

## **International Legal Malpractice in a Global Economy: A Growing Phenomenon**

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### Introduction

International and domestic transactions involving foreign parties present special challenges to the legal practitioner and increased risks of legal malpractice. This is especially true for transactions involving parties operating in or from countries without a well-developed rule of law. Not only can it be difficult to ascertain the proper answers to legal questions, but actual practice also often deviates from official norms.

Generally when a client retains an attorney or law firm on an international matter, the client is not merely asking that certain documents be prepared or seeking an accurate description of a country's "black letter" law. Rather, the client wants practical advice about how to accomplish particular goals in an unfamiliar environment. The lawyer is sought out for his judgment, knowledge and experience about how to achieve favorable outcomes, if possible. Thus, the lawyer functions as a country or regional advisor who has developed an understanding of political issues, economics, and sociology. Under these circumstances, the lawyer has a broader role than he would traditionally exercise in a purely domestic transaction. Not surprisingly, the client may solicit the "counselor's" views on the political and business risk of proceeding with a transaction or an assessment of the trustworthiness of the client's counterparts.

This view is consistent with Rule 2.1: Advisor of the American Bar Association's Rules of Professional Conduct. It reads "[i]n representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social, and political factors, that may be relevant to the client's situation." The Comments to this rule provides relevant examples of how this rule is applied." In light of the client's

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reliance on the lawyer, a higher standard of care may apply to his conduct.

### Economic Globalization and Its Impact on the Provision of Legal Services

From 1973 to 1999, according to the World Trade Organization, the volume of international trade in goods grew from \$578 billion to \$5,473 billion. Since the 1970s, according to the United Nations Conference on Trade and Development, worldwide foreign direct investment has increased seven-fold, reaching \$865 billion in 1999. Furthermore the cross-border provision of services has also increased significantly in recent years.

This growth in international transactions has contributed to an increased demand for legal services and almost certainly an increase in the number of errors made by lawyers in fulfilling this demand, though the publicly available data tends to mask this development. Nonetheless, despite the globalization of the world economy, a lack of sufficient number of lawyers and businessmen having a well-grounded understanding of the country-specific that often hinder commercial success.

One recent prominent case may prove to be a “case study” in this area. Insufficient practical knowledge of the political, economic and legal situation in Turkey on the part of their outside lawyers (and other advisors) may have contributed to Motorola’s and Nokia’s initial loss of more than \$2.7 billion dollars, as a result of their dealings with Telsim Mobil Telekomunikasyon Hizmetleri A.S. (“Telsim”) and members of the Uzam family, who reportedly are part of an organized crime syndicate. As the *Economist* noted with more than a touch of sarcasm, “the world’s two largest mobile-phone makers, may be wishing they had called around a bit before choosing a business partner in Turkey.” Given that the Plaintiffs’ relationship with Telsim began in 1997 and involved the preparation of scores of licensing, loans and purchase agreements as well as other documents by lawyers for the two telecom companies, one might wonder whether the lawyers took too narrow a view of their role in the numerous separate transactions over the years (i.e., a responsibility to share their judgment of the situation and not merely the preparation of documents). Ultimately, the U.S. District Court for the Southern District of New York awarded Motorola and Nokia in excess of \$5.7 billion in compensatory and punitive damages. Motorola v. Kemel Uzan, 274 F. Supp.2d 481 (S.D.N.Y. 2003). Fortunately for Motorola and Nokia, the defendants have some assets that are reachable. It remains to be seen how much money Motorola and Nokia actually recover. If recovery proves impossible, will such companies begin looking around for other possibly negligent parties to compensate for their losses?

A study conducted by the American Bar Association is mentioned as the principal public source on legal malpractice claims. The data were collected from the member-companies of the National Association of Bar-Related Insurance Companies (NABRICO) as well as some other insurance providers. Given that the small size of this sampling and that it does not include many of the major international providers, it is not clear to what degree the data are representative.

The survey data indicated that approximately 11% of legal malpractice claims (2,042) in the period 1990-95 were in the area “business transactions/commercial law.” Only 0.08% of the survey’s legal malpractice claims (16) were within the category “international law,” which was defined as covering “all aspects of the relations among states, international business transactions, international taxation, customs and trade law, and foreign and comparative law. The survey, however, did not permit a respondent to list a claim under more than one category, thus probably understating the “international” factor in legal malpractice, since many were likely listed in the “business transactions/commercial law” category.

