Litigation Webinar Series: INSIGHTS
Our take on litigation and trial developments across the U.S.

The Highest Duty Known to Law . . .
Fiduciary Liability in the 21st Century

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Overview

• Monthly
  • 3rd Wednesday at 1pm ET
  • Key Developments & Trends

• Housekeeping
  • CLE Contact: makarevich@fr.com
  • Questions
  • Materials: fishlitigationblog.com/webinars

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Agenda

LAWYERS AND THEIR FIDUCIARY DUTIES
• Duty of Confidentiality
• Duty of Loyalty
• Asserting a Breach of Fiduciary Duty Claim Against a Lawyer

FIDUCIARY DUTIES IN A CORPORATE SETTING
• Officers/Directors
• Majority Shareholders – Minority Shareholder Oppression

PARTNERS
• General vs. Limited Partners
• Contractual Limitations on a Partner’s Fiduciary Duty
Lawyers and their Fiduciary Duties

• A Lawyer’s Fiduciary Duties – Do they ever end?
  - Confidentiality
  - Loyalty

• Fracturing of Claims – When is a breach of fiduciary duty claim not a breach of fiduciary duty claim?
A lawyer’s duty of confidentiality lasts forever.

- It doesn’t matter that the attorney-client relationship has ended.
- However, there are recognized exceptions to this rule if the lawyer is aware of impending wrongdoing by the client. These exceptions vary by jurisdiction. For example:
  - In CA, threatened crime must be a crime involving death or serious bodily injury.
  - But in DE, non-criminal fraud may be enough.
  - Other jurisdictions fall somewhere in-between.
The Duty to Preserve Confidentiality is Broad

Non-clients covered; so is public information


- *Sealed Party v. Sealed Party*, No.Civ.A. H-04-2229, 2006 WL 1207732 (S.D. Tex. 2006) (duty applied even to confidential settlement information that had been disclosed by a law firm, even though it had also subsequently been disclosed in publicly filed pleadings)

  **Practice Tip** – Be careful about publicly disclosing confidential settlements on law firm websites without obtaining former client’s permission
Breach of Confidentiality – Proof Standards


  - When a former law firm for the church sued it for another client, then withdrew when the church moved to DQ, the church later sued for breach of fiduciary duty. The law firm moved for SJ, claiming, among other things, that it had not disclosed any of the church’s confidential information to the adverse party. The church cited DQ cases saying that disclosure is presumed. **Held:** the presumption applies to a DQ motion but not in a breach of fiduciary duty suit for damages – the fact of disclosure is an element of the plaintiff’s cause of action.
A Lawyer’s Duty of Loyalty Isn’t Permanent

• It is widely recognized that the duty of loyalty ends with the attorney-client relationship.

  ▪ This means a lawyer can represent Client A at one time and then, later, represent Client B adverse to Client A, so long as the first engagement has been completed.

• However, this freedom is not unlimited. Some duties continue after the end of the relationship.
THE LAWYER CANNOT BECOME ADVERSE TO THE FORMER CLIENT ON A CLOSELY RELATED MATTER AND MUST NOT USE INFORMATION OBTAINED DURING THE FORMER REPRESENTATION AGAINST THE FORMER CLIENT IN A LATER ADVERSE ACTION

\textit{Oasis West Realty, LLC v. Goldman}, 250 P.3d 1115 (Cal. 2011)

- Anti-SLAPP First Amendment protection denied to attorney who allegedly used confidential information to oppose former client’s development project.

“The attorney] may not doing anything which will injuriously affect the former client in any matter in which [the attorney] formerly represented [the client] nor may [the attorney] at any time use against [the] former client knowledge or information acquired by virtue of the previous relationship.”
Legal Malpractice vs. Breach of Fiduciary Duty


- Prison inmate had cause of action against former counsel to recover fees not earned.
- Keeping fees was not malpractice but rather a breach of fiduciary duty.

“If…Sharp refused to return unearned retainer belonging to Burnett, this conduct would be actionable but it would not constitute professional negligence.”
Legal Malpractice vs. Breach of Fiduciary Duty

• “Fracturing” of claims
  ▪ Plaintiffs’ attorneys may seek to recharacterize ordinary malpractice (professional negligence) claims as claims for breach of fiduciary duty.

