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# Summary of Recent Developments in Texas Legal Malpractice Law Symposium: Legal Malpractice and Professional Responsibility.

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## SUMMARY OF RECENT DEVELOPMENTS IN TEXAS LEGAL MALPRACTICE LAW*

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## I. INTRODUCTION

An article published in the *St. Mary's Law Journal* several years ago predicted that the number of legal malpractice cases brought in Texas would dramatically increase in the following years.[1] While this has not been the case, the nature of the claims that have been brought has changed dramatically and the potential for attorney liability has increased as a result. The new equitable remedy of fee forfeiture, as well as causes of action that are now available to non-clients, have led to an increased potential for damages and a corresponding trend of high dollar settlements. These changes may significantly impact the ability of lawyers in Texas to simultaneously avoid liability while also zealously representing their clients and preserving client confidences.

This Article discusses these recent developments, emphasizing those areas in which the most significant changes in the nature of liability has changed in recent years. Section II discusses the liability of attorneys to their clients based on privity. Section III examines the emerging areas of liability that may extend beyond the attorney-client relationship, especially with respect to claims of negligent misrepresentation, fraud, and conspiracy. Section IV discusses other areas of liability, both to private claimants and in administrative and disciplinary proceedings. Sections V and VI review recent case law regarding the assignability of legal malpractice claims and the statute of limitations. Finally, section VII mentions additional recent cases of note in the area of attorney liability.

1. Gary N. Schumann & Scott B. Herlihy, *The Impending Wave of Legal Malpractice Litigation—Predictions, Analysis, and Proposals for Change*, 30 ST. MARY'S L.J. 143, 146 (1998).

## II. LIABILITY TO CLIENTS

Texas law generally limits malpractice suits to claims by clients against their attorneys.[2] In contrast, non-clients may not sue attorneys because they are not in contractual privity[3] with the attorney, and thus the attorney owes them no duty.[4] Interestingly, this privity requirement is somewhat unique to Texas law, as many other states no longer consider privity to be an essential component of malpractice liability.[5] Texas non-clients, however, have been increasingly successful in bringing creatively pled causes of action against attorneys, typically by alleging fraud, conspiracy, and negligent misrepresentation, none of which necessitates a showing of privity.

The success of these new causes of action, that do not require privity, raises the question: is privity obsolete? Recent case law indicates a strong belief on the part of Texas judges that privity remains a central element of malpractice liability. This section discusses the basic requirements for establishing privity, as well as the policy reasons advanced by Texas judges for requiring it. In addition, this section describes the general requirements for establishing an attorney-client relationship (and thus privity) and outlines the primary vehicles used by clients for suing their attorneys: negligence, breach of contract, breach of fiduciary duty, and fee forfeiture based on breach of fiduciary duty.

### A. *Privity Rule*

Generally, in the absence of privity, an attorney owes no duty to third party non-clients.[6] Thus, persons outside the attorney-client

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2. *See* David J. Beck, *Legal Malpractice in Texas*, 50 BAYLOR L. REV. 546, 581 (1998) (referring to the lack of duty between attorneys and non-clients).

3. Geoffrey C. Hazard, Jr., *The Privity Requirement Reconsidered*, 37 S. TEX. L. REV. 967, 998 (1996) (stating that this concept of contractual privity "means that a contract cannot create, in and of itself, duties in tort to third parties who are strangers to the contract").

4. *Id.*

5. *See* Robert L. Paddock, *Torts—Negligent Misrepresentation—Liability of Attorneys to Third Parties Through Opinion Letters—A Well Intentioned Rule Which May Stifle the Legal Profession if Not Modified*—Mehaffy, Rider, Windholz & Wilson v. Central Bank Denver, N.A. 892 P.2d 230 (Colo. 1995), 38 S. TEX. L. REV. 325, 326 n.3 (1997) (listing case law from a number of jurisdictions in which attorneys were found liable to third parties for malpractice).

6. *See, e.g.*, Gamboa v. Shaw, 956 S.W.2d 662, 665 (Tex. App.—San Antonio 1997, no pet.) (holding that a lawyer representing a corporation does not owe a fiduciary duty to

relationship have no cause of action for injuries sustained due to an attorney's malpractice.[7]

Despite the apparent trend in some jurisdictions to eliminate the privity requirement, Texas courts have continued to require privity, especially as a means of protecting attorneys from liability in contexts where the scope of their duty is unclear. For example, under Texas law the privity rule protects attorneys in a class action lawsuit from legal malpractice claims brought by non-client potential class members.[8] There is no implied attorney-client relationship between the attorney and potential class members; therefore, there is no privity between them until the class is certified.[9] Even if the attorney's work benefited or was intended to benefit the potential class, the attorney owes no pre-certification duty to potential class members and thus may not be liable to them for a legal malpractice claim.[10]

The same is true of will and trust beneficiaries. In *Dickey v. Jansen*,[11] the court upheld the application of privity in the context of a trust.[12] In *Dickey*, the intended beneficiaries under a testator's testamentary trust brought suit against the testator's attorney for negligent preparation of the trust.[13] The court of appeals held that the intended beneficiaries were not in privity with the testator's attorney, and lack of privity precluded the action.[14] Justice Evans wrote a strong dissent in favor of creating an exception to the privity rule when third parties are the intended beneficiaries of the services sought by the client.[15]

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shareholders of the corporation because the lawyer was not in privity with the shareholders); Draper v. Garcia, 793 S.W.2d 296, 301 (Tex. App.—Houston [14th Dist.] 1990, no writ) (finding insurer not in privity with attorney insured hired to handle insured's claims).

7. Vinson & Elkins v. Moran, 946 S.W.2d 381, 401 (Tex. App.—Houston [14th Dist.] 1997, pet. dism'd by agr.).

8. *See* Gillespie v. Scherr, 987 S.W.2d 129, 132 (Tex. App.—Houston [14th Dist.] 1998, pet. denied) (refusing to find an attorney-client relationship in case of unnamed class members).

9. *Id.*

10. *Id.* at 131-32.

11. 731 S.W.2d 581 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

12. Dickey v. Jansen, 731 S.W.2d 581, 583 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

13. *Id.* at 581-82.

14. *Id.* at 582.

15. *Id.* at 583-84 (Evans, J., dissenting).

In *Thompson v. Vinson & Elkins*,[16] the same court of appeals, citing the lack of privity between the residual beneficiaries of the will and the attorneys representing the trustee, affirmed summary judgment on the beneficiaries' claims of negligence and breach of fiduciary duty.[17] With regard to the beneficiaries' DTPA claims, the *Thompson* court noted that although the beneficiaries did not directly seek or acquire goods or services from the attorneys, privity between a plaintiff and an attorney is not required in a DTPA case.[18]

In *Huie v. DeShazo*,[19] the Texas Supreme Court held that only the trustee, not the trust beneficiary, is a client of the trustee's attorney.[20] While the trustee still has a fiduciary duty to the beneficiary, any communication between the trustee and his attorney is protected from the beneficiary because of the attorney-client privilege.[21] In *Barcelo v. Elliot*,[22] the Texas Supreme Court refused to recognize an exception to the privity rule in the estate planning and trust context, concluding that an attorney who drafts a will or trust does not owe a duty of care to named beneficiaries under the will or trust.[23] In so holding, the *Barcelo* court reasoned that "the greater good is served by preserving a bright-line privity rule which denies a cause of action to all beneficiaries whom the attorney did not represent."[24]

Finally, in *Gamboa v. Shaw*,[25] the San Antonio Court of Appeals refused to waive the privity requirement in the context of a malpractice claim brought against a lawyer by the shareholder of a corporation.[26] The court reasoned that "[s]uch a deviation would result in attorneys owing a duty to each shareholder of any corporation they represent," which would in turn mean that "attorneys representing corporations would owe a duty to both sides of the

16. 859 S.W.2d 617 (Tex. App.—Houston [1st Dist.] 1993, writ denied).

17. Thompson v. Vinson & Elkins, 859 S.W.2d 617, 621-24 (Tex. App.—Houston [1st Dist.] 1993, writ denied).

18. *Id.* at 625.

19. 922 S.W.2d 920 (Tex. 1996).

20. Huie v. DeShazo, 922 S.W.2d 920, 925 (Tex. 1996).

21. *Id.*

22. 923 S.W.2d 575 (Tex. 1996).

23. Barcelo v. Elliot, 923 S.W.2d 575, 578-79 (Tex. 1996).

24. *Id.* at 578.

25. 956 S.W.2d 662 (Tex. App.—San Antonio 1997, no pet.).

26. Gamboa v. Shaw, 956 S.W.2d 662, 665 (Tex. App.—San Antonio 1997, no pet.).

litigation in any type of derivative suit brought against the corporation by a shareholder."[27]

### B. *Policy Behind Privity Rule*

Texas courts have advanced several policy concerns in favor of the privity rule. First, liability to non-clients can hamper an attorney's vigorous representation of his own client. As one court stated: "The attorney's preoccupation or concern with the possibility of claims based on mere negligence (as distinguished from fraud) by any with whom his client might deal would prevent him from devoting his entire energies to his client's interest."[28] Thus, "[w]ithout the privity barrier, fear of liability would inject undesirable self-protective reservations into the attorney's counseling role."[29]

A second concern is that liability to non-clients may "tend to encourage a party to contractual negotiations to forego personal legal representation and then sue counsel representing the other contracting party for negligent misrepresentation if the resulting contract later proves disfavorable in some respect."[30] Furthermore, "[i]t is obvious that opening attorney-client contracts to third party scrutiny would entail a vast range of potential liability."[31] Despite these policy concerns, however, the Texas Supreme Court has opened the door to allow suits by non-clients for an attorney's negligent misrepresentations.[32] The recent proliferation of lawsuits by non-clients based on fraud and conspiracy are also a significant crack in the wall. The existence of the attorney-client relationship,

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27. *Id.*

28. Bell v. Manning, 613 S.W.2d 335, 339 (Tex. Civ. App.—Tyler 1981, writ ref'd n.r.e.); *see also* Am. Centennial Ins. v. Canal Ins., 843 S.W.2d 480, 484 (Tex. 1992) (stating "Texas courts have been understandably reluctant to permit a malpractice action by a non-client because of the potential interference with the duties an attorney owes to the client").

29. Vinson & Elkins v. Moran, 946 S.W.2d 381, 401 (Tex. App.—Houston [14th Dist.] 1997, pet. dism'd by agr.); *see also* Geoffrey C. Hazard, Jr., *The Privity Requirement Reconsidered*, 37 S. TEX. L. REV. 967, 968 (1996) (citing to the concern that, with respect to litigation, "[i]f there were . . . liability in favor of the losing party in litigation, it is rightly feared that there would be no end to litigation").

30. *Bell*, 613 S.W.2d at 339.

31. Dickey v. Jansen, 731 S.W.2d 581, 583 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

32. McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787 (Tex. 1999).

however, still remains a central component of lawsuits based on traditional legal malpractice.

### C. *Existence of Attorney-Client Relationship*

#### 1. Nature of the Attorney-Client Relationship

To have privity, there needs to be an attorney-client relationship. The attorney-client relationship is a contractual relationship in which the attorney agrees to render professional services on behalf of the client.[33] The relationship "can be formed by explicit agreement of the parties or may arise by implication from the parties' actions."[34] The attorney-client relationship can also extend to "preliminary consultations between the client and the attorney regarding the attorney's possible retention."[35] In litigation, the purported client must prove that the attorney-client relationship existed between himself and the attorney.[36] Courts will apply an objective standard, examining what the parties said and did, in order to determine if there was a meeting of the minds with respect to the creation of an attorney-client relationship.[37] The mere fact that services are rendered does not mean that an attorney-client relationship existed. For example, it is possible that an attorney may act as a mere scrivener between two parties in drafting documents for a transaction.[38]

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33. *See* Banc One Capital Partners Corp. v. Kneipper, 67 F.3d 1187, 1198 (5th Cir. 1995) (citing Yaklin v. Glusing, Sharpe & Krueger, 875 S.W.2d 380, 383 (Tex. App.—Corpus Christi 1994, no writ)); Sutton v. McCormick, 47 S.W.3d 179, 182 (Tex. App.—Corpus Christi 2001, no pet.); *Moran*, 946 S.W.2d at 405 (holding that an attorney-client relationship means a relationship that exists if an attorney or law firm has agreed, expressly or impliedly, to render legal services to the person claiming such a relationship exists); *see also* Prigmore v. Hardware Mut. Ins. Co., 225 S.W.2d 897, 899 (Tex. Civ. App.—Amarillo 1949, no writ) (noting that an employment contract can be implied from the conduct of the parties).

34. *Kneipper*, 67 F.3d at 1198.

35. Nolan v. Forman, 665 F.2d 738, 739 n.3 (5th Cir. 1982).

36. *Sutton*, 47 S.W.3d at 181.

37. *Id.* at 182.

38. *Id.* at 184.

2. Express Agreement

An attorney-client relationship is ordinarily created by an express agreement between the parties.[39] A contractual relationship can be implied, but, this is generally only imputed upon a showing of sufficient intent.[40] In *Banc One Capital Partners Corp. v. Kneipper*,[41] some investors argued that the defendant law firm manifested an intent to create a limited attorney-client relationship upon issuing an opinion letter in connection with a securities offering.[42] The court affirmed a summary judgment for the attorneys because the opinion letter did not evidence an intent to form an attorney-client relationship.[43]

3. Implied by Conduct

An attorney may also incur liability when the circumstances would lead the non-client to believe the attorney has undertaken the representation.[44] The fact that the purported client may have subjectively trusted the lawyer and relied upon him, without more, is insufficient.[45] The relationship does not depend upon the payment of a fee, but may exist as a result of rendering services gratuitously.[46]

4. Failure to Advise That No Attorney-Client Relationship Exists

In the absence of evidence that the attorney knew that the parties assumed he was representing them in a matter, the attorney

39. *See, e.g.*, Bergman v. New England Ins. Co., 872 F.2d 672, 675 (5th Cir. 1989) (applying Louisiana law and recognizing that in the absence of an express agreement, even though attorney for one party prepared instruments which were to be signed by all parties, no attorney-client relationship existed); *see also Sutton*, 47 S.W.3d at 182.

40. *Kneipper*, 67 F.3d at 1198.

41. 67 F.3d 1187 (5th Cir. 1995).

42. *Kneipper*, 67 F.3d at 1198.

43. *Id.*

44. *See* Cantu v. Butron, 921 S.W.2d 344, 351 (Tex. App.—Corpus Christi 1996, writ denied) (recognizing that gaining trust and confidence can establish a relationship); Byrd v. Woodruff, 891 S.W.2d 689, 700 (Tex. App.—Dallas 1994, writ denied); Perez v. Kirk & Carrigan, 822 S.W.2d 261, 265-66 (Tex. App.—Corpus Christi 1991, writ denied).

45. *See* Castillo v. First City Bancorporation of Tex., Inc., 43 F.3d 953, 958 (5th Cir. 1994); Terrell v. State, 891 S.W.2d 307, 313 (Tex. App.—El Paso 1994, pet. ref'd).

46. *See* Parker v. Carnahan, 772 S.W.2d 151, 157 (Tex. App.—Texarkana 1989, writ denied); *see also* Kotzur v. Kelly, 791 S.W.2d 254, 257-58 (Tex. App.—Corpus Christi 1990, no writ).

has no affirmative duty to inform the parties otherwise.[47] An attorney can be liable for negligence if "the attorney was aware or should have been aware that his conduct would have led a reasonable person to believe that the attorney was representing that person."[48] To avoid any potential for misunderstanding, an attorney declining representation should clearly state in writing to a person whom the attorney has declined to represent that the attorney is not taking the person's case, and should urge that person to obtain other counsel immediately because of the possibility of problems with the statute of limitations.

### D. *Liability to Clients Based on Privity*

Clients often sue lawyers for malpractice based on independent theories, typically negligence, and breach of fiduciary duty. Each claim requires privity, but otherwise is distinct, involving a different set of standards, pleading and proof requirements, and potential for damages. Many Texas courts recognize, however, that these claims often arise out of the same set of facts and the same basic allegation, namely that the lawyer failed to adequately fulfill her obligations and thereby harmed the client. As a result, many courts have held that all these claims should be subsumed into one central allegation: legal malpractice based on negligence.[49] This approach is by no means universal,[50] and therefore this section discusses the basic requirements and legal developments related to

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47. *See, e.g.*, Dickey v. Jansen, 731 S.W.3d 581, 582 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.) (finding that an attorney owes a duty to those persons in privity of contract).

