

## ■ Specific Engagement Letters: A Risk Management Tool?

BY JOANNA J. CLINE

Over the past several years, the role of the engagement letter has assumed an increasingly heightened profile in the management of a law practice. Gone are the days when lawyers viewed drafting and securing the return of an engagement letter as optional, ministerial tasks. Instead, practicing attorneys (and firm managers) are beginning to accept the view that a thoughtful and specific engagement letter can be a powerful asset, while an overbroad or boilerplate retention agreement can come back to haunt lawyers and law firms as a liability.

Among the reasons to put forethought and energy into an engagement letter that succinctly and specifically defines the scope of engagement is that doing so may provide a very good defense

to a legal malpractice claim.<sup>1</sup> Legal malpractice claims are no longer limited to egregious situations in which lackluster counsel have blown a deadline or made an obvious error in legal analysis. Very good lawyers from very well respected law firms are being sued with more and more frequency,<sup>2</sup> sometimes with respect to matters that counsel believed to be outside the scope of the engagement. A specific engagement letter is an underutilized tool to prevent confusion over the scope of engagement and to help defend against claims brought by slippery former clients.

Recent case law provides some illustrations. Last year, in *AmBase Corp. v. Davis Polk & Wardwell*,<sup>3</sup> Davis Polk & Wardwell defeated a malpractice claim on a motion to dismiss in part because of the specificity of its engagement letter. AmBase sued Davis Polk for malpractice notwithstanding that Davis Polk won a complete victory for AmBase in a tax dispute with the IRS. AmBase claimed that even though Davis Polk successfully litigated the dispute with the IRS and achieved a finding of no

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## ■ Fee Disgorgement in Attorney Breach-of-Fiduciary-Duty Cases

BY MICHELE HANGLEY

From a plaintiff's point of view, the most difficult element of a legal malpractice case often is causation of damages. A plaintiff may be able to prove that his lawyer was negligent—even grossly so—but if the plaintiff cannot show that the negligence caused him harm, most courts will not permit recovery. Recognizing this barrier to legal malpractice claims, more and more plaintiffs are pursuing claims for breach of a lawyer's fiduciary duties along with, or instead of, legal malpractice claims. A breach of fiduciary duty claim carries a distinct advantage for a plaintiff: Often, the plaintiff need not show that the breach of duty harmed him in any way. Instead, the plaintiff can seek the equitable remedy of fee forfeiture, also known as "disgorgement."

Most courts that have considered the issue have held that a client need not show actual harm if he or she seeks only disgorgement.<sup>1</sup> One justification for this rule is that under agency principles, an agent "is not entitled to be paid when he has not provided the loyalty bargained for and promised."<sup>2</sup> The second justification is deterrence: Attorneys should be afraid to act disloyally, whether or not it is likely that their clients will be harmed by their actions.<sup>3</sup>

In an era of ever-rising legal costs and ever more complicated representations, the stakes in a disgorgement claim can be high. Recently, for example, a New York trial court ordered an insurance defense firm to repay the approximately \$3 million that a former client had paid it over three and a half years,<sup>4</sup> a decision that attracted much attention. Despite the potential importance of the remedy, there is not a great deal of guidance from the courts on when, how, and to what extent disgorgement should be granted. Ac-

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## Letter from the Chairs

This issue of *Commercial & Business Litigation* examines several hot issues in professional liability litigation. These articles contrast with another recent project of the committee—a June 17, 2008, teleconference entitled “Keeping It Real: Making White Collar Defendants Blue Collar Friendly.” The materials from that presentation are on the our website at [www.abanet.org/litigation/committees/commercial](http://www.abanet.org/litigation/committees/commercial). It is interesting to examine the thoughtful articles about legal doctrine in this newsletter in light of the highly practical tips from the teleconference about how people perceive one another in this type of litigation.

