the state where the damage caused by the debtor's intoxicated driving occurred.

These requirements must be meet in order for an intoxicated driving debt not to be discharged. In other words, a court for the state where the accident or damages occurred must find the debtor legally drunk or under the influence of drugs and then order the debtor to pay compensatory damages to the injured parties (fines payable to a state as punishment are already non-dischargeable under paragraph 4 above).

Intoxication means that at the time of the incident, the debtor was operating the vehicle while under the influence of either alcohol or drugs to such an extent as to be unable to operate it safely. In addition, many states have enacted laws that specifically make it a crime for a person to operate a vehicle with a blood alcohol level above a certain level. In California, for instance, the legal level above which no person can operate a vehicle is a blood alcohol level of .08%. A person involved in an accident while having a blood alcohol level over the legal level is guilty of driving while intoxicated and the damages resulting

therefrom are not dischargeable.

Generally, if a debtor files for bankruptcy relief prior to a state court issuing its judgment, the debtor's debts are discharged. However, some courts will not discharge drunk driving debts if a judgment is obtained after the filing of the petition, **In re Thomas** (1985) 51 B.R. 187. The Ninth Circuit Court of Appeal in the case, **In re Hudson** 859 F.2d 1418 denied a debtor's discharge for a drunk driving debt stating:

> "Since enactment of Section 523(a)(9) bankruptcy courts have consistently held and litigants relying on those opinions have assumed that language include claims against drunk driver bankrupts reduced to judgment after commencement of the case. We are not inclined to disturb the consistent body of law which Congress apparently acquiesces."

A person with drunk driving debts that have not been reduced to a judgment should consult a bankruptcy attorney. It might be possible to avoid payment of the intoxicated debts by filing for bankruptcy relief prior to a state court judgment being rendered. This might mean having to move to a state whose federal bankruptcy disagrees with and is not governed by the above Ninth Circuit Court's case.

g. PREVIOUSLY UNDISCHARGED DEBTS

Under section 523(a)(10), if a debtor had an earlier bankruptcy petition dismissed in its entirety because of substantial misconduct or fraud by the debtor, then none of the debts that could have been listed in that earlier dismissed case can be discharged in a subsequent bankruptcy case. In the same vein, if the debtor waived a discharge in an earlier case, then as

to that debt the debtor cannot seek a discharge in a subsequent case.

The exception to discharge under this section does not apply to technical dismissal of the earlier case. For example, dismissals based upon a failure to pay a filing fee or a dismissal based upon the fact that a previous discharge had been obtained with six years.

2. DEBTS THAT WILL BE DISCHARGED UNLESS A CREDITOR OBJECTS

There are three other types of debts that may, under certain circumstances be non-dischargeable under Section 523 of the bankruptcy code. These debts are :

1. Under Section 523(a)(2), those debts deriving from fraudulent acts by the debtor:
2. Under Section 523(a)(6) those debts deriving from the debtor's willful or malicious which injures another person or causes damage to another's property;
3. Under Section 523(a)(4) those debts deriving from a debtor's breach of a fiduciary relationship, embezzlement or larceny.

Under 523(c)(1), the above debts will be discharged unless the a creditor times files an objection with the court seeking to have the above debts declared non-dischargeable.

Bankruptcy Rule 4007(c) governs the procedure by which a creditor may object to the discharge of any of the above debts. Under Rule 4007(c), in order to have any of the above debts

declared non-dischargeable, the creditor, who holds the debt, must file a complaint seeking to have the debt declared non-dischargeable within sixty (days) of the First Meeting of Creditors. If the creditor does not file this complaint within the allotted time then the debts will be discharged.

a. FRAUDULENT DEBTS

What constitutes a fraudulent debt is rather liberally construed. The operative word is fraud. By definition fraud is the intentional making of a misrepresentation (false statement) about a material fact upon which another party reasonably relies to his or her detriment. In other words, if a debtor tricks another person out of cash or property by false statements, then that is a fraud.

Fraud also includes obtaining loans by making false statements such as obtaining a loan based on false statements of credit worthiness. Fraud also exists whether the debtor obtained property by false pretenses such as agreeing to hold property for another but instead taking the property for one's own use.

The most common type of fraudulent involves credit cards. A court will not permit a discharge of credit card bills if they were incurred with the deliberate intent to have them discharged in bankruptcy. It is a common misconception that people have that credit cards debts are always dischargeable and thus the debtor will max out the card (charge to the maximum of the line of credit) prior to filing for bankruptcy relief. In that case, the court will not discharge the charges that are out of the ordinary. For

example, Mary normally charges $500 per month and has a $5,000 line of credit. One week before Mary files her bankruptcy petition she charges $5,000 on the card. The creditor can object to the discharge of the credit card debts because it is clear from the facts that Mary deliberately made the charges with the intent to have the debt discharged.

Fraud requires an intent to deceive at the time the contract or representation is made. If a debtor enters into a contract with the intent of performing it, then there is no fraud and debt for failure to perform the contract is dischargeable. On the other hand, if the debtor entered into a contract with no intent of ever performing it, then the debtor is not discharged from paying those debts deriving from the breach of the contract or misrepresentation.

2. DEBTS FOR WILLFUL AND MALICIOUS ACTS

A debt deriving from the willful or malicious act that injures another person or property is not dischargeable if the creditor objects. A crime that injures a person or property is a willful and malicious act under bankruptcy code and the debts deriving therefrom are not dischargeable. For example, if a debtor attacks an innocent person and puts the victim in the hospital, the debtor's liability to pay the medical bills is not discharged by a bankruptcy. Also as discussed earlier, debts incurred from damages caused by the debtor's intoxicated driving have been held by some courts not to be dischargeable as willful and malicious acts

regardless of whether they can be discharged under section 523(a)(9).

Debts that do not derive from criminal act may nonetheless be non-dischargeable if the act was malicious. To be malicious, the act must be one that a reasonable person would believe to be highly likely to cause injury to another or property. An example of a malicious might be the reckless operation of a power saw which cuts another person. There was no intent to cause the injury but a reasonable person could see that playing with a power saw could cause that injury. In such an event, the damages caused by the reckless operation of the saw would not be dischargeable.

c. EMBEZZLEMENT, LARCENY OR BREACH OF A FIDUCIARY DUTY

Basically, larceny and embezzlement are just different forms of theft. If the debtor steals property from a fiduciary position of trust then it is embezzlement. If the debtor steals the property from people at large then it is larceny. In either case, the debts deriving from the thefts, either the obligation to pay for the property or to return it, is not discharged by the bankruptcy if the creditor objects. This seems rather straight forward. Otherwise a person steals a million dollars would not have to pay it back.

A fiduciary duty is the obligation, imposed by law, on a person in a position of trust to act reasonably. A fiduciary is liable for any damages caused by the breach of this duty to act reasonably. In such a case, if the fiduciary acts irresponsibly and injures the person for whom he or she is required to protect then

the debts deriving from the breach of duty are not discharged. For example, if a person is the guardian of another and invests that person's assets in risky investments, which a reasonable person would not invest, then the guardian is liable to replace any losses. The debts for any breach of a fiduciary duty will not be discharged provided the creditor (the person injured or the representative) objects.

C. STEPS IN A BANKRUPTCY ACTION

A bankruptcy proceeding is methodical, procedural and entirely predictable. The steps begin from first finding the correct court and end with the receipt of the final discharge. Throughout, the case is just one logical progression from one step to another. Once the debtor understands the steps that will occur in the ordinary Chapter 13 case, the debtor will be able to appreciate the orderly nature of the bankruptcy procedure and therefore be more at ease.

1. SELECTING THE PROPER BANKRUPTCY COURT

Every state has at least one bankruptcy court. Some states have divided themselves into judicial districts and have a bankruptcy court for each judicial district. The debtor is required to file the bankruptcy petition with the bankruptcy court covering the debtor's home state. If there is more than one bankruptcy then the filing is with the court in whose judicial district the debtor has lived the most in the last six months (in other words more than 180 days before filing the petition).

Where there are more than one bankruptcy court in a state, the

debtor the bankruptcy court closest to the debtor's home is probably the one where the debtor should file. To be sure, the debtor could call the court and ask the clerk if the debtor's home is covered by that bankruptcy court. Once the proper court has been determined, the debtor should call the clerk and ask the following questions:

1. Ask the clerk if you send a check and a large self-addressed envelope would they send the following to you:
    a. the local rules of court;
    b. a fee schedule for all court filings; and
    c. copies of all local forms. Many Courts have adopted their own local forms to filed in addition to the Official Forms. Those local forms will have be filed as well. Generally, the local forms are merely information forms that are very easy to complete.
2. Ask the clerk whether the court requires blue backing on the pleading and if so what must be typed on it. (This information is also included in the local rules. Some courts, in order to make the petition more recognizable in a file cabinet, require that the petition be stapled to a stiff blue sheet of paper (obtainable from any office supply or art store) usually an inch longer than the petition. On the inch that overlaps the court usually requires that the name of the case be typed). Most courts don't require a backing.
3. Ask the clerk whether the court uses the standard creditor

matrix (the form with the many blocks)? If not the debtor will have to request it in the letter to the clerk.

Calculate the amount of money all this will require and send a check in that amount to the clerk in a self-addressed envelope. Given the work load of many court do not be surprised if the you cannot get through or if the clerk will not answer your questions (they don't have to do it). In such a case, the only alternative is to drive to the courthouse and ask get this information in person.

Each court can adopt its own rules of procedure within the confines of the Bankruptcy Code as passed by Congress and the Bankruptcy Rules adopted by the Supreme Court. Anyone filing a bankruptcy petition must comply with all rules and procedures adopted by the court in which the petition is filed. For that reason, the debtor must get a copy of the local rules. Usually, the local rules are no more than a statement of the general bankruptcy rules. The advice in this book is directed for compliance with the general rules and should usually comply with most local rules.

2. EMERGENCY FILINGS

There are occasionally situations where the debtor does not have the time to complete the full petition before some type of foreclosure act of a creditor occurs. In this situation, under Bankruptcy Rule 1007 (c), it is possible to file just the petition along with the list of creditors so as to get the automatic stay.

In such a situation, the debtor will have fifteen (15) days in which to file the missing schedules and statements. If the omitted

schedules are not filed within the fifteen days, the Court will dismiss the petition unless the debtor obtains an extension to file from by the Court. If the petition is dismissed, the debtor could refile again but will have lost the $160 filing fee already paid.

The emergency filing requires that the debtor file at least the following:

1. The Voluntary Chapter 13 Petition; and
2. The list of all the creditors as known by the debtor (especially listed must be the creditor whose collection is forcing the emergency filing).

The list of creditors must be put in the form approved by the local rules of court. Not all courts used the creditor matrix (the sheet with blocks for the named of creditors to be typed). Whatever form of the list of creditors used by that court is the form that the debtor must use.

3. THE PREPARATION AND FILING OF THE PETITION

Once all the appropriate forms are obtained, the debtor then determines the size, manner and type of the debts in the estate. To help in organizing the estate, there is, following this chapter a worksheet for the debtor to list the assets and liabilities of the debtor's estate. After completing the worksheet, the debtor will use it to determine which debts, if any are non-dischargeable, and which debts are dischargeable. Toward this end, the debtor should review the NON-DISCHARGEABLE DEBTS for the state of the law.

After the debts have been divided into the various categories,

the debtor will then decide if their are any liens on exempt property which may be avoided (taken off) in accordance with the Bankruptcy Code. Once the above decisions are made, the debtor is now ready to fill out the schedules, the statement of intention and summary of debts and property. The remaining acts to be done prior to filing is the completion of the creditor matrix, the statement of the debtor engaged or not engaged in business and the cover sheets of the petition. When everything is complete, the debtor is ready to file the petition.

The filing fee is $160 dollars (a $130 filing fee and $30 administrative fee) which is payable in full upon the filing. It may seem a bit strange that if someone is bankrupt that they nevertheless must come up with $120 dollars to seek relief under the bankruptcy code. Bankruptcy Rule 1006(b)(1) permits a debtor to pay the $160 fee in installments over four months if the court approved form Application to Pay Filing fee in Installments is filed with the petition. No installment plan will be given to a debtor who has previous paid an attorney for consultation or assistance in preparing the bankruptcy petition.

4. MEETING OF CREDITORS

Soon after the petition for bankruptcy is filed with the court, the clerk of the court will schedule a meeting of creditors. The clerk will send notice of the hearing to all of the creditors named in the petition. Even though the court will notify the creditors of the bankruptcy, the debtor should send a letter immediately to the

creditors informing them of the bankruptcy petition, the court where it was filed and the case number.

The purpose behind the debtor giving this notice is simply to void possible hassles. Under the bankruptcy law, once the debtor files the bankruptcy petition, there is an automatic stay on debt collection and foreclosure proceedings against the debtor. However unless a creditor knows of the bankruptcy, collection proceedings may go forward and, even though they will be subsequently set aside, there's no reason to go through the hassle and bother of doing so when a quick letter from the debtor early in the case would prevent that from having happened.

Shortly after the petition is filed, the court appoints the Trustee to handle the case. The Trustee will preside over the creditor meeting. The judge will not be there. The Trustee and then the creditors will question the debtor about the location of the property in the estate and the debtors intent as to whether to set aside any liens on secured property.

5. TRUSTEE'S MANAGEMENT OF THE ESTATE

(a). Chapter Seven Estate

After the Creditor's meeting, the Trustee takes possession of the nonexempt property in the estate which will yield proceeds after the costs of sale and any liens on the property have been sold. For example, if the debtor owned a nonexempt truck that could be sold for \$2,000 and only \$500 was owed or it and the cost of sale was \$200, the Trustee would take and sell the truck because it would leave

$1,300 left over.

The remaining proceeds are used to pay any cash exemptions permitted to the debtor under the law. The remaining amount, if any, if spread among the unsecured creditors of the debtor. The debtor has the right, although usually not the resources, to purchase nonexempt property from the Trustee for cash or trading exempt property for it.

Following the meeting of creditors, the debtor may motion to purchase from a secured creditor exempt property that is collateral for a secured debt by payment of the fair market value of the property. If the creditor agrees to the sale, then there is no reason to have a motion a written agreement between the debtor and creditor is sufficient to bind each. However, when the creditor fails to agree, usually because the debtor wants to make payments while the creditor wants the fair market price to be paid in full, the debtor must make a motion for a court order requiring the debtor to take the purchase price in installments. Many bankruptcy courts will not force a creditor to take the payments in installments. In such an event, if the entire purchase price cannot be paid within forty-five days of the order permitting the redemption, then creditor can repossess the property and return the payments made up to that point, if any.

(b). Chapter Thirteen Estate

Once a chapter 13 bankruptcy petition is filed, the bankruptcy court appoints a person called a trustee to handle the normal administration and management affairs of debtor's plan. The trustee calls and oversees the creditors' meeting wherein the creditors of

the debtor examine the debtor in an attempt to discover the location of assets.

Following the Meeting of Creditors there is a hearing to confirm the debtor's chapter 13 plan. This hearing can be set by the Court to immediately follow the Meeting of Creditors or may be set at another date. If the debtor files his proposed plan, at the same time of the petition rather than later, then the confirmation hearing will probably be held at the same time as the Meeting of Creditors.

Once the Court has approved a debtor's plan, it is the trustee's responsibility to receive the debtor's payments ordered under the plan. The Trustee will then make the payments to the debtor's creditors pursuant to the court approved chapter 13 plan. Generally, the Trustee receives as his or her payment 10% of all payments received as the Trustee's fee.

Payments under the Plan must begin within 30 days after the filing of the plan with the court. The plan must be filed within 30 days of the filing of the chapter 13 petition. The payments must be regularly made, usually on sa monthly basis. Some bankruptcy courts will order an attachment of the debtor's wages to assure payments are made under the plan.

These payments are then transmitted to the creditors in accordance to the payment schedule set up in the approved plan. The trustee has also has the power to bring or defend lawsuits on behalf of the bankruptcy estate. Once the plan has been completely fulfilled, according to its terms, the debtor is given a discharge as

to all dischargeable debts. If the plan can not be fully completed, then the debtor can seek a partial discharge for certain debts.

6. THE CHAPTER 13 PLAN

In a chapter 13 proceeding, the debtor is required to submit, for court approval, a written plan for the payment of creditors over a period of year. The plan must last for three years and with court approval may be extended to five years. The plan must provide payments to the unsecured creditors that will, at a minimum, equal the amount that they would have received had the debtor filed a chapter 7 liquidation instead of a chapter 13 petition. The debtor is not required to pay all of the unsecured debts.

To determine how much the unsecured creditors receive, the debtor determines what property is exempt from unsecured creditors and what property is not exempt from unsecured creditors. The value of unsecured property is totaled and that is the minimum value that must be split among the unsecured creditors. Each unsecured creditor is given a minimum payment amount based upon that creditor’s percentage share of all creditors. For example, if an unsecured creditor is owed 10% of all unsecured debts then 10% of the value of the estate, on the date of filing, must be paid to the creditor. Since the payment schedule for the plan extends over several years (no more than five years), it is permitted to pay a creditor more than the minimum amount as long as each unsecured creditor receives at least as much as the creditor would have received if a Chapter 7 petition had been filed at the beginning. To determine the minimum

amount to pay the unsecured creditors, the debtor must first determine what property is exempt in the estate. The nonexempt property will then be used to calculate the amount to be paid to the unsecured creditors.

It is also permitted in a chapter 13 proceeding to treat unsecured creditors differently. The Bankruptcy Code permits a debtor to establish classes of unsecured creditors and treat them differently in the percentage of their debts which are paid. As long as the classes are established in good faith and with a legitimate reason, the debtor may pay the creditors of one class a higher percentage of their debt than creditors of another class.

The plan may also provide for the payment of secured debts as well as unsecured debts. Under the bankruptcy code, fully secured debts must be paid in full if they are included in the plan. If secured creditors are not fully paid in the plan, they can object and no discharge will be granted as to their debts. A debtor is not required to deal with a secured creditor in the plan and may continue to deal with them outside the plan. The main reason for listing a secured creditor is to stave off a foreclosure. As long as the plan provides for the curing of a default and the resumption of normal payments in a responsible time, the court would prevent the secured creditor from proceeding with a foreclosure action. If the debtor cannot cure the default and resume payments within the plan, the court will release the debt from the automatic stay and permit the creditor to foreclose on the property. The debtor is required to pay

interest on the debt of any creditor covered under the plan.

Secured creditors are treated in one of four ways. In the first instance, each secured creditor is given the option of accepting a proposed payment plan. This usually means that an agreeing secured creditor will be paid less than the creditor is actually owed under the security agreement. Secondly, each secured creditor may reject the proposed payment plan and stand on their security instrument. In this instance, the creditor must be completely paid off within the term of the plan. The court will not approve any plan which will not pay off an objecting secured creditor within the term of the plan. Interest must be paid on all secured claims handled in the plan. In the third case, the debtor may surrender the collateral to the secured creditor holding a security interest on it. In such a situation, the secured creditor would become an unsecured creditor to the extent of any deficiency resulting from a proper resale of the property. The last way for a debtor in a chapter 13 proceeding to deal with a secured creditor is to omit the creditor from the plan and continue to make the payments as before the filing.

When dealing with secured creditors, it is important to remember that a secured creditor’s lien only extends to the fair market value of the security. As such, if a secured claim is handled in the plan, once the creditor receives the fair market value of the collateral, the lien is discharged and the secured creditor becomes an unsecured creditor as to any remaining unpaid balance.

A chapter 13 payment plan must be approved by the bankruptcy

court in order to discharge the debtor for unpaid portions of the debts. The procedure for obtaining court approval is very straight forward. The debtor files the chapter 13 petition, Notice of the petition is given to the creditors which places an automatic stay on any collection actions by the creditors. The debtor then prepares the proposed plan which is filed with the court and served upon the Trustee and all of the creditors.

A hearing date is then set for the confirmation of the plan. Any creditor having objections to the plan may file objections which will be heard at the hearing. As long as the unsecured creditors are paid the minimum amount that would have received had a chapter 7 petition been filed and the debt is properly dischargeable then the objections will be overruled and the plan approved.

A Chapter 13 plan is not final and can be modified by the court upon the debtor showing good cause such as a reduction in earnings. The debtor may convert a Chapter 13 petition to a Chapter 7 liquidation at any time provided the debtor had not filed a previous Chapter 7 petition within the previous six years. In addition, the debtor may dismiss the Chapter 13 at any time prior to completion of the plan and thereafter be treated as though the bankruptcy petition had never been filed.

7. MOTION TO SET ASIDE A LIEN

The bankruptcy code gives the debtor the right to set aside judicial or judgment liens against exempt property. The procedure for setting aside a judicial lien calls for the debtor to file a motion

with the court with notice of the motion also having been given to the creditor possessing the lien. A judicial lien is a lien placed against exempt property for a monetary judgment resulting from a lawsuit against the debtor. A judicial lien is quite different from a statutory lien created by operation of law. A statutory lien cannot be avoided by a debtor although it might under circumstances be avoided by the Trustee which usually does not benefit the debtor.

8. CREDITOR'S MOTION TO SET ASIDE THE AUTOMATIC STAY

Once a debtor filed for bankruptcy relief, there is an automatic stay on all proceedings against the debtor's estate. In other words, all lawsuits including collection and repossession proceedings against the debtor are automatically stayed for the duration of the bankruptcy case. The automatic stay remains in effect against all of the debtor's creditors although it can be lifted, upon request, by individual creditors under certain circumstances.

To get the automatic stay lifted, the creditor must file a complaint to lift the automatic stay with the court and serve it on both the Trustee and the debtor. The debtor is not required to file a response to the complaint unless the local rules require it. The creditor is required to convince the court that the automatic stay should be lifted as to that particular creditor. The debtor, whether a response is filed or not, must explain to the court why the stay should not be lifted.

After hearing both sides, the court will decide whether to lift the stay and permit a creditor to foreclose against secured property

in the estate or maintain a lawsuit for damages against the debtor.

9. DISCHARGE HEARING

If the plan has been fully performed and no objections to discharge have been filed, then most courts will not hold a discharge hearing because there is nothing to be accomplished by the hearing. Instead, the debtor is mailed an order stating that the final discharge is granted. The case is then over for almost all intents and purposes.

(a) Chapter Seven

The debtor has the right to reaffirm debts on nonexempt property in order not to have the property repossessed by the creditors. If the debtor is seeking to reaffirm a debt, then the court is required to hold a discharge hearing. The purpose of requiring court approval is to make sure that the debtor does not by either mistake or fraud reaffirm a debt against the debtor's best interest.

No ratification agreement will be valid unless it meets the following requirements:

1. The agreement must have been made prior to the granting of the discharge;
2. The agreement must clearly state that the debtor can rescind it at any time prior to the discharge and for sixty (60) days thereafter; and
3. The agreement must have been approved by the court. It is for this reason that the agreement is submitted to the court so that the debtor can have the agreement approved.

In order to approve a ratification agreement, the court must find that the ratification will not impose an undue hardship on the debtor or the debtor's dependents and is in the debtor's best interest. To make that determination, the judge must ask sufficient questions so as to be assured that the above requirements are met.

Once the court is satisfied that the reaffirmation of the debt should occur, then it will approve the ratification agreement and issues the final discharge. At this point, unless something happens that requires the case to be reopened such as newly discovered property, an omitted creditor or a complaint to set aside the discharge for fraud, the case is closed and debtor is now free to get on with his or her life without fear of the discharged creditors.

When the debtor is not seeking to reaffirm a debt, most courts will not hold a discharge hearing because there is nothing to be accomplished by the hearing. Instead, the debtor is mailed an order stating that the final discharge is granted. The case is then over for almost all intents and purposes.

(b) Chapter Thirteen

A complete chapter 13 discharge is granted under section 1328 (a) and is broader than a chapter 7 discharge. A discharge granted by the Bankruptcy Court pursuant to section 1328(a) discharges the debtor from all but the following debts:

(a) any debt not covered in the plan;

(b) debts for alimony or spousal support;

(c) student loans unless grounds for discharge are met;

(d) debts resulting from injuries caused while driving intoxicated;

(e) restitution for criminal offenses;

(f) debts for which the last payment is due after the date of the final payment of the plan; and

(g) post-petition debts that were not allowed under section 1305 and allowed post-petition consumer debts, the prior Trustee approval for which was practicable but not obtained.

(h) priority claims, which include tax claims, refund claims, wage claims, salaries, commissions and employee benefits, are dischargeable. However under section 1322(a)(2) priority claims must be paid in full under the plan unless the creditor agrees otherwise. As such, priority claims usually must be paid in full under the plan.

If the debtor is unable to complete the plan, the debtor has three options. The debtor can dismiss the case and be treated by the creditors as having never filed the petition. In such an instance the debtor will owe the creditors the amount that would have been owed had the chapter 13 petition never been filed after taking into account any payments that had been made through the plan.

The second alternative is for the debtor to convert the plan into a chapter 7 filing. At which case, the debtor's estate will be liquidated and the creditors paid in accordance with the bankruptcy law pertaining to chapter 7 cases.

The last alternative is for the debtor to seek a partial discharge of the case under section 1328(b). A partial discharge discharges the debtor from all debts except for:

a. secured debts (debts secured by collateral or liens);
b. debts paid outside of the plan and not a part of the plan;
c. instalment debts whose last payment is due after the completion of the plan;
d. debts incurred while the plan was in effect;
e. debts not dischargeable under chapter 7.

In a partial discharge, the debtor is released from the obligation to pay the discharged debts.

To obtain a section 1328(b) discharge, the debtor must file a motion requesting a partial discharge. Upon filing the motion, at least 30 days notice must be given to the creditors of the date for their filing any objections to the partial discharge. A hearing is then held on the granting of the discharge. If no complaint is filed against the discharge, the debtor usually does not have to appear. If a complaint is filed then a hearing is held on the matter. In order to receive a section 1328(b) discharge, the debtor must have paid each unsecured creditor at least as much as the creditor would have received had the debtor filed a chapter 7 petition instead of the chapter 13 petition.

10. DEBTOR'S REOPENING OF THE ESTATE

The bankruptcy court has full discretion to reopen a case when

good cause is shown. Any interested party, creditor, debtor or trustee, may ask the court to reopen the case for cause. See section 350(a). There is no definition of cause. It is left to the court to decide when the circumstances of the case are such that the court feels that its sense of justice requires the case to be reopened.

There is no express time limitation for making a motion to reopen an estate for cause. The motion must state those facts giving rise for the reopening of the case. The court will hear the arguments, both pro and con, for reopening the case. After the hearing on the motion, the court will render its order. If the motion is granted, the order cannot be attacked in a collateral action. The reopening does not automatically reinstate the Trustee. A court will not reinstate the Trustee unless it finds the reappointment to be necessary to protect the interests of both the creditors and the debtor or the Trustee is needed to administer the estate.

Generally, it is difficult for a debtor to convince a court to reopen a case. For that reason, the debtor must do everything possible to assure that all creditors and property are duly listed.

BANKRUPTCY QUESTIONNAIRE

A. BACKGROUND INFORMATION

1. Name (include all other names once used, i.e. maiden)

____

2. Address and Phone Number (home and business) ____________

____

____

3. Employer's name, address and phone number: ______________

____

____

4. Spouse's employer's name, address and phone number: _____

____

____

5. Occupation: ______________________________________

6. Spouse's occupation: ____________________________

7. Social Security Number: __________________________

8. Spouse's social security number: _______________________

9. Former military service (branch and dates of service):

____

____

10. Date and Place of Birth: __________________________

11. Name of Spouse: _________________________________

12. Date and Place of Spouse's Birth: _____________________

13. Date and Place of Marriage: _________________________

14. Length of Residency in the State: ____________________

15. Previous marriages for each spouse: ____________________

____

____

16. Children: ____

____

____

17. Children of spouse (stepchildren): ____________________

____

____

18. Deceased Children: ____________________________________

____

____

19. Grandchildren: ____

____

____

20. Grandchildren of spouse: ______________________________

____

____

21. Parents and addresses: ________________________________

____

____

22. Parents of spouse and addresses: ______________________

____

____

B. PROPERTY

1. Real Property (for each piece of real property state):

a (1). Type of property: ____________________________________

a (2). Location of property: ________________________________

____

a (3). Holder and amount of liens on the property: ________

____

____

a (4) Fair market value of the property not deducting for the liens: ____

a (5) Date of purchase and original amount: ________________

____

a (6) How is title to the property taken? (What does it say on the deed - separate property, joint tenancy, tenancy in the entirety, tenancy in common?): __________________________

____

b (1). Type of property: ____________________________________

b (2). Location of property: ________________________________

____

b (3). Holder and amount of liens on the property: ________

____

____

b (4) Fair market value of the property not deducting for the

liens: ____

b (5) Date of purchase and original amount: ______________

____

b (6) How is title to the property taken? (What does it say on the deed - separate property, joint tenancy, tenancy in the entirety, tenancy in common?): _______________________

____

c (1). Type of property: ___________________________________

c (2). Location of property: ______________________________

____

c (3). Holder and amount of liens on the property: _______

____

____

c (4) Fair market value of the property not deducting for the liens: ____

c (5) Date of purchase and original amount: ______________

____

c (6) How is title to the property taken? (What does it say on the deed - separate property, joint tenancy, tenancy in the entirety, tenancy in common?): _______________________

____

2. Bank Accounts (including savings and loans and credit unions):

a. Name, address and account number: _____________________

____

b. Name, address and account number: ______________

____

c. Name, address and account number: ______________

____

3. Stocks and Bonds:

a. Type and company issuing: ______________________

____

b. Amount: ____________________________________

c. Date and manner of acquisition (purchase, gift or inheritance): _______________________________

d. Fair Market Value: __________________________

e. Basis (purchase price or basis on date of gift or inheritance): _______________________________

4. Insurance:

a. Type: ______________________________________

b. Group, term or whole life:______________________

c. Company and policy number: ____________________

____

d. Amount: ____________________________________

e. Beneficiaries: _______________________________

____

5. Safety Deposit Boxes:

a. Location: ___________________________________

____

b. Box number: ____

c. Contents: ____

____

____

6. Tangible personal property (list all property worth over $100.00 such as jewelry, tools, cars, boats, etc)

____

____

____

____

____

____

____

____

7. Intangible personal property: (list all intangible property such as money owed, royalties, copyrights and other interests not previously listed:

a. Loans:

1(a) Name and address of debtor: ______________________

____

1(b) Amount of loan outstanding:______________________

1(c) Security for loan (deed of trust, mortgage, collateral: ____

2(a) Name and address of debtor: ______________________

____

2(b) Amount of loan outstanding: ______________________

2(c) Security for loan (deed of trust, mortgage,

collateral: ____

3(a) Name and address of debtor:_______________________

____

3(b) Amount of loan outstanding: ______________________

3(c) Security for loan (deed of trust, mortgage,

collateral: ____

4(a) Name and address of debtor: ______________________

____

4(b) Amount of loan outstanding: ______________________

4(c) Security for loan (deed of trust, mortgage,

collateral: ____

b. Other Interests:

1. Type of Interest: ________________________________

2. Date and manner of acquisition (gift, purchase or

inheritance: ____

3. Basis (purchase price or value at basis at time of

gift or inheritance) ________________________________

8. Pensions, IRA's, SEP's, Death and Retirement Benefits (list location, account number and amount of each plan or account): ____

____

____

____

____

____

____

9. Expectancies (list any property that is expected to be received in the future along with the source for instance inheritances, property settlements or insurance proceeds):

____

____

____

____

10. Debts and Liabilities (list all debts and liabilities along with whether the obligation is secured):

    a. Secured debts:

        1(a) Creditor and address: ______________________________

        ____

        1(b) Account number and outstanding balance: ___________

        ____

        1(c) Nature of Collateral: ______________________________

        ____

        2(a) Creditor and address: ______________________________

        ____

2(b) Account number and outstanding balance: ____________

____

2(c) Nature of Collateral: ________________________________

____

3(a) Creditor and address: ________________________________

____

3(b) Account number and outstanding balance: ____________

____

3(c) Nature of Collateral: ________________________________

____

b. Judgment Creditor:

1. Case number and amount of lien: _____________________

____

2. Property which lien attaches: _______________________

____

c. Unsecured debts:

1. Debts owed under contractual or leasehold agreements:

____

____

2. Pending lawsuits: _____________________________________

____

3. Unsecured loans: ______________________________________

4. Damages caused to others: ______________________________

____

5. Other liabilities: ____________________________________

C. BANKRUPTCY

1. Date and Court where previous petition filed:

2. Type of bankruptcy- Chapter 7 or Chapter 13

3. If a Chapter 13, has the plan been completed? If not what remains to complete the plan?

4. If a Chapter 7, are there any debts being redeemed, ratified or affirmed in the bankruptcy action?

5. If married, has your spouse filed a bankruptcy petition?

6. What property in the estate is exempt under the federal exemption?

7. What property is exempt under state exemptions?

8. What property and its value in the estate is not exempt?

9. What is the total of unsecured claims owed?

10. What is the total owed to each unsecured creditor?

Creditor: __________

Creditor: __________

Creditor: __________

Creditor: __________

Creditor: __________

Creditor: __________

Creditor: __________

11. What is each unsecured creditor's percentage in the estate? Divide each creditor's amount stated in number 10 by the figure in 9 (number 10/number 9)

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

12. What is the minimum amount that must be paid to each unsecured creditor? Multiply the percentage for each unsecured creditor as calculated in number 11 by the value of nonexempt estate listed in number 8.

