

The “But For” Standard In Transactional Malpractice

BY ROY SIMON

Transactional lawyers across the country recently had a close shave. The close shave came in a California legal malpractice suit against Williams & Connolly and its partner Charles Sweet. The suit, called *Viner v. Sweet*, arose out of a complex transaction (stock purchases, non-compete clauses, security, employment termination, etc.). At trial, the court refused to instruct the jury that the plaintiffs (the Viners) had to prove “but for” causation – i.e., to prove that they would have obtained a better deal in the transaction but for Sweet’s negligence. The jury awarded the Viners \$13 million in damages. The Court of Appeal (California’s intermediate appellate court) affirmed the judgment, holding as “a pure issue of law” that “the trial court did not err in failing to require the Viners to prove they could have obtained a ‘better deal’ on the terms in question.” *Viner v. Sweet*, 112 Cal.Rptr.2d 426 (Cal. App. 2d Dist. 2001).

This holding – that plaintiffs in transactional legal malpractice cases were not required to prove “but for” causation – set off alarm bells in California and nationwide. The ABA’s 29th National Conference on Professional Responsibility in May devoted an entire program session to the decision, and when defendants appealed to the California Supreme Court, amicus briefs in support of the defendant law firm were filed by several professional liability insurance companies; by the Bar Associations of San Francisco, Beverly Hills, Los Angeles County, and Orange County; by two associations of California defense counsel; and by a bevy of California’s leading law firms, including Morrison & Foerster; Gibson, Dunn & Crutcher; Crosby Heafey Roach & May; Heller Ehrman White & McAuliffe; Thelen Reid & Priest; O’Melveny & Myers; the Venture Law Group, and Wilson Sonsini Goodrich & Rosati. (One law firm and the anti-lawyer organization HALT filed amicus briefs on behalf of the Viners.)

How did the Court of Appeal reach the surprising result that the venerable “but for” test did not apply in transactional legal malpractice cases – and how did the California Supreme Court respond? More important, what does *Viner v. Sweet* mean for transactional lawyers in New York State? This article addresses those questions.

The facts in *Viner v. Sweet*

In 1984, Michael and Deborah Viner founded an innovative company called Dove Audio, Inc. Dove was one of the first companies to issue audio books read by their authors or celebrities. Dove was also involved in television and movie projects and print books. In 1994, Dove went public, and in 1995 the company entered into long-term employment contracts with the Viners, guaranteeing them large salaries, bonuses, fringe benefits, and indemnification, and giving the Viners a large amount of Dove’s common and preferred stock. But by 1997 Dove was in serious financial trouble. In March 1997, a company called Media Equities International (“MEI”) agreed to give Dove a cash infusion by buying \$4 million worth of Dove stock while the Viners simultaneously bought \$2 million of Dove stock. MEI also apparently took an active hand in managing the company.

Within two months, however, “significant differences” had developed between MEI and the Viners. The parties threatened each other with litigation, but essentially settled the litigation before it was filed by entering into a transaction in which the Viners signed an Employment Termination Agreement (“ETA”) and related documents. The Viners were represented in the negotiations and in the transaction by Charles Sweet, a partner in the Washington, D.C. law firm of Williams & Connolly. Under the ETA, the Viners sold much of their stock to MEI and were to be paid over time to cancel their employment contracts. Disputes arising under the ETA were to be resolved via arbitration, and the Viners, who were apparently quite litigious, went to arbitration under the ETA six times during the next year.

Eventually, the Viners concluded that Charles Sweet had been negligent in negotiating the terms of the ETA, and they sued Williams & Connolly and Sweet for legal malpractice regarding numerous items in the ETA. For example:

1. *The Non-Solicitation Clause.* The ETA contained a non-solicitation clause providing, essentially, that for four years after the ETA was signed the Viners could not contract with, hire, or solicit any author or reader in Dove’s catalog – though after two years the Viners were to be free to contract with any such author or reader “for books only.” Before the Viners signed the ETA, Michael Viner asked whether the non-solicitation clause might forbid the Viners from soliciting their old contacts to work on television and feature film projects. Sweet told Viner not to worry because the clause was limited to the book and audio book businesses. But the language was ambiguous and Dove asserted that the clause prohibited the Viners from soliciting Dove authors or readers for television or movie projects even after the initial two year period. The Viners alleged that the ambiguous language in the clause allowed Dove to prevent them from doing projects with Larry King, Carl Reiner, Andy Rooney, and Stephen King, and Frederick Forsythe, causing them millions of dollars in lost profits.

