

## Legal Malpractice & Breach Of Fiduciary Duty (Part II)

BY ROY SIMON

Last month's article asked whether courts should permit clients to pursue parallel claims for both legal malpractice and breach of fiduciary duty if the breach of fiduciary duty claim is based on the same facts and seeks the same relief as the legal malpractice claim. The article reviewed the Second Circuit's well-known opinion in *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537 (2d Cir. 1994), which held that a plaintiff seeking damages based on a law firm's breach of fiduciary duty need not satisfy the stringent "but for" causation test that applies in legal malpractice cases, but instead need show only that the law firm's breach of fiduciary duty was a "substantial factor" in causing harm to the client. This was "a prophylactic rule intended to remove all incentive to breach," the *Boon* court said.

The article then reviewed two other New York cases, *Estate of Re v. Kornstein, Veisz & Wexler*, 958 F. Supp. 907 (S.D.N.Y.1997), and *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), that confronted parallel claims for legal malpractice and breach of fiduciary duty based on the same facts. Those two cases reached opposite results as to whether the "substantial factor" test applied to breach of fiduciary duty claims seeking money damages. The *Estate of Re* court dismissed plaintiff's legal malpractice claim because the plaintiff could not show "but for" causation, but allowed the breach of fiduciary duty claim to go forward because the defendant law firm allegedly had a conflict of interest that might have been a "substantial factor" in motivating the law firm to make decisions that harmed the client. The *Fashion Boutique* court, on the other hand, held that the "but for" test applied to the breach of fiduciary duty claim despite the alleged conflict of interest, and that a breach of fiduciary duty "premised on the same facts and seeking the identical relief sought in the legal malpractice cause of action, is redundant and should be dismissed."

Finally, last month's article promised that this month's column would explore cases from outside New York (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.

### Parallel universes

To get a better sense of the implications of the Second Circuit's decision in *Milbank Tweed v. Boon*, supra, I will start with a case that raised the same basic issues in the context of a suit against non-lawyers.

In *Resolution Trust Co. v. Gladstone*, 895 F.Supp. 356 (D. Mass. 1995), which was decided only a year after *Boon*, the RTC sued a non-lawyer named Sumner Gladstone, a former officer (President) and Director of a failed savings and loan, and other directors of the failed institution. The RTC accused Gladstone of (1) demanding a \$50,000 kickback for making a loan commitment to a New Hampshire real estate developer, (2) extending a \$6,000,000 loan from the savings and loan to another real estate developer on the condition that Gladstone would personally be permitted to buy the property back after the borrower had developed it, and (3) causing the savings and loan to lend \$1.12 million to two individuals for the

purpose of developing a residential subdivision in New Hampshire, without disclosing to the Board that Gladstone was a trustee of a company that owned adjoining land and would benefit from the loan. The RTC alleged that each of these actions constituted both negligence (*i.e.*, neglecting to tell the Board about his interests before the loans were made) and a breach of Gladstone's fiduciary duty of loyalty (*i.e.*, putting his own personal interests above the interests of the savings and loan).

Defendants moved for summary judgment on multiple grounds, including that the so-called "Business Judgment Rule" was a "complete bar" to the RTC's recovery. The Business Judgment Rule, the court agreed, "shields directors and officers from liability for corporate decisions made in good faith and after due care," and thus "allows corporate managers to do their job – take risks in search of return on investment." Phrased another way: "A director or officer of a bank shall not be held liable for an honest mistake of judgment if he acted with due care, in good faith, and in furtherance of a rational business purpose."

But the court noted that the Business Judgment Rule is not without limits: "the Rule will not protect the director or officer when the decision is the result of an 'interested' transaction." Because the RTC had offered evidence that Sumner Gladstone had engaged in "interested" transactions while a director of the savings and loan, the court found that the Business Judgment Rule was not a bar to plaintiff's recovery.

Defendants also argued that the RTC could not establish a "but for" causal nexus between the alleged misconduct and the alleged harm, but the court rejected that argument as well. Citing *Boon* for the proposition that breaches of a fiduciary relationship comprise "a special breed of cases that often loosen the normally stringent requirements of causation and damages," the court noted that "the RTC's burden of establishing causation is low and usually a question of fact left to the jury."

Have those arguments carried the day outside New York?