48. Burnap v. Linnartz, 914 S.W.2d 142, 148-49 (Tex. App.—San Antonio 1995, no writ); *see also* Randolph v. Resolution Trust Corp., 995 F.2d 611, 615 (5th Cir. 1993); Parker v. Carnahan, 772 S.W.2d 151, 157 (Tex. App.—Texarkana 1989, writ denied); Dillard v. Broyles, 633 S.W.2d 636, 643 (Tex. App.—Corpus Christi 1982, writ ref'd n.r.e.); Rice v. Forestier, 415 S.W.2d 711, 713 (Tex. Civ. App.—San Antonio 1967, writ ref'd n.r.e.).

49. *See, e.g.*, Stewart Title Guar., Co. v. Sterling, 822 S.W.2d 1, 7 (Tex. 1991) (stating that the "one satisfaction rule" applies where defendants either commit the same or different acts that result in only one injury); McGuire v. Kelley, 41 S.W.3d 679, 682-83 (Tex. App.—Texarkana 2001, no pet.) (finding that where the plaintiff alleged multiple theories of liability from the same course of conduct, he may elect to recover damages on one theory).

50. *See, e.g.*, Roy Ryden Anderson & Walter W. Steele, Jr., *Fiduciary Duty, Tort and Contract: A Primer on the Legal Malpractice Puzzle*, 47 SMU L. REV. 235, 251-59 (1994) (discussing the inherent differences in pleading, proof, and damages among the causes of action and criticizing case law that fails to distinguish between them).

each of these theories of liability. Special focus is given to the newly recognized claim for fee forfeiture based on breach of fiduciary duty.[51]

### 1. Traditional Legal Malpractice Liability Based on Negligence

A legal malpractice action in Texas is traditionally based on professional negligence.[52] The plaintiff must prove: (1) there is a duty owed by the attorney to the client, (2) that duty was breached, (3) the breach proximately caused the client's injury, and (4) damages resulted.[53] Thus a jury charge on professional negligence would typically include the following question to the jury:

*Question*:

Did the negligence, if any, of [Lawyer] proximately cause damages to [Client]?[54]

#### a. Proving Breach

In proving that the lawyer breached the standard of care, the plaintiff must show that the lawyer failed to do that which an attorney of ordinary prudence would have done under the same or similar circumstances. This generally is done through expert testimony.[55] The jury may not rely solely upon the fact that the lawyer violated the Texas Disciplinary Rules of Professional Conduct. The Rules will not support a claim of negligence per se, nor do they give rise to a private cause of action.[56] Some courts may consider them to be admissible, however, as evidence to demon-

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51. Note that the claim of fee forfeiture may be considered sufficiently distinct such that it may be maintained in addition to a legal malpractice claim. *See, e.g.*, Burrow v. Arce, 997 S.W.2d 229 (Tex. 1999).

52. Barcelo v. Elliot, 923 S.W.2d 575, 580 (Tex. 1996).

53. Cosgrove v. Grimes, 774 S.W.2d 662, 665 (Tex. 1989).

54. COMM. ON PATTERN JURY CHARGES, STATE BAR OF TEX., TEX. PATTERN JURY CHARGES PJC 60.1-60.3 (2000 ed. 2000); *see also Cosgrove*, 774 S.W.2d at 665 (setting out the elements of a professional negligence claim).

55. Streber v. Hunter, 221 F.3d 701, 724 (5th Cir. 2000). Expert testimony typically would come from other lawyers or from law professors. *See* Jett Hanna, *Moonlighting Law Professors: Identifying and Minimizing the Professional Liability Risk*, 42 S. TEX. L. REV. 421, 445 (2001) (discussing liability risks to law professors acting as experts).

56. Cuyler v. Minns, 60 S.W.3d 209, 214 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

strate what the standard of care should be.[57] For example, in one recent opinion, a court of appeals stated that "[b]arring the use of the code and denying that the code is relevant to the duties a lawyer has to his client is not logical and would require the re-creation of a standard of care without reference to verifiable or pre-existing rules of conduct."[58]

The judge who tried an underlying lawsuit cannot offer his opinion on whether or not malpractice was committed.[59] Opposing counsel in the underlying trial can, however, offer such testimony and can testify as to whether such malpractice caused harm to the complaining party.[60] This is one more reason to stay on good terms with opposing counsel.

b. Causation

The cases involving the alleged mishandling of litigation have created a question of how causation should be established. To establish causation, "the client may be required to prove that he or she would have been successful in prosecuting or defending the underlying action, if not for the attorney's negligence or other improper conduct."[61] Thus, a successful legal malpractice action requires that the plaintiff show that she would have prevailed in the underlying suit but for the counsel's negligence.[62] This means the plaintiff will conduct a "trial within a trial" in which both the malpractice claim and the underlying claims are tried to the same

57. *See* Two Thirty Nine Joint Venture v. Joe, 60 S.W.3d 896, 905 (Tex. App.—Dallas 2001, pet. filed) (quoting the preamble to the Disciplinary Rules and holding that although they are not intended to define standards of liability, the preamble is not inconsistent with use of the Rules as evidence of a duty of care); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 52(2) & cmt. (f) (2000) (stating that the rules of professional conduct may be considered by the trier of fact as evidence of the standard of care).

58. *Joe*, 60 S.W.3d at 905.

59. *See* Joachim v. Chambers, 815 S.W.2d 234, 238-39 (Tex. 1991); McDuffie v. Blassingame, 883 S.W.2d 329, 334 (Tex. App.—Amarillo 1994, writ denied).

60. *Cf. McDuffie*, 883 S.W.2d at 334 (Tex. App.—Amarillo 1994, writ denied) (referring to the ability of judges to testify and stating that everyone "must testify to relevant facts within [their] personal knowledge" where required to do so); Vinson & Elkins v. Moran, 946 S.W.2d 381, 394 (Tex. App.—Houston [14th Dist.] 1997, writ dism'd by agr.) (referring to ability of attorneys to reveal information that is confidential if necessary for the attorney's defense).

61. Joseph H. Koffler, *Legal Malpractice Damages in a Trial Within a Trial—Critical Analysis of Unique Concepts: Areas of Unconscionability*, 73 MARQ. L. REV. 40, 41 (1989).

62. Mackie v. McKenzie, 900 S.W.2d 445, 449 (Tex. App.—Texarkana 1995, writ denied).

jury.[63] In this scenario, the malpractice defendant often contends that the plaintiff-client would still have lost the underlying case.

Texas cases are not clear on how this "case within a case" should be submitted to the jury. In *Cosgrove v. Grimes*,[64] the trial court submitted a separate question as to whether or not the plaintiff would have prevailed at the prior trial but for the negligent conduct of the attorney.[65] In *Rhodes v. Batilla*,[66] in contrast, a separate question asking whether the plaintiff would have prevailed but for the negligent conduct of the attorney was omitted.[67]

In *Haynes & Boone v. Bowser Bouldin, Ltd.*,[68] the Texas Supreme Court addressed the issue of causation in a legal malpractice context, holding that "to recover damages, a plaintiff must produce evidence from which the jury may reasonably infer that the damages sued for have resulted from the conduct of the defendant."[69] The *Bowser Bouldin* court further concluded that the causation "requirement is met when a jury is presented with pleading and proof that establish a *direct causal link* between the damages awarded, the actions of the defendant and the injury suffered."[70] While expert testimony on proximate cause may be required to prove some legal malpractice claims, it is not required in cases where lay people will ordinarily be competent to make the decision on causation.[71]

Texas courts fail to clarify whether an objective or subjective standard should be used to prove the direct causal link. Many commentators and other states do recognize such a distinction. One position states:

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63. *Id.*; *see also* Gibson v. Johnson, 414 S.W.2d 235, 238-39 (Tex. Civ. App.—Tyler 1967, writ ref'd n.r.e.) (stating the defendants were entitled to stand just where the defendant in the underlying suit would have stood and to have before the jury every fact that might tend to mitigate the damages).

64. 774 S.W.2d 662 (Tex. 1989).

65. Cosgrove v. Grimes, 774 S.W.2d 662, 665 (Tex. 1989).

66. 848 S.W.2d 833 (Tex. App.—Houston [14th Dist.] 1993, writ granted, writ withdrawn, writ denied).

67. Rhodes v. Batilla, 848 S.W.2d 833, 841 (Tex. App.—Houston [14th Dist.] 1993, writ granted, writ withdrawn, writ denied).

68. 896 S.W.2d 179 (Tex. 1995).

69. Haynes & Boone v. Bowser Bouldin, Ltd., 896 S.W.2d 179, 181 (Tex. 1995).

70. *Id.* (emphasis added).

71. Streber v. Hunter, 221 F.3d 701, 726-27 (5th Cir. 2000).

> Often, "should" and "would" are used interchangeably. There is a difference because the objective of a trial-within-a-trial is to determine what the result *should have* been (an objective standard) not what the result *would have* been by a particular judge or jury (a subjective standard). The phrase "would have" been, however, does have the same meaning as "should have," if the inquiry is what a *reasonable* judge or jury "would have" decided . . . . In any event, what "could have" or "might have" been decided is speculative and is not the standard.[72]

Several cases use the ambiguous "would have been" language.[73] However, no cases have directly confronted the distinction between an objective standard (what should have occurred or what a reasonable judge or jury would have done) and a subjective standard (what the particular judge or jury in the underlying case would have done). One recent opinion, however, suggests an objective standard. In *Swinehart v. Stubbeman, McRae, Sealy, Laughlin & Browder, Inc.*,[74] the court held that a malpractice defendant is not limited to the defenses actually raised in the underlying suit, but rather may discuss all possible defenses that should have been raised in the underlying suit in order to disprove causation.[75]

In an appellate legal malpractice claim, the plaintiff must prove that he would have prevailed on appeal in the underlying case but for the attorney's negligence.[76] The plaintiff must prove the "case within a case" in order to prove that the attorney's negligence caused the damage; if the appeal would not have been successful, then the attorney's negligence could not have caused harm.[77] In *Smith v. Heard*,[78] the court rejected the plaintiffs' contention that the attorney had negligently failed to challenge the trial court's cal-

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72. 5 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 33.8, at 70 (5th ed. 2000).

73. *See, e.g., Mackie*, 900 S.W.2d at 448 (showing that the client must prove he "would have been successful"); MND Drilling Corp. v. Lloyd, 866 S.W.2d 29, 31 (Tex. App.—Houston [14th Dist.] 1987, no writ) (stating that the client must prove he "would have been successful but for the negligence of his attorney"); *Cosgrove*, 774 S.W.2d at 665, 666 (explaining that the plaintiff must show what she "would have recovered and collected . . . if the suit had been properly prosecuted").

74. 48 S.W.3d 865 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

75. Swinehart v. Stubbeman, McRae, Sealy, Laughlin & Browder, Inc., 48 S.W.3d 865, 876 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

76. Smith v. Heard, 980 S.W.2d 693, 696 (Tex. App.—San Antonio 1998, pet. denied).

77. *Id.*

78. 980 S.W.2d 693 (Tex. App.—San Antonio 1998, pet. denied).

culation of damages, as the trial court's calculation was valid and would not have been error even if the attorney had properly appealed.[79] Additionally, the *Smith* court relied on the underlying appellate court's statement that the certification of the defendant's expert witness was "patently immaterial."[80] Thus, the court concluded that any failure of the attorney to pursue this avenue of appeal could not have damaged the plaintiff, thereby barring a malpractice claim on this issue.[81]

c. Damages

Proving damages in a professional negligence case is largely the same as for traditional negligence. In both situations, the plaintiff bears the burden of proof. The Texarkana Court of Appeals in *Mackie v. McKenzie*[82] held that the lawyer being sued for malpractice was entitled to summary judgment because the plaintiff failed to show damages.[83] The court determined there should be no recovery in the legal malpractice action because the client ultimately recovered more money than would have been recovered had the attorney succeeded in the underlying suit.[84]

While the Texas Supreme Court has upheld an award for mental anguish damages that occurred as a result of attorney negligence, the court has not endorsed recovery of mental anguish damages in all legal malpractice cases.[85] Indeed, the supreme court recently held that a party cannot recover for mental anguish damages that are a consequence of economic loss resulting from legal malpractice.[86] This rule is consistent with the majority of other states in recognizing that mental anguish is typically not a foreseeable result of legal malpractice, and that recovery should generally be limited to making the plaintiff whole for his economic loss.[87]

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79. *Smith*, 980 S.W.2d at 696.

80. *Id.*

81. *Id.*

82. 900 S.W.2d 445 (Tex. App.—Texarkana 1995, writ denied).

83. Mackie v. McKenzie, 900 S.W.2d 445, 451 (Tex. App.—Texarkana 1995, writ denied).

84. *Id.*

85. Douglas v. Delp, 987 S.W.2d 879, 884 (Tex. 1999); *see* Cosgrove v. Grimes, 774 S.W.2d 662, 666 (Tex. 1989).

86. *Delp*, 987 S.W.2d at 885.

87. *Id.* at 884.

2. Breach of Contract

In the past, plaintiffs have attempted to take advantage of the four-year limitations period applicable to breach of contract actions by framing their legal malpractice claims as breaches of contract. Typically, this was done by alleging that the attorney was obligated to perform certain duties to the client under the terms of the contract, and that by failing to adequately perform these duties, the attorney committed a breach. Texas courts, however, have treated such breach of contract claims as tort claims.[88] Now that the Texas Legislature has made it clear that breach of fiduciary duty claims are governed by a four-year limitations period, there is less need for plaintiffs to plead a contract cause of action.[89]

3. Breach of Fiduciary Duty

Attorneys owe a fiduciary duty to their clients as a matter of law on the grounds that "the attorney-client relationship is one of 'most abundant good faith,' requiring absolute perfect candor, openness and honesty, and the absence of any concealment or deception."[90] Most allegations of breach of fiduciary duty involve "failure to disclose conflicts of interest, failure to deliver funds belonging to the client, placing personal interests over the client's interest, improper use of client confidences, taking advantage of the client's trust, engaging in self-dealing, and making misrepresentations" to the client.[91] In *Vinson & Elkins v. Moran*,[92] for example, the Houston Court of Appeals for the Fourteenth District upheld the trial court's finding that the law firm had breached its fiduciary duty because there was some evidence that the firm failed to dis-

88. *See, e.g.*, Woodburn v. Turley, 625 F.2d 589, 592 (5th Cir. 1980); Willis v. Maverick, 760 S.W.2d 642, 644 (Tex. 1988); Am. Med. Elecs. v. Korn, 819 S.W.2d 573, 576 (Tex. App.—Dallas 1991, writ denied); Sledge v. Alsup, 759 S.W.2d 1, 2 (Tex. App.—El Paso 1988, no writ).

89. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(5) (Vernon Supp. 2002).

90. Goffney v. Rabson, 56 S.W.3d 186, 193 (Tex. App.—Houston [14th Dist.] 2001, no pet.); *see also* 2 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 14.1, at 530 (5th ed. 2000) (stating that "[t]he attorney is under a duty to represent the client with undivided loyalty, to preserve the client's confidences and to disclose any material matters infringing upon these obligations"). "The basic fiduciary obligations are two-fold: undivided loyalty and confidentiality." 2 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 14.1, at 530 (5th ed. 2000).

91. *See Goffney*, 56 S.W.3d at 193.

92. 946 S.W.2d 381 (Tex. App.—Houston [14th Dist. 1997, pet. dism'd agr.).

close its conflicts of interest with the clients, and then acted in the firm's own interest rather than in the best interest of the estate.[93]

When breach of fiduciary duty is pled as part of a malpractice claim, and damages are requested as a result, Texas courts treat it as a tort closely resembling negligence. In particular, the elements remain as: (1) a duty; (2) a breach of that duty; (3) the breach proximately caused injury; and (4) damages resulted.[94] The plaintiff must still prove the existence of an attorney-client relationship, which of course means that the attorney owes a fiduciary duty to the client.[95] Similarly, the plaintiff must prove causation and damages in the same way as is necessary for a legal malpractice claim that is based on negligence.[96]

In certain circumstances, the defendant actually bears the burden of proof on the second element—whether the attorney breached a fiduciary duty. "[W]here 'self-dealing' by the fiduciary is alleged, a 'presumption of unfairness' automatically arises and the burden is placed on the fiduciary to prove (a) that the questioned transaction was made in good faith, (b) for a fair consideration, and (c) after full and complete disclosure of all material information to the principal."[97] In addition, expert testimony often does not need to be admitted in order to prove breach because whether or not the attorney was loyal to the client is generally a matter of common knowledge, as compared to whether the attorney met the standard of care.[98]

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93. *See* Vinson & Elkins v. Moran, 946 S.W.2d 381, 400-06 (Tex. App.—Houston [14th Dist.] 1997, pet. dism'd by agr.) (discussing evidence supporting an attorney-client relationship).

