

Legal Malpractice & Breach Of Fiduciary Duty (Part I)

BY ROY SIMON

Every lawsuit alleging legal malpractice seeks money damages, and almost every suit seeking damages for legal malpractice also contains a separate claim seeking damages for breach of fiduciary duty. Some courts have permitted these twin claims even where the breach of fiduciary duty claim is based on the same facts and seeks the same relief as the legal malpractice claim. But other courts have insisted that legal malpractice plaintiffs state different facts or seek different relief in the breach of fiduciary duty claim, and these courts have dismissed the breach of fiduciary duty claim if a plaintiff does not do so. Which approach is better? And in courts requiring a plaintiff to allege different facts or seek different relief, how should a plaintiff proceed?

This month, Part I of this article explores the relationship between legal malpractice and breach of fiduciary duty claims in New York state and federal courts. Next month, Part II will explore cases from other jurisdictions as well as additional cases from New York.

The Elements of Both Claims

The elements of a claim for legal malpractice are simple. According to §48 of the RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (hereinafter cited simply as "RESTATEMENT"), a lawyer is civilly liable for professional negligence to a client if (1) the lawyer owes a duty of care to the client, (2) the lawyer fails to exercise care, and (3) that failure is a legal cause of injury to the client. That approach accords with the law in New York, where a plaintiff in a legal malpractice action must allege (1) a duty, (2) a breach of the duty, and (3) proof that the client's actual damages were proximately caused by the breach of the duty. *See, e.g., Ocean Ships, Inc. v. Stiles*, 315 F.3d 111 (2d Cir. 2002); *Marshall v. Nacht*, 172 A.D.2d 727, 728 (2d Dep't 1991).

The elements of a claim for breach of fiduciary duty are (not surprisingly) very similar. According to §49 of the RESTATEMENT OF THE LAW GOVERNING LAWYERS, a lawyer is civilly liable to a client if (1) the lawyer owes a fiduciary duty to a client, (2) the lawyer breaches the fiduciary duty, and (3) that failure is a legal cause of injury to the client. Both claims therefore depend on knowing what duties a lawyer owes to a client. These duties are specified in §16 of the RESTATEMENT, which provides, in pertinent part, as follows:

§16 *A Lawyer's Duties to a Client – In General*

[A] lawyer must, in matters within the scope of the representation:

- (1) proceed in a manner reasonably calculated to advance a client's lawful objectives, as defined by the client after consultation;
- (2) act with reasonable competence and diligence;

- (3) comply with obligations concerning the client's confidences and property, avoid impermissible conflicting interests, deal honestly with the client, and not employ advantages arising from the client-lawyer relationship in a manner adverse to the client; and
- (4) fulfill valid contractual obligations to the client.

Because an action for legal malpractice depends on breach of a "duty of care" whereas an action for breach of fiduciary duty depends on breach of a "fiduciary duty," one way to distinguish between the two causes of action would (in theory) be to determine which of the duties in §16 fall under the heading "duty of care" and which fall under the heading "fiduciary duty." But that will not be easy to do. The text of § 16 does not contain the word "fiduciary," and the Comment to § 16 is ambiguous.

The confusion is compounded in Chapter 4 of the RESTATEMENT, entitled "Lawyer Civil Liability," where the Introductory Note states: "As used in this Chapter, 'legal malpractice' or 'malpractice' of a lawyer refers to theories of both professional negligence (§48) and violation of a fiduciary duty (§49)." This confusion is further compounded by Comment c to §49 of the RESTATEMENT, which says:

c. Classification: breach of fiduciary duty and professional negligence. Many claims brought by clients against lawyers can reasonably be classified either as for breach of fiduciary duty or for negligence without any difference in result. For example, the duty of care enforced in a negligence action is also a fiduciary duty (§ 16(2)); likewise, the specific duties of lawyers help define both their fiduciary obligations and the contents of their duty of care. Most rules applicable to negligence actions also apply to actions for breach of fiduciary duty. Pleders typically add a fiduciary-duty claim to a negligence count for reasons of rhetoric or completeness. ...

Comment d to § 49 adds more fog. It says:

d. Proving breach. The principles governing proof that a lawyer's acts constitute negligence apply generally to proving breach of fiduciary duty. ... Breaches of some fiduciary duties, for example, the duty not to use client confidences for the lawyer's profit, typically involve intentional conduct, in that the lawyer chooses to act knowing facts that make the act improper. However, a lawyer who violates fiduciary duties to a client is subject to liability even if the violation or the resulting harm was not intended. ...[Citations omitted.]