### **The "Show Me" state rejects twin claims**

The facts in *Klemme v. Best*, 941 S.W.2d 493 (1997), were dramatic. James and Cathy Linzie alleged that Officer Byron Klemme and six other Columbia, Missouri police officers had intentionally shot and killed their nineteen-year-old daughter. Before filing a complaint, plaintiffs' counsel showed a draft to attorney Robert Best of the law firm of Watson & Marshall, L.C. Best had been chosen by the City of Columbia (which was self-insured) to represent all seven police officers. During the pre-filing negotiations, attorney Best told plaintiffs' counsel that one of the officers named in the draft complaint had not been involved in the shooting and the plaintiffs did not name that officer as a defendant in the filed complaint. Officer Klemme also had not been involved in the shooting, and Best knew that, but Best did not inform plaintiffs' counsel about Klemme's lack of involvement, so Klemme was named in the complaint. Klemme remained a defendant for about ten months, but shortly after he retained independent counsel, the court dismissed Klemme with prejudice because the facts did not support a claim against him.

Klemme then filed suit in state court against Best and his law firm, alleging breach of the fiduciary duties of loyalty and good faith. The trial court dismissed the complaint, holding that the facts did not make out a claim either for negligence or for breach of fiduciary duty, but the Supreme Court reversed, holding that the allegations stated a cause of action for breach of fiduciary duty. The court set out the elements of

a breach of fiduciary duty claim as follows: “(1) an attorney-client relationship; (2) breach of a fiduciary obligation by the attorney; (3) proximate causation; (4) damages to the client; (5) *no other recognized tort encompasses the facts alleged.*” (Emphasis added.) The last element would rule out claims for breach of fiduciary duty that could also be defined as negligence (i.e., legal malpractice).

The Missouri Supreme Court must have agreed with the trial court that Klemme’s facts did not state a claim for negligence because the court next said: “If the alleged breach can be characterized as both a breach of the standard of care (legal malpractice based on negligence) and a breach of a fiduciary obligation ... then the sole claim is legal malpractice.” But the court also said that its precedents did not preclude a claim for breach of fiduciary duty where the alleged breach was “independent of any legal malpractice.” Here, it was independent. The court therefore reinstated the claim for breach of fiduciary duty.

### **New York courts: mixed decisions**

Three recent decisions from New York –all decided since the leading New York State case of *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), *supra*, – have reached mixed results.

In *Ciocca v. Neff*, 2005 WL 1473819 (S.D.N.Y. 2005) (Swain, J.), plaintiff was an inventor whose company (Megatrends) retained attorney Gregor Neff of Whitman, Breed, Abbott & Morgan to prosecute a patent. After Megatrends went bankrupt and discharged its debt to the Whitman firm for legal fees, plaintiff Ciocca ended up owning the patent and personally retained Neff and the Whitman firm to sell the patent to a company called TracFone. Because Megatrends had never fully paid Neff’s legal bills for the patent prosecution matter, Neff insisted that Ciocca pay a balance of \$60,000 out of the proceeds of the proposed patent sale to cover the unpaid fees and expenses.

Ciocca sold the patent to TracFone for \$850,000, but later decided that amount was too low, so he sued Neff and the Whitman firm for legal malpractice and breach of fiduciary duty. Ciocca contended that Neff had committed legal malpractice by failing to suggest that Ciocca obtain an independent valuation of the patent before the sale and by failing to disclose that the Whitman firm had agreed to represent TracFone while still representing him in the sale to TracFone. Plaintiff also alleged that Neff had breached his fiduciary duty by failing to disclose that the Whitman firm had agreed to represent TracFone while still representing plaintiff in the sale negotiations with TracFone, and by failing to advise Ciocca that the \$60,000 in unpaid legal fees incurred by Megatrend had been discharged in bankruptcy. Defendants, of course, argued that the court was required to dismiss plaintiff’s claim of breach of fiduciary duty as a matter of law because it was “duplicative” of plaintiff’s malpractice claim.