94. *See* Two Thirty Nine Joint Venture v. Joe, 60 S.W.3d 896, 904-06 (Tex. App.—Dallas 2001, pet. filed) (stating that "a lawyer can be civilly liable to a client if the lawyer breaches a fiduciary duty to a client by not avoiding impermissible conflicts of interest, and the breach is a legal cause of injury"); *see also In re* Segerstrom, 247 F.3d 218, 225 n.5 (5th Cir. 2001) (differentiating among claims for damages and claims for fee forfeiture and explaining that, in the former, the plaintiff must still prove causation and damages).

95. Longaker v. Evans, 32 S.W.3d 725, 733 (Tex. App.—San Antonio 2000, no pet.).

96. *In re* Segerstrom, 247 F.3d at 225 n.5.

97. Jackson Law Office, P.C. v. Chappell, 37 S.W.3d 15, 22 (Tex. App.—Tyler 2000, pet. denied); *see also* 2 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 14.2, at 541 (5th ed. 2000) (stating that "[t]he rationale for shifting this burden is the preservation of the integrity of the profession in a situation that imperils the fundamental concept of loyalty").

98. 2 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 14.2, at 540 (5th ed. 2000).

Despite these distinctions, however, many courts still hold that claims of breach of fiduciary duty may be simply subsumed into the plaintiff's claim of legal malpractice based on professional negligence. In *Two Thirty Nine Joint Ventures v. Joe*,[99] for example, the court of appeals noted that "avoiding conflicts of interest and thereby observing the fiduciary duty of loyalty is an action that a reasonably prudent lawyer would observe."[100] The court also observed that the Disciplinary Rules are important evidence of the scope of the fiduciary duty a lawyer owes to a client, and thus should be admissible to assist the jury in determining breach.[101]

It is important to note that attorneys may also owe fiduciary duties to non-clients. This typically will occur in the context where any lay person might also become a fiduciary.[102] For example, partners owe fiduciary duties to one another, trustees owe fiduciary duties to the beneficiaries of the trust,[103] and the Texas Supreme Court has ruled that associates owe a fiduciary duty to the partners in their law firm.[104] In addition, a lawyer who consults with a prospective client may owe that client a fiduciary duty in giving advice during the interview, protecting the information disclosed, and avoiding future conflicts.[105] This would be the case regardless of whether an attorney-client relationship is eventually formed.

One basis that might become dangerous with respect to lawyers is the potential liability of a third party who intentionally causes

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99. 60 S.W.3d 896 (Tex. App.—Dallas 2001, pet. filed).

100. *Joe*, 60 S.W.3d at 905.

101. *See id.* at 906-07.

102. *See* John F. Sutton, Jr., *The Lawyer's Fiduciary Liabilities to Third Parties*, 37 S. TEX. L. REV. 1033, 1042 (1996) (listing a number of functions lawyers often perform in society that give rise to a fiduciary relationship).

103. *Id.*

104. Brewer & Pritchard, P.C. v. Johnson, 7 S.W.3d 862 (Tex. App.—Houston [1st Dist.] 1999), *aff'd on other grounds*, 45 Tex. Sup. Ct. J. 470, 2000 WL 33716714 (Mar. 21, 2002). In *Brewer*, an associate at a law firm represented to his partners that he was bringing in a client on a contingency fee arrangement while he simultaneously contacted other lawyers about taking that client in exchange for paying him a referral fee. *Id.* at 864-65. Although the appellate court did not rule on whether this behavior did in fact constitute a breach of fiduciary duty, it did state that associates at a law firm do owe a fiduciary duty to the partners. *Id.* at 868.

105. John F. Sutton, Jr., *The Lawyer's Fiduciary Liabilities to Third Parties*, 37 S. TEX. L. REV. 1033, 1043-44 (1996).

the breach of a duty to a fiduciary.[106] This is based on the Restatement (Second) of Agency, which provides that "[a] person, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal."[107] Thus, a third party who knowingly assists a fiduciary in breaching her fiduciary duties may become a joint tortfeasor with the fiduciary. Potentially, this theory could have significant implications for attorneys who represent trustees or corporate fiduciaries. However, it still necessitates a showing of causation and damages to prove liability.

4. Fee Forfeiture Based on Breach of Fiduciary Duty

By contrast, the new claim of fee forfeiture based on breach of fiduciary duty, although still requiring an attorney-client relationship, does not necessitate a showing of either causation or injury. It is therefore a unique claim, although it is relatively new and is not completely defined. The fee forfeiture claim represents a significant development in malpractice liability, and is a claim that plaintiffs have begun to plead more frequently.

In *Burrow v. Arce*,[108] the Texas Supreme Court first 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 attorney's fee, regardless of whether the client suffers any actual damages.[109] When a client seeks a fee forfeiture, the trial court must determine whether a factual dispute exists that must be decided by a jury before the court can determine whether a clear and serious violation of the duty has occurred.[110] The court must then determine whether forfeiture is appropriate, and if so, whether all or part of the attorney's fee should be forfeited.[111] 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.[112]

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106. RESTATEMENT (SECOND) OF AGENCY § 312 cmt. a (1958).
107. *Id.* § 312.
108. 997 S.W.2d 229 (Tex. 1999).
109. Burrow v. Arce, 997 S.W.2d 229, 241 (Tex. 1999); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 49 (Proposed Final Draft No. 1, 1996).
110. *Arce*, 997 S.W.2d at 246.
111. *Id.*
112. *Id.*

a. Background on *Burrow v. Arce*

The *Arce* case arose out of "[e]xplosions at a Phillips 66 chemical plant in 1989 [that] killed twenty-three workers and injured hundreds of others."[113] Five attorneys filed one suit on behalf of 126 plaintiffs.[114] The case settled for approximately $190 million, resulting in a contingency fee of more than $60 million.[115] Forty-nine plaintiffs then sued their attorneys, alleging various violations of the rules governing professional conduct.[116] The list of alleged violations included soliciting 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' claim 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.[117] 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.[118] 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.[119]

On appeal, the *Arce* clients contended that the attorneys' serious breaches of fiduciary duty required full forfeiture of all of their fees, irrespective of whether the breaches caused actual damages.[120] Alternatively, the clients argued that a jury should determine the amount of any lesser forfeiture.[121] The attorneys countered that the court could not order a fee forfeiture absent proof that the clients sustained actual damages.[122] Furthermore, the attorneys also argued the misconduct alleged by the clients was

113. *Id.* at 232.
114. *Id.*
115. *Arce*, 997 S.W.2d at 232.
116. *Id.*
117. *Id.*
118. *Id.* at 233.
119. *Id.*
120. *Arce*, 997 S.W.2d at 240.
121. *Id.* at 245.
122. *Id.* at 240, 246.

in sufficient to justify ordering a forfeiture.[123] The supreme court reviewed the background of the equitable remedy of fee forfeiture noted in the Restatement (Second) of Trusts (1959)[124] and, most importantly, section 49 of the proposed Restatement (Third) of the Law Governing Lawyers.[125] Section 49 states in part: "A lawyer engaging in clear and serious violation of duty to a client may be required to forfeit some or all of the lawyer's compensation for the matter."[126] The *Arce* court also reviewed previous cases involving fee forfeiture in other principal/agent situations.[127] The court concluded that in these other situations, Texas courts of appeals, courts in other jurisdictions, and the supreme court itself, in *Kinzbach Tool Co. v. Corbett-Wallace Corp.*,[128] have held that fee forfeiture was appropriate without regard to whether the breach of fiduciary duty resulted in damages.[129]

The supreme court rejected the argument that there should be an automatic and complete forfeiture for every breach of fiduciary duty, referring to section 49 of the proposed Restatement, which restricts the remedy to "clear and serious" violations of duty.[130] A comment 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."[131] The *Arce* 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

123. *Id.*

124. *Id.* at 243; RESTATEMENT (SECOND) OF TRUSTS § 243 (1959).

125. *Arce*, 997 S.W.2d at 243; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 49 (Proposed Final Draft No. 1, 1996) (current version at RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 (2000)).

126. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 49 (Proposed Final Draft No. 1, 1996) (current version at RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 (2000)).

127. *Arce*, 997 S.W.2d at 243.

128. 160 S.W.2d 509 (Tex. 1942).

129. *Arce*, 997 S.W.2d at 238-40; Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509, 514 (Tex. 1942).

130. *Arce*, 997 S.W.2d at 241; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 49 (Proposed Final Draft No. 1, 1996) (current version at RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 (2000)).

131. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 49 cmt. d (Proposed Final Draft No. 1, 1996) (current version at RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 (2000)).

amount.[132] These factors 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.'"[133] In addition to the section 49 factors, however, the supreme court added another factor that was to be given great weight: "the public interest in protecting the integrity of the attorney-client relationships."[134]

The *Arce* court concluded that because forfeiture is an equitable remedy, it should be decided by the court and not a jury.[135] However, a party is entitled to have contested fact issues decided by a jury.[136] These contested fact issues could include issues such as whether the lawyer acted intentionally, with gross negligence, or if the conduct was merely inadvertent.[137] Other factors, such as adequacy of other remedies, the public interest in protecting the integrity of the attorney-client relationship, and weighing all other relevant considerations, present further legal policy issues.[138] The trial judge must decide these legal policy issues.[139]

In *Arce*, the attorneys argued that none of the misconduct alleged by the clients justified a forfeiture of any fees.[140] The arguments of all parties in *Arce* regarding misconduct tended to focus on an assertion of an aggregate settlement in violation of Texas Disciplinary Rule of Professional Conduct 1.08(f).[141] The supreme court, however, 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.[142]

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132. *Arce*, 997 S.W.2d at 243.

133. *Id.* (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 49 (Proposed Final Draft No. 1, 1996) (current version at RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 (2000))).

134. *Id.* at 245.

135. *Id.* at 245-46.

136. *Id.* at 245.

137. *Arce*, 997 S.W.2d at 245.

138. *Id.*

139. *Id.*

140. *Id.* at 246.

141. *Id.*; TEX. DISCIPLINARY R. PROF'L CONDUCT 1.08(f) *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. A (Vernon 1998) (TEX. STATE BAR R. art. X, § 9).

142. *Arce*, 997 S.W.2d at 246.

b. Subsequent Fee Forfeiture Cases

In *Lopez v. Munoz, Hockema & Reed, L.L.P.*,[143] the Texas Supreme Court held no breach of fiduciary duty existed in its first post-*Arce* fee forfeiture decision.[144] The Lopezes sued their attorneys for breach of contract and breach of fiduciary duty.[145] The attorneys successfully handled a wrongful death lawsuit that resulted in a jury verdict in excess of $25 million against Westinghouse Electric Corporation.[146] The trial court entered judgment and the attorneys began settlement negotiations with Westinghouse to avoid the risk of appeal.[147] The parties reached an oral settlement for $15 million on October 11, 1991.[148] Westinghouse filed a deposit in lieu of a cost bond, as the parties had not finalized a settlement agreement.[149] The contingency fee contract provided that the attorneys were to receive forty percent of any recovery. The contingency contract further provided that if the case was "'appealed to a higher court'" the attorney fee would increase to forty-five percent.[150] The settlement agreement was signed on October 30, 1991.[151]

In 1995, the clients filed suit against the attorneys to recover $750,000 (five percent of the $15 million settlement) in overpayment of attorneys' fees, contending that the attorneys had breached the contract by charging forty-five percent instead of forty percent, and that such action constituted a breach of fiduciary duty.[152] The clients sought a complete forfeiture of the entire attorney fee.[153] 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

143. 22 S.W.3d 857 (Tex. 2000).

144. Lopez v. Munoz, Hockema & Reed, L.L.P., 22 S.W.3d 857, 862 (Tex. 2000).

145. *Id.* at 860.

146. *Id.* at 859; Lopez v. Munoz, Hockema & Reed, L.L.P., 980 S.W.2d 738, 740 (Tex. App.—San Antonio, 1998), *rev'd*, 22 S.W.3d 857 (Tex. 2000). The Texas Supreme Court reversed the court of appeals on the breach of contract and fiduciary duty claims and remanded on several other issues. *Lopez*, 22 S.W.3d at 864.

147. *Lopez*, 22 S.W.3d at 859; *Lopez*, 980 S.W.2d at 740.

148. *Lopez*, 980 S.W.2d at 740.

149. *Lopez*, 22 S.W.3d at 859.

150. *Id.* (citation omitted in original).

151. *Lopez*, 980 S.W.2d at 740.

152. *Id.*

153. *Id.*

"'appealed to a higher court.'"[154] The court of appeals stated that by charging forty-five percent instead of forty percent, the attorneys breached their employment contract, and that the attorneys' characterization of the status of an appeal induced the clients to agree to forty-five percent.[155] The court of appeals concluded that this conduct constituted a breach of fiduciary duty because the attorneys knew that the case was not going to be appealed.[156] The court found this breach to be a serious one, considering the substantial fees charged, and rendered judgment for $750,000 in favor of the clients on both the breach of contract and the breach of fiduciary duty claims.[157] The court of appeals remanded the case to the trial court to consider the clients' claim for attorneys' fees incurred in bringing the action.[158]

The Texas Supreme Court disagreed, holding that under the appellate rules in effect at the time, an appeal was "taken" when the cash deposit in lieu of a cost bond was filed.[159] Thus, the case was "'appealed to a higher court'" under the contract terms and, as a matter of law, the law firm did not breach the contingency fee contract, nor any fiduciary duty.[160] The Lopezes' allegations of fraud, negligence, and DTPA claims were remanded to the trial court.[161]

Justice Gonzales, joined by Chief Justice Phillips, wrote a concurring and dissenting opinion to advance the proposition that attorneys owe a fiduciary duty to fully explain the ramifications of their employment contracts to their clients.[162] Justice Gonzales concluded that the language of the contract was ambiguous and that an ambiguous contract between a lawyer and a client should generally be construed against the lawyer-drafter.[163] Justice Gon-

154. *Id.* at 742 (citation omitted in original).

155. *Id.* at 742-43.

156. *Lopez*, 980 S.W.2d at 742.

157. *Id.* at 738, 742-44 (pointing out that the attorneys only needed to return the portion that amounted to overpayment, which was $750,000).

158. *Id.* at 744.

159. Lopez v. Munoz, Hockema & Reed, L.L.P., 22 S.W.3d 857, 861 (Tex. 2000).

160. *See id.* at 861-63 (citation omitted in original) (stating that as a matter of law the firm did not breach the contract and because the Lopezes' breach of fiduciary duty was based on the alleged breach of contract, the breach of fiduciary duty claim was disposed of as well).

161. *Id.* at 864.

162. *Id.* at 864 (Gonzales, J., concurring and dissenting).

163. *Id.* at 866.

zales also discussed the lawyer's duty to fully and honestly inform the client about the fee arrangement and the lawyer's fiduciary duty not to collect an unconscionable fee from the client.[164]

In *Upchurch v. Albear*,[165] the Amarillo Court of Appeals relied upon *Arce* in reversing a summary judgment in favor of the attorneys in a fee forfeiture action.[166] *Upchurch* also resulted in a favorable outcome for the clients that generated considerable attorneys' fees.[167] "The attorneys represented approximately 870 clients as plaintiffs in two underlying toxic tort cases."[168] The cases settled for approximately $27 million.[169] In this case, there was a complicated and unusual set of facts that involved an action brought by the attorneys against the clients.[170] The clients, however, did not contend that the monetary settlements were inadequate.[171] In reversing a summary judgment for the attorneys, the court of appeals did not determine whether any of the attorneys' conduct constituted a breach of fiduciary duty, "'clear and serious'" or otherwise, and remanded the case to the trial court.[172]

In *Spera v. Fleming, Hovenkamp & Grayson, P.C.*,[173] an aggregate settlement was also used as a basis for reversing a summary judgment for the attorneys on a fee forfeiture claim. In *Spera*, the clients also complained about a potential conflict of interest because the attorneys representing the clients allegedly did not notify the clients of a hearing on the reasonableness of the fees sought by the attorney as part of the settlement of a class action so that the clients could obtain other counsel with respect to the fee issue.[174]

Another recent opinion confirmed that a client seeking forfeiture of a fee must plead and prove breach of a fiduciary duty, but

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164. *Lopez*, 22 S.W.3d at 867 (Gonzales, J., concurring and dissenting).

165. 5 S.W.3d 274 (Tex. App.—Amarillo 1999, pet. denied).

166. Upchurch v. Albear, 5 S.W.3d 274, 283-84 (Tex. App.—Amarillo 1999, pet. denied).

167. *Id.* at 276.

