LEGAL MALPRACTICE AND FEE FORFEITURE DANGERS
Get a Great Result and Lose Your Fee?

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INTRODUCTION

The past year has seen a number of cases which, for the most part, tend to expand attorneys' liability. The most significant development is in the area of attorney fee forfeiture. Specifically, the Texas Supreme Court has held that an attorney who breaches his fiduciary duty to his client may be required to forfeit all or part of his fee, irrespective of whether the breach caused the client actual damages. Recent opinions also seem to expand attorneys' liability to non-clients. The courts continue to look with some disfavor, however, on the assignability of legal malpractice claims.

This paper will review the significant opinions of the past year on attorney liability with a special emphasis on fee forfeiture.


FEE FORFEITURE

Burrow v. Arce

In Burrow v. Arce, 997 S.W.2d 229 (Tex. 1999), the Texas Supreme Court held that an attorney who committed a clear and serious violation of a fiduciary duty to a client may be required to forfeit all or part of the fee regardless of whether the client suffers any actual damages. When a client seeks a fee forfeiture, the trial court must determine whether factual disputes exist that must be decided by a jury before the court can determine whether a clear and serious violation of the duty has occurred. The court must then determine whether forfeiture is appropriate, and, if so, whether all or only part of the attorneys fee should be forfeited. Thus, the jury decides the factual issues regarding the breach of a fiduciary duty, and then the court determines the amount, if any, of the fee that should be forfeited to the client.

The Burrow case arose out of explosions at a Phillips 66 chemical plant in 1989 that killed twenty-three workers and injured hundreds of others. Five attorneys filed one suit on behalf of one hundred twenty-six plaintiffs. The case settled for approximately $190 million, resulting in a contingency fee of more than $60 million. Forty-nine plaintiffs then sued their attorneys, alleging various violations of the rules governing their professional conduct. The list of alleged violations included soliciting of business through a lay intermediary; failing to communicate offers received and demands made; failing to fully investigate and assess individual claims; entering into an aggregate settlement with Phillips on all of the plaintiffs' claims without the specific plaintiffs' authority or approval; agreeing to limit their law practice by not representing others involved in the same incident; and intimidating and coercing clients into accepting the settlement. The trial court granted summary judgment on the grounds that the settlement of the claims in the Phillips suit was fair and reasonable and that the clients had suffered no actual damages as a result of any misconduct by the attorneys. The trial court reasoned that in the absence of actual damages, the clients were not entitled to a forfeiture of any of the attorneys' fees.

On appeal, the clients contended that the attorneys' serious breaches of fiduciary duty required full forfeiture of all their fees, irrespective of whether the breaches caused actual damages. Alternatively, the clients argued that a jury should determine the amount of any lesser forfeiture. The attorneys countered that the court could not order fee forfeiture absent proof that the clients sustained actual damages. Alternatively, the attorneys argued the misconduct alleged by the clients was not sufficient to order a forfeiture.

The supreme court reviewed the background of the equitable remedy of fee forfeiture found in the RESTATEMENT (SECOND) OF TRUSTS (1959) and, most importantly, Section 49 of the proposed RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (proposed final draft no. 1, 1996). That section states in part: "A lawyer engaging in a clear and serious violation of a duty to a client may be required to forfeit some or all of the lawyer's compensation for the matter." The court also reviewed previous cases involving fee forfeiture in other principal/agent situations. The court concluded that in these other situations, Texas courts of appeal, courts in other...
jurisdictions, and the supreme court itself in Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509 (Tex. 1942), have held that fee forfeiture was appropriate without regard to whether the breach of fiduciary duty resulted in damages.

The supreme court rejected the argument that there should be an automatic and complete forfeiture for every breach of fiduciary duty. The court again referred to Section 49 of the proposed Restatement, noting that section restricted the remedy to "clear and serious" violations of duty. Comment d to Section 49 explains: "A violation is clear if a reasonable lawyer, knowing the relevant facts and law reasonably accessible to the lawyer, would have known that the conduct was wrongful." The supreme court discussed several factors that a trial court should consider in determining whether a violation is clear and serious, whether forfeiture should be required, and, if so, the amount. These include the gravity and timing of the violation, its willfulness, its effect on the value of the lawyer’s work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies. In addition to the Section 49 factors, however, the supreme court added another that was to be given great weight in applying the remedy of fee forfeiture: the public interest in maintaining the integrity of the attorney-client relationship.