According to the ABA Survey, the percentage of malpractice claims labeled “business transactions/commercial law” from 1990-95 period increased by 7.62% over the 1983-85 period. The comparable rate of increase for so-called “international law” claims grew only by .04%. On first impression, such data are surprising given the greater complexity of international commerce. In our opinion, these data are misleading and most likely do not reflect the current realities given the limited number of companies responding and certain methodological limitations of the survey itself.

Furthermore, the low figure given for international malpractice claims may be explained by a number of important factors. First, clients may feel that they assumed the risk by conducting business abroad. Second, clients may have less confidence that they could successfully make a claim against U.S. counsel on an international matter due to the actions of their own personnel. Third, the data may not be accurate (e.g., international business transactions/commercial law may already include cross-border transactions).

The full scope of international legal malpractice is also obscured because these disputes are often resolved through private arbitration. The extent of the problem is difficult to gauge because the malpractice insurers regard as proprietary information on the number and amount of their claims as well as the formulae for calculating insurance premiums.

The experience of the authors of this article is that the number of international legal malpractice claims is significant and likely to increase. At present or in the near future, more legal practitioners working on international matters will learn that they are not immune from malpractice suits (many already have learned this). Some of the likely factors supporting this view are:

- In recent years, there has been a dramatic increase in both the number of U.S. law firms opening subsidiaries, or branches, or establishing formal relations with local affiliates abroad. As this occurs, clients will develop higher expectations of the work product and standard of care shown by the attorneys of such law firms;

- As less developed countries and states transitioning from centrally planned to market economies create laws and institutions (often with the assistance of foreign aid organizations or multinational organizations), clients will have an opportunity to better assess the performance of law firms; and
- Less costly local lawyers (many of whom were trained at Western law firms or educated in U.S. law schools have been forming their own law firms with up-to-date technology. As these attorneys gain the knowledge and experience to better service clients from developed countries, general counsels of established corporations are likely to become even more willing to retain them. At the same time, this will position the foreign local law firms to bring to the attention of their client alleged shortcomings in work done by more established law firms.

Consequently, it is indeed likely that the past will not be prologue in the area of legal malpractice. In the past, a Western corporation might be hesitant to bring a claim against a large law firm it used in Russia, since it might also use the services of such law firm in Japan, France and Germany. Now, the same corporation has the option of using different law firms in different countries or discontinuing a relationship with a law firm that provided inadequate or overpriced services.

#### Smaller Law Firms Are Often Reluctant to Seek Needed Expertise

Most American lawyers practice in small to medium-sized firms. Many are reluctant to refer matters to larger law firms with an established international practice out of fear of permanently losing the client. While such lawyers could work with local foreign counsel, they are unlikely to have established the necessary personal and professional relations. In addition, where local attorneys are capable of providing a full-range of sophisticated legal services, the U.S. lawyer may fear being excluded from the matter as it progresses, particularly where foreign legislation and documents are in an unfamiliar language.

#### Many Lawyers Lack Knowledge or Experience in Many of the Jurisdictions in which there Clients Conduct Business.

The United States has primarily a “common law” legal system, though international treaties, laws and regulations play important roles in determining the content of U.S. law. With the exception of most of the Anglophone countries, the majority of countries have “civil law” legal systems (e.g. France, Germany, Japan, Spain, etc.). In civil law systems, law is systematically codified into various “codes” (e.g. civil, administrative, labor, etc.). Although there is the freedom to contract in many areas, in others, the Civil Codes (and analogous laws) establish preemptory rules, which cannot be overridden by private agreement. Furthermore, countries have different practices with respect to the ease of piercing the corporate veil. Thus, the use of special purpose entities for tax reasons may present other unforeseen consequences.

The neophytes to the world of international trade are more reliant on counsel for guidance than is ordinarily the case. At the same time, lawyers are often reluctant to educate themselves before educating a client for fear of spending excessive time that cannot be billed. Similarly, unsophisticated users of legal services as well as those operating on a limited budget are often reluctant to keep counsel informed of aspects of a transaction for fear of generating a high bill.

This can be termed “the practice of American law in a foreign country.” Quite frankly, it causes significant problems. It often strains relations with one’s counterpart(s). It can lead to contracts that cannot be legally implemented due to foreign regulatory requirements. This situation may also result in contracts that prove unenforceable by foreign courts.

