PART 1

CHAPTER 1

What Is “Risk Management” (or “Loss Prevention”) Anyway?

RISK

For present purposes, “risk” means any danger that, if not controlled, may lead to consequences unintended by and harmful to a law firm or practitioner. This includes professional discipline, malpractice or other claims for disgorgement of fees or money damages, and other allegations of wrongful conduct in the course of law practice.

One way of making the subject of risk concrete is to relate it to the deductible amount that is part of every professional liability insurance policy. If a firm’s policy sets a deductible level of, say, $25,000 per claim, then the simplest way for lawyers in the firm to visualize the risk presented by each new client or matter is that it carries a potential price tag of $25,000 of “bottom line” profits or of $50,000 in gross fees if the firm’s variable costs consume 50% of gross fees. For many larger firms, the deductible levels are much higher, and they are often payable before the insurer is required to contribute anything, including defense costs. In those firms, even if a client may be expected to yield very substantial fees, the actual out-of-pocket costs of defending a claim may not be greatly disproportionate to the anticipated billings. The first question that firms must ask before opening every new file is thus whether the potential rewards anticipated from the new file are worth the potential risk of having to pay the cost of covering the deductible if a claim is made arising out of the representation.

Of course this method of evaluation focuses only on the financial costs implicated in defending claims; it ignores other additional, if hidden, costs associated with claims. Hidden costs may include time and billings lost from productive activities, damage to reputation, and increased future costs of insurance. Furthermore, not all claims are settled within the limits of a firm’s insurance policy—as demonstrated by several of the larger savings and loan cases, including the Kaye, Scholer case, and in other cases since then. Accordingly, recognizing that every client and matter carries potential costs, as well as profit, gives substance to the meaning of risk in law practice. (For an in-depth examination of malpractice, see The Lawyer’s Desk Guide to Preventing Legal Malpractice, 2nd ed., 1999.)
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RISK MANAGEMENT

Risk management is the establishment of institutional (i.e., firm or practice-wide) policies, procedures, or systems (sometimes referred to as risk management “tools”) designed to minimize risk within the firm and its practice. Ideally, every risk management tool should:

- Establish uniform standards.
- Be capable of ready monitoring for compliance.
- Involve the minimum of intrusion and expense into other operations of the law practice consistent with maintaining the efficacy of the tool.

LOSS PREVENTION

“Loss prevention” and “loss control” are the professional liability insurance industry’s terms, and they are synonymous with risk management. It is worth noting in this context that risk management is not a new phenomenon to anyone—except lawyers. If you reflect on the history of the insurance industry, going back even to its roots in Lloyd’s coffee parlor in London in the eighteenth century, a crucial element of underwriting has always been to seek to reduce the insurance risk by improving the safety of the product or service being insured. Initially, because shipping commerce was the first industry to seek insurance, this meant the drive to improve shipbuilding and navigation techniques. Subsequently, improving safety has become a key element of all underwriting; hard hats for construction workers and seat belts and air bags in automobiles are obvious examples of modern-day risk management tools generated, or at least strongly supported, by insurers.

Risk management is so well developed in the accounting profession that it goes beyond the elements suggested in this book, often involving regularly scheduled mandatory external reviews—conducted by competitor firms. This comparison is important because it helps to correct the mistaken notion that risk management is needed, and effective, only where a product (such as an architect’s plans) or a risk to life and health (such as a doctor’s treatment) is involved.

CASE STUDY—HOW RISK MANAGEMENT COULD HAVE HELPED KAYE, SCHOLER

The importance of risk management and loss prevention is clear in the much-publicized case involving the firm of Kaye, Scholer, Fierman, Hayes, & Handler (Kaye, Scholer) and the claims made against it by the federal Office of Thrift Supervision. For this discussion, the authors considered picking a more recent large claim that resulted in an abundant settlement or award. That there are plenty of such cases out there is an
unfortunate reality. While this Second Edition was being prepared, a leading underwriter of large law firms told the authors there were over 40 currently pending claims for which the industry had made significant reserves because the damages claimed exceeded $40 million. Since the purpose of this volume is to identify the components of risk management; and since the breakdowns within law firms that cause these claims has, regrettably, not changed in any significant way, the original example remains as useful as it did in 1995. However, as you will see in later chapters of this book, more sophisticated risk management tools and systems are available today, and the diagnostic tools exemplified by the questionnaires are also significantly more sophisticated.

The Kaye, Scholer case arose out of the collapse of the Lincoln Savings & Loan Association (Lincoln) of Irvine, California. The assumption underlying the government’s main claim for $275 million against Kaye, Scholer was that the firm had helped keep Lincoln in operation long after it had ceased to be solvent, thereby greatly inflating the eventual losses, which allegedly cost the government more than $2 billion. These claims were ultimately settled by Kaye, Scholer for $41 million. In using that case as an example, it must be conceded that hindsight is easy. Still, the case has many lessons for those willing to view it from a different perspective than simply as a battle between good and evil (assigning these qualities to whichever of the protagonists one’s individual proclivities, preferences, and allegiances dictate).

Three aspects of risk management are particularly relevant to the Kaye, Scholer case: (1) intake policies and procedures, (2) practice group management (a subcategory of practice and human resource management), and (3) firm management (including risk management oversight).