In the last sentence of Comment *d*, however, the RESTATEMENT begins to explain where the overlap between legal malpractice and breach of fiduciary duty ends and how the two causes of action differ from and complement each other: "A lawyer who has acted with reasonable care is *not liable in damages* for breach of fiduciary duty, but *other remedies* such as disqualification, restitution, and injunctive or declaratory relief may be available." (Emphasis added.)

Taken as a whole, therefore, the RESTATEMENT suggests two crucial variables that distinguish most claims for breach of fiduciary duty from most claims for legal malpractice: intent, and remedy. Using those two variables, we can divide the lawyer liability universe into three parts:

1. When a lawyer unintentionally (i.e., negligently) fails to exercise due care in providing legal services to a client – the classic conception of legal malpractice – the only available remedy is money damages.

2. When a lawyer unintentionally fails to exercise due care in fulfilling a fiduciary duty, money damages are not available but other remedies (such as disqualification, restitution, and injunctive relief) are available.
3. When a lawyer intentionally breaches a fiduciary duty, then both money damages and equitable remedies (including restitution) are available. (Ordinarily two variables lead to four possibilities, but “intentional negligence” is a non sequitur and is thus a null set that we can ignore.)

Two tests: “but for” v. “substantial factor”

Apart from intent and remedy, some courts have perceived another crucial difference between actions for legal malpractice and actions for breach of fiduciary duty. Almost universally, plaintiffs in legal malpractice actions must satisfy the stringent “but for” standard of causation – plaintiffs must show that “but for” the negligence of the defendant lawyer, they would not have suffered damages. In breach of fiduciary duty actions, however, some courts have held that plaintiffs need not satisfy the “but for” standard.

This vital difference was explained in the landmark case of *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537 (2d Cir. 1994). Effective deterrence of breaches of fiduciary duty requires “a prophylactic rule intended to remove all incentive to breach – not simply to compensate for damages in the event of a breach,” the court said. When a law firm has allegedly breached a fiduciary duty, therefore, the plaintiff “does not have to show strict ‘but for’ causation or proximate cause.” Rather, the plaintiff claiming a breach of fiduciary duty has to show only that the defendant law firm’s breach was at least a “substantial factor” in causing harm. The defendant law firm “cannot enjoy impunity by showing that [the plaintiff’s] losses might have resulted from other possible causes.”

In *Estate of Re v. Kornstein, Veisz & Wexler*, 958 F. Supp. 907 (S.D.N.Y.1997), an opinion written by Judge Sondra Sotomayor before she was elevated to the Second Circuit, the court illustrated the difference between the “but for” and “substantial factor” standards. The plaintiff in *Estate of Re* had attacked the defendant law firm’s handling of an arbitration matter, arguing that the law firm’s judgment had been skewed by conflicts of interest that caused the law firm to pursue flawed strategies and forego better ones. The defendant law firm moved for summary judgment on all counts, explaining why each of its challenged strategies was reasonable. Invoking *Boon*, Judge Sotomayor granted summary judgment for the defendant on the legal malpractice claim because the plaintiff could not possibly satisfy the strict “but for” causation test, but the court denied summary judgment on the breach of fiduciary duty claim, ruling that the evidence was strong enough for a reasonable jury to find that the alleged conflicts of interest were a “substantial factor” in the law firm’s losing effort in the underlying matter. (The law firm appealed, but the case settled after oral argument.)

Later Second Circuit cases, however, suggest that *Boon*’s “substantial factor” test applies only in actions seeking restitution or other remedies apart from money damages. In *LNC Investments, Inc. v. First Fidelity, N.A. New Jersey*, 173 F.3d 454 (2d Cir. 1999) (a suit not against lawyers), the Second Circuit cut back sharply on the applicability of the “substantial factor” test, stating:

[T]he level of causation required in breach of fiduciary duty and breach of contract cases depends on the type of remedy sought. “Where ... the remedy sought is damages to compensate for a claimant’s loss, the usual damages causation rule for tort and contract breach cases is appropriate,” but “where ...

the remedy being sought is a restitutionary one to prevent the fiduciary's unjust enrichment as measured by his ill gotten gain, the less stringent 'substantial factor' standard may be more appropriate."

