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FEATURE ARTICLES

'OTHER DUTIES' OF LITIGATORS

Taxes, investments and Medicare aren't in most litigators' job description, but neglecting to consider them can sometimes come back to haunt you.

WELL-BEING WEEK IN LAW

LAWYER WELL BEING

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STATE BAR ELECTIONS

State Bar elections open till May 24. Meet the candidates. **Page12**

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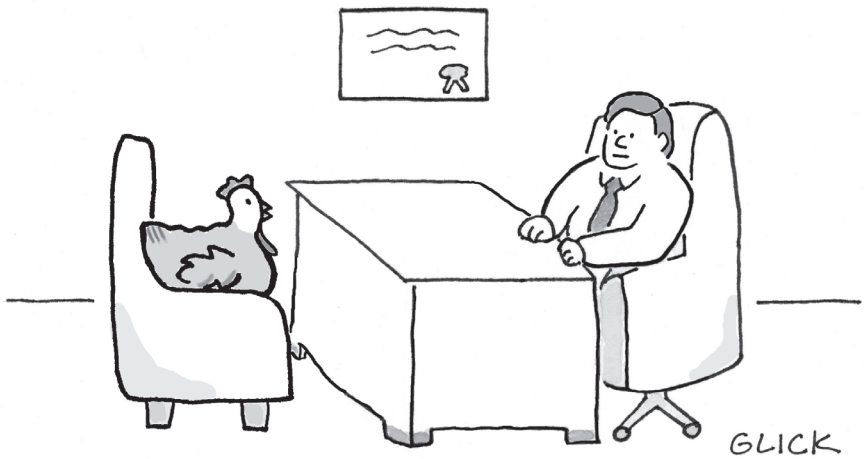

"I have been accused of trespassing, but I can't help it -- I'm a free-range chicken."

‘Other duties’ of litigators

Hidden issues with taxes, asset protection, and Medicare can easily come back to haunt an unsuspecting trial lawyer

By Jeremy Babener and Jack Meligan

Ask most anyone what a personal injury lawyer does – they won’t think of taxes, investments, or Medicare. And yet, that won’t stop the aberrant client when IRS, Medicare, and financial problems come knocking. Thanks to an ever-increasing standard of care in trial work, some personal injury firms have paid a steep price without ever claiming to advise on these non-litigation issues. »

Says Arden Olson, Former Member of the ABA's Committee on Ethics & Professional Responsibility, and current Director of the Association of Professional Responsibility Lawyers:

> Too often, personal injury lawyers don't tell clients everything needed to make good decisions on specialty subjects like tax, finance, and government benefits. But ethical rules require that lawyers do so, or that they obtain their clients' informed consent not to do so.

Here, we discuss the trial lawyers' rising standard of care and what to do about it. In short, inform your clients, recommend involving specialists, and exclude the issues from the scope of your representation. Here's a good start…

- **Taxes** – Notify your client that she may owe tax on part of her personal physical injury award, save taxes on her emotional distress settlement, and get taxed on the amount she pays you in legal fees.
- **Financial Protection** – Notify your client that settlement presents her with a one-time option, but not the obligation, to make use of certain financial strategies, including a special-needs trust or a structured settlement annuity. They also need to be notified of the risks – neither of these are right for everyone. In fact, the last two decades many plaintiffs and attorneys have been irresponsibly recommended to these strategies.
- **Medicare** – Notify your client that her recovery may prompt Medicare to withhold future coverage or to take part of her settlement proceeds as reimbursement for past covered medicals.

To shortcut the process, you can use disclosure forms intended to limit the scope of your representation, inform clients, and remind them that you're focused on the most important job – fighting for the big recovery.

Client liability becomes firm liability

When it comes to legal malpractice, personal injury lawyers are the most common defendants among all legal specialties, including divorce lawyers.[1] This is probably unsurprising since their clients have sued or considered suing before. Making things more difficult, trial lawyers are expected to advise on an expanding range of specialized issues.[2]

American Bar Association materials advise that "competent representation" of plaintiffs requires "considering the tax implications of the settlement."[3] And, that a trial lawyer must "ensure his client is informed about the options of structured settlements, trusts and the effect of the judgment or settlement on the client's public benefits eligibility."[4] State Bar Associations have come to similar conclusions.[5] Attorneys must take care to avoid inserting their bias for or against these options, especially structured settlements.

Though lawyers can limit their scope of representation, doing so requires "informed consent" and limitations that are "reasonable under the circumstances" – an evolving concept.[6] The D.C. Bar Association writes, "Because the tasks excluded from a limited services agreement will typically fall to the client to perform or not get done at all, it is essential that clients clearly understand the division of responsibilities under a limited representation agreement."[7]

Though lawyers can limit their scope of representation, doing so requires "informed consent" and limitations that are "reasonable under the circumstances" – an evolving concept. The D.C. Bar Association writes, "Because the tasks excluded from a limited services agreement will typically fall to the client to perform or not get done at all, it is essential that clients clearly understand the division of responsibilities under a limited representation agreement."

