

Beware When Client Claims Breach of Fiduciary Duty

BY MARY C. DALY

In response to a local bar association's initiative, you have agreed to mentor Junior Lawyer. After a few years as associate in a large metropolitan law firm, Junior has moved into the community and set up an office as a solo practitioner. One day, Junior calls asking for your advice. He has been representing a client in a difficult litigation. During pretrial depositions, the defendant made an offer of settlement, but the client rejected the offer despite Junior's strong recommendation. The case went to trial. Although the client prevailed, the judgment was less than the settlement offer. Now the client is refusing to pay Junior's fee. Junior is inclined to sue to recover the fee, but he wants your input. What do you recommend?

Your initial response will most likely be to ask Junior for a detailed description of the litigation. The majority of claims for malpractice arise in precisely the scenario he has presented. Suing to recover legal fees is an open invitation for a disgruntled client to counterclaim for malpractice, and many clients eagerly accept the invitation. The phenomenon is so well documented that some insurance companies are now including a policy provision excluding coverage for a malpractice counterclaim unless the lawyer has received the company's prior permission to file the action for fees.

Junior assures you that his representation was A+. After all, he won the case. The fact that the jury returned a verdict for a sum less than the settlement was clearly not his fault. He had warned the client of the case's weaknesses and urged acceptance of the offer. Junior has researched the law and is confident that under New York's "but for" standard to measure proximate cause he will be able to secure the dismissal of any malpractice counterclaim. "Why shouldn't I go ahead and file the complaint?" Junior presses. He is surprised by your response, "Slow down. There are other issues to consider."

Judge Lowe's recent decision in *Weil, Gotshal & Manges v. Fashion Boutique of Short Hills Inc.*, N.Y.L.J., Dec.12, 2003 (Sup.Ct. N.Y.Co.) illustrates the wisdom of your caution. Fashion Boutique originally retained Weil Gotshal in 1993 to represent it in an action in the Southern District of New York against Fendi Stores, Inc., a competitor of Fashion Boutique, and its parent, Fendi USA, Inc. (collectively "Fendi"). Fashion Boutique claimed essentially that Fendi had disparaged Fashion Boutique's products in violation of federal and state laws. Weil was the third law firm retained by Fashion Boutique in connection with the lawsuit.

Discovery and briefing proceeded over the course of the next six or so years. The district court at one point dismissed part of Fashion Boutique's federal claims, and the Second Circuit affirmed the dismissal. Fendi ultimately offered to settle the action for \$1.4 million. Fashion Boutique rejected Weil's advice to accept the offer. After the case went to trial, the jury returned a verdict in August 2000 in Fashion Boutique's favor for \$110,000. In January 2003, Weil sued Fashion Boutique for \$2,700,000 in unpaid legal fees. Fashion Boutique counterclaimed, alleging malpractice and breach of fiduciary duty.

Judge Lowe dismissed Fashion Boutique's malpractice counterclaim. His reasoning was relatively straightforward. To be successful, a malpractice claimant must show "the negligence of the attorney, that the negligence was the proximate cause of the loss sustained; and actual damages." Fashion Boutique, citing *Reibman v. Senie*, 302 App.Div.2d 290, 290 (1st Dep't 2003). Judge Lowe concluded that Fashion Boutique could not demonstrate proximate cause, basing his decision on the district court's dismissal of certain federal claims and the Second Circuit's affirmance.

He also rejected several challenges to Weil's trial conduct, relying on a well established line of cases holding that "selection of one among several reasonable courses of action does not constitute malpractice." *Id.*, citing *Rosner v. Paley*, 65 N.Y.2d 736, 738 (1985).

Claim of Fiduciary Breach Survives

While that part of Judge Lowe's opinion that dismisses the malpractice counterclaim may give Junior solace, the remainder of the opinion should give him reason to pause. Judge Lowe refused to dismiss the counterclaim for breach of fiduciary duty. Weil had represented Fashion Boutique from 1993 to 2000. In 1999, Prada USA retained Weil in connection with certain trademark litigations. At approximately the same time, Prada and another luxury goods manufacturer purchased a fifty one percent in Fendi's corporate parent. Weil did not advise Fashion Boutique of its representation of Prada until some point during the trial between Fashion Boutique and Fendi.

Fashion Boutique alleged that Weil's representation of Prada diminished the vigor of its litigation against Fendi. It also challenged the timing of Weil's disclosure of its representation of Prada, contending that the partners who served as lead counsel in the litigation knew of Prada's representation nine or ten months before they actually disclosed it.

In refusing to dismiss the breach of fiduciary duty counterclaim, Judge Lowe first noted the "high degree of undivided loyalty" that a lawyer owes a client. He then distinguished the different standards of proximate causation needed to successfully prosecute a malpractice claim and a cause of action for breach of fiduciary duty. Citing both federal and state cases, he rejected in fiduciary claims "the higher standard of proximate causation which is necessary for a malpractice claim." Instead, he applied a less stringent standard. Under this standard, a client who accuses a lawyer of a breach of a fiduciary duty need "only to demonstrate a conflict of interest which amounted merely to a substantial factor in [its] loss." He also rejected Weil's arguments that rested upon traditional principles associated with conflicts of interest in the context of motions for disqualification.

The distinction drawn by Judge Lowe between the standards of proximate causation for malpractice and breach of fiduciary duty claims is an important one. As a practical matter, the less stringent standard makes it more difficult for a court to dismiss a claim for breach of fiduciary duty than one for malpractice. Proving damages may also be easier under the less burdensome standard. See, *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537 (2d Cir.1994).

The different treatment of malpractice and breach of fiduciary duty claims arises from the historic evolution of the common law in New York. Generally speaking, malpractice relates to the manner in which a lawyer conducts litigation or handles a transaction. Breach of fiduciary duty, in contrast, relates to the specific duties a lawyer owes a client, such as loyalty and the preservation of confidences and

secrets. The case law is not always consistent on this point, however. Some courts would disagree with Judge Lowe's formulation, both with respect to proximate causation and damages. For example, in *LNC Investments, Inc. v. First Fidelity, N.A. New Jersey*, 173 F.3d 454, 46566 (2d Cir. 1999), a case not involving legal advice, the Court of Appeals for the Second Circuit suggested that New York law would apply the "but for" malpractice standard of causation in an action for breach of fiduciary duty if the plaintiff was seeking compensatory rather than restitutionary damages.

What is the best advice you can give Junior? The answer to that question will turn in large measure on the additional facts that you learn from Junior about the course of the representation. *Fashion Boutique* teaches that if any facts exist on which the client can allege a breach of fiduciary duty, Junior should proceed with great caution. It also suggests that a difficult client may be more prone to suing its lawyer than a more agreeable one. Judge Lowe's opinion noted not only that Weil was the client's third lawyer in the litigation but also that Weil had tried to withdraw from the representation on two separate occasions.

Finally, *Fashion Boutique* highlights the importance of monitoring new representations for conflicts of interest that arguably may affect existing matters. If Weil had advised *Fashion Boutique* of the firm's engagement by Prada when it initially occurred rather than several months later during the trial, Weil might have been able to obtain *Fashion Boutique*'s consent to any actual or potential conflict. Obviously, the disparity between the jury verdict and Weil's fee was a critical element in the client's aggressive pursuit of its claims.

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