

# Dodging Trigger-Happy Legal Malpractice Plaintiffs

BY ROY SIMON

Many legal malpractice cases have been in the legal newspapers lately. In two high-profile cases, one in federal court and one in state court, the plaintiffs asserting malpractice lost on motions to dismiss, and the dismissals were affirmed on appeal, suggesting that the claims were weak. Yet these weak claims were filed and the defendant-lawyers had to spend substantial time and money defending the suits. Were the plaintiffs in these cases trigger happy? If so, what can lawyers do (if anything) to protect themselves and their firms against trigger-happy legal malpractice plaintiffs? This article will briefly review some recent legal malpractice cases and suggest steps lawyers can take to avoid being sued by their former clients.

## Class Action Against Class Action Lawyers

This one goes in the irony column. In the 1990s, the Bennett Funding Group ("BFG"), an equipment finance company based in Syracuse, New York, swindled investors out of more than \$500 million through an elaborate "Ponzi" scheme involving sham contracts and "chimerical" financial statements. In April 1996, plaintiff-investors began filing class action complaints in federal courts against BFG. Curiously, the plaintiffs did not sue Arthur Andersen & Co. ("Andersen"), which had audited BFG's allegedly misleading 1989 and 1990 financial statements, but plaintiffs did sue Mahoney Cohen & Co., which had succeeded Arthur Andersen as BFG's auditor.

The many class actions were consolidated for pretrial purposes before Judge Sprizzo in the Southern District of New York. In August 1996, Judge Sprizzo appointed two law firms - Kirby, McInerney & Squire, LLP ("Kirby") and Bernstein, Litowitz, Berger & Grossman, LLP ("Bernstein") - to serve as co-lead counsel in the consolidated actions. Several months later, the district court certified a class of over 20,000 investors in BFG securities. Eventually, the district court approved a \$125 million settlement with BFG's insurers and a \$14 million settlement with Mahoney Cohen & Co. While approving fee applications by the Kirby and Bernstein firms, the district court repeatedly praised their "novel and creative" approach, which produced an "exceptional result for the class." Plaintiffs did not object to either the settlements or the award of attorneys' fees.

During the class action litigation, some individual BFG investors sued Arthur Andersen and obtained settlements. Despite these settlements, Kirby and Bernstein did not add Arthur Andersen as a defendant in the BFG class action. When other law firms attempted to file a class action against Arthur Andersen in May 1999, the district court dismissed the claims on statute of limitations grounds. In December 2002, foreclosed from suing Arthur Anderson directly, various members of the successful BFG litigation class filed a putative class action against Kirby and Bernstein on behalf of BFG class members. Plaintiffs' main claim was that the Kirby and Bernstein firms had failed to name Andersen as a defendant in the BFG class action litigation.

In September 2004, the district court dismissed plaintiffs' complaint for failure to state a claim. On appeal, the Second Circuit affirmed. The dismissal of a legal malpractice claim is a question of law - see *Rosner v. Paley*, 65 N.Y.2d 736 (1985) ("a cause of action for legal malpractice pose[s] a question of law which [can] be determined on a motion to dismiss"). To state a claim for legal malpractice, a plaintiff must allege: (1) negligence; (2) proximate cause; and (3) damages. To plead negligence, a party must aver that an attorney's conduct "fell below the ordinary and reasonable skill and knowledge commonly possessed by a member of his profession." A complaint that essentially alleges and relies on either an "error of judgment" or a "selection of one among several reasonable courses of action" fails to state a claim for malpractice.

Applying these principles, the Second Circuit held that defendants had decided not to sue Arthur Andersen in the BFG class action for three "legitimate reasons." First, when suit was filed, there was "serious doubt as to auditor securities liability" under *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). Second, damages were uncertain because the BFG securities issued when Andersen was auditing BFG had been largely paid down by the time of the BFG suits. Finally, "when other law firms brought individual actions against Andersen as part of the BFG litigation, the district court threatened Rule 11 sanctions." Andersen did eventually settle some of these individual actions, but "none of the twenty-five class action suits filed by twenty-five different law firms in the BFG securities litigation named Andersen as a defendant." (Emphasis in original.) Kirby and Bernstein therefore acted reasonably in not suing Andersen.

