

ETHICS ALERT

INTERNET SCAMS TARGETING ATTORNEYS

Committee on Professional Responsibility and Conduct
(August, 2010)

Attorneys in the United States, particularly sole practitioners and small firms, are falling prey to a sophisticated international internet scam, which has severe consequences, financial and otherwise. To date, the scams have been more prevalent among, although not exclusive to, collection and family lawyers; mainly because these practice areas make it easier for those initiating the scam to make it look legitimate.

The fraudsters perpetrating the scams have been successful for a number of reasons, not least of all, the decline in the general economy, which has led to a lull in most businesses, including that of lawyers. Lawyers' desire, and often need, for new clients and cashflow or simply quick access to cash based on relatively high profit opportunities, leads to short-cuts that have severe hidden consequences, including, losses of money as well as damage to the Lawyers' reputation, standing or business.

The main characteristics of the scam are as follows:¹

1. Lawyer receives what appears to be a legitimate solicitation e-mail from a prospective client;
2. After checking the legitimacy of the company on the Internet, lawyer responds and relationship terms are "negotiated" between the lawyer and the prospective client, including agreement to a written retainer, substantial deposit and substantial contingent or flat fee;
3. Lawyer receives an e-mail from the new client that the threat of legal action has caused debtor to agree to pay up;
4. Lawyer quickly receives what seems to be a valid domestic cashier's check from a reputable bank as a settlement payment, which is deposited in Lawyer's client trust account;
5. Client requests a wire distribution of the settlement funds to a foreign account and provides approval for the attorney's retainer or fees to be deducted from the funds and paid from the trust account;
6. Lawyer retains the fee and wires the balance to a foreign bank account.

It is then discovered that the cashier's check is fraudulent and it is returned unpaid. By this time however, the funds have already been wired to the foreign bank and the scammer has disappeared with the funds. The lawyer's client trust account is overdrawn by the amount of the counterfeit cashier's check, which the lawyer's bank is obligated to report to the State Bar.

¹ As far back as July 2008, the California Bar Journal published an article entitled "*Embarrassed Lawyers Fall Victim to Internet Scams*", which contained a similar list of characteristics.

The attorney is now liable to the bank for the balance of the bad check and subject to an investigation the State Bar, which may lead to discipline.

The foregoing chain of events leaves the victim attorney in a precarious and vulnerable position. For all purposes, under the scenario described above, the lawyer has been retained by a client, legitimate or otherwise, and a retainer agreement has been signed. This means that the attorney-client privilege applies to the relationship and also that the lawyer has numerous responsibilities towards his/her new "client," including fiduciary duties, which conflict with the lawyer's own interests and concerns after the scam has taken place.

Furthermore, the deception suffered by the lawyer is not generally covered by typical errors and omissions insurance policies carried by most practicing lawyers.

In a recent alert regarding internet scams², the State Bar President, Holly Fujie said: "Attorneys should be the last people to fall for these scams, Be Careful!" The following non-exhaustive steps should be taken by attorneys to protect themselves and their practice and to avoid falling victim to the scam:

1. Diligently perform conflict checks on all prospective clients, especially unknown foreign clients and particularly if the introduction comes via e-mail and the main mode of communication is through the internet. Referral sources, if any, should be included in the conflict check process, as should all relevant contact information for the prospective client and all related parties. To the extent possible, references should be obtained and researched thoroughly.
2. Retainer agreements should be in writing and should include all pertinent information, including a valid billing street address. If the purported client is a corporate entity, an authorizing resolution of the shareholders or board of directors of the entity should be requested. For unknown foreign clients in particular, a more substantial than usual deposit should be required.
3. The Lawyer should make it clear to the prospective client that until (a) the Lawyer has completed the engagement process in accordance with his/her firm's policies, and (b) the Lawyer receives confirmation from his/her bank that the retainer deposit check has cleared in accord with bank policy, the Lawyer has not accepted the representation and no attorney-client or other relationship has been created.
4. Third party funds, specifically those that must be deposited in the attorney trust account should not be accepted until the Lawyer is satisfied that the client is legitimate, the process of engagement is complete and the Lawyer has been retained. Assuming the foregoing criteria is met; all funds deposited into the trust account should be held until the bank confirms clearance.

² State Bar Fraud Alert to California Attorneys, dated May 29, 2009

Banks often accommodate good customers by making deposited funds available before clearance. This is considered a provisional settlement, which may be revoked by the bank³ and is not the same as the funds having cleared.⁴ Banks are generally only required to follow their own prescribed procedures in collecting and processing deposits and are not considered to have acted negligently by failing to discover a fraudulent instrument.⁵

In addition, Lawyers should immediately review their business related insurance policies with their brokers to determine what if any insurance options might be available to provide coverage (indemnity or defense) relating to claims arising from internet scam activities.

Finally, if a Lawyer finds that they have become a victim of one of these scammers, they should treat it like any other theft by reporting the crime to appropriate local law enforcement authorities and assure that a police report is generated and a case opened. Doing so promptly upon discovery of the fraud, is a strong indication that the Lawyer was not involved in the perpetration of the scam and also illustrates the Lawyer's desire to mitigate the damage he/she has suffered. Furthermore, law enforcement investigators may be the only resource available to trace funds or to establish the existence of the scam or the scammers.

As the Lawyer technically represents the client despite the fraud that has taken place, he/she continues to have responsibilities towards the client and remains subject to the attorney-client privilege. Therefore, care must be taken to avoid disclosing "client" confidences in the course of such investigation, because it is unclear when the scammer ceases to also be a client.

In choosing clients and accepting to represent them, it is better to err on the side of caution and remember that if it is too good to be true, it usually is.

³ In pertinent part, section 4214 of the California Uniform Commercial Code states the following regarding the right of a bank to charge back an item: "If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain a refund from its customer ... A collecting bank's right to charge back is not affected by the customer's previous use of the of the provisional credit given, or even the bank's own negligence in handling the check.

⁴ In *Scott P. Holcomb v. Wells Fargo Bank, N.A., et al* (2007) 155 Cal.App.4th 490, 66 Cal.Rptr.3d 142, the Court stated that "We caution, however, that a bank should not incur liability for simply telling a depositor that he or she may write checks against deposited funds where the depository bank has granted the depositor a provisional settlement and not yet received a notice of dishonor from the payor or intermediary bank."

⁵ In *Chino Commercial Bank, N.A. v. Brian D. Peters* (2010) 184 Cal.App.4th 1333, 109 Cal.Rptr.3d 806, the defendant was the victim of Nigerian-style e-mail scam similar to the scam being targeted against attorneys and which ultimately led to his bank account being overdrawn in the amount of \$458,782.60. The Court held that under the California Uniform Commercial Code, the defendant (Peters) had the burden of proving that the Bank acted negligently. Although the Bank in this case had represented that the counterfeit checks had cleared, the defendant did not argue that such representations barred the Bank from recovery. The Court cites section 3103, subd. (a)(7) of the California Uniform Commercial Code, which states that "In the case of a bank that takes an instrument for processing for collection ..., reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage, not disapproved by this division or Division 4 ..."