**Intake Policies and Procedures**

The best time for lawyers and firms to protect themselves is when a client first seeks to engage them. Even aside from malpractice and other money claims, the developing law, ethics, and practice relating to conflicts of interest and law firm disqualification is testimony to that. Many sources of potential risk posed by clients, as well as appropriate controls to exclude or limit such risks, can be readily identified at or before the time of engagement. In the Kaye, Scholer case, consideration could and should have been given to at least the following issues:

- The competence of the firm to provide the services requested (and actually required) by the prospective client.  
- The agreement of both firm and client as to the actual scope of services to be provided, including any limitations imposed by either side.  
- The agreement of both firm and client as to the professional staff to be assigned to the client’s matter or affairs.  
- The ability of the client to pay the firm’s fees and expenses.  
- The agreement of the client to execute a written engagement letter, in a form prepared and approved by the management of the firm (rather than by the partner introducing the client).
If a firm truly desires an effective intake review, its management or their designees, independent of the introducing partner, should assess all new clients regarding each of these issues, based on adequate information that the introducing lawyer must produce as a prerequisite for the firm’s evaluation. What would a thorough review of these issues by Kaye, Scholer have revealed if it had been undertaken when Lincoln was being proposed as a client?

**Competence.** ABA Model Rule 1.1, equivalent rules in other jurisdictions, and fundamental concepts of self-preservation all prohibit a lawyer from handling a matter that the lawyer is not competent to handle unless the lawyer either is prepared to learn what he or she needs to know on a timely basis or associates someone who is competent. In the Kaye, Scholer case a single partner, who was also the introducing partner, unilaterally decided to treat the representation of Lincoln as a form of aggressive litigation. An independent review would have revealed that the representation was in the area of bank regulation and that predecessor counsel had been treating it as such—not as a litigation matter. Of course, the partner concerned would have argued that the client’s whole reason for approaching him (and the firm) was for litigation. An independent review process, however, would have forced the firm to make a considered, collective judgment regarding whether this was a viable position—or whether, and to what degree, the engagement should be reviewed or overseen by a partner with bank regulation experience. The process also could have led the firm to require the involvement of partners with knowledge of bank regulation as a condition of its accepting the engagement.

**Scope of Services.** Following from the discussion of competence, any exploration of the work expected of the firm would necessarily have led a reviewer independent of the introducing partner to conclude that some limits should be expressed on the scope of services. As noted by Professor Wilkins, the distinction between what is permitted in the zealous representation of a litigant and the level of unrestrained disclosure required in a federal bank audit was well known to practitioners—at least to bank regulation practitioners—in the 1980s. The Financial Institutions, Reform, Recovery and Enforcement Act of 1989 and its predecessor laws and regulations were hardly secret information. A prudent firm, alerted and on its guard either due to the subject matter of the engagement or due to the limitation of its enquiries to predecessor counsel by the new client, might at least have requested an engagement letter that protected its right to act in accordance with the requirements of the applicable laws as it saw them, specifically including the limitations on attorney-client privilege at least potentially implicated by the applicable banking laws.

This concept of limiting the scope of employment is hardly revolutionary (and was not at the time of the Kaye, Scholer case). Rule 1.2 of the Model Rules implicitly recognizes the parties’ right to control the scope of representation, and the commentary to Rule 1.2 (a) states explicitly:

> The scope of services to be provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer’s services are made available to the client. . . . In addition,
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the terms upon which representation is undertaken may exclude specific means that might otherwise be used to accomplish the client’s objectives. Such limitations may exclude actions . . . that the lawyer regards as repugnant or imprudent. [Emphasis added.]

What was apparently missing at Kaye, Scholer was the idea that these risk management techniques could or should be applied as an essential element of this new client intake process.

**Assignment of Staff.** Following from discussions of competence and scope of services, management would necessarily have insisted—despite the urgings of the introducing partner and the client itself—that the firm retain the authority to assign lawyers competent to work on the matter. Clearly, such a requirement is part of the same duty to provide competent counsel.

If Keating (the chief executive of Lincoln) balked at these terms (as he might have, given that he had fired the predecessor firm of Jones, Day), hindsight shows that Kaye, Scholer would have benefited from the nonengagement.

**Ability to Pay.** Remembering that every client comes with a potential price tag of at least the amount of the firm’s insurance deductible, the question whether the client can pay its bills is of heightened significance. Included here for the sake of completeness, this consideration was obviously not an issue in the Kaye, Scholer case.

**Engagement Letter.** All the concerns discussed in this section should have been addressed at length in a written engagement letter. The fact that some lawyers and firms continue to resist the use of written engagement letters does nothing to reduce the importance of such letters or their value to those who use them. Of course an engagement letter alone, in standard boilerplate form without reference to the circumstances discussed earlier, would not have helped much. The point, however, is that effective risk management here, including identifying the issues raised by the proposed representation of Lincoln, would have called for a carefully tailored engagement letter to protect the firm from being forced into objectionable positions by its client.

The need for a written engagement letter is also emphasized by another New York case involving the leading bankruptcy firm of Weil, Gotshal & Manges. The firm had accepted an engagement subject to a verbal limitation that it would not be required to represent this particular client in any issue relating to “lender liability” because doing so might require the firm to take positions adverse to the interests of the firm’s other clients. Because the limitation was not in writing, the court explicitly declined to allow the firm to withdraw from the engagement when the client sought to have the firm assert lender liability claims.

**Practice Group Management**

One risk management structure that large firms have increasingly adopted in the years since the Kaye, Scholer case is the establishment, or development of the role, of practice groups to oversee the nature and
quality of the services being provided to clients. At the time of the Kaye, Scholer case, the closest approximation of this current approach was a limited form of peer review practiced at a small number of firms. The very mention of peer review aroused fear and loathing in many lawyers and many firms. In contrast, practice group management—if properly implemented—should be considered a positive and integral part of the way a firm practices law and provides services to its clients.