The court recognized that under New York law, “where a breach of contract or breach of fiduciary duty claim is premised on the same Facts and seeks relief identical to that sought in a legal malpractice cause of action, such claims are redundant and should be dismissed.” But here, the breach of fiduciary duty claim added a new ingredient to the legal malpractice claim. The court explained:

... Although the underlying factual assertions relating to disclosure of the alleged relationship between Defendants and TracFone are the same, the standard of proof applicable to the fiduciary duty claim is different from that pertinent to the malpractice claim. Furthermore, to the extent the

fiduciary breach claim is premised on the demand for payment of a \$60,000 debt, the relevant Facts are not entirely duplicative. Plaintiff alleges that Neff breached his fiduciary duty by requiring Ciocca to pay a debt owed to Neff by the bankrupt Megatrends. An attorney is "charged with a high degree of undivided loyalty to his client." In order to "prevail on a claim of breach of fiduciary duty, plaintiffs must demonstrate a conflict of interest which amounted merely to a 'substantial factor' in their loss ...." *Estate of Re v. Kornstein, Veisz & Wexler*, 958 F. Supp. 907, 924 (S.D.N.Y. 1997); see also *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537, 543 (2d Cir. 1994). ...

The court perceived genuine issues of material fact as to (a) whether defendants had created the impression that Megatrend's debt to Neff for fees had become Ciocca's personal obligation, and (b) whether Neff's request for payment was a "substantial factor" in Ciocca's loss "and therefore constituted a breach of fiduciary duty." The court therefore denied defendants' motion for summary judgment on the breach of fiduciary duty claim.

In the recent case of *Williams v. Sidley Austin Brown & Wood L.L.P.*, 11 Misc.3d 1064(A), 2006 WL 684599 (N.Y. County Supreme Ct., March 13, 2006) (Fried, J.), the plaintiff was not so lucky. Based in part on advice from Sidley & Austin, plaintiffs had purchased a supposed tax shelter device that the IRS disallowed, costing the taxpayers hundreds of thousands of dollars in interest and penalties. Plaintiffs sued for damages based on legal malpractice and breach of fiduciary duty. The court recognized that attorneys have a duty to deal fairly and honestly with their clients, and that a duty of "undivided loyalty ... is superimposed onto the attorney-client relationship, and creates a set of special and unique obligations including the avoidance of conflicts of interest, operating competently, safeguarding client property and honoring the clients' interests over their own." This is an "inflexible" rule of fidelity. A fiduciary may not have interests adverse to those of the client, and where a conflict of interest exists, nothing less than full and complete disclosure is required of the fiduciary." Thus, "within the context of an attorney-client relationship, plaintiffs' claims that Sidley was acting in its own self interest, and that it did not fully disclose the extent and nature of its relationship with the other defendants, are sufficient to support a cause of action for professional malpractice," and that "but for" causation could be inferred. Yet, despite the allegation that Sidley & Austin was laboring under a conflict, the court dismissed the breach of fiduciary duty claim as "redundant of the malpractice claim," citing *Fashion Boutique*.

In the still more recent case of *Amadasu v. Ngati*, 2006 WL 842456 (E.D.N.Y., March 27, 2006) (Bianco, J.), the plaintiff was also a victim of the redundancy rule. Acting pro se, plaintiff sued his former lawyer for legal malpractice and breach of fiduciary duty. Plaintiff alleged that he had hired attorney Ngati on a contingent-fee to prosecute a wrongful termination action, but that Ngati had failed to prepare pleadings, failed to appear at a deposition, extorted money from him (in the form of additional fees), failed to keep him apprised of developments in the case, verbally abused him on the telephone, and generally failed to prosecute the action.

Apparently sua sponte, the court dismissed the breach of fiduciary duty claim as duplicative of the legal malpractice claim. "New York law holds that, where a breach of contract or breach of fiduciary duty claim is premised on the same facts and seeks relief identical to that sought in a legal malpractice cause of action, such claims are redundant and should be dismissed." Here, the malpractice and breach of contract claims arose from the same facts. Thus, plaintiff's claim for breach of fiduciary duty "merge[d] into the malpractice claim" and was "redundant." The breach of fiduciary duty claim arose from the same

conduct – the defendant attorney’s alleged breach of the duties of “honest, good faith, fairness, integrity, fidelity, and reasonable care” and involved “no distinct damages.” The court therefore dismissed the claim for the breach of fiduciary duty, letting only the legal malpractice claim stand. (The court cited *Cioca v. Neff*, but not on the issue of the relationship between breach of fiduciary duty and legal malpractice.)

### **What should the rule be?**

In light of the conflicting decisions discussed this month and last, we are left with the same question we asked in the beginning: Should courts permit clients to pursue parallel claims for damages for both legal malpractice and breach of fiduciary duty based on the same facts?