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

Creditor: ____________________

CHAPTER FIVE

FEE DISPUTES

INTRODUCTION

Often first inkling that an attorney has that a client may allege malpractice against the attorney, occurs when a matter is concluded and the attorney presents the final bill. There is an old legal adage that a person who has been given a final bill by both a doctor and a lawyer will pay the doctor' bills saying, "I may need the doctor again." Such is true indication of real life. Most attorneys will readily admit that they have had clients who never paid their final bill because their clients never expected to use the attorney ever again. In such a situation, the attorney must either sue the former client or write off the bill. There is also a certain type of client, whose numbers appear to be growing that will always dispute a bill and threaten a malpractice action as a means to reduce it regardless of how reasonable it is. It is to help avoid such fee disputes and to aid an attorney is the proper collection of attorney fees that this chapter is directed.

Unless an attorney works for the government or a tax-exempt legal services corporation, the attorney and the law office will need to collect legal fees for its services in order to pay its bills and, most importantly, for the attorney to survive. There are a few instances where wealthy people become attorneys and form tax exempt

organizations and work for free. It is interesting how many of these people subsequently run for public office, usually Congress, touting their free legal work as proof of their feeling their constituents pain. For most attorneys, however, they can survive only by selling their legal services. The only asset that an attorney has, on which to trade, is legal knowledge. When someone uses that legal knowledge, they should compensate the attorney. While an attorney is working for one client, the attorney cannot be working for another. A law practice is a one to one relationship between the client and the attorney. The attorney has nothing to sell but the attorney's ability and time and when they are used on behalf of a client, the attorney should be compensated.

When a client fail to pay on time or, heaven forbid, refuses to pay at all, the attorney can be forced into immediate financial chaos. The payment of an attorney's bills, like most other persons, is not contingent upon payment by their client's of their bills. Regardless of whether an attorney is paid by his or her clients, the attorney must still pay the staff, office rental, student loans, and all other personal and professional debts.

In order for any attorney to survive, and most importantly, new attorneys, billing practices and procedures should be both understood and implemented so as to maximize the collection of attorney fees. There is nothing inherently wrong in collecting fees for work that has been done. Some people, ignorant in how the legal profession

works, erroneously believe that simply because an attorney charges $150 per hour that the attorney earns and collects that amount each day. The fact of the matter is that the average attorney, in private practice, earns around $35,000 per year. There are many attorneys in California for instance, that earn in the mid-$20,000's. An attorney's hourly fee covers the attorney down time, which is the time the attorney is not doing billable work such when doing pro bono, office management attending CLE programs or when there simply are no clients. Whatever the amount of the fee that the attorney charges, that fee should be recovered, provided that it is not unconscionable, or the attorney simply will become an unincorporated, public charity providing legal services for free. Such is nice if the attorney intended to this to happen otherwise it is a personal and financial disaster for the attorney.

BILLING

Billing should not be considered by an attorney as merely consisting of the sending a statement for work done to a client. Billing, as a concept, should be viewed as one of the marketing strategies of the office. As such, billing is one of the most important practical aspects of a law practice and any other profit making business as well. Without money coming in the pay the bills, no business can survive. Only the government can constantly spend more than it collects. In the real world a law practice must collect

more than it spends in order to make a profit and be a success. As such, an attorney should concentrate on strategies to increase cash inflow and thus increase the practice's success.

The very first thing that any attorney should do is stop dispensing free advice or at least cut back on doing it. There are many attorneys who advertise free consultations in the hope of getting new clients. This can work reasonably well when the consultation is limited to special fields of law such as bankruptcy, family law etc. The fact is, however, that most people who seek free legal advice do not have a case for which the attorney could take or reasonably charge. Much of the free advice that an attorney gives is on small matters for which the person can go to small claims courts and handle the matter himself. For the most part, the giving of free advice by an attorney seldom leads to the person becoming a client. Nonetheless, many attorneys believe giving free legal advice pays for itself in the long run. If an attorney decides to give free consultations, the attorney should decide the manner for which it should be done. Many attorneys believe that no free legal advice should be dispensed over the phone. These attorneys believe that the attorney should be forced to come in and have the free consultation in person so that, if the person has a case, the person will feel morally obligated to retain the attorney sitting across from the client giving the free consultation. Other attorneys believe that an

initial free consultation should be done over the phone, if possible. It is usually quite possible for an attorney to determine if a caller has a case for which the attorney could assist or take within a few minutes, whereas most personal consultations take between 15 minutes and a half an hour. If the attorney feels that the caller actually many have a case for which the attorney could be assistance, then the attorney can offer an appointment to come and more fully discuss it. As such, it would make no sense to have the person come in for a free consultation if the attorney will not ultimately be hired. Whatever type of free consultation is employed by the attorney, the point to remember, that the attorney is not being compensated for the time spent in these consultations. As such, the attorney must manage the consultation in such a manner as to over spending unnecessary time in determining if the client has a case that the attorney can be of assistance.

Another billing concern which many attorneys have is how to treat legal advice given to friends. As stated before, the only has to sell is his or her time. A mechanic may talk shop over a drink but no work is done until the mechanic looks under the hood. An attorney, however, does legal work every time the attorney speaks on a legal matter. Once a person hears the attorney's advice and acts on it, the person has been benefitted. For this reason, an attorney should bill friends for the legal advice or work given. The point to remember is

that when an attorney gives advice or does work for the friend, the attorney is not doing work for someone else who would pay for the service. The fact of the matter is that friends usually want to hire friends and refer business to friends. Attorneys are no different from the average person when human relationships exist. It is not uncommon for an attorney to feel odd or ill at ease in charging a friend for legal service. Usually, in situation where the attorney represents a friend, the attorney charges less than the hourly rate. The attorney usually tells the friend what the attorney's normal hourly rate is and what would be charged for the representation. Even between friends, there should be an attorney fee agreement. It should be explained that the state Cannons of Professional Responsibility require a written agreement, even if no fee is being charged, and that the attorney could be disciplined for not having such an agreement. An agreement should be used even if the attorney represents the attorney's own parents. If the friend or relative refuses to sign a fee agreement, then the attorney should not take the case for the same reasons, as discussed above, that an attorney should not take a case if a client refuses to pay a retainer.

IT IS IMPORTANT FOR EVERY ATTORNEY TO REMEMBER THAT THE FEE AGREEMENT MUST CONFORM TO THE REQUIREMENTS OF STATE LAW. MANY STATES REQUIRE SPECIFIC PROVISIONS TO BE INCLUDED IN AN ATTORNEY'S FEE AGREEMENT OR ELSE THE ATTORNEY MAY BE SUBJECT TO DISCIPLINE.

California, for example, as of January 1, 1994, required all of its attorneys who do not carry errors and omissions insurance to so state it in their fee agreements. In place of the statement, the attorneys can file with the State Bar a written agreement guaranteeing payment of any claims arising out of the practice of law for errors and omissions.

An attorney must send statements to the clients at least monthly. The majority of all ethics complaints lodged against attorneys are based upon an alleged failure to keep the client informed as to the status of the case. In fact, very few of the ethics cases, by percentage, actually involved mismanagement of a case but are simply the result of frustration by the client in the ability to communicate with the attorney. The monthly billing statement, even if nothing has been done for which a charge can be made, at least, will keep open the lines of communication.

Many attorneys believe that along with the bill, the attorney should send copies of all pleading received or which were prepared since the last statement. The advantage of this is that it will satisfy the client that the case is proceeding. Certainly in a big case, the client would be inundated by copies of the paperwork. The other point to remember is that an attorney can only take money from a client's refundable retainer for work done after a bill has been submitted and the client has not objected. Therefore, if the attorney had done $1,000 of work, that attorney still cannot take it out of the trust account until the client has been billed and has not

objected to the charge.

If the attorney waits for long periods of time before submitting bills for the service rendered, problems tend to arise.
In such a situation, the clients begin to believe that the attorney is not charging for the services rendered and will object to the subsequent billing for the services. The other situation is more onerous to the attorney. The attorney is not permitted to commingle trust funds. By not promptly billing for the services, the attorney is commingling the funds by not seeking his funds from the accounts for which the attorney controls. As discussed in the Chapter TRUST ACCOUNT, the IRS will audit attorney trust accounts to determine that they are not being used to defer taxation. The result is that if an attorney unreasonably leaves money for fees that have been earned in the trust account and does not claim it on the tax return, the attorney may be subject to underpayment tax penalties.

A final consideration in billing is not to overwork a case. An attorney owes a duty to a client to settle a case when a reasonable opportunity exists to do so. Taking a case to trial to gain trial experience is not a good reason to pursue a case. In time, every attorney will acquire trial experience. It is more important for an attorney to do what is best for the client rather than to pursue the attorney's own interest. A good settlement for a client is often better than fighting the case at trial and risk recovering nothing. The attorney should never settle a case without the client's consent even in the situation where the client has given the attorney the

written authority to settle on terms that the attorney thinks reasonable. The attorney should always present all settlement offers, even in criminal matters, to the client and explain all of the options. The attorney could make recommendations but should never insist on a course of action. An interesting point for an attorney to bear in mind is that in most instances where the client participates in a settlement, the client seldom sues the attorney for malpractice, or for that matter, seldom sues over the bill either.

ATTORNEY LIENS

Several states will allow attorneys to claim an attorney fee lien on the property of the client. Sometimes the lien is limited to the settlement in a particular case. In some states it will be against all of the property owned by the client, until there is a resolution of it. Usually in a lien situation, the attorney must thereafter commence a suit within a specific period of time that the lien is filed or the conclusion of the case in which the client received a judgment. In some states, that lien period for filing suit on an attorney is six months. In most states, in order to perfect an attorney lien, the attorney usually would have to file a notice of lien in the case and the lien would stay in effect until the case is concluded. Upon conclusion of the case, if the client wins and receives a judgment, the amount of the attorney fees claimed by the attorney lien will be held in trust either by the succeeding attorney or the court, until a hearing held been held to determine the correct

of attorney fees to be awarded to the attorney asserting the lien.

Any discussion of fee agreements would be incomplete if the attorney didn't discuss what happens if an attorney is fired during the middle of your representation of a client. If an attorney in on an hourly fee arrangement, there is no problem. In such a situation, the attorney would simply submit the bill for the work done up to that point and the client is responsible to pay it. If the attorney is in a flat fee situation, the attorney can collect for the reasonable value of the provided legal services. An attorney, in a flat rate situation, would not be able to collect for the full amount owed under the contract because the attorney had not completed the work and thus did not earn all of it. The attorney would get the reasonable value of the rendered legal services based on a percentage of how far along the attorney had worked on the case. If the attorney, for example, was 50% along in the case, the attorney would probably get half of the agreed fee. Courts or fee arbitrators would look at it that way or they would put an hourly fee value on the work that had been done and charge accordingly, In neither event would an attorney ever collect more than the attorney would have received under the actual fee agreement itself. In fact, if another attorney is hired, the courts or arbitrators would reflect on the value of the amount of work the discharged performed versus the amount of work that new attorney had to do to complete the case. In the area of a contingency fee agreement, where the attorney had been fired, the discharged attorney is entitled to recover the reasonable value of

the provided legal services based upon the percentage of the actual award. If the discharged attorney, for example, was going to get 30% of the case and the case gets settled for $500,000, there is a $150,000 fee award and the value of discharged attorney's work is $50,000. The discharged attorney would never get more than the fee agreement called for and in addition, the recovery is also based upon the amount that the other attorney is paid to finish up and complete the case.

In order to ascertain whether attorney lien may be available in state, an attorney must check the appropriate state and, if so, the scope of the lien. The existence of a lien should be determined by the law of the site of the fund or recovery against which the lien is sought to be imposed. In **Gelfand, Greer, Popko & Miller vs. Shivener** (1973) 30 Cal.App.3d 364 the contingent fee agreement was executed in Oklahoma but the recovery made in California. The California court applied California in determining if a lien should apply when the fee agreement failed to mention it.

Under the common law, there was a general possessory retaining lien which allowed an attorney to keep a client's papers or assets until the attorney's legal fee is paid. Many states have replaced the retaining lien or adopted in addition to it, a charging or special lien, against monies recovered by the attorney's efforts in litigation for the client. New York, for example, permits both the retaining lien and the charging lien to be imposed by attorneys. **Adan**

vs. Abbott (1982) 452 NYS2d 476, 114 Misc 2d 735.

Absent, statutory law or case law which permits the attorney to have a lien on the proceeds of a case or on property in the possession of the client, it is improper for an attorney to claim such a lien. When an attorney has a lien on the case or the property of the client, the attorney has acquired an interest in the case. Such an interest violates the general rule that an attorney cannot have a personal interest in the subject matter or outcome of the action for which the attorney had been retained. The exception to the general rule is for attorney liens permitted under state law in accordance with ABA Code DR 5-103(A)(1) and ABA Model Rule 1.8(j)(1).

(a) RETAINING LIENS

A retaining lien, by it’s very nature, when it exists usually attaches to all papers, documents, pleading and other such matters which comes into the attorney's possession by reason of the attorney services. The lien, by its nature, will not cover items or property that the attorney comes into possession for a client that are unrelated to the legal services for which the attorney was retained to represent the client. A good example is that if a person gave the attorney a gift to deliver to the client, the attorney would usually not be permitted to claim a lien against the gift for any unpaid legal fees.

Many attorneys, specifically in the criminal area, insist on security for the payment of their fees. As such, these attorneys

require that their clients put up land, cars, or jewelry or get co-signors as security for payment of the attorney fees to be incurred in the case. Such is an example of the working of retaining liens. A practice of requiring collateral for payment of attorney fees must be conducted in conformity with the law of the state where the property against which the collateral upon which the lien is to be imposed upon is located.

By it’s very nature, a retaining lien of an attorney attaches to all property, papers, documents and money of a client coming into the attorney’s hands during the course of the client's representation. By virtue of the lien, the attorney acquires the right to retain possession of the above items in order to secured payment of the fees and expenses due to the attorney as a result of the legal representation of the client. In situations where the client is in need of the documents or property held by the attorney but is unable or refuses to pay the attorney fees, the client has two options available. The client may, seek a court order through a subpoena duces tecum, to require the attorney the attorney to provide the property, records or pleading for the client's use upon the client furnishing adequate security for the payment of the legal fees. In short, the client trades the new property as security for the property held under the retaining lien. In the situation where the client disputes the fees rather than merely being unable to pay them, the retaining lien remains until their is an adjudication on the merits and scope of the lien. In most states where there exists the

retaining lien, summary proceedings are often available to adjudicate these issues, In addition, some states have created fee arbitration boards disputes over fees and retaining liens to quickly adjudicate the matter. **Foor vs. Huntington Nat. Bank** (1986) 27 Ohio App.3d 76, 499 NE2d 1297

Not all states recognize retaining liens anymore. There is a move throughout the United States to do way with retaining liens. The arguments against enforcing retaining liens is that they permit the attorneys to engage in legalized blackmail. In the situation of an ongoing case in litigation, if the attorney is permitted to retain the files until payment of the legal fees, the client may lose the case by being unable to prepare for the litigation. Nonetheless, as long as a retaining lien is permitted under state law, an attorney should pursue it to assist in the payment of all valid attorneys fees.

A retaining lien is rather different from the ordinary lien in that such a lien cannot be actively enforced by judicial proceeding meaning an attorney cannot get a court order directing a client to turn over files in the client's possession. In **Upgrade Corp. vs. Michigan Carton Co.** (1980) 87 Ill.App.3d 662, 410 NE2d 159, the court recognized that despite the existence of a statutory lien for attorney fees in Illinois, attorneys still had the protection of the retaining lien even though active judicial enforcement of the lien was not available. In the same vein, it is recognized that an

attorney retaining lien is passive in nature and not enforceable by a foreclosure or sale. **Frazee vs. Frazee** (1983) 104 Idaho 463.

A retaining lien also is usually only valid against property actually in the hands of the attorney. Where an attorney is not in possession of the money, papers or other property upon which the retaining lien is sought, then the attorney will not have a valid lien. **United States vs, Fidelity Philadelphia Trust Co,** (1973) 459 F2d. 771. An attorney who has a valid retaining lien on property will, nonetheless, lose that lien once the property leaves the attorneys possession. In **Eiduson Fuel & Hardware co. vs. Drew** (1977) a New York court held that an attorney's retaining lien on a stock certificate terminated once the attorney lost possession of the certificate.

Oklahoma limits the scope of an attorney lien to any money held for a client for which specific direction for its use was not made. In **State ex rel. Oklahoma Bar Assn vs. Cumming** (1993), the court upheld Oklahoma's disciplinary rule that money or property entrusted to an attorney for a specific purpose is not subject for a retaining lien. In this case, the client had deposited money to cover projected deposition costs which the attorney attempted to hold as a retaining lien for attorney fees. The court held that the attorney could not do so.

A retaining lien only attaches to the extent of services which have been actually rendered. The retaining lien does not attach to

property held by an attorney which has not yet been earned. This situation arises when an attorney is given a retainer and a creditor of the client wishes to attach it. Courts have agreed that a client cannot avoid attachment of his or her assets buy giving them as an attorney as a retainer. Obviously, until the attorney actually earns the money which the attorney is holding, the attorney is merely a fiduciary for the client in much the same manner as a bank. For this reason, excess money or property being held by an attorney is not subject to an attorney retaining lien.

(b) CHARGING LIEN

In addition to the attorney retaining lien, or in some states, in place of it is the special or charging lien. The requisites for a charging lien may be imposed by state law or may arise out of an agreement between the client and the attorney so that the attorney is to receive a portion of the judgment recovered or proceeds therefore, provided it appears that such judgment or proceeds be looked to for security. An attorney's charging lien vests in the attorney the right to recover money from the client in a particular manner so as not to be uncompensated for the legal services rendered in obtaining the recovery for the client.

A charging lien is generally viewed as an equitable assignment to the attorney of the revery derived from the attorney's efforts. As such, the attorney charging lien enjoys a paramount priority over other claims. As a matter of equity, the charging lien bestows upon

the attorney to have costs and fees due as a result of legal representation secured to the attorney either in the judgment rendered or in a separate suit.

By its very nature, a charging lien is confined to the fees and costs due for the legal services provided by an attorney in a particular action in which a judgment or settlement was obtained. Not included in a charging lien is the value of the work for which an attorney engages while seeking to be relieved as the client's attorney. The reason behind not allowing the lien to attach for such services is that the lien attaches only for services that benefit the client. An attorney seeking to be removed from a case does not benefit the client and therefore the lien does not attach for the value of such work. The fact that the lien does not attach for such work does not mean that the attorney cannot sue the client for the value of such work only that settlement or judgement proceeds will not be used to secured payment for such work.

Most states impose the charging lien by statute. As such, the procedure for perfecting the lien must be reviewed for each state where the lien is sought to be imposed. Most states, require that an attorney seeking to perfect a charging lien file a notice of lien. The notice of lien usually must be filed in the client and the opposing parties within a period of time or the lien is lost. Specific care must be directed to determining when the notice can be filed. An example of this is in the Illinois case, **Rhpades vs.**

Norfolk & W.R. Co. (1979) an attorney charging lien was denied because the law firm filed the claim four days after being discharged by the client. Most states require that notice of the lien be filed before the end of the proceeding and do, as Illinois did above, require the attorney be the client's attorney at the time of the filing of the lien. An unperfected charging lien may be effective between the client and the attorney but not third parties without knowledge of the lien. For that reason, it is always a good idea for an attorney to enter into the habit of filing a notice of lien in every case where a charging lien is permitted to the attorney fee portion of the judgment being attached by the client or lost in bankruptcy.

The charging lien will terminate and be deemed waived as to proceeds which the attorney knowingly allows to be paid to the client or to a third party without raising any objections by virtue of the lien. in short, the attorney cannot stand on the equitable right to have a charging lien and must steps to preserve the right to the lien.

In Florida, charging liens have been recognized since the mid 1800's. Florida requires, for the creation of a charging lien, that there must be a contract between the client and the attorney, either express or implied. As part of the contract, there must be an understanding, under Florida law, that there be an understanding either express or implied, that any recovery by the client will be

used to assist in the payment of the attorney fees and costs. Lastly, to have a charging lien in Florida, the client must either avoid payment of the attorney fees or dispute the amount of the fees. In essence, the Florida charging lien is imposed once the client does an act which evidences an intent either to avoid payment altogether of the legal fees or objects to the amount claimed. This is usually not a major issue because upon settlement, the attorney receives the settlement check. In disbursing the settlement proceeds to the client, the attorney usually will present the bill at the same time. At this time, the client will raise any objections to the payment of the attorney. If such objections are then raised, the attorney will assert the charging lien. Florida has no requirement for perfecting a charging lien beyond that of timely notice to the client and opposing parties, if reasonable.

As with any other equitable right, a charging lien is based upon natural equity that a plaintiff should not be allowed to take or receive the entire judgement derived as the result of the attorney's legal representation without paying the attorney.

Minnesota follows the general rule that an advance payment for services to be rendered by an attorney will not be subject to attachment as a charging lien. The charging lien, by its very nature, attaches only to the recovery or settlement of a case as a result of the attorney's efforts. The attorney may still sue the client for unpaid legal fees, it is just that the attorney charging lien will

not attach to such advance payments. **St. Cloud Nat. Bank & Trust Co. vs. Brutger** (1992) 488 NW2d 852.

Because of its equitable nature, an action by an attorney against the client to enforce a charging lien is also equitable in nature and does not entitle the client to a jury trial. **Rosenman & Colin vs. Richard** (1988) 850 F2d. 57

In Colorado, there is no common law attorney lien and instead replaced it with a statutory lien which is basically the same. Under Colorado law, the attorney has a retaining lien on the client's papers until the legal services have been paid. In addition, an attorney in Colorado is given a charging lien on any judgment that the attorney obtained or assisted in obtaining in favor of the client. **People vs, Brown** (1992) 840 P2d. 1085, **People vs. Smith** (1992) 830 P2d 1003. While the charging lien exists in Colorado between an attorney and client, it will not be enforced against a third party unless a notice of lien is filed. This means that Colorado, creditors of the client along with a bankruptcy trustee of the client can attach the entire judgment unless the attorney has perfected the lien by filing a proper notice of lien.

California upheld in **Bluxome Street Associates vs. Fireman's Fund Ins. Co.** (1988) 206 Cal.App.3d 1149, a contractual security interest lien on a client's recovery by the law firm. The lien was not permitted as an equitable charging lien but as any other contractual lien. This lien was given priority over a subsequently

created lien of the attorney who represented the client in the suit which was the subject of the security interest, and over the subsequently filed lien of a judgment creditor of the client, even though no notice of the first law firm's lien had been filed although the notices of the subsequent liens were filed.

COLLECTION

The area of fee dispute has engendered a lot of controversy over the years. Primarily, an attorney is not supposed to sue his client for payment of money. Nonetheless, if the attorney doesn't sue and the client doesn't pay, how is he supposed to get his money and earn a living? There are the two different competing thoughts on the issue of collection of fees. In the situation where the attorney has received the settlement for the client, or the client has been paying the fees up front in advance, the attorney will give an accounting to the client and a bill stating how much is owed. If the client objects to the bill, the attorney is required to pay to that client all of the money that is not in dispute and take as payment for his attorney fees the amount of money from the client trust account that the client agrees is owed to the attorney. The amount of money that the client and the attorney do not agree on remains in the client trust account until there has been a resolution.

(a) ARBITRATION OF FEE DISPUTES

There are two ways of going about this. The client can seek fee arbitration, and in many states it is mandatory if the client

requests it and the attorney is required in some states to inform his client of that right. The ABA's Comment under Model Rule 1.5 is a recommendation to attorneys that fee disputes be resolved in an arbitration proceeding. Many state bars, have taken this recommendation to heart and require an attorney to submit to fee arbitration of the client requests it. Furthermore these states require their attorneys to inform their clients of the right to demand arbitration of fee disputes.

When arbitration is not required, an attorney can immediately sue his delinquent client in court for a determination of what amount is owed for the rendered attorney services. Even when a client may insist of arbitration, it is not mandated. The client can elect to reject arbitration and instead sue in court, but usually that is an unnecessary burden on the client. A real situation comes into play where the client does not have any money and has not paid anything to the attorney. If the state gives the client the right to insist of mandatory arbitration, the client would object to the bill and then they could arbitrate it. Without mandatory arbitration, the attorney could immediately go ahead and sue. Generally, with arbitrations, the attorney often will have the requested fee is reduced anywhere from one-quarter to as much as one-half, although one-third seem to be about the average. In an arbitration, the arbitrator will usually be a practicing attorney appointed by the county bar association. The arbitrator will look at the evidence, see how much time the attorney has spent on the case and then determine what fee amount should

actually be charged. If it appears the attorney has been churning the case, then of course the fee award is going to be reduced considerably.

(b) SUING THE CLIENT

Unless an attorney is required by state law to enter binding arbitration with a client over attorney fees, the attorney can sue the client for unpaid attorney fees. Suing a client is never a popular thing to do. When viewed carefully, little is really lost by suing a client. When things have deteriorated to an extent that the attorney is considering suing the client that means, for all practical purposes, that the attorney has already lost the client as a source for any future work.

Notoriety is often cited as a reason for a client not to sue a client. That argument, however, cuts both ways. If an attorney refuses to stands up against charges of improper billing or malpractice by a client seeking not to pay the legal bill, the attorney is impliedly agreeing to the charges. If the charges are true, the attorney should forgive the bills and hope the client eventually shuts up and does not sue the attorney for malpractice. When the charges are not true, the attorney must sue to keep his good name. In Bakersfield, California, an attorney sued a client in small claims for $500 in legal fees. The attorney normally charges $175.00 per hour and the total preparation and hearing took four hours. When asked why, she sued the former client rather than

forgive the fee, the attorney replied, "I would have had the client kept the matter between ourselves. But she (the client) went around stating that I had over billed and did not handle the case properly. I heard this from several persons. As such I felt that I had to do so to protect myself and my reputation." The attorney lost from a financial standpoint but she cleared her name and removed any cloud on it when she was awarded judgment for $500.

Every fee agreement should have a clause that bestows attorney fees to the prevailing party in the event of a lawsuit. Some attorneys leave this provision in the hope that in the event of a successful malpractice action the client will not receive attorney fees. There might be a good reason not to include such a clause in the fee agreement, especially in the situation where the attorney does not have malpractice coverage or is sloppy in the manner in which the attorney practices. In most instances, the clause will be of benefit to the attorney. In lawsuits against the client for failure to pay fees, the attorney will, if such clause is present in the agreement, receive attorney fees if another attorney is hired to handle the collection. The reason for this is that many states will not permit an attorney to collect attorneys fees for collecting a judgment on the attorney's own case. In such states, the attorney who wins the case against the client will not be compensated for the time spent in getting the judgment. When an attorney fee clause is in the retainer agreement, the attorney has the option of hiring another attorney to get the judgment. By doing

so, the attorney will not be out anything when the judgment is obtained because the client will pay the attorney fees incurred in the collection.

Of the most important things for any attorney to remember is that an attorney probably should not, in most instances, sue a client who is judgment proof. If the client is broke, going bankrupt or if the likelihood of a recovery is slight, then the attorney should not waste time suing the client. In such a situation, obtaining a judgment is waste of time and for an attorney to pursue the action, instead of working on paying cases, is an equal waste of money as well.

CHAPTER SIX

TAXATION MALPRACTICE

INTRODUCTION

One of the most dangerous areas of law in which an attorney can practice is that of taxation. The tax advisor is probably the attorney who will most be sued either by the client, the Internal Revenue Service or the State taxing agency as a result of the attorney's advice. Attorneys have always been subject to lawsuits from clients based upon alleged malpractice in the type of advice given by the attorney. The far more recent development has been the attachment of disciplinary rules and penalties against the attorney by various government agencies as a result of that advice. The Treasury Department, in addition to an attorney's state bar, has implemented its own disciplinary rules under 31 C.F.R. Part 10, discussed below. An attorney, who violates the standard of care adopted by the Treasury Department, will be subject to discipline or penalties by the IRS. In addition, the violation of this standard will automatically give rise to a malpractice action by the client, unless the attorney had fully advised the client of the potential rejecting by the IRS of the claimed tax position.

Nearly all advice given by an attorney has some type of tax implication. An attorney is held to the standards of a tax attorney when giving tax advice. The potential for malpractice liability for giving erroneous tax advice is very great. The purpose of this book

cannot be to educate attorneys as to every area of potential liability for improper tax advice. This chapter is intended to briefly discuss tax law in general. By giving attorneys a basic overview of tax law and potential areas of liability, attorney, hopefully, will be better able to understand the tax effects of their advice and when it would be better to refer the client to tax professionals. To avoid malpractice liability for improper tax advice, the attorney should consult with a tax attorney, or else conduct tax research, on a matter involving potential tax consequences to a client before advising action. The purpose of this chapter is limited to the malpractice liability which may derive from an attorney's tax advice or from dealing with the Internal Revenue Service.

ATTORNEY'S STANDARD FOR TAX ADVICE

Attorneys should understand that malpractice liability may arise from tax return preparation or audit representation with the IRS. A client seeking tax guidance goes to an attorney or other tax professional for that advice. The first question that arises is what duty the attorney owes to the client? Model Rules of Professional Conduct 2.1 reads as follows:

> "A client is entitled to straightforward advice expressing the lawyer's honest assessment. Legal advice often involves unpleasant facts and alternatives that a client may be disinclined to confront. In presenting advice, a lawyer endeavors to sustain the client's morale and may put advice in as acceptable a form as honesty permits. However, a lawyer should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client."

The first problem that an attorney must face in advising a client on a potential course of action is the selection of the tax standard which the attorney will apply to the problem. Over the years, there have developed different standards to govern the propriety of an attorney's tax advice to a client. The standards for which an attorney's advice is compared are: the reasonable basis or support test, the substantial authority test or the reasonable authority test.

Often the decision as to whether an attorney is liable to the government for the tax advice given to the client will depend on the particular type of tax standard utilized in that client's fact situation. The problem with the various standards is obvious; an attorney may choose the wrong standard. If the attorney plays it safe and uses the most conservative standard, then the attorney will never violate any Treasury Rules. In that situation, however, the client may end up paying more taxes than legally could be required if the transaction was organized differently, although a greater likelihood of IRS challenge would exist. If the client will pay more taxes solely because the attorney is attempting to protect himself from government review, then the attorney may be exposed for malpractice to the client for the client's increased costs, taxes and lost revenues. The attorney is therefore caught between a rock and hard place. Playing conservatively may protect the attorney from government sanction while exposing the attorney for malpractice to the client. The only real defense that an attorney

has against malpractice suits for rendering tax advice is to understand the various standards for tax practitioners and to knowledgeably adhere to them. When in doubt, the best practice for an attorney is to advise the client to obtain, if time permits, a private letter ruling or other opinion from the IRS as to the tax results from the proposed action.

