

Q&A

Perspectives on risk drawn from our claims experience.

Question

Our firm is handling a corporate transaction and has been asked to hold funds in escrow pending certain milestones. Is there any risk in doing this?

Answer

Subject to obtaining appropriate waivers, there is nothing that forbids lawyers from this activity, and, in fact, many law firms undertake this role as a "favor" to clients. However, escrow services are a longstanding and fertile source of malpractice claims and for this reason there are also many established law firms that forbid the practice. Firms serving as escrow agents should take steps to address the areas of risk, including:

- ✓ An essential step is to obtain written conflict waivers from the client and the other parties. Another way that firms can protect themselves is to include a "withdrawal clause" in the escrow agreement which states that if there is any dispute over the release of the escrowed funds, then the firm's agency is extinguished in favor of an independent agent.
- ✓ Firm lawyers must realize that service as an escrow agent creates a parallel legal relationship with the client, i.e., you have an attorney-client relationship on which you are layering an agency relationship via the escrow. Among other things, this means attorneys must be careful to distinguish when they are communicating with the client as counsel (such that privilege applies), and when they are communicating with them as an escrow agent.
- ✓ If possible, avoid situations where the firm or its attorneys have an interest in the escrow itself (e.g., escrowed fees, shares from a client investment). Regardless of the technical validity of the waiver, the optics of that situation will play very poorly if there is a dispute down the line.

Ultimately, avoiding such situations may be the best risk management strategy. The elephant in the room with respect to escrow service is that all is well until the parties to the escrow get into a dispute. When that happens, the "reasonably foreseeable adverse consequences" described with clinical precision in the conflict waiver are suddenly the subject of a very real and awkward conversation with the client. Disqualification/withdrawal often follow, along with the ill will of a client who feels betrayed.



Beazley Hotline
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