• Why?
  ▪ Limitations (periods have historically been longer for breach of fiduciary duty claims)
  ▪ Different relief afforded (punitive damages, injunctive relief)
  ▪ Jurisdiction (in Delaware, may provide access to Court of Chancery)
Lawyers and their Fiduciary Duties

Examples of Courts Addressing Fracturing

**Limitations:**

California courts have addressed the difference in limitations by applying the same limitations period to both professional negligence actions and claims against attorneys for breach of fiduciary duty.

Examples of Courts Addressing Fracturing

New York legislature and courts have also worked to eliminate the difference in limitations periods.

- Civil Practice Law & Rules (CPLR) 214(6) – Three-year provision applies to “an action to recover damages for malpractice, other than medical, dental, or podiatric malpractice, regardless of whether the underlying theory is based in contract or tort.”

“Since plaintiffs’ claim, while cast in contract, is essentially that defendants failed to perform services in a professional, non-negligent matter, it is governed by the three-year statute of limitations.”


- Applying CPLR 214’s three-year period to a claim for breach of fiduciary duty where that claim sought disgorgement of attorneys’ fees.

“For breach of fiduciary duty claims, ‘the choice of the applicable limitations period depends on the substantive remedy that the plaintiff seeks.’”
In Texas, where malpractice claims are subject to a 2 year statute of limitations, and breach of fiduciary duty claims are subject to a 4 year period, courts have expressly applied an “anti-fracturing” rule.


- Upholding a limitations-based summary judgment where a claim for inadequate representation had been recharacterized as one for breach of fiduciary duty based on conflict of interest.

“All even if a complaint implicates a lawyer’s fiduciary duties, it does not necessarily follow that such a complaint is actionable apart from a negligence claim.”
Jurisdiction

With its special court of equity, the Court of Chancery, Delaware presents an unusual reason for attempts at claim fracturing. Plaintiffs who are willing to limit their recovery to equitable relief may file their suits in that court to avoid a jury trial—but the Court of Chancery is wise to such tactics.
Sokol Holdings, Inc. v. Dorsey & Whitney, LLP, 2009 WL 2501542 (Del. Ch.).

- Court of Chancery transferred a case to the Delaware Superior Court (a court at law), despite the fact that the plaintiff entity had pled breach of fiduciary duty against the defendant law firm based on the firm’s alleged overbilling. The plaintiff had also alleged professional negligence on the part of the defendant firm. The case was unusual in that the plaintiff had selected the forum, but the defendant was the one that tried to keep the case there.
Lawyers and their Fiduciary Duties

“[L]imiting the availability of equitable jurisdiction to circumstances in which an attorney exercises control over the property of a client” made more sense for purposes of Delaware’s court system.

“[C]lients with malpractice claims should not be able to bootstrap their way into Chancery simply because the conduct of attorneys can at times and in certain circumstances raise fiduciary concerns.”
The following year, the Court of Chancery reached a similar result in another case:

**Gelof v. Prickett, Jones & Elliott, P.A.,** 2010 WL 759663 (Del. Ch.).

- Trust beneficiary sought to maintain a breach of fiduciary duty claim against the attorney of the trust settlors, based on allegedly poor drafting of trust agreements. The Chancery Court dismissed the action, which also included professional negligence and breach of contract claims.
Lawyers and their Fiduciary Duties

• Clearly, courts are increasingly resistant to attempts to turn garden variety malpractice actions into claims for breach of fiduciary duty.

• However, when a lawyer’s misconduct goes beyond mere negligence, there may indeed be a valid claim for breach of fiduciary duty.
  ▪ Mishandling of client property
  ▪ Undisclosed conflicts of interest
  ▪ Overbilling
Indeed, there are cases in which both breach of fiduciary duty claims and professional negligence claims are upheld.

- Rule against fracturing was not applied to breach of fiduciary duty claims where plaintiff alleged defendant law firm not only negligently failed to tender defense to carrier but also intentionally failed to do so because, the plaintiff alleged, “it would have deprived [the firm] of an extremely lucrative employment arrangement.”

- Plaintiff sued for breach of fiduciary duty for failure to disclose conflict of interest, for negligence for allegedly poor legal advice, and for breach of contract.
- Appellate court reversed lower court’s dismissal and remanded for new trial, holding that plaintiff established prima facie cases for all three claims.
Lawyers and their Fiduciary Duties

Practice Tip: Look for willful violations of the attorney ethical rules.