For many years, the standard used to govern a tax attorneys' advice to a client was that of the reasonable basis or support test. Under this test, as announced in ABA Formal Opinion 314, an attorney was not to be subject to discipline for supporting or presenting a client's position as long as the attorney had a reasonable basis for the assumed position. A determination of what constituted a reasonable basis for an assumed position were the negligence provisions promulgated under section 6653(a) and 6694(a) which originally read as follows:

> 6653 (a) NEGLIGENCE OR INTENTIONAL DISREGARD OF RULES AND REGULATIONS WITH RESPECT TO INCOME, GIFT, OR WINDFALL PROFIT TAXES.
>
> If any part of any underpayment (as defined in subsection (c)(1) of any tax imposed by subtitle A, by chapter 12 of subtitle B (relating to income taxes and gift taxes) or by chapter 45 (relating to windfall profit tax) is due to negligence or intentional disregard of the rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.
>
> 6694(a) NEGLIGENT OR INTENTIONAL DISREGARD OF RULES AND REGULATIONS
>
> If any part of any understatement of liability with respect to any return or claim for refund is due to the negligent or intentional disregard of rules and regulations by any person

> who is an income tax preparer with respect to such return or claim, such person shall pay a penalty of $100 with respect to such return or claim. (Section 6694 was amended in 1989 as stated below)

As long as the attorney had a reasonable basis for the position taken, the client would not be subject to negligence or fraud penalties. The definition as to what constituted a reasonable basis was, by nature so lose, that nearly every position argued by an attorney would qualify for a reasonable basis defense against negligence or fraud penalties. Since the mid 1980's, the reasonable basis test has been steadily reduced in its application. The ABA, for instance, now limits the application of its Formal Opinion 314, to advice given by attorneys to taxpayers engaged in audits, trials or other adversarial proceedings. The ABA no longer uses the reasonable basis standard to govern attorney tax advice to clients rendered for the purpose of tax return preparation but since sues that standard to govern representation is tax audits and tax suits.

In 1982, the substantial authority test first appeared. The test itself is, as the name implies, one that requires the tax advisor to have "substantial authority" as support behind the taking of a tax position. Failure to have such substantial authority could expose both the client and the tax advisor to tax penalties. A reasonable belief in the correctness of a tax position will not protect the tax advisor or client from tax penalties if the position is not supported by substantial authority. The substantial authority requirement was created as a result of

Internal Revenue Code section 6662 which created the "audit lottery". Under section 6662, penalties are assessed against taxpayers whose tax returns contain "substantial understatements" of owed income tax unless there is either "substantial authority" for the position or the position is "adequately disclosed" on the return. By defining, a "substantial understatement" as one that exceeds the greater of (1) 10 percent of the tax required to be shown on the return for the taxable year, or (2) $5,000. There is a 20% accuracy-related penalty for a substantial understatement of tax liability. To avoid or lessen the penalty, the taxpayer must show that (a) the position was taken in good faith with a reasonable cause for the understatement, (b) the understatement was based upon substantial authority in its support; or (c) the relevant facts relating to the position were adequately disclosed on the return so as to give the IRS notice of the position being taken. A very important aspect of this test is that even when a taxpayer possesses substantial authority for a position, a tax penalty will be asserted unless the taxpayer had a reasonable belief that the action taken was more likely than not the correct one. In other words, the client and the tax attorney must believe that they would probably win in the face of an IRS audit even though they have substantial authority for their position in order to avoid penalties (Sec. 6662(d)(2)(C)). Under Section 6662(d)(2)(D), the IRS is required to publish an annual list of positions for which there is no"substantial authority" when

significant numbers of taxpayers may be affected.

The substantial authority test was specifically adopted because it is more demanding than the reasonable basis test. The Conference Report for the proposed provision. 1982-2 C.B. 600, reads, in part;

> "The conferees believe such a standard (substantial authority) should be less stringent than a 'more likely than not' standard and more stringent than a 'reasonable basis' standard. Thus, it is anticipated that this new standard will require that a taxpayer have stronger support for a position than a 'reasonable basis' (a 'reasonable basis' being one that is arguable, but fairly unlikely to prevail in court upon a complete review of the relevant facts and authorities).

The result of the substantial authority test is that the attorney advising a client will be more likely to be subjected to a malpractice action than under the earlier "reasonable basis" test.

The ABA responded to the "substantial authority" test by revising its Formal Opinion 314, as discussed above. The ABA replaced its earlier reasonable basis or support test for tax advice with one of "realistic possibility of success." In its Formal Opinion 85-352, the ABA took the position that attorneys did not violate their professional duty by taking or asserting a tax position for a client where the attorney has a "realistic possibility of success if the matter is litigated". The ABA standard is markedly less stringent than the "substantial authority" test in IRS section 6662. The substantial authority test almost creates the presumption that the client would win on an IRS challenge. Whereas under the realistic test, the attorney must have

more than a reasonable belief that the client would win but less than an almost dead certain of prevailing.

In response to the various standards for tax advice covered above, the Congress, in 1989, rewrote section 6662 to add a new "accuracy-related penalty" as part of the Improved Penalty and Compliance Act (IMPACT). As part of Impact, Congress adopted the ABA standard of "realistic possibility of success" for determining when negligence and fraud penalties should be asserted. In doing so, Congress, rewrote section 6694 as follows.

6694(a) UNDERSTATEMENT DUE TO UNREALISTIC POSITIONS. --If--

> (1) any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits,
>
> (2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and
>
> (3)such position was not disclosed as provided in section 6662(d)(20(B)(ii) or was frivolous, such person shall pay a penalty of $250 with respect to such return or claim unless it is shown that there is reasonable cause for such understatement and such person acted in good faith.

(b) WILLFUL OR RECKLESS CONDUCT. --If any part of any understatement of liability with respect to any return or claim for refund is due:

> (1) to a willful attempt in any manner to undertake the liability for tax by a person who is an income tax return preparer with respect to such return or
>
> (2) to any reckless or intentional disregard of rules or regulations by any such person, such person shall pay a penalty of $1,000 with respect to such return or claim. With respect to any return or claim. With respect to any return or claim, the amount of the penalty payable by any person by reason of this subsection shall be reduced by

> the amount of the penalty paid by such person by reason of subsection (a).

The significance of this section is not in the relatively small penalty. Rather, the significance lay in the unstated results on the attorney. Once the IRS makes a determination that the attorney had engaged in willful or reckless conduct and assesses a penalty, the attorney may thereafter be subject to a malpractice action by the client. The IRS determination is the first step by the client of a malpractice action against the attorney. If the IRS finds that the position taken was proper or supported by a realistic possibility of success, then the attorney did nothing wrong as is not subject to a malpractice action. Only when the IRS rejects the position as being unrealistic, does the possibility of a malpractice action begin to loom against the attorney.

The most interesting aspect of the regulations promulgated under section 6694 is the type of authority upon which an attorney or client can rely upon in taking their position. Under Treas. Reg. 1.6694-2(b)(3), once proposed regulations have been adopted on a matter, previously issued private letter rulings which are inconsistent with the proposed regulation, regardless of whether it is adopted or not, is no longer authority for which a position can be based. The IRS's stated position is that "proposed regulations are subject to a higher level of review than private rulings and it are not appropriate to retain as an authority a document that does not accurately reflect the current status of the law and the

position of the Service." Despite private letter rulings, contradicted by proposed regulations may not be relied upon as authority, the attorney or client may use other "certain types of authority" for as a basis for their position. Regulation 1.6662-4(d)(3)(ii) holds that a "taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision". This regulation has been taken to mean that if a construction of a statute is such that it can reasonably be thought to be interpreted in the manner asserted by the taxpayer, then the position is realistic until a court renders a final construction and interpretation of the statute. Under Treas. Reg. 1.6694-2(b)(3), a policy argument on a situation not addressed by a statute does not, in itself, meet the realistic possibility standard. In addition, the well-reasoned construction of a statute will not constitute a realistic possibility of success when the statute is "unambiguous" on its face.

ATTORNEYS AS TAX PREPARERS

It is very important for attorney understand their relationship with their client. An attorney who can or will be classified as a tax preparer may lose the attorney-client privilege and therefore be forced to testify on information used to prepare the tax return. An income tax preparer is defined in I.R.C. section 7701(a)(36)(A) which reads as follows:

"(A) IN GENERAL.- The term "income tax return preparer" means

> any person who prepares for compensation, or who employs one or more persons for compensation any return of tax imposed subtitle A or any claim for refund of tax imposed by subtitle A. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

The determination of issue of whether an attorney an attorney is acting as an attorney or as a tax preparer is difficult. The test is whether the person receives compensation for preparing some portion of the income tax return. Compensation, as used in the Internal Revenue Code (IRC), is not limited to the receipt of cash by the attorney and includes any property, both real or personal, for the preparation of the return. In addition, the compensation may be paid by someone other than the taxpayer. In **Goulding vs. United States** (1989) 717 F.Supp. 545, an attorney was found to be an income tax preparer for a partnership even though the general partner, not the limited partners, had paid the attorney to prepare the limited partners' tax returns.

For attorneys, the issue of when a return is prepared is critical. Treasury Regulation section 301.7701-15(a)(2)(ii) defines preparing, besides filling out the return, as also including advising a taxpayer on an item which is directly relevant to an item to be listed on any return or claim for refund. Under Treas. Re, 1.6694-1(b)(2), preparer penalties will be assessed not only against the person "who signed the tax return or claim for refund but also to the any other preparer who did not sign the return but

who provided advice to a taxpayer or to (the signing) preparer."

Tax advice from an attorney may make the attorney an income tax preparer depending upon when that advice is given in relation to the transaction involved. Under Treas. Reg. section 301.7701-15(a)(2)(I), when an attorney gives tax advice on the tax consequences of actions which have not yet been taken, the attorney will not be treated as an income tax preparer. On the other hand, when the attorney gives advice on the tax effects of actions which have already been taken, the attorney made become an income tax preparer. In other words, an attorney advising the client on the tax implications of buying a building will not be a tax preparer. An attorney advising a client, after the building the building has been bought, as to the tax deductions and depreciation on the building to be claimed on the client's tax return, may under the fact situation be considered a tax preparer.

For an attorney to be found to have acted as a tax preparer, the attorney must have prepared either all or a "substantial" portion of the return or a claim of refund. Whether an attorney has completed a "substantial" portion of a return or claim of refund is defined by the circumstances of the case. Under Treas, Reg. 301.7701-15(b)(1), the IRS considers the following factors in determining whether the attorney's involvement in the preparation of the tax return or refund claim was substantial: length of time spent on the advice, the complexity of the matter on which the advice was given and the amount of the tax matter in question as it

relates to the client's tax return or refund claim in total. In **Goulding vs. United States**, supra, an attorney who prepared schedules for three partnerships was subsequently liable for the returns of over 200 limited partners who based their returns on the furnished schedules. Under Treas. Reg. 7701-15(b)(2), there is a safe harbor provision which holds that where the attorney's advice involves amounts which are (1) less than $2,000 or (2) less than $100,000 and less than 20% of the taxpayer's gross income, then the advice involved is not substantial to the client's tax return.

Under IRC section 6694(a) there is a $250 penalty assessed to any preparer for a client's understatement of tax liability when there is not a realistic possibility of the asserted position being sustained on its merits. Under Treas. Reg. 1.66942(b)(1), a position is considered to be realistic when it is held to have, at least, a one in three chance of success by the reasonable and well-informed analysis of a knowledgeable tax professional. Under Treas. Reg. 1.6694-3(b)(5), the realistic possibility standard must be met as of the date of return which is easier than under the substantial authority test which must be met as of the date of the end of tax year in question.

Under section 6662, a client and therefore a tax preparer is not required to support a position if the position is disclosed to the IRS and the position is not frivolously taken. For the purposes of this section, frivolous is defined as being a position that is

patently improper which is held to mean that the preparer's knowledge or tax analysis is irrelevant to the asserted position. Disclosure of such information can me made on Form 9275 or in accordance with the IRS's annual revenue procedure Rev. Proc.92-23. From the standpoint of an attorney, no attorney can ever advance or assert a frivolous position without becoming subject to discipline. Under Model Rule 3.1:

> "A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."

As such, an attorney who has a client insisting on asserting a frivolous position must seek withdrawal from the action or else risk being subject to severe disciplinary action for asserting a frivolous position, In addition to state bars disciplinary action, an attorney who asserts and maintains frivolous action before the IRS may be disqualified or suspended from practice before the IRS.

A situation often arises for attorneys that their advice to clients to disclose their position under section 6662 is not followed. In such an instance, the attorney may find himself liable as a tax preparer for the client's action. To address this situation, under Treas, Reg, 1.6694-2(c)(3(iii)(A), an attorney could avoid liability to the IRS for the client's failure to disclose by advising the client in writing that the position lacks "substantial authority" and therefore may subject the client to a penalty used the matter is adequately disclosed. An attorney giving

such notice to the client will not be subject to any penalty by the IRS as a result of the client's act. In addition, by giving the client such a written notice, the attorney would have a defense for malpractice for any claim raised by the client. In such a case, the attorney would be able to prove that he or she advised the client that the client's proposed position was without substantial authority and therefore likely to expose the client to additional taxes and penalties. In the same vein, when the attorney's advice is given to a preparer of the return rather than the client, giving a written notice to the preparer of the disclosure requirement will relieve the attorney of liability as well for the client's failure to disclose an unrealistic position.

IRS CIRCULAR 230

The Treasury Department adopted Circular 230 to govern who and how individuals, including attorneys, practice before the Internal Revenue service. Practice before the IRS includes a representation of an attorney which involves "a client's rights, privileges or liabilities under the laws or regulations administered by the Internal revenue Service." Under Circular 230, attorneys licensed in any state could practice before the IRS.

Attorneys could be suspended or disbarred from practicing before the IRS for either disreputable conduct or a willful violation of the rules set forth under Circular 230. The issue of disreputable conduct includes a criminal conviction for the violation of a federal tax law, providing false and misleading

information to the IRS, a willful attempt to evade federal tax, and knowingly suggesting illegal tax evasion schemes.

An attorney practicing before the IRS has certain duties imposed upon them in addition to the state bar's disciplinary rules. Among such Treasury imposed practice rules under Circular 230 are: not to work with anyone disbarred or suspended from practice before the IRS, the duty to furnish information to the IRS, duty of due diligence in the operations with the IRS, prohibition against unreasonable fees and conformity with the due diligence requirements for rendering tax shelter opinions.

I. GENERAL TAX ADVICE

INTRODUCTION

The IRS provides free tax information and services. IRS publication 910, Guide to Free Tax Services, describes the publications and services available to taxpayers. There are more than 100 publications by the IRS containing tax information. Videotaped instructions for completing tax returns have been prepared by the IRS in both Spanish and English. They are available in some public libraries. Braille materials are also available at regional libraries in conjunction with the Library of Congress. The IRS offers the TELE-TAX service which is a telephone service that provides recorded tax information on more than 140 subjects. The TELE-TAX service will also tell a taxpayer the status of a refund.

In addition, the IRS also operates a telephone service for hearing-impaired persons who have access to TDD equipment. Call

1-800-829-4059. The IRS provides toll-free numbers in every state for taxpayers to call regarding tax questions.

Congress mandated that the IRS create a Problem Resolution Program for taxpayers that are unable to resolve their problems with the IRS. A taxpayer may write to the local IRS District Director or call the local IRS office and ask for Problem Resolution Assistance. The problem resolution officer will advise the taxpayer of the Taxpayer's Bill of Rights and help solve problems. While the problem’s resolution officer cannot change tax law or technical decisions, the officer can assist in other ways.

A. UNDERSTANDING TAXATION

Every person, business or entity that earns money must pay taxes. The amount is an increasing scale based on the amount of earnings. An individual taxpayer's tax rate, filing requirements and standard deduction are determined by his filing status. The five filing statuses are:

1. Single. Unmarried or legally separated on the last day of the tax year. State law determines if a person if married or legally separated.
2. Married filing jointly.
3. Married filing separately.
4. Head of Household. A qualifying widow or widower with a dependent child.
5. Qualifying widow or widower.

Congress has provided tax exemptions. These are set amounts that

taxpayers deduct from their income before calculating taxes. Tax exemptions reduce a taxpayer's income before tax is computed. There are two types of tax exemptions which are personal exemptions and dependency exemptions. A taxpayer is entitled to one exemption for himself and, one for his spouse. These are the personal exemptions. An exemption for a spouse with individual income can only be taken if a joint return is filed. In 1990 each exemption was worth $2,050. For example, a married couple with $35,000 income will pay taxes on $30,900 after the personal exemptions are taken: $35,000 -(2) 2,050 = $30,900.

The dependency exemption of $2,050 is permitted for each dependent of a taxpayer. As with a personal exemption, each dependency exemption reduces the taxpayer's gross income before tax calculation. There are five tests for dependency that must be met before an exemption is allowed.

1. Member of Household or Relationship Test. The dependent lives with the taxpayer or is a relative.
2. Citizenship Test. The dependent is a U.S. citizen or resident, or a resident of Canada or Mexico.
3. Joint Return Test. The dependent has not filed a joint return with his spouse.
4. Gross Income Test. Generally, a dependency exemption is unavailable if the person sought to be claimed has earned more than $2,050 for the year. This does not apply to the earnings of a child or a student under 24 years of age.

5. Support Test. More than half of the support of the person must be provided by the taxpayer during the year.

A situation may exist where several persons contribute at least ten percent (10%) to the support of a person, such as children supporting an elderly parent. In such a case, no one individual can meet the support test. When this happens, each person providing more than ten percent (10%) of the support may agree for one of them to claim the exemption. Each person agreeing not to claim the exemption must sign a written statement to that effect. Form 2120 is used for that purpose. It must be filed with the tax return of the person claiming the exemption.

Not everyone is allowed an exemption. The amount that a taxpayer may claim as a deduction is gradually reduced once his taxable income exceeds the level for his filing status.

Filing Status	Taxable Income Subject to Exemption Phaseout
Single	$97,620
Married filing jointly	$162,770
Married filing separately	$123,570
Head of Household	$134,930
Qualifying Widow(er)	$162,770

If the taxable amount is less than the amount shown in the above table, the taxpayer continues to deduct the exemptions on the Form 1040 as usual. The amount of the exemption phaseout is computed using the tax rate schedules.

B. ACCOUNTING METHODS

The Internal Revenue Code requires all persons in business to

elect one of two forms of accounting methods. The two methods of accounting are the cash method and the accrual method. The requirement for an individual to deduct business expenses as they are paid or to deduct them as they occur (maybe before they are paid) depends on the accounting method employed. Once an accounting method is selected, a taxpayer cannot change it without the consent of the IRS.

Under the accrual method of reporting, a taxpayer reports income when earned; not when received. Likewise, expenses are deducted when incurred; not when paid.

Under the cash method of accounting, the taxpayer reports all items of income in the year that they are actually or constructively received. The taxpayer will only deduct those expenses actually paid. This is the tax method that most individuals utilize. Income is considered constructively received by a taxpayer when it is credited to a taxpayer's account or is set apart in any way that makes it available to the taxpayer. Actual possession of the income is not necessary. If a person cancels a debt that is owed him by a taxpayer, the amount of the canceled debt is income to the taxpayer and must be reported. Income received by an agent of a taxpayer is constructively received by the taxpayer and must be reported. Regardless of the method used, prepaid income is generally reported when received if the funds are available to the taxpayer.

If the taxpayer is on the accrual method of reporting, advance

payments for services to be performed by the end of the tax year can be deferred from income until the taxpayer actually earns them by performing the services, Publication 538, Accounting Periods and Methods, covers the advantages and detriments of both methods.

Once an accounting method is chosen, it cannot be changed without IRS approval. A taxpayer, however, can use a different method for each business the taxpayer may have. If the taxpayer wishes to change his accounting method, Form 3115, Application For Change of Accounting Method, is used.

C. FILING A TAX RETURN

Married taxpayers have the election of filing separate tax returns or just one joint return. In a joint return the income and expenses of both spouses are combined and treated as one. In the vast majority of cases filing a joint return is best because it usually results in a lower total tax than if each spouse filed a separate return. The tax advantage arises because the married-filing-separate returns employ the same income levels as a joint return but at higher tax rates.

There can be instances when it is better to file separate returns. One such situation might be when one spouse has high medical bills that do not exceed the required percentage of income for deductibility on a joint return but would be deductible on the separate return. In the same vein, large miscellaneous itemized employee deductions might not reach the two percent (2%) floor for adjusted gross income on a joint return but might be deductible on

the separate return. The only way to know which return is best for the couple is to compare the taxes owed under both returns. The couple should then use the return under which the least amount of taxes are owed.

D. TAX EXEMPT BONDS AS GOOD TAX PLANNING

Tax exempt bonds are one of the few tax avoidance vehicles still available. A tax exempt bond is a special bond issued by a federal, state or municipalities that is free of federal and, in some cases, state income tax. Bonds are issued by the government, are usually secure and a good stable investment. Tax exempt bonds pay less interest than regular bonds. The advantage of the tax-free bonds over most regular bonds is that the amount of total income available to the taxpayer is greater.

The following is a chart of the interest a taxpayer would have to be paid on a regular bond to match a tax-free bond yield:

	TAX-EXEMPT YIELD						
	4%	5%	6%	7%	8%	9%	10%
TAX RATE	REGULAR BOND YIELDS						
15%	4.74%	5.88%	7.06%	8.24%	9.41%	10.59%	11.77%
28%	5.56%	6.94%	8.33%	9.72%	11.11%	12.59%	13.89%
31%	5.80%	7.25%	8.70%	10.14%	11.59%	13.04%	14.49%

Before anyone invests in tax-free bonds, they should determine whether the income from the bonds will result in an alternative minimum tax being paid. Generally a wealthy person who otherwise shelters income from regular income tax may still have to pay a minimum tax. This is called the alternative minimum tax. Most

investors need not be concerned with the alternative minimum tax because the exemption for the tax is $45,000 for joint return, $33,750 for single returns and $22,500 for married persons filing separately.

E. THE DEDUCTIBILITY OF MEDICAL BILLS

To the extent that medical bills are not covered by insurance and exceed seven and one-half percent (7.5%) of the taxpayer's adjusted gross income they are deductible. The medical expenses are deductible in the year in which they were incurred and paid regardless of whether the taxpayer uses the accrual or cash method of accounting. The failure of a taxpayer to claim or file for reimbursement from an employer or insurance company for medical bills do not affect the deductibility of the expense. The medical deduction also extends to prescription drugs including insulin and other qualified miscellaneous medical expenses.

Miscellaneous medical expenses are:

1. Cost of purchasing and training a seeing-eye dog or other such helpful animal.
2. Lodging expenses while traveling for treatment.
3. Medical expenses paid for a dependent. The taxpayer must keep records of all medical bills in order to deduct them.

The taxpayer must keep records for all medical bills in order to be able to properly deduct them.

F. TAX TREATMENT OF ALIMONY PAYMENTS

The alimony rules changed in 1985. Anyone paying or receiving alimony pursuant to divorce or separation agreements executed prior to 1985 will continue to have those payments governed by the tax law in effect at that time. Persons paying or receiving alimony pursuant to a divorce or separation agreement executed after 1984 will have the tax characteristics of the payments governed by the Tax Act of 1984:

1. The payments must be received by or on behalf of former or separated spouse under a divorce or separation agreement,
2. The payments must be in cash or its equivalent,
3. When legally separated or divorced, the payor and payee must not live in the same household,
4. Responsibility to make the payments must end on the death of the payee spouse, and
5. The payor and payee must not file joint returns.

Qualified alimony payments are taken as a deduction from gross income by the paying spouse. The alimony deduction can be taken whether the payor spouse itemizes or not. The Tax Act of 1984 created a special alimony recapture provision for "excess alimony payments." The purpose of this rule is to prevent the parties from claiming a tax deduction for a property settlement by simply calling the payments alimony.

Under the Act, alimony payments made in the second year following the separation will be recaptured to the extent that they

exceed the third year's payments plus $15,000. Likewise, there will be a recapture of the first year's alimony payments to the extent that the second year's payments exceed them plus $15,000. Occurrences which do not trigger a recapture of alimony payments are:

1. When the payments are made pursuant to a temporary support order.
2. When the payments are from an instrument requiring the payor to pay a fixed percentage from a business.
3. For the year the payments end, the payee remarries or the payor or payee dies.

Recapture of alimony payments may occur when:

1. The payor misses too many payments.
2. Payments are reduced because of modification of the agreement or a reduced need on the part of the payee or a reduced ability to pay by the payor.

Anyone divorced or separated after 1985 who is paying or receiving alimony should be aware of the tax recapture provisions of the 1984 Act and structure their affairs accordingly.

G. THE EARNED INCOME TAX CREDIT

The Earned Income Tax Credit is a refundable tax credit available for a low-income worker who maintains a household in the U.S. that is the principal residence of the worker plus a child or children for over one-half of a tax year. The taxpayer must also meet the following requirements:

1. Be married and filing a joint return and entitled to a dependency exemption for the child or children, or
2. Be a surviving spouse, or
3. Be a person qualifying as a head of household whose unmarried child or children are part of the household.

The earned income credit is refundable to the extent that it reduces the tax below zero. An eligible taxpayer may elect to receive an advance payment of the credit through the taxpayer's paychecks. Form W-5 can be used by a taxpayer to notify his employer that he chooses to receive the advance payments rather than wait for a tax refund after the return is filed.

H. THE GASOLINE TAX CREDIT

A credit for federal excise taxes on gasoline and special fuels exists for fuel used for the following:

1. Farming purposes.
2. Non-highway purposes of a trade or business.
3. Operation of an intercity, local, or school bus.

A one-time credit or refund is allowed to the purchaser of a qualified four-wheeled diesel-powered vehicle, one with a gross weight of less than 10,000 pounds that is registered for highway use. The credit is one hundred ninety-two dollars ($192) for a truck or van and one hundred two dollars ($102) for other vehicles. The credit reduces the basis of the vehicle and is computed on Form 4136 and attached to the taxpayer's Form 1040.

I. THE ALTERNATIVE MINIMUM TAX

The alternative minimum tax was designed to assure that wealthy corporations and high-income individuals do not avoid taxation altogether through legitimate investments and tax planning. The calculation of the alternative minimum tax is figured on Form 6251. If the minimum tax is greater than the taxpayer's regular tax, he must pay the alternative minimum tax amount.

The minimum tax applies to taxpayers who have the following tax preference deductions which exceed $45,000 if married filing jointly, $33,750 if single or head of household, or $22,500 if married filing separately:

1. Accelerated depreciation.
2. Tax-exempt interest from private activity bonds.
3. Intangible drilling costs for oil or gas wells.
4. Depletion allowance for natural resources.
5. Tax shelter farm losses.
6. Passive activity losses.
7. Installment sales of certain property.
8. Mining exploration and development costs.

Children 13 years of age or younger may also have to pay a minimum tax at the same rate their parents would have to pay.

J. DEDUCTIONS FOR COMMUTING COSTS

Transportation expenses incurred in traveling from one workplace to another in the course of a taxpayer's business, profession or job are deductible as long as the taxpayer does not incur them while traveling to or from home. Costs incurred in

traveling to a place of work from home or to home from a place of work is not deductible. It makes no difference how far a taxpayer has to commute or even if work is done during the trip.

If a person gets his work assignments from a union hall, travel from home to a union hall and from a union hall to the job are not deductible. There is no deduction for the travel to the union hall. The union is not an employer; so travel from there to the job is not travel to another work place and is not deductible.

K. DEDUCTIONS FOR DISASTER LOSSES

Special tax treatment is available to persons who have suffered losses from a disaster in an area in which the President awards federal disaster relief. The taxpayer may deduct the loss caused by the disaster in either:

1. The year in which the loss occurred or
2. The preceding year.

Non-business casualty losses may not be deducted for damage suffered on insured property unless the taxpayer files an insurance claim for the property damage within a reasonable time after the loss. The taxpayer should compare the tax effects in claiming the loss for both the year suffered and the preceding year. The taxpayer should then file for the year in which it is most advantageous.

L. DEDUCTIBLE INTEREST

Personal interest is no longer deductible, but there is a substantial exception to this rule for taxpayers who own a home.

Homeowners are allowed interest deductions for loans on their homes and second homes subject to these limitations:

1. The total debt to acquire the home may not exceed $1,000,000, and
2. The total amount of home equity debt may not exceed $100,000.

This exception allows homeowners to take a home equity loan on their homes of $100,000 or less and reduce consumer loans whose interests are not deductible. Using home loans in place of consumer loans is wise tax planning because interest on home loans is deductible while other personal loans are not.

M. CAN GIFTS BE USED TO REDUCE TAXES IN A FAMILY?

One of the best ways of avoiding or reducing taxes in a family is to split the income among the family members. Income splitting is beneficial: graduations in individual income tax rates reduce total income tax liability for the family when income is shifted to family members in a lower tax bracket. Two family members paying taxes on $25,000 each is cheaper than one member paying taxes on the whole $50,000. A transfer to a child younger than 14 years of age might not result in a tax saving because the "kiddie tax" generally will require the income to be taxed at the parents' rate.

N. PARENTS EMPLOYING THEIR CHILDREN TO REDUCE TAXES

For parents owning a business, substantial tax savings usually will result if a taxpayer is able to employ his children in the business. Hiring a child always results in income being shifted from the parent to the child.

The child's wages are deductible as a legitimate business expense by the parent. To be deductible, the services must actually be rendered by the child. In addition, the child's wages must be reasonable for the services rendered. Accurate record keeping is needed to document that the payments to a child are for work actually done and not gifts.

O. PROVIDING FOR A CHILD'S COLLEGE THROUGH THE TITLE GUARANTY PROGRAM

The title guaranty program is relatively new but offers significant benefits to parents seeking to provide for their children's future college education. Under this program a parent pays a lump sum to the trust established by the state's tuition program and identifies the child as the beneficiary. Under the terms of the trust the child will be entitled to four years of college services at no additional cost to the parent. The trust may also provide cash refunds in the event that the child does not attend the college.

This program provides a way for parents to prepay a child's college education at a lower tax rate. The payment is viewed as a gift by the parent and applied to the $600,000 unified credit of the parent: the $10,000 annual gift exclusion is not available for the parent because the student is not immediately attending the college.

The increased value of the education over the amount the parent had paid is income to the child, once the child starts

attending a college under this program. The increased value must be reported as income by the child. Still, there will probably be no taxes since the child will be in a low tax bracket.

For example, assume that a parent pays $15,000. Ten years later when the child attends college a four-year education costs $31,000. The income to the child will be $16,000 spread over the four college years. The child will report $4,000 per year income: the increased value of the education.

P. THE INVESTMENT TAX CREDIT

An investment tax credit is a special credit in the tax code for investment in a trade or business involving any of the following:

1. Qualified rehabilitation of an older building,
2. Investment in solar or geothermal energy equipment, or
3. Investment in qualified timber property.

The investment tax credit is combined with the targeted jobs tax credit, the alcohol fuels credit, the research credit and the low-income housing credit to make up the general business credit. Each of the credits is calculated separately and then totaled for the general business credit. The general business credit is used to apply credit limitation and carry back and carryforward rules.

The investment tax credit for rehabilitating old buildings is ten percent (10%) of the expenditures. The requirements for the tax credit are:

1. The credit is only available for nonresidential buildings,

and

2. The building must have been placed in service prior to 1936.

In addition, a twenty percent (20%) credit is available for certified historic structures listed in the National Register or located in registered historic districts and certified as being historically significant. The basis of the building is reduced by the amount of the investment tax credit claimed.

The solar and geothermal credit was scheduled to expire at the end of 1991. Instead, its name was changed to "energy investment credit." Now there is a ten percent (10%) energy investment credit for solar or geothermal energy equipment placed in service during the year. The credit is limited to such depreciable property that is constructed, reconstructed, erected, or newly acquired that meets certain required performance and quality standards.

A ten percent (10%) reforestation credit on an amortizable basis is allowed on any qualified timber property that a taxpayer acquires during the year. This basis may not exceed $10,000 ($5,000 if married filing separately). A qualified timber property is any wood lot or other site in the United States that contains trees in significant commercial quantities and that is held by the taxpayer for the planting, cultivating, caring for, and cutting of trees for sale or use in the commercial production of timber products. Reforestation expenditures include:

1. Preparing the site for replanting.

2. Purchase or seeds or seedlings.

3. Costs of labor and tools used in the replanting.

An investor (such as a limited partner) in a qualified timber property may claim his share of the investment tax credit on the investor's tax return.