### **Total Victory is Not Enough**

The malpractice case against the Kirby and Bernstein firms illustrates that obtaining a good result for a client is not enough to prevent a legal malpractice suit. Clients - even seemingly happy clients - can change like the weather. Another recent illustration of client ingratitude is *AmBase Corp. v. Davis, Polk & Wardwell*, N.Y. County Clerk's Index No. 04-107762, which is now headed for the New York Court of Appeals. In that case, AmBase agreed with the Internal Revenue Service ("IRS") to assume the Federal income tax liabilities of City Investing Company ("City"). City paid AmBase \$178,767,000 (in a combination of cash and debt forgiveness) to assume these IRS obligations (and some other obligations). The IRS then sought to assess \$60,000,000 in taxes against AmBase arising out of the so-called "N.V. Matter." AmBase repeatedly reaffirmed in various judicial and administrative proceedings that it was liable for the taxes owed by City in an amount finally determined by the IRS, but it hired Cravath, Swaine & Moore to contest the tax liabilities. When Cravath did not succeed, AmBase retained Davis Polk & Wardwell. That was in 1992. The total amount of the proposed tax deficiencies at the time AmBase retained Davis Polk was more than \$60 million. The IRS claim was a guillotine hanging over AmBase's corporate head because AmBase did not have the money to pay the full amount of the claim.

The Retainer Agreement between AmBase and Davis Polk set forth a contingent fee arrangement. Davis Polk agreed to charge only 50% of its billed time at standard rates as long as the litigation was pending, but if Davis Polk were to "win the case in litigation," then it would receive an additional 150% of its billed time at standard rates, subject to a \$2 million cap on its total fees. (In short, Davis Polk agreed to bill only half of its standard fees if it lost, but double its standard fees if it won, up to \$2,000,000.)

Davis Polk went to trial in the Tax Court and won. In 2001, after Davis Polk had litigated the matter for nine years, the Tax Court ruled in favor of AmBase for all years at issue, meaning that AmBase owed no taxes at all. Instead of paying \$60,000,000 in taxes, as the IRS had demanded, AmBase paid zero. Not surprisingly, AmBase executives described the Tax Court's ruling as a "fantastic" and "spectacular" result. In fact, AmBase paid its CEO, a Mr. Bianco, a bonus of \$2,500,000 for the year 2001, largely "in recognition of his focused management and successful resolution of the N.V. Withholding Obligation against City Investing Company." Mr. Bianco later testified that he recommended the payment of this bonus to himself solely because of his work on the N.V. matter.

But AmBase's tune changed when Davis Polk sent its bill seeking payment in the amount of over \$1,424,000 (which reflected about \$356,000 in half-price billing during the litigation, plus a "success fee" of three times that amount). AmBase soon advised Davis Polk that AmBase would not pay the success fee, and complained for the first time that Davis Polk had not raised a certain defense (the "wrong taxpayer" defense) in the Tax Court litigation. The thrust of AmBase's argument was if Davis Polk had raised the "wrong taxpayer" defense, AmBase would not have been forced to maintain huge reserves that tied up AmBase's cash and caused it to lose its principal subsidiary,

In 2004, AmBase filed an action in New York County Supreme Court seeking a declaratory judgment that AmBase did not owe any fees to Davis Polk for legal services because Davis Polk had committed legal malpractice, thus vitiating any outstanding claim by Davis Polk as against AmBase for legal fees allegedly due and owing. AmBase moved for summary judgment on this claim. Davis Polk countered with a motion to dismiss, arguing as a matter of law that AmBase could not complain of legal malpractice based on an allegedly flawed strategy when the litigation had ended with the most favorable result possible to AmBase.

The Supreme Court's ruling on the competing motions was a triple play in favor of Davis Polk. The court (a) denied AmBase's motion for summary judgment, (b) granted Davis Polk's motion to dismiss, and (c) declared the rights of the parties by entering a money judgment in favor of Davis Polk for the full amount of fees claimed by Davis Polk, plus prejudgment interest (a total of \$1,867,244.15).