2. *Non-Competition Clause.* The ETA prohibited the Viners from competing in the audio book business for five years. The Viners contended that Williams & Connolly was negligent in permitting the non-competition clause to be included in the ETA because it was arguably unenforceable under California law. Although an arbitrator held that the non-competition clause was enforceable, the Viners presented expert testimony at the legal malpractice trial that Sweet (who was not licensed in California) was negligent because he did not know California law. Absent the non-competition clause, the Viners contended, they could have published 72 audio books that would have earned them profits of nearly \$1,250,000.

3. *Attorney Fees.* Since disputes under the ETA were to be resolved by arbitration, the Viners asked Williams & Connolly to include a provision in the ETA awarding attorney fees to them if they prevailed in an arbitration hearing. But the ETA awarded attorney fees only if a party prevailed in enforcing an arbitration victory. The Viners claimed damages in the amount of \$462,284, representing the fees that they incurred in the two arbitrations that they won. (Curiously, the jury did not subtract the legal fees that Dove had incurred in the four arbitrations the Viners lost.)

After a four week trial on the legal malpractice claims, a divided jury returned a special verdict in favor of the Viners, awarding damages for every alleged instance of malpractice. The total damages exceeded \$13 million. Williams & Connolly appealed, arguing that the trial court should have instructed the jury that it could not find for the Viners unless they proved that they would have obtained a better deal but for Sweet’s negligence. The Court of Appeal reduced the damages by \$5 million but held that the “but

for” test did not apply in transactional malpractice cases and affirmed an award of \$8 million in damages against Williams & Connolly and Sweet. How did that happen?

The Court of Appeal’s Reasoning

On the appeal, Williams & Connolly argued that a plaintiff can prevail in a transactional legal malpractice case only by proving that, in the absence of negligence, one of two things would have occurred — either (1) the client would have obtained a different agreement that was more advantageous (the “better deal” scenario), or (2) the client would not have entered into the transaction at all and thereby would have been better off (the “no deal” scenario). Unless the plaintiff can prove either that it would have obtained a better deal or that it would have walked away from the deal if the attorney had not been negligent, Williams & Connolly argued, the plaintiff cannot prove proximate cause – it cannot show that the attorney’s negligence caused the plaintiff to suffer damage. Thus, allowing a plaintiff to obtain through a legal malpractice claim what the plaintiff could not have obtained at the bargaining table would award the plaintiff an undeserved windfall.

Because it was undisputed that the Viners had not attempted to prove that Dove would have agreed to a better deal regarding any of the five contract terms at issue in the case, Williams & Connolly said that reversal of the trial court’s judgment was required. The Viners, however, contended that they were not required to prove that they could have obtained a better deal (or would have walked away from the deal) absent Williams & Connolly’s negligence. The Court of Appeal agreed with the Viners and held that they had adequately established causation at trial. The Viners did not have to prove “but for” causation to win. See *Viner v. Sweet*, 112 Cal.Rptr.2d 426 (Cal. App. 2d Dist. 2001).

The Court of Appeal reasoned that while the case-within-a-case method of determining causation is appropriate in a litigation malpractice action, it is not appropriate for a transactional legal malpractice action because it would essentially require the plaintiff to prove not only that the other party to the deal breached a contract term, but also that “someone else would have agreed to and properly performed that term” Relying heavily on a law review article, a Pennsylvania Superior Court case, and a recent California Court of Appeal case reviewing an insurance company’s legal malpractice action against a law firm it had hired to represent its insured in a car accident case, the Court of Appeal in *Viner v. Sweet* said:

[T]ransactional malpractice cases call for a “less structured approach to proof of causation and damages.” The case within a case approach has limited utility in such cases. While the case within a case method is an efficient and well-established way of determining damages where an attorney has been negligent in the conduct of litigation, it should be limited to that context. In litigation malpractice, the parties and the court are faced with a zero-sum game: either the plaintiff would have won the underlying litigation but for the attorney’s malpractice (or would at least have suffered a smaller loss), or he would have lost at trial anyway. It is therefore a relatively simple matter (conceptually if not practically) to go back and re-construct the underlying litigation absent the attorney’s negligence, in order to see if the result was indeed caused by such negligence. The very jury hearing the malpractice case can hear the evidence the plaintiff would have used in the underlying litigation and objectively decide whether the plaintiff’s case would have been successful.

