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Professional Malpractice

Where Were the Lawyers?

Aiding and abetting a client's breach of fiduciary duty

By Bennett J. Wasserman

There is a new legal malpractice cause of action tapping at New Jersey's door. It is not the garden variety legal malpractice claim brought by a client against his lawyer, but rather a claim brought by a plaintiff who is not the lawyer's client. That, of course, evokes the frightening scenario of unlimited types of claims by unlimited groups of potential plaintiffs. This relatively new arrival on the legal malpractice scene in New Jersey is called "aiding and abetting breach of fiduciary duty."

At the time the federal Sarbanes-Oxley Act — which implemented lawyer conduct rules to prevent disasters similar to Enron — was being debated, then Senator Jon Corzine (D-N.J.), former head of Goldman Sachs, said:

…in our corporate world today — and I can verify this by my own experience — [corporate] executives and accountants work day to day with lawyers. They give them advice on almost each and every transaction. That means when executives and accountants have been engaged in wrongdoing, there have been some other folks at the scene of the crime — and generally they are lawyers. 148 Cong. Rec., S. 6556 (daily ed., July 10, 2002).

Of course, Senator Corzine was using the word "crime" colloquially. But soon after, that very same question — "Where were the lawyers?"— was being asked in a variety of litigated cases on the state court level in factual settings that did not involve publicly traded corporations, such as Enron. Evidently, the question had been raised with sufficient frequency that two major legal malpractice conferences in 2006, attended by nearly a thousand professional liability lawyers, billed "aiding and abetting breach of fiduciary duty" as a major new "hot topic" in the field.

In *Tarr v. Ciasulli*, 181 N.J. 70 (2004), a case involving aiding and abetting under the Law Against Discrimination, the Supreme Court adopted § 876(b) of the *Restatement (Second) of Torts*' formulation of the tort that is designed to address civil conspiracies or aiding and abetting a breach of fiduciary duty. Essentially, the *Restatement* provides that a person (e.g., a lawyer) is liable for harm resulting to a third person (such as one who is not the lawyer's client) from the conduct of another (e.g., the lawyer's client/fiduciary) when he "knows that the other's [i.e., the client/fiduciary's] conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself…" It has been this specific section of the *Restatement of Torts* that has been recognized as the standard for aiding and abetting liability in civil actions. *Judson v. People's Bank and Trust Co*., 25 N.J. 17 (1957). Although not addressed by the *Tarr* Court, it would appear that when applied to the legal malpractice context, there are at least two other necessary elements: An attorney-client relationship between the lawyer and fiduciary and a fiduciary relationship between the lawyer's client and the plaintiff, who is not the lawyer's client.

In *N.J. Dep't of Treasury v. Qwest Communications, Inc.,* 387 N.J. Super. 469 (App. Div. 2006), the court addressed a claim for aiding and abetting brought against accountants. Notwithstanding the shield from third-party liability suits, which, unlike lawyers, accountants enjoy from the Accountant Liability Act, N.J.S.A. 2A:53A-25, the court specifically rejected the defendant accountant's, Andersen's, contention that aiding and abetting is not a recognized cause of action in New Jersey and found that it is, indeed, a "cognizable cause of action under New Jersey law." It must be, if it survived that potent statutory

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In a well written and scholarly, but unpublished, opinion in *Bondi v. Citigroup, Inc*., 2005 WL 975856 (N.J. Super. 2005), Judge Jonathan Harris in Bergen County wrote:

> Fiduciaries appear in a variety of forms and in a variety of contexts. Managers, officers, agents, partners, receivers, trustees and executors are entrusted in one way or another with the conduct of the affairs or the protection of the rights of another. In many instances, those rights are purely economic and a breach of the fiduciary's duty normally generates only economic loss... A third party who knowingly aids and abets the agent of another in breach of fiduciary duty is liable to the principal. *Jaclyn, Inc. v. Edison Bros. Stores, Inc*., 170 N.J. Super. 334 (Law Div. 1979).

The court concluded that the plaintiff presented "viable claims for relief under a theory of aiding and abetting breaches of fiduciary duties," and further noted "this state's expansive adherence to aiding and abetting liability in other tort contexts...."

Attorneys have always represented fiduciaries, and they probably constitute one of the largest client groups. For example, what lawyer has not represented an individual or institutional executor, trustee, guardian or others who fulfill similar fiduciary functions? Each of those fiduciaries has clients, beneficiaries or wards of some sort to whom he owes a duty of trust, candor, loyalty and honesty for one specific purpose: to protect their particular rights and interests. Where one has such duties, a fiduciary relationship arises.

Surely, lawyers have fiduciary duties to clients. But when it comes to a lawyer's basic duty of competently and diligently representing the client, who himself is a fiduciary or stands in a fiduciary relationship with others, that necessarily requires that the lawyer represent the client/fiduciary in such a way as to benefit the fiduciary's beneficiary first and foremost. That is because the client/fiduciary, by definition, must put his beneficiary's interests above his own. Thus, the lawyer's objective in representing the client/fiduciary necessarily requires that the lawyer's duties be discharged for the benefit of the fiduciary's beneficiary.