Practice group management should be implemented for many reasons. First, it is the only way to be assured of maintaining a universally high standard of client service over time. Second, and if properly implemented, it forms the basis for continuous training of all lawyers within the group. Third, it enables firms to incorporate clients into the risk management structure rather than leaving them, like separate and untouchable fiefdoms, within the personal domain of individual partners. Fourth, in a well-organized practice group, when mistakes are made, they can be identified and dealt with promptly—and almost always before devolving into calamities and crises. Fifth, effective practice management is a tool for improving profitability, both by focusing marketing efforts and because better-managed practices make for satisfied clients who pay their bills, bring additional business, and refer other clients. Accordingly, when presented to the outside world as part of a firm’s commitment to providing consistently high standards of work to its clients, this aspect of risk management has the potential for becoming a positive marketing tool.

With all the admitted benefits of hindsight, it is in this latter context that the topic of practice group management is relevant to the Kaye, Scholer case. In a firm that has accepted the validity, and the value, of fully implemented practice group management, the failure to work with colleagues whose expertise is relevant (if not central) to serving a client is relatively unlikely to occur. Had practice group management been in place at Kaye, Scholer, it would have been much less likely for the firm, and the lawyers working on the Lincoln case, to have failed to involve or consult their colleagues with bank regulation experience. Similarly, and again following the theme of Professor Wilkins’s article,11 the lawyers involved would have been prepared for, and would have considered the differing standards applicable to, the modes of representation involved in dealing with this client’s problems. Whether this would have yielded the result argued for by Professor Wilkins (addressing the problem of the relevant standards directly with the agency in time to thrash out the problem in the context of the representation—rather than later, in the firm’s self-defense) is conjectural. But at least the possibility exists that the issue would have been raised and dealt with in a manner other than a confrontation with the government—from which the firm came out the loser.

**Firm Management and Risk Management Oversight**

For the Kaye, Scholer case and for the utility of law risk management programs generally, the last and most crucial element in the risk management equation is the role of law firm management. In the Kaye,
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Scholer case the fundamental failure, from which all the other failures flowed like a row of falling dominoes, was the failure of the firm to have in place independent management capable of enforcing “the Rule of Law”—the principle of equality before the law—over the partner (who also happened to be the firm’s most powerful partner) who introduced Lincoln Savings Bank as a client. The Kaye, Scholer case is a clear example of the consequences to a firm of failing to manage its practice, including the practice of its most powerful member.

Unfortunately, Kaye, Scholer is in no sense unique. Other prestigious firms can attest to the perils of failing to manage and oversee all of their partners, including their managing or senior partners. Two other examples, each involving billing procedures, are the forced withdrawal of Gary Fairchild of Chicago’s Winston & Strawn and the withdrawal (and indictment and guilty plea) of former partner Webster Hubbell of the Rose Law Firm, Hillary Clinton’s former firm in Little Rock, Arkansas. In both examples, the firms apparently had no systems in place to check or control against improper or outright fraudulent billings, or even against improper or fraudulent expense claims. Sadly, even as the authors prepare this Second Edition, another prominent national firm is suffering from the same damage to its reputation; the damage arises from the public dissemination of identical allegations of a senior partner engaging in fraudulent billing practices that equally suggest a management structure inadequate to control these practices. Similarly, the recent spate of claims against multiple firms relating to the issuance of tax shelter opinions (some of which already have been settled for very large sums and one of which recently led to a firm’s demise), and many of the other large claims against law firms that have arisen from the most recent rounds of corporate scandals, also attest to the continuing shortcomings in the way that firms actually manage what their lawyers do and how they behave.

For risk management practices to succeed, it is essential that the need for risk management be accepted by everyone in a firm, from the most powerful partner on down. A program that is recognized as being for the common good can operate as an effective brake on dangerous activities, including engagements having the potential to harm the firm. In the years since the First Edition was published, many firms (including a substantial majority of large firms) have institutionalized their risk management functions by appointing a general counsel for the firm. There is no doubt today that a properly empowered, appropriately staffed, and adequately supplied office of general counsel is a critical component of risk management for those firms. Apart from functioning as a lightning rod for the early identification and resolution of problems and issues, general counsel should also monitor all other components of the firm’s risk management policies, procedures and systems, from the moment of client intake to file destruction. Had there been a general counsel at Kaye, Scholer, who is to say that the issues would not have been brought to the firm’s attention in time to avoid the catastrophe that instead occurred?

Having thus reviewed how risk management might have prevented the Kaye, Scholer case, we can now turn to describe, in outline form, the components of risk management in the law firm context.
THE MAIN ELEMENTS OF RISK MANAGEMENT FOR LAWYERS

To understand what is involved in effective risk management, we must first try to define what constitutes good health in the context of law firm practice and management generally. This requires an understanding that risk management is a continuous process.

Effective risk management has three elements:

1. Identifying risk management categories (encompassing both firm management and practice oversight categories).
2. Knowing what, if any, procedures or systems are already in place in each of the risk management categories.
3. Developing strategies to control risk categories, or particular risks identified but not yet adequately managed.

The first element requires the establishment of a framework of general, if not universal, application among law firms to be used in evaluating risks. The second element, particular to each firm willing to engage in appropriate self-examination, involves active inquiry and investigation to determine the nature and scope of risk management practices that are currently in place. The third element involves posing, for each risk identified during the investigation phase, the question, “What realistic risk management tools could be put in place that would effectively and efficiently control that risk?”

If, for example, a firm has concerns about the adequacy of its ability to catch conflicts of interest at the client intake stage, the firm will need to review both its management structure and the entire system of file opening, internal notification, and checking for conflicts. Similarly, if a firm notes that a pattern of billing disputes with clients is developing, perhaps involving a particular practice group, it will need to review two aspects of its operations: its engagement letter practices and its billing policies and procedures. In each case, once the review is complete, the firm can add any procedures that may be necessary to remedy any deficiencies that may have been uncovered.