The court concluded that because forfeiture is an equitable remedy, it should be decided by the court and not a jury. A party is entitled to have contested fact issues decided by a jury, however. These could include such issues as whether the lawyer acted intentionally, with gross negligence, or if the conduct was merely inadvertent. Other factors such as adequacy of other remedies, the public interest in protecting the integrity of the attorney-client relationship, and the weighing of all other relevant considerations present legal policy issues. The trial judge must decide these legal policy issues.

The attorneys argued that none of the misconduct alleged by the clients justified a forfeiture of any fees. The arguments of all parties about misconduct tended to focus on an assertion of an aggregate settlement in violation of TEX. DISCIPLINARY R. PROF’L CONDUCT 1.08(f). The supreme court did not address the issue of the alleged misconduct itself, but rather remanded all issues about the alleged disciplinary rule violations as justification for fee forfeiture to the district court.

. Other Fee Forfeiture Cases

It appears that the supreme court has before it an opportunity to develop the fee forfeiture remedy adopted in Burrow. The supreme court heard argument this past fall in Lopez v. Munoz, Hockema & Reed, L.L.P., 980 S.W.2d 738 (Tex. App.—San Antonio 1998), pet. granted, 42 Tex. Sup. Ct. J. 1110 (Aug. 26, 1999). The court has not yet issued an opinion.

The Lopezes sued their attorneys for breach of contract and breach of fiduciary duty. The attorneys successfully handled a wrongful death lawsuit that resulted in a jury verdict in excess of $25 million against Westinghouse Electric Corporation. The trial court entered judgment and the attorneys began settlement negotiations with Westinghouse to avoid the risk of appeal. The parties reached a settlement for $15 million on October 11, 1991. Westinghouse filed a deposit in lieu of a cost bond, as the parties had not finalized a settlement agreement. The contingency fee contract provided that the attorneys were to receive forty percent of any recovery, increasing to forty-five percent "if the case is appealed to a higher court." At a meeting on October 21 of the clients, the attorneys, and a tax attorney, the attorneys said that their fee would be forty-five percent and that the family's recovery would be $8,250,000. The settlement agreement was signed on October 30.

In 1995, the clients filed suit against the attorneys to recover $750,000 (five percent of the $15 million) in overpayment of attorneys' fees. The clients contended that the attorneys had breached the contract by charging forty-five percent instead of forty percent, and that the action constituted a breach of fiduciary duty. The San Antonio Court of Appeals reversed a summary judgment for the attorneys, holding that the mere filing of a cash deposit in lieu of a cost bond does not mean the case was "appealed to a higher court." The court of appeals held that by charging forty-five percent instead of forty percent, the attorneys breached their employment contract. The court of appeals likewise held that the attorneys' characterization of the status of an appeal induced the clients to agree to forty-five percent. The court concluded that this was a breach of the fiduciary duty, because the attorneys knew that the case was not going to be appealed. The court of appeals found this breach to be a serious one considering the substantial fees charged. The court rendered judgment for the amount of the overcharge in favor of the clients on both the breach of contract and the breach of
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fiduciary duty claim. The court of appeals remanded the case to the trial court to consider the clients' claim for attorneys' fees incurred in bringing the action.

Justice Duncan wrote a concurring and dissenting opinion, stating that she would "follow established Texas law in this case and render judgment in favor of the Lopez family for the full forty-five percent contingent fee collected by the attorneys ($6,750,000), pre- and post-judgment interest, and costs of court. To do otherwise, in my view, constitutes yet another example of the special rules made by lawyers for lawyers, and it will further erode public confidence in the legal profession as a whole and the elected Texas judiciary in particular."

The Amarillo Court of Appeals relied upon Burrow in reversing a summary judgment in favor of the attorneys in a fee forfeiture action in Upchurch v. Albear, 5 S.W.3d 274 (Tex. App.--Amarillo 1999, no pet.). Upchurch also involved a good outcome for the clients that involved huge attorneys' fees. The attorneys represented approximately eight hundred seventy clients as plaintiffs in two underlying toxic tort cases. The cases settled for approximately $27 million. There was a rather complicated and unusual set of facts involved in this case, and also an action brought by the attorneys against the clients. No one contended that the monetary settlements were inadequate. In reversing a summary judgment for the attorneys, the court of appeals did not determine whether any conduct of the attorneys in the case constituted a breach of fiduciary duty, "clear and serious" or otherwise, and remanded the case to the trial court.

The impact of Burrow is by no means limited to personal injury cases. On January 24, 2000, a district court judge in Harris County signed a judgment awarding fee forfeiture of $3 million plus interest in the amount of $625,479. The attorneys had received a $6,45 million fee for handling a high-profile divorce that resulted in the client receiving a $56 million divorce settlement, even though the client had signed a prenuptial agreement that entitled her to only about $12 million. Final judgment, Linda Sarofim Lowe v. Robert J. Piro, et al., No. 97-62103 (295th Judicial District Court of Harris County, Tex. Jan. 24, 2000); see Angela Ward, Texas Lawyer, Nov. 15, 1999, at 16: "Arce Jeopardizes Family Lawyers’ Fee." This case should make all attorneys aware of the potential impact of Burrow, regardless of area of practice.