In such a context, it is acknowledged that the lawyer and the plaintiff are not in a direct attorney-client relationship. But with this new cause of action being asserted against a lawyer, the classic defense where a nonclient plaintiff sues a lawyer — "no privity" or no reliance on the lawyer by the third-party beneficiary — would generally not be available to the lawyer.

Although New Jersey was among the first states to eliminate the requirement of strict privity between a lawyer and plaintiff who is not technically the client, and even though New Jersey has gone further than any other state in extending a lawyer's duty to nonclients — even to an *adversary* in a transactional setting, subsequent case law would seem to require that the nonclient plaintiff must still show some sort of *reliance* on the lawyer as a necessary predicate to establish liability against the errant lawyer. But that should not be the case if the lawyer's client stands in some sort of a fiduciary relationship with the nonclient plaintiff. Here, the *Restatement of Law Governing Lawyers*, on which the Court relied heavily in *Banco Popular v. Gandi,* 184 N.J. 161 (2005), and which, over the past few years, has been recognized by our courts as the single most authoritative guide to lawyer liability is clear. Section 51 (4) specifically provides that a lawyer owes a duty to a nonclient when:

> a) the lawyer's client is a trustee, guardian, executor or fiduciary acting primarily to perform similar functions for the nonclient;
> b) the lawyer knows that appropriate action by the lawyer is necessary…to prevent or rectify the breach of fiduciary duty owed by the client to the nonclient where … (ii) the lawyer has assisted or is assisting the breach;
> c) the nonclient is not reasonably able to protect its rights; and
> d) such a duty would not significantly impair the performance of the lawyer's obligations to the client.

Subsection (c) portrays the very case where beneficiaries, who may never know that their rights have been violated by their fiduciary's breach of duty, have no place to turn to protect their rights. These are the very plaintiffs to whom the fiduciary's lawyer owes a duty of care to make certain he does not assist, i.e., "aid and abet" the breach of duty by his client/ fiduciary. While the law can create a fictitious implied reliance by these beneficiaries on the lawyer to keep his client/fiduciary honest, the better view is simply to acknowledge that these plaintiffs might never come to rely on the fiduciary's lawyer for advice or service of any kind. Thus, reliance on the lawyer is not an element of the "aiding and abetting breach of fiduciary duty" cause of action.

The fiduciary duty is actually a conglomeration of specific duties. While traditional thinking had limited the fiduciary duty to confidentiality and conflict of interest avoidance, the more contemporary view adds two additional duties: communication and competence. It is the expansion of the definition of these "core fiduciary obligations (the "4 C's")" that has caused a corresponding expansion of the definition of the fiduciary status.

In addition to the more traditional fiduciary positions such as executor, guardian or trustee, courts have found fiduciary relationships among business partners, shareholders of a close corporation and even a landlord and tenant. Where a lawyer has a client who is in a fiduciary relationship with others, he may be called upon to assume the duty

of a gatekeeper specifically to protect the beneficiaries from his errant client/fiduciary. That's the very role that former Senator Corzine was thinking about when the topic of "Where were the lawyers?" was raised.

Nonlawyer fiduciaries share the very same duties to their respective clients or beneficiaries that lawyers have to their clients. Whether we speak of the lawyer's fiduciary duties to the client or the fiduciary's duties to the beneficiary, the fundamental theme underlying both is the same: the primacy of the beneficiary's interests and the fiduciary's duty to protect those interests.

If the lawyer perceives the need to protect the rights of the beneficiary/nonclient, will that constitute a breach of the lawyer's duty to the client/fiduciary? If the lawyer compromises that duty, how will that impact on his duty to represent his client/fiduciary competently and diligently? On the other hand, if the essential objective of the lawyer's representation of the client/fiduciary is to assist that client in carrying out his duties to his beneficiaries, is it not a departure by the lawyer from that fundamental objective if he assists his client's action in frustrating that objective?

How much a lawyer must know about a client's breach of fiduciary duty invariably turns on fact-sensitive considerations. Cases in other jurisdictions suggest that even constructive knowledge of a client's breach of duty is enough, and there is no reason to believe that New Jersey's courts would not adopt a similar approach.