Q. TAXATION OF SOLE PROPRIETORSHIPS

A sole proprietorship is a business that is totally owned and operated by just one person or a husband and wife and is not incorporated. The owner is taxed directly on all income from the business. The sole proprietor reports the business income and expenses on Schedule C of his Form 1040.

The sole proprietor must pay estimated tax and self-employment tax on business net income. A sole proprietor may take deductions for business expenses that are reasonable and ordinary. In addition, a sole proprietor may take a deduction of twenty-five percent (25%) of the health insurance premium for himself, a spouse and dependents.

R. TAXATION OF A PARTNERSHIP

A partnership is a legal entity composed on two or more individuals or companies to conduct a business, usually for profit. A partnership does not pay any taxes. The partnership merely reports all of its income and expenses by filing a tax return. Under the Internal Revenue Code, all of the income and expenses of a partnership are attributed to the partners according to their ownership interest in the partnership. The partners are required

to include their share of the partnership income and expenses on their personal tax returns.

S. TAXATION OF A REGULAR CORPORATION

A regular corporation is referred to in the tax code as a C corporation because that is the chapter of the tax code which deals with it. A C corporation is subject to a different taxing structure than an S corporation, partnership, or sole proprietorship.

The income of a C corporation is subject to double taxation. The corporate income is taxed first when the corporation files its corporate tax return for the net earnings of the corporation. The C corporation income is taxed again when the corporation pays dividends to its shareholders. The dividends that a shareholder of a C corporation receives are includible in the income of the shareholder on his Form 1040 Schedule B.

For example, assume that a C corporation has $1,000,000 in net profit, it pays approximately $340,000 in taxes. After it distributes the remaining $640,000 in dividends to the shareholders, they pay taxes on the amount they receive. Assuming that all shareholders' tax rates are twenty-eight percent (28%), they will pay an additional $179,200 in taxes. The total tax on the corporate income of $1,000,000 is $519,200. In other words, the joint tax on corporate income exceeds fifty-one percent (51%).

T. TAX SHELTERS

Tax shelters are investments that offer the possibility of reducing the investor's current income taxes through legal methods.

There are many different types of tax shelters such as:

A. S corporations.

B. 401(k) plans.

C. IRA's (Individual retirement accounts).

D. SEP's (Simplified Employee Plans).

E. Real Estate Shelters.

F. Oil and Gas Shelters.

G. Equipment Leasing.

The type of tax shelters most familiar to taxpayers involve the acquisition and leasing of property with the intent of deriving a special tax benefit beyond the ordinary investment in the property. The basic aims of tax shelters are to use available tax opportunities to the fullest extent and to reduce current taxes and, if possible, future taxes and past taxes.

1. TAXATION OF AN S CORPORATION

An S corporation is a corporation given special tax treatment. It consists of a corporation with no more than 35 shareholders who have elected to have the corporation receive S status. The effect of the S corporation election is to have the corporation taxed as if it were a partnership.

In an S corporation the income is attributed to shareholders in accordance with their stock ownership. The S corporation itself pays no federal income tax. The shareholders pay the taxes on the corporate income. For example, assume that an S corporation earns $1,000,000. It pays no taxes. The shareholders include the

$1,000,000 on their tax returns. Assuming a twenty-eight percent (28%) federal tax rate, the shareholders pay $280,000, not the total $519,200 that a C corporation and its shareholders must pay.

Because of its tax advantages, every highly successful small corporation should consider the tax effects of making an election to become an S corporation. An S corporation is an excellent tax shelter for avoiding double taxation. A C corporation must pay a corporate tax on its income before it pays dividends to the shareholders. The shareholders must then pay taxes on those dividends. The S corporation does not pay taxes on its income. Instead S corporation income is treated as though it had all been paid to the shareholders, whether it was or not. The shareholders then pay taxes on the attributed income, achieving a substantial reduction in taxes and an increase in income.

For example, assume that a C corporation has two shareholders and $1,000,000 in profits. At an assumed federal corporate tax rate of thirty-three percent (33%) the federal corporate tax is $330,000. If the entire profit is paid as dividends to the shareholders, they have to pay another twenty-eight percent (28%) personal income tax or $187,600. If the corporation were an S corporation, the federal tax would be twenty-eight percent (28%) on the entire $1,000,000: $280,000.

2. USE OF A 401(k) PLAN

A 401(k) plan is also called a "cash or deferred arrangement" (CODA), a "cash option plan" or a "salary reduction plan". It

permits an employee to make an election between receiving current compensation or having a portion of it contributed to a qualified stock bonus or profit-sharing plan.

This type of retirement plan can be more advantageous to an employee than an individual retirement account (IRA). While IRA deductions are limited to the lesser of $2,000 or 100% of the employee's wages, an employee may defer a maximum of $8,475 into a 401(k) plan. Another advantage is that 401(k) plan participants can use favorable lump sum distribution rules whereas under an IRA all distributions are taxed in full.

The use of a 401(k) plan is a fringe benefit that in reality does not cost the employer. The contribution which the employee makes into the plan is with money that the employer would have paid regardless of whether a plan had been implemented or not. Therefore the adoption of a 401(k) plan by an employer makes good sense because it provides a fringe benefit to the employees which helps foster employee loyalty and contentment.

3. INDIVIDUAL RETIREMENT ACCOUNT (IRA)

An IRA, Individual Retirement Account, is one of the few tax shelters that is available to low and working class taxpayers. An IRA is virtually the exclusive tax shelter of low and working class taxpayers. It is reduced as income increases. The maximum amount that can be contributed is as follows:

1. If neither taxpayer nor spouse is an active participant in a retirement plan, the IRA contribution is fully

deductible (up to $2,000 for worker, $2,250 with nonworking spouse).

2. If either taxpayer or spouse participates in a retirement plan, the following contributions are tax deductible:

   a. Single with an adjusted gross income of $25,000 or less, the deduction is 100% of the contribution to a maximum of $2,000.

   b. Single with an adjusted gross income of more than $25,000 but less than $35,000, the $2,000 deduction is reduced $200 for every $1,000 earned over $25,000.

   c. Single with an adjusted gross income over $35,000 there is no deduction.

   d. Married-Filing-Jointly with an adjusted gross income of less than $40,000 the deduction is $2,000 or $2,250 if a non-working spouse is included.

   e. Married-Filing-Jointly with an adjusted gross income over $40,000 but less than $50,000, the $2,000 deduction is reduced $200 for every $1,000 earned over $40,000.

   f. Married-Filing-Jointly with an adjusted gross income over $50,000, there is no deduction.

   g. Married-Filing-Separately the deduction is reduced for every $1,000 of adjusted gross income up to $10,000.

An active participant in a qualified retirement plan may be ineligible to participate in an IRA. For that reason it is necessary to know what constitutes an active participant. The Internal Revenue Code defines an active participant is an individual or spouse on a joint tax return who has had a contribution made to a defined contribution plan account for his benefit. The contributions to the plan can be made by either the employer or by the employee. The employer's retirement contribution does not have to be a vested contribution (immediately owned by the employee).

An active participant for a defined benefit or money purchase plan is an individual who is included under the plan's eligibility rules even if no benefit accrues to the individual. Since there are limitations for contributions to an IRA for an individual or spouse participating in a qualified retirement plan, the individual must know what constitutes a qualified retirement plan. A qualified retirement plan is any pension or a profit-sharing plan described in the Internal Revenue Code:

1. A section 401(a) plan: a defined benefit, contribution or profit-sharing plan.
2. A 401(k) plan discussed above.
3. An annuity plan under section 403(a).
4. An annuity contract described in section 403(b).
5. A plan established by the United States, a state, or political subdivision or agency or instrumentality

thereof, except for a plan described under section 457(b).

6. A simplified employee pension under section 408.

7. A plan under section 501(c)(18).

As can be seen from the above list, nearly all pension plans will be qualified retirement plans. Anyone making an IRA contribution must first determine that the employer does not maintain a qualified pension plan which may prohibit such IRA contribution.

Active participation in a qualified retirement plan ends when the employment ceases. A person covered by a plan who ceases working for the employer and begins receiving distributions from the plan is also not considered an active participant in the plan. An individual can make contributions to an IRA over the tax deductible amount. These excess contributions will not be deductible for tax purposes. Example: George is single and earns $22,000 per year. He can contribute a maximum of $2,000 and deduct it on his taxes. If he contributes $5,000, only $2,000 of the contribution will be deductible. There can be a tax advantage in contributing the extra amount to the IRA: the earnings of the excess contributions are tax free until the time of distributions.

Nondeductible IRA contributions are not taxable when withdrawn because taxes have previously been paid on them when they were originally earned. The earnings attributable to the contributions are taxable.

When there is a withdrawal, the owner must file Form 8606 to

designate the portion of the withdrawal attributed to a return of the nondeductible contributions and the portion attributed to the earnings on them. Example: George contributes $5,000 to the IRA. $2,000 is deductible and $3,000 is nondeductible. If the $5,000 IRA is worth $10,000 at the time of withdrawal, $3,000 is not taxable, and the remaining $7,000 is taxable.

4. SIMPLIFIED EMPLOYEE PENSION (SEP)

A simplified employee pension (SEP) is a simple written plan that allows an employer to make tax deductible contributions toward the employer's and the employees' retirement. The SEP program allows the employer to make contributions to the Individual Retirement Accounts (IRAs) of each participating employee. A SEP may be established by an unincorporated employer thereby making the contribution to a self-employed participant "earned income."

The annual SEP contribution of an employer excluded from the participant's gross income is the lesser of fifteen percent (15%) of the participant's compensation or $30,000. If the employer exceeds this amount, the participant will be subject to a six percent (6%) excise tax on the excess contribution. A SEP requires the following:

1. That the employer contribute to each employee who has reached the age of 21 years,
2. That each employee has worked for the employer three of the last five years, and
3. That each employee received at least the indexed dollar

amount of compensation for the year (in 1990, it was $342).

Any plan that discriminates by excluding otherwise eligible employees will not qualify for tax exemption. An employee can also contribute to the SEP-IRA subject to the normal IRA contributions limits.

5. REAL ESTATE SHELTERS

The most common tax shelter involves rental real estate. In the past few years, however, rental real estate as an investment has lost much of its tax saving potential. Passive activity tax laws no longer permit tax losses generated by passive real estate investments to be offset against the investor's active income (his wages or stock dividends or bond interest).

In the face of these tax restrictions, investment in rental real estate should only be undertaken if the property can pay for itself. Relying on expected appreciation as a justification for purchase of a property may no longer be wise since passive losses from the property are not deductible against active income.

Anyone intending to invest in rental real property should be aware of the following tax characteristics affecting such property:

a. Passive Activity Rules. Unless an investor owns more than ten percent of the property or investment, the investment will be considered passive in nature. A limited partnership investment is considered passive regardless of how much the investor owns. If the investor meets the

active participant test, he can deduct up to $25,000 of rental losses from non-passive sources. This $25,000 maximum is reduced for investors with over $100,000 adjusted gross income.

b. Straight Line Depreciation. All real property since 1986 must use straight line depreciation. No recapture of depreciation occurs on the property's sale.

c. Special Credits. There are special credits for rehabilitation and low income housing.

6. OIL AND GAS SHELTERS

Oil and gas tax shelters refer to those investments in programs for the drilling or development of oil and gas properties. Within the last ten years the tax benefits behind such shelters have gradually been reduced or eliminated. Thus oil and gas projects presently are not highly profitable. Consequently, domestic oil and gas production has steadily dropped and foreign dependence has increased.

Oil and gas tax shelters still have a few characteristics with which an investor should be aware:

1. Intangible drilling expense deduction. Expenses incurred or paid after 1986 for the drilling and completion of an oil or gas well are

    a. Amortized over a 10-year period using a straight line method, or

    b. Added to the basis of the property in the determination of cost depletion.

2. Passive Activity Rules. Investors who obtain working interests in wells are exempt from the passive activity rules. This is better tax treatment than is available in rental real estate. All losses can be deducted against non-passive sources.
3. Depletion Allowance. Investors are permitted a deduction for the depletion of the oil and gas removed from their properties. In addition, independent producers (those with less than 1000 barrels per day) are entitled to a percentage depletion.
4. Alternative Minimum Tax. Both the depletion allowance and the intangible drilling costs are tax preference items: the investor may be subject to the alternative minimum tax as a result of the investments.

7. EQUIPMENT LEASING

Equipment leasing offers the experienced investor several distinct tax advantages:

1. Assuming the investor is not in the leasing business, the lessor has the depreciation on the equipment. Accelerated depreciation may be used under the MACRS system, and this is better than straight-line depreciation over the useful life of the equipment.
2. If the lessor is not in the leasing business, the income from the leasing is passive income that can be used to offset passive investment losses.

3. Interest deductions are allowed for the borrowed funds used to purchase the equipment. These deductions may not exceed the amount of yearly income from the leasing.

In order for the investor who purchased the equipment with borrowed funds to be able to deduct losses from the equipment leasing, he must have his investment "at risk." The "at risk" rules require the investor personally to be responsible to repay the loans on the equipment. If the investor is not personally responsible to repay the loans, the investor may not deduct the interest payments on his income tax return.

U. PAYMENTS RECEIVED UNDER THE FEDERAL EMPLOYEES COMPENSATION ACT

Payments received under the Federal Employees Compensation Act for personal injury or sickness, including payments to beneficiaries in case of death, are not taxable. On the other hand payments received which are classified as "continuations of pay" are taxable for a maximum of forty-five (45) days while the legitimacy of the claim is being decided. Sick leave pay for the time that the claim is being processed is also taxable as wages and must be reported.

The employee may "buy back" sick leave for an earlier year so as to be eligible for non-taxable FICA benefits for that period. Buying back sick leave entitles the employee to a miscellaneous deduction subject to the two percent (2%) limitation of Schedule A of Form 1040.

V. TAXABILITY OF SCHOLARSHIPS AND EDUCATIONAL GRANTS

Some or all of a scholarship or grant may be excluded from income under certain conditions. Publication 520, Scholarship and Fellowship Grants, covers this area of the law. A person receiving a qualified scholarship may exclude the amount from income. A qualified scholarship is any amount received by a student that is for the following:

1. Tuition and fees to enroll at or attend an educational organization.
2. Fees, books, supplies, and equipment required for courses at the educational institution. Amounts used for room and board do not qualify for exclusion.

All payments received for services, such as teaching or conducting research, must be included in the recipient's income even though the receiving of the grant is possible only if certain services are performed.

Scholarship prizes won in a contest are includible income whether the recipient must use them for educational purposes or not. Educational assistance allowances paid by the Department of Veteran Affairs are not includible in gross income. Such educational allowances are not considered scholarships or fellowship grants.

W. TAXABILITY OF WORKERS COMPENSATION BENEFITS

Payments received for an occupational sickness or injury are fully exempt from tax if the payments are made under a workers compensation act or a state statute similar to it. The exemption

also applies to payments to a survivor if they would otherwise qualify as workers compensation.

The tax exemption does not apply to retirement benefits received based on age, length of service, or prior contributions to the plan, even though the worker retired because of occupational sickness or injury. Should the worker later return to work and be assigned light duties while still receiving benefits, the benefits received thereafter are taxable. If "workers compensation" reduces social security or railroad retirement benefits the worker is receiving, part of the "worker's compensation" may have to be included income. This issue is addressed in Publication 915, Social Security Benefits and Equivalent Railroad Retirement Benefits.

X. TAXABILITY OF BARTERING ACTIVITIES

Bartering is the trading of property for services or the trading of services for services without the payment of money. Under the Internal Revenue Code bartering is treated the same as the payment of money for the property or services. The persons receiving the bartered property or the services must include, the fair market value of the property or the services received on their tax returns as income. Taxation of bartering activities is the government's attempt to tap into the underground economy of an estimated hundred billion dollars per year.

For example, assume that a painter paints a house and the paint job is worth $1,000. At the same time, the owner, a mechanic, does a $1,000 repair job on the painter's truck. Each

person has $1,000 income to include on their tax return.

If property or services are exchanged through a bartering club, the club is required to furnish the parties and the IRS a Form 1099B, Statement for Recipients of Proceeds for Exchange Transactions. The club is also required to withhold taxes on the bartering unless the parties furnish their social security numbers on Form W-9.

Y. INSTALLMENT SALE METHOD OF REPORTING GAIN

A special tax method of reporting gain from the sale of property is used when at least two payments are received by the seller over a period longer than a year. Installment sale reporting is not usually available for dealers in the property. Moreover, this installment reporting is not available for reporting losses from the sale. Under this method a percentage of each payment reflects the percentage gain on the sale. Example: A car is sold for $2,000. It had cost the seller $1,000. The profit (gain) is $1,000 which is 50%. Payments are $83.33 per month for two years. Therefore, one half ($41.66 per month) is gain from the sale and must be reported on the seller's tax return.

Under the old law installment sale treatment was limited. The seller had to pay taxes on the full profit of the sale although full payment for the property would not be received till some time in the future. The advantage of current installment sale law is that the seller only has to pay taxes on the profits from the sale as they are received.

CHAPTER 7

THE LIMITED LIABILITY COMPANY

I. DEFINITION

In the recent when a client wished to form a business the attorney only had to present the options of a corporation or partnership. That has changed. The most recent development in business law is the creation of the Limited Liability Company (LLC). Failure to advise a new client on the possibility of doing business in this form may, at worse, expose the attorney to a malpractice suit and at best have the attorney labeled as ignorant and unreliable.

The first LLC was created in the 1970's. For many years LLC's were not popular because the tax laws subjected them to more taxation than either a corporation or a limited partnership. In 1977, the first LLC was created in Wyoming for an oil company. The company was granted a private tax ruling stating that it would be treated as a partnership. In 1980, the U. S. Treasury issued proposed regulations that stated an LLC would be taxed as a corporation because its members did not have a partner's liability for the company's debts. In 1988, the Internal Revenue Service finally issued Revenue Ruling 88-76, 1982 CB 360, stating that an LLC could be taxed as a partnership. This revenue ruling calmed concerns about forming LLC's. As a result, all the other states began adopting limited liability company acts.

An LLC is a cross between a corporation and a partnership. The characteristics that are shared with a corporation or a

partnership are:

1. It bestows limited liability on its members just as a corporation does on its shareholders and a limited partnership does on its limited partners.
2. It can provide for the free transferability of its membership interests the same as a corporation or partnership.
3. It can provide for continuity of life after the death, resignation, expulsion or bankruptcy of a member the same as a corporation or a partnership.

In addition, an LLC operating agreement may give full management and control to just a few managing members, which is the same treatment that is available in a partnership and similar to that of the board of directors of a corporation. The following, however, are the major differences between LLC's and corporations or partnerships:

1. Unlike a corporation, which can have perpetual existence, an LLC can only exist for a stated period of time (30 years in many states) before it is terminated.
2. Unlike the partners of a general partnership, the members of the LLC are not personally liable for the debts of the company, which is the same basic treatment as that of shareholders of a corporation or limited partners of a limited partnership.
3. Unlike a corporation, the company does not have the corporate restrictions on financing. Example: The company does not need to create a special surplus account for distributions.
4. Unlike a corporation, in the majority of states, absent an agreement among the members to the contrary, profits and losses of an LLC are allocated in accordance with each member's percentage of capital contributions. A few

> states have adopted the per capita partnership rule: if there is no agreement on decision, profits and losses will be allocated equally among members. Either method is different from that of a corporation. Division of corporate profits and losses must be based upon the number of shares that a shareholder owns in the corporation.

These characteristics are important. If an LLC has any three of them (as discussed below), it will be taxed as a corporation. Such taxation would be detrimental to members so care must be taken in deciding which common characteristics the company should share with a corporation.

The main advantage of an LLC is the limited liability that it provides its owners, who are called members. In an LLC, the most that its members can lose in a lawsuit against the company are the assets they contributed to the LLC. The limitation of liability would naturally not extend to any personal guarantees of company debts by a member. If a member personally guarantees a company loan of $100,000, the member is personally liable for the repayment. The member's liability arises not because the person is a member of the company but because the member guaranteed that he personally would repay the loan. It is immaterial that the money may have gone directly to the company. The limited liability for members is quite different from that of a general partnership where the partners are totally liable for all debts of the business. The creditors of a general partnership can seek and attach every dollar and piece of property that a partner owns in order to settle a judgement against the partnership. Such personal attachment to

satisfy company debts cannot be taken against the assets of a member. People either incorporate or form an LLC to eliminate this unlimited business liability exposure. Few people will invest in a business that risks everything they have or will earn.

LLC's are relatively new and has taken time for them to catch. As of April 1997, all fifty states and the District of Columbia have enacted a limited liability company act. All states also now permit foreign limited liability companies to operate within their borders.

An LLC is considered to be separate and apart from all of the people who own, control and operate it. An LLC holds most of the rights of a legal person. An LLC is able to validly execute contracts, incur debts, hold title to both real and personal property and pay taxes. The attractiveness of LLC's is that they are held to be separate legal entities from owners, the members, which gives them unique advantages over both corporations and partnerships.

II. FORMATION

A. General

An LLC is a statutory creation. It can only be formed by strict compliance with the state law under which it is being created. An LLC, just as with a corporation or a limited partnership, requires a public filing of its formation documents. The filing of the articles of organization is required:

1. To give public notice that the company is formed in a way that bestows limited liability on the members for the debts of the company, and

2. To give the public notice where the company is located and who can act in its behalf.

Most states permit an LLC to be formed with only one owner, member. However, a number of states require that an LLC have at least two members. This is a different requirement from corporations, which are permitted to have only one shareholder. In addition, several states including Arizona, Colorado, Delaware, Illinois, Iowa, Kansas, Louisiana, Maryland, Minnesota, and Virginia permit one person to form an LLC, but the company is not given effect until it has more than one member. States that require a company to have two or more members often also require two or more persons to sign the articles of organization or a subscription agreement prior to filing the articles. If a company falls below the minimum number of members for an LLC, it will not only be dissolved but it will lose the limited liability shield for its members to the extent necessary to dissolve the company. A company will be treated harshly if it continues to do business for an undue period after ceasing to have the minimum number of members. Those states that have the two member requirement use it to insure the availability of the partnership classification for tax purposes. A partnership requires, by definition, two or more persons engaged in business.

B. ARTICLES OF ORGANIZATION

Articles of Organization is the term given to an application by a group of individuals or entities for a license to do business as an LLC. Once the articles are accepted and filed, the LLC is thereafter formed. Each state sets its own requirements for the contents of the articles, however, they all require:

1. A name for the company which does not mislead the public but does disclose that it is an LLC.
2. The address of the company's principal place of business.
3. The name and address of the company's registered agent in the state.

The requirement for listing both the resident agent and the registered office is also imposed upon a company which is incorporating. Listing of a registered agent ensures that someone is authorized to receive legal process against the company. The resident agent is the person who is served any legal notices or summons and complaint on behalf of the company. A company maintains a resident agent in the state, or by default agrees to let the Secretary of State serve as the resident agent. The registered office is the location where the company's authority is kept in the state. The registered office address gives notice to the world where any complaint against the company can be served.

Several states also require additional provisions to be included in the articles, such as:

1. How capital contributions will be made to the company.
2. Whether the company will be treated as a corporation or partnership for tax purposes.
3. Name and address of each organizer.
4. Whether all the members or a centralized management will manage the company.

The states of Colorado, Florida, Minnesota, Nevada, West Virginia and Wyoming require the articles to state if the company will continue in effect upon the death, bankruptcy or withdrawal of a member.

This book attempts to provide a general set of articles

sufficient for most states and has provided specific articles when necessary. The reader should, nonetheless, familiarize himself with the particular LLC law of the state where the LLC will be formed. There are possibly current changes not reflected in this text. The provisions contained in the articles of organization for an LLC can only be altered or changed by the filing of an amendment to the articles. Members frequently place important management provisions in the articles because it is difficult to amend them. The articles contained in this book are all that are needed to meet minimum requirements under state law. In practice, the entire operating agreement or any of its provisions can be included in the articles. Remember, once something is listed in the articles, it can only be changed by filing an amendment.

Before the articles are filed, they must be approved and adopted. The person who will file the articles calls a meeting of potential members where they decide what provisions will be contained in the articles. They also decide another important detail: whether all the members or a centralized panel of selected managers will manage the business. Once the articles are adopted, they must be signed either by all the selected managing members, or by all of the members (if no managing members are selected. Usually, the operating agreement for the company is also created and adopted at this meeting.

C. OPERATING AGREEMENTS

After the LLC files its articles, it exists on paper; it does not exist at law (de jure) until membership certificates are

actually issued. It is the fact that the company has outstanding membership certificates in the hands of members that are the defining characteristic behind the existence of an LLC. Similarly, a corporation is not deemed to be in effect until it has sold and issued stock. Following the filing of the articles, the potential members of the LLC meet to purchase their membership certificates and adopt the operating agreement for the business. After the membership certificates have been issued, the company is fully formed.

Operating agreements are the rules for the general day-to-day management and operation of the LLC. Contained in the operating agreement are the terms of the company concerning:

1. Capitalization of the business,
2. Distributions made from the business,
3. Admission and withdrawal of members,
4. Management of the business,
5. Fiduciary duties owed to and by the members, and
6. Dissolution of the company.

The operating agreement is adopted by the members and thereafter can be amended only by a majority vote of the members. An operating agreement is an attempt to resolve the many areas of potential conflict within an LLC and to delegate duties and assign responsibilities.

Operating agreements can be general in nature or tailored to the needs and desires of the members. Most operating agreements contain or mention most of the issues covered in the Operating Agreements chapter. A few states do not require the operating agreement to be in writing. Only if the agreement is in writing can

the actual intent of the members be ascertained with confidence.

Operating agreements are not set in concrete and, in fact, quite flexible. Members can change the operating agreements by simple amendments. The purpose of operating agreements is to establish procedures for daily administration and management of the company. As the company develops the operating agreement must be amended to meet new requirements.

As can be seen from the foregoing discussions, the steps for forming a business as an LLC are simple:

1. File the articles of organization,
2. Adopt the operating agreement, and
3. Issue the membership certificates.

Once these steps have been accomplished, the LLC is formed and can commence operations. An LLC is easier and less expensive to create than a corporation or a limited partnership provided ordinary caution and cares are undertaken.

D. MEMBERS

Members are the owners of the LLC. Usually an LLC need only have one member although some states, such as Nevada, require at least two. Members own the membership certificates of the LLC and have the right to vote in the election of managing members. The extent of ownership interest a member has in the company is usually based either:

1. Upon a member's percentage of contribution to the total contribution of all the members,
2. Upon an equal division among all the members irrespective of contribution (per capita), or
3. Upon some other agreement between the members.

Members are not personally liable for the debts of the LLC beyond the extent of their investment in the LLC. Exception: A member is personally liable for a company debt or obligation if he personally guarantees repayment.

Members may agree for all members to manage the company or agree to elect a few members to manage, who will be called "managing members." In addition to electing any managing members, the members are required to vote on the following:

1. Amendment of the articles of organization,
2. Sale, option or lease of substantially all of the LLC's assets,
3. Merger or consolidation of the LLC with another LLC,
4. Amendment of the operating agreement,
5. Removal and replacement of managing members, and
6. Dissolution of the LLC.

The term "managing member" refers to all of the managing members. Managing members must be elected if the operating agreement does not reserve the management to all of the members. If managing members are elected, they alone are responsible for running the day-to-day business of the LLC. When the LLC is taxed as a corporation, the managing members are permitted reasonable compensation for their services. In small LLC's, the managing members usually serve for free to protect their investments.

Caveat: The decision to have the LLC managed by elected managing members is an element of corporate existence. If the company also has free transferability of its shares or continuity of life, it will be taxed as a corporation and not as a partnership.

Most operating agreements for an LLC require an annual members' meeting to review business affairs and conduct. The members also will elect or reelect the managing members for another year. Members are usually given votes proportional to their percentage of ownership in the company. A majority of those membership interests voting are needed to carry a resolution or any other matter brought to the floor.

A member has a duty of loyalty to the LLC. A member cannot usurp a company benefit that could go to the LLC. A member owes the LLC the right of first refusal on any business opportunity he discovers that could affect the company. For example, if the company is in the paving business, a member could not form a competing paving business and solicit business from the LLC's existing clients. When a member has a personal interest on a matter before the board, the member is only allowed to vote on it if:

1. The member's interest has been fully disclosed to the board, and
2. The contract is just and reasonable.

A member cannot be sued by other members for losses incurred as a result of the member's actions or decisions provided they were reasonable and prudent. As agents of the LLC, members have the authority to bind the company by their actions. Members can execute contracts for the company and can subject the company to liability for damages arising from negligent or intentional acts they may commit on behalf of the company.

All states hold that an assignment of a member's interest only passes financial right unless the operating agreement states

otherwise. The assignee (person who acquired a member's interest in the company) only acquires the right to participate in the management of the company through a majority vote of the other members. Usually, a consensus is required.

This is important enough to repeat. The non-assigning members must agree to let the new member participate in the management unless the operating agreement states otherwise. This lack of full transferability of interest means that the interests do not have "free transferability." As a result, the value of the company is lessened and the company is assisted in obtaining tax treatment as a partnership.

E. MEMBERSHIP CERTIFICATES

Membership certificates should be thought of as the ownership interests in an LLC. The membership certificate is little more than a record that a person is a member of the company. The degree of interest that the member has in the company is determined by the terms of the operating agreement. Every LLC is authorized to sell only a certain amount of membership certificates in accordance with the security laws of the state where the company is formed. The purchasers of the membership certificates acquire an ownership interest in the common equal to their percentage of membership certificates to the total number of membership certificates outstanding. Membership certificates may be sold by an LLC for money, labor, services, canceled debts or property contributed to the LLC. Membership certificates can also be purchased with promissory notes. Although not required, membership certificates

acquired with notes are usually secured by tangible property.

Membership certificates can be voting or non-voting. Non-voting membership certificates are usually issued by an LLC to raise money without giving the certificate owner the right to participate in the business. To attract purchasers for non-voting membership certificates, an LLC may guarantee a fixed distribution payment or the right to convert the non-voting interests into voting interest based upon a fixed formula at a later date.

F. SECURITY LAWS

A membership interest in an LLC is a security just like stock in a corporation or interest in a limited partnership. Thus a membership certificate cannot be sold unless it is either registered or exempt from registration under both federal and state law. Registration for sale of a security under federal law costs thousands of dollars and takes months. Fortunately, there are several specific exemptions that a qualified LLC can use to avoid the federal registration requirement. Most small LLC's have at least one exemption available to avoid registration. The exemptions are:

1. The company is exempt under section 3(a)(1) of the Securities and Exchange Act. This is the most popular exemption for small companies. It is available where all the members reside in the same state where the LLC is incorporated and doing business.
2. The sale of the membership certificates is a non-public offering under section 4(2) to sophisticated investors and there was no public advertisement or solicitation for the membership certificates sale.

3. The sale complied with SEC Regulation D requirements by adhering to strict SEC disclosure regulations.

Once the requirements for claiming an exemption have been satisfied, then the LLC can issue its membership certificates without fear of violating federal security laws.

In addition to the federal registration requirement, all states have registration requirements for securities sold in their jurisdictions. Just as there are exemptions from the federal registration requirement, all of the entities that permit LLC's also have exemptions. Usually, an LLC of less than 15 members can simply sell membership certificates and notify the secretary of state of the sale. An LLC using this exemption is generally not required to identify the members who purchased.

If a membership certificate is sold without complying with both federal and state exemption procedure, the sale is voidable at any time by the purchaser. If the company fails, the members could use the fact that no exemption was ever obtained to sue the organizer for their money. A California case provides an actual example of how security laws are applied. A limited partnership was sold to fund the drilling of an oil and gas well. At the time the legal exemption was for a maximum of five persons (it has since been increased to 35). The interests were sold to nine members. The well was drilled and was dry. Two of the investors sued to get their money claiming the sale was not exempt because more than five persons bought interests. The general partner faced criminal charges for selling an unlicensed security and had to refund the full investment money to all of the investors. If the sale had

been to only five persons, there would not have been a problem. The lesson to be borne in mind is that it is not only necessary but critical to open both the state and federal security laws.