This process, and the list of components of a comprehensive risk management system, may be daunting when viewed as an apparently monolithic structure in the form described here; but it is in fact just a matter of remembering that we all have to take things one step at a time. Precisely because risk management is a process, it does not have to happen (and generally cannot happen) all at once. Both the investigation and implementation elements of the process can, and should, be done in discrete stages and over time. Establishing effective risk management can best be viewed as steady, continuous progress along a defined path, rather than the sudden and jarring imposition of particular (and painful) solutions. To use a medical analogy, risk management should be like taking vitamins, not undergoing major surgery.

The second and third elements of the process are addressed in later chapters. Nonetheless, it is worth noting here that Part 2 of this book is deliberately divided into separate questionnaires that make it easy for firms to address specific risk management categories separately and according to their own schedule.
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When deciding which risk categories are most relevant to its particular needs, a firm should first consider the overall range of risk management issues. Then, in that context, the process of evaluation can proceed on a selective basis. Therefore, we now turn to a survey of all of the basic risk management categories.

Identifying the Risk Management Categories

Law Firm Management Structure and the Firm Culture—The Leadership Component in the Control of Risk. Effective management of individual elements of risk within the practice of law can occur only within an overall management environment that meets two basic requirements:

1. Authority The firm’s management must have sufficient authority delegated by all partners to be able to control the practice of all the individual members of the firm without exception (and regardless of seniority) where management perceives the need to impose such controls.

2. Leadership The firm’s management must recognize and accept the importance of effective risk management and must actively, continuously, and consistently communicate to all of the firm’s personnel its commitment to implement risk management throughout the firm.

Assigning the Risk Management Responsibilities. Separate from the fundamental requirement that firms recognize the need for effective management in principle is the actual assignment of management functions. To move from the philosophical and cultural recognition of the importance of risk management to its effective introduction throughout the organization, the firm must, in a coherent and centralized way, delegate ongoing duties to control the individual categories of risk identified as concerns. This process of moving from the theoretical to the practical requires that a specific partner be designated as general counsel or, at a minimum, that an ethics or risk management committee be given the responsibility and authority to fulfill the day-to-day functions of managing the practice to reduce risk.

When a firm has recognized the need for loss prevention and delegated the risk management function, it must next assess the ways in which the separate categories of practice risks are relevant to its membership structure, culture, and practice areas. What follows is a list of the headings of the principal categories of risk that firms need to manage in today’s environment. It cannot be comprehensive, since new risks arising out of the practice of law are frequently demonstrated. Nevertheless, it does categorize most of the problems that firms have faced in the twenty or so years since liability to clients, third parties, and regulators have become such regular and increasingly serious matters of concern.

The Practice Oversight Categories. The following is an outline of the main categories of risk management evaluation. This outline demonstrates the scope of the risk management function and the necessary reach of any survey that seeks to measure the level of a firm’s adoption of risk management principles. Next to the heading of each category is a reference to the relevant questionnaire in Part 2 of this book that,
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together with the corresponding answer and analysis sheet in Part 3, explores each subject area in greater depth. These materials are referred to collectively as QUIC (standing for “Quality/In Control”) Surveys, and they are designed to offer a specific solution to firms interested in improving their risk management. For completeness, the first section of the following outline reviews the law firm management components just discussed; the remaining sections encompass the practice oversight components. As explained earlier, references to the questionnaires should not be taken as an indication that every risk management topic is of equal concern to every law firm, or that firms must address every topic at once to practice appropriate risk management. Rather, the following outline is like a complete menu in a restaurant, or a list of all medicines available to a physician; firms will choose segments relevant to their own particular needs, and few will have sufficient appetite to digest the whole subject at one sitting or be ill enough to need the entire pharmacopoeia at once.

I. Management Structure—Questionnaire 1 (See page 57.)
   A. Is there a written partnership/shareholder agreement?
      1. Has it been reviewed recently?
      2. Review management and compensation structure to determine whether it may unduly reward client introduction or other competitive behavior that is likely to impede management.
   B. Review management structure generally, and:
      1. Determine whether adequate personnel and time are allocated to management.
      2. Determine whether management functions are adequately compensated to encourage appropriate time and energy to be devoted to managing the firm.

II. Risk Management Oversight—Questionnaire 2 (See page 59.)
   A. Who is responsible for risk management oversight, and what is that person’s (or committee’s) title?
   B. What is the scope of the risk management function, and what is included within or excluded from the function?
   C. Does the person/committee have sufficient authority, time, staff, and resources to perform this function?
   D. Are partners, professional, and support staff trained in and aware of the risk management structure, the chain of responsibility and authority, and their individual responsibilities to report every kind of issue and concern to the responsible person?
   E. What is the nature and scope of the protocol for training and ongoing dissemination of risk management policies and procedures at every level in the firm?
   F. Does the firm have policies and procedures for controlling lawyers’ freedom of access to the media?
   G. Does the firm have identified programs to deal with alcohol, drug, and stress-related problems?

III. New Client/Matter Intake—Questionnaire 3 (See page 65.)
   A. New Business Screening and Intake
      1. Who is responsible for oversight and implementation of the intake process?
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2. Can the introducing lawyer unilaterally make client selection decisions?
3. What screening mechanisms are in place, and how is information gathered and distributed in connection with new client and new matter acceptance?