. Unsettled Issues

Burrow and its progeny leave several unsettled issues. Among the most significant are what conduct will be found to constitute a breach of a fiduciary duty and, in the case of multiple clients, whether the attorney can be ordered to forfeit the fee attributable only to the disgruntled client or to all clients.

None of the fee forfeiture opinions defines "fiduciary duty." Furthermore, note that Section 49 of the proposed Restatement does not use the word "fiduciary." An agent owes many fiduciary duties to the principal. These duties include the duties of care and skill, to act only as authorized and a variety of obligations that arise from the duty of loyalty. See, e.g., RESTATEMENT (SECOND) AGENCY §§ 376-398 (1958).

. Insurance

Most professional liability policies exclude coverage for overcharge, refund, or offset of legal fees. The duty to defend turns on the allegations of the petition.

. LIABILITY TO NON-CLIENTS

In First National Bank of Durant v. Trans Terra Corp., 142 F.2d 802 (5th Cir. 1998), the Fifth Circuit held that Texas law allows recovery against an attorney by a non-client under a theory of negligent misrepresentation. The case involved a negligence claim against an attorney who, in the course of representing a borrower, allegedly submitted an inaccurate title opinion to the lender. The Fifth Circuit followed the RESTATEMENT (SECOND) OF TORTS § 552 (1977), which allows a recovery against one who supplies false information for the guidance of others in their business transactions if he fails to exercise reasonable care or competence in obtaining or communicating the information. The liability is limited to a loss suffered by a person for whose benefit and guidance he intends to supply the information, or knows that the recipient intends to supply it. The loss must be caused by reliance upon the misrepresentation in a transaction that he intends the information to influence, or knows that the recipient so intends, or in a substantially similar transaction.

The Texas Supreme Court specifically adopted Section 552 of the Restatement in McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787 (Tex. 1999). The law firm in that case represented Victoria Savings Association in a lender liability claim by some borrowers against the savings and loan. The law firm and the savings and loan client executed a settlement agreement in which they allegedly
represented that the settlement agreement met the criteria to bind the Federal Savings & Loan Insurance Corporation (FSLIC) in the event the savings and loan became insolvent and was placed under the control of the FSLIC. The settlement agreement did not contain any disclaimer for reliance on the representations made by the other party, even though all parties were in litigation. The savings and loan went into supervision, was declared insolvent, and the FSLIC removed the former case to federal court where the court held the settlement agreement was not binding. The borrowers sued the law firm alleging negligent misrepresentation of the firm on the settlement agreement.

The Texas Supreme Court specifically rejected an argument that Section 552 of the Restatement should not apply to attorneys. The court noted, however, that allowing a non-client to bring a negligent misrepresentation cause of action against an attorney does not undermine the general rule that persons who are not in privity with an attorney cannot sue the attorney for legal malpractice. Furthermore, the court stated that applying Section 552 does not implicate the policy concerns behind the court's strict adherence to the privity rule in legal malpractices cases. Again, the court relied upon the proposed Restatement, i.e., RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 73 (tentative draft no. 8, 1997). The court noted that other jurisdictions have held attorneys liable under Section 552 based on issuing opinion letters and preparing different types of evaluations, including warranty deeds, title certificates, offering statements, offering memoranda, deeds of trust, and annual reports. The court, however, reaffirmed, Barcelo v. Elliott, 923 S.W.2d 575 (Tex. 1996), which holds that an attorney does not owe a duty of care that could give rise to malpractice liability to will beneficiaries because the attorney does not represent the beneficiaries.

The court further noted that the Texas Disciplinary Rules of Professional Conduct prohibit an attorney from giving an evaluation to a third party unless the attorney reasonably believes that making the evaluation is compatible with other aspects of the attorney-client relationship and that the client consents after consultation. TEX. DISCIPLINARY R. PROF'L CONDUCT 2.02. Comment 5 to that rule commands the lawyer to advise the client of the implications of an evaluation. The comment emphasizes the lawyer's responsibility to third persons and the duty to disseminate the findings after determining that no conflict exists between the client and the lawyer or the client and a third party. Thus, Rule 2.02 safeguards a lawyer from exposure to conflicting duties and ensures that the client makes the ultimate decision of whether to provide the evaluation. The court noted that the lawyer should not allow a client to make the decision about providing an evaluation without first advising the client about the potential impact such an evaluation might have on the scope of the attorney-client privilege.