G. TAXATION

How an LLC will be taxed is the second most important concern, the first being the limited liability of members. Because an LLC has elements of both a corporation and partnership, it can, depending on the facts, be treated for tax purposes as either a corporation or a partnership. When the LLC is taxed as a partnership, its income is passed to its members and double taxation is avoided. On the other hand, when an LLC is taxed as a corporation, its income is taxed twice, first upon being earned and second when distributed to its members as dividends. It is almost always better for an LLC to be taxed as a partnership so as to avoid the double taxation.

Regardless of how a LLC is treated for tax purposes, be it as a partnership or as a corporation, the members of the LLC will not have personal liability for the debts of the company.

Federal Tax law changed dramatically in 1997. As of January 1, 1997 all newly formed LLC's with two or more members will be treated as a partnership for tax purposes unless the LLC elects corporate tax treatment either as a C corporation or S corporation. A single member LLC will be treated as a sole-proprietorship for federal tax purposes. This is a complete reversal of prior federal tax law. Prior to 1997, an LLC was taxed as a corporation unless it could prove to the IRS that is should be a partnership. In order

to prove that a pre-1997 LLC should be taxed as a partnership it had pass a special four-prong test created by the IRS.

As of January 1997, LLC are automatically given partnership tax treatment unless they specially opt out of it. To opt for corporate tax treatment, the LLC will file a new IRS Form 8832. The election is effective on the date specified in Form 8832 or the date filed if no date is specified. An effective date can even be chosen that preceeds the filing date by up to 75 days. See IRS. Regulation sec. 301.7701-3(c)(1)(i).

While LLC’s no longer have to pass the IRS’s four prong test for federal tax purposes, many states still apply that test in order to determine if the LLC will get state partnership tax treatment. These states had patterned their tax laws after the federal tax law and have not, as yet, changed their tax law to coincide with the new federal laws. In addition, some states have written the four-prong test into their LLC Acts so that the Articles of Organization filed in those states must address the issues raised in the four prong test.

Because some states still use the IRS four-prong test to determine if an LLC will be treated as a partnership for state tax purposes, this chapter will discuss the four-prong test. The IRS Revenue Rulings on the four-prong test are still persuasive authority for determining whether an LLC will get partnership taxation in a state which still employs the test. If it is not known whether a particular state uses the IRS four prong test in deciding whether to give an LLC partnership treatment, the

organizer can go ahead and assume that it does and meet the test, thereby assuring partnership tax treatment for both federal and state purposes. Later if it is determined that the state does not use the four prong test or if state law is changed to do away with it, the company can change the articles or operating agreement any way that it wishes without fear of losing the state partnership tax treatment.

THE FORMER IRS FOUR-PRONG TEST STILL USED IN MANY STATES

The IRS utilized until January 1, 1997, a four-prong test for determining whether an LLC will be taxed as a corporation or a partnership. If an LLC possesses any three of the four following corporate characteristics, it will be taxed as a corporation and not as a partnership:

1. Limited Liability For Its Members. All LLC's will have this characteristic. It is to obtain limited liability for the members and the members elected to conduct business as an LLC.
2. Centralized Management. The states which permit LLC's allow the members to vest the management of the business in certain managing members. When this is done, the management of an LLC assumes the corporate characteristic of a board of directors.
3. Free Transferability of Interests. The right to sell, transfer or convey an interest in a business freely and without restrictions is a corporate characteristic. Such a right is similar to a person being able to sell his stock in a company. If the non-selling members must consent before the new member can participate in the management, then there is no free transferability, and this corporate characteristic would not be present.

4. Continuity of Life. The most important aspect of a corporation is its continuance after the death or withdrawal of one of its shareholders. A corporation, unlike a partnership, does not terminate upon the death of its shareholders. If an LLC is required under the terms of the operating agreement to remain in full effect until its termination date, and even after the death of a member, it will be considered to have the continuity-of-life characteristic of a corporation. If the remaining members must vote to continue the company life, this corporate characteristic does not exist.

When three of the four characteristics listed above were present, the LLC was taxed as though it is a corporation. It does not make good sense to do business as an LLC unless the company will be treated as a partnership for federal tax purposes. In states which still utilize the IRS test for determining whether the LLC will be treated as a partnership for state tax purposes, if an LLC has any three of the above characteristics, it will be taxed as a corporation. Such taxation would be detrimental to members so care must be taken in deciding which common characteristics the company should share with a corporation.

Another tax concern of an LLC is how its property will be treated for tax purposes. Property which is titled in the LLC name is owned by the LLC, not the individual members. The same is true for property contributed to a corporation or a partnership. A member who contributes property to an LLC relinquishes ownership in the property, and property purchased with LLC funds is owned by the LLC. This company ownership of the property means that creditors of members cannot attach the property. They are limited to

attaching the member's interest in the LLC. The property held by an LLC can be legally sold, transferred or conveyed only by the company. The LLC's basis in the contributed property is the basis that the member had before it was contributed.

H. DEBTS OF THE PRIOR BUSINESS?

Many new businesses are really reformations of existing businesses. Frequently general or limited partnerships are changed to LLC's. At times a sole proprietor will contribute assets of an existing business into the LLC being formed. Question: How are debts from an existing business treated when the business assets are transferred to a new LLC? The general rule is that a newly formed LLC is not liable for the debts of a prior business whose assets were transferred into it unless all of the members (or all of the managing members) agreed to have the LLC so bound. Still, assured by the new LLC or not, the owners of the prior business still remain personally liable for the debts of the prior business. If the transfer of assets into the LLC is intended to defraud creditors or is in violation of a state's Bulk Transfer Act (which governs the transfer of assets of a business), creditors can sue the company to the extent of the value of the property transferred.

Every state has adopted the Uniform Commercial Code, which contains the Bulk Transfer Act. Under the Bulk Transfer Act, notice must be given to creditors of a business whenever the majority of a business's assets are transferred. The Bulk Transfer Act also applies to transfers into a new LLC. The transfer is usually required to give at least 10 days notice to creditors and

the local tax assessor before the transfer. The tax assessor will impose a property tax on the transaction. Notice to creditors is usually given by publishing a Notice of Bulk Transfer in the newspapers of general circulation. If no creditor objects, the transfer occurs and the creditors lose their right to seek return of the transferred assets from the LLC.

III. DISSOLUTION OF AN LLC

Dissolution of an LLC is the termination of the company and is, in fact, its legal death. Dissolution usually occurs under the terms of the operating agreement when one of the following acts occur:

1. Members holding more than 50% of the voting rights in the LLC vote to dissolve.
2. Managing members dissolve the LLC because:
   (a) The LLC did not issue any shares and thus was never really an LLC, or
   (b) The LLC has filed a chapter 7 bankruptcy petition, or
   (c) The LLC has disposed of all of its assets and hasn't conducted business for several years (usually five years).
3. Creditors file a legal action and win involuntary dissolution of the LLC to liquidate company assets and pay the creditors.
4. The termination date listed in the articles of organization arrives.

The most common reason for the early termination of a company is the death, bankruptcy or expulsion of a member. Unless the operating agreement states otherwise, a company will automatically terminate upon the death, bankruptcy or expulsion of a member.

In the absence of a contrary provision in the operating agreement, the voluntary withdrawal of a member will automatically dissolve the company in most states. A few states (such as Delaware, Iowa, Maryland, Texas, Virginia and West Virginia) permit members to withdraw without dissolving the company unless the operating agreement states otherwise. The states of Arizona, Colorado, Illinois and Minnesota permit a member to withdraw even though forbidden in the operating agreement. In a situation where a member withdraws and the company is not dissolved, the member is entitled to the return of his capital. Specifically, Florida, Kansas, Nevada, Utah, and Wyoming each require the return of a withdrawing member's capital within six months unless an earlier date is specified in the operating agreement.

Several states (Arizona, Colorado, Illinois and Minnesota) provide for a reduction of the capital returned to a withdrawing member when the withdrawal was in violation of the operating agreement and caused the company to incur damages. In the absence of contrary intent expressed in the operating agreement, the states of Arizona, Colorado, Delaware, Illinois, Iowa, Louisiana, Minnesota, Nevada, Oklahoma, Rhode Island, Texas and Virginia state that a withdrawing member is to receive the fair market value of his interest in the company minus any damages caused by a wrongful withdrawal from the company.

After dissolution has been approved or ordered, the LLC must stop doing business except to the extent necessary to discharge the affairs of the company. When a resolution to dissolve is adopted

or ordered, the LLC must file a certificate of dissolution with the secretary of state where it was formed.

The distribution of company assets, following dissolution, will be made as follows:

1. All federal and state taxes are paid.
2. All employee wages and benefits are paid.
3. All secured liabilities are paid.
4. All unsecured liabilities are paid.
5. Any remaining funds are distributed pro rata among the members in accordance with their percentage of ownership interest in the company.

The proceeds received by a member in the dissolution of an LLC are a return of the member's investment. Any gain or loss realized by a member as a result of the dissolution is treated as a capital gain or loss. For example, assume that a member paid $4,000 for the membership certificates. He received $3,000 at dissolution. He has a $1,000 capital loss. Likewise, if the member received $6,000, he would have a $2,000 capital gain.

All states require that LLC's formed under their laws file a statement of dissolution either before or after the dissolution is completed. Arizona, Florida, Kansas, Louisiana, Maryland, Minnesota, Nevada, Oklahoma, Utah and Wyoming require filing a statement of intent when the dissolution begins and a statement of conclusion when the dissolution is finished. Other states such as Delaware, Illinois, Iowa, Rhode Island, Texas, Utah, Virginia and West Virginia do not require the first filing stating the intent to dissolve. All states require the final filing when the dissolution is completed.

Some states require the creditors of the company to be given specific notice of the intent to dissolve the company. For instance, Kansas requires the company to mail each creditor a notice of the dissolution within 20 days after filing the intent to dissolve.

IV. LAWSUITS

An LLC is a legal entity, but because it is an artificial entity, it needs an individual to file any lawsuit on its behalf. When the company is managed by all the members, a suit can be brought by a member only after a majority vote of approval by the members. An exception to the majority vote approval requirement for filing a suit may exist where there is a conflict of interest among the members or members are breaching their fiduciary duties. The non-agreeing members would be excluded from the voting, and only the votes of the disinterested members would be considered. If the suit is commenced, and it is later found that the members whose votes were ignored were not in violation of their fiduciary duties and had no conflict of interest, the persons bringing the suit might be held personally responsible for any damages caused by virtue of the suit.

When a suit is brought by virtue of a majority vote of approval by all members, no member will be personally liable for any damages that might result to the company. When the company is being managed by managing members, it is the managing members who have the authority to file suit on behalf of the company. A manager is bound by the fiduciary standard of care of a reasonable and

prudent manager in making a decision concerning the commencement of a lawsuit.

Liability attaches to a member who brings unauthorized or improvident suit that violates the fiduciary standard of care. Should a member act without the approval of the other members to file suit, the company would nonetheless be bound by the decision or settlement. The company may sue a member for any damages which the company suffered by virtue of the member bringing an unauthorized suit or settling one improperly.

As part of this legal series, a book on forming and operating limited liability companies has also been written.

CHAPTER EIGHT

ALTERNATIVE DISPUTE RESOLUTION

INTRODUCTION

The use of the alternate dispute resolution (ADR) procedures in the place of filing a lawsuit or maintenance of a judicial action has greatly increased in recent years. Arbitration, mediation and the like are very good alternatives to a lawsuit. I have done a lot of arbitrations over the years. If it is an out-of-state situation then arbitration doesn't really bestow a benefit to the client. If a client is in California and arbitration is going to take place in New York, the plaintiff may have financial difficulty in bringing the suit due to the mere distance involved. Nonetheless, the U. S. Supreme Court recognizes arbitration clauses and gives them effect.

Alternative dispute resolution is the term applied to any proceeding used to resolve a dispute other than going to court. The majority of alternative dispute procedures involve some type of arbitration or mediation of the dispute. The advantages of ADR over the traditional lawsuit is that it is usually significantly faster and can be extremely flexible in its operation. In ADR, the traditional litigation procedures for discovery, motions and hearings can be easily redesigned to meet the needs of the parties something usually not available for a judicial proceeding. Another advantage of ADR is that it is relatively inexpensive when compared

to even a moderate trial. In California, for instance, it takes between two to five years to be heard in a jury trial. The very cost of judicial proceedings has spawned the need for cheap, fast and effective alternative dispute resolutions procedures. Another indirect advantage of arbitrations is that it permits the parties to try their respective cases before an independent person. In the situation where the arbitration is non binding on the parties, each party is therefore able to evaluate the strengths of their respective positions without spending a great amount in a court trial. A loser in the arbitration may, therefore, decide that there is no likelihood of prevailing in a regular trial and it is not worth the time or extra expense to retry the case.

ARBITRATION AND MEDIATION

ARBITRATION

The main forms of ADR are arbitration and mediation. Of the two, arbitration is, by far and away, the most utilized form of ADR. The major difference between arbitration and a judicial proceeding is that the trier of fact, in the arbitration is not a judge. In arbitration proceeding, the arbitrator is usually an attorney who is trained in the particular area that is being arbitrated. The parties may even go so far as to agree that the arbitrator need not be an attorney although that is rare. The arbitrators are usually picked by joint agreement or by the fact that each attorney has submitted a list of proposed arbitrators and

the attorney is chosen by his name appearing on both lists. Arbitrators are almost always chosen because they possess special knowledge, training or experience in the area in which the dispute has arisen. There are two types of different types of arbitration the usual non binding judicial arbitration and the usual binding consensual arbitration.

Judicial arbitration exists when a court orders the matter into arbitration. Many states, such California, require a judge to order the parties to enter non-binding arbitration when the judge feels that the value of the case is below a certain threshold amount. **Krause vs. Andersen** (1991) 108 Or.App.211. In California, a judge can tend to order a case into judicial arbitration if the judge feels that the recovery will be less than $50,000. In a judicial arbitration situation, whether or not the parties get a chance to go to regular trial after the award is issued, depends upon applicable state law. Judicial arbitration does not work outside the judicial system but rather in conjunction with it. In addition to state having judicial arbitration programs, several federal districts have also adopted judicial arbitration programs. The United States District Court for the Middle District of North Carolina, for instance, under its Local Rules 601-611 implemented judicial arbitration for cases in controversy below $150,000 with limited discovery and a decision within 15 days of the hearing. Under most judicial arbitration statutes, the decision is non

binding upon the parties. As such, both parties have an absolute right to request a trial de novo before a regular judge.

A version of judicial arbitration practiced in some jurisdictions is that advisory or mini-trials which do not bind the parties. In such instances, the court orders the parties to come to court, summarize their positions and, in some instances, to present key witnesses for examination. Following the presentations, the judge or advisory jury, if present, issues an advisory decision. As with an arbitration award, the advisory decision carries a great deal of weight in persuading a party to continue on with a suit or settling. Local rules may require an attorney to participate in such an advisory trial even though it is non-binding on the parties. In **Standell vs. Jackson County** (1985) 115 F.R.D. 333, an attorney was held to be in criminal contempt for refusing to participate in such a nonbinding advisory trial.

The second type of arbitration is the more common type, consensual arbitration in which the parties have agreed to resolve disputes by arbitration. Most often consensual arbitration is brought about as a result of an arbitration clause in a contract. The parties simply agree to submit the matter to arbitration by one of the arbitrating agencies such as the American Arbitration Association, or other organizations that conduct arbitration proceedings. An arbitration award may or may not be subject to judicial review, so arbitrators are governed by the same ethical

standards that govern a judge. In any arbitration, there must not be any appearance of impropriety on the part of the arbitrator, and there cannot be any conflicts of interest between the arbitrator and any of the other parties for whom the decision is being rendered. Consensual arbitration is usually binding upon the parties which means that a trial de novo is not permitted if a party objects to the decision.

MEDIATION

The second major area of ADR is that of mediation. The major difference between arbitration and mediation is that mediation is more of counseling procedure. Mediation is, by its own unique nature, limited to the situation where the parties are willing to sit down with a mediator and attempt to resolve their differences directly. In the mediation situation, the intermediary, i.e. the attorney who is handling the matter, is required under Model Rule 2.2(A)(1) to consult with each of the parties in order to get a feel of what each client wants and the implications of how the matter is being handled. Also, there must be an explanation of the attorney-client privilege and a full statement of what is going on so everyone knows what to expect. The mediator is not in an adversarial position. The mediator does not get involved in the mediation to try to force one party to accept the will of the other. Mediation, to be effective, must be a joint effort by persons trying to resolve the matter and where everyone leaves with the belief they have gotten what they wanted or at least they have

a solution they can live with.

In California, mediation is very popular in the family law area. In a California divorce or dissolution, if the parties have children they must state in their petition if they want mediation or if mediation will be appropriate in setting up child custody and the like. Mediation is valuable because it permits people can sit down together, if they really want to settle a matter, and work it out. Mediation is especially appropriate when the parties know there will be a determination one way or the other and they are willing to accept that determination. The role of the mediator is to try to reach a joint resolution. If they can't, the mediator has a duty to explain to both parties the results of failing to reach an agreement, i.e., going through a regular lawsuit, a trial, etc. That is an incumbent duty upon the mediator, and the attorney is in a very good position to explain that situation, having practiced in this area and is familiar with what to expect.

A question which often arises in a mediation situation is whether the attorney serving as a mediator can give legal advice to one or both of the parties. Some state bars take the view that an attorney serving as a mediator may not give legal advice to a party. These states believe that doing so turns the attorney into sa representative of the party to whom the advice is given. New Hampshire Opin. 1983-4/4, Wisconsin Opin. E-79-2 (1980) A few states permit an attorney serving as a mediator to give legal information to a party but not actual advice as to hope to use that

information Maryland Opin. 80-55A, Oregon Opin. 488 (1983), Virginia Opin. 511 (1983). The majority view is, however, that an attorney mediator may give legal advice to a party in the mediation as long as it is given in the presence of all of the parties and is given under circumstances that do not infringe upon or destroy the mediator's neutrality. Conn. Opin 35 (1982), Florida Opin. 86-8.

ATTORNEY AS ARBITRATOR OR MEDIATOR

Once the attorney is appointed the arbitrator, the same rules of judicial ethics that apply to a judge, apply to the arbitration as well. The ABA has enacted several types of canons of ethics for different types of arbitrators. The canons used depends on what area of arbitration is being pursued. The ABA has a recommended standard of practice for lawyer-mediators in family disputes. This was enacted in 1984 and is called the ABA Family Mediation Standards. There are also Ethical Standards of Professional Responsibility for the Society of Professional Dispute Resolution, which are applicable to mediators, arbitrators and such which are called the SPIDR Standards, often "spider." There is also the ABA American Arbitration Association Code of Ethics for Arbitrators in Commercial Disputes, the commercial arbitrators' code. The ABA has also adopted a code of professional responsibility for arbitrators of labor management disputes, called the Labor Arbitrators CPR, and the standards of practice for family and divorce mediation of the Academy of Family Mediators, the AFM standards. If there are no

special standards for the type of arbitration that an attorney is involved, then the attorney will still be governed by the Model Code or the Model Rules of Professional Responsibility as adopted by the particular state. An attorney serving as an arbitrator must remember that the attorney's conduct as arbitrator is governed by the highest standard of ethics. The highest standard imposed by the judicial ethics, the canons of professional responsibility for the attorney's particular state and the Canons of Professional Responsibility that governs arbitrators will be applied to the attorney's actions as an arbitrator.

When an attorney is acting as an arbitrator or mediator, impartiality is expected. Many states prohibit or discourage a lawyer from serving as a mediator in a dispute involving present or former clients. In this situation, the attorney should certainly get the consent of both parties to act as a mediator after full disclosure. An attorney should always review state law to determine how the state handles this situation. In the arbitration situation, it is a little bit different. Unlike a mediation where the attorney-mediator trying to get a joint resolution of the dispute, an arbitration is a mini-trial. The closest analogous situation would be that of an administrative hearing and a regular trial itself. The arbitration is somewhere in between the two.

(a) ARBITRATION OF LEGAL MALPRACTICE CASES

The use of attorneys to require arbitration of legal

malpractice claims is an area of dispute. The ABA Model Code Disciplinary Rule 6-102(A) reads as follows:

> "A lawyer shall not attempt to exonerate himself from or limit his liability to his client for his personal malpractice."

In contrast, Rule 1.8(h) of the Model Rules states:

> "A lawyer shall not make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented in making the agreement, or settle a claim for such liability with an unrepresented client or former client without first advising that person in writing that independent representation is appropriate in connection therewith."

The question comes down as to whether an arbitration clause is an attempt to determine the extent of liability for malpractice or an attempt to limit that liability. The conflict between the two rules has caused split decisions among the states. The Maryland State Bar Association has interpreted Model Rule 1.8(h) as to preclude the enforcement of an arbitration clause for malpractice unless the client has independent legal counsel before executing the agreement. A federal decision **Monhan vs. Paine Weber** (1989) 724 F.Supp. 224, ruled that Disciplinary Rule 6-102(A) does not bar arbitration clauses for legal malpractice. The federal court in New York held that the federal policy was to enforce arbitration agreements when the agreement to submit the dispute to arbitration was clearly stated in the agreement.

The trend is for courts to enforce mandatory arbitration clauses for legal malpractice. In the District of Columbia, the Standing Committee on Lawyer's Malpractice approved a procedure

whereby the board which arbitrates attorney-fee disputes can also arbitrate malpractice clams. The arbitration is voluntary and is designed to permit clients, with relatively small claims, to be able to purse them in an economic manner. In **Haynes vs. Kuder** (1991) 591 A.2d 1286, the court upheld a clause requiring mandatory arbitration of legal malpractice actions which read:

> "Although we do not anticipate any dispute concerning payment of fees, it is out policy that in case any such disputes arise, they will be handled through the less formal and more expeditious process of arbitration, rather than court action. Accordingly, it is agreed between you and the firm that any claim by the firm for unpaid fees and expenses, and any defense or counterclaims or such claim, whether based on a claim of negligent misrepresentation or other ground, shall be resolved exclusively through arbitration in the District of Columbia under the then applicable rules of the American Arbitration Association."

The Court ordered the client's claim for legal malpractice submitted to binding arbitration because the client sought, as an element of damages, the attorney fees previously paid. Since attorney fees were in question, the court ruled that the arbitration clause was applicable to determine the fee dispute.

In **Lawrence vs. Walzer vs. Gabrielson** (1989) 207 Cal.App.3d 1501, a California Court of Appeal refused to enforce an arbitration provision in a fee agreement which read, "In the event of a dispute between us regarding fees, costs or any other aspect of our attorney-client relationship, the dispute shall be resolved by binding arbitration," when the client filed a civil suit for breach of contract and breach of a fiduciary duty. The court ruled

that the clause did not put the client on notice that it applied to negligent and professional malpractice actions in addition to fee disputes. It is unclear how the court would have ruled if the provision had stated that any malpractice claims would also be subject to binding arbitration. A California Ethics Opinion, Ethics Committee Opinion 1989-116, subsequently held that a mandatory arbitration provision for legal malpractice did not violate California's ethics standards.

CHAPTER NINE

THIRD PARTY MALPRACTICE SUITS

INTRODUCTION

One of the most troublesome aspects of legal malpractice is the liability to a third party for advice that an attorney gives to a client. In such a situation, the attorney is not being sued by a client but rather the attorney is being sued by a third party with whom the attorney has never had any contact. This is one of the more interesting and developing areas of the malpractice law. In the past, attorneys have had immunity from liability to third parties for advice given to clients, unless there was some type of fraud or intentional act that was committed by the attorney. Generally, attorneys are not liable for wrongful attachment, malicious prosecution or some type of advice that has been honestly given to a client. Likewise, an attorney has usually not been held liable for actions that have been undertaken as a result of fraud or deception practiced upon him by his client.

There has been a steady development of cases in which third parties can sue an attorney for the advice the attorney has given or services that have been rendered to a third party. These tend to be the opposing parties in a lawsuit, beneficiaries of a trust or estate plan that the attorney may have created for a client, and any other person that may have been injured by the attorney or his client while working in concert. The most common type of

third-party liability is in the area of estate planning. In this instance, the attorney will draft a will or trust that won't come in to play for years. It is after the death of the client that the heirs or beneficiaries find out how much they will actually inherit from the deceased client. At this time, any errors in behalf of the attorney in drafting the estate document will come to bear. If a trust was not properly executed, it might fail or a Will that was not properly witnessed or prepared, will terminate and the heirs might not get what they should have gotten under the Will had it been valid. In which case, the heirs and beneficiaries will sue the attorney. In the past, the attorney was not liable for that because he was only interpreting the contract with the client, but modernly more and more states recognize the liability to the third party heirs and beneficiaries. If the attorney has committed malpractice in the drafting of the documents or the giving of advice, the heirs and beneficiaries can sue the attorney for such advice.

Most states now permit some degree of third party malpractice claims against an attorney. In fact, such claims now account for a little more than 20% of all malpractice claims. In determining whether or not an attorney should be sued for malpractice for advice that was given a client by third parties, many courts have adopted the five-element test that was created in Washington in the case **Strangland vs. Brock** (1987) 747 P.2d 464. In this case, the court developed a test to determine whether or not a malpractice

action should go forward by third parties against an attorney. The main factor that State Bars view is the extent in which the attorneys' action was intended to directly affect that person. In a situation of a Will or trust, it is obvious that the Will or trust was deliberately drafted to so as to determine and set forth the amount of money that a third person would or would not inherit from an estate. Obviously, that element is met in most instances with the ability of harm to others. It is foreseeable that if a will or trust is drafted improperly, the heirs or beneficiaries won't recover. In other cases, that liability or foreseeability is not often as evident.

The third element is the degree of certainty in which the third party suffered or will suffer injury. Again, most states do not permit speculative damages. If you have a third party who wants to sue an attorney and they have not suffered any injury and may not suffer any injury in the future, that person might be precluded from bringing a malpractice action under this particular test. Likewise, there must some type of causal relationship between the attorney's conduct and the injury. The attorney must do something or not do something when he has a duty to act that results in the injury and there must be a policy to prevent future harm. All states have that. No state wants to set up a procedure that allows an attorney freedom to continue to engage in misconduct. The courts balance all these factors on a one-to-one basis to determine whether or not in a particular instance a malpractice action should

go forward.

PRIVITY OF CONTRACT

Up until very recently, an attorney could only be sued for malpractice by the client. Non-clients of the attorney, traditionally were barred from bringing an action against the attorney for injuries suffered as the result of malpractice committed on a client. The basis for this non-client bar for malpractice claims was based upon the theory of a lack of privity of contract between the attorney and the non-client third party. In the past, in order for a person to be legally permitted to maintain a malpractice action against an attorney, that person must have been the client of the attorney. A client is, by virtue of the attorney-client relationship, in a contract situation with the attorney and thus has privity of contract to sue the attorney for malpractice. **Williams vs. Burns** (1992) 540 F.Supp. 1243, **Thrall Car Manufacturing Co. vs. Lindquist** (1986) 145 Ill.App.3d 712, **Young vs. Hecht** (1979) 3 Kan.App.2d 510, **Ames Bank vs. Hahn** (1980) 205 Neb. 353, **Michalic vs. Klat** (1987) 128 A.D.2d 505. Non-clients, however, are not in an attorney-client relationship with the attorney and, therefore, have traditionally been held not to be in privity of contract with an attorney for malpractice. **Marker vs. Greenberg** (1981) 313 N.W.2d 4, **Spicknall vs. Panhandle State Bank** (1954) 278 S.W.2d 622, **McGlone vs Lacey** (1968) 288 F.Supp. 662. Some states such as Arkansas have codified the common law rule that

attorneys have no privity of contract with non-clients. Arkansas Code Ann section 16-22-310 reads as follows:

> "No person licensed to practice law in Arkansas and no partnership or corporation of Arkansas licensed attorneys or any of its employees, partners, members, officers, or shareholders shall be liable to persons not in privity of contract with the person, partnership or corporation for civil damages resulting from acts, omissions, decisions or other professional services performed by the person, partnership or corporation, except for:
>
> > (1) Acts, omissions, decisions, or conduct that constitutes fraud of intentional representations; or
> >
> > (2) Other acts, omissions, decisions, or conduct if the person or partnership or corporation was aware that a primary intent of the client was for the professional services to benefit or influence the particular person bringing the action...

In **Copenhaver vs. Rogers** (1989) 238 Va. 361, the Virginia Supreme Court held that a beneficiary of an estate plan was not in privity with the attorney. A similar holding occurred in the California case, **Goldberg vs. Frye** (1990) 217 Cal.App.3d 1258.

The modern trend is to extend privity of contract to persons who have a special relationship with the client and the relationship of the attorney-client relationship and the purpose of that the representation. Where the client consults the attorney to obtain services for the benefit of a third person, there may be privity of contract between the attorney and the third party. Privity of contract also is found to exist when the person paying for the legal services is not the client. In **Ward vs. Arnold** (1958) 328 P.2d 164, a Wisconsin court permitted a wife to sue an attorney

who she had hired to draft a Will for her husband for his advice that her husband did not need to have a Will. In the situation, where an attorney represents both parties to a transaction, the party who does not pay the fees may still maintain a malpractice action against the attorney. Lawall vs. Groman **180 Pa. 532,** Stinson vs. Brand **(1987) 738 S.W.2d 186.** A difficult problem can exist is the relationships between the attorney and the client's spouse. Representation of a client does not automatically result in representation or a duty to protect the rights of a spouse. In **Lee vs. Nash** (1983) 671 P.2d 703, an Oregon court held that an attorney was liable for damages a client's wife suffered when the attorney field a joint bankruptcy petition on the client's request without the wife's consent.

Privity of contract to sue for malpractice is determined in accordance with state law. A guarantor for the payment of attorney fees might not have privity to sue for malpractice. In **McFarland vs. O'Gorman** (1991) 814 S.W.2d 692, a Missouri court held that a parent who was a guarantor for a son's legal fees lacked privity of contract to sue the attorney for breach of contract or malpractice. Many states, such as Texas, require an attorney to inform a person the attorney is not acting as that person's attorney in a situation where a person may believe that the attorney is engaging in joint representation. **Kotzur vs. Kelly** (1990) 791 S.W.2d 254, **Parker vs. Carnahan** (1989) 772 S.W.2d 151.

Privity of contract will be found to exist when an attorney volunteers to do something and does not. The liability for this is based upon the theory of justifiable reliance not an attorney-client relationship. **Simmerson vs. Blanks** (1979) 149 Ga.App. 478, **Schwartz vs. Greenfield, Stein and Weisinger** (1977) 396 N.Y.S.2d 582. In the case of a volunteered service, the attorney could be sued for failure to perform the service if a third party reasonably relied on the attorney's to perform the service. The failure of the attorney, however, to perform the service will not expose the attorney to a claim of a violation of fiduciary duty because no attorney-client relationship was created by a gratuitous promise to perform a service.

EXPANSION OF PRIVITY

Privity of contract has been significantly eroded in many states by the extension of privity to persons who could have been foreseeably affected by an attorney's malpractice at the time of the attorney's retention. The pivotal case on this point is **White vs. Guarente (1977) 43 N.Y.2d 356.** In **White,** accountants were held liable for damages suffered by third parties who relied on the accountants audited statements of a company. The court held that the accountants knew that third parties would be relying upon the reports and therefore they owed a duty of care to any such foreseeable persons. The rationale behind the holding for this case has been extended to attorneys in certain instances.

In **Deep South Properties vs. Corson** (1992) 612 So.2d 359, the Court abolished the need for privity in legal malpractice based on negligence. The court ruled that Miss. Code section 11-7-20 abolishes privity for "causes of action for ...economic loss brought on account of negligence..."