B. Conflicts
   1. Identification and Analysis of Conflicts
      a. Review all new client/prospective client information forms; determine whether, when properly used, they will identify:
         (1) Conflicts between or among existing and/or former clients of the firm and clients of individual lawyers who have joined laterally, as well as staff (such as secretaries and legal assistants) with access to confidential information.
         (2) Entrepreneurial activities and other personal interest conflicts involving lawyers, staff, and prospective clients.
         (3) “Positional” or issue conflicts.
         (4) Use and screening for conflicts of temporary or contract lawyers and staff.
      b. Review all systems and procedures for collection and distribution of new client forms and for scope of information required.
      c. Review procedures used by administrative staff in checking for conflicts.
      d. Review policies and procedures for firm management oversight regarding (1) client acceptance and (2) disclosure decisions when actual or potential conflicts are identified.
      e. Review policies and procedures for engaging in “beauty contests,” including prior discussion of potential conflict:
         (1) With potential clients.
         (2) Within the firm: review the adequacy of the process used to obtain any required prior approvals.

2. Waivers and Consents
   a. Review standard form letters, or procedure for preparing and issuing client-specific letters requesting client consent to act where potential conflict exists, including appropriate disclosure language.
   b. Review procedures for ensuring use of standard form, or for obtaining a variance or specially prepared letters, where potential conflicts have been identified.
   c. Review sample files to determine whether proper waivers, based on adequate disclosure, were actually obtained.

3. Oversight, Control, and Avoidance
   a. Review claims of conflicts in the three years before current audit.
   b. Review level of knowledge among partners and professional staff, and level of compliance with policies and procedures for:
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(1) Conflicts checking.
(2) Use of new client forms.
(3) Procedures for obtaining exceptions, if any.
(4) Prenotification of participation in beauty contests.
(5) Making adequate disclosure and use of standard form or client-specific letters regarding waivers.

c. Review policies and procedures for monitoring changes in client composition (e.g., changes in corporate structure, change in status of client, substitution of client in same matter, etc.).

d. Review policies and procedures for restarting or completing conflicts-checking process when client composition changes.

e. Review level of knowledge among partners and professional staff and level of compliance with these policies and procedures.

C. Assignment of Personnel

1. Review procedures for identifying nature of client problem.
2. Confirm existence of oversight procedure independent of introducing partner.
3. Review procedures for convening meetings and making decisions.
4. Control overstaffing:
   a. Review authority of oversight partner or committee, and level of adherence to decisions regarding partners’ assignments.
   b. Review policies and procedures for assigning professional staff, including use of existing skills versus retraining partners’ preassigned staff.
   c. Review policies and procedures for avoiding overcommitment of staff to given matter (i.e., potential for overbilling), and overcommitment of individuals (i.e., too much work in time available, with potential for inadequate work product).

D. Engagement and Nonengagement Letters

1. Confirm requirement to use engagement letters for new clients, scope of engagement confirmations for new matters for existing clients, and nonengagement letters where initial contact does not result in engagement, including following beauty contests.
2. Confirm existence of requirement that new clients countersign engagement letters.
3. Confirm existence of review procedures to ensure compliance with engagement letter and nonengagement letter requirements, including actual receipt of countersigned engagement letters.
4. Review use of standard forms:
   a. Review standard form engagement and nonengagement letters.
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b. Review policies and procedures for varying standard forms and arrangements.

5. Review procedures to determine whether policies and procedures are being adhered to for both engagement and nonengagement letters.

E. Terms of Engagement

1. Review policies regarding the following:
   a. Nonrefundable and other inappropriate fee arrangements.
   b. Entrepreneurial arrangements of any type with clients.
   c. Authority to terminate client relationships.

2. Review knowledge of the partners, professional staff, and clerical staff regarding all of these policies and procedures.

IV. Client Relations—Questionnaire 4 (See page 73.)

A. Confidentiality

1. Review policies and procedures for ensuring protection of client confidences
   a. Review controls and protections in place regarding:
      (1) Public display of files, papers.
      (2) Access by outsiders to lawyers’ offices and support areas.
      (3) Use of e-mail and other electronic communications technologies.

2. Review knowledge of lawyer and professional staff regarding these policies and controls, including scope of training and dissemination of the information.
   a. Review compliance with these policies and controls.
   b. Review policies and procedures for communicating confidentiality protection issues to and obtaining appropriate instructions from clients.

B. Client Communications

1. Review existence and scope of requirements for regular communication with clients.

2. Review procedures for obtaining client feedback regarding quality of services provided.

C. Billing and Collections

1. Review time recording and entry policies and procedures, and confirm degree of compliance.

2. Review existence, scope, and degree of enforcement of controls over unauthorized, nonstandard, or otherwise improper billing practices.

D. Collection Procedures

1. Confirm that collection partners cannot unilaterally write off substantial receivables and that appropriate criteria are used for making those decisions.

2. Review all significant outstanding receivables at least yearly.

3. Review policies and procedures for collecting overdue bills and suing clients, including matter reviews and the decision-making process before commencing a suit.
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E. Client/Matter Closing Letters
   1. Confirm existence of, and review policy requiring issuance of, client/matter closing letters at end of engagement (or new engagement letters, for which the firm accepts continuing review obligations).
   2. Review standard forms; check for language stating that no follow-up work will be performed, and no client notification of changes in law will be provided, without a new engagement letter.
   3. Review knowledge of lawyers and professional staff regarding need for, and policies regarding use of, closing letters.
   4. Review policies and procedures for compliance (e.g., reminders, or billing system fail-safe requirements).
   5. Check a random sample of files to confirm that closing letter compliance system is working.