168. *Id.*

169. *Id.*

170. *Id.* at 276-78.

171. *Upchurch*, 5 S.W.3d at 283.

172. *Id.* at 286.

173. 25 S.W.3d 863 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

174. Spera v. Fleming, Hovenkamp & Grayson, P.C., 25 S.W.3d 863, 873 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

her obligation does not extend beyond this.[175] In *Green v. Brantley*,[176] the Fort Worth court of appeals affirmed a "no-evidence" summary judgment for lawyers who were sued over their handling of a medical malpractice/wrongful death action.[177] The plaintiffs in *Green* argued that even without proof of causation or damages, they were entitled to a fee forfeiture because the lawyers had allegedly breached a fiduciary duty.[178] The court of appeals affirmed on the ground that the summary judgment record contained no evidence establishing a breach of fiduciary duty.[179] Likewise, in *Longaker v. Evans*,[180] it was held that *Arce* had no application where the client does not seek fee forfeiture, but rather seeks actual damages caused by the fiduciary's alleged misconduct.[181] In *Longaker*, the client alternatively argued that proof of damages was not required when a lawyer breaches a fiduciary duty.[182]

A dispute over a fee arrangement led to a partial fee forfeiture in *Jackson Law Office, P.C. v. Chappell*.[183] In *Chappell*, the lawyers and client failed to reduce their fee agreement to writing.[184] The lawyers also failed to keep billing records, record services rendered, or provide billing statements to their client.[185] Instead, they charged the plaintiff for what the court characterized as an inflated fee, and eventually sued the client for non-payment.[186] The court found that "[t]he evidence supports the jury's finding of breach of fiduciary duty in that there is evidence of failure to disclose, misrepresentation, conflict of interest, and self-dealing" and therefore upheld the trial court's order of a partial fee forfeiture.[187] The les-

175. *Upchurch*, 5 S.W.3d at 283.

176. 11 S.W.3d 259 (Tex. App.—Fort Worth 1999, pet. denied).

177. Green v. Brantley, 11 S.W.3d 259, 268 (Tex. App.—Fort Worth 1999, pet. denied).

178. *Id.*

179. *Id.*

180. 32 S.W.3d 725 (Tex. App.—San Antonio 2000, no pet.).

181. Longaker v. Evans, 32 S.W.3d 725, 733 n.2 (Tex. App.—San Antonio 2000, no pet.).

182. *Id.*

183. 37 S.W.3d 15, 20-21 (Tex. App.—Tyler 2000, pet. denied).

184. Jackson Law Office, P.C. v. Chappell, 37 S.W.3d 15, 22 (Tex. App.—Tyler 2000, pet. denied).

185. *Id.*

186. *Id.*

187. *Id.* at 23.

son of *Chappell* is that one should endeavor to have a clear written fee agreement.

A fee forfeiture was denied under an unusual set of facts in *Haase v. Herberger*.[188] The attorneys represented a couple in a lawsuit arising out of construction defects on their home.[189] Subsequently, the wife filed for divorce.[190] A settlement offer was made by the defendants in the construction litigation, and the wife, through her divorce attorney, filed a motion in family court to obtain the exclusive right to settle the litigation.[191] The motion was granted.[192] The attorneys then filed a plea in intervention in family court requesting a disbursement of their fees.[193] The husband objected and counter-claimed for fee forfeiture and legal malpractice, alleging a conflict of interest between the husband and the wife due to the couple's difference of opinion as to whether to accept the settlement offer.[194] The court of appeals affirmed summary judgment for the attorneys, holding that the trial court did not err in refusing to order a forfeiture of attorneys' fees because this would constitute forfeiture of a fee that the attorneys had ultimately earned by following a court order.[195]

c. Unsettled Issues

*Arce* and its progeny leave several unsettled issues. Among the most significant are what types of conduct will be found to constitute a clear and serious breach of 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. It

188. 44 S.W.3d 267, 268 (Tex. App.—Houston [14th Dist.] 2001, no pet.).

189. Haase v. Herberger, 44 S.W.3d 267, 269 (Tex. App.—Houston [14th Dist.] 2001, no pet.).

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.*

194. *Haase*, 44 S.W.3d at 269.

195. *Id.* at 270. Whether an attorney can be liable for both fee forfeiture and damages was at issue in *Piro v. Sarofim*. Piro v. Sarofim, No. 01-0000398-CV, 2002 WL 538741, at *1 (Tex. App.—Houston [1st Dist.] Apr. 11, 2002, no pet. h.) (not designated for publication). The jury awarded actual damages of $3 million based on the breach of fiduciary duty and the trial judge awarded $3 million in the alternative as fee forfeiture. *Id.* The appellate court stated that "we agree the trial court could have rendered judgment . . . on both awards without creating a double recovery" but nevertheless found that the trial court did not err in making fee forfeiture an alternative award. *Id.* at *7.

should be noted that none of the fee forfeiture opinions define "fiduciary duty," nor do they clearly explain what kind of breach is clear and serious. Furthermore, section 49 of the proposed Restatement does not use the word "fiduciary." An agent owes many fiduciary duties to the principal, including the duties of care and skill, the duty to act only as authorized, and a variety of obligations that arise from the duty of loyalty.[196] An attorney-client relationship generally terminates upon the completion of the purpose of the employment. Thus, a breach of fiduciary duty cannot be based upon conduct subsequent to the completion of the purpose of the employment.[197] Furthermore, the only "duty" that an attorney owes as a trustee under a deed of trust is to adhere to the terms of the deed of trust.

Another problem arises from the fact that several cases thus far have involved fee forfeiture claims following the aggregate settlement of a mass tort, certainly because of the resulting large attorneys' fees. What, then, should an attorney do to protect himself in these settlements? Texas Disciplinary Rule of Professional Conduct 1.06(c) allows an attorney to conduct multiple representation despite the potential for conflict, so long as the attorney "reasonably believes the representation of each client will not be materially affected" and obtains consent from each client after full disclosure.[198] But what kind of permission or waiver will be sufficient to protect the attorney from liability in the context of a mass tort, which could potentially involve thousands of plaintiffs?

### d. Implications for Insurance

Most professional liability policies exclude coverage for overcharge, refund, or offset of legal fees. The duty of the insurance company to defend is determined by the allegations of the petition and the language of the insurance policy.[199] Thus, a claim for damages for legal malpractice, coupled with a claim for fee forfeiture,

196. *See, e.g.*, RESTATEMENT (SECOND) AGENCY §§ 376-98 (1958).

197. Stephenson v. LeBoeuf, 16 S.W.3d 829, 836 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

198. TEX. DISCIPLINARY R. PROF'L CONDUCT 1.06(c), *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. A (Vernon 1998) (TEX. STATE BAR R. art X, § 9).

199. Nat'l Union Fire Ins. Co. v. Merchs. Fast Motor Lines, 939 S.W.2d 139, 141 (Tex. 1997).

may give rise to a duty of the insurance company to defend, but not to indemnify, a claim for fee forfeiture.

## III. LIABILITY TO NON-CLIENTS

Besides the new claim for fee forfeiture, the most significant developments in the area of attorney liability have occurred in the context of lawsuits brought by non-clients. These suits, especially those alleging conspiracy, are becoming more common and have resulted in large settlements by lawyers in recent years.

### A. *Negligent Misrepresentation*

Despite concepts of privity, the Fifth Circuit held in *First National Bank of Durant v. Trans Terra Corp.*[200] that Texas law allows a non-client to recover against an attorney under a theory of negligent misrepresentation.[201] *Trans Terra* involved a negligence claim against an attorney who, in the course of representing a borrower, allegedly submitted an inaccurate title opinion to the lender.[202] The Fifth Circuit followed the Restatement view, which allows recovery against one who negligently supplies false information upon which another relies for guidance.[203] The Restatement limits liability to loss suffered either by a person for whose benefit and guidance the defendant intends to supply the information, or by those to whom the defendant knew the recipient intended to give the information.[204] The loss must be caused by reliance upon the misrepresentation "in a transaction that [the attorney] intends the information to influence or knows that the recipient so intends or in a substantially similar transaction."[205]

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200. 142 F.2d 802 (5th Cir. 1998).

201. First Nat'l Bank of Durant v. Trans Terra Corp., 142 F.2d 802, 808 (5th Cir. 1998).

202. *Id.* at 805.

203. RESTATEMENT (SECOND) OF TORTS § 552 (1997).

> One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

*Id.*

204. *Id.* § (2)(a).

205. *Id.* § (2)(b).

In *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*,[206] the Texas Supreme Court specifically adopted section 552 of the Restatement.[207] The law firm in *McCamish* represented Victoria Savings Association in a lender liability claim by some borrowers against the savings and loan.[208] 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.[209] 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.[210] 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.[211] The borrowers sued the law firm alleging that the firm negligently misrepresented that the settlement agreement met the criteria to bind the FSLIC.[212]

The Texas Supreme Court specifically rejected the law firm's argument that section 552 of the Restatement should not apply to attorneys.[213] The *McCamish* court stated 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.[214] 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 malpractice cases.[215] The supreme court noted that other jurisdictions have held attorneys lia-

206. 991 S.W.2d 787 (Tex. 1999).

207. McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 791 (Tex. 1999).

208. *Id.* at 789.

209. *Id.* at 790.

210. *Id.* at 789.

211. *Id.* at 790.

212. *McCamish*, 991 S.W.2d at 790.

213. *Id.* at 791.

214. *Id.*

215. *Id.* (citing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 73 (Tentative Draft No. 8, 1997)). *Compare id., with* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 (2000).

ble 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.[216] The *McCamish* court, however, reaffirmed *Barcelo*, which held that an attorney does not owe a duty of care that could give rise to malpractice liability to beneficiaries of wills or trusts because the attorney does not represent the beneficiaries.[217]

The Texas Supreme Court further noted that the Texas Disciplinary Rules of Professional Conduct prohibit an attorney from giving "an evaluation to a third party unless she reasonably believes that making the evaluation is compatible with other aspects of the attorney-client relationship and the client consents after consultation."[218] Comments to that Rule command the lawyer to advise the client of the implications of an evaluation.[219] The comments emphasize 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.[220] 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 an evaluation."[221] The *McCamish* 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 the evaluation might have on the scope of the attorney-client privilege.[222]

Responding to the law firm's claim that adopting section 552 would threaten lawyers with almost unlimited liability, the *McCamish* court pointed out that section 552 limits liability to situations in which the attorney providing the information is aware of the non-client and intends that the non-client rely on the information.[223] Therefore, a claim is available under section 552 only upon

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216. *McCamish*, 991 S.W.2d at 793.

217. *Id.* at 793 (recognizing *Barcelo's* legitimate policy considerations).

218. *Id.* (citing TEX. DISCIPLINARY R. PROF'L CONDUCT 2.02, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. A (Vernon Supp. 2001) (TEX. STATE BAR R. art. X, § 9)).

219. TEX. DISCIPLINARY R. PROF'L CONDUCT 2.02 cmt. 5; *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. A (Vernon 1998) (TEX. STATE BAR R. art. X, § 9).

220. *Id.*

221. *McCamish*, 991 S.W.2d at 793.

222. *Id.*

223. *Id.* at 794.

the transfer of information "to a known party for a known purpose."[224] Furthermore,

> [a] lawyer may also avoid or minimize the risk of liability to a nonclient by setting forth (1) limitations as to whom the representation is directed and who should rely on it, or (2) disclaimers as to the scope and accuracy of the factual investigation or assumptions forming the basis of the representation or the representation itself.[225]

Section 552 limits liability to misrepresentation of material facts.[226] For example, the supreme court noted that the communication of a client's negotiating position is not a statement of material fact.[227]

Further, justifiable reliance is an element of a cause of action under section 552.[228] Third party reliance may not be justified if the representation is within an adversarial context because of the attorneys' obligation to pursue the clients' interest with undivided loyalty.[229] *McCamish* also states that "a nonclient cannot rely on an attorney's statement, such as an opinion letter, unless the attorney invites that reliance."[230]

Another interesting case applying this principle of justifiable reliance is *Chapman Children's Trust v. Porter & Hedges.*[231] In *Chapman*, the court of appeals upheld summary judgment for a law firm that had been sued for breach of contractual, fiduciary, and other common law duties.[232] Because the original contract between the law firm and the plaintiff trusts specifically excused the attorneys from a "duty to cooperate," the court explicitly refused to impose that duty.[233] The lesson to be learned is that if a law firm places itself in a position of disbursing funds, its duties should be strictly defined in order to protect itself from liability to third parties.

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224. *Id.*

225. *Id.*

226. *McCamish*, 991 S.W.2d at 794.

227. *See id.* (citing TEX. DISCIPLINARY R. PROF'L CONDUCT 2.02 cmt. 1), *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. A (Vernon 1998) (TEX. STATE BAR R. art. X, § 9).

228. *See* RESTATEMENT (SECOND) OF TORTS § 552(c) (providing that the party must have justifiably relied upon the false information).

229. *McCamish*, 991 S.W.2d at 794.

230. *Id.* at 795.

231. 32 S.W.3d 429 (Tex. App.—Houston [14th Dist.] 2000, pet. denied).

232. Chapman Children's Trust v. Porter & Hedges, 32 S.W.3d 429, 436-43 (Tex. App.—Houston [14th Dist.] 2000, pet. denied).

233. *Id.* at 437.

Finally, *Lesikar v. Rappeport*[234] is a recent case interpreting negligent misrepresentation and section 552 in the context of attorney liability.[235] This case distinguishes between statements and misrepresentations that are made in a litigation context versus a transactional context.[236] The court focused on the requirement of justifiable reliance, explaining that when determining whether there was justifiable reliance on the part of the third party, "a reviewing court must consider the nature of the relationship between the attorney, client, and nonclient."[237] Because the representations in *Lesikar* were made in a litigation context, the element of justifiable reliance likely was not present because no litigant would be justified in relying on representations made by opposing counsel in the course of the suit.[238] When there is no justifiable reliance, the lawyer cannot have a duty and it therefore becomes irrelevant whether the misrepresentations were material or relied upon by the plaintiff.[239] This distinction is also consistent with a number of recent decisions in fraud cases, which also distinguish between statements made in an adversarial context from those made in a more congenial, transactional setting.

## B. *Fraud*

It is well-established under Texas law that privity is not a defense to fraud claims brought by third parties against attorneys.[240] In *Likover v. Sunflower Terrace II, Ltd.*,[241] a non-client sued an attorney for fraud and conspiracy to defraud.[242] The court rejected the attorney's non-duty argument, stating: "An attorney has no general duty to the opposing party, but he is liable . . . to third parties

234. 33 S.W.3d 282 (Tex. App.—Texarkana 2000, pet. denied).

235. Lesikar v. Rappeport, 33 S.W.3d 282, 319 (Tex. App.—Texarkana 2000, pet. denied).

236. *Id.*

237. *Id.*

238. *Id.*

239. *See id.* (concluding that there was no justifiable reliance even if the statements were material).

240. Likover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468, 472 (Tex. App.—Houston [1st Dist.] 1985, no writ).

241. 696 S.W.2d 468 (Tex. App.—Houston [1st Dist.] 1985, no writ).

242. *Likover*, 696 S.W.2d at 469.

when his conduct is fraudulent or malicious. He is not liable for breach of a duty to the third party, but he is liable for fraud."[243]

Fraud is the misrepresentation of a material fact, with the intent that the person or entity to whom the misrepresentation is made will rely upon it.[244] In the context of attorney liability, it is usually based on an affirmative misrepresentation rather than a mere failure to disclose.

*Bernstein v. Portland Savings & Loan Ass'n*[245] first distinguished fraud claims that are based on material misrepresentations from those that are based on a failure to disclose.[246] The court explained that silence can only be fraudulent when the person is under some duty to disclose the information.[247] The duty to disclose is primarily based on some sort of fiduciary or confidential relationship between parties, and although this does exist between attorney and client,[248] it generally does not extend beyond that relationship.[249] The court also relied upon Rule 1.05 of the Texas Disciplinary Rules of Professional Conduct, which prohibits attorneys from revealing client confidences, except when necessary to avert an act that "is likely to result in death or substantial bodily harm to a person."[250] The court stated that "[b]ecause the Texas Supreme Court has chosen not to force attorneys to disclose client confidences to avert non-violent fraud by clients, we decline to do so as well."[251]

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243. *Id.* at 472.

244. Trenholm v. Ratliff, 646 S.W.2d 927, 930 (Tex. 1983) (citing Wilson v. Jones, 45 S.W.2d 572, 574 (Tex. Comm'n App. 1932, holding approved)).