The California Supreme Court in **Lucas vs. Hamm** (1961) 56 Cal.2d 583 created a balancing test for determining whether a non-client is in privity with an attorney. The California test requires that a court evaluate the following elements:

(a) whether it was the purpose of the client to bestow a benefit upon or affect the non-client;

(b) there was a foreseeability of harm to the non-client if the attorney committed malpractice;

(c) the relationship of the attorney's conduct to the harm suffered by the non-client;

(d) the public policy to prevent recurring harm; and

(e) the effect of permitting a malpractice action by a non-client would have on the legal profession.

A court, will evaluate all of the above factors. Foreseeability of harm alone will not guarantee that a non-client will be able to sue an attorney for malpractice. On the other hand, if foreseeability of harm is missing, then under this test, the attorney cannot be sued for malpractice by a non-client. The California approach has been followed by many other states. **Travelers Ins.Co. vs. Breese**

(1983) 138 Ariz. 508, **Licata vs. Spector** (1966) 26 Conn.Supp. 378, **McAbee vs. Edwards** (1976) 340 So.2d 1167, **Kirby vs. Chester** (1985) 174 Ga.App. 881, **Silver vs. George** (182) 64 Hawaii 503, **York vs. Stiefel** (183) 99 Ill.2d 312, **Shideler vs. Dwyer** (1981) 275 Ind. 270, **Flaherty vs. Weinberg** (1985) 303 Md. 116, **Jenkins vs. Wheeler** (1984) N.C.App. 140. Florida in **Lorraine vs. Grover** (1985) held that under this test contractual privity rights are not important since the duty is imposed under public policy.

In place of the California balancing test, some states have adopted a beneficiary test. Under this test, the privity will exist between a non-client and an attorney when the attorney's retention, by a client, was to provide a legal services to assure some benefit to the non-client. Florida rejected the Californian test and used this test in **Angel, Cohen & Rogovin vs. Oberon Investment** (1987) 512 So.2d 192. The California Supreme Court even recognized the viability of this test, in place of the earlier balancing test in certain circumstances **Heyer vs. Flaig** (1969) 70 Cal.2d 223. Under the beneficiary test, it is not determinative that there is an express or implied attorney-client relationship between the client and attorney. The important factor under this test is whether the attorney and client agreed to benefit the non-client by the attorney services. In **Flaherty vs. Weinberg** (1985) 303 Md. 116, a Maryland court held that privity with a non-client when the attorney and client had a direct and agreed purpose to benefit the

non-client by the rendering of legal services.

The beneficiary test requires that in order for there to be privity with the attorney, the non-client must be an intended beneficiary rather than just an incidental beneficiary of the attorney-client relationship. **Orr vs. Shepard** (1988) 171 Ill.App.3d 104, **Mason vs. Levy** (1978) 77 Cal.App.3d 60. In **Torres vs. Divis** (1986) 144 Ill.App.3d 958, an incorporator could not sue an attorney for the personal damages suffered in the formation of the corporation. The retention of the attorney was not directly for the benefit of the incorporators. In **Formento vs. Joyce** (1988) 168 Ill.App.3d 429, there was no privity of contract between an attorney and unnamed members of a potential class action when the class was never certified.

Both the beneficiary test and the California test, revolve around the foreseeability of the harm to non-client claiming privity. When the non-client is the intended beneficiary then the beneficiary test creates privity and the foreseeability of harm for malpractice is presumed. The California test requires that the court review the facts of the case and determine if the harm suffered by the non-client was foreseeable to be suffered by that person in the event of malpractice by the attorney. The California Supreme Court in **Goodman vs. Kennedy** (1976) 18 Cal.3d 335, held that purchasers of stock issued as a result of improper advice by an attorney could not sue the attorney. A similar result occurred

in **Chaplin vs. Brennan** (1976) 114 Ariz. 124. The rationale for these cases was that the attorney's advice was not communicated to the purchasers so they never acted upon that advice so as to be bound as an intended beneficiary of that advice.

THE MODERN TREND

The extension of liability to non-clients is both expanding and evolving. The New Jersey Supreme Court held in Petrillo vs. Bachenberg 655 a.2d 1354 (1995) that attorneys are liable to third parties for their legal opinions. The court stated,

> "[T]he purpose of a legal opinion is to induce reliance by others. If an attorney foresees or should foresee that reliance, the resulting duty of care can extend to non-client third parties."
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> *******
>
> "...like certified public accountants or other professionals involved in commercial transactions, a lawyer's duty may run to third parties who foreseeably rely on the lawyer's opinion or other legal services."
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> **********
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> "...[m]ore recently, other doctrines have replaced privity as a means of limiting a professional's duty to a non-client... Whether an attorney owes a duty to a non-client depends on balancing the attorney's duty to represent client's vigorously...with the duty not to provide misleading information on which third parties foreseeably will rely."

The majority of the New Jersey Supreme Court relied heavily on a "nature of the relationship test" rather than privity holding, " "...when courts relax the privity requirement, they typically limit a lawyer's duty to situations in which the lawyer intended or should have foreseen that the third party would rely on the

lawyer's work." The New Jersey Supreme Court cited cases supporting this modern trend from Massachusetts, Mississippi, New York and California, Norman vs. Brown, Todd & Heyburn 693 F.Supp. 1259 (D. Mass. 1988), Century 21 Deep South Properties, Ltd. vs. Corson 612 So.2d 359 (1992). Prudential Insurance Company vs Dewey, Ballantine, Bushby, Palmer and Wood, 605 N.E.2d 318 (1992) and In re Reexplore Inc. Sec. Litig. 685 F.Supp. 1132, 1146 (N.D.CAL. 1988).

Petrillo went farther than existing case law in imposing liability on the attorney. In Petrillo, the attorney did not prepare an opinion letter, title report or an offering statement for the sale of a security. The liability in Petrillo was based upon a clerical copying error of the attorney's staff. In this case, percolation test results were improperly collated with the result that they not reproduced in the report.

At first blush, liability appears absolute. However, deeper review of the facts are unsettling. The error the attorney made occurred while his client owned the property and therefore was, presumably, aware of the error and able to correct it. However, the real problem with the application of Petrillo **arises from the fact** the plaintiff purchased the property from a real estate broker who had purchased the property at a sheriff's sale following the loss of the property by the attorney's client. In other words, even after the client lost the property and it was reacquired by people

a person who never relied on the title report could be resold to third parties through the use of the report, possibly without the attorney's consent, with the result of liability thereafter being held against the attorney.

Missouri in Donahue vs. Shughart, Thompson and Kilroy, P.C. 900 S.W.2d 624 (1995) relied on many of the same case cited in Petrillo and likewise found an attorney liable to the non-client heirs of a client as a result the testamentary documents which the attorney prepared.

While the modern trend is undoubtedly to extend the attorney's duty of care to anyone who can be foreseeable affected by the attorney's work, not all states are marching in this direction. The South Carolina Court of Appeals in Garr vs. North Myrtle Beach Realty Co., Inc. 339 S.E.2d 887 (1986) rejected such an abolition of the privity requirement:

> "[I]n our opinion, the better rule is that an attorney is immune from liability to third persons arising from the performance of his professional activities as an attorney on behalf of an with the knowledge of his client.
>
> ******
>
> In his professional capacity, the attorney is not liable, except to his client and those in privity with his client, for injury allegedly arising out of the performance of his professional activities."

Likewise, the Fourth Circuit in Fleming vs. Asbill 42 F.3d 886 (1994) held that, "[S]o long as an attorney acts in his client's interests, and not for personal and malicious reasons, he is immune from suit to an opposing party." In Fleming, the court restated the

privity rule in a malicious prosecution setting by holding that an attorney could not be sued for malicious prosecution for pursuing an action on behalf of a client.

Some states are strongly situated in the middle between the privity requirement and the foreseeably standard of the modern trend. Nevada law, as stated in Hartford Acc. and Indem. Co. vs. Rogers 96 Nev. 576, 613 P.2d 1025, 1027 (1980) and in Hotel Employees and Restaurant vs. Getner 50 F.3d 719, 721 (9th Cir. 1995) has limited claims by third-party non-clients to "intended beneficiaries" who are held to be the persons for whose benefit the action or services of the attorney were being performed.

CHAPTER TEN

REAL ESTATE MALPRACTICE

INTRODUCTION

It is the American Dream for a person to strive to own real property. When the United States was first formed, only those persons of property could vote. Wealth, land and happiness have always been viewed as the same in America. For this reason, it can easily be seen that when an attorney's action or inaction jeopardizes a client's interest in real property that attorney is often sued for malpractice. This chapter is intended to cover the basic tenets of real property law, and the violations of which often, lead to malpractice actions. Real estate law covers more than just the land itself. It also covers the rights and duties owed by the landowner to neighbors and even, under certain circumstances, to trespassers. In the not so dim past, an owner could do virtually anything that he or she wished on or with the property. Today, however, such unbridled control over own s property is past. Land use is now strictly controlled and regulated by zoning and environmental laws.

The rights and duties of landowners form a rich and diverse body of law. Every state has its own body of real property law and the best this chapter can accomplish is to point the majority and minority views when they are not unanimous. In those situations, the user must consult applicable state statutes to determine which view is followed in the user's home state.

BASIC REAL ESTATE LAW

FEE SIMPLE TITLE TO REAL PROPERTY

A fee simple is the total ownership of all property rights and is recognized, as such, by law. A fee simple carries with it the attribute of full and complete transferability. In addition, it passes by inheritance to both lineal and collateral heirs of the owner. The duration of time for which a fee simple will last is forever provided it is a fee simple absolute. If it is a fee simple defeasible, the ownership rights may be altered on the happening on Certain conditions. A fee simple absolute is the most complete and comprehensive form of real property permitted by law. A fee simple absolute is limited only by governmental powers such as zoning and eminent domain. A fee simple absolute lasts forever. It will not terminate in the future based on time or the happening of any designated event.

At common law, a fee simple absolute had to be expressly created. It was necessary to use the language "and his or her heirs" to create a fee simple absolute. For example the deed had to read, "To George and his heirs," in order to create a fee simple absolute. The language "and heirs" did not create an estate in the heirs but was still needed to show that a fee simple absolute had been granted. Today, only South Carolina requires that the language "and heirs" still be on the deed to prove that a fee simple absolute was granted. All of the other states now, either by law or judicial decision, hold that unless a grantor states otherwise on

the deed a fee simple absolute is presumed to have been granted.

DEFEASIBLE FEE IN REAL PROPERTY

A fee simple defeasible in real property refers to three main of fee simple in which an owner's otherwise infinite possession of the property could be terminated under certain circumstances. These types of defeasible fees are:

1. Fee Simple Determinable. Under this type of defeasible fee, the estate lasts only so long as the property is used in certain manner. The words "for so long as", "until" or "while" are used. The example is, "For A as long as it used for a farm." If the land is not farmed, then it reverts back automatically to the grantor or the grantor's heirs.
2. Fee Simple With Condition Subsequent. Under this type of defeasible fee, upon the happening a certain event, the grantor has a right to take the property back. It isn't automatic. Courts prefer this over a determinable fee.
3. Fee Simple with Executory Interest. This defeasible fee is similar to the fee simple determinable except that on the happening of the event the title passes automatically to another. For example, "To A so long as he farms the property, if not to B."

A fee simple feasible can be characterized as belonging to a person until the happening of an event which takes the title away and gives it to another.

A LIFE ESTATE

A life estate is an estate in real property that lasts only as long as a person or persons lives. It does not terminate based on a certain length of time. A conventional life estate comes into being as a result of the stated intent of the grantor to create it. For example, "To A for life," means that A is entitled to complete possession of the property for his or her life. The right to possess the property ends on his or her death. Another example is, "For A as long as B lives". A's right to possess the property ends when B dies not when A dies. Life estates are generally created for estate planning purposes such as where a one spouse will give the other spouse a life estate and then passes the property to children. Life estates are also used in charitable gifts wherein the donor gives the property to a charity but retains a life estate for the life of the donor and donor's spouse.

JOINT TENANCY

joint tenancy is the concurrent ownership of real property by two or more persons with the right of survivorship. When a joint tenant dies, his or her interest in the property passes automatically to the surviving joint tenant or joint tenants. An Owner's joint tenancy interest in the joint tenancy property passes without a probate and is not affected by the terms of the owner's Will. A joint tenancy must be expressly created. The deed must have language similar to this, "To A and B as Joint Tenants."

Anyone can be a joint tenant with anyone else. Usually spouses

or a parent and children are joint tenants so as to avoid probate of the property. A joint tenant owns an equal interest in the property regardless of whether that interest was purchased or acquired by a gift. As such, each joint tenant's interest can be attached by that joint tenant's creditors. A joint tenancy can be terminated and turned into a tenancy at common by the following acts:

1. Conveyance by one joint tenant of part or all of his or her interest. Any conveyance will terminate the joint tenancy because the other joint tenants did not agree to give to the new co-tenant in the property a right of survivorship in their interest in the property.
2. Mortgaging by one joint tenant of his share of the joint tenancy property without the consent of the other joint tenants,
3. Leasing by one joint tenant of the joint tenancy property without the consent of the other joint tenants.
4. A few states permit the termination Of a joint tenancy in a Will. This is a minority view.

Only about twenty states recognize tenancy in the entirety, It is a special joint tenancy estate between a husband and wife.

Neither spouse may can obtain a partition of the estate or defeat the right of survivorship of the other spouse. A tenancy in the entirety can not be terminated by the unilateral act of one spouse.

A tenancy in the entirety is terminated only by:

1. Divorce which changes the tenancy into that of a tenancy in common.
2. Mutual agreement whereby they agree to terminate the tenancy.
3. Execution against the property by a joint creditor of both spouses. A creditor of just one spouse cannot execute against property held in a tenancy in the entirety.

The advantage of joint tenancy and tenancy in the entirety deeds are that they can pass property to heirs without the necessity of opening a probate. The disadvantage is that a present interest in the property is usually conveyed in the property in order to create the joint tenancy. By doing this, creditors of a joint tenant, are then able to attach and sell the debtor joint tenant's interest in the property.

TENANCY IN COMMON

A tenancy in common is ownership among two or more persons of An undivided interest without a right of survivorship. The interest in the real property is entirely transferable and subject only to the claims of the owner's creditors. A tenant in common has the right to possess and use all of the property subject only to the equal right of the co-tenants to do likewise. Such right to equal possession exists even though the tenants may own unequal percentage rights. A tenant in common can be thought of as being in

a partnership with the other tenants in common of the property. There are specific statutes and case law, in each state which govern the duties and responsibilities existing between tenants in common.

EASEMENT

An easement is a liberty, privilege, or advantage which one may hold in then lands of another. It is a non-possessory interest, The holder of an easement has the right to use the real property for a certain use but has no general right use to possess or occupy the land. The owner of the servient estate, the land subject to the easement, continues to have the right to full possession and enjoyment of his property subject only to the limitation that the owner cannot interfere with the special use of the property by the easement holder.

A easement appurtenant is an easement in one piece of land, the servient estate, that benefits another piece of land, the dominant estate. The easement appurtenant becomes an incident of possession of the dominant estate. All of the successors in interest, those who buy or inherit or otherwise succeed in ownership to the dominant estate, are entitled to ownership and benefit of the easement, There can be no transfer of the easement apart from the dominant estate. The easement goes with the dominant estate.

An easement is gross is a personal easement owned by the easement holder. The easement does not benefit a dominant estate.

For example, giving an easement to a person to hunt birds on the real property is an easement in gross, it does not benefit any other land.

A easement by reservation exists when the owner of a piece of property conveys it but reserves the right to continue to use the real property for a special purpose after he conveyance. In essence, the owner gave himself an easement on the property at the time of conveyance. An easement by reservation was required, under common law, to specifically contain language stating that the easement was intended to pass to the grantor's heirs. Without such language, the easement terminated on the death of the grantor. The modern view is for courts to presume that easements by reservation run with the land.

When a tract of land is sold that has no outlet to a public road except over the remaining lands of the seller, a right-of way is created by the implied grant over the remaining lands of the seller. This easement based on absolute necessity is for access to the property and, in some states, utilities also.

Easements are terminated by the following:

1. The express terms of the easement can state on what conditions, if any, the easement will terminate.
2. Excessive or misuse of the easement can terminate an easement.
3. The easement holder can abandon the easement by actions that manifest an intent to permanently abandon the

easement and never use it again.

4. The parties may agree in writing to release the easement.
5. An easement may be ended by adverse possession of the easement by the owner of the servient estate.
6. When the easement owner acquires the servient easement, there is a merger of interest which terminates the easement.

An owner cannot have an easement in his own property. Easements are widely utilized in real estate and a major source of malpractice actions against real estate attorneys. Whenever an attorney reviews the title to property in order to grant an opinion, the attorney must specifically look for easements of record. Failure to advise clients of the existence of such easements will expose the attorney for liability for the damages or any diminution of the property’s value such easements may cause to the client.

ADVERSE POSSESSION

Title to real property of another can be acquired by adverse possession if the possession of the land is:

1. Open and Notorious. The possession is sufficient to put the owner of the real property interest be acquired on notice, either the owner or the land or easement.
2. Hostile. The possession must be without the owner's consent.
3. Claim of Right. The person seeking to acquire the

property by adverse possession must assert his claim of ownership to the world. The majority of states hold that the good or bad faith belief of the person is not a factor in determining adverse possession. The person just has to assert that he or she is the true owner,

4. Continuous. The property must be held for a statutory period, usually 20 years. In California, a person holding the property for five years and pays the taxes on the property has acquired title to the property by adverse possession.

When all of the above elements are met, then title passes to the persons performing the acts by virtue of adverse possession.

Similar to adverse possession is the acquisition of an ease by prescription. An easement in real property can be acquired by adverse possession. A person who fulfills the requirements for adverse possession by using the real property for the required period of time, in an open and notorious manner and without the consent of the owner will acquire a Prescriptive easement to continue using the property in that manner. A prescriptive easement is personal to the holder unless it was acquired by the public under state law. Public use of the property may result in an implied dedication for public use. An easement acquired by prescription may be terminated in the same manner as ordinary easements.

COVENANTS AND SERVITUDES

A covenant is an agreement by the owner of the real property to do or refrain from doing some action. A covenant runs with the land when the burdens, benefits or both Pertaining to the covenant passes to the succeeding holders of the property. An enforceable covenant requires:

1. A writing which satisfies the Statute of Frauds.
2. The parties must intend the covenant to run with the land.
3. The covenant must touch and concern the land, The covenant must affect the parties as landowners not just as members Of the community,
4. There must be privity of estate between the parties. There must be a direct relationship connecting the parties to the covenant.

If the foregoing conditions are not met, the covenant would not be found to run with the land and thus be unenforceable by or against the successors in interest of the parties.

An equitable servitude is similar to a covenant. It is a restriction on the use of the land adopted by the owner of the land. The basic behind the enforcement of an equitable servitude is that a person who takes property with notice that the property's use is restricted by the equitable servitude should be bound by the restriction. An equitable servitudes requires:

1. A writing which satisfies the Statute of Frauds.
2. The owner must intend the servitude to run with the land.
3. The servitude must touch and concern the land. The

servitude must affect the parties as landowners not just as members of the community.

The majority of states do not require privity of contract between the owner and the person seeking to enforce the servitude. Anyone can seek to enforce an equitable servitude in these states.

If the foregoing conditions are not met, the servitude would not be found to run with the land and thus be unenforceable after the original grantor dies or divests himself of the property.

Covenants and servitudes terminate when:

1. When all the parties release them.
2. Adverse possession destroys them.
3. Enforcement is waived by not timely objecting to the breaches.
4. Enforcement would violate public policy such as violating zoning requirements or be illegal discrimination,
5. The terms of the agreement state the conditions by which they terminate.

Covenants and equitable servitudes are enforced by the courts, The party seeking enforcement asks for a court order, such as an injunction, to require the owner to perform the covenant or refrain from violating the servitude. Damages may also be awarded for injuries suffered as a result of any breach of the covenant or servitude that the owner committed.

A RECORDING ACT

All states have statutes called recording acts to determine

the legal ownership of real property when two or more persons claim ownership of the same property. These acts vary from state to state but fall into three separate categories, Notice, Race and Race-Notice Statutes. The rights of the parties in the real property is determined by who recorded their deed first and if they knew of the claims by the other parties against the property. A person who purchased the property may still be denied title to the property under a state's recording act. It is important that anyone purchasing property be aware of their state's recording acts and perform a comprehensive title search to be sure that the seller has a valid title to the property.

Most states require that all deeds, mortgages, powers of attorney and other instruments relating to affecting the title to real property to be recorded. The recordation is done in the Recorder's Office of the County where the real property is located. Most County Recorder Offices use two indexes to aid in title search of the property, the Grantor and Grantee indexes. Every transaction relating to the real estate is listed in a chronological order according to the respective names of the grantor and grantee. A few states use a Tract Index which list all of the transactions involving particular piece of property. Searches in Tract Indexes are easiest to perform since all of the transactions affecting the title are listed in one document. The purpose of recordation is to give notice to the world of the buyer's ownership interest in the real property. Recording gives constructive notice of the person's

claimed ownership to the world from the date of recordation forward.

Recording gives the court a basis to determine the conflicting claims of ownership in real property where there are multiple sales or conveyances of the property in conformity with the state's recording act.

a. NOTICE RECORDING ACT

About half of the states have a pure notice recording act. Under this statute, a good faith purchaser, also called a bona fide purchaser, without notice of the conflicting claims of others will acquire the property free of all conflicting claims regardless of whether he or she is the first to record. The important issue under this statute is when the purchaser acquired notice of the other conflicting claims and not when the deed was actually recorded. For example, assume as follows, A sells a farm to B and later sells the same farm again to C who had no knowledge of the earlier sale. Under a notice act, C gets the title to the farm and B is left to sue George for his damages.

b. RACE RECORDING ACT

Two states, North Carolina and Louisiana, have this type of recording act. Under this type of recording act, the first purchaser who records wins. Notice of the conflicting claims is irrelevant. The first purchase who records his or her deed cuts off all rights in the property of anyone recording later. In the above example, if C knew of the sale to B and recorded his deed first, he

would still acquire title to the farm.

c. RACE-NOTICE RECORDING ACT

Most states have enacted a race-notice recording act. Under this type of act the first good faith purchaser who records will be recognized as the owner of the property. This requires that the purchaser both buy the property without knowledge of the conflicting claims on the ownership and then be the first one to record his deed. A person who acquires his or her interest in a manner other than virtue of a sale, such as by a gift, is not a purchaser and therefore can have his or her interest in the property terminated by the subsequent recordation of a deed by a good faith purchaser. For example, A sells the property first to B and then to C and finally to D, C records first followed by B and then D. Under the race-notice recording act, the property will go to C because be bought it in good faith, without knowledge of the earlier sale and recorded first,

THE STATUTE OF FRAUDS

All states have laws that require that a contract for the sale of land or that affects any interest that will touch and concern the land for over a year, such as a lease, easement, condition, covenant or restriction, must be in writing to be enforceable, a court may order specific performance of a contract
involving real property that is not in writing if it can be proven that a contract did exist between the parties along with one or more of the following acts:

1. The purchaser has taken possession of the land,
2. The purchaser has made substantial improvements to tile real property, or
3. The purchaser has paid for the property,

The purpose behind the statute of frauds is to determine at what point an actual enforceable contract exists regarding real property.

MARKETABLE TITLE

All contracts for the sale of land contain an implied warranty of marketable title unless expressly stated otherwise. The warranty of marketable title requires that the property be delivered free from reasonable doubt either in law or fact regarding the title. The warranty of marketable title does not require perfect title be delivered. It does require that the real property not have any clouds on the title that pose an unreasonable risk of litigation. Title is marketable if a reasonably prudent buyer would accept it after exercising ordinary diligence and prudence.

REMEDIES FOR BREACH OF A SALES CONTRACT

The remedies for breach of the contract for sale of real property are:

1. Damages. The non-breaching party may sue the breaching party for the damages suffered as a result of the breach, The measure of the damages is the difference between the fair market value of the property and the sale price. In addition, consequential damages, damages reasonably

foreseeable to be suffered from a breach, are also recoverable. Examples of consequential damages are replacement rents, costs of title searches, etc.

2. Specific Performance. Land is considered unique. For that reason, courts will always force the seller to honor the contract and complete the sale. Courts will sometimes force the buyer to purchase the property if the seller cannot reasonably sell it to someone else for the contract price. If the seller sells for less than the contract price, the buyer will have to pay the difference.

Whenever there is a breach of a sales contract, the attorneys for both parties have an obligation to inform their clients of their rights. Failure to inform the clients of their rights may expose the attorney to malpractice for the damages suffered.

COVENANTS OF TITLE

A grant deed is a deed contains the following covenants of title by implication:

1. Covenant of Seisin: This covenant is that the grantor has both title and possession of the property.
2. Right to Convey: This is a covenant that the grantor has the right and authority to make a conveyance.
3. Encumbrances: This covenant is that the property is not encumbered by liens, or mortgages not previously disclosed.

4. Quiet Enjoyment: That the purchaser will not have his or her possession of the property interrupted by any lawful claim against title by a third party.
5. Warranty: The seller will defend the title against claims by third parties.
6. Further Assurances: The seller will do all acts necessary to perfect the buyer's title in the property.

The Doctrine of After Acquired Title is also called Estoppel on the Deed. If a person sells, by a warranty deed, real property that he or she does not own and subsequently acquires title to the property, then under this doctrine the title to the property will pass automatically to the person to whom the property had been previously sold. For example if Mary sold a farm which she did not own, by a warranty deed, to George and then inherited the farm from her mother, the title will immediately vest in George's name. Under this legal theory, then the seller, Mary, becomes just a conduit to pass the title George if and when she ever receives it. This doctrine only works for a grant deed with a warranty and future assurance covenant. The doctrine does not work for a quitclaim deed.

A QUITCLAIM DEED

A quitclaim deed is a written instrument that transfers all of a person's right title and interest, if any, to another, a quitclaim deed is not a statement that person actually owns the property but that if the person did have an interest in the

property then he has transferred it by the quit claim deed. A quitclaim deed is usually used to perfect a person's title -n real property by having persons holding potential conflicting claims release their contingent interest in the property. A person cannot be Se sued for issuing a quitclaim deed because there is no warranty being made that the person actually has an interest in the property.

A MORTGAGE

A mortgage is a security interest in real property given by the owner to secure payment of a loan. The borrower is called the mortgagor and the lender is the mortgagee. In the event of a mortgagor's default on the mortgage, the only remedy available for the mortgagee is a lawsuit seeking a judicial foreclosure on the property. At trial if the court finds the mortgagor is in default, the court will order the property sold In a judicial sale. Most slates allow the mortgagor to redeem the property within a year by paying the buyer of the property at the judicial sale the amount actually paid by him not the amount originally owed. If the sale proceeds do not satisfy the amount owed, a deficiency judgment for the balance may be obtained against the debtor if permitted under state law.

A DEED OF TRUST

A deed of trust is a security interest in real property to secure payment of a loan or some other obligation. The borrower is called the trustor and the lender is the beneficiary. The trustor

executes a promissory note for the amount of the loan. The payment of the loan is secured by a trust deed on the property for the benefit of the lender referred therein as the beneficiary. In the event of a trustor's default on the payment of the promissory note, the beneficiary notifies the trustee of the breach. The trustee then gives the trustor (the lender) notice that unless the default is cured within a statutorily mandated period of time the property will be sold. If the default is not cured (back payments made), the property will be sold at a public auction. The advantages of a deed of trust are twofold: (1) there is no power of redemption after the property is sold and (2) the lender does not have to go through the long expense and delay of a judicial foreclosure. A trustee usually has the option of selling the property at a private sale, under the terms of the deed of trust, or filing a lawsuit for judicial foreclosure. The only real advantage of filing a judicial foreclosure action (sue in court) is that a deficiency judgment might be obtainable. Many states have enacted anti-deficiency legislation to preclude a lender from getting a deficiency judgment on any purchase money loan on residential real property.

In a long form deed of trust, all of the terms and conditions of the trust deed are specifically stated, spelled out and recited. As such, the full document tends to runs between five to ten pages. Many institutional lenders do not use a long form deed of trust. Instead, they record a standard list of clauses for their trust deeds in each county. Then, the lender simply refers to those

clauses in their abbreviated short form deed of trust and incorporate the clauses therein by reference. The reason for doing this is to save money by not having to record as many pages. The important clauses are, of course, still listed in the short form deed of trust, i.e. the payment and acceleration clauses. A copy of the recorded clauses is given to the borrower. The total loan agreement then consists of the short form trust deed and the incorporated clauses.

When a promissory note secured by a deed of trust is paid off, in order to have the trust deed encumbering the property removed from the title to the property, a deed of reconveyance must be recorded, The recording of the deed of reconveyance takes the deed of trust off the title to the property and places the title to the property solely in the name of the owner. The trustee listed on the deed of trust or the successor trustee must sign a deed of reconveyance and then record it. The mechanics of the procedure is as follows:

1. The lender marks the original promissory note paid in full.
2. The note Is then sent to the trustee. The trustee will prepare and execute a Deed of Reconveyance.
3. The Deed of Reconveyance is recorded.

Trustees then to charge between $100 and $500 for signing and recording a Deed of Reconveyance.

A DEFICIENCY JUDGMENT

In the case of a mortgage debt, if the judicial sale does not pay off the debt, the mortgagee can sue the mortgagor for the balance remaining which is called the deficiency. A number of states have limited the judgment in such cases to the difference between the debt and the foreclosure price. Some states, including California, have anti-deficiency legislation that prohibit deficiency judgments on purchase money mortgages. A purchase money mortgage is one used to buy the property rather than improve it. Many states do not permit deficiency judgments in the case of a deed of trust where the property was sold under a trust deed's power of sale. If a deed of trust is foreclosed using a judicial foreclosure (suing in court for a judgment rather than selling the property under a power of sale in the trust deed), then a deficiency judgment may be possible provided there is no anti-deficiency legislation barring them.

EFFECT OF A FORECLOSURE ON OTHER LIENHOLDERS

Any foreclosure, either judicial in nature or by a deed of trust, wipes out all junior liens and encumbrances. It does not affect in any way a superior lien or encumbrance. For example, assume that George purchases a piece of property at a foreclosure sale on a second mortgage. The property had a first mortgage of $100,000 and a third mortgage of $50,000.00. The first mortgage still stays on the property but the third mortgage is wiped out. The holder of the third mortgage can sue the mortgagee personally for the balance owed on the third mortgage but cannot go against

the new buyer of the property for the payment of the junior lien.

AN INSTALLMENT LAND CONTRACT

An installment sales contract is one is which legal title stays with the seller until the contract is paid off. In the event of the buyer's breach, this type of contract results in the forfeiture of the buyer's interest rather than foreclosure on the property. Because of the harshness of the forfeiture, some states treat installment sales contracts as mortgages. These states require the seller to judicially foreclose on the property in order to clear his title on the land. If the seller elects to treats the property as a forfeiture then the seller is prevented by law from suing for damage s or specific performance. The seller cannot keep the property and yet still demand payment for it.

A. HOMESTEAD

Most states permit an owner of real property which is his or her primary residence to claim a certain amount of equity, usually $40,000, in the property as exempt from attachment by creditors. In such states, creditors cannot attach a debtor's home if a homestead declaration was recorded and the debtor's equity does not exceed the statutory amount. If the equity does exceed the statutory amount, then on the sale, the statutory amount is returned to the debtor even if the debt is not paid off. A declaration of homestead must be recorded in the County Recorder's Office of the County where the home is located prior to any lawsuit by a creditor being filed. Recording the homestead declaration of homestead after the

lawsuit is filed does not perfect the homestead or afford any protection from creditors.

IMPLIED WARRANTY OF FITNESS FOR USE IN THE SALE OF REAL PROPERTY

At common law, there was no implied warranty of implied fitness for use in the sale of real property. The major exception, at common law, existed for a building under construction or to be constructed based on the rationale that the buyer had no ability or opportunity to inspect the building. A majority of states now hold that there is an implied warranty for fitness in the sale of a new house by the builder. The warranty implied, by these states, is that the house is designed and constructed in a reasonably workmanlike manner and is suitable for human occupation.