The court answered the law firm's claim that adopting Section 552 would threaten lawyers with almost unlimited liability and pointed out that Section 552 limits liability to situations in which the attorney who provides the information is aware of the non-client and intends that the non-client rely on the information. In other words, a cause of action is available under Section 552 only when information is transferred by an attorney to a known party for a known purpose. A lawyer may avoid or minimize the risk of liability to a non-client by setting forth (1) limitations as to whom the representation is directed and who should rely on it, and (2) disclaimers as to the scope and accuracy of the factual investigation or assumptions forming the basis of the representation or of the representation itself. Section 552 limits liability to misrepresentation of material facts. The court points out that an attorney's statements communicating the clients' negotiating position are not statements of material fact.

Justifiable reliance is an element of the cause of action. Reliance may not be justified when the representation takes place in an adversarial context because of the attorneys' obligation to pursue the clients' interest with undivided loyalty. The court also suggests that a non-client cannot rely on an attorney's statement, such as an opinion letter, unless the attorney invites that reliance.

ASSIGNABILITY OF LEGAL MALPRACTICE CLAIMS

The Texas Supreme Court decided two cases in 1999 in which the transferability of legal malpractice cases was at issue, but did not actually reach that issue in either case.

In Douglas v. Delp, 987 S.W.2d 879 (Tex. 1999), a husband and wife brought a legal malpractice and Deceptive Trade Practices Act suit against their former attorneys. The husband filed for bankruptcy, and the bankruptcy trustee sold his claims to a representative of the attorneys' malpractice carrier. The representative then
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moved for an agreed dismissal. The motion was granted and, after trial, the trial court directed a verdict for the attorneys on the wife's claims. The court of appeals reversed and remanded the malpractice claims of both the husband and the wife and part of the wife's DTPA claims.

The attorneys complained in the supreme court that the husband lacked standing to challenge the dismissal of his legal malpractice claims, reasoning that Texas law prohibits assigning legal malpractice claims. Without addressing the validity of the assignment or of the dismissal, the supreme court agreed that the husband lacked standing to challenge the assignment or dismissal because he had relinquished to the trustee any standing to prosecute or dispose of the claims by filing bankruptcy. With respect to the wife's claims, the court concluded that most of her losses were swept into the husband's bankruptcy estate, leaving the wife without standing to pursue those claims also.

Mallios v. Baker, 43 Tex. Sup. Ct. J. 254 (Jan. 6, 2000), presents an interesting attempt to avoid the rule against assignment of legal malpractice claims. Baker hired Mallios after he was seriously injured on his motorcycle while fleeing from police officers who were attempting to stop him from driving while intoxicated on the wrong side of the road. The intoxication was allegedly the result of Mimi's Pub's selling him alcoholic beverages when he was obviously intoxicated. Mallios obtained a default judgment in excess of $1 million against a corporation which he believed to own Mimi's Pub.

Baker sought out T.J. Herron after reading a local newspaper advertisement by Herron offering to buy judgments in excess of $25,000. Herron learned that Mallios had sued the wrong company, and Baker's claim was now barred by limitations. The attorneys complained in the supreme court that the husband lacked standing to challenge the dismissal of his legal malpractice claims, reasoning that Texas law prohibits assigning legal malpractice claims. Without addressing the validity of the assignment or of the dismissal, the supreme court agreed that the husband lacked standing to challenge the assignment or dismissal because he had relinquished to the trustee any standing to prosecute or dispose of the claims by filing bankruptcy. With respect to the wife's claims, the court concluded that most of her losses were swept into the husband's bankruptcy estate, leaving the wife without standing to pursue those claims also.

The supreme court stated that the summary judgment could have been based on one of two theories: (1) that Baker assigned his claim to Herron and, therefore, was not the proper party to pursue it, or (2) that Baker, by making an invalid assignment, is precluded from pursuing the claim. The supreme court declined to decide whether the assignment contravened public policy. Instead, the court held that the summary judgment was inappropriate because Baker still retained a portion of his claim because it was only a partial assignment and, even if the assignment was invalid, it would not vitiate Baker's right to sue Mallios. The court specifically noted it was expressing no opinion on the validity of the underlying agreement.