For example, the teleconference materials feature a detailed analysis of Ken Lay’s testimony in his high-profile criminal trial. A lawyer involved in that case questions the popular perception that Mr. Lay’s testimony was combative, and presents a number of anecdotes from jurors in the case about aspects of his testimony that actually helped humanize his side of the Enron story. Considering those anecdotes, and then picturing the lawyer trying to defend against a claim for fee disgorgement (the Hanglely article in this issue), or an insurance broker defending a claim about coverage for a subprime liability (the Bortnick and Kennell article in this issue), helps bring those legal issues to life.

The teleconference materials also examine some general principles for witness preparation in litigation about “white

collar” matters—for example, taking time to give a jury a real sense of the witness’s work environment. This sort of general advice helps all of us remember that, if the kinds of claims about professional liability discussed in this issue reach a jury, the attorneys cannot simply assume that jurors are familiar with all the aspects of a witness’s work life and related pressures. Even the driest legal issue has a human element, and potentially a very important one for the overall presentation of the case.

Please come to the ABA Annual Meeting in New York City, August 7–9, 2008, where we will present, in addition to our customary evening dinner, a full program on August 7 about cross-border discovery, including experts from the United States, Canada, the United Kingdom, Mexico, and China. We will also have a breakfast presentation about several important recent developments in patent law, designed to assist the general commercial litigator who may not deal with patent issues every day.

Please keep an eye out for an email inviting participation as a subcommittee chair in the next bar year. The Commercial and Business Litigation Committee is one of the largest in the Section of Litigation and offers many opportunities to learn, teach, and build professional relationships across the country.

David S. Coale  
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## Letter from the Editor

The theme of this issue of *Commercial & Business Litigation* is professional responsibility. It includes highly informative articles on fee disgorgement, the importance of engagement letters, frivolous litigation, and insurance coverage issues arising from the subprime meltdown. This issue of *Commercial & Business Litigation* also contains a new department entitled "Procedure." In the first Procedure article, we highlight David S. Clancy and Matthew M.K. Stein's article analyzing the inconsistency in the application of the diversity jurisdiction statute. It is our hope to continue to produce in future issues additional analyses of various procedural topics that many of you encounter in your practices.

If you have any comments about this issue or if you wish to contribute articles to future issues of *Commercial & Business Litigation*, please contact me at [stioa@pepperlaw.com](mailto:stioa@pepperlaw.com). A standard article is roughly 1,500 words, with all citations in the form of endnotes. Upcoming newsletter themes and the submission dates for articles are as follows:

- Fall 2008—Financial Services Litigation  
Submission Deadline: September 1, 2008
- Winter 2009—Class Actions  
Submission Deadline: November 10, 2008

As always, thank you for your interest in the ABA and the Committee on Commercial and Business Litigation.

Angelo A. Stio III

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# Frivolous Litigation: What Is It and What Can You Do about It?

BY MICHAEL LEBOFF

We have all seen cases that make us shake our heads and wonder how any reasonable person could file such a lawsuit. Such as a debtor filing a factually meritless unfair debt collection practices claim to avoid a debt rightfully owed.<sup>1</sup> Or a borrower filing a lawsuit to invalidate a loan because it was not funded with gold or silver.<sup>2</sup> Or a plaintiff filing a false advertising claim based on advertising he never saw.<sup>3</sup> These are not the important issues that made us want to become lawyers—rather, they are the lowest of the low, the bowels of the law that sully our profession to the outside world.

However, most defense counsel do not set their hourly rates based on the merits of the action they are defending. An hour spent defending a frivolous lawsuit costs the same as an hour spent defending a meritorious one. But the party (or client) who spends good money defending a bad law is frustrated—maybe even vengeful. But when your client is faced with a frivolous lawsuit, what can you do about it? The most common response (and often the best) is to do nothing, but there are options.

## What Is Frivolous Litigation?

Of course, the first step in the process is identifying what is frivolous, which is often easier said than done. From the outset, it is important to realize that only a small fraction of cases can be considered “frivolous” or “without probable cause.” Many defendants have lost cases they felt were frivolous, largely because they did not look at the case objectively. In addition, courts routinely express their displeasure for malicious prosecution lawsuits and have intentionally set a very low bar for what passes for “probable cause.”<sup>4</sup>

Nevertheless, either through a complete lack of facts or legal support, many cases should never be filed. Although standards vary from state to state, generally speaking, a lawsuit lacks probable cause where it is not founded on facts sufficient to support an *objective* belief that the evidence will sustain a favorable judgment<sup>5</sup> or where no reasonable attorney would have thought the claim tenable.<sup>6</sup>

Aside from those cases completely lacking support in law or fact, there are several other scenarios that could make a case, or part of a case, frivolous.

