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In The News

The Burden Of Full Disclosure Regarding Transactions With Clients May Be Too High To Satisfy.
***Iowa Supreme Court Attorney Disciplinary Board v. Wintroub* 2008 WL 466754.**

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Be very careful when entering into an adverse financial arrangement with your client. The rules of full disclosure may require you to act outside your normal practice area. That is the message from the Supreme Court of Iowa.

Attorney Wintroub was a litigation attorney who represented his close personal friend Bergman in several litigation matters. Bergman was a sophisticated investor who often hired multiple attorneys and it was undisputed that Wintroub was not Bergman's attorney for business or financial matters. During Wintroub's representation of Bergman in litigation matters, Wintroub sold Bergman a minority interest in a corporation that Wintroub had formed for the purpose of selling artwork by a particular artist and then obtained an unsecured loan from Bergman. Wintroub never disclosed that Bergman should seek independent counsel. Although Wintroub made significant disclosures to Bergman about both of these transactions, the Iowa Supreme Court found that these disclosures did not satisfy Wintroub's high burden of proving that that he had acted in good faith and had made full disclosures to Bergman.

With regard to the sale of stock, the Court ruled that Wintroub was under a duty not just to disclose the material terms of the transaction, but to "'fully disclose every relevant fact and circumstance which the client should know to make an intelligent decision concerning the wisdom of entering [into] the agreement' [by providing the client with] the same kind of legal advice that the client would have received if the transaction involved a stranger and not the attorney."[1]

In this particular transaction, the Court found that Wintroub was required to disclose the financial performance of the corporation from the date of its formation through the date of Bergman's investment (by providing financial statements or oral summaries of their contents) and to advise Bergman about the lack of liquidity ordinarily associated with minority corporate interests in closely held corporations. As this advice would have been provided by an independent transactional attorney, Wintroub's failure to provide this advice demonstrated that he failed to prove that the transaction was in good faith.

With regard to the loan, Wintroub made several disclosures to Bergman which would have caused any sophisticated investor pause. Wintroub revealed that he had expanded his business in reliance on his principal client's promise to pay amounts due to Wintroub, he had invested his personal financial resources to pay the expenses of his law practice and had exhausted his credit, he had no other source of funds to keep his law practice in operation and he had no idea when he would be able to repay the loan. However, the Court held that this disclosure was insufficient. The Court stated that "competent independent counsel would have engaged in an interactive process" with Bergman that would have gone beyond determining that Wintroub was a poor credit risk.[2] Instead, according to the Court, independent counsel would have "questioned the unsecured nature of the loan, the lack of interest or timetable for repayment, and possible contingencies that could arise, likely demonstrating why the unstructured nature of the loan was not in Bergman's best interests."[3]

Practice Note: The Iowa Supreme Court has placed a heavy burden on attorneys who enter into financial transactions with their clients. Wintroub may have thought that he was providing Bergman with sufficient information about the stock sale when he described the nature of the transaction and may have thought that disclosing his poor financial situation was sufficient to satisfy Bergman's needs with regard to the loan. But the Iowa Supreme Court held Wintroub to the standard of an experienced transactional attorney. As the Court stated, "perhaps the safest and best course for an attorney is to decline to personally participate in business transactions where the attorney and the client have differing interests."

[1] 2008 WL 466754 at 4.

[2] Id. at 5.

[3] Id.