A business deal, by contrast, is not a zero-sum game with a clear winner and a clear loser. The terms of the contract are interdependent, with much give-and-take and trading between the parties. If one party gives on one contract term the other party may well give on another. Thus, it is difficult if not impossible to conclude a party could not have obtained a "better deal" from the other party as to any given contract term or terms. Moreover, while parties to litigation are generally committed to the process until the case is either settled or comes to judgment, each party to a business transaction generally remains free to walk away at any time and often can seek a better deal elsewhere if not satisfied with the terms the other side is offering.

Accordingly, the Court of Appeal said the case within a case method of reconstructing an auto accident or some other historical event in a litigation context was "a rather straightforward enterprise," relying on objective evidence of what witnesses saw or heard or said at the time. On the other hand, determining whether a party would have been willing to give a better deal on a given contract term or terms during a past negotiation is "a highly speculative venture." This was especially true because (as here) the defendant law firm's evidence will typically not consist of testimony that during the negotiations the client (now the legal malpractice plaintiff) asked the opposing party for the disputed contract terms and was turned down. Rather the defendant law firm will present "subjective testimony about hypothetical scenarios," relying mainly on the lawyers and principals who negotiated for the other side during the contract negotiations— "the very party the plaintiff typically will have been forced to litigate against and antagonize because of the disputes generated by its own lawyer's malpractice in drafting or negotiating the contract." Elaborating on the problem of hypothetical and speculative proof, the Court of Appeal further reasoned:

If the "case within a case" approach were applied in this case, the parties and eventually the jury would be required to struggle with hypothetical scenarios along the following lines: Ignoring what has happened since the negotiations, would the party on the other side of the negotiating table from plaintiff now admit it would have agreed on that earlier occasion to a more favorable version of contract term X than it did? If not, would it have done so if plaintiff had adopted a position more favorable to the other party on term Y? If so, would plaintiff actually have offered a more favorable term Y, or is it only saying now it would because it knows the adverse possibility that the particular term protected against never happened? And if the opposing party was unwilling to give plaintiff everything it wanted on contract term X, would that party nonetheless been willing to give the plaintiff some or most of what it sought?... The litany could continue, but the point is made.

Later in the opinion, the Court of Appeal spun out the jury's predicament in even greater detail, emphasizing the difference between transactions and litigation matters:

[B]usiness transactions generally involve a much larger universe of variables than litigation matters. In a contract negotiation, the number of possible terms and outcomes is often virtually unlimited. Even if the party on the other side of the table will not agree initially to a particular term, creative transactional attorneys can often gain agreement to the disputed term by sweetening the offer on other terms. Or they can achieve the same result through offsetting concessions on other issues. The jury would have to evaluate a nearly infinite array of "what-ifs," to say nothing of the many "if that, then whats," in order to determine whether the plaintiff

would have ended up with a better outcome “but for” the malpractice. Each of these possible combinations of contract terms, in turn, could have led to different results ...

Returning to the severe proof problems that transactional malpractice plaintiffs would face using the case within a case method, the Court of Appeal said:

[T]rying to determine what the other side of the negotiations would have been willing to accept at the time of the negotiations consigns the parties and the court to a contest built on speculation and conjecture. Both sides to the negotiation, now in all probability bitter adversaries, would have to testify about what they would have done if presented with a vast array of hypothetical situations involving different combinations of terms and potential terms and conceivable terms....

The problem of proving what would have happened, using arch enemies as witnesses, would be compounded by the dynamic, future-oriented nature of transactions (in contrast to the fixed nature of events like auto accidents and litigation mistakes that occurred in the past). During a trial on the transactional malpractice case, the plaintiff and the witnesses from the other side of the transaction would, theoretically, be expected to “ignore everything that had happened in the real world since they signed the contract, events which inevitably would have rendered some hard fought terms completely irrelevant and others of supreme importance.” Accordingly, the Court of Appeal said that requiring plaintiffs to prove that they would have “prevailed” in the negotiations, on the precise terms at issue in the malpractice action, “would confound instead of contributing to the causation analysis.”