### International Legal Malpractice is More Than Missing Deadlines

In the period 1983-85, the ABA found that the largest category of malpractice claims were in connection with the alleged failure to “calendar properly” (i.e., missed deadlines). In the later 1990-95 ABA survey, however, the principal cause of malpractice claims was the “failure to know or apply law.” Since most of such “failure to know” cases would have involved U.S. law, where foreign law and practice are involved the risks of malpractice increase. While the broad categories used in the survey are of limited value, it would seem that as the volume of law to know expands (for example, by conducting business abroad), one’s ability to ascertain and properly apply it decreases.

The human component of international malpractice must not be ignored. It is difficult to manage from afar. In many markets, senior attorneys lack the language skills to properly render legal services to clients. Expatriate lawyers become increasingly dependent on the judgment of junior, inexperienced local attorneys. While many firms do an excellent job training and assimilating local lawyers, this is not always the case. Furthermore, U.S.-based law firms often find the use of expatriate lawyers present special problems. While it is usually easy to find qualified individuals to live and work in Berlin, Hong Kong, London, and Paris, this is less true in locations where the standard of living is low, western goods are in short supply and good medical care is not accessible. The result is high turnover among expatriate lawyers. These factors accelerated the process of American firms relying prematurely on local lawyers in various less developed countries.

Lawyers (particularly partners) whose firms maintain offices abroad need to be vigilant in exercising quality control over the work produced for clients. Otherwise, they may find themselves directly liable for malpractice under theories of the failure to supervise, or not having in place an adequate mechanism for other attorneys to articulate their concerns about the unsatisfactory manner in which particular matters are being handled. Even domestically, large law firms are appointing general counsel out of concern for liability arising from their domestic American operations while the chances of error internationally are as a practical matter much greater. Often lawyers inclined to be “whistleblowers” but see that their firm’s management is non-responsive usually will

stop expressing their views and may ultimately leave the firm. The result is that an overseas office will be staffed and overseen by attorneys who are less sensitive to potential legal malpractice risks or the requirements of professional conduct.

### Future Risks for the Insurance Industry

It is human nature to expect that past is prologue; however, compared to the past, the number of international legal malpractice claims is likely to grow significantly. Increasingly, less developed countries going through economic transformation are developing a body of law that will offer standards to follow. Where the outcomes sought are not obtained, the client may seek a legal remedy in the U.S. or by private arbitration.

Many law firms have sought protection against exposing themselves to liability by forming wholly-owned or majority-owned subsidiaries in foreign states. In many cases, however, such efforts are ineffective. Despite the establishment of a foreign local subsidiary, judges and arbitrators may find the parent entity liable since it (i) supplied personnel to work on the relevant matter in the subsidiary's office, (ii) dealt with aspects of the manner in its own offices (e.g. client communication and billing), and (iii) it and its subsidiary did not strictly observe corporate formalities (holding of required meetings, formation of required management bodies, etc.).

The number of instances when a client would refrain from making a malpractice claim against its outside counsel because the law firm also serviced it in other countries is becoming less common for a number of reasons. As the law becomes more developed in foreign countries, clients are more likely to have standards by which to judge a lawyer's or law firm's performance. While personal relationships will continue to deter some corporations from filing a legal malpractice claim arising from their international commercial activities, with today's new emphasis on corporate ethics, with more active boards of directors, their willingness to tolerate flawed services should decrease. Lawyers, law firms, and their insurers must react to these trends or face increased malpractice exposure.

At first glance, corporate risk managers may view outside counsel as a potential "deep pocket" to pursue when there are losses from transactions with foreign counterparts or as a result of unsuccessful direct investments abroad. Risk managers and corporate counsel must investigate the role of the company's employees' in contributing to the failed endeavor. The corporation will face major problems if they have terminated persons who may be future witnesses in legal actions. Consequently, corporate risk managers and general counsel must (i) examine the dispute resolution clauses in the retention agreements (if any) with the law firms to ascertain the process by which the matters can be resolved and (ii) determine whether potential legal actions will prove pointless if brought in contributory negligence jurisdictions. Another factor that must be considered is whether a specific U.S. court will be willing to exercise jurisdiction over the dispute, particularly if foreign law plays an important role and/or many of the

potential witnesses (and evidence) are located abroad. Judges will often differ in this regard. These issues are indeed complex and cannot be overlooked.

International transactions and foreign direct investments tend to involve large amounts of money. Often, they take years to consummate. Insurance companies must be extremely careful in assessing a law firm's ability to assist their clients on international matters. They must be confident that the standard of care within a law firm will not deteriorate if key personnel depart. Consequently, insurers must ensure that procedures are in place that minimizes the risks posed by personnel turnover. In light of clients' rising expectations of law firms, insurers will have to take a more active role in knowing their insureds than ever before.

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