245. 850 S.W.2d 694 (Tex. App.—Corpus Christi 1993, writ denied).

246. Bernstein v. Portland Sav. & Loan Ass'n, 850 S.W.2d 694, 701-02 (Tex. App.—Corpus Christi 1993, writ denied); *see also Lesikar*, 33 S.W.3d at 319-20 (stating that "an attorney has no duty to reveal information about a client to a third party when that client is perpetrating a nonviolent, purely financial fraud through silence").

247. *Bernstein*, 850 S.W.2d at 701-02.

248. *Id.* at 701.

249. *See id.* (emphasizing the lack of such a duty where there is no fiduciary or confidential relationship). The duty to disclose arises: "(1) when one is in a fiduciary relationship; (2) when one voluntarily discloses some information, but not all of the pertinent information; (3) when new information makes an earlier representation misleading or untrue; and (4) when one makes a partial disclosure and conveys a false impression." *Lesikar*, 33 S.W.3d at 319.

250. *Bernstein*, 850 S.W.2d at 701.

251. *Id.* at 701-02.

However, in a footnote, the court recognized a significant problem: "If we found a duty in lawyers to disclose confidential information in this situation, we would place lawyers in the difficult position of choosing either to remain silent and risk fraud liability or to betray client confidences and risk jeopardizing that and other attorney-client relationships."[252] Thus, attorneys may follow Rule 1.05 and theoretically also avoid liability for fraud. However, in reality, the line between affirmative misrepresentation and failure to disclose is not clear, and lawyers are certain to face a serious dilemma in the future, especially as the number of cases based on fraud and conspiracy to defraud continues to grow.

In fact, this dilemma has led to significant recent debates at the American Bar Association ("ABA") over whether or not to revise Rule 1.6 of the Model Rules of Professional Conduct, which is the equivalent of Texas Rule 1.05.[253] These debates led to a proposed Model Rule 1.6, which would allow lawyers to reveal confidential information in order "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services."[254] However, at the 2001 Annual Meeting, the ABA voted not to broaden the exception.

Recently, state and federal regulatory agencies have sued attorneys who make allegedly fraudulent statements to those regulators on behalf of clients. Being sued by the Federal Deposit Insurance Corporation ("FDIC"), a state securities commission, or any regulatory agency presents special problems, and these difficulties may be exacerbated by a recent Texas Supreme Court opinion.[255] In

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252. *Id.* at 702 n.7.

253. Mary C. Daly, *To Betray Once? To Betray Twice?: Reflections on Confidentiality, A Guilty Client, An Innocent Condemned Man, and an Ethics-Seeking Defense Counsel*, 29 LOY. L.A. L. REV. 1611, 1619-20 (1996).

254. A.B.A. COMM. ON EVALUATION OF THE RULES OF PROF'L CONDUCT, REP. OF THE COMMISSION ON EVALUATION OF THE RULES OF PROF'L CONDUCT R. 1.6(b)(2), (Ethics 2000 Commission), *available at* http://www.abanet.org/cpr/e2k-rule16.html (last visited Apr. 1, 2002).

255. *See* Ernst & Young, L.L.P. v. Pacific Mut. Life Ins. Co., 51 S.W.3d 573, 578-80 (Tex. 2001) (discussing the application of section 531, Restatement (Second) of Torts, to a claim against an accounting firm by third parties under a theory of fraud, and holding that the accounting firm negated the intent element of a fraud claim as a matter of law by

*Ernst & Young, L.L.P. v. Pacific Mutual Life Insurance Co.*,[256] the Texas Supreme Court considered "whether the intent-to-induce-reliance element of a fraud claim requires a direct relationship between the alleged fraudfeasor and a specific known person" and concluded that it did not.[257] In this case, Ernst & Young had issued an audit report to its client, a bank, which gave an unqualified opinion that the bank's financial statements fairly presented its financial position.[258] The bank then used this report in its annual report, the Form 10-K it filed with the Securities and Exchange Commission, and several prospectuses that were sent to the plaintiff, Pacific Mutual Life Insurance Company.[259] Pacific Mutual Life bought notes from the bank, in reliance at least partly upon Ernst & Young's representations in the audit report and prospectuses.[260] When the bank thereafter filed for bankruptcy, Pacific Mutual Life sued Ernst & Young for fraud.[261]

The supreme court agreed with Pacific Mutual Life's argument that a plaintiff need not show that the defendant had a "direct intent to specifically induce [the plaintiff's] reliance in order to maintain its fraud claim."[262] Rather, the court adopted section 531 of the Restatement (Second) of Torts, stating that a person who makes a misrepresentation is liable "to the persons or class of persons [the maker] intends or *has reason to expect* [will] act . . . in reliance upon the misrepresentation."[263] The court opined that this standard does not eliminate the specific intent requirement for establishing a fraud claim, because "a defendant who acts with knowledge that a result will follow is considered to intend the result."[264] Therefore, it seems that a plaintiff need only show that the defendant had knowledge of the possibility of reliance, rather than

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establishing that it did not have reason to expect the third party would rely on the audit report).

256. 51 S.W.3d 573 (Tex. 2001).

257. *Ernst & Young*, 51 S.W.3d at 574-75.

258. *Id.* at 575.

259. *Id.*

260. *Id.* at 576.

261. *Id.*

262. *Ernst & Young*, 51 S.W.3d at 577-78 (referring to traditional jurisprudence that focuses on intended rather than direct reliance).

263. *Id.* (quoting RESTATEMENT (SECOND) OF TORTS § 531 (1977)).

264. *Id.* at 579.

that the defendant specifically intended to induce the reliance, in order to prove fraud in Texas.[265]

Moreover, the court relied on comment (c) to the Restatement, stating that "one who complies with a statutory filing requirement is presumed to have reason to expect that the information will reach and influence the class of persons the statute is designed to protect."[266] This opinion could lead to increased liability for lawyers, especially in the context of representing companies in SEC filings. First, the court has said that a defendant who acts with knowledge that a result will follow is considered to intend that result. Second, if a defendant makes a statutory filing, that defendant is presumed to know that the class of persons covered by that statute will be affected. Needless to say, this is a potentially dangerous development for any lawyers who assist their clients in making filings with administrative agencies such as the SEC.

## C. *Conspiracy*

### 1. Recent Developments

A number of recent cases illustrates the increasing potential for liability that lawyers now face for suits by third parties based on allegations of conspiracy to defraud. Two major law firms have recently settled lawsuits for millions of dollars.[267] One of these suits was brought by a class of investors who had allegedly been defrauded by Russell Erxleben, a former University of Texas football star, into investing in a "Ponzi" scheme.[268] The investors alleged that the law firms, which represented Erxleben, engaged in a con-

265. *See id.* at 580 (characterizing this knowledge as "a degree of certainty that goes beyond mere foreseeability"). The court also explained that "[g]eneral industry practice or knowledge may establish a basis for foreseeability to show negligence, but it is not probative of fraudulent intent." *Id.* at 581.

266. *Ernst & Young*, 51 S.W.3d at 581.

267. Janet Elliott, *Locke Liddell Settlement Serves as Warning to Other Firms*, TEX. LAW., Apr. 24, 2000, at 14, WL 4/24/2000 TEXLAW 14. In addition to the cases specifically discussed, it is important to note that many of the malpractice lawsuits brought in recent years also include allegations of conspiracy. *See, e.g.*, Vinson & Elkins v. Moran, 946 S.W.2d 381, 389 (Tex. App.—Houston [14th Dist.] 1997, writ dism'd by agr.) (involving allegations by the beneficiaries of an estate against Vinson & Elkins for breach of fiduciary duty, professional negligence, violations of the DTPA, and conspiracy in the alleged mishandling of the estate).

268. Janet Elliot, *Locke Liddell Settlement Serves as Warning to Other Firms*, TEX. LAW., Apr. 24, 2000, at 14, WL 4/24/2000 TEXLAW 14.

spiracy to defraud investors by allowing his company, Austin Forex International, to "sell unregistered securities" and because it "knew about the company's growing losses for months before state securities regulators began investigating."[269]

A mere five months later, a similar lawsuit was again brought against the same firm, this time based on its alleged involvement in assisting Brian Russell Stearns in defrauding investors under a similar scheme.[270] In this suit, the plaintiffs (again in a class action lawsuit) alleged that the firm "assisted Stearns in selling unregistered securities, aided him in breaching fiduciary duties to investors, and conspired with Stearns to breach fiduciary duties to commit securities fraud and fraud."[271] This lawsuit was also settled for a significant amount.[272]

Of course the most infamous lawsuit of recent years brought the venerable law firm of Kaye, Scholer, Fierman, Hayes, and Handler ("Kaye Scholer") to its knees when it settled a suit brought against it by the Office of Thrift Supervision ("OTS") for $41 million, only six days after the suit was filed.[273] This suit arose out of the firm's aggressive representation of the Lincoln Savings and Loan Association in an examination conducted by the Federal Home Loan Bank Board ("FHLBB").[274] The allegations brought against Kaye Scholer centered on its failure to disclose material facts about its client, its participation in misrepresenting Lincoln's financial worth to investors, its use of tax shelters, and its falsification of documents, among other things.[275]

For attorney-defendants, these cases are foreboding. By alleging conspiracy in some way, the plaintiffs have bypassed the privity requirement and opened the door to lawsuits on behalf of potentially thousands of individuals, and many millions of dollars. In addition, conspiracy is often less difficult to prove as a claim of fraud. Law-

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269. *Id.*

270. Brenda Sapino Jeffreys, *Locke Liddell Sued for Allegedly Helping Client in Ponzi Scheme*, TEX. LAW., Sept. 18, 2000, at 1, WL 9/18/2000 TEXLAW 1.

271. *Id.*

272. Brenda Sapino Jeffreys, *Locke Liddell Agrees to Settle Suit Over Alleged Ponzi Scheme*, TEX. LAW., Aug. 6, 2001, at 1, WL 8/6/2001 TEXLAW 1.

273. W. Frank Newton, *A Lawyer's Duty to the Legal System and to a Client: Drawing the Line*, 35 S. TEX. L. REV. 701, 706 (1994).

274. *Id.* at 702.

275. *Id.* at 705.

yers can therefore expect the number of lawsuits alleging conspiracy to continue to grow exponentially, and the number of settlements to echo this growth.

2. Elements of Conspiracy

An attorney may be liable for conspiring with the client to commit a wrong.[276] To recover against an attorney for conspiracy, the plaintiff must show that: (1) the attorney knew the object and purpose of the conspiracy; (2) there was an understanding or agreement to inflict a wrong or injury; (3) there was a meeting of minds on the object or cause of action; and (4) there was some mutual mental action, coupled with an intent to commit the act that resulted in the injury.[277] Privity is not required to bring a conspiracy cause of action.[278]

The Texas Supreme Court has recently granted petition for review in a case holding that claims of conspiracy must be based on another, substantive tort with a specific intent.[279] Thus, under this rule, claims of conspiracy to breach a contract may fail because they are not based on another substantive tort.[280] Similarly, claims of conspiring to be negligent or grossly negligent fail because they do not involve a specific intent.

In order to support a finding of civil conspiracy, there is no need that the defendant actually be found *liable* for a separate tort.[281] Rather, "[a] finding of civil conspiracy does require . . . that the plaintiff be able to *plead and prove* 'one or more wrongful, overt acts' in furtherance of the conspiracy that would have been actionable against the conspirators individually."[282] Both with respect to criminal and civil conspiracy, the evidence used to prove conspir-

276. Likover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468, 472 (Tex. App.—Houston [1st Dist.] 1985, no writ); Bourland v. State, 528 S.W.2d 350, 353-57 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

277. *Likover*, 696 S.W.2d at 472.

278. *Id.*; *see also* 1 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 6.5, at 559 (5th ed. 2000) (explaining that conspiracy is typically based upon fraudulent or intentional misconduct and thus does not necessitate a showing that there is a duty).

279. Grizzle v. Tex. Commerce Bank, 38 S.W.3d 265, 285 (Tex. App.—Dallas 2001, pet. granted).

280. *Id.*

281. Banc One Capital Partners Corp. v. Kneipper, 67 F.3d 1187, 1195 (5th Cir. 1995) (declaring such a district court judgment an error).

282. *Id.* (quoting Massey v. Armco Steel Co., 652 S.W.2d 932, 934 (Tex. 1983)).

acy may be circumstantial "because conspirators' work is often clandestine in nature."[283] However, "[m]ere knowledge and silence are not enough to prove conspiracy . . . because of the attorney's duty to preserve client confidences, there must be indications that the attorney agreed to the fraud."[284] This creates an open question: if the attorney agreed to commit fraud, but if that fraud was by nondisclosure where there was not otherwise a duty to disclose, can the defendant nevertheless be liable for conspiracy even when there would not otherwise be liability for fraud?

The reason that allegations of conspiracy may result in excessive liability is that "[o]nce a civil conspiracy is proven, each co-conspirator is responsible for the acts done by any of the conspirators in furtherance of the unlawful combination."[285] Thus, if a conspiracy was found where the law firm's client had engaged in behavior that resulted in millions of dollars of losses, the law firm may be equally responsible for those losses. In many cases, the law firm will be viewed as having a deeper pocket than the client. In addition, because many cases involve allegations of both civil and criminal conspiracy, the clients may become more concerned about protecting themselves from the criminal charges than from denying civil liability,[286] perhaps meaning that the client will agree to waive the attorney client privilege and testify against the firm as part of the client's criminal plea.

Another problem is that most insurance policies do not cover fraud,[287] which is the claim upon which many conspiracies are based. Adding to the claimants' collectability problems, most firms

283. Cantrell v. State, 54 S.W.3d 41, 46 (Tex. App.—Texarkana 2001, pet. granted).

284. Bernstein v. Portland Savings & Loan Assoc., 850 S.W.2d 694, 706 (Tex. App.—Corpus Christi 1993, writ denied).

285. *Likover*, 696 S.W.2d at 474.

286. *See* TEX. PEN. CODE ANN. § 15.02 (Vernon 1994) (outlining the following elements of criminal conspiracy: with the intent to commit a felony, the defendant (1) "agrees with one or more persons" to engage in conduct that constitutes the offense; and (2) "he or one or more of them performs an overt act in pursuance of the agreement").

287. *See* 5 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 34.23, at 301 (5th ed. 2000) (stating "[t]he so-called 'willful acts' or 'fraud' exclusion is the most common basis upon which insurers reserve rights on coverage or refuse to defend an insured"); *see also* Andrew S. Hanen & Jett Hanna, *Legal Malpractice Insurance: Exclusions, Selected Coverage and Consumer Issues*, 33 S. TEX. L. REV. 75, 83 (1992) (stating that every malpractice policy contains an exclusion for fraud although some do not contain a detailed definition of fraud).

are either limited partnerships or professional corporations.[288] This designation means that the individual partners are not jointly and severally liable for the acts of the wrongdoer.[289]

### D. *The "Litigation Privilege" as a Defense*

Texas courts have protected attorneys involved in litigation against claims by the opposing party by fashioning a litigation privilege, sometimes referred to as "attorney immunity," which prevents most claims by opposing parties against those attorneys. In dismissing a wrongful garnishment claim by an opposing party against an attorney, the Fort Worth Court of Appeals stated:

> Under Texas law, attorneys cannot be held liable for wrongful litigation conduct. A contrary policy "would dilute the vigor with which Texas attorneys represent their clients" and "would not be in the best interests of justice."
>
> This rule focuses on the type of conduct in which the attorney engages rather than on whether the conduct was meritorious in the context of the underlying lawsuit. Accordingly, the present case turns on whether the attorney's conduct was part of discharging his duties in representing his client. If the conduct is within this context, it is not actionable even if it is meritless.[290]

Similarly, in *Taco Bell Corp. v. Cracken*,[291] the Northern District of Texas dismissed claims brought against two attorneys as a matter of law on the grounds that they involved conduct undertaken in the course of representing a client in litigation.[292] As the court explained, "an attorney's knowledge that he may be sued by the

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288. *See* Jett Hanna, *Legal Malpractice Insurance and Limited Liability Entities: An Analysis of Malpractice Risk and Underwriting Responses*, 39 S. TEX. L. REV. 641, 647 (1998) (stating that the vast majority of TLIE insureds are limited liability entities).

289. *See id.* at 644-45 (stating that partners are insulated from both contract and tort liability as long as they are not the result of a partner's own actions or those under the direct supervision of a partner).

