Law Firm Bankruptcies:

Liability for Third-Party-Provided Litigation Services

By Adam L. Rosen

ATTORNEYS routinely enter into contracts on behalf of their clients for litigation-related services, such as court reporting, printing and expert witness testimony. These routine arrangements have created an issue in several law firm bankruptcies: Are debtor law firms liable under 11 U.S.C. Sec. 502 for claims based on litigation-related services provided for the benefit of clients?

It is a well-settled principle of agency law that an agent for a disclosed principal is not liable on a contract entered into by the agent on behalf and with the authority of the principal, unless there is clear and explicit evidence of the agent's intention to substitute or add his own personal liability for, or to, that of his principal. *Dow Chemical Pacific Ltd. v. Rascator Maritime. S.A.*, 782 F.2d 329, 339 (2d Cir. 1986).

In actions brought by court stenographers against attorneys who engaged their services on behalf of disclosed clients, for example, the majority of courts have applied this longstanding principle of agency law and refused to impose liability for unpaid fees upon the attorney in the absence of an express undertaking to assume such responsibility. *See Eppler, Guerin & Turner Inc. v. Kasmir*, 685 S.W. 2d 737 (Tex. Civ. App. 1985); *Free v. Wilmer J. Helric Co.*, 688 P.2d 117 (Ct. App. Ore. 1984).

Recent Trend to Liability

There has been a recent trend, however, toward a view that considers the agency relationship of the attorney and client as a special one requiring different rules. Courts espousing this minority view hold attorneys liable for expenses incurred unless the attorney made an express disclaimer of responsibility when entering the contract. *See McCullough v. Johnson*, 816 S.W. 2d 886 (Ark. S.Ct. 1991); *Hankin v. Hamernick, NYLJ*, 11/12/91, p. 35, col. 2 (N.Y. Civ. Ct, Kings Cty. 1991) (citing dicta in *Urban Court Reporting Inc. v. Davis*, 158 A.D. 2d 401, 402, 551 N.Y.S. 2d 235, 236-37 (1st Dept. 1990)); *Ingram v. Lupo*, 726 S.W. 2d 791 (Mo. Ct. App. 1987).

Bankruptcy Code Sec. 502(b) provides that a claim is not allowable to the extent that it is unenforceable against the debtor and property of the debtor under any agreement or applicable law for a reason other than because the claim is contingent or unmatured. Thus, the issue can be resolved by determining whether the costs of litigation-related services are an obligation of a debtor attorney or law firm under state law.

As explained above, the majority rule is that the attorney or law firm is the agent for the client-principal absent explicit evidence to the contrary. Courts following this view require the service provider to obtain the attorney's express promise to pay.

The Minority Rule

The minority rule, which holds the attorney liable in the absence of an express declaration to the contrary, considers modern litigation practices where attorneys, and not clients, are responsible for engaging specialists for the purposes of conducting lawsuits. Courts following this view emphasize that the attorney orchestrates and manages modern litigation, determining the steps to be taken in the client's interests. These courts conclude that an attorney is more than a mere agent and can be treated as a principal even when it is apparent that he is acting on behalf of a particular client.

The recent decisions espousing this minority view object to placing the burden upon service providers to recover payments from clients they have not dealth with directly, and whose credit standing often is unknown. These cases note that an attorney may avoid liability by a simple disclaimer which permits the service provider to protect itself before extending credit to the client.

More Equitable Result

These ideas were set forth in dicta by the Appellate Division, 1st Department of the New York Su-

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Adam L. Rosen *practices bankruptcy law in Garden City, N.Y., and is representing a litigation service provider in the Chapter 11 case of the Bower & Gardner law firm. Telephone: (516) 745-9044. Jill Makower assisted in the preparation of the article.*

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preme Court, which has adopted the minority approach:

"We add that, contrary authority notwithstanding..., we think an attorney who, on his client's behalf, obtains goods or services in connection with litigation should be held personally liable unless the attorney expressly disclaims such responsibility...As aptly stated in *Beizer v. Goldberg* (*NYLJ* 6/10/88, p 28, cols. 2,4, Goldstein, J.), which adhered to the prevailing rule while criticizing it as anachronistic, '[i]t is both illogical and unnecessary to compel the reporter to proceed against a client he or she has not dealt with, probably never saw [ ], undoubtedly, would have difficulty locating' and, we add, whose credit standing is probably unknown. 'This burden may more conveniently and appropriately be placed upon the attorney.' (*Id*). It seems to us to be more equitable to hold the attorney liable in the absence of his express indication to the contrary, since the attorney may avoid liability by the simple expedient of indicating to the reporting service or other provider of services that the client and not the attorney is liable for the obligations incurred...." *Urban Court Reporting v. Davis, supra*, at 236-37.

Ultimate Liability

Courts adopting the minority view note that their approach does not absolve the client of responsibility because payment for litigation costs ultimately is the client's responsibility. This view has been criticized by another New York court, which recently declined to follow the dicta of the Appellate Division:

"The First Department offers the reassurance that the client is still ultimately responsible for payment. This should be little comfort to the attorney since the reason this issue arises at all is that the client has already failed or refused to pay. A rule whose likely consequence is an increase in lawsuits by attorneys against their clients has little to recommend it. Until such time as the Court of Appeals agrees with the First Department, I can find no justification for singling out lawyers to be unprotected by well-settled agency principles." *Reach v. Balaban*, *NYLJ*, 5/6/94, p. 33, col. 3 (N.Y. Civ. Ct., Richmond Cty. 1994).

The disagreement among jurisdictions as to whether the costs of litigation-related services are an obligation of an attorney acting within the scope of his authority on behalf of a disclosed client should result in different results in bankruptcy courts on the issue of allowability of claims against debtor attorneys and law firms under 11 U.S.C. Sec. 502.

The issue appears ripe for litigation because it is unclear what constitutes an attorney's "consent" to be bound directly to the service provider. ■

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