

Tuesday, July 19, 2011

Failed real estate deals driving malpractice claims

Professional liability lawyer says troubled commercial real estate deals mean suits are still in the pipeline

By Meredith Hobbs, Staff Reporter



(Allison Church)

Attorney Johannes Kingma: "In this market, people have lost money and would like to blame it on you."

Professional liability suits have become the next big thing in the litigation fallout from the commercial real estate bust.

Real estate law has always been one of the top practice areas for malpractice claims against lawyers, second only to personal injury, according to an American Bar Association study of professional liability claims against lawyers. (Divorce lawyers are No. 3.) But the nature of the suits has changed.

"Failed real estate deals are driving the bus," said Johannes S. Kingma, who has defended lawyers, accountants and other professionals against allegations of negligence for 25 years. Kingma said litigation springing from real estate deals gone bust and banks gone belly up dominates his professional liability practice right now.

When a developer has personally guaranteed a loan he can't pay, or a bank is feeling the heat for a loan that's gone bad, they start looking for "anyone in the neighborhood" to sue, said Kingma, who heads the business litigation practice at Carlock Copeland & Stair.

Kingma said 80 percent of the firm's professional liability practice is defending suits against lawyers and accountants. He sees far more malpractice suits against lawyers than accountants. "People like accountants better than lawyers," he said.

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There are also some cases against real estate agents and brokers. "Not as many, but there are some juicy ones right now stemming from failed real estate transactions," he said.

Kingma said most real estate suits used to be against residential real estate lawyers over mortgage fraud, such as flips, and transactions with title problems. From about 2002 to 2008, during the mortgage-backed securities era, residential

real estate loans gone bad prompted a lot of malpractice litigation. "All those trash loans were being sold, and no one cared what the loans looked like," he said.

Those suits have dwindled since the mortgage-backed securities market dried up around 2008, said Kingma. After that, not many residential real estate loans were made, and a lot of residential real estate lawyers went out of business.

But a raft of troubled commercial real estate transactions are still in the pipeline, he said. "From around 2006 to 2008, developers and lenders were increasingly desperate for ways to make money and keep their operations going." The developers and lenders got overly aggressive in making deals, he said. They built projects that no one wanted, creating empty subdivisions with roads and sewage lines in place.

"These developments have failed, and the banks, the guarantors and the developers are desperately trying to pay off the debt," said Kingma.

"There are a lot of big shots who've signed guarantees and have no way to pay them. They are drowning men and women. The banks who made the loans know this. They are looking to get the loan paid off. They don't want the FDIC to pull up in their black vans at 4 p.m. on Friday," he said.

And so lenders and borrowers "start suing someone in the neighborhood," said Kingma. That can often be a lawyer on the deal.

Types of claims

Kingma said typical claims against lawyers in such cases are for malpractice, breach of fiduciary duty and breach of contract, which are covered by professional liability insurance. Plaintiffs "often throw in a little fraud and racketeering," he said, which are not covered, to intimidate the defendant.

A recurring claim Kingma sees is in a real estate deal with multiple borrowers or investors that turns into a malpractice suit against the law firm on the transaction when the deal goes bad. Kingma said one party will often claim the lawyer was not looking out for his interests.

This can be a murky area, he said, and not one that a lawyer being sued wants a jury to decide. Such claims "can resonate with a jury," said Kingma. "They can be sympathetic to a claim that 'that's my lawyer—he should have looked out for my interests, but didn't.'"

In such cases, he said, there is often a lack of documentation, such as an engagement letter or a "we're not your lawyer letter" that definitively proves or disproves an attorney-client relationship existed. "Juries don't like that," he said. "They think we're the kings and queens of documentation."

He won summary judgment on such a case in mid-June, but declined to name the client firm. Kingma said that partners in a real estate assemblage parted ways when the market went south. One of the partners sued Kingma's client, the law firm of another party in the deal, for malpractice and breach of fiduciary duty, claiming that the firm represented him and failed to adequately protect his interest.

Kingma said the question he had to address for his client was "Did the so-called client reasonably think this was their lawyer based on representations that the lawyer made?"

In this case, the judge said no. When asked whom the firm represented, Kingma replied no one. "They were in the neighborhood," he said, explaining that the firm represented the business entity in a couple of specific transactions.