AmBase appealed, arguing that the Supreme Court had violated AmBase's state and federal constitutional rights (including the right to due process of law) by entering a money judgment in favor of Davis Polk even though Davis Polk had not commenced any litigation, claim or proceeding seeking a money judgment. The constitutional issues, while interesting, are beyond my expertise and beyond the scope of this article. In any event, the First Department affirmed without reaching the constitutional issues. The heart of the First Department's very short opinion said:

This legal malpractice claim, premised on defendants' failure to exercise due diligence and pursue a different defense that would have resulted in the underlying tax dispute being resolved in a more expeditious fashion, was properly dismissed as speculative. Defendants achieved success for plaintiff, who should "not be heard to complain that the result was not achieved in the precise manner [plaintiff] would have preferred."

AmBase sought review in the Court of Appeals, and the Court of Appeals has granted review. (My guess is that the Court of Appeals will explore whether a court has statutory and constitutional

power to enter a money judgment as part of a declaratory judgment action, but will leave the malpractice issues essentially untouched.)

### **"What Have You Done For Me Lately?"**

The malpractice cases against such highly regarded law firms as Davis Polk, Kirby, McInerney & Squire, and Bernstein, Litowitz, Berger & Grossman illustrate that clients - even seemingly happy clients - can change like the weather and turn on their lawyers even when the lawyers have achieved substantial success. Success by itself is apparently not enough. Lawyers can never totally eliminate the threat of legal malpractice suits, but what can (and can't) lawyers do to reduce the risks of being sued for legal malpractice?

Let me start with what lawyers cannot do to reduce malpractice risks. The main restriction is DR 6-102(A), which provides that a lawyer "shall not seek, by contract or other means, to limit prospectively the lawyer's individual liability to a client for malpractice ...." Thus, a retainer agreement may not ask a client to hold the lawyer harmless in the event the lawyer commits legal malpractice.

But there are many things lawyers can do. Here are a few:

First, communicate regularly with clients about strategies and tactics. One of the most important Ethical Considerations is EC 7-8, which provides, in part: "A lawyer should exert best efforts to ensure that decisions of the client are made only after the client has been informed of relevant considerations. ... A lawyer should advise the client of the possible effect of each legal alternative..." Although ECs are not binding (meaning that a lawyer cannot be disciplined for failing to live up to an EC), EC 7-8 is full of wisdom. I do not know whether the law firms representing the plaintiffs in the class action against BFG discussed with the named plaintiffs the pros and cons of naming Arthur Andersen as a defendant, or whether that discussion would have avoided the eventual legal malpractice suit, but in many situations I think discussions about advantages and disadvantages will reduce second-guessing that take the form of suits for legal malpractice.

Second, lawyers should bill regularly. Clients are more likely to pay bills cheerfully when they still need you, and a client's failure to pay will serve as an early signal that the client is not fully satisfied. This method works best if a law firm is billing by the hour and is entitled to periodic payment throughout the suit, and it might not have helped Davis Polk collect a "success fee" that was not due until the end of the case. But if frequent billing is not an option, lawyers should find other ways to secure their fees out of the proceeds so that they do not have to send a bill after the major work has been done.

Third, law firms should staff cases with the right people. In the business bestseller GOOD TO GREAT by Jim Collins, he observes that great companies first assemble the right people and put them in the right positions, then move forward. Putting together a team of competent people who work well together is the foundation of doing competent work. Supervising those people adequately as commanded by DR 1-104 is a necessary corollary to successful representation. And while the suits against Kirby/Bernstein and Davis Polk show that clients sometimes sue even successful lawyers, it cannot be denied that lawyers who achieve success for their clients are less likely to be sued for legal

malpractice than those who fail.

Finally, choose clients carefully. Clients who are dissatisfied with their first lawyer are often dissatisfied with their second lawyer (and their third lawyer, etc.). It is often dangerous to take over clients from other lawyers without knowing exactly why the clients left their earlier lawyers. Ditto clients who have poor credit ratings or who cannot afford your standard fees. Turning down business always hurts - but not as much as it hurts to work hard, obtain a good result, and then be sued for legal malpractice by a client who hasn't even paid the bill.

Clients will of course continue to sue lawyers for legal malpractice, and they will continue to counter sue when sued for fees. But lawyers can take steps to reduce the risk of being sued. And perhaps the dismissal without trial of the malpractice cases against Kirby/Bernstein and Davis Polk signal a trend that courts are growing increasingly impatient with clients who get good results but then look to the lawyers who achieved that success to provide a bonus check in the form of legal malpractice damages.

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