Justice Hecht, in a concurring opinion joined by three other justices, stated that the court "dodges the only question the parties in the lower court have put to us." The concurring justices would hold the assignment invalid. The concurring opinion reviewed the court's previous opinion in Zuniga v. Groce, Locke & Hebdon, 878 S.W.2d 313 (Tex. App.--San Antonio 1994, writ ref'd), where the court voided an assignment by a defendant in a products liability suit of his claim against his own lawyers to the plaintiffs as part of a settlement of the lawsuit. Interestingly, Justice Hecht stated that Douglas v. Delp acknowledged that a debtor's legal malpractice claims become property of the bankruptcy estate upon filing of the bankruptcy and are to be pursued by the bankruptcy trustee. He, therefore, concluded that Zuniga did not bar all transfers of legal malpractice claims. He likewise noted that the court in American Centennial Insurance Co. v. Canal Insurance Co., 843 S.W.2d 480 (Tex. 1992), had held that an excess insurance carrier could be equitably subrogated to an insured's action against his attorney, as well as the primary carrier, for negligence in handling the defense of the underlying liability claim. Justice Hecht was particularly critical of the commercial marketing aspect of the Baker claim.

Justice Enoch, joined by Chief Justice Phillips, wrote a separate concurring opinion in which he stated that he did not share Justice
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Hecht's view that so-called commercial legal malpractice claim assignments are against public policy.

. MISCELLANEOUS DEVELOPMENTS


In Judwin, the law firm sued its former client and the client's insurer for unpaid fees. The client brought a counterclaim for negligence, breach of contract, warranty, and fiduciary duty, and for unauthorized disclosure of confidential fee statements which were included in the petition by the law firm. The law firm settled with the insurer, and the law firm's claims were dismissed. The client argued that under comment 15 of the Rules of Professional Conduct, any disclosure by the lawyer in an action to collect the fee should be as protective of the client's interest as possible. TEX. DISCIPLINARY R. PROF'L CONDUCT 1.05 cmt. 15. The law firm argued that under TEX. R. EVID. 503(d)(3) there was no attorney-client privilege for communication relevant to an issue of breach of duty by the lawyer to the client or by the client to the lawyer. The court of appeals held that Rule 503(d)(3) controlled and affirmed the summary judgment. Justice O'Connor wrote a lengthy dissent arguing that Rule 503(d)(3) does not allow a lawyer to unnecessarily disclose confidential information in a fee dispute with the client and that the law firm should not have attached to its petition the detailed summary of its work that unnecessarily revealed confidential information protected by the attorney-client privilege.

In its per curiam denial of the petition for review, the supreme court specifically disapproved of the court of appeals' language that Rule 503(d)(3) "conclusively disproved the duty element of Judwin's [the former client's] claim." Certainly, this case suggests a an attorney should exercise prudence in disclosing confidential information, even in a fee dispute. A lot of trouble may be avoided by not including confidential communications in a petition for a fee.

Douglas v. Delp was discussed in Section IV above in connection with the issue regarding transferability of legal malpractice claims. This opinion is also significant because it denies the wife's claim for mental anguish, which was her separate property and, therefore, not a part of the husband's bankruptcy estate. The supreme court held that when a plaintiff's mental anguish is a consequence of economic losses caused by an attorney's negligence, the plaintiff may not recover damages for that mental anguish. The court expressed no opinion on what standard might be appropriate when additional or other kinds of loss or claims or when heightened culpability are alleged. The court in Delp also affirmed a directed verdict for the law firm on the DTPA claims against the attorney because the wife identified no particular statements about the "characteristics" or "benefits," or about any "rights, remedies or obligations" conferred by the agreement. She basically testified that she did not recall anything about a compromise settlement agreement that the law firm had advised her to sign. She testified that the law firm did advise her to sign it and that she signed it based on their advice. The court held this evidence to be too vague to support a claim for DTPA liability.

. CONCLUSION

Disgruntled clients have a powerful weapon in the remedy of fee forfeiture under Burrow v. Arce for "clear and serious violations" of the lawyer's duty to the client. No court has yet identified the specific duties which may expose a lawyer to this remedy. The Preamble to the Texas Disciplinary Rules of Professional Conduct includes a disclaimer that the Rules do not undertake to define standards of civil liability of lawyers, that a violation of the Rules does not give rise to a private cause of action, and that the Rules do not create any presumption that a legal duty to a client has been breached. Despite this language, it appears that the courts have assumed without discussion that violating the Rules can form the basis for fee forfeiture. While purporting to retain the doctrine of privity, the court has expanded attorneys' liability to non-clients, and a lawyer should carefully consider the potential exposure when preparing an opinion that the lawyer knows will be relied upon by others. Finally, while declining to approve the assignment of legal malpractice claims in two instances over the past year, the court's failure to rule that the claims were not assignable may portend less of a reluctance by the court to void the assignment of legal malpractice claims in the future.