Kingma declined to name other clients or specific cases, but Carlock Copeland's website, without naming names, details several cases where he won summary judgment for law firm defendants. In another case, a guarantor for a mixed-use development in Cartersville sued Kingma's client, the borrower's lawyer, for malpractice, breach of fiduciary duty and fraud, alleging that the lawyer had conflicts of interest, owed the guarantor a duty and gave bad advice.

Kingma said a scenario in which a bank or developer blames the closing attorney arises when there are problems with the property. He said the bank or developers' story is "If only I'd known, I never would have made the loan—or borrowed the money."

In a June 2009 summary judgment decision, a buyer planning to create a residential development on a large tract of land in North Georgia discovered an industrial waste landfill on the property and sued the seller. The seller sued Kingma's law firm client, which closed the sale of the tract.

"There is always some little imperfection in a real estate transaction," said Kingma. "When the market is going up, nobody cares because everybody is going to make money. Nobody wants to waste time suing. But in this market, people have lost money and would like to blame it on you."

FDIC suits

The Federal Deposit Insurance Corp. is also looking for anyone in the neighborhood of a failed bank, including law firms.

When a bank starts to fail, Kingma said, the bank officers become desperate and may pressure the professionals working with it, including the lawyers and auditor, to do things they would not normally do. "Failing businesses are like drowning people," he said. "They lose their ethics and their rationality. They are trying to stay alive."

And when the bank fails, the lawyers and other professionals are dealing with receivers and trustees, not their buddies at the bank. "Receivers and liquidating trustees are very aggressive plaintiffs," he said.

In an attempt to recover money from bad loans for banks in receivership, the FDIC is suing lawyers for professional negligence, along with officers and directors, accountants, appraisers and brokers. According to the website for the FDIC, as of July 7 it has authorized suits in connection with 28 failed institutions—including 14 malpractice suits against lawyers and other professionals involved in failed real estate developments. Three of those suits are against Georgia law firms.

In February, the FDIC in its capacity as the receiver for Neighborhood Community Bank in Newnan, which was shut down on June 30, 2009, sued Henry County firm Smith, Welch & Brittain and one of its partners, J. Mark Brittain, over \$11.5 million in failed real estate loans made by the bank to a developer, Jeff Grant. The firm handled the closings for the loans. The suit alleges the developer overstated to the bank the value of the properties he was acquiring and used the excess funds from the loan for collateral.

In October, the FDIC sued two firms for malpractice over failed loans, acting as the receiver for Integrity Bank in Alpharetta, which was closed in 2008. Kingma is representing one of the firms, Andersen, Tate & Carr of Duluth, which the FDIC alleged botched a closing for Integrity on a \$14.5 million loan to a developer in November 2007 to pay off another lender and fund construction of houses for a Stockbridge development. The FDIC is also suing the title insurer, Chicago Title Insurance Co.

The FDIC alleged that the firm should have obtained a quitclaim deed from the prior lender, Colonial Bank, before wiring it a \$10 million loan payoff. Because it didn't, the complaint alleges, Colonial Bank—which failed a year later—retained a first-priority lien on the development.

The FDIC is also suing Alpharetta firm Jampol, Schleicher, Jacobs & Papadakis, now North Atlanta Law Group, and partner Michael E. Jacobs, alleging errors rendered a security deed invalid that backed a failed \$2.8 million loan by Integrity to build a self-storage facility in Ellijay.

There is an 18-month investigation process before the FDIC authorizes a suit, so more are likely in the offing, said Kingma.

During the savings and loan crisis, the Resolution Trust Corp., and then the FDIC, filed 205 legal malpractice claims and 139 accounting malpractice claims in connection with 2,744 lenders that failed, according to Kevin LaCroix's D&O Diary blog, which cites NERA Economic Consulting.

Kingma said a lot of bad loans have not yet come to light in the current real estate bust. Many commercial real estate foreclosures have not yet taken place because the banks are not in a good position to foreclose, he said. If they write the bad loans down, he explained, it can hurt their status with regulators.

"I'd like to think things are bottoming out, but there is a vast inventory of real estate transactions that haven't failed and that aren't getting better," he said.

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