V. Docket (i.e., Tickler/Critical Date Reminder) and Calendar Systems—Questionnaire 5 (See page 77.)
   A. Calendar and Docket Systems
      1. Is there a central calendaring system for firm, offices, or practice groups?
      2. Are there any lawyers, groups, or offices with no central, and only personal, calendars?
      3. To the extent there is any central calendaring, are lawyers permitted to maintain personal and individual calendars?
      4. Where there are central calendars, who is responsible for overseeing them?
      5. To what extent is the firm using PDA or equivalent technology to force central, and prevent individual, calendaring and docket control?
      6. How comprehensive are the central systems in various special practice areas (e.g., litigation, tax, intellectual property, regulatory, etc.)?
      7. How comprehensive is the reminder system, and does it work effectively to prevent missed deadlines and unnecessary last-minute rush projects in each practice area?
   B. File Controls
      1. Review systems and controls on issuance of file numbers.
      2. Review systems and controls for locating and storing “live” files and “dead” files.
      3. Review systems and controls for inventory, storage, and location of original documents.
      4. Review systems and controls for backup and storage of computer memory:
         a. For client/matter/form/library materials.
         b. For administrative and accounting management materials.
      5. Review policies and procedures for retention and destruction of dead files.
   C. Closing Letters
      1. Is a policy in place for sending closing letters when matters are concluded?
2. Is a standard form provided?
3. Are monitoring procedures in place to trigger closing letters (or obtain management approval for an exception) when matters are dormant and unbilled for a fixed amount of time?

VI. Practice and Human Resource Management—Questionnaire 6 (See page 81.)

A. New Employee Orientation
1. Are there formal orientation programs for all new lawyer and nonlawyer hires at every level of the firm?
2. What topics are addressed?
3. Does the orientation include a thorough review of the firm’s risk management policies?

B. Practice Management
1. Review the nature, structure, and composition of practice groups.
   a. Are matters assigned to individuals or practice groups?
   b. Are there practice areas in which only one attorney has expertise?
   c. Explore whether—and if so, to what extent—matters are handled from beginning to end by a single lawyer.
2. Review policies and procedures for frequency and effectiveness of oversight of all lawyers’ work.
3. Review policies and procedures for identifying lawyers with any kind of practice or personal problems; also review policies and procedures for transfer of client responsibilities.

C. Opinion and Audit Letter Issuance
1. Use of standard forms and client-specific letters:
   b. Review policies and procedures for signing and issuing all opinion/letters, including independent review or second signature requirement.
   c. Review procedures for monitoring changes in the substantive law of third-party liability for opinion/auditor letters.
   d. Review policies and procedures for updating standard forms to conform to substantive law developments.
2. Procedures for Variances
   a. Review policies and procedures for independent review/signing letters with variances from standard forms.
   b. Review knowledge of partners and professional staff regarding risk management policies and procedures governing opinion/audit letters.

3. Control over Compliance
   a. Review procedures to monitor compliance with use of standard forms, issuance or second-signature requirements, and independent review of variances.
   b. Check a random sample of files containing opinion or audit letters to confirm compliance with policies and procedures.
D. Continuous Practice Review
   1. Review detailed procedure and documentation, including
      questionnaires and reporting material relating to periodic
      review of the work of all partners.
   2. Confirm that the review process is being conducted regu-
      larly, and check files relating to recent sample reviews.

E. Branch Office Controls
   1. Review policies and procedures for monitoring compliance
      by branch offices with all risk management functions, poli-
      cies, and procedures.
   2. Review knowledge of branch office partners and profes-
      sional staff of all risk management policies and procedures,
      and compare to those policies and procedures used at the
      home office.
   3. Conduct checks at branch offices parallel to all those con-
      ducted at home office, and compare compliance.

F. Lateral Partner and Merged Practice Controls
   1. Confirm prehiring/merger risk management checks being
      performed.
   2. Confirm client intake policies and procedures being strictly
      followed before new client matters are opened.
   3. Confirm existence of effective orientation process to train
      and inform merging practices/lateral hires in the firm’s risk
      management policies and procedures.

G. Oversight Policies and Practices
   1. Review supervision, review, and evaluation policies:
      a. Review policies and procedures for regular review of all
         non-partner professional and support staff.
      b. Review policies and procedures for review by profes-
         sional staff of supervisors/partners.
      c. Review grievance policies and procedures.
      d. Obtain partner and professional staff evaluations of
         workings of these oversight and review policies and
         procedures.
      e. Review compensation structure for professional person-
         nel, availability of family leave, flexible hours, and qual-
         ity of life programs.
      f. Review policies and procedures to ensure compliance
         with laws/court rules relating to attorney registration or
         required bar association membership.
   2. Review hiring processes; check for:
      a. Reference checks and transcript validation.
      b. Written interview policies.
   3. Review termination processes; check for:
      a. Counseling process.
      b. Documentation of reviews.
      c. Compliance with written policies.
      d. Independent prior review of terminations.
   4. Review controls and procedures for impaired personnel:
      a. Review policies and procedures for periodic enquiry to
         find and evaluate partner/professional personnel behav-
         ior pattern changes.
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b. Review policies and procedures for encouraging early reporting of and counseling for impairment problems.
c. Review written questionnaires/materials regularly circulated regarding impairment.
d. Confirm regular compliance with impairment review policies.
e. Review contact between firm and bar association/insurer impairment programs.

5. Review antidiscrimination policies and procedures:
   a. Review written policies.
   b. Review frequency of distribution.
   c. Review procedures for handling complaints and problems.
   d. Review knowledge of policies:
      (1) Within firm generally.
      (2) Among those responsible for human resource matters, including those handling complaints and problems.