REMEDIES AGAINST A SELLER FOR MAKING FALSE STATEMENTS OR CONCERNING RELEVANT CONDITIONS

If the seller knowingly made false statements to the buyer on a fact that materially affects the value of the real estate which the buyer relied upon in purchasing, then the buyer has the following remedies:

1. The buyer may rescind the contract and demand return of the money purchase price plus damages incurred in performing the sale.
2. The buyer can affirm the contract and sue for damages. The damages are the difference in value between the purchase price and the true value of the property. Additional damages may be recovered for incidental

expenses incurred because of the false statements

and if appropriate punitive damages may be obtained. The seller is just as liable for defects that he actually conceals from the buyer as he is if he makes false statements about them. The common law view is that the seller is under no duty to disclose defects as long as he does not lie about them or conceal them. Many states, including California, now require an owner to disclose all known defects where the defect is not readily discoverable.

DUE ON SALE CLAUSE IN A MORTGAGE OR DEED OF TRUST

Many mortgages and deeds of trust contain clauses that state if the property is sold or conveyed in any manner, then the entire balance becomes immediately due and payable. The purpose of these clauses are to protect the lender from risky sales or assignments. These clauses have the effect of preventing the sale of the property without the lender's approval unless the lender's loan is paid off.

Federal law will enforce a due on sale clause if the loan is from a federally insured lender. Some states, such as California, have adopted legislation that prevent private lenders or state charted lenders from enforcing due on sale clauses if the value of the property exceeds the amount owed.

A frequent source of malpractice actions against attorneys is for missing due on sale clauses in lending documents. In these situations, the client will purchase the property, after the attorney’s review of the documents, and then later surprised by a

demand from the lender that either the loan be paid off or the buyer pay a higher rate of interest, In such an event, the attorney may be liable for the increased interest or other damages incurred by the client due to the failure to inform the client of the potential risks of purchasing property through the assumption of a loan which contains a due on sale clause.

ZONING

Every state has the authority to enact all laws reasonably necessary for the health, safety and welfare of its citizens, this is known as the state's police power. Zoning is the term most often given to those laws enacted by a city, county or state that regulates the development of land within its boundaries according to an adopted general plan of development. The implementation of any zoning plan must comply with the constitutional provisions of due process or equal protection. If as a result of zoning, private property is taken for public use, this is called eminent domain, the owner must be paid the fair market value of the property.

The government can so restrict the development of private property that no reasonable use of the property remains. In that event, the United States Supreme Court has held that inverse condemnation ha s occurred. Inverse condemnation is a violation of the U.S. Constitution's Fifth Amendment as a taking without just compensation. A taking for public purposes can occur if the government requires dedication of easements or transfers of portions of the property in order to get building permits when such

easements or dedications have no relationship to the project sought to be built. This is the hottest area of contention in zoning law. Many regulatory agencies routinely demand public easements across private property or dedications of land in order to grant building permits.

The Republican Party, when it assumed control of Congress in 1995, promised in its Contract with America, to present legislation to protect private property rights. Under the Republican Party’s Contract with America, if a property owner's value of the land is reduced as a result of government action, the government must compensate the owner. Such legislation has not, as yet passed, but if it does it will permit owners to sue the government for losses in value in the land that exceed ten percent as a result of government conduct.

MINERAL AND WATER RIGHTS

Mineral rights are the ownership rights of all the minerals on a designated piece of real property. Mineral rights can be segregated and split off from land. Mineral rights carry with them a right to enter upon the real property to search for and develop the minerals contained thereon. This right of entry is called a “Profit A Prendre” and is a nonpossessory interest in the land. A profit a prendre is in essence an easement to enter upon and develop the minerals on the property. It can be terminated for the same reasons as an easement. It is possible for mineral rights to be sold with out the right to enter upon the surface to develop.

This is referred to as retaining surface rights. In such an instance, development must be done under ground. As example of development by a mineral owner where surface rights are retained would be in the slant drilling for oil wherein the oil well is drilled offsite but the well bore ends up under the land for which the mineral rights are owned.

A riparian right is the right of the owner of land bordering a stream to use all of the water necessary for the domestic purposes. The owner also has the right to use a reasonable amount of the water for other non-domestic, business, purposes provided he returns the water to the stream in an unpolluted state. The water from the stream may not be diverted beyond the watershed of the stream. A subterranean stream is treated the same as a surface stream. The owner has an absolute right to use as much water as he or she wants from water percolating on the surface, Many states, especially in the West, now hold that such use must be reasonable and that there may not be careless waste or pollution. Other states hold that all of water belongs to the state and the owner of the land must perfect his or her rights to legally use the water on the property by application to the state.

An attorney, unfamiliar with state law regarding mineral or water rights may inadvertently lose those rights for the client. In such an event, the attorney may be sued for malpractice for the value of those lost rights.

THE TORRENS TITLE SYSTEM

In a very few jurisdictions, the ancient Torrens Title System is still used to clear title. In those few places where it is used, a buyer will petition a court for a hearing. At the hearing, the court will direct the issuance of a certificate of title after giving creditors with liens or security interests on the property a chance to assert their liens or security interest. The court may order the creditor's obligation paid off as a condition of passing title. With a few exceptions, the court's certificate is conclusive on the title **of** the landowner.

II. MALPRACTICE CONSIDERATIONS

INTRODUCTION

Malpractice involving reaL property is usually quite easy to prove. In addition, the number of malpractice lawsuits filed against attorneys, in general, have been steadily increasing. A client has two options in pursuing a malpractice claim. The client can sue in court or report the malpractice to the state disciplinary board. In Colorado, a state with less than 20,000 attorneys, 1189 grievances were filed in 1989 which was an increase of 16% over those filed in 1988. Nearly one-fourth of the grievance complaints filed in Colorado in 1989 involved real estate malpractice. Even though a disciplinary finding against an attorney is not conclusive proof for liability in a civil case, it is highly persuasive evidence. For that reason, most clients will first present their complaint for malpractice to the disciplinary board before filing a civil suit. A ruling in favor of the client would

then be used in the civil case.

CONFLICTS OF INTEREST

One of the most common sources of malpractice actions is the multiple representation of clients in a real estate matter. The Model Code, Disciplinary Rule 5-105 (B) and (C) read as follows:

"(B) A lawyer shall not continue multiple employment if the exercise of his independent professional judgment in behalf of one's client will be or is likely to be adversely affected by his representation of another client, except to the extent permitted under DR. 5-105(C).

(C) In the situations covered by DR 105(A) and (B), a lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each and if each consents to the representation after the full disclosure of the possible effects of such representation on the exercise of his independent professional judgment on behalf of each."

Multiple representation is permitted when formalities are met. For multiple representation to be permitted, warnings and ·explanations of the attorney's responsibilities must be given and the clients must make an informed decision to permit the multiple representation. Even though multiple representation may be permitted, the attorney is still bound by any ethical standards which may cause a conflict in representation of the multiple

clients.

The Colorado Bar Association issued Formal Opinion No. 68 (1985) set forth the guidelines for an attorney's representation of both the buyer and seller in the area of residential real estate. Under this ethics opinion, an attorney

(1) should make sure that the parties have agreed on the material terms of the agreement. These agreed terms should be in writing and signed both of the parties so as to be able to prove the agreement;

(2) must disclose to the client the risks attendant in using a joint attorney. The attorney must explain that in a lawsuit the attorney will not represent either party and may be called to testify by either party against the other. As such, the attorney should inform the clients that the information and conversations given to the attorney may not be confidential if the attorney is called to testify in court against the other party.

(3) must obtain specific and informed consent to represent both clients from each client only after the disclosure of the information discussed above;

(4) should not take the joint representation if the attorney believes that the interests of both clients cannot be adequately represented and that it is unlikely a conflict resulting in a lawsuit will develop.

The Colorado ethics opinion states the general ethical standard for for multiple representation followed in most states. In the case of multiple representation, care must be take by the attorney to assure that the attorney will not be accused of taking sides in a dispute. The attorney, because of the joint representation, should avoid trying to settle disputes between the clients and act only as

a mediator. This is severe limitation on the conduct of an attorney which is not imposed on an attorney representing only one client. In addition, should the attorney in a joint representation discover fraud being practiced by one client upon the other, the attorney must disclose that fraud. This also is a different rule from that imposed on an attorney with a sole client.

ABA For. Op. 331 held that an attorney could represent a title insurance company and yet still recommend the company to other clients. The attorney is required, however, to be sure that his or her professional judgment is not affected by the representation of the title company.

ABA. Inf. Op. 1170 permitted an attorney to represent both clients in a real estate transaction with the informed consent of both clients but the attorney could not, with his own funds, cover the clearance of the buyer's out of state check.

Another form of conflict of interest occurs when the attorney is engaged in a business relationship with the client. Disciplinary Rule 5-104 reads as follows:

"(A) A lawyer shall not enter into a business relationship with a client if they have differing interests therein and if the client expects the lawyer to exercise his professional judgment therein for the protection of the client, unless the client has consented after full disclosure.

(B) Prior to conclusion of all aspects of the matter giving

> rise to his employment, a lawyer shall not enter into any arrangement or understanding with a client or a prospective client by which he acquires an interest in publication rights with respect to the subject matter of his employment or proposed employment.

Under this disciplinary rule, an attorney cannot represent a client if the representation is affected by a business relationship with the client without full consent of the client.

For. Op. 176 held that an attorney reviewing title could not agree with the person purchasing a future interest in the property that the attorney would be a part owner.

Inf. Op. A-268 held that an attorney acting as executor of an estate may purchase an asset of an estate of sold at an auction administered by a judge.

LIABILITY UNDER FIRREA

In 1989, Congress passed the Financial Institutional Reform and Recovery Act (FIRREA). This Act imposed liability upon attorneys for knowingly or recklessly participating in any violation of law, fiduciary duty or unsound practice that resulted in causing or was "likely to cause more than a minimal effect on, the insured depository institution." FIRREA was enacted in response to the savings and loan collapse of the mid 1980's. Under FIRREA, attorneys will have a whistle blowing responsibility and duty to assure that their clients do not undertake transactions with insured institutions which pose high risk without disclosing such

risk to the institution. Under FIRREA, attorneys are not required to analyze the financial loan transactions proposed by their client with insured institutions to assure that any unreasonable risk is disclosed. This can be defined as requiring attorneys to exercise a duty of due diligence for the banking institution even though the client is not that institution. In essence, FIRREA may be considered a codification of the ethical duty that an attorney cannot participate with a client in the perpetuation of a fraud or violation of the law. The extent in which law firms and attorneys will be found liable for lessees under FIRREA for their client's actions will be set by precedent on a case by case basis.

TITLE OPINIONS

The most common source of real estate malpractice actions against attorneys involve errors in title opinions. In many states, title companies do not exist. In those states without title insurance companies, attorneys render title opinions and therefore they guarantee the opinion by virtue of their malpractice insurance. Whenever an attorney issues a title opinion, there is a duty of due care owed to third parties who may foreseeably rely on that opinion. Such persons are usually purchasers or lenders on the property who justifiably rely on the opinion in making the purchase or loan. Negligence on the part of the attorney in rendering the title opinion will expose the attorney to liability for damages suffered by those persons who justifiably relied upon the attorney’s title opinion, **Crawford vs Gary and Associates** (1986)

493 So.2d 744.

In making a title opinion, an attorney should be as specific as possible as to what has been considered and what exactly the attorney's opinion covers. The attorney should state with specificity those facts and assumptions which serve as a basis of the attorney’s opinion. Therefore, if the facts or assumptions are wrong, tho opinion will, likewise, be wrong as well but a person having knowledge of the falsity of the assumed facts cannot justifiably rely upon the attorney’s opinion. In addition, an attorney should limit the opinion to the areas in which the attorney has actual facts on which to base the opinion. The attorney should list as an exception to the title opinion those issues or areas for which the attorney does not have sufficient knowledge on which to render an informed opinion. Usually, a attorney will list as exceptions anything not of record in the County Recorder's office and anything which would not be disclosed in a visible inspection of the land in the situation where the attorney did not visibly inspect the land.

NEGLIGENCE

An attorney is always liable for title damages caused to a client as a result of the attorney's negligence. One of the most common forms of attorney negligence in real estate occurs in the drafting area. A common drafting error occurs when the attorney fails to include a material term in a sales agreement or an easement or reservation in a deed. In such instances, the attorney

is liable for the damages suffered by the client.

In **Shealy vs. Walters** (1979) 256 S.E.2d 739, an attorney was liable for damages suffered by a client for improperly changing the grantee of a deed without the client's consent. The client was prevented, thereby, from obtaining marketable title on the property.

Where an attorney failed to include in escrow instructions a clause restricting the use of escrow proceeds, from a mortgage loan, to the payment of the client's purchase money loan was liable for malpractice. **Starr vs. Mooslin** 93 Cal.Rptr. 583

Failure of an attorney to list in a deed specific easements identified in the purchase agreement made the attorney liable for malpractice. **Becker vs. Port Dock Pour Inc**., (1988) 752 P.21. 1235.

The major point for attorneys to remember in dealing in real estate law is that the attorney will be held to the standard of a real estate attorney not a general practitioner engaging in a real estate matter. Therefore, it is incumbent for the attorney to pay close attention to real estate matters and research any areas in which the attorney may have doubts.

CHAPTER ELEVEN

DAMAGES AND DEFENSES

INTRODUCTION

An attorney is sued for malpractice for only one reason which is that a client wants to collect money from that attorney. The plaintiff, in a malpractice suit, seeks damages, both compensatory and, if possible, punitive as well as recompense for the improper advice and action of the attorney. Most malpractice actions seek monetary compensation for an injury allegedly derived from the attorney's breach of the duty of care owed to the plaintiff, who may not even have been the client. An attorney is liable for an intentional tort committed against the client independently from any malpractice action. This chapter is not directed toward suits against attorneys which derive from an alleged intentional tort because any liability against the attorney is not based upon malpractice but rather a state's general tort law. Rather, instead, this chapter is devoted to discussing the damages and basic defenses which generally arise in a malpractice action.

Generally, if a reasonable client feels that some part or type of attorney’s conduct was wrong, then quite likely it may be wrong. If an attorney’s conduct is found to have constituted a malpractice violation then the courts, the state bar or both will punish the attorney. Generally, attorneys, in a malpractice action, are not treated any differently from the typical defendant in a civil

lawsuit. The most common difference between how a malpractice action and the basic negligence action are handled in the courts is that malpractice actions often have a special statute of limitations, as discussed below.

In the malpractice action, the attorney defendant may be held liable for the direct compensatory damages suffered by the plaintiff which are found to be directly related and flowing from the attorney's conduct. In addition to the possibility of a compensatory judgment award being entered against him, an attorney may also, under a state's malpractice law, be subject to a punitive damage award as well. Besides liability for the direct damages flowing from an attorney's malpractice, consequential damages, those flowing indirectly but predictably from the attorney's malpractice, may also be assessed.

Just as an attorney can be sued as any other defendant for alleged malpractice, the attorney is likewise permitted to defend against those allegations. It is the purpose of this chapter to help educate an attorney as to theories of damages in most malpractice actions and the defenses which may be asserted therein.

I. DAMAGES

A. VICARIOUS LIABILITY

Vicarious liability is liability imposed, at law, on someone for the torts committed by another. Generally, this means that a third party may be liable and have to pay damages for the torts committed by someone else. The basis for this liability rests on

the special relationship between the person committing the tort and the person to whom the liability is imputed or assessed. Vicarious liability is substituted or indirect liability imposed on one person or entity for the actions of another. An attorney, simply by the virtue of being an attorney, will be held to be vicariously liable for the damages suffered by a client as the result of the acts committed by persons under the attorney's control in most circumstances.

(1) ATTORNEY'S STAFF

An attorney will be vicariously liable for all torts committed by an employee within the employee's scope of the employment. The liability is founded on the principle that a duty rests upon every attorney in the management of his legal affairs, whether by himself or by agents, to conduct those affairs in such a manner so as to not injure others. The liability of an attorney for the every employee's act is referred to as "Respondeat-Superior". As long as the employee was acting within the scope of his employment when the misconduct occurred, then the attorney-employer is liable for all damages resulting therefrom to any of the attorney's clients.

Generally, intentional torts committed by an employee are not considered to be within the normal course of employment. As such, attorneys are seldom found liable for intentional torts committed by their employees unless such torts would have been very easily discovered or prevented had the attorney exercised reasonable oversight of the employee. Courts, however, have found vicarious

liability when the intentional torts committed by the employee were within the scope of employment. Some considerations used in determining whether such conduct was within the course of employment are:

1. The use of force was authorized by the type of employment;
2. Friction is generated by the type of employment; and
3. Whether the servant is furthering the employer's business through the intentional tort.

An attorney hiring an independent contractor will, generally, not be held liable for the torts committed by the independent contractor. An attorney may, however, be held liable for the damages caused by any employee or independent contractor under the theory of negligent selection. Under such a theory, if a reasonable attorney would not have used the services of the employee or independent contractor, then the attorney may be held liable for the damages flowing as a result of the torts committed by said employee or independent contractor.

Liability for negligent selection is a totally separate cause of action from that of negligent supervision. The attorney could have properly supervised the employee or independent contractor up to the point of time when a tort as committed. In such an instance the attorney would not be liable for negligent supervision but could, nonetheless, be held liable under the theory of negligent selection or employment of the person if a reasonable attorney

would not have employed the person to start. For example, assume that an attorney holding a power of attorney for health care hired a companion for the principal. Assume further that the attorney regularly visited the principal and kept diligent track of the companion’s care. If the companion turned out to be an escaped mental patient with a history of violence who subsequently harmed the principal, the attorney could be liable for negligent selection even though there is no negligence in supervision of the companion.

a. PARALEGALS

In response to the explosion of the use of paralegal in the legal profession the American Bar Association has created a Standing Committee on Legal Assistants to help mange and regulate their use in the legal profession. The ABA has adopted the following definition of a legal assistant, which includes paralegals:

> "Persons who, although not members of the legal profession, are qualified through education, training, or work experience, are employed or retained by a lawyer, law office, governmental agency, or other entity in a capacity or function which involves the performance, under the direction and supervision of an attorney, of specifically-delegated substantive legal work, which work, for the most part, requires a sufficient knowledge of legal concepts, such that, absent the legal assistant, the attorney would perform the task."

Just as the ABA certifies law schools, its Standing Committee certifies paralegal and legal assistant programs to assure a minimum legal standard of competency.

The Model Rule 5.3 specifically requires that attorneys oversee their legal assistants. It reads as follows:

> "Rule 5.3 Responsibilities Regarding Nonlawyer Assistants with respect to a nonlawyer employed or retained by or associated with a lawyer.
>
> > (a) A partner in a law form shall make reasonable measures giving reasonable assurance that the person's conduct is compatible with professional obligations of the lawyer.
> >
> > (b) A lawyer having direct supervisory authority over the non-lawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and
> >
> > (b) A lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if:
> >
> > > (1) the lawyer orders, or, with the knowledge of the specific conduct, ramifies the conduct involved; or
> > >
> > > (2) the lawyer is a partner in the law firm in which the person is employed, or has direct supervisory authority over the person, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Model Rule 5.5(b) states that an attorney is not permitted to, "assist a person who is not a member of the bar in the performance of an activity that constitutes the unauthorized practice of law." However, the Comment promulgated under the Rule makes it clear that it does not apply to paralegals working under the direction of an attorney. Specifically, it states that the Rule," does not prohibit a lawyer from employing the services of para professionals and delegating functions to them so long as the lawyer supervised the delegated work and retains responsibility for the work."

While paralegals can do a lot for an attorney, they cannot do everything. The Model Code of Professional Responsibility was

adopted by the American bar Association in 1969 and was replaced with the Model Rule of Professional Responsibility in 1983. All states have adopted one or the other Act, with modifications, as the rules for governing the legal practice of attorneys in the state.

Paralegals are not members of the bar. As such, they are not subject to the same legal sanctions for unethical conduct, disbarment or suspension which can be imposed against attorneys. Nonetheless, the attorney hiring or using the paralegal is responsible for the unethical conduct of the paralegal. The Model Code, in its Preliminary Statement, imposes that duty as follow:

> “Obviously, the Canons, Ethical Considerations, and Disciplinary Codes cannot apply to non-lawyers, however, they do define the type of ethical conduct that the public has a right to expect not only of lawyers but also of their non-professional employees and associates in all matters pertaining to professional employment. A lawyer should ultimately be responsible for the conduct of his employees and associates in the course of the professional representation of the client.”

The Model Rules, adopted in 1983, went even further in defining the attorney obligation to oversee and manage the paralegals used in the practice. The Comment to Model Rule 5.3 reads in pertinent part:

> "A lawyer should give assistants appropriate instruction and supervision concerning the ethical aspects of their employment... and should be responsible for their work product. The measures employed in supervising non-lawyers should take account of the fact that they do not have legal training and are not subject to professional responsibility."

As stated above, all states have adopted either the Model Code or the Model Rules for governing attorneys in their state. Therefore,

are required to supervise their paralegals and are responsible for the actions of their paralegals.

There are certain matters which paralegal is not permitted To undertake even if their attorney attempts to delegate such authority to act in those areas. The Model Code, Canon 3, specifically bars paralegal from acting "in matters involving professional judgment. Where this professional judgment is not involved, non-lawyers .... may engage in occupations that require a special knowledge of law in certain areas." The Ethical Consideration 3.5 goes further to state: "A lawyer often delegates tasks to ... lay persons. Such delegation is proper if the lawyer maintains a direct relationship with his client, supervises the delegated work, and has complete professional responsibility for the work product."

Probably the greatest concern that the legal profession has with the use of paralegal is the maintenance of clients' confidences. Clients know that an attorney cannot divulge their communications or information without being sanctioned, possibly to the extent of losing their license. With the use of paralegal, a concern exists because as stated above, paralegal have no license to lose. In an attempt to address such client concerns, Canon 4 of the Model Code and its Ethical Considerations were adopted. Ethical Consideration 4-2 states, "It is a matter of common knowledge that the normal operation of a law office exposes confidential professional information to non-lawyer employees... (T)his

obligates a lawyer to exercise care in selecting and training his employees so that the sanctity of all confidences and secrets of his clients may be preserved. Furthermore, Ethical Consideration 4-4 states, "A lawyer should endeavor to act in a manner which preserves the evidentiary privilege...(H)e should avoid professional discussions in the presence of persons to whom the privilege does not extend." The professional limitations on paralegals not exercising professional judgment still permits them to do a great deal for the attorney. Specifically, paralegals are permitted to interview witnesses, communicate with clients which also includes conducting interviews, conduct investigations, speak with court personnel, perform legal research, draft preliminary pleadings. Such conduct does not violate any Professional Canon, Rule, or Ethical Consideration as long as the paralegal acts under the direct supervision of the paralegal. The Attorney cannot turn over case management or client communication to the paralegal.

With the above exceptions, a paralegal is not permitted to engage in any activity which involves professional judgment on the Bar of an attorney. This limitation is defined rather broadly to mean that a paralegal may not render legal advice or counsel to a Client. The paralegal can take and rely a client's questions to the Attorney but may not render its own opinion or answers to those questions. An interesting exception to this limitation has developed regarding court appearances by paralegal. Some states,

but not all or even a majority, permit paralegals to appear in court. Such states usually limit the court appearances to uncontested cases or administrative law cases. Usually, in such a situation, the written consent of the client must have been obtained prior to the appearance. Even, if such a requirement does not exist, it should be obtained anyway from a malpractice avoidance standpoint.

(2) RES IPSA LOQUITUR

Res ipsa loquitur is Latin for "The thing speaks for itself." It is a legal doctrine sometimes evoked in negligence actions to support liability. Under this doctrine, no proof of negligence need be proven beyond the incident itself. The injury suffered is presumed to have been caused by the negligence of the defendant when the following conditions are met:

1. The event causing the injury, such as an airplane crash, does not usually occur in the absence of negligence,
2. Other causes of the event are eliminated by the evidence,
3. The indicated negligence is within the scope of the defendant's duty to the plaintiff, operate the airplane safely.

In short, malpractice liability is presumed in those circumstances where it is the only explanation for the injury. For an attorney, this imposes amounts to strict liability. If an attorney's office make s a mistake and no one can figure how it happened, then the attorney will still be liable for the damages suffered by the

client or affected third party. In the attorney situation, the theory is basically to impose a duty on the attorney to manage the law office so that no mistakes ever happen. A mistake that is traced to the attorney's office will be imputed to the attorney even though no one may know for certain how the mistake actually happened.

(3) LIABILITY FOR ATTORNEY'S PARTNER'S MALPRACTICE

Every partner is jointly and severally liable for the torts committed by the other partners committed in the scope and course of affairs of the partnership. A partnership is two or more persons or entities working together as co-owners to run a business for profit. The Internal Revenue Code defines a partnership in Section 761(a) as:

> **"a syndicate, pool, joint venture or other unincorporated organization through which...any business is carried on..., and is not a corporation trust or an estate (meaning sole proprietorship)"**

A partnership may be formed by a written agreement or it may be formed by an oral agreement of the parties. The determining factors as to whether a partnership exists are whether the parties intended to form a partnership and whether they intended to make a profit from the activities. Once the foundational elements of a partnership are met, the partnership is formed and governed either by the terms of the written agreement, the UPA or in the case of Louisiana, its own state partnership law.

The main drawback to any general partnership is the fact that the partners are personally liable for the debts of the partnership. In short, the partners have agreed, by forming a partnership, to guaranty payment of any debtor judgments taken against the partnership. Partners are not liable for the personal non partnership related debts of the other partners. Under the Uniform Partnership Act, the partnership (and thus the partners) are liable for "any wrongful act or omission of any partner in the ordinary course of the business of the partnership. Where loss or injury is caused to any person by the partnership, the partners are individually liable for payment of the damages. In addition, the partners are liable for the money damages that arise for the actions of any partnership employee or the other partners during the course of their work for the partnership. The classic example of malpractice liability for a partner 's action is the sexual harassment case **Rena Weeks vs. Baker & McKenzie and Greenstein**. In 1994, a jury in San Francisco, awarded a legal secretary $6.5 million, nearly all of which, was punitive damages against Baker & McKenzie. The trial court later reduced the judgment against Baker & McKenzie to $3.5 million. The judgment is under appeal. The plaintiff's attorneys are seeking another S3.3 million as attorney fees under the Fair Employment and Housing Act and private attorney general statutes. This case demonstrates that partners may be personally liable for the acts committed by their partners. If the firm' s malpractice insurance policy does not cover intentional

torts such as sexual harassment, then the partnership will have to pay the judgment itself. In the event that there is no malpractice coverage, the partners of Baker & McKenzie may have to take a reduced share of profits in order to pay the judgment.

B. COMPENSATORY DAMAGES

There is only one reason why a person sues an attorney for malpractice and that reason is to collect money. A person injured by the malpractice by or attributed to an attorney is permitted to sue that attorney for the value of the damages suffered. In addition, where the attorney's conduct justifies it, the attorney may also be subject to exemplary or punitive damages purely as a form of punishment. Compensatory damages covers a wide variety of damages all of which are designed to make the plaintiff whole and to restore the plaintiff to the condition prior to the attorney's malpractice. The basis types of compensatory damages are those that are classified as either direct or indirect.

Direct damages are those that flow immediately as a direct result of the attorney's misconduct. Direct damages are the type that are immediately foreseeable as occurring as the result of the malpractice. Included in direct damages are nominal, general and actual damages. Pain and suffering can also be awarded as a direct damages when it is foreseeable that such pain and suffering could result from the malpractice. Indirect damages, by contrast, are those damages that are not readily foreseeable by nonetheless flow from the attorney's malpractice. The major type of indirect damages

are consequential damages. An injury to a person which gives rise to consequential damages is one which did not arise from the loss of the intended benefit sought to be obtained through the attorney's services but occur because that benefit was lost. Included as a consequential damage are mental distress, loss of reputation, and economic losses.

The purpose of compensatory damages is to make the client whole again. For that reason, the client has the duty to prove the amount of damages suffered as a result of the attorney’s malpractice. The majority view is that a client who has not suffered actual damages is not entitled to nominal damages. **Alhino vs. Starr** (1980) 112 Cal.App. 3d 158, **Trustees of Schools vs. Schroeder** (1971) 2 Ill.App.3d 1009, **Duke & Co. vs. Anderson** (1980) 275 Pa.Super. 65, **Dunn vs. McKay** (1978) 584 P.2d 894. Some states,however, do permit nominal damages to be awarded even though there were no actual damages suffered as a result of the attorney's malpractice, **Olson vs. Fraase** (1988) 421 N.W.2d 820, **Spence vs. Hilliard** (1987) 181 Ga.App. 767, **Carrol vs. Rountree** (1977) 34. N.C.App. 167. **Holmes vs. Drucker** (1991) 201 Ga.App. 687.

In a malpractice action, an attorney is usually not liable for speculative damages. Speculative damages are those damages which are considered to be only remotely related to the attorney's malpractice if at all. The fact that a client may, in the future suffer an injury as a result of an attorney's malpractice does not usually give rise to a suit for damages. **Alhino vs. Starr**, supra,

Dunn vs. McKay (1978) 584 P.2d 894, **Fuschetti vs. Bierman** (1974) 128 N.J.Super. 290. The standard for determining whether damages are speculative is not the amount of the damages but rather whether there are any damages actually suffered, Even if the damages are hard to calculate, if they can be estimated and are assured of occurring then the damages are not speculative. **Benard vs. Walkup** (1969) 272 Cal.App.2d 595, **Keener vs. Karr** (1987) 528 A.2d 1236. **Miami International Realty Co. vs. Paynter** (1988) 841 F.2d 348, **Whitehead vs. Cuffie** (1987) 185 Ga.App. 351.

1. MALICIOUS PROSECUTION

Both an attorney and a client can be sued together for malicious prosecution if their actions are improper. Malicious prosecution is
a tort based upon the fact that the plaintiff was wrongfully and maliciously accused of a crime and by that suffered damage. The elements of the malicious prosecution are:

1. The institution of criminal proceedings against the plaintiff;
2. A conclusion of the criminal proceeding favorable to the plaintiff;
3. Absence of probable cause for the prosecution;
4. Improper purpose of the defendant;
5. Damages to the plaintiff.

The attorney or client, upon the attorney 's advice, must have initiated the criminal proceeding by filing a complaint. The

criminal case terminates in such a manner that the innocence of the accused is demonstrated. There must have been no probable cause for the attorney's activities in instituting the criminal prosecution. The defendant must have known that there were insufficient facts to believe the plaintiff was guilty or did not actually believe the accused to be guilty. The defendant must have had the primary purpose in initiating the false criminal proceeding the intent to injure the plaintiff and not to bring a person to justice. Many jurisdictions extend the tort of malicious prosecution to improperly brought civil actions. A civil suit for malicious prosecution must prove the same elements as a criminal malicious prosecution action. An attorney, who participates in a criminal malicious prosecution may, in addition to civil liability, also face disciplinary action as well. It is a violation of both the Model Code and Model Rules of Professional Responsibility for an attorney to file a criminal complaint in order to obtain an advantage in a civil case.

Many states also permit a civil suit for malicious prosecution to be predicated upon the intentional filing of frivolous civil complaint. In states, such as California, once the defendant in the civil case has prevailed, he or she can sue the attorney and the attorney's client for malicious prosecution. The plaintiff in a malicious prosecution suit must prove that the suit was filed without merit, that the attorney was aware that the complaint was frivolous and filed merely to harass the plaintiff.

A companion tort to malicious prosecution is abuse of process which the proceeding or process was not intended to accomplish. An example is an attorney's attachment of wages on a debt that is known not to be owed. The gist of this tort is the wrongful use of the judicial process and not the motive in doing so. If the process is used in the manner it was designed to be used, it does not matter that the intent was to injure a person. No liability will exist for damages caused as the result of properly executed judicial process. For example, an attorney's attachment of wages to satisfy a judgment is proper even though it is designed to injure a person and done while an appeal is pending which the attaching party knows will be granted. Abuse of process is different from malicious prosecution because the merits of the case are irrelevant. All that is needed to be proven is that the judicial process was misused causing damages to the other party.