• Even though there is not complete overlap between fiduciary duties and attorney ethical rules, courts of every jurisdiction rely heavily on those rules for determining whether a claim is one of simple malpractice or something more.
Fiduciary Duties in the Corporate World

Officers and Directors
Officers/Directors are Fiduciaries

• Duties usually arise from state statutes augmented by common law
• Primarily, duties include duty of loyalty and duty to exercise due care

• Duty is to the corporation and its shareholders (but generally not to individual shareholders or groups of shareholders)
• Majority shareholders may owe fiduciary duties to minority shareholders under certain circumstances (“shareholder oppression”) in some but not all jurisdictions
Duty of Loyalty to Corporation

- Breach of duty of loyalty – examples include:
  - Self-dealing
  - Usurping Corporate Opportunities
  - Using Corporate Assets to Achieve Personal Gain
Defendant directors of International Bankers’ Life (“IBL”) (1) sold shares of their own stock in competition with IBL’s effort to sell newly issued shares of stock, (2) received undisclosed commissions from the sale of IBL shares, and (3) purchased a tract of land under the name of a company they had formed and then sold it to IBL for a $15,000 profit without disclosing their interest in the selling entity.

**Held:** Affirmed award of disgorgement of all profits earned by directors or the company they formed.

“Contracts between a corporation and its officers and directors are not void but are voidable for unfairness and fraud with the burden upon the fiduciary of proving fairness.”
Texas Business Organizations Code ("BOC") § 7.001(b)

- Permits adoption of “exculpatory clauses” in governing documents to protect corporate officers and directors from personal liability
- Important exceptions:
  - Breach of duty of loyalty
  - Acts not in good faith involving breach of duty or intentional/knowing misconduct
  - Receipt of an improper benefit (e.g., undisclosed profit)
  - Other conduct prohibited by statute
Similar Principles Apply Under Current Law

• Specific provisions vary somewhat by jurisdiction but similar principles apply

• Delaware “entire fairness” rule applies when fiduciary is on both sides of a transaction with the corporation or receives benefits not shared equally among shareholders
  - Burden is on the fiduciary to prove the “entire fairness” of the transaction [Kahn v. Tremont Corp., 694 A.2d 422 (Del. 1997)]

• Delaware Supreme Court has distinguished between duty of care and duty of good faith - a director accused of breach of duty of care is protected by the Delaware “exculpatory clause” statute and the “business judgment rule” (with it being the plaintiff’s burden to defeat these defenses), but one whose good faith is called into question must shoulder the burden to prove the “entire fairness” of her conduct
• California Corporation Code § 309(a):
  
  ▪ A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

• C**ompare:** Graham v. Allis-Chalmers Manuf. Co., 188 A.2d 125, 130 (Del. 1963) (director “bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances”)

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**FISH.**
“Business Judgment Rule” [“BJR”]

• Presumes that officers and directors act in interest of corporation and accords deference to their managerial decisions

• Overcoming business judgment rule is a “near-Herculean task” *In re Tower Air, Inc.*, 416 F.3d 229, 238 (3d Cir. 2005)
Corporate Officers – Protected by the BJR?

- **CALIFORNIA**: No, according to some recent federal court rulings
  - California Corporation Code § 309(a) refers only to “directors”

- **GEORGIA and Elsewhere**: Yes
Duties of Majority Shareholders to Minority
Duties of Majority Shareholders to Minority

• 37 states have some form of “oppression” statute authorizing the appointment of a receiver where members of the governing body of a business organization have engaged in “illegal, oppressive or fraudulent” actions, including conduct directed at minority shareholders – see, e.g., Tex. BOC § 11.404 (a)(1)(c)

• Receiver may be appointed only if “the court determines that all other available legal and equitable remedies . . . are inadequate” Id. § 11.404(b)(3)
Duties of Majority Shareholders to Minority


- Suit by minority shareholder against controlling directors who were also trustees of family trusts that owned majority of shares

*Held:* Despite a number of Texas intermediate court decisions upholding an implied cause of action by minority shareholders for remedies other than receivership, the Supreme Court rejected any cause of action other than that expressly authorized by the oppression statute.
Duties of Majority Shareholders to Minority Shareholders


The Court distinguished the statutory prohibition against oppressive conduct from fiduciary duties:

“With regard to formal fiduciary duties, this Court has never recognized a formal fiduciary duty between majority and minority shareholders in a closely-held corporation, see *Willis v. Donnelly*, 199 S.W.3d 262, 276-77 (Tex. 2006), and no party has asked us to do so here.”
Duties of Majority Shareholders to Minority


**Dissent:**

- “Today, Texas becomes the first of [37] jurisdictions with a statute that unequivocally prefers lesser remedies [than receivership] to effectively preclude those remedies—despite overwhelming authority observing that, to the contrary, many if not all jurisdictions allow these lesser remedies.”