### *Ignoring Newly Discovered Evidence*

A plaintiff may have had a reasonable basis for bringing a claim that later proves to be futile after getting into discovery and further investigation. Instead of admitting defeat and dismissing the claim, the persistent plaintiff may press on without regard to the newly discovered lack of merit. Frivo-

lous actions include not only claims initiated without probable cause but also claims continued once the plaintiff should have known there is no chance of success.<sup>7</sup> However, this does not mean that plaintiffs need to take adverse evidence at “face value,” and plaintiffs are able to challenge testimony and facts that may reasonably be thought untruthful.<sup>8</sup>

### *Piling on Bad Claims*

It is not uncommon to see a complaint that contains one legitimate claim followed up by several nonsensical claims. For example, this can be seen where a promissory fraud claim trails a garden-variety breach-of-contract claim, or pretty much every civil RICO action I have ever seen. In many states, a malicious prosecution action may be brought where only one of multiple theories of recovery was maliciously asserted.<sup>9</sup> But this rule does not eliminate the requirement to prove a favorable termination of the *entire* underlying litigation.<sup>10</sup>

### *Suing an Innocent Defendant*

As frequently happens in commercial litigation, when suing a company for some alleged wrongdoing, a plaintiff will also name the company president or other high-ranking individual, or an uninvolved parent or affiliate company, in an effort to manufacture some additional leverage in the underlying litigation. Aside from rarely achieving its desired result, it may open the door to a subsequent sanctions motion or a malicious prosecution action by that extra innocent defendant—even if the plaintiff prevails against its primary target.<sup>11</sup>

### *Overblown Damages Claims*

Many of us have seen the following scenario: The plaintiff has a legitimate case as to liability, but little or no damages. Knowing that summary judgment will be difficult, if not impossible to obtain, the plaintiff puts forward a frivolous damages theory seeking millions for a relatively minor claim. A malicious prosecution action or other remedial action may lie where most—but not all—of the damages sought in the prior action were claimed without probable cause.<sup>12</sup>

### *The Frivolous Class*

Class actions are not entitled to any special treatment, and the same rules for frivolous litigation apply where the action was brought without probable cause.<sup>13</sup> But what about those instances in which the plaintiff may have a legitimate individual claim but needlessly inflates the claim by asserting it as a class action? There is a lack of published case law to provide guidance in these situations. Nevertheless, if there is

no probable cause for seeking class relief, the same rules and remedies should apply. At the very least, a plaintiff and the plaintiff's counsel may be subjecting themselves to sanctions for bringing a frivolous motion for class certification.

### What Can You Do about It?

Once you have determined that your case is frivolous, what next? The law provides a myriad of remedies for addressing frivolous lawsuits, but, before embarking on any such course, it is crucial to assess the costs of doing so, all with the knowledge that actually recovering damages or obtaining sanctions for frivolous actions is tenuous. Nevertheless, in certain situations, it may make sense to fight back, and here are some of the best options for doing so.

#### *Malicious Prosecution*

The most obvious recourse for frivolous litigation is bringing a subsequent lawsuit for malicious prosecution. The elements of that claim are that a prior action<sup>14</sup> (1) was commenced by or at the direction of the defendant and was pursued to a legal termination in the plaintiff's favor; (2) the prior action was brought without probable cause; and (3) was initiated with malice.<sup>15</sup> If you can establish each of the elements of a malicious prosecution action, then you are entitled to recover traditional tort damages, including costs incurred in defending the frivolous action (including attorney fees), as well as other economic loss, harm to reputation, and mental or emotional distress.<sup>16</sup> You may also be entitled to punitive damages.<sup>17</sup>