H. Training, Continuing Legal Education (CLE), and Development Policies and Practices
   1. Review policies and procedures regarding in-house and outside CLE, including monitoring compliance with state bar requirements.
   2. Review policies and procedures for informing, and conveying importance of, risk management policies and procedures throughout the firm other than mere circulation of policy manuals, including the following:
      a. Use of in-house seminars, retreats, and lunch meetings
      b. Knowledge of policies and procedures generally

I. Internal Reporting Policies and Procedures
   1. Confirm existence of, and review policies and procedures for, internal reporting, including violations of any risk management policy or procedure, or any other ethical problems.
   2. Review policies for handling all reports of such occurrences, including identification and availability of:
      a. Internal general counsel.
      b. External ethics counsel or equivalent.
      c. Appropriate protection of whistle-blowers.
   3. Review knowledge among partners and all professional staff of reporting policies and procedures.
   4. Confirm that the exercise of the risk management function is combined with sufficient authority to address such occurrences.
   5. Review policies and procedures regarding fee disputes, fee collections, and independent assessment of whether to commence suit for fees. (Note: This is a cross-check on the matters covered by Questionnaire 4.)

J. Response Procedures
   1. Insurers
      a. Confirm familiarity with insurance policy requirements, law of disclaimers, and procedures for compliance.
      b. Review files relating to all incidents reported to insurers within three years before current review; check for:
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1. Timeliness of notification.
2. Adequacy of notification.
3. Adequacy of cooperation with insurer/assigned counsel.

2. Clients
   a. Review policies and procedures for notifying clients of incidents constituting potential claims.
   b. Review procedures for assigning partner to deal with matters involving actual or potential problems, including dealings with courts, opposing counsel, and any replacement counsel.
   c. Check files involving all incidents reported to clients within three years before current evaluation for compliance with policies and procedures.

3. Professional Authorities
   a. Review policies and procedures for reporting current violations of rules of professional conduct to appropriate authorities (both when arising inside the firm or noted in dealings with opposing counsel).
   b. Review all files relating to such reports made within three years before current evaluation.

4. Public Relations
   a. Review policies and procedures for assigning one spokesperson, and for determining responses to media enquiries, including review of policies of any outside consultants.
   b. Review public relations responses as well as press and media coverage regarding all incidents in three years before current evaluation.

K. Professional Liability Coverage Management
   1. Review existing policies with broker; check for:
      a. Level of coverage and deductible.
      b. Per-lawyer premiums.
      c. Special provisions or exclusions.
      d. Coverage of all areas of firm’s practice.
      e. Disclaimer provisions.
   2. Confirm that risk management partner/committee is responsible for coverage issues.
   3. Confirm review by risk management partner within prior year.
   4. Review potential for negotiating premium, and review deductible level.

L. General counsel and Other Internal Review Structures
   1. Delineate role of existing general counsel.
   2. Delineate risk management areas not encompassed by general counsel’s responsibilities.
   3. Review reporting structure, hierarchy, and utilization by lawyers and professional staff of general counsel.
   4. Review concerns and issues raised by general counsel.
   5. Review concerns and issues raised by personnel administrators.
   6. Review sufficiency of resources critical to general counsel.
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VII. Trust Accounts—Questionnaire 7 (See page 87.)
A. Review escrow account records for three years before current evaluation and verify complete compliance with applicable rules of professional conduct.
B. Check that all deviations from applicable rules of professional conduct were reported to discipline authorities if required.
C. Review all escrow and client account policies and procedures to determine adequacy to assure continued compliance with applicable rules of professional conduct.

VIII. Disaster Recovery Planning—Questionnaire 8 (See page 89.)
A. Impact Analysis
   1. Review level of planning for a disaster.
      a. Plan preparation and maintenance.
      b. Frequency of review.
      c. Distribution arrangements.
      d. Identification of emergency recovery site.
      e. Equipment availability.
      f. Roles of personnel in event of a disaster.
      g. Identification and training of a recovery team.
      h. Service and utility availability and arrangements.
      i. Contact list and arrangements.
   2. Support Functions
      a. Role of support staff.
      b. Availability of supplies.
      c. Availability of backed-up data and software necessary for practice and essential support functions.
   3. Firm records—storage and availability of backup records necessary for continuing practice
B. Response Procedures
   1. Maintenance of calendar, time, and docket control functions.
   2. Review of plan by risk managers.
   3. Adequacy of notification arrangements to personnel, clients, and other affected parties.
   4. Adequacy of composition of the recovery team.
   5. Procedures in event of sudden death or incapacity of professionals.

This framework for evaluating risk management is not exhaustive. For instance, one can add categories relating to specific practice areas, or categories having to do with particular activities that lawyers often undertake. Nevertheless, this outline sets the firm on the road to understanding what risk management includes.

Identifying Risk Management Already in Place

Two elements involved in determining which components of risk management are actually in place within a firm are often in conflict. They are
1. What the firm’s management thinks is in place—based on policy manuals and procedures, firm “culture,” specific directives, and so on.
2. As opposed to what the people practicing law within the firm actually do on a day-to-day basis, including partners, associates, and support staff.
Descriptions at these two levels can be totally different. To give the simplest of examples, a managing partner of a firm was considering her firm’s policy of maintaining and periodically reviewing a complete “chronological file” of outgoing correspondence. The managing partner noted that a recent check had belatedly revealed that only half of the firm’s professionals were contributing to the chronological file. In itself, this was not surprising. What was startling was the reason. It turned out that in the half with secretaries who had been with the firm since the policy was established four years earlier, all professionals were following the system; but almost none of the professionals whose secretaries had subsequently joined the firm were following the procedure because no one had told them about it. In the larger scheme of things, this was not a catastrophe. Nevertheless, it illustrates the problem of the disconnect between theory and practice.