The Gladstone decision suggests two important principles of analysis. First, when a lawyer’s bad decisions are accompanied by a breach of the fiduciary duty of loyalty – when the defendant lawyer has made unwise decisions while burdened with an alleged conflict of interest – the defendant should lose the right to take advantage of the affirmative defense of reasonable judgment. Second, even when claims for breach of fiduciary duty and negligence are based on the same facts, the breach of fiduciary duty claim should be easier to prove because breach of fiduciary duty cases are “a special breed of cases” that do not demand the usual high standards of proof of causation required for malpractice claims.

Lawyers also can ordinarily seek protection from a form of the Business Judgment Rule. An attorney is not the guarantor of a client’s success and is not liable for legal malpractice simply because he does not achieve the client’s objectives. “[A]n attorney is not negligent merely for advocating a different view of the law than that eventually adopted.” RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE §18.7, at 972 (2005). Thus, an attorney is not ordinarily liable for legal malpractice if the attorney made reasonable judgment calls. But courts should not allow an attorney to invoke the “judgment call” defense if the attorney made decisions while his judgment was distorted or impaired by a conflict of interest. When that happens, the premise of the judgment-call defense is gone. If the attorney arguably favored his own interests over the client’s interests, then the attorney should have to show not merely that the decision was “reasonable” but also that the decision was better for the client, in light of all the facts and circumstances, than alternative decisions.

Moreover, because the effects of conflicts of interest are so difficult to detect, a plaintiff who can demonstrate that an attorney had an undisclosed conflict of interest should not have to meet the high “but for” malpractice standard for showing harm. Rather, as the courts recognized in *Milbank Tweed v. Boon*, a plaintiff should be able to recover on a claim for breach of the fiduciary duty of loyalty merely by showing that the conflict was a “substantial factor” in causing harm to the client. And as *Estate of Re v. Kornstein, Veisz & Wexler* and *Cioca v. Neff* showed, this principle should apply even if a legal malpractice claim is based on the same facts as the breach of fiduciary duty claim, and even if the plaintiff seeks only money damages. A lawyer should not be forced to pay damages every time the lawyer fails (negligently or intentionally) to disclose a conflict of interest, but if a lawyer burdened by a conflict makes decisions that harm the client, the burden should shift to the lawyer to show that the conflict was not a substantial factor in reaching those decisions.

## Conclusion

Putting all of this together, I come down on the side of the decisions in *Ciocca v. Neff*, *Estate of Re v. Kornstein, Veisz & Wexler*, 958 F. Supp. 907 (S.D.N.Y.1997), and *Resolution Trust Co. v. Gladstone*. I think those decisions are right, and I think the First Department's decision in *Weil, Gotshal & Manges, LLP v. Fashion Boutique of Short Hills, Inc.* is wrong.

In my view, every undisclosed conflict of interest is a breach of the fiduciary duty of loyalty. If a lawyer is laboring under an undisclosed conflict of interest, therefore, two consequences should result. First, the lawyer should forfeit the right to plead the "reasonable judgment" defense. The lawyer should not be permitted to argue that unwise decisions were mere "judgment calls." If the lawyer's professional judgment was skewed by conflicting interests, then the lawyer should have to prove not only that the decisions were reasonable but also that the lawyer would have made the same decisions if there had been no conflict. Second, the plaintiff should not be saddled with the stringent "but for" burden of proof, but should instead have to prove only that the conflict was a "substantial factor" in causing the plaintiff's damages. As the Second Circuit said in *Milbank, Tweed v. Boon*, an attorney's "unique position of trust and confidence" provides a "compelling reason to apply a prophylactic rule to remove the incentive to breach" when the plaintiff alleges a breach of the fiduciary duty of loyalty.

When the only breach of fiduciary duty alleged is nothing more than a breach of the fiduciary duty of competence and no conflict of interest is alleged, then I agree that the breach of fiduciary duty claim is redundant and should be dismissed. But when the plaintiff alleges that the attorney's independent professional judgment was distorted by a conflict of interest, courts should permit the legal malpractice and breach of fiduciary duty claims to go forward together, lowering the plaintiff's burden on the fiduciary duty claim to proving that the conflict was a substantial factor in the attorney's harmful decisions. That approach will best serve the goal of deterring breaches of fiduciary duty in the first place and providing harmed clients an easier path to obtaining a remedy when those breaches do occur.

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