In sum, the Court of Appeal provided three justifications for rejecting the “but for” test in transactional legal malpractice cases: (1) litigation is a “zero sum” game, whereas transactions are not, so a plaintiff in a transactional malpractice case will have trouble proving that the opposing party in the transaction would have agreed to any given term if the plaintiff’s attorney had not been negligent; (2) business transactions are so complex that the “but for” test would require juries to evaluate a nearly infinite array of “what-ifs” at every stage of the transaction; and (3) the proof that the plaintiff could have gotten a better deal absent the attorney’s negligence would have to come from the opposing party in the transaction, which is unrealistic.

Based on these arguments, the Court of Appeal affirmed the judgment below in favor of the Viners. The Court of Appeal did knock out some \$5 million of damages for lack of appropriate evidence, but the Court unequivocally held that the plaintiff in a legal malpractice case arising out of a transaction did not have to prove that it would have gotten a better deal absent the attorney’s negligence.

The California Supreme Court Reverses

In its brief to the California Supreme Court, Williams & Connolly began with these powerful paragraphs:

Attorneys are not guarantors of their clients’ dreams. Even the finest efforts by a lawyer may leave clients with less than they desire: a trial with an unfavorable verdict, or a business deal with terms that an intractable adversary would not agree to improve. Making clients whole after an attorney errs, therefore, requires a realistic assessment of what would have been obtained in the absence of error.... [M]alpractice actions are not a way for clients to recover wishes and

desires that would not have been realized in the absence of negligence by the attorney--or even by a perfect attorney.

Yet the Court of Appeal, in the first ruling of its kind anywhere in the country, has turned transactional malpractice cases into precisely that. It ruled, as a "pure issue of law," that a client claiming his lawyer was negligent in failing to obtain certain terms or benefits in an agreement may recover the value of those missing terms or benefits without proving that, in the absence of negligence, that lawyer (or any lawyer) could have obtained them. The longstanding requirement of proof that the client would have achieved a better outcome absent negligence, the Court of Appeal held, applies only to litigation malpractice cases, not to cases alleging negligence in connection with a transaction.

Fortunately for transactional lawyers (though perhaps unfortunately for their clients), the California Supreme Court agreed with Williams & Connolly and reversed the Court of Appeal's holding. *Viner v. Sweet*, 30 Cal.4th 1232, 70 P.3d 1046 (June 23, 2003).

The California Supreme Court began with the basic premise that a client suing an attorney for legal malpractice must prove that "the attorney's negligent acts or omissions caused the client to suffer some financial harm or loss." The court then asked and answered the following crucial question:

When the alleged malpractice occurred in the performance of transactional work (giving advice or preparing documents for a business transaction), must the client prove this causation element according to the "but for" test, meaning that the harm or loss would not have occurred without the attorney's malpractice? The answer is yes.

The purpose of the "but for" requirement, the Supreme Court said, is to "safeguard against speculative and conjectural claims." It serves the "essential purpose" of ensuring that "damages awarded for the attorney's malpractice actually have been caused by the malpractice." Based on this premise, the Supreme Court systematically rejected every rationale the Court of Appeal had advanced for relaxing the "but for" test of causation in transactional legal malpractice cases.

First, the Supreme Court did not agree with the Court of Appeal that litigation was necessarily a "zero sum" game. "In litigation, as in transactional work," the Supreme Court said, "a gain for one side does not necessarily result in a loss for the other side." Litigation may involve multiple claims and issues arising from complaints and cross-complaints, and the parties in such litigation may prevail on some issues and not others. In the end, litigation may have "no clear winner or loser" and "no exact correlation between one side's gains and the other side's losses." Moreover, representing clients "often combines litigation and transactional work," as when an attorney negotiates a settlement of pending litigation. Under well established California precedent, the "but for" test of causation applies when a client claims that the lawyer committed legal malpractice in reaching the settlement, even though the settlement agreement is itself a form of business transaction. It would be anomalous to apply the "but for" test to a complex settlement agreement but not to apply that test to a business agreement.