Often, however, there will be serious questions as to whether the plaintiff in the underlying litigation will be able to satisfy a malicious prosecution judgment. But, even if the party itself is judgment-proof, a malicious prosecution claim may also lie against the attorney who brought the frivolous lawsuit.<sup>18</sup> In addition, in some states, malicious prosecution may be covered by an insurance policy.<sup>19</sup>

Be careful, however, to choose your malicious prosecution case wisely. In California, for example, malicious prosecution actions arise out of a constitutionally protected activity, that is, petitioning the courts.<sup>20</sup> For that reason, to avoid being subject to an anti-SLAPP motion (Strategic Lawsuit Against Public Participation), you will need to be able to prove—at the outset—that you have a reasonable probability of winning your malicious prosecution claim. Although other states do not have statutes comparable to California's anti-SLAPP laws, a frivolous malicious prosecution case could lead to other adverse consequences, such as retaliatory malicious prosecution action or, at the very least, wasting time and money pursuing a claim that has no value.

#### *Attorney Fee Clauses*

Perhaps the best mechanism to recover your losses and deter frivolous litigation is a contractual attorney fee clause because there is no need to debate whether the action was

frivolous. Fees are awarded to the prevailing party regardless. However, if there is no contractual attorney fee clause, then look for statutory clauses. Most statutory attorney fee clauses benefit only the plaintiff, but there are some, such as the Uniform Trade Secrets Acts, that allow defendants to recover their fees, often upon a showing of bad faith by the plaintiff.<sup>21</sup> The benefit to seeking recourse through a fee provision is that you can avoid going back to “square one” with a whole new lawsuit. All you need to do is bring a motion for attorney fees in the same action and before the same judge that just threw out the case.

#### *Motion for Sanctions*

Federal Rule of Civil Procedure 11 allows the court to sanction an attorney for filing papers for an improper purpose or for making claims, defenses, or legal arguments that are not “warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law.” Every state has statutes that give courts similar discretion.<sup>22</sup> Despite this discretion, courts rarely sanction parties, even for the most obvious and egregious abuses. But it can happen. And, as with a fee provision, you can seek sanctions through a motion and avoid

the need for a second lawsuit. If considering this alternative, however, be aware that Rule 11 and many analogous state laws contain safe-harbor provisions, which allow the offending party to avoid sanctions by removing the frivolous aspects of the case in response to such a motion.

In every case, it will be a very fact-intensive inquiry as to whether the action is frivolous. But, if you think the case may be frivolous, then do the ground work in the underlying lawsuit. For example, defendants contemplating a subsequent malicious prosecution action will want to use all of the discovery tools available in the frivolous case, including depositions and interrogatories, to ascertain the factual and legal basis for that suit as soon as possible. Furthermore, in the right situations, you also may be able to use the threat of sanctions or a potential malicious prosecution action to force

**Rule 11 contains safe-harbor provisions, which allow the offending party to avoid sanctions by removing the frivolous aspects of the case in response to such a motion.**

a dismissal, because plaintiffs who file frivolous lawsuits often do so believing there will be no repercussions.

You should also carefully consider which motions you intend to bring during the frivolous lawsuit. Several courts have held that an unsuccessful motion for summary judgment or directed verdict can establish, as a matter of law, that the action had merit.<sup>23</sup> This rule, however, does not apply where the unsuccessful motion was the product of fraud or perjured testimony.<sup>24</sup>

## Conclusion

Every business needs to tolerate a certain amount of frivolous litigation. For good or bad, it is simply part of the cost of doing business in this country. But that does not mean that defendants are powerless to fight back against serious or repeat violations. ■