290. Renfroe v. Jones & Assocs., 947 S.W.2d 285, 288 (Tex. App.—Fort Worth 1997, writ denied) (citations omitted); *see also* Lewis v. Am. Exploration Co., 4 F. Supp. 2d 673, 680 (S.D. Tex. 1998) (refusing tort damages for conduct of opposing counsel in client representation); Taco Bell Corp. v. Cracken, 939 F. Supp. 528, 532 (N.D. Tex. 1996) (discussing the possible chilling effect of one professional retaliating against his colleague); Bradt v. West, 892 S.W.2d 56, 72 (Tex. App.—Houston [1st Dist.] 1994, writ denied) (stating "[a]n attorney should not go into court knowing that he may be sued by the other side's attorney").

291. 939 F. Supp. 528 (N.D. Tex. 1996).

292. Taco Bell Corp. v. Cracken, 939 F. Supp. 528, 532-33 (N.D. Tex. 1996).

other side's attorney would favor tentative rather than zealous representation of the client, which is contrary to professional ideals and public expectations."[293] The *Taco Bell* court focused solely on the nature of the conduct, that is whether it was part of the attorney's duties, and refused to consider whether it was meritorious conduct.[294] It dismissed all of the claims, including claims for fraud and civil conspiracy.[295]

Since that time, however, courts have held that the litigation privilege will not overcome an opposing party's allegation of fraud or conspiracy to defraud against an attorney.[296] This is because lawyers may only be immune for "actions which are 'within the bounds of the law.'"[297] Moreover, the Northern District of Texas subsequently held in *Miller v. Stonehenge/FASA-Texas, JDC, L.P.*[298] that when an attorney is engaging in behavior that falls outside the scope of representation of the client, that attorney may not be entitled to the litigation privilege as a defense.[299] In *Miller*, the attorney was representing a client in its collection efforts and chose to accompany the federal marshals to a debtor's home in order to seize certain assets.[300] The attorney then "demanded access to the premises and, under threat of force, inspected, inventoried, and videotaped plaintiff's 'personal and intimate' property and effects."[301] The court held that because this conduct did not involve "'the office, professional training, skill, and authority of an attorney'" it was not properly subject to the litigation privilege de-

293. *Id.* at 532 (citing Bradt v. West, 892 S.W.2d 56, 72 (Tex. App.—Houston [1st Dist.] 1994, writ denied)).

294. *Id.* at 532-33.

295. *Id.* at 533.

296. Mendoza v. Fleming, 41 S.W.3d 781, 787-88 (Tex. App.—Corpus Christi 2001, no pet.); Querner v. Rindfuss, 966 S.W.2d 661, 666 (Tex. App.—San Antonio 1998, pet. denied) (refusing a global privilege). *But see Lewis*, 4 F. Supp. 2d at 679 (refusing to follow this line of case law and continuing to hold that "[c]haracterizing the attorney's actions in defending his client as fraudulent or as part of a conspiracy to defraud does not change the rule or provide a basis for recovery").

297. *Mendoza*, 41 S.W.3d at 787 (quoting Renfroe v. Jones & Assocs., 947 S.W.2d 285, 288 (Tex. App.—Fort Worth 1997, writ denied)).

298. 993 F. Supp. 461 (N.D. Tex. 1998).

299. *See* Miller v. Stonehenge/FASA-Texas, JDC, L.P., 993 F. Supp. 461, 464 (N.D. Tex. 1998) (refusing this contention outright but requiring that the court focus on whether the conduct "requires 'the office, professional training, skill, and authority of an attorney'") (quoting *Taco Bell Corp.*, 939 F. Supp. at 532).

300. *Id.* at 463.

301. *Id.*

fense.[302] Additionally, it is important to note that even if the litigation privilege protects an attorney from liability, that attorney may still be subject to sanctions.[303]

### E. *Texas Deceptive Trade Practices—Consumer Protection Act ("DTPA")*

While the DTPA might have formed the basis for a claim against an attorney by a non-client in the past, the current version of the DTPA will seldom be of much assistance to someone making a claim against an attorney.[304] The majority of cases discussed in this section were decided under the previous version of the statute. Tort reform legislation in Texas effective September 1, 1995 blocks most professional liability under the DTPA in connection with the providing of advice, judgment, or opinion.[305] Section 17.49(c) of the Texas Business and Commerce Code provides:

> (c) Nothing in this subchapter shall apply to a claim for damages based on the rendering of a professional service, the essence of which is the providing of advice, judgment, opinion, or similar professional skill. This exemption does not apply to:
> (1) an express misrepresentation of a material fact that cannot be characterized as advice, judgment, or opinion;
> (2) a failure to disclose information in violation of Section 17.46(b)(23);
> (3) an unconscionable action or course of action that cannot be characterized as advice, judgment, or opinion; or
> (4) breach of an express warranty that cannot be characterized as advice, judgment, or opinion.[306]

Thus, the plaintiff must now show not simply negligent conduct, but deceptive conduct.[307] In that context, however, the DTPA may be applied to attorneys.[308] The plaintiff must also establish "con-

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302. *Id.* at 465 (citation omitted in original).

303. *See* White v. Bayless, 32 S.W.3d 271, 276 (Tex. App.—San Antonio 2000, pet. denied) (referring to public remedies that are available even if private remedies are not).

304. *See* Burnap v. Linnartz, 38 S.W.3d 612, 619 n.1 (Tex. App.—San Antonio 2000, no pet.).

305. *Id.*

306. TEX. BUS. & COMM. CODE ANN. § 17.49(c) (Vernon Supp. 2002).

307. *See* Latham v. Castillo, 972 S.W.2d 66, 69 (Tex. 1998) (emphasizing the importance of differentiating between deceptive and negligent conduct).

308. Lucas v. Nesbitt, 653 S.W.2d 883, 886 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.); Barnard v. Meconn, 650 S.W.2d 123, 125 (Tex. App.—Corpus Christi 1983, writ

sumer" status under the DTPA in order to have the requisite standing. To establish "consumer" status under the DTPA, the plaintiff has the burden of showing: (1) the plaintiff "acquired goods or services by purchase or lease, and (2) that the goods or services purchased or leased form the basis of the complaint."[309] In *DeBakey v. Staggs*,[310] the court held the DTPA applied to the purchase or acquisition of legal services, reasoning that an "attorney sells legal services and the client purchases them."[311] Therefore, an attorney's client can be a "consumer" under the DTPA.

In determining the "consumer" status of third parties, however, Texas courts have split. One Texas court has interpreted "consumer" to include a third party if the transaction was consummated for the benefit of the third party.[312] Other Texas courts have held that third parties do not qualify as DTPA "consumers."[313] A "consumer" may recover against a third party under the DTPA without privity of contract when the transaction was consummated for the benefit of the third party.[314]

*Latham v. Castillo*[315] is the Texas Supreme Court's latest application of the DTPA to attorney misconduct, and it addresses the question of whether an attorney's misrepresentations to his clients, which caused the clients to lose their day in court, can constitute

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ref'd n.r.e.); DeBakey v. Staggs, 605 S.W.2d 631, 633 (Tex. Civ. App.—Houston [1st Dist.] 1980), writ ref'd n.r.e., 612 S.W.2d 924 (Tex. 1981) (per curiam).

309. Marshall v. Quinn-L Equities, Inc., 704 F. Supp. 1384, 1393 (citing Cameron v. Terrell & Garrett, Inc., 618 S.W.2d 535, 539 (Tex. 1981)).

310. 605 S.W.2d 631 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

311. *DeBakey*, 605 S.W.2d at 633.

312. Parker v. Carnahan, 772 S.W.2d 151, 158-59 (Tex. App.—Texarkana 1989, no writ). *But see* Thompson v. Vinson & Elkins, 859 S.W.2d 617, 618-19 (Tex. App.—Houston [1st Dist.] 1993, writ denied) (holding beneficiaries of a trust not to be consumers of services of the attorney whom the trustee hired).

313. *See* Roberts v. Burkett, 802 S.W.2d 42, 47-48 (Tex. App.—Corpus Christi 1990, no writ) (denying "consumer" status because no purchase of legal services actually occurred, although legal services were sought and acquired gratuitously); Fielder v. Abel, 680 S.W.2d 655, 657 (Tex. App.—Austin 1984, no writ); First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin & Stewart, 648 S.W.2d 410, 417 (Tex. App.—Dallas 1983, writ ref'd n.r.e.).

314. *See, e.g.*, *Burnap*, 38 S.W.3d at 619, n.1; Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 815 (Tex. 1997); Amstadt v. U.S. Brass Corp., 919 S.W.2d 644, 649 (Tex. 1996); Kennedy v. Sale, 689 S.W.2d 890, 892-93 (Tex. 1985); Flenniken v. Longview Bank & Trust Co., 661 S.W.2d 705, 707 (Tex. 1983).

315. 972 S.W.2d 66 (Tex. 1998).

unconscionable action under the DTPA.[316] In *Latham*, there was evidence that the attorney, Latham, affirmatively misrepresented to his clients, the Castillos, that he had filed a medical malpractice claim when in fact he had not.[317] The Castillos offered no evidence that they would have prevailed in their medical malpractice suit against the hospital had it been brought properly by Latham.[318]

The Texas Supreme Court held that Latham's affirmative misrepresentations caused the Castillos to lose the opportunity to prosecute their claim against the hospital.[319] Because it was an "unconscionable action" that resulted in unfairness to the consumer, the Castillos were able to bring their suit under the DTPA.[320] The *Castillo* court stated that to be actionable as an "'unconscionable action or course of action,'" the resulting unfairness must be "'glaringly noticeable, flagrant, complete and unmitigated.'"[321] Moreover, under the statute, the Castillos were not required to prove that they would have won the underlying medical malpractice action to prevail in their DTPA cause of action against Latham.[322] This is in contrast to a legal malpractice claim, in which the client would have to prove the "case within a case," in other words, that the client would have won the underlying suit but for attorney malpractice. Finally, the *Castillo* court held that the Castillos did not have to first prove that they suffered economic damages to recover mental anguish damages.[323] Concurring and dissenting, Justice Owen, joined by Justices Gonzalez, Hecht, and Enoch, concluded that because the Castillos did not prove that they had a meritorious claim against the hospital, the Castillos presented no evidence of unconscionable action by Latham, and no evidence of actual damages.[324]

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316. Latham v. Castillo, 972 S.W.2d 66, 67 (Tex. 1998).

317. *Id.* at 68. In reviewing the appeal, the court viewed all "the evidence in the light most favorable to [the Castillos] and indulge[d] every reasonable inference in their favor." *Id.* (referring to Harbin v. Seale, 461 S.W.2d 591, 592 (Tex. 1970)).

318. *Id.* at 67-68.

319. *Id.* at 68.

320. *Latham*, 972 S.W.2d at 68.

321. *Id.* (quoting TEX. BUS. & COMM. CODE ANN. § 17.50(a)(3) (Vernon 1987) and Chastain v. Koonce, 700 S.W.2d 579, 584 (Tex. 1985)).

322. *Id.* at 69.

323. *Id.*

324. *Id.* at 72 (Owen, J., concurring and dissenting).

F. *Attorney Liability to Insurer*

Since *American Centennial Insurance Co. v. Canal Insurance*,[325] it has been clear that an excess insurer can sue an attorney employed by a primary insurer for negligence in defending a case.[326] When excess insurance is involved, defense counsel should advise the client to notify the excess carrier of the claim, and to ask the carrier if it wishes to be kept informed of the progress of the litigation.

In *Keck, Mahan & Cate v. National Union Fire Insurance Co. of Pittsburgh*,[327] the excess insurance carrier brought suit against its primary insurance carrier along with the attorneys whom the primary carrier had hired to defend its insured after the settlement of a claim, asserting "that it had been forced to settle the third-party claim for too much because the attorneys and primary carrier had mishandled the insured's defense."[328] The Texas Supreme Court reaffirmed the *American Centennial* case, and further held that: (1) an insured's release of its attorneys may not always be a complete bar to equitable subrogation claims for legal malpractice against the attorneys;[329] (2) the excess insurer's alleged negligence for not contributing to the insured's defense prior to a tender from the primary carrier is irrelevant to the issue of comparative responsibility unless the excess carrier interfered with the insured's defense or assigned control of the defense;[330] (3) the excess insurer owed no duty to evaluate the settlement demand or supervise the defense prior to the tender of the limits by the primary carrier;[331] and (4) the possibility that the excess policy provided no coverage did not make the policy involuntary and thus did not bar the equitable subrogation.[332]

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325. 843 S.W.2d 480 (Tex. 1992).

326. Am. Centennial Ins. Co. v. Canal Ins., 843 S.W.2d 480, 484 (Tex. 1992).

327. 20 S.W.3d 692 (Tex. 2000).

328. Keck, Mahan & Cate v. Nat'l Union Fire Ins. Co. of Pittsburgh, 20 S.W.3d 692, 695 (Tex. 2000).

329. *Id.* at 703.

330. *Id.* at 701-02.

331. *Id.*

332. *Id.* at 703.

The potential liability of insurance companies for litigation supervision is not clear.[333] An insurance company is not liable for the legal malpractice of an independent attorney it appoints to represent its insured.[334] As a practical matter, some insurance companies attempt to instruct defense counsel about whom the insured/client can sue, and impose limits on what the attorney can and cannot do in the representation of the insured/client. Such attempts by the insurer to control an attorney's independent professional judgment are improper, and present an ethical dilemma for the attorney. A recent ethics opinion holds that a lawyer violates the rules of professional conduct if he agrees with insurance company restrictions on the lawyer's exercise of his or her independent professional judgment in representing the insured/client.[335]

## IV. Miscellaneous Causes of Action

Beyond the primary theories of liability, attorneys in Texas should be aware of a number of other potential bases for liability. These are based on both private causes of action and public sanctions or administrative proceedings.

### A. *Professional Misconduct*

Paragraph 15 of the preamble to the Texas Disciplinary Rules of Professional Conduct provides: "Violation of a rule does not give rise to a private cause of action nor does it create any presumption that a legal duty to a client has been breached . . . . [N]othing in the rules should be deemed to augment any substantive legal duty of lawyers or the extra-disciplinary consequences of violating such a duty."[336] Professional misconduct does not give rise to a private

333. Ellen S. Pryor & Charles Silver, *Defense Lawyers' Professional Responsibilities Part I - Excess Exposure Cases*, 78 Tex. L. Rev. 542, 607 (2000).

334. State Farm Mut. Auto Ins. Co. v. Traver, 980 S.W.2d 625, 628 (Tex. 1998); *see also* Michael Rigby, *The Broken Triangle—Should Insurers Be Held Vicariously Liable for the Legal Malpractice of Counsel They Retain to Defend Their Insureds?*—State Farm Mutual Automobile Insurance Co. v. Traver, *980 S.W.2d 625 (Tex. 1998)*, 41 S. Tex. L. Rev. 651, 652-53 (2000) (discussing the implications of the *State Farm* opinion and criticizing the decision on the ground that it will increase temptation on the part of insurance companies to place their own interests ahead of the insured).

335. Op. Tex. Ethics Comm'n No. 533 (2000).

336. Tex. Disciplinary R. Prof'l Conduct preamble ¶ 15, *reprinted in* Tex. Gov't Code Ann., tit. 2, subtit. G app. A (Vernon 1998) (Tex. State Bar R. art. X, § 9).

cause of action.[337] Texas courts do, however, apply the disciplinary rules as standards of conduct for attorneys in legal malpractice actions.[338] In many cases, the pertinent disciplinary rules can come into evidence.[339] Moreover, attorneys may be subject to disciplinary proceedings at their bar associations if they engage in serious violations of disciplinary or other ethical rules.

### B. *Frivolous Lawsuits and Pleadings*

A party or his attorney may be liable for attorneys' fees incurred by an adversary in defending against certain frivolous pleadings and lawsuits: (1) under the DTPA;[340] (2) under Texas Rule of Civil Procedure 13;[341] (3) under the Civil Practice and Remedies Code;[342] and (4) under Federal Rule of Civil Procedure 11.[343] In addition, recent opinions indicate that sanctions may be authorized even outside the bounds of the above statutes and rules. In *Johnson v. Johnson*,[344] the San Antonio Court of Appeals relied on its

337. Dyer v. Shafer, Gilliland, Davis, McCollum & Ashley, Inc., 779 S.W.2d 474, 479 (Tex. App.—El Paso 1989, writ denied); Blanton v. Morgan, 681 S.W.2d 876, 879 (Tex. App.—El Paso 1984, writ ref'd n.r.e.).