As a result, trial lawyers are particularly vulnerable to malpractice claims for simply failing to inform clients about specialized subjects that could drastically impact the rest of their clients' lives. Here, we discuss three of the most impactful: Taxes, Financial Protection, and Medicare.

Taxes. Personal injury plaintiffs often believe the IRS cannot tax their recovery, in large part due to mistaken and outdated information published online. Others believe the IRS taxes all recoveries, only to find out later how much they could have saved with small, simple changes to their settlement agreement.

Tax advisors specializing in litigation advise plaintiffs and their lawyers how to reduce taxes resulting from settlement – often by "allocating" more to tax-free damages – and by enabling plaintiffs to deduct more of their legal fees and medical expenses. But many tax-saving

strategies are lost forever once a settlement is signed, and sometimes, once a complaint is filed or a demand letter is sent. For example, by not acting on tax strategies before settlement, a plaintiff can entirely lose their opportunity to shift the "burden of proof" to the IRS in any tax challenge.[8]

Legal malpractice literature recounts many examples of plaintiffs suing their lawyers after settlement regarding tax matters.[9] Plaintiffs have brought actions after learning that their lawyers' assumption of a complete or partial tax-free recovery were wrong.[10] Similarly, they have pursued claims for failure to "allocate" within the settlement agreement,[11] which can dramatically increase settlement taxation. In sending a malpractice matter to trial, one court wrote, "Had the settlement agreement apportioned the monies … the compensatory portion … arguably would have been nontaxable."[12]

Financial Protection. An award or settlement is the largest influx of money many plaintiffs will ever see – and it is critical to preserve for their financial future. Unfortunately, a lack of financial experience leads many to dissipate the money within several years. Preserving funds requires proper planning, and often, ensuring continued eligibility for government benefits (e.g., Medicaid).

Structured settlements, settlement-preservation trusts, and special-needs trusts have proven invaluable to some plaintiffs. In fact, a few plaintiffs not at least offered those opportunities later sued counsel based on their lost protection and never realized gains.

For example, in 2001 two Texas plaintiff firms paid $1.6 million to settle malpractice claims brought by their former client. In 1990, the firms had settled the client's medical malpractice suit for $2.5 million in direct cash rather than exploring a structured settlement or establishing a special-needs trust – failing to account for the client's $20 million of future medicals.[13]

In another case, a gunshot victim sued her lawyers for incorrectly advising that she could preserve her Medicaid eligibility by establishing a special-needs trust after settlement, rather than beforehand.[14]

In 2019, California firm Lieff Cabraser successfully defended against a $25 million legal malpractice suit – the former client brought her action after the firm settled a wrongful death claim for $24 million in cash, and allegedly not exploring a structured settlement to minimize taxes.[15] Fortunately for the lawyers, they could provide evidence that the defendant's insurer would not have agreed to a structured settlement.

Medicare. Medicare has a new mentality when it comes to personal injury plaintiffs – do not cover medicals when a defendant or insurer should.

And, take portions of plaintiff recoveries as a refund for Medicare's past payment of medicals. This presents a huge risk to your plaintiffs and their lawyers. In fact, some plaintiff firms have faced "double damages" for not directing settlement proceeds to Medicare or Medicare Advantage companies[16] – liability not covered by their malpractice insurance.

There have been many suits against plaintiff firms for not reimbursing Medicare at settlement. Perhaps best known is the 2016 lawsuit for $20 million against five plaintiff firms in Texas by Humana, UnitedHealthcare, and Aetna insurance companies, all of which offer Medicare Advantage plans.[17] The three had paid $20 million in medical expenses for the firms' 300 asbestos-litigation clients – Humana also pursued the firms for double damages.

Also of concern, the U.S. Department of Justice has increased its enforcement and rhetoric. For example, the Department recently issued press releases announcing settlements with two firms that failed to direct settlement proceeds to Medicare as reimbursement for past coverage of their clients' medicals. The language used by the DOJ attorneys in these cases is quite telling:

- "We intend to hold attorneys accountable for failing to make good on their obligations to repay Medicare for its conditional payments, regardless of whether they were the ones primarily handling the litigation for the plaintiff."[18]
- "When an attorney fails to reimburse Medicare, the United States can recover from the attorney — even if the attorney already transmitted the proceeds to the client."[19]

From the U.S. Department of Justice, Medicare, and private companies entitled to recoup previously covered medicals, plaintiffs and their lawyers face increasing exposure post-settlement.

Now What?

The risk from ignoring these specialized issues is daunting, but lawyers can avoid it by limiting the scope of engagement. To do so, it's necessary to disclose material risks in order to obtain clients' informed consent. For lawyers who want expert support we recommend consulting with advisers from the Society of Settlement Planners, the Academy of Special Needs Planners, and the National Association of Medicare Set-Aside Professionals.

When referring plaintiffs to advisers we recommend the same groups. Lawyers should make referrals "based on assessment of the quality of the third party's services and fairness of the price,"[20] and provide enough information for the client to make an informed decision.[21]

Jeremy Babener is a tax lawyer specializing in settlement issues. He is Chair of the Society of Settlement Planner's Legal Committee and a former Tax Policy Fellow at the U.S. Treasury. Jack Meligan is a settlement planner, financial advisor, and government benefits specialist. He has advised plaintiffs and their attorneys for over 30 years. Together, they co-authored a set of engagement documents for trial lawyers to address each of these issues, available at TrialLawyerProtection.com."