Second, the California Supreme Court disagreed that litigation is inherently or necessarily less complex than transactional work. Some litigation, such as a run-of-the-mill lawsuit involving a car accident, is relatively uncomplicated, "but so too is much transactional work, such as the negotiation of a simple

lease or a purchase and sale agreement.” At the same time, some litigation, such as a beneficiary’s action against a trustee challenging the trustee’s management of trust property over a period of decades, “is as complex as most transactional work.” Of course, the Court of Appeal was correct that litigation generally involves an examination of past events whereas transactional work involves anticipating and guiding the course of future events. But the Supreme Court said this distinction makes little difference for purposes of selecting an appropriate test of causation because determining causation “always requires evaluation of hypothetical situations concerning what might have happened, but did not.” In both litigation and transactional malpractice cases, the crucial causation inquiry is “what would have happened if the defendant attorney had not been negligent.” (Emphasis by the court.) The very idea of causation “necessarily involves comparing historical events to a hypothetical alternative.”

Finally, the Supreme Court rejected the argument that the “but for” test of causation should not apply to transactional malpractice cases because it is “too difficult to obtain the evidence needed to satisfy this standard of proof” – especially since the plaintiffs could satisfy the “but for” test only if the other parties to the transaction (who have since become their adversaries) testified that they would have given the plaintiffs more favorable terms if the plaintiffs’ attorneys had not performed negligently in the underlying transaction. “Not so,” said the Supreme Court. “In transactional malpractice cases, as in other cases, the plaintiff may use circumstantial evidence to satisfy his or her burden. An express concession by the other parties to the negotiation that they would have accepted other or additional terms is not necessary.” In any event, the Supreme Court said, “difficulties of proof cannot justify imposing liability for injuries that the attorney could not have prevented by performing according to the required standard of care.”

For all of these reasons, the California Supreme Court held that the familiar “but for” test applies not only in cases alleging litigation malpractice but also in cases alleging transactional malpractice.

Implications for New York lawyers

California lawyers may now be able to breathe easy, but New York lawyers should not exhale yet because the New York Court of Appeals has not decided a case directly asking whether the “but for” test of causation should apply in transactional legal malpractice cases. In fact, although Williams & Connolly’s brief in the California Supreme Court in support of the “but for” test cited more than a dozen cases from outside California, the brief cited only two cases from New York – the famous Court of Appeals decision in *Palsgraf v. Long Island R. Co.* 248 N.Y. 339 (1928), which is much too general to settle the issue, and an obscure half-page Appellate Division decision, *Rubenstein & Rubenstein v. Papadakos*, 295 N.Y.S.2d 876 (1st Dep’t 1968), which held that though a lawyer’s failure to disclose a settlement offer to a client in litigation is “improper,” that failure “does not in and of itself give a right to affirmative relief” because the client “must show damage from the omission which would result only in the event that the offer would have been accepted.”

In *Rubenstein*, the client “unequivocally conceded that the offer would have been rejected.” Because the *Rubenstein* case is old, short, cryptic, and arose out of litigation, it would not dispose of the “but for” question in transactional legal malpractice cases in New York even if it had been decided by the Court of Appeals instead of by the First Department.

Nor was the issue decided in *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537 (2d Cir. 1994), a case arising out of a complex transaction. The Second Circuit held that a plaintiff who alleges that a law firm breached its fiduciary duty to the plaintiff need not satisfy the “but for” test, but must show only that the law firm’s breach of fiduciary duty was a “substantial factor” in preventing the plaintiff from achieving her objectives in the underlying transaction. The Boon case was a pure breach of fiduciary duty case – the plaintiff did not allege that Milbank Tweed acted negligently in any respect – so it did not decide the issue posed in *Viner v. Sweet*.

New York lawyers must therefore view the “but for” question in transactional legal malpractice cases as undecided. In my own view, New York state and federal courts will ultimately agree with the California Supreme Court that the “but for” test does apply in legal malpractice cases arising out of transactions. But until then, plaintiffs in transactional legal malpractice cases – and in analogous cases alleging negligence in reaching settlement agreements in litigation – will make the same arguments in New York that the Viners rode to their short-lived multi-million dollar victories in the trial court and in the intermediate Court of Appeal in California.

Moreover, because New York firms serve clients in many jurisdictions around the country, clients from other jurisdictions may try to convince courts in their home jurisdictions that the “but for” test does not apply in transactional legal malpractice cases.

Accordingly, New York lawyers will need to study the arguments on both sides in *Viner v. Sweet* and make sure they are prepared to explain to courts in New York and across the country why the “but for” test of causation is just as necessary and appropriate in transactional legal malpractice cases as it is in litigation legal malpractice cases. And in the meantime, when you are negotiating a transaction for a client, take the advice your mother gave you every time you took the car when you were a teenager: Be careful!

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