338. *See, e.g.*, Avila v. Havana Painting Co., 761 S.W.2d 398, 400 (Tex. App.—Houston [14th Dist.] 1988, writ denied) (claiming the code required an attorney to promptly deliver funds to the client and finding that the failure to do so would give rise to a legal malpractice cause of action); Heath v. Herron, 732 S.W.2d 748, 751 (Tex. App.—Houston [14th Dist.] 1987, writ denied) (rejecting attorney's "no duty" argument by reference to the code requirement that a lawyer shall represent a client competently and shall not handle a legal matter without adequate preparation); *see also* 1 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 1.8, at 41 (5th ed. 2000) (explaining that the relevancy of the ethics rules depends upon the jurisdiction; many states allow them to be "a consideration for the court or the trier of fact" while in others the "rules can establish controlling civil law standards").

339. 1 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 1.8, at 41 (5th ed. 2000).

340. *See* Donwerth v. Preston II Chrysler-Dodge, Inc., 775 S.W.2d 634, 636-38 (Tex. 1989) (finding the plaintiff's claims under DTPA were not groundless).

341. TEX. R. CIV. P. 13 (imposing Rule 13 sanctions against an attorney who files a pleading that is both groundless and brought in bad faith); Gaspard v. Beadle, 36 S.W.3d 229, 239 (Tex. App.—Houston [1st Dist.] 2001, pet. denied). A pleading that is "[g]roundless" has "no basis in law or fact and [is] not warranted by good faith argument." TEX. R. CIV. P. 13. In *Gaspard*, the court of appeals upheld the imposition of sanctions for pleadings that were filed merely for harassment purposes. *Gaspard*, 36 S.W.3d at 240 (sanctioning the lawyer for filing pleadings that asked that the plaintiffs be "horse whipped" and accusing them of conspiring with devil).

342. TEX. CIV. PRAC. & REM. CODE ANN. § 9.011 (Vernon 1987).

343. Thomas v. Capitol Sec. Servs., Inc., 836 F.2d 866, 877 (5th Cir. 1988).

344. 948 S.W.2d 835 (Tex. App.—San Antonio 1997, writ denied).

inherent disciplinary power to sanction an attorney for his conduct, which it considered to be "personal attacks on the trial judge" and it cautioned that "[z]ealous representation does not and cannot include degrading the court in the hopes of gaining a perceived advantage."[345] The Fifth Circuit also recently upheld a bankruptcy court's imposition of sanctions in excess of $20,000 against an attorney whose "egregious, obnoxious, and insulting behavior . . . constituted . . . an affront."[346] In addition, attorneys may be subject to disqualification by the court if they represent clients despite a conflict of interest.[347]

### C. *Collection*

An attorney may be held liable for violating the Federal Fair Debt Collection Practices Act.[348] To prevail on an unfair debt collection action under the federal statute the plaintiff must prove the attorney is a "debt collector," as defined in the applicable statute.[349] Under Texas law, section 82.063 of the Texas Government Code provides a statutory right for a client to recover on demand money an attorney receives or collects on the client's behalf.[350]

### D. *Federal and State Securities Law*

Attorneys may be liable under the 1933 Securities Act,[351] the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, and the Texas Securities Act.[352] Of these various theories of liability, however, the most notable is the Securities Exchange Act

345. Johnson v. Johnson, 948 S.W.2d 835, 840 (Tex. App.—San Antonio 1997, writ denied).

346. *In re* First City Bancorporation of Tex., Inc., 282 F.3d 864, 866 (5th Cir. 2002).

347. *See In re* George, 28 S.W.3d 511, 512 (Tex. 2000) (disqualifying two law firms due to their violations of rules of professional conduct disallowing representation under a conflict of interest).

348. 15 U.S.C. §§ 1692a-1692o (1994).

349. Catherman v. First State Bank of Smithville, 796 S.W.2d 299, 302-03 (Tex. App.—Austin 1990, no writ).

350. TEX. GOV'T CODE ANN. § 82.063 (Vernon 1988); *see also* Avila v. Havana Painting Co., Inc., 761 S.W.2d 398, 400-01 (Tex. App.—Houston 1998, pet. denied) (applying section 82.063 of the Texas Government Code).

351. *See* Securities Act of 1933 § 11, 15 U.S.C. § 77k(a) (2000) (establishing liability for representing an investor in issuing a public offering registration statement that includes a materially false or misleading statement or omission).

352. *See, e.g.*, SEC v. Spectrum, Ltd., 489 F.2d 535, 541 (2d Cir. 1973); SEC v. Manor Nursing Ctr., Inc., 458 F.2d 1082 (2d Cir. 1972); Marshall v. Quinn-L Equities, Inc., 704 F.

of 1934 because it creates a number of possible ways in which attorneys may become liable.[353]

Section 10(b) of the Securities Exchange Act makes it illegal to "use or employ . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[354] Although the Act does not explicitly prescribe a cause of action for violating this provision, courts have developed a common law claim for securities fraud, which holds a company liable for misrepresenting its financial position to investors, failing to disclose the factual importance about stock price, or being over-optimistic about future expectations.[355] Lawyers, in turn, can be held liable for aiding and abetting in the securities fraud.[356]

In addition, the SEC may regulate lawyers that appear before it under its disciplinary Rule 2(e), which allows the SEC to suspend or deny to the lawyer the privilege of appearing or practicing before it if the lawyer willfully aided or abetted in violating the federal securities laws.[357] The 1990 revisions to the Act also invest the SEC with power to bring administrative proceedings against, and to impose cease and desist orders against, any person who causes another to violate the securities laws.[358]

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Supp. 1384, 1390-91 (N.D. Tex. 1988); *In re* N. Am. Acceptance Corp. Sec. Cases, 513 F. Supp. 608, 619 (N.D. Ga. 1981).

353. *See* James R. Doty, *SEC Enforcement Actions Against Lawyers: The Next Phase*, 35 S. TEX. L. REV. 585, 586 (1994) (analyzing the increasing potential that lawyers will be found liable for aiding and abetting in fraudulent securities transactions).

354. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2000).

355. *See* Tanya Patterson, Note, *Heightened Securities Liability for Lawyers Who Invest in Their Clients: Worth the Risk?*, 80 TEX. L. REV. 639, 647 (2002) (discussing typical securities-fraud cases under section 10(b) of the Securities Exchange Act of 1934).

356. *See id.* (citing Brennan v. Midwestern United Life Ins. Co., 286 F. Supp. 702 (N.D. Ind. 1968), *aff'd*, 417 F.2d 147 (7th Cir. 1969), which was the first case to develop this secondary liability for securities fraud cases).

357. James R. Doty, *SEC Enforcement Actions Against Lawyers: The Next Phase*, 35 S. TEX. L. REV. 585, 593 n.34 (1994) (stating that there is some question as to what standard of professional misconduct is sufficient to justify such sanctions).

358. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, § 203, 104 Stat. 939 (1991).

### E. *The Attorney-Client Privilege When Suing a Client for Unpaid Fees*

In a per curiam opinion, the Texas Supreme Court indicated that the attorney-client privilege protecting an attorney fee statement remains even after the attorney sues the client for nonpayment of legal fees.[359] In *Judwin Properties, Inc. v. Griggs & Harrison, P.C.*,[360] a law firm sued its client for unpaid attorneys' fees and attached the firm's unpaid fee statement to the firm's petition.[361] The client then counterclaimed for negligent disclosure of the information in the fee bills, claiming that the fee bills were protected under the attorney-client privilege.[362] The trial court granted the lawyers' summary judgment.[363] The court of appeals affirmed the lawyers' summary judgment stating:

> [The client] did not dispute that the fee statements were related to the issue of nonpayment. Rule 503(d)(3) [the attorney-client privilege evidence rule] says the attorney-client privilege does not apply to evidence related to a breach issue between the lawyer and client. The lack of privilege favors the finding that [the attorney] had no duty to withhold the information. *Accordingly, by citing Rule 503(d)(3), [the lawyer] conclusively disproved the duty element of [the client's] claim and was entitled to summary judgment.*[364]

The client then appealed to the Texas Supreme Court. In denying the petition for review, the Texas Supreme Court made the following comment: "In affirming the summary judgment, the court of appeals concluded that Rule 503(d)(3) of the Texas Rules of Evidence 'conclusively disproved the duty element of [the client's] claim.' *In denying this petition for review, the Court disapproves of this language.*"[365]

Thus, it appears that the Texas Supreme Court believes that, even after an attorney sues a client for unpaid fees, the attorney must be sensitive to preserving the attorney-client privilege.

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359. Judwin Props., Inc. v. Griggs & Harrison, P.C., 11 S.W.3d 188, 188-89 (Tex. 2000) (per curiam).

360. 981 S.W.2d 868 (Tex. App.—Houston [1st Dist.] 1998, pet. denied).

361. Judwin Props., Inc. v. Griggs & Harrison, P.C., 981 S.W.2d 868, 868 (Tex. App.—Houston [1st Dist.] 1998, pet. denied).

362. *Id.* at 868-69.

363. *Id.* at 869.

364. *Id.* at 870 (emphasis added) (citation omitted).

365. *Judwin Props.*, 11 S.W.3d at 188-89 (emphasis added) (citation omitted).

## V. ASSIGNABILITY OF LEGAL MALPRACTICE CLAIMS

The Texas Supreme Court recently decided two cases in which the transferability of legal malpractice claims was at issue, but the court did not actually reach that issue in either case. In *Douglas v. Delp*,[366] a husband and wife brought a legal malpractice and DTPA suit against their former attorneys.[367] The husband filed for bankruptcy, and the bankruptcy trustee sold his claims to a representative of the attorneys' malpractice carrier.[368] The representative then moved for an agreed dismissal.[369] The motion was granted and, after trial, the trial court directed a verdict for the attorneys on the wife's claims.[370] 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.[371]

The attorneys complained to the supreme court that the husband lacked standing to challenge dismissal of his claims based upon the contention that Texas law prohibits the assignment of legal malpractice claims.[372] Without addressing the validity of the assignment or of the dismissal, the Texas Supreme Court agreed that the husband lacked standing to challenge the assignment of the legal malpractice claims or their dismissal because he had relinquished to the trustee any standing to prosecute or dispose of the claims by filing bankruptcy.[373] 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 also without standing to pursue those claims.[374]

*Mallios v. Baker*[375] presents an interesting attempt to avoid the rule against assignment of legal malpractice claims.[376] Baker hired attorney Mallios after he was seriously injured on his motorcycle while fleeing from police officers who were attempting to stop him

366. 987 S.W.2d 879 (Tex. 1999).
367. Douglas v. Delp, 987 S.W.2d 879, 880 (Tex. 1999).
368. *Id.*
369. *Id.*
370. *Id.*
371. *Id.*
372. *Douglas*, 987 S.W.2d at 882.
373. *Id.*
374. *Id.* at 883.
375. 11 S.W.3d 157 (Tex. 2000).
376. Mallios v. Baker, 11 S.W.3d 157, 158 (Tex. 2000).

from driving on the wrong side of the road while intoxicated.[377] The intoxication allegedly resulted from employees of Mimi's Pub selling him alcoholic beverages when he was obviously intoxicated.[378] Mallios obtained a default judgment in excess of $1 million against a corporation that he believed to own Mimi's Pub.[379]

Baker sought out T.J. Herron after reading a local newspaper advertisement by Herron offering to buy judgments in excess of $25,000.[380] Herron learned that Baker's attorney had sued the wrong company, and his claim was now barred by limitations.[381] "Baker assigned an interest in the proceeds from his [legal] malpractice claim against Mallios to Herron in exchange for Herron's assistance in pursuing the claim."[382] Herron agreed to recommend legal counsel and negotiate the terms of employment for the attorney, subject to Baker's approval, and Herron was required to "pay 'all attorney fees, costs and expenses of the investigation, pursuit and prosecution' of the claims."[383] Herron was to "be reimbursed out of any recovery from Mallios and would also" receive "fifty percent of any recovery net of all expenses."[384] The claim was not able to be settled without both Baker and Herron's consent, and Baker agreed to fully cooperate in the pursuit of the claim.[385] Herron was allowed to terminate the agreement if he determined that prosecuting Baker's claims would not be economically feasible.[386] Suit was filed and the attorney thereafter filed a motion for summary judgment based upon the theory that an assignment of his legal malpractice claim had occurred, and that the prosecution of the claim by Baker therefore contravened public policy.[387] The trial court granted summary judgment, which was reversed by the court of appeals.[388]

377. *Id.*
378. *Id.*
379. *Id.*
380. *Id.*
381. *Mallios*, 11 S.W.3d at 158.
382. *Id.*
383. *Id.*
384. *Id.*
385. *Id.*
386. *Mallios*, 11, S.W.3d at 158.
387. *Id.*
388. *Id.* at 158-59.

The Texas Supreme Court found that the summary judgment could have been based on one of two theories: (1) that because he assigned his claim to Herron, Baker was not the proper party to pursue it; or (2) that by making an invalid assignment, Baker was precluded from pursuing the claim.[389] The supreme court declined to address the issue of whether the assignment contravened public policy.[390] Instead, it held that the summary judgment was inappropriate because Baker still retained a portion of his claim and, even if the assignment was invalid, it would not vitiate Baker's right to sue Mallios.[391] The supreme court specifically noted it expressed no opinion on the validity of the underlying agreement.[392]

Justice Hecht, in a concurring opinion joined by three other justices, stated that the court "dodges the only question the parties and the lower courts have put to us."[393] Thus, the concurring justices opined the assignment invalid.[394] The concurring opinion reviewed *Zuniga v. Groce, Locke & Hebdon*,[395] 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.[396] Interestingly, Justice Hecht stated that the decision in *Douglas* 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."[397] Therefore, Justice Hecht concluded that *Zuniga* did not bar all transfers of legal malpractice claims.[398] He likewise noted that the court in *American Centennial*[399] "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."[400] Justice

389. *Id.* at 159.
390. *Id.*
391. *Mallios*, 11 S.W.3d at 159 (Hecht, J., concurring).
392. *Id.*
393. *Id.*
394. *Id.*
395. 878 S.W.2d 313 (Tex. App.—San Antonio 1994, writ ref'd).
396. Zuniga v. Groce, Locke & Hebdon, 878 S.W.2d 313, 315-18 (Tex. App.—San Antonio 1994, writ. ref'd); *Mallios*, 11 S.W.3d at 163 (Hecht, J., concurring).
397. *Mallios*, 11 S.W.3d at 163 (Hecht, J., concurring).
398. *Id.* at 164.
399. Am. Centennial Ins. Co. v. Canal Ins. Co., 843 S.W.2d 480, 484 (Tex. 1992).
400. *Mallios*, 11 S.W.3d at 163 (Hecht, J., concurring).

Hecht was particularly critical of the commercial marketing aspect of the claim in *Mallios*.[401] Justice Enoch, joined by Chief Justice Phillips, wrote a separate concurring opinion in which he stated that he did "not share Justice Hecht's view that so-called 'commercial' legal malpractice claim assignments are against public policy."[402]

Prior to *Mallios*, several courts of appeals addressed the assignment of legal malpractice claims issue. These decisions all rejected the validity of assignments of legal malpractice claims.[403] For instance, in *Tate v. Goins, Underkofler, Crawford & Langdon*,[404] a partial assignment of a legal malpractice claim was held invalid, but the court pointed out that because of the invalidity of the assignment, the client could still pursue a claim against the lawyer.[405]

## VI. STATUTE OF LIMITATIONS

### A. *Legal Malpractice Statutes of Limitations*

In Texas, a cause of action for legal malpractice is a tort and thus is governed by the two-year statute of limitations.[406] Unlike malpractice claims, fraud claims against attorneys are governed by a four-year statute of limitations.[407] Some plaintiffs have attempted to apply the four-year statute of limitations to legal malpractice claims by structuring their pleadings to allege breach of contract. The courts, however, have consistently prevented these attempts and uncovered this "wolf in sheep's clothing."[408]

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401. *See id.* at 166-69 (reporting that no assignments of a legal malpractice claim have been upheld in a reported decision and noting arguments frequently advanced in opposition to such assignments).

402. *Id.* at 172 (Enoch, J., concurring).

403. Izen v. Nichols, 944 S.W.2d 683, 685 (Tex. App.—Houston [14th Dist.] 1997, no pet.); McLaughlin v. Martin, 940 S.W.2d 261, 262 (Tex. App.—Houston [14th Dist.] 1997, no pet.); City of Garland v. Booth, 895 S.W.2d 766, 773 (Tex. App.—Dallas 1995, writ denied); Charles v. Tamez, 878 S.W.2d 201, 208 (Tex. App.—Corpus Christi 1944, writ denied).