Endnotes

1 ABA, Profile of Legal Malpractice Claims 2016-2019 (2020).

2 Relevant here are ABA Model Rules 1.1, 1.3, 1.4, 1.7, 1.9, and 2.1, which have been directly or in some version by most states. To focus on practical applications, we instead discuss conclusions made by the ABA and State Bar Associations.

3 ABA, Ethical Guidelines for Settlement Negotiations, August, 2002. See generally Smith v. St. Paul Fire & Marine Ins. Co., 366 F. Supp. 1283, 1290 (D.C. La. 1973) (lawyer required to inform client of potential negative consequences), aff'd, 500 F.2d 1131 (5th Cir. 1974).

4 ALI-ABA, Krooks, Bernard, Special Needs Trusts: The Basics, The Benefits, and The Burdens (2009).

5 See generally Bd. of Comms. on Grievances and Discipline of the Supr. Ct. of Ohio, Op. 2019-10 (Oct. 4, 2019) ("If, during the legal representation, a lawyer ascertains that a client needs financial services, the lawyer has a fiduciary duty to counsel the client accordingly, and may refer the client to appropriate resources."); Utah State Bar Ethics Advisory Op. Comm., Op. 193 (Sept. 23, 1993) ("In this case, as in others, the attorney should assist the client in becoming fully informed of the economic benefits and risks of the client's actions."); Conn. Informal Ethics Op. 89-10 (1989) ("Some degree of investment advice may be necessary to the adequate representation of the client in many situations."); Ala. Ethics Op. 2015-01 (2015) (holding that negotiations to reduce third party liens are generally "incidental to normal representation" in a personal injury settlement); Doucette v. Kwiat 392 Mass. 915 (1984) (noting that a personal injury attorney's services normally includes the discharging of unchallenged liens and similar claims).

6 E.g., ABA Model Rule 1.2(c); CRPC 1.2(b). NYRPC 1.2(c). Obtaining "informed consent" for limiting scope requires the same disclosure protocols as obtaining a conflict waiver. ABA Model Rule 1.2, Commentary Note 8. See Indianapolis Podiatry, P.C. v. Efroymson, 720 N.E.2d 376, 381 (Ind. Ct. App. 1999). Click here for the ABA's catalogue of the states' scope-limitation rules.

7 D.C. Ethics Op. 330 (2005).

8 See 26 U.S.C. Section 7491(a)(1). To shift the burden of proof, a plaintiff must introduce "credible evidence" on the factual issue. Typically, a plaintiff's best opportunity to establish that evidence is in the complaint or settlement agreement.

9 E.g., 4 Legal Malpractice § 33:105 (2019 ed.).

10 E.g., Cire v. Cummings, 134 S.W.3d 835 (Tex. 2004); Jalali v. Root, 109 Cal. App. 4th 1768 (2003) (lawyer assumed that plaintiff would not be taxed on portion paid to attorney).

11 Naqvi v. Rossiello, 321 Ill. App. 3d 143 (2001); see generally Ortiz v. Allyn, Hausner & Montanile, LLP, 852 N.Y.S.2d 555 (App. Term 2007).

12 Naqvi, 321 Ill. App. at 150.

13 Grillo v. Pettiete, 96-45090-92, 96th District Court, Tarrant County, Texas; Gullen, Christopher, What Attorneys Need to Learn from Grillo v. Pettiete, 82 Mich. B. J. 27 (2003).

14 French v. Glorioso, 94 S.W.3d 739 (Tex. App. 2002).

15 A.M. v. Lieff Cabraser Heimann & Bernstein, LLP, No. B269624, 2019 WL 2433188 (Cal. Ct. App. June 11, 2019).

16 E.g., Humana Ins. Co. v. Paris Blank LLP, 187 F.Supp.3d 676, 680 (E.D. Va. 2016); In re Avandia Mktg., Sales Practices & Prod. Liab. Litig., 685 F.3d 353 (3rd Cir. 2012); but see Aetna Life Ins. Co. v. Guerrera, 300 F. Supp. 3d 367, 378 (D. Conn. 2018) (concluding that a company are not entitled to double damages).

17 Humana, Inc. v. Brent W. Coon, 2016 WL 4702759 (S.D. Tex.).

18 U.S. Dep't of Justice, Baltimore Plaintiffs' Law Firm Saiontz & Kirk, P.S., Pays the United States Over $90,000 to Settle Allegations that it Failed to Reimburse Medicare for Payments Made on Behalf of Firm Clients (Nov. 4, 2019).

19 U.S. Dep't of Justice, Philadelphia Personal Injury Law Firm Agrees to Start Compliance Program and Reimburse the United States for Clients' Medicare Debts (June 18, 2018).

20 *E.g.* D.C. Bar Ethics Opinion 245 (Nov. 1993).

21 *See* ABA Model Rule 1.4, Comment 5.