When a real estate venture to develop a residential community with a golf course did not proceeded as anticipated, one of the partners decided to buy out the other. *Thornwood v. Jenner & Block*, 344 Ill. App. 3d 15, 799 N.E.2d 756 (2003). The buying partner hired Jenner & Block to negotiate the buyout. At the same time, that buying partner had been negotiating with other parties to turn the partnership's venture into a PGA Tournament Players course, which would have brought far greater financial returns. Those negotiations, which took place during the pendency of the other partner's buyout, were never disclosed to the selling partner. Lawyers at Jenner & Block were also involved in the undisclosed negotiations with the PGA parties. The transactional documents included a settlement agreement and release of all claims, including claims of breach of fiduciary duty. More disturbing, however, Jenner & Block required the selling partner to execute a general release, releasing that law firm of all liability. The Jenner & Block release contained sweeping exculpatory language. The court referred to the more specific release between the partners, which mentioned the released claims for breach of fiduciary duty against the buying partner and pointed out that it was Jenner & Block who drafted the release. Because the negotiations concerning the PGA course were concealed by the buying partner, and because his lawyers were aware of that concealment and realized that it would amount to a breach of fiduciary duty to the selling partner, they would not be absolved by the release. In other words, Jenner & Block was aware that its client, the buying partner, had a fiduciary duty to the selling partner. By negotiating on his behalf for the PGA course, the firm was made aware of a potential breach of fiduciary duty of the buying partner to the selling partner.

Another interesting illustration is seen in a case currently being litigated in New Jersey. A group of mobile home owners have sued the lawyer of their landlord, the owner of a trailer park, in which their mobile homes are situated. The landlord sold the trailer park and thus the land on which the mobile homes are situated, to an adjacent property owner, who plans to replace the trailer park with an upscale town house development. The trailer park owner did not give the home owners notice of the intended sale, as was arguably required by N.J.S.A. 46:8C-11, which would have triggered the home owners' statutory right to purchase the land first. It is alleged that as between the trailer park owner and the home owners, there was a fiduciary duty stemming not only from the landlord/tenant relationship between them — the landlord/trailer park owner had separate leases with the mobile homeowners relating to the realty under their homes — but also by virtue of the statutory duty imposed on the trailer park owner to give the homeowners notice of the intended sale. Here, it would appear that one of the chief ends of the landlord's role was the duty to protect his tenants' specific statutory right to have the first opportunity to buy the property on which their homes were situated before he literally sold the land out from under them to the adjacent developer. That duty is expressly mentioned in the statute's legislative history.

And so, the Catch-22 dilemma: if the lawyer discloses the breach of duty, it will damage the client/fiduciary; if he doesn't, it will damage the beneficiary to whom the fiduciary owes the duty. The dilemma is entirely unresolved by the *Restatement's* subsection 4 (d), because it offers little guidance to the lawyer who is confronted with the difficult decision. But thankfully, New Jersey law seems to provide a beguilingly simple answer. If what the client/fiduciary wants to achieve will be a breach of the fiduciary's duty to his beneficiary, the lawyer must withdraw from continued representation of that client or proceed at the peril of liability to the nonclient. That's a choice that the lawyer must make. But if he makes the wrong choice, the law ought not penalize the innocent beneficiary by requiring him to shoulder the impossible burden of reliance on the lawyer that aids and abets the breach by his client of his fiduciary duties.

In this regard, *Davin L.L.C. v. Daham*, 329 N.J. Super 54 (App. Div. 2000), is instructive. In that case, the lawyer represented the owner of a strip mall whose mortgage was in foreclosure. His lawyer knew he would be

unable to stop the foreclosure. Notwithstanding these difficulties, the owner entered into a 10-year lease with a tenant in the mall. The lawyer represented the owner during the negotiations on the lease and an addendum, drafting an agreement that included a covenant of quiet enjoyment. The lawyer, however, never mentioned the pending foreclosure, even though he knew that it could subject the tenant to ejectment.

The *Davin* court permitted the tenant to maintain an action against the owner and against the owner's attorney, based on a breach of the lawyer's duty to act fairly and in good faith. The duties of candor and honesty, the court stated, may necessitate the disclosure of significant facts, even though that disclosure might not be in the client's best interests. The lawyer was required to advise the owner to disclose the pending foreclosure to the tenant. If the client refused, the attorney would have been under a duty to decline to continue the representation. By following his client's instructions and inserting the covenant of quiet enjoyment in the lease, in the absence of the disclosure, the lawyer aided and abetted the breach of his client's fiduciary duty to the tenant.

As this relatively new cause of action of "aiding and abetting breach of fiduciary duty" begins to take root in New Jersey, and is applied in legal malpractice cases, it will be interesting to watch whether our courts will reflexively require a showing of "reliance" by third-party beneficiaries. Or, will the courts appreciate the conceptual difference between this relatively new cause of action and the garden variety legal malpractice claims brought by nonclients. If the courts choose the latter, then a new and effective mechanism to check and discourage breaches of fiduciary duty will emerge. But if they choose the former path, then they will have effectively turned the honest "gatekeeper" that lawyers could be into the "fox that guards the chicken coop." And then, when more Enrons and other breach of fiduciary duty cases emerge, we can all sit back and continue to ask what will remain a rhetorical question, "Where were the lawyers?" ■