- “Shareholder oppression was not the only cause of action in this proceeding. Rupe also sued for breach of fiduciary duty. . . .”
Duties of Majority Shareholders to Minority

NEW YORK:
Topper v. Park Sheraton, 107 Misc. 2d 25 (NY Sup. Ct. 1980) (majority action is “oppressive” if it thwarts “the reasonable expectations of the minority shareholders in light of the particular circumstances of each case”)

MASSACHUSETTS:
Donahue v. Rodd Electrotyle Co., 328 N.E.2d 505, 515 (Mass. 1975) ("stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another")
**DUTIES OF MAJORITY SHAREHOLDERS TO MINORITY**

**DELAWARE:**
- No shareholder oppression statute
- Imposition of fiduciary duty on majority directors/shareholders is not limited to close corporations
- Three standards for reviewing action of directors
  - Business judgment rule
  - “Enhanced scrutiny”
  - “Entire fairness”
Duties of Majority Shareholders to Minority

Delaware’s Three Standards for Judging Conduct Of Controlling Shareholders/Directors

• Business judgment rule – default standard – burden is on plaintiff
• Enhanced scrutiny – intermediate standard – applies when context of decision by governing body raises question about their independence (e.g., hostile takeover) – directors must show that their actions were for good of the company, not their own self-interest
• Entire fairness – most onerous standard – when plaintiff overcomes the business judgment rule then the burden shifts to the defendants to prove they engaged in fair dealing and offered a fair price

See generally, Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442 (Del. Ch.2011)
Sources of Fiduciary Duties

- State Partnership/Organizations Statutes, such as:
  - Delaware Limited Partnership Act
  - Texas Business Organizations Code

- Common Law
- Partnership Agreements
Fiduciary Duties Among Partners

Duties Typically Owed by Partners in a General Partnership

• Duty of loyalty

• Duty of fair dealing

• Duty of disclosure*

• Duty of care in managing partnership activities
Fiduciary Duties Among Partners

Duties Typically Owed by Partners in a Limited Partnership

- General Partners (some courts have historically compared to a trustee):
  - Duty of loyalty
  - Duty of fair dealing
  - Duty of disclosure
  - Duty of care in managing partnership activities

- Limited Partners
Limiting or Eliminating Duties in Partnerships

States Vary on the Contractual Elimination of Duties Among Partners

- Delaware
  - General partnerships – duties may not be eliminated
  - Limited partnerships
    - Partners may modify, limit, or eliminate duties. (Del. Code Ann. Tit. 6, § 17-1101(d) (Del. Ltd. Partnership Act))
      - However, the duty of good faith and fair dealing may not be eliminated.
  - Why? Limited Partnerships are creatures created by contracts.
Limiting or Eliminating Duties in Partnerships

States Vary on the Contractual Elimination of Duties Among Partners

**TEXAS:**

- General partnerships:
  - Duties of loyalty, care, and good faith may not be eliminated
  - However, certain acts may be enumerated that do not violate those duties. *Tex. Bus. Org. Code § 152.002(b)*

- Limited partnerships:
  - Liability of managing partners (i.e. general partners) may be modified or eliminated in certain respects. *Id. § 7.001(d)(2)*
Beware of Unintentional Formation

Energy Transfer Ptrs. v. Enterprise Prods. Ptrs. LP

• Parties entered into a confidentially agreement and a “Non-binding Term Sheet” regarding a potential joint venture for oil and gas exploration.

• Both agreements included language that there was “no binding or enforceable obligations” between them “unless and until” they parties had board approval and definitive agreements memorializing the terms of the agreement.

• Despite that language, the court and the jury found that the parties’ conduct established the statutory elements in the Tex. Bus. Org Code for forming a partnership.

• The jury found that the defendants breached their duties to plaintiff as partners, and awarded plaintiff more than $300 million in damages.
Questions?
Thank you!

Please send your NY CLE forms or questions about the webinar to Ellen at makarevich@fr.com.

A replay of the webinar will be available for viewing at http://fishlitigationblog.com.

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