

## Swindlers, Cheats, and Other Fine Clients

It's one thing to be devoted to a client. It's another thing to be sued for aiding and abetting a client in wrongdoing.

A lawyer's steadfast devotion to his client is a very good thing. But like most good things, if it is carried to extremes, that devotion sometimes can be hazardous. One emerging hazard lies with lawsuits alleging that lawyers have aided and abetted their clients when those clients breached their fiduciary duty to others.

The concern for lawyers is that this expands the potential circle of parties who can sue. It also expands the type of conduct that can create potential liability. Even when such allegations are eventually disproved, law firms may have to spend lots of time and money defending these suits.

Traditionally, lawyers have been held to owe a duty of care only to their clients, with few exceptions. In conventional mal-

practice claims, courts have mainly ruled that only a client can sue his lawyer for negligence. And in jurisdictions that have allowed nonclients

to sue, the courts have usually limited that power to the intended beneficiaries of wills and estates.

This exception makes sense because the client's primary objective in hiring the lawyer is often to confer a benefit on those beneficiaries. Courts have rightly been reluctant to otherwise expand the circle of those who can sue a lawyer for malpractice, because it could undermine lawyers' incentive to be zealous in protecting the interests of their clients.

Though this rule has substantially held steady in the context of malpractice claims, when lawyers knowingly assist their clients in wrongful conduct, courts have been more willing to allow nonclients to sue on other tort grounds. In recent years



many of these situations have involved cases in which a lawyer is alleged to have aided and abetted a client when that client has breached his fiduciary duty to another.

Courts in these cases have not found that the lawyers themselves owed a fiduciary duty to the injured party. Instead these suits are based on two key elements: that the lawyer knows that his client is breaching a fiduciary duty to another, and that the lawyer substantially assists his client in carrying out the breach. And yes, Enron provides one example of this, but it is far from the only one.

In *Anstine v. Alexander* (2005), the Colorado Court of Appeals upheld a jury's finding that while a law firm and its lawyers had not engaged in malpractice in representing their client, they were liable for aiding and abetting their client in breaching its fiduciary duty to others.

In that case, the lawyers represented Builders Home

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Warranty, a company that sold home buyers warranties for newly constructed homes, purportedly having valid insurance policies to back up the warranties. The lawyers learned that the insurance policies the company purchased were probably worthless. In fact, the company had bought the policies from impostors claiming to represent large insurance companies. When the company declined the lawyers' suggestion to file for bankruptcy, the lawyers allegedly assisted the company in arranging a doubtful plan to attempt to purchase replacement policies. At the same time, they didn't tell the home buyers who had bought warranties that the validity of their insurance was uncertain.

On the claim of aiding and abetting, the jury apportioned the lawyers' comparative fault at just 1 percent, compared with 99 percent for the company's president. The court nevertheless found the lawyers jointly and severally liable. The court also rejected the lawyers' argument that the case against them should be dismissed because they owed no fiduciary duty to the purchasers of the warranties. The court stated that "the law does not insulate aiders and abettors simply because they acted in the course of fulfilling separate and distinct duties as lawyers."

In *Chem-Age Industries v. Glover* (2002), a lawyer represented a corporate officer who was found to have breached his fiduciary duty to the company and its investors by spending company funds for his personal use and by keeping for himself the proceeds of sales of corporate assets. The Supreme Court of South Dakota held that the investors in the company could sue the lawyer because there was evidence that the lawyer knew of his client's conduct and substantially assisted him in carrying it out.

The court stated, "If he did not know his client was in the midst of a swindle, he certainly knew [the client] had several questionable investment schemes in the past, leaving unhappy investors in his wake." The court also noted the importance of the lawyer's assistance in carrying out the misconduct: "The creation of a corporation with the assistance of an attorney gave a patina of authenticity to [the client's] otherwise rogue activities."

The court concluded: "It may be that [the lawyer] was duped by [the client's] conniving business dealing, but that is for the jury to decide."

### WARNING SIGNS

This type of allegation is more likely to be made in matters involving transactional cases than in litigation. That's for two reasons: Litigation typically is focused on determining liability for past conduct rather than providing advice about ongoing conduct, and a lawyer's obligations for client loyalty are more clearly defined when a lawyer acts as an advocate in a court proceeding.

Among transactional matters, those relating to intracorporate disputes or disputes within a partnership or other entity in which there are mutual fiduciary obligations provide fertile ground for charges of aiding and abetting. One type of transactional matter, which until now has been excluded by the U.S. Supreme Court from this type of suit under federal law, is brought under Section 10(b)(5) of the Securities and Exchange Act of 1934, relating to deceptive practices in the sale of securities. In *Central Bank of Denver v. First Interstate*

*Bank of Denver* (1994), the Court found that the language of the statute created liability only for those who engaged in the defined prohibited conduct. The Court declined to interpret the mere silence in the statutory language on the subject of aiding and abetting as creating liability for such acts.

The court in *Chem-Age Industries* also found possible grounds to suspect a lawyer's awareness that something was amiss when, during the course of the representation, he accepted a gift of an expensive desk from the client. The court stated, "Accepting such a 'gift' from a client . . . who [the lawyer] knew had longstanding financial problems, raises a question of constructive knowledge."

Besides the obvious problem of lawyers who might actually be aiding and abetting clients in wrongdoing, there's another problem. In fact, the more pervasive problem is that suits alleging this sort of thing will not be readily dismissed at the outset and firms may be forced to spend a lot of money defending them.

So what can a law firm do to minimize the risks of such suits? First, before agreeing to undertake a new client, a firm should learn something about the prospective client's history and reputation. A firm should also consider the nature of the transaction it is being asked to assist in, and consider whether the client may be arguably engaging in a breach of his fiduciary responsibility to others. Armed with this information, the firm may want to decline to take on the matter.

Second, once undertaking a case, a lawyer should remain alert for telltale signs that something is amiss. These might include, for example, indications that the client has unusually strong personal animus toward a former partner or other constituent of a company; that the client insists on a strategy of self-gain that is at odds with the interests of a company to which he owes a duty and beyond what appears reasonable or warranted; or that the client seeks to gain the allegiance of the lawyer in unconventional ways, such as the gift of a desk in *Chem-Age Industries*. If so, the lawyer should not ignore those concerns but instead confront the client and insist that the client comply with the law.

Third, if a client persists in wrongful conduct and refuses to abide by the lawyer's advice, the lawyer should consider withdrawing from the representation. Often the lawyer can use the threat of withdrawal as an incentive to persuade the client to take the advice.

There was a time when lawyers thought nothing of agreeing to represent whoever happened to walk in the door. Some even took a whimsical pride in doing so, since it proved their versatility and skill. Today those involved in risk management for law firms have learned that a law firm's potential liabilities greatly expand when its clients engage in fraudulent or criminal conduct. Cautious lawyers should hesitate before agreeing to take on a matter for an unknown client, and once they have taken on that client, they should remain loyal yet vigilant.

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