New York state court cases

New York state court case law has not been kind to mirror- image claims for legal malpractice and breach of fiduciary duty. A good example is *Weil, Gotshal & Manges, LLP v. Fashion Boutique of Short Hills, Inc.*, 10 A.D.3d 267, 780 N.Y.S.2d 593 (1st Dep't 2004). In the underlying matter, Weil, Gotshal had represented Fashion Boutique in a suit against Fendi, a competing store, and had obtained a jury verdict of \$110,000. When Fashion Boutique did not pay Weil Gotshal's legal bills, Weil Gotshal sued for \$2.7 million in unpaid fees. Fashion Boutique counterclaimed for both legal malpractice and breach of fiduciary duty, alleging that Weil Gotshal had been burdened at trial by an improper conflict of interest (because it represented Prada, which had taken over Fendi) and therefore did not adequately use the testimony of a former Fendi officer who could have supplied "critical elements" of proof on behalf of the plaintiff. The facts underlying the legal malpractice and breach of fiduciary duty claims were identical, and the only relief Fashion Boutique sought was money damages.

On a motion for summary judgment, the trial court rejected all of Fashion Boutique's criticisms of Weil, Gotshal's conduct at the trial against Fendi, brushing aside the complaints as simply "dissatisfaction with strategic choices." Nevertheless, the trial court refused to dismiss Fashion Boutique's breach of fiduciary duty claim, holding that even if the Weil, Gotshal did not have an "actual" conflict of interest, its lawyers still might not have been "sensitive ... to forces that might operate upon them subtly in a manner likely to diminish the quality of [its] work" (quoting *Estate of Re*).

On appeal, the First Department did a double reverse (so to speak), reinstating the legal malpractice claim that the trial court had dismissed but dismissing the breach of fiduciary duty claim that the trial court had sustained. Fashion Boutique's theory of liability, which was "common to both the legal malpractice and breach of fiduciary duty counterclaims," was that Weil, Gotshal had labored under a serious conflict of interest that "compromised the law firm's level of advocacy and contributed to a trial outcome less favorable than would otherwise have been achieved." Weil, Gotshal had not "conclusively controverted" the allegation in plaintiff's legal malpractice claim that "but for" the law firm's "debilitating" conflict of interest, Fashion Boutique would have obtained a more favorable result against Fendi. The legal malpractice claim therefore had to be reinstated. But as to the claim for breach of fiduciary duty, the First Department said it had "consistently held that such a claim, premised on the same facts and seeking the identical relief sought in the legal malpractice cause of action, is redundant and should be dismissed."

The First Department then went further, taking the trial court to task for holding that breach of fiduciary duty claims were governed by the less rigorous "substantial factor" standard rather than by the stringent "but for" standard that applied in legal malpractice claims. "We have never differentiated between the standard of causation requested for a claim of legal malpractice and one for breach of fiduciary duty in the context of attorney liability," the court said. "The claims are co-extensive." *Under the Fashion Boutique* approach, therefore, a client claiming a breach of fiduciary duty "must meet the 'case within a case' requirement, demonstrating that 'but for' the attorney's conduct the client would have prevailed in the underlying matter or would not have sustained any ascertainable damages."

Conclusion: Layers of an Onion

The relationship between legal malpractice claims and breach of fiduciary duty claims suggests a progression of remedies, like layers of an onion. If a lawyer negligently falls below the standard of care, the only remedy available to the client is compensatory damages. A negligent breach of the duty of care by itself does not elevate the claim to the level of a breach of fiduciary duty. If the same lawyer also negligently breaches a fiduciary duty, then additional, complementary remedies are available to the client, including restitution (for example, a refund of legal fees). And if the lawyer intentionally breaches a fiduciary duty, then both sets of complementary remedies – money damages and equitable remedies – are available to the client, possibly including punitive damages. In other words, as the law firm’s misconduct grows more severe, the remedies also grow more severe.

Thus, plaintiffs in New York courts who seek compensatory damages for a lawyer’s negligent conduct apparently cannot escape the tough “but for” test simply by adding a count for breach of fiduciary duty based on the same facts that gave rise to a legal malpractice claim. Rather, a New York plaintiff wanting to take advantage of the lenient “substantial factor” test must seek a remedy other than compensatory damages, such as restitution. For those breach of fiduciary duty plaintiffs who lose underlying contingent fee cases and therefore do not pay any legal fees, the remedy of restitution is of little help. But for breach of fiduciary duty plaintiffs who obtain bad results after paying tens or hundreds of thousands of dollars in hourly-rate fees, the remedy of restitution may have real bite.

Next month, Part II will explore cases from other jurisdictions, as well as additional cases from New York, with a special focus on decisions that have allowed parallel claims for legal malpractice and breach of fiduciary duty to go forward in the same case.

Roy Simon is the Howard Lichtenstein Distinguished Professor of Legal Ethics at Hofstra U. School of Law, and the author of SIMON’S NEW YORK CODE OF PROFESSIONAL RESPONSIBILITY ANNOTATED, published annually by Thomson West.