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1. See, e.g., *Miller v. Javitch, Block & Rathbone*, 534 F. Supp. 2d 772 (S.D. Ohio 2008).
2. See, e.g., *Hinz v. Wash. Mut. Home Loans*, 2004 WL 729239 (D. Minn. Apr. 2, 2004).
3. See, e.g., *Buckland v. Threshold Enters., Ltd.*, 155 Cal. App. 4th 798, 66 Cal. Rptr. 3d 543 (2007).
4. *Zamos*, 32 Cal. 4th at 966, 12 Cal. Rptr. 3d 80; *Clyne v. Doyle*, 740 A.2d 781, 782 (R.I. 1999).
5. See, e.g., *Palmer v. Zaklama* 109 Cal. App. 4th 1367, 1383, 1 Cal. Rptr. 3d 116, 127 (2003); *Lierly v. Tidewater Petroleum Corp.*, 139 P.3d 897, 903–4 (Okla. 2006).
6. *Lasic v. Moreno*, 504 F. Supp. 917, 923 (E.D. Cal. 2007).
7. *Zamos*, 32 Cal. 4th at 966–67, 12 Cal. Rptr. 3d 60–61 (citing RESTATEMENT (SECOND) OF TORTS § 674 cmt. c); *Poff v. Hayes*, 763 So. 2d 234, 241 (Ala. 2000).
8. *Marijanovic v. Gray, York & Duffy*, 137 Cal. App. 4th 1262, 1271, 40 Cal. Rptr. 3d 867, 873–74 (2006).
9. *Soukup v. Law Offices of Herbert Hafif*, 39 Cal. 4th 260, 292, 46 Cal. Rptr. 3d 638, 663 (2006); *Crowley v. Katleman*, 8 Cal. 4th 666, 679, 34 Cal. Rptr. 2d 386, 392 (1994); *but see Joseph H. Held & Assoc. v. Wolff* (39 S.W.2d 59, 63 (Mo. App. 2001) (holding entire action must lack probable cause)).
10. *Crowley*, 8 Cal. 4th at 686, 34 Cal. Rptr. 2d at 397.
11. *Siebel v. Mittlesteadt*, 41 Cal. 4th 735, 62 Cal. Rptr. 3d 155 (2007).
12. *Citi-Wide Preferred Couriers, Inc. v. Golden Eagle Ins. Corp.*, 114 Cal. App. 4th 906, 914, 8 Cal. Rptr. 3d 199, 205 (2003).
13. *McShares, Inc. v. Barry*, 266 Kan. 479, 970 P.2d 1005 (Kan. 1998); *In re Am. Continental Corp.*, 845 F. Supp. 1377 (D. Ariz. 1993).

14. Although a small minority of jurisdictions allow defendants to assert malicious prosecution as a counterclaim in the underlying litigation itself.

15. See, e.g., *Zamos v. Stroud*, 32 Cal. 4th 958, 965–66, 12 Cal. Rptr. 3d 54, 60 (2004); *Nutter v. Messerli & Kramer, P.A.*, 500 F. Supp. 2d 1219, 1224 (D. Minn. 2007). Malicious prosecution is a common-law tort, so the elements of the claim are generally the same from state to state, with minor variations. It is, of course, necessary to research the precise elements of the state in which you are considering bringing the action.

16. See, e.g., *Citi-Wide Preferred Couriers*, 114 Cal. App. 4th at 911–12, 8 Cal. Rptr. 3d at 203; *Pernoud v. Martin*, 891 S.W.2d 528, 539 (Mo. App. 1995).

17. *Stamathis v. Flying J, Inc.*, 389 F.3d 429, 440 (4th Cir. 2004); *Crosson v. Berry*, 829 N.E.2d 184, 191 (Ind. App. 2005).

18. See *Zamos*, 32 Cal. 4th at 969–70, 12 Cal. Rptr. 3d at 63; *U.S. Express Lines, Ltd. v. Higgins*, 281 F.3d 383, 394 (3d Cir. 2002).

19. *Smith & Newpew Inc. v. Fed. Ins. Co.*, 113 Fed. App'x 99, 102 (6th Cir. 2004); *Fluke Corp. v. Hartford Accident & Indemn. Co.*, 145 Wash. 2d 137, 143, 34 P.3d 809, 812 (Wash. 2001); *but see Butcher v. Truck Ins. Exch.*, 77 Cal. App. 4th 1442, 1467, 92 Cal. Rptr. 2d 521, 539 (2000).

20. See, e.g., *HMS Capital, Inc. v. Lawyers Title Co.*, 118 Cal