2. NEGLIGENCE

The most common source of malpractice actions involved alleged negligence on the part of the attorney, Negligence is, by definition, the breach of the normal standard of care owed to the World at large in performing an act which causes the actual and proximate injury to another. By duty of care it is meant that everyone owes the duty to everyone else to conduct himself in such a way as to not injure anyone else or their property. That duty of care is breached when a perform acts in such a manner as to result in another person being injured. The standard of acre owed in a

negligence case is expanded in the area of attorney malpractice. Attorneys are held to the standard of a reasonable attorney practicing in the field. As such, an attorney who handles a bankruptcy matter will be held to the standard of a reasonable bankruptcy attorney even though the attorney actually practices in another field. **Mageary vs. Hoyt** (1962) Ariz. 41, **Dillard Smith Constr. Co. vs. Greene** (1976) 337 So.2d 841, **Ward vs. Anrold** (1958) 52 Wn.2d 581, **In re Hegarty's Estate** (1924) 47 Nev.369, **McCafferty vs. Musat** (1990) 817 P.2d 1039.

The requirement of the breach causing the actual injury of another is met when as a result of the attorney's actions another Person is injured. The issue in negligence, for many cases, is whether the defendant's actions proximately caused the injury. This requires an determination as to whether the breach was sufficiently connected to the plaintiff's injuries so that the attorney should beheld accountable. If not, then there is no liability on the part of the attorney. Actions by third parties may intervene and cut off an attorney’s liability or a long delay between the time of the breach and the injury may cut off the liability. These are issues for the court or jury to decide.

C. PUNITIVE DAMAGES

Punitive damages are also called exemplary or special damages. Punitive damages is an additional damage award given to the Plaintiff in an action and over and above the amount necessary to compensate the Plaintiff for his actual damages. Punitive damages

are awarded where the wrong done to the Plaintiff was aggravated by circumstances of violence, oppression, malice, fraud, or wanton and wicked conduct on the part of the defendant. Punitive damages are intended to afford solace to the innocent Plaintiff for the undeserved mental anguish, shame, degradation suffered or to punish the defendant for his evil behavior or make an example of him. Punitive damages can be awarded by the court for any intentional tort. Intentional torts for which punitive damages can be awarded are assault, battery, false imprisonment, and defamation. Punitive damages can also be awarded in negligence cases where the negligent act is so gross and unreasonable that it becomes almost intentional.

State law determines whether attorneys may be liable for punitive damages. A few states do not permit punitive damages to be awarded in a legal malpractice case. **Abel vs. Conover** (1960) 170 Neb.926, Illinois Code of Civil Procedure 110 Section 2-1115, **Bernier vs. Burris** (1986) 113 I11.2d 219. The states permitting punitive damages in a legal malpractice case require that there be a showing of actual damages suffered as a result of the malpractice. Nominal damages are not sufficient to uphold an award for punitive damages. **Kluge vs. O'Gara** (1964) 227 Cal.App.2d 207, **Clark Bros. vs. Anderson & Ferry** (1931) 211 Iowa 920, **Widemshek vs. Fale** (1962) 17 Wis.2d 337.

Punitive damages require a finding of fraud, duress or malice on the part of the attorney. Punitive damages may be awarded in the

situation where the attorney had a conscious disregard of the dangerous consequences of his or her conduct. **Blegen vs. Superior Court** (1981) 178 Cal.App. 3d 959. Punitive damages in a legal malpractice action require conduct by the attorney which amounts to a wanton or reckless indifference to the rights of the Plaintiff," **Mosseri vs. Zimmerman & Zimmerman** (1985) 114 A.D.2d 338. Gross negligence is the basis for punitive damages in some jurisdictions **Stinson vs. Feminist Women's Health Center** (1982) 416 So.2d 1183, **Welder vs. Mercer** (1970) 247 Ark. 999 but not in others **Carroll vs. Rountree** (1977) 34 N.S.App. 167, **Singleton vs. Foreman** (1970) 435 F.2d 962.

II. DEFENSES

A. DEFENSES TO DEFAMATION

Defamation is term that applies to both libel and slander and involves false statements which injures a person 's or business ' reputation. An attorney along with a client can be sued for damages arising from defamation which is not protected. The main defenses to defamation:

1. Consent of the party being defamed is a defense as with an intentional torts as discussed above.
2. Truth is an absolute defense for defamation. A person can not be defamed by the truth. However, statement while true may nonetheless expose the person telling it to liability under the theory of infliction of emotional distress or invasion of privacy.

3. There are absolute privileges for defamatory statements made in court, for judges, attorneys and witnesses.
4. Qualified privileges exist, meaning there can be no recovery unless actual malice (knowledge of the falsity or reckless disregard of its truthfulness) is proven in:
    a. Reports of Public Proceedings;
    b. Statements made to those taking public action;
    c. Statements made to someone having an interest in the information. An example is a potential employer speaking to a former employer about an applicant, anything said, without malicious intent, is privileged from a lawsuit for defamation.

An attorney cannot do for a client that which a client cannot do himself. In other words, if the client cannot issue a statement which is defamatory, then neither can the attorney. The main defense that an attorney will have to a defamation action is that the information came out in a court room. An attorney has absolute immunity from the most egregious defamation committed in a judicial proceeding but would not be protected in committed outside the courtroom.

B. CONSENT AS A DEFENSE

Consent is almost always a defense to a claim of malpractice. When the client expressly consented to the attorney's conduct, the attorney normally will not be liable for injuries resulting from the attorney's conduct. Where the plaintiff had consented to the

attorney's conduct by mistake, the consent is still valid unless the attorney knows of the mistake on the part of the plaintiff and takes advantage of it. A consent induced by fraud will not constitute a defense. Likewise, a consent obtained by force, threats or duress is invalid. In the professional setting, especially medical, the lack of informed consent invalidates the consent given to the attorney. Some courts have declared that the failure to disclose risks is a breach of the standard of care as therefore treats the tort as negligence rather than an intentional tort. For example, a doctor that performs an operation and filed to disclose all risks could be sued for negligence not assault or battery. Consent may also be implied by the apparent conduct of the plaintiff which would lead a reasonable person to infer that consent was given for the attorney's conduct.

For the defense of consent to be applicable in a malpractice action, it must be informed consent. An attorney, in order to rely upon a client's consent, must fully appraise the client on all of the risks and dangers inherent to the proposed transaction. If for example, an attorney drafted a Will for a client and upon the client's death the estate pays $160,000 in probate fees. The attorney may be subject to malpractice if the attorney did not apprize the client of the opportunity to engage in estate planning to limit the probate fees. The fact that the client consented to the use of the Will may not be informed consent if the client did not know of the alternative available such as revocable trusts and

estate planning which could have reduced the probate fees. Where the attorney discussed such alternatives, then the client made an informed decision in consenting to the Will's use and therefore no action for malpractice would lie.

C. CONTRIBUTORY NEGLIGENCE

Contributory negligence is a defense to a charge of negligence against a attorney. Every person is held by law to owe himself a duty of care that is to conduct himself in such a way as to not injure himself. Therefore a person who violates that duty and contributes to his own injury because of another person's negligence has committed contributory negligence. For example, assume that two drivers are speeding, have an accident and then one driver sues another for negligence. In such an event, the contributory negligence of the plaintiff for speeding is a defense for the other driver.

Acts that may constitute contributing negligence are:

1. failure to discover or appreciate a risk which wouldbe apparent to a reasonable man,
2. an inadvertent mistake in dealing with a recognized risk; or
3. recognizing the danger or risk and still exposing oneself to it.

The common law rule was that a person could not recover on a negligence suit if the person had in any way contributed to his or her injury. Contribution in states which still follow the common

law would be complete bar to malpractice action if the client in any way helped to caused his or her injury.

While contributory negligence is a defense against the ordinary negligence of the attorney, it is not a defense when the attorney actually intended to inflict harm. The defense of contributory negligence has never been applied to intentional torts such as assault and battery or false imprisonment. Just as the defense of contributory negligence is not available for an intentional tort, it is also not available when the attorney's negligence was so great as to be characterized as "wanton", "reckless" or "willful". In these instances, the attorney's is so grossly negligent and such a departure from ordinary standards of conduct that the possibility of causing an injury is so great that the act is almost intentional, Most states permit recovery in case where there was contributory negligence provided that the attorney was over 50% at fault.

In a few states, including California, a defense of comparative negligence exists to reduce the award of damages recoverable where the plaintiff was also negligent. In such states, the plaintiff's damage s are calculated and then the attorney's percentage of blame is assessed. The attorney is then assessed his percentage of liability for the plaintiff's injuries. In the case where the attorney's negligence accounted for 90% of the client's damages of $1,000,000 and the client's negligence caused the rest, the client would get a judgment of $900,000 against the attorney.

In states which followed the common law, the client would be barred from recovering anything.

D. STATUTE OF LIMITATIONS

The most important question, and possible defense, for any malpractice action is whether the statute of limitations has expired. Every state has a malpractice statute of limitation. For some states, the statute of limitation runs form the period of time that the attorney services are rendered. In other states, the statute of limitations runs from the point in time that the client or third person discovered or should have discovered the attorney's alleged malpractice.

Most states have adopted a malpractice statute similar to California 's Civil Procedure Code section 340.6 which reads as follows:

> "An action against an attorney for a wrongful act or omission, other than for actual fraud, a rising in the performance of professional services shall be commenced within one year after the plaintiff discovers, or though the use of reasonable diligence should have discovered, the facts constituting the wrongful act or P four years from the date of the wrongful act or omission."

In California, a malpractice action accrues at the point in time where the former client discovers or should have discovered the information giving rise to the malpractice. The time to file the malpractice action is tolled until the client actually suffers damages as a result of the attorney's malpractice. The California Supreme Court held in **ITT Small Business Finance Corp. vs. Edward I. Hines (**1995) 94 D.A.R. 18210 that:

> "Thus, discovery of the facts essential to the malpractice claim and the suffering of actual harm from the malpractice establish a cause of action and begin the running of the statute of limitations.
>
> ******
>
> In transactional legal malpractice cases, when the adequacy of the documentation is the subject of the dispute, an action for attorney malpractice accrues on entry of adverse judgment, settlement, or dismissal of the underlying action. It is at this point that the former client has discovered the fact of damage and suffered 'actual injury' due to the malpractice under section 340.6. Therefore in the present case, the statute of limitations of section 340.6 was tolled until the action concerning the documentation was concluded."

Another California case, **Kidd vs. Kopald** (1995) 94 D.A.R. 18238 the court dismissed a malpractice case for delay in service and failure to prosecute. The Appellate Court upheld the trial court's finding:

> "Delay in service of process constitutes a 'potentially pernicious form of delay in terms of potential justice.' Here was a two-year delay in service and a delay of a year and a half thereafter during which some actions were taken but no effort was made to get the case to trial. The need to ascertain damages did not constitute good cause for the delay of service. There is no excuse for not informing a lawyer that he is being sued by his client and that the client expects the lawyer to continue to give his all for the client."

The significance of the statute of limitations and service statutes are obvious. If the complaint is filed or served late, the attorney can move to dismiss the action. The determination of whether a malpractice action can be filed depends on the statute of limitations adopted by each state and the case law developed thereunder. It is important, however, for any attorney facing a malpractice action to review state 's statute of limitation to determine if the suit was timely filed.

CHAPTER TWELVE

JUDICIAL ETHICS

INTRODUCTION

Judges cannot be sued for malpractice. Judges have complete immunity for what they do in their judicial capacity. Judges can, however, be removed from the bench for judicial misconduct. Judicial conduct is determined by the Canons of Judicial Ethics adopted by each state. Judicial ethics apply to judges and attorneys serving as arbitrators. Attorneys generally are aware of the ethics standards to which judges are held accountable. When judges violate those ethic standards, it may well be grounds to have the judge's decision set aside. An attorney, on a winning side, would not a judgement set aside because of misconduct by the judge. By contrast, a losing attorney would like to be able to show that the judge has acted improperly as a ground to overturn the decision. For this reason, it is important for both judges and attorneys to know and understand what actions a judge can or cannot do in a judicial capacity.

To have guidelines to appraise a judges performance, the American Bar Association has enacted the Canons of Judicial Ethics in 1924, the Code of Judicial Conduct (CJC) in 1972, and the Code of Judicial Conduct in 1990. In 1973, the CJC was adopted as the official standard of conduct for all federal judges. All states

have adopted either the 1972 or the 1990 CJC. There are differences between the two CJC's and whether conduct of a judge is a violation of the CJC will obviously depend on which standard of judicial ethics is employed in that particular state.

ELECTION OF JUDGES

There are two types of Judges those who are federal judges and those who are state judges. The federal judges, if they are a federal district court judge or higher, have lifetime appointments under Article III, section 1 of the United States Constitution. A federal judge can be impeached by the Congress for high crimes and misdemeanors under Article 1 section 4 of the Constitution. There was a federal judge in Nevada who was impeached a few years ago for income tax evasion and went to prison for a while, but generally a federal judge serves for life, which means ten to twenty years of the person's professional career, and then the federal judges generally retire. Few federal judges have died in office and even the U.S. Supreme Court judges tend to retire after so many years. With state judges there is a different story. Federal judges can discipline themselves though the use of a committee of federal judges for the violation of any judicial standard stated under the CJC pursuant to 28 U.S.C. section 332, 372 (c)(1) through (17). Not all federal judges have lifetime appointments, only judges appointed to courts established under Article III of the Constitution are entitled to lifetime appointment (Supreme Court, Court of Appeals, District, Claims). Judges of other federal courts

(such as the Tax Court, Bankruptcy Court) only have an appointment for a number of years usually ten and then must be reappointed to continue to serve. In contrast to federal judges, state judges have to stand for election. In California and Nevada, for instance, the judges term of office are six years. In the Supreme Court or appellate branch in California, the judges are nominated by the Governor and they then must be elected by the people. In Nevada, any attorney with the requisite years in practice (i.e., five years or more) can run for Supreme Court Justice. Nevada does not have an intermediate appellate court like California although it is under consideration. Since state judges have to be elected, they have to campaign for the office. They have to have campaign staff, people working for them, etc. There is a much greater tendency that judges may be influenced by people they know in appreciation for the work they have done for the judges. That is not to say it always happens, in fact, in most cases it doesn't happen. There is always that inclination, and that is the price that must be paid for a democracy.

Not all states requires that their judges be attorneys or possess a legal background. Nevada, for instance, permits non-attorneys to be as a Justice of the Peace. A Nevada Justice of the Peace tries all civil cases up to $7,500, conducts all preliminary hearings, and tries all misdemeanors yet is not required to possess any legal education for that position. California, in contrast, since 1974, has required all of its judges to be attorneys. Under

the Rule 8.2(b) of the Model Rules, an attorney seeking a judicial office is required to comply with the CJC. Disciplinary Rule 8-102(A) reads as follows:

> "A lawyer shall not knowingly make false statements of fact concerning the qualifications of a candidate for election or appointment to a judicial office."

Under Canon 7B(1)(c) [5A(3)(d)(I)] a candidate, presumably an attorney candidate, is not permitted to "make pledges or promises of conduct in office other than the faithful and impartial performance of the duties of the office." Included under this provision, is the prohibition not to comment on the outcome of potential cases or disputes which may come before the candidate if he or she is elected judge. A candidate for a judgeship is permitted to advertise and extol the candidate ability, experience and record which qualifies the person for the position.

One of the sorest points in a judicial campaign is the funding of the campaign. Under Canon 7B(2) [5C(2)], a candidate for a judicial office should not solicit campaign funds or publicly stated support. The candidate may, however, establish a campaign committee which can publish campaign literature, conduct pubic forums and solicit public support and reasonable contributions from the public, including lawyers. Contributions made to the committee must be reasonable. Contributions received from lawyers or litigants appearing before the judge raises the issue of potential disqualification of the judge for a matter handled by that attorney or any case of contributor. Canon 7B(2) [5C(2)] Many states have

adopted Canon 7(A)(3) [5A(2)] which require a judge to resign form the bench once the judge becomes a candidate for an elective nonjudicial office. The United States Supreme Court upheld the constitutionality of such a provision in **Clements vs. Fashing** (1982) 457 U.S.957 in a challenge of a Texas Justice of the Peace to "resign and run" statute.

When considering the wisdom of electing judges, there are two different views. Some people feel that because the judge is on the bench for life, once he gets appointed he can thereafter rule without any fear of loss of favor by the rulings. On the other hand, many people feel that since the judge is elected the judge has to become more reflective of the people who elect him, or he will be voted out of office. In many instances, the federal judges have been characterized as virtual Gods because once they are on the bench, they are answerable to no one except to federal appellate judges who are higher than they. Congress can only impeach a good for high crimes or misdemeanors not for incompetence or partisanship in office The United States Supreme Court is, in essence, answerable to no one. Only the Supreme Court defines the Constitution and it can interpret it in virtually any way.

INTEGRITY AND INDEPENDENCE

Under the CJC Canon 3 (1972) and Canon 1 (1990), a judge is mandated to dispense all judicial duties in an impartial and diligent manner. A judge is required to place the judicial responsibilities of the office above all other considerations. A

judge is required to remain ever faithful to the law and to work to maintain confidence in it. **In re Hague** (1982) 315 N.W.2d 524, a judge was disciplined for routinely dismissing gun control and prostitution cases because disagreements with the law despite instructions not to do so from higher courts. In the conduct of the court, the judge is required to be patient, dignified and courteous to all and is to require persons appearing in the court to be so also. In the conduct of the court and the rulings made therein, a Judge is not to be influenced by "partisan interests, public clamor or fear of criticism. A judge should conduct all judicial business in a prompt and efficient manner. In operating a court, a judge's appointments should be necessary and based upon merit. A judge should avoid nepotism or favoritism and the compensation for the appointees should be no more than the fair market value for the services.

A judge should conduct the court so as to give everyone a full right to be heard. A judge must operate a courtroom so that justice is served. The atmosphere of the court must be such that a defendant is granted a full and fair trial with an impartial jury. **Illinois vs. Allen** (1970) 397 U.S. 337, **Mayberry vs. Pennsylvania** (1971) 400 U.S. 455.

Inf. Op. 641 held that is improper for a judge to berate or criticize a jury for perceived errors in its rendered judgement. A judge may inform the jury of the judge's reasons for the disapproval of the verdict but may only do so in a dignified and

considered manner.

Inf. Op. 779 held that a judge should not participate in any arrangements for the determination of a criminal sentence, whether as a result of a guilty plea or otherwise, in advance of the guilty judgment or plea.

Ex parte appearances and hearings should be avoided unless authorized by law. The judge should avoid the use of disinterested experts on the law unless notice of their use is given to the parties in the proceeding. When such experts are used, the court is required to reveal the advice given and an opportunity of must be granted to the parties to respond to it. The use of amicus curiae by Judges is encouraged as a means for the court to obtain valuable advice on the law. **The Judiciary Need Your Help, Teachers** (1970) 22 J. Legal Ed. 197, **Badlands in an Appellate Judge's Realm of Reason** (1960) 7 Utah L. Rev. 157.

A judge should not make any public comments on any judicial proceeding occurring presently or anticipated in the future as occurring in any court. Likewise, the judge should prevent persons under the judge's control from making such comments. A judge is permitted to make public statements required as a result of the judicial duties. A judge is permitted to publicly explain the procedures and operations of the court in general.

A judge is under an obligation to disqualify himself or herself whenever the circumstances arise that the judge's impartiality may be reasonably questioned. A judge should always be

aware of both the his or her personal and financial interests along with those of the spouse and resident children. **Commonwealth Coatings Casualty Company vs. Continental Casualty Company** (1968) 393 U.S. 145.

Inf. Op. 5594 permits a judge to sit in a case where the judge's former firm is the trial counsel when the judge was not with the firm at the time that it took the case, unless a near relative employed by the firm actively participated in the case.

Inf. Op. 806 held that a judge may serve as a Trustee if the judge does not exercise any judicial discretion in relation to the matter and the appointment does not interfere with judicial duties.

A judge's conduct out of court must be exemplary or else the judge may be subject for discipline conduct which brings the judiciary into disrepute. In the case **In re Roth** (1982) 645 P.2d 1064 a judge was disciplined for breaking a car window and slapping his estranged wife when he found her in a car with another man. In the **Matter of Lawson** (1991) 590 A.2d 1132, a judge was disciplined for drunk driving. Discipline was appropriate for not only failing to obey the law, something a judge is always required to do, but also for conduct off the bench which brought the court into disrepute.

APPEARANCE OF IMPROPRIETY

The governing principle for any judicial conduct is that it does not create the appearance of impropriety CJC 2A. This principle applies to a judges's conduct both on and off a bench.

Canon 2(A) and (B) of the CJC (1972) reads as follows;

> "A. A judge should respect and comply with the law and should conduct himself at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary.
>
> B. A judge should not allow family, social or other relationships to influence his judicial conduct or judgment. He should not lend the prestige of his office to advance the private interest of others, nor should he convey or permit others to convey the impression that they are in a special position to influence him. He should not testify voluntarily as a character witness."

In furtherance of this duty, the Code of Judicial Conduct covers, as an example, several specific types of conduct for which a judge may not engage both on and off the bench.

A judge is prohibited from permitting outside relationships from affecting the judge's conduct or judgment. Under this canon, such outside relationships include, but are not limited to familial, social or political relationships. The gist of this prohibition is that a judge must recuse himself or herself from any action in which some type of outside personal relationship will exert direct or indirect influence or pressure on the ruling which the Judge must make.

A more obvious violation of the canon against the appearance of impropriety is where a judge uses the office the personal interests of the judge or other persons. Under this prohibition judges are barred from presenting their opinions on a person's in such a manner as to create the impression that the judge's opinion is more considered and correct than anyone else's opinion. The standard complaint occurs with the Judge saying something to the

effect, "As a judge with many years experience, I know that person is a good individual and should be hired," to a potential employer. Another source of discipline would be a judge telling a prosecutor, "As a Judge, I know the defendant he is a good person and deserves reasonable consideration." Such statements actually violate CJC 2B in using the office to advance the personal affairs of another.

The A.B.A. Committee on Professional Ethics have issued both formal and informal opinions regarding a judge’s duty under Canon 2. The formal opinions are official opinions on the general practice in question wherein the informal opinions are opinions furnished on the request of judges regarding specific proposed conduct.

Under Op. 110, a judge, permitted to have an outside practice of law, could not serve as a judge in a criminal case for non support of the husband, when the judge represented the wife in the dissolution.

Op. 215 held that it is not improper for a Judge to be a member of the National Guard if not otherwise prohibited by law. (A Judge however, would be subject for disqualification for handling for hearing any suits involving the National Guard.)

Inf. Op. 419 held that it would be improper for a judge to write letters which endorse a life insurance contract because it would be considered lending judicial influence and support to promote the business of others.

Inf. Op. 639 held that an attorney serving as a Judge Pro tem

should not use the pro tem practice to advance the attorney's private practice of law. This opinion would tend to preclude the advertisement of attorneys who practice as Judge Pro tem's from using the information that they also serve as Judge Pro Tem's in their advertisements.

Inf. Op. 1015 held that a judge should not agree to be a guest of honor at a funding raising event.

The most controversial aspect of CJC 2 is CJC 2C which forbids a judge being a member of an organization that currently practices "invidious discrimination" based upon race, sex, religion or national origin. Specifically exempted under CJC 2C is membership in an "intimate, purely private organization" the membership in which could not be constitutionally prohibited. In addition, members is permitted in an organization which otherwise would be prohibited if the organization is "dedicated to the preservation of religious, ethnic or cultural values of legitimate concern to its members." Some states, such as California, have added or propose to add to their CJC a provision that a Judge may not belong to an organization which discriminates based upon sexual preference. In California, a dispute has arisen because such a provision would expose a Judge for discipline for serving as counselor or even driving a child to a Boys Scouts of America function because the Boys Scouts do not support homosexuality. It is asserted that such conduct by the Judges would be perceived as support for the anti-homosexuality position of the Boy Scouts and thus is support of an

organization supporting invidious discrimination. Under the Comment to CJC 2C, when a Judge discovers that the organization practices invidious discrimination which is not otherwise permitted, the Judge must either resign promptly from the organization or work to end the discriminatory practice. If the organization does not change its discrimination practice within one year, then the Judge must resign from the organization.

A companion provision to CJC 2 (1972) is CJC 5 which states, "A Judge should regulate his extra-judicial activities to minimize the risk of conflict with his judicial duties." This provision is now covered under CJC 4 (1990). The CJC recognizes that it is not a good idea for a judge to withdraw from community involvement. the Comment under CJC 5 states: "Complete separation of a judge from extra-judicial activities is neither possible nor wise, he should not become isolated from the society in which he lives." A judge is permitted to engage in avocational activities which do not detract from the dignity of the office. A judge is also permitted to participate in charitable and civic organizations but must avoid organizations which may come before the judge in the performance of his judicial duties. A judge is permitted to attend fund raising events but should not solicit funds for the organization, be a speaker or a guest of honor. A judge's personal business affairs should be conducted in such a way as to assure that no appearance on impropriety will exist or called into question. Under CJC 4D(5), the general rule is that a judge should not accept gifts, bequests

or loans from any one. It is also suggested that a judge urge that the members of the household not accept gifts either. Exceptions do exist that allow judges to accept the following:

(1) a testimonial gift, except when given from a from a litigant, past or present, before the judge;

(2) books, tapes and literature for official use;

(3) an invitation to attend a law-related function;

(4) an ordinary social invitation;

(5) a gift from a relative or friend on a special occasion if the gift is relative in value to the friendship and the occasion

(6) a gift, loan or favor from a close friend for whom the judge would have to disqualify himself if the person appeared before the judge;

(7) an ordinary business transaction given to the judge on the same terms as given to an ordinary individual; and

(8) any other gift, favor or loan less than from a person or attorney not likely to appear before the judge. When the value of the gift, favor or loan it must be reported in accordance with state law in the same manner as outside compensation.

Generally, judges are not permitted to take any special favors which might create the appearance that a special financial or personal relationship exists between the donor and the judge.

A recent case which evidences a judges' requirement to avoid the appearance of impropriety is **Fitch vs. Commission on Judicial Performance** (1995) 95 D.A.R. 1842. The California Supreme Court censured a Judge for frequently making sexually offensive comments to female court personnel and occasionally touching those staffers improperly. The Court ruled that the conduct was "such as to bring

the judicial conduct into disrepute, being conduct damaging to the esteem for the judiciary held by the members of the public who observed such."

In avoiding the appearance of impropriety, a judge is required to comply with the law in all instances and also to conduct all personal affairs in a manner as so promote public confidence in the judiciary. The CJC imposes upon judges the duty to avoid all irresponsible and improper conduct. By virtue of the position a judge, a person agrees to lead a life with restrictions on the person's conduct that are imposed on the ordinary individual. A judge is considered to always be under public scrutiny. Therefore the conduct of the judge is always susceptible to review and comment and where it exposes the judiciary to disrepute, that conduct is subject to discipline.

DISQUALIFICATION

Traditionally, a judge could only be disqualified from a case if the judge actually had a financial interest in the outcome of the case. This rule has changed and a judge may, today, be disqualified from hearing a case for several reasons. The Judicial Code of 1991, by its section 21, first recognized that judges should be disqualified upon a showing of bias on the party of the judge for or against one of the parties or attorneys handling the case. The United States Supreme Court in **Berger vs. United States** (1921) 255 U.S. 22, an appeal of the convictions of German-Americans for espionage was granted. The appellants argued that the

trial judge was prejudiced and submitted, as proof, the trial judge's statement:

> "One must have a very judicial mind, indeed, not to be prejudiced against German-Americans in this country. Their hearts are reeking with disloyalty."

The Supreme Court agreed with the appellants that the bias on the part of the trial judge prevented them from receiving a fair trial. Under the **Berger** holding a person seeking to disqualify a judge in a Federal case is required to allege in their disqualification motion facts which are sufficient to support the bias charge. A judge, hearing the disqualification motion is required to rule on the sufficiency of the affidavit not on the truth of the facts stated therein. The facts, stated in the motion are required to be deemed true by the judge.

Following the **Berger** decision, was the enactment of 28 U.S.C. section 144 which reads in pertinent part:

> "Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein..."

Under section 144, a motion for disqualification of a Federal District Court Judge must be both timely filed and accompanied by an affidavit of the moving party's attorney stating that the motion is made in good faith. Once those requirements are met, the **Berger** restriction that the determination of the motion is limited to the sufficiency of the affidavit applies. The truth of the facts alleging bias stated in such a motion are presumed to be true.

While 28 U.S.C. section 144 only pertains to disqualification of judges in federal District Courts, 28 U.S.C. section 455 applies to the recusal duties of all federal judges. Section 455 applies to voluntary recusal of the judge rather than mandated disqualification under section 144. Section 455 mandates recusal of a judge for several reasons:

> (1) when either the judge or a member of the judge's immediate family will be financially affected by the outcome of the case.
>
> (2) when the judge has personal knowledge of the evidentiary facts because the judge may be called as a witness or may have become prejudiced as a result of the possessing this knowledge, which might not come out at trial;
>
> (3) when the judge has served as an attorney in the matter or associated with an attorney appearing in the matter while that attorney was handling the matter;
>
> (4) when the judge, judge's spouse or person within three degrees of relationship to the judge has an interest which could be substantially affected by the outcome of the case;

In **Aetna Life Ins. Co. vs. Lavoie** (1986) 475 U.S. 813, the Supreme Court held that a judge has a duty to recuse himself from a case when the judge possesses an interest in the case which can be characterized as "direct, personal, substantial (or) pecuniary." In this case, a state Supreme Court justice cast the deciding vote for a case establishing a cause of action against insurance companies for acting in bad faith while the judge was a plaintiff in a suit against an insurance alleging bad faith.

In **Liljeberg vs. Health Services Acquisition Corp.** (1988) 486 U.S. 847, the Supreme Court vacated a District Court's judgment because the Judge had forgotten that Loyola University, for which

he was on the Board, had an interest in the property which was the subject matter of the suit. The Supreme Court held that "recusal is required even when a judge lacks actual knowledge of the facts indicating his interest or bias in the case if a reasonable person, knowing all the circumstances, would expect that the judge have actual knowledge." As such, a judge is required to act with complete candor regarding the disclosure of all potentially disqualifying information.

Canon 3C(1) of the 1972 CJC stated, "A judge shall disqualify himself in a proceeding in which his impartially might reasonable by questioned." Under CJC 3E(1), a judge is required to be disqualified in any action in which the judge's impartially might be questioned. **In re Drexel Burnham Lambert Inc.** (1988) 861 F.2d 1307. Under CJC 3C(1), a judge should disclose on the record an information which the judges believes might be relevant on the issue of disqualification. The disclosure should be made even if the judge believes that it is not sufficient to mandate the judge's disqualification. The Comment to CJC 3C(1) created an exception to the disqualification rule for necessity. Under this exception, if an emergency exists so that the judge must make the ruling, then the judge can do so. The Judge should still, however, place on the record the facts which might be relevant to a disqualification motion and, if appropriate, the judge should recuse himself from further action on the case.

Under CJC 3(E)(1)(a), a judge is required to disqualify

himself from a case when there are sufficient facts to give rise to a reasonable belief that the judge is biased against a party or a party's lawyer or has personal knowledge of relevant evidentiary facts. The bias of the judge must arise from an extra-judicial source. A bias allegedly formed from the evidence presented in the presentation of the trial or proceeding is not sufficient to mandate disqualification **In re Cooper** (1987) 821 F.2d 833. Under CJC 3E(1)(b), a judge is required to disqualify himself when the judge has personal knowledge of the evidentiary facts because the judge may be called as a witness, when the judge has served as an attorney in the matter or was associated with an attorney appearing in the matter while that attorney was handling the matter. Under CJC 3E(1)(c), a judge is required to recuse himself in any action in which the judge or any member of the judge's immediate family and anyone living in the judge's household has an economic interest in the matter or with one of the parties or has other interest other than de minimis that could be affected by the judicial proceedings.

Even though the recusal statute is written in terms of being self-directed, litigants can raise the issue by mandamus, interlocutory appeal, motion or appeal. In the same vein, under CJC 3F, the parties may agree to waive any potential claim for disqualification if the judge is willing to continue on with the case, the judge has fully disclosed all relevant information, the attorneys have consulted with their clients who consent to the

judge remaining in the case and the parties and their attorneys have met outside the presence of the judge and agreed for the judge to continue in the case.