404. 24 S.W.3d 627, 634 (Tex. App.—Dallas 2000, pet. denied)

405. Tate v. Goins, Underkofler, Crawford & Langdon, 24 S.W.3d 627, 629 (Tex. App.—Dallas 2000, pet. denied).

406. Willis v. Maverick, 760 S.W.2d 642, 644 (Tex. 1988); Am. Med. Elecs. v. Korn, 819 S.W.2d 573, 576 (Tex. App.—Dallas 1991, writ denied).

407. Williams v. Khalaf, 802 S.W.2d 651, 658 (Tex. 1990).

408. *See Korn*, 819 S.W.2d at 576 (stating that attorney malpractice claims sound in tort regardless of whether they are framed as tort or contract actions); Sledge v. Allsup, 759 S.W.2d 1, 2 (Tex. App.—El Paso 1988, no writ) (quoting RONALD E. MALLEN &

A breach of fiduciary duty claim avoids the two-year statute of limitations.[409] Prior case law conflicted as to whether breach of fiduciary duty claims were governed by a two-year statute of limitation or a four-year statute of limitation.[410] However, in its 1999 session, the Texas Legislature amended the Texas Civil Practice and Remedies Code to specifically provide that breach of fiduciary duty claims are subject to the four-year statute limitations.[411] Nevertheless, when a case that is essentially a legal malpractice claim also includes claims for breach of fiduciary duty or breach of contract that are based on the same factual allegations, those claims may be subsumed so that the traditional limitations period applicable to malpractice tort claims would apply.[412]

### B. *When Cause of Action Accrues and Limitations Begin to Run*

The difficult question regarding the applicable statute of limitations is not what limitation period applies, but when the cause of action accrues and limitations begin to run.[413] When a cause of action accrues is a question of law for the court.[414]

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VICTOR B. LEVIT, LEGAL MALPRACTICE § 100, at 170 (2d ed. 1981) that "[r]egardless of how the undertaking to exercise ordinary skill and knowledge is characterized, the essential tort is legal malpractice").

409. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(5) (Vernon Supp. 2002).

410. *See, e.g.*, McGuire v. Kelley, 41 S.W.3d 679, 682 (Tex. App.—Texarkana 2001, no pet.) (finding the statute of limitations to be four years); Farias v. Laredo Nat'l Bank, 985 S.W.2d 465, 471 (Tex. App.—San Antonio 1997, no writ) (finding the statute of limitations to be two years); Smith v. Chapman, 897 S.W.2d 399, 402 (Tex. App.—Eastland 1994, no writ) (finding the statute of limitations to be two years); Perez v. Gulley, 829 S.W.2d 388, 390 (Tex. App.—Corpus Christi 1992, writ denied ) (finding the statute of limitations to be four years); Spangler v. Jones, 797 S.W.2d 125, 132 (Tex. App.—Dallas 1990, writ denied) (finding the statute of limitations to be four years).

411. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(5) (Vernon Supp. 2002).

412. *But see* CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 9.2 n.48 (1986) (noting that where a state allows for a separate contract claim it will have a longer limitation period than for a tort).

413. *See* John H. Bauman, *The Statute of Limitations for Legal Malpractice in Texas*, 44 BAYLOR L. REV. 425, 425-26 (1992) (discussing the various rules for determining when a cause of action accrues as well as the tolling rules).

414. Computer Assoc. Int'l, Inc. v. Altai, Inc., 918 S.W.2d 453, 456-57 (Tex. 1994); *Willis*, 760 S.W.2d at 644; Black v. Wills, 758 S.W.2d 809, 815 (Tex. App.—Dallas 1988, no writ).

1. The Legal Injury Rule

Texas has adopted the legal injury rule, which provides that a legal malpractice cause of action accrues only when the negligence of the attorney results in damage to the client.[415] Previously, Texas applied the occurrence rule, which provided that the legal malpractice cause of action accrued when the negligent act occurred.[416] The legal injury rule avoids the problem of a legal malpractice action being barred before any damage occurs. However, it does not require that plaintiff's damages be fully ascertained or even known.[417] The legal injury rule only requires the existence of a "legal injury" that would support the filing of suit.[418] Once this threshold requirement is met, the cause of action accrues and limitations begin to run.[419] As a result, many legal malpractice actions may be "time barred before the client [is] aware of [the injury or] the necessity of filing a suit."[420] Determining whether a legal injury has occurred is not simple.[421]

2. Tolling Provisions

Texas courts have adopted three tolling theories to protect plaintiffs from the sometimes harsh application of the legal injury rule. Two of these theories are alive and well; one of these theories is dead.

a. Duty to Disclose Rule a/k/a the Continuous Representation Rule

The continuous representation rule defers accrual or tolls the running of limitations while the allegedly negligent attorney continues to represent the client in the matter in which the negligence

415. *Willis*, 760 S.W.2d at 646; *Korn*, 819 S.W.2d at 577.

416. Crawford v. Davis, 148 S.W.2d 905, 907 (Tex. Civ. App.—Eastland 1941, no writ); Fox v. Jones, 14 S.W. 1007, 1007-08 (Tex. Ct. App. 1889, no writ).

417. Trinity River Auth. v. URS Consultants, Inc., 889 S.W.2d 259, 262 (Tex. 1994); Jim Arnold Corp. v. Bishop, 928 S.W.2d 761, 768 (Tex. App.—Beaumont 1996, no writ).

418. J.H. Bauman, *The Statute of Limitations for Legal Malpractice in Texas*, 44 BAYLOR L. REV. 425, 432 (1992).

419. *Id.*

420. *Id.*

421. *See, e.g.*, Burnap v. Linnartz, 38 S.W.3d 612 (Tex. App.—San Antonio 2000, no pet.) (noting the dissenting opinion of Justice Lopez).

occurred.[422] "The continuous representation rule allows time for the negligent attorney to attempt to correct the situation, while preserving the client's right to sue if the efforts" are not successful.[423]

The Texas Supreme Court, however, has refused to follow the "duty to disclose/continuous representation" rule and has adopted the discovery rule.[424] It is important to note that in *FDIC v. Nathan*,[425] Judge Harmon appeared to rely on the "continuous representation" rule to toll the running of limitations against the FDIC.[426]

b. The Discovery Rule

The discovery rule applies to legal malpractice actions, and provides that the statute of limitations for legal malpractice actions does not begin to run until the claimant discovers or should have discovered through the exercise of reasonable care and diligence the facts establishing the elements of the claimant's cause of action.[427] The discovery rule protects clients injured by attorney malpractice whose injuries may not be *discovered* until after the formal legal injury rule has been satisfied.[428] The discovery rule tolls the running of limitations. It is not an accrual rule for legal malpractice causes of action. The discovery rule does not replace the legal injury rule to determine accrual of legal malpractice causes of action.[429]

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422. J.H. Bauman, *The Statute of Limitations for Legal Malpractice in Texas*, 44 BAYLOR L. REV. 425, 437 (1992).

423. *Id.*

424. *Willis*, 760 S.W.2d at 646; *see also* Estate of Degley v. Vega, 797 S.W.2d 299, 303 n.3 (Tex. App.—Corpus Christi 1990, no writ) (stating "[i]n *Willis* the court expressly disapproved of this approach to accrual, holding that the discovery rule balances limitations policies better than simply tolling limitations during the attorney-client relationship").

425. 867 F. Supp. 512 (S.D. Tex. 1994).

426. FDIC v. Nathan, 867 F. Supp. 512, 519-20 (S.D. Tex. 1994).

427. RTC v. Boyar, Norton & Blair, 796 F. Supp. 1010, 1013 (S.D. Tex. 1992); *Willis*, 760 S.W.2d at 646; Am. Med. Elecs. v. Korn, 819 S.W.2d 573, 577 (Tex. App.—Dallas 1991, writ denied); Gordon v. Ward, 822 S.W.2d 90, 93 (Tex. App.—Houston [1st Dist.] 1991, writ denied); Med. Protective Co. v. Groce, Locke & Hebdon, 814 S.W.2d 124, 127 (Tex. App.—Corpus Christi 1991, writ denied).

428. J.H. Bauman, *The Statute of Limitations for Legal Malpractice in Texas*, 44 BAYLOR L. REV. 425, 431 (1992).

429. *Id.* at 440.

The discovery rule is determined by the facts of each case.[430] "The limitations period begins to run as soon as the plaintiff discovers or should discover *any* harm, however slight, resulting from the negligence of the defendant."[431] Hence, if the plaintiff discovers a minor injury but waits until the injury becomes substantial to sue, and two years have expired since the discovery of the minor injury, the suit will be time-barred.[432]

The discovery rule is a plea in avoidance.[433] A claimant seeking to avoid the statute of limitations has the burden of pleading the discovery rule, and has the burden at trial of establishing facts supporting application of the discovery rule.[434] Once the claimant pleads the discovery rule, however, the defendant can only obtain summary judgment based on limitations by showing that no issue of fact exists concerning the time when the plaintiff discovered or should have discovered the cause of action.[435] If the defendant moves for summary judgment and produces evidence of when the plaintiff should have discovered the cause of action, the plaintiff must show that a person exercising reasonable diligence would not have discovered the cause within the statutory period.[436]

### c. The Exhaustion of Appeal Rule

The Texas Supreme Court has held that "when an attorney commits malpractice in the prosecution or defense of a claim that results in litigation, the statute of limitations on the malpractice claim against the attorney is tolled until all appeals on the underlying claim are exhausted."[437]

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430. *See* Jampole v. Matthews, 857 S.W.2d 57, 62 (Tex. App.—Houston [1st Dist.] 1993, writ denied) (discussing the application of the discovery rule to various cases).

431. *Korn*, 819 S.W.2d at 577.

432. *Id.*

433. Woods v. William M. Mercer, Inc., 769 S.W.2d 515, 517 (Tex. 1988).

434. *Id.* at 518; Autry v. Dearman, 933 S.W.2d 182, 192 (Tex. App.—Houston [14th Dist.] 1996, writ denied); Gordon v. Ward, 822 S.W.2d 90, 94 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

435. Burns v. Thomas, 786 S.W.2d 266, 267 (Tex. 1990); Farah v. Mafrige & Kormanik, P.C., 927 S.W.2d 663, 676 (Tex. App.—Houston [1st Dist.] 1996, no writ); *Korn*, 819 S.W.2d at 576; *Med. Protective Co.*, 814 S.W.2d at 127; *see also* Gibson v. Ellis, 58 S.W.3d 818, 824-25 (Tex. App.—Dallas 2001, no pet. h.) (holding that where a plaintiff pleads that the defendant has fraudulently concealed certain information, that constitutes an implicit pleading of the discovery rule in legal malpractice cases).

436. Smith v. Flinn, 968 S.W.2d 12, 14 (Tex. App.—Corpus Christi 1998, no. pet.).

437. Hughes v. Mahaney & Higgins, 821 S.W.2d 154, 157 (Tex. 1991).

In *Hughes v. Mahaney & Higgins*,[438] the court justified the "exhaustion of appeal" rule by stating that without such a rule, a client may be forced into adopting inconsistent litigation positions as to the underlying case and the malpractice case if an attorney makes a mistake in the course of representing the client.[439] This rule also applies in the bankruptcy context, as the statute of limitations is tolled during the pendency of an attorney's representation of a client in a bankruptcy proceeding.[440] The plaintiff has the burden of pleading and proving the applicability of the "exhaustion of appeal" rule to toll limitations.[441]

In *Apex Towing Co. v. Tolin*,[442] the Texas Supreme Court applied the *Hughes* tolling rule and rejected an argument by the attorney that Hughes did not apply where the client hired a new lawyer for the appeal, holding that continued representation by the allegedly negligent attorney is not a requirement under *Hughes*.[443] In *Underkofler v. Vanasek*,[444] the Texas Supreme Court held that the limitations period on a common-law malpractice claim was tolled under *Hughes* until there was a final judgment or other resolution in the underlying case, despite the fact that the client had obtained a new lawyer to handle the appeal.[445] The supreme court further held that the *Hughes* tolling rule does not apply to a DTPA claim, deferring to the legislature's policy determination that only two exceptions apply to the statute of limitations for a DTPA claim, and refusing to rewrite the DTPA statute to add the *Hughes* tolling rule as a third exception.[446]

Further, the *Hughes* tolling rule does not apply to toll limitations for a threatened subsequent litigation that might arise out of the

438. 821 S.W.2d 154 (Tex. 1991).

439. *Hughes*, 821 S.W.2d at 156; *see also* Norwood v. Piro, 887 S.W.2d 177, 180 (Tex. App.—Texarkana 1994, writ denied); Washington v. Georges, 837 S.W.2d 146, 147 (Tex. App.—San Antonio 1992, writ denied).

440. Guillot v. Smith, 998 S.W.2d 630, 633 (Tex. App.—Houston [1st Dist.] 1999, no pet.).

441. *Hughes*, 821 S.W.2d at 157; Hall v. Stephenson, 919 S.W.2d 454, 464 (Tex. App.—Fort Worth 1996, writ denied).

442. 41 S.W.3d 118 (Tex. 2001).

443. Apex Towing Co. v. Tolin, 41 S.W.3d 118, 121 (Tex. 2001).

444. 53 S.W.3d 343 (Tex. 2001).

445. Underkofler v. Vanasek, 53 S.W.3d 343, 346 (Tex. 2001).

446. *Id.*

underlying "malpractice" litigation.[447] In *Brents v. Haynes & Boone, L.L.P.*,[448] the plaintiffs did not immediately bring a malpractice claim because they were concerned about a federal investigation, which arose out of the underlying litigation and which ultimately did result in a lawsuit.[449] The court dismissed their lawsuit under the statute of limitations, stating that "we decline to broaden 'litigation' to include an administrative investigation that might later result in a lawsuit . . . . [t]olling limitations through administrative investigations with the potential of litigation would extend the equitable tolling principle beyond that contemplated in *Hughes*."[450]

## VII. MISCELLANEOUS CASES

### A. *Criminal Cannot Sue Attorney for Conviction*

As a general matter, a criminal defendant who has a final, non-appealable conviction cannot sue his defense attorney for malpractice.

> Because of public policy, we side with the majority of courts and hold that plaintiffs who have been convicted of a criminal offense may negate the sole proximate cause bar to their claim for legal malpractice in connection with that conviction *only* if they have been exonerated on direct appeal, through post-conviction relief, or otherwise. . . . [This is so because] it is the illegal conduct rather than the negligence of a convict's counsel that is the cause in fact of any injuries flowing from the conviction.[451]

### B. *Contingent Fee is Based on Net Recovery*

In *Levine v. Bayne, Snell & Krause, Ltd.*,[452] the Texas Supreme Court interpreted a contingency fee agreement that entitled a law firm to one-third of "'any amount received'" as referring only to

447. *See* Brents v. Haynes & Boone, L.L.P., 53 S.W.3d 911, 916 (Tex. App.—Dallas 2001, pet. filed) (declining to broaden the term "litigation" to include a subsequent lawsuit that may result from an administrative investigation).

448. 53 S.W.3d 911 (Tex. App.—Dallas 2001, pet. filed).

449. *Brents*, 53 S.W.3d at 916.

450. *Id.*

451. Peeler v. Hughes & Luce, 909 S.W.2d 494, 497-98 (Tex. 1995) (emphasis added) (affirming summary judgment for defendants).

452. 40 S.W.3d 92 (Tex. 2001).

the net cash amount of the client's recovery.[453] The clients were awarded over $243,000 in damages for foundation defects in a house, but a counterclaim of approximately $161,000 for the balance due on the mortgage, accrued interest, and attorneys' fees offset the dollar amount awarded.[454] The Texas Supreme Court held that the attorneys were only entitled to a percentage of the net recovery after the offset, despite the fact that the clients received the benefit of having their mortgage paid off as part of the judgment.[455] In light of *Levine*, when drafting a fee agreement, attention should be given to a potential counterclaim and the effect. The *Levine* decision would likely not prohibit a collection of a fee based on benefit to the client, but rather places the burden on the lawyer to express in the fee agreement how the contingency fee is to be calculated if benefits received are non-monetary.

## VIII. CONCLUSION

Although the number of malpractice suits may not be increasing, the way that these suits are pled is changing dramatically. The claim for fee forfeiture is becoming more prominent as an alternative to traditional malpractice claims that require proof of both causation and damages. In addition, suits by third parties based on negligent misrepresentation, fraud, and conspiracy are proliferating and resulting in high-dollar settlements. In this climate, attorneys must perform their duties with the utmost caution, as their obligation to zealously represent their clients becomes tempered by a new range of duties that they now owe to the world beyond.

453. Levine v. Bayne, Snell & Krause, Ltd., 40 S.W.3d 92, 96 (Tex. 2001) (Owen, J., concurring).

454. *Levine*, 40 S.W.3d at 93.

455. *Id.* at 95.