To repeat: whether it is Web-based or printed on premium stock and placed in a gilt-edged binder, the world’s most elegant and beautifully written policy manual is meaningless if it is regularly, or at times even irregularly, ignored. In fact, the failure to follow a recognized policy can itself have adverse consequences in either damage or disciplinary litigation. Put another way, there must be more than just an initial, one-time announcement or circulation of policies. There must also be provision for a continuing initiation of newcomers and for appropriate reminders to both lawyers and nonlawyers of the content and significance of firm-critical policies.12

With the increasingly detailed questionnaires that comprise their application forms, professional liability insurers try to compel at least elements of this verification process. Unfortunately, the attention these questionnaires receive is often perfunctory at best, and the opportunity for an effective review of management practices is lost for another year. Without continuous monitoring from the perspectives of both management and staff, even adequate risk management policies may be useless. For instance, it may be advisable to check that client-intake procedures are being followed every month. To await the insurance application process, which might not even ask a question that would require the relevant review, might allow more than enough time for a breakdown in the risk management system to occur. It might also allow time for circumstances to develop that will lead to a claim.

Chapters 2 through 4 explain the role of law firm audits in enabling firms to take control of the process of determining what level of risk management is in place and where the gaps are. A firm interested in performing an audit will then have all the background necessary to proceed to the questionnaires in Part 2 of this book. Part 3 will then reveal, question by question, what each answer indicates regarding the state of the firm’s risk management.

**Developing Adequate Risk Management**

Assuming that the firm’s management has recognized the need to adopt effective risk management strategies, and assuming that a survey has therefore been done to verify the systems already in place, the firm must turn to developing and implementing new policies and procedures. As
expressed by one firm's general counsel, "The standard reaction is, 'Don't bother me; I'm not your problem; go bother Joe down the hall—he had the last claim.'" Furthermore, many lawyers who are accustomed to billing by the hour resent bitterly (though not necessarily wisely) any new procedure that arguably "wastes" billable time on apparently non-income-producing activities. Not surprisingly, our view is that over time, such an approach generally creates unnecessary risks of mortgaging or destroying the future for the sake of relatively modest gains in the present. If a risk management program is well conceived, its burdens should be small compared to its benefits. If the burdens appear to outweigh the benefits, the first approach should be to look for more appropriate policies—not simply to ignore a risk or hope that the firm's past luck continues to hold until after particular lawyers have retired and any applicable statutes of limitations have run their course.

As a general proposition, risk management controls should be self-executing to the extent practicable. "Self-executing" means that the control works as an automatic alert and that if an automatic control fails, the activity cannot proceed. A simple example is a file opening system with a procedure in place whereby, before a file can be opened, a copy of the engagement letter sent to the client (or, even more useful, already countersigned by the client) must be submitted to a designated administrator. Similarly, many firms require that, as a general proposition, no time should be recorded as billable until all mandated conflicts checking, engagement letters, and assignment of staff decisions and processes have been completed and the required independent approvals given. In this way, the incentive on the partner and staff is to comply—quickly and efficiently—with the systems.

The importance of this kind of control is clear from the example of a New York firm that was allowed to proceed with a suit against one of its lawyers, who had solicited a client to pay him individually in return for a limitation of the firm's bill. If controls had been in place, the lawyer would have known that as soon as the billing process began, his attempt to redirect payment would have been detected.

Some procedures or controls are, by their nature, only partially self-executing. A simple example may be found in the policy of many firms that formal opinion letters require the signature of two partners (thereby ensuring oversight of documents likely to be asserted as a basis for liability against the firm). Such a policy works only if the attorney who is asked to prepare such a letter initially complies with the policy by showing a draft to the appropriate partner or committee. Nevertheless, there may be room for additional controls to increase the likelihood of compliance. In many if not most cases, the actual or potential need for such a letter will be apparent from the time the matter is opened. If new matter forms require that such a possibility be identified, the appropriate second signer can be identified from the outset—and perhaps before the opportunity or urge to subvert the policy arises. Many firms with tax opinion practices, for example, establish the second opinion process at the outset to assure compliance with IRS Circular 230.

Whether intended to be self-executing or not, a second element of any system of controls must also be present: "the Rule of Law." In other words, and subject only to such express exceptions as are (wisely)
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contained in a firm’s policies, no one can be above the firm’s “law” or allowed to flout it. No matter how senior or venerated, or how large the billings of a partner or practice group, everyone must generally be subject to the same basic rules and procedures. In other words, there may be policies that are specially adapted to the practical or legal needs of a particular practice area, such as the need of tax lawyers to comply with IRS Circular 230 and the need of securities lawyers to comply with Sarbanes-Oxley requirements. Above and beyond such principled and reasonable exceptions, however, the firm’s rules and procedures must be applied—and must be perceived to be applied—consistently.

NOTES

1. See, e.g., Ronald E. Mallen & Jeffrey M. Smith, Legal Malpractice, § 7.8, Chap 16 (West, 2007 ed.).
2. See Questionnaire 3 at p. 65 and Answer and Analysis Sheet 3 at p. 105.
3. See Questionnaire 3 at p. 65 and Answer and Analysis Sheet 3 at p. 105.
4. See Questionnaire 3 at p. 65 and Answer and Analysis Sheet 3 at p. 105.
5. See Questionnaire 3 at p. 65 and Answer and Analysis Sheet 3 at p. 105.
6. See Questionnaire 3 at p. 65 and Answer and Analysis Sheet 3 at p. 105.
9. See Questionnaire 3 at p. 65 and Answer and Analysis Sheet 3 at p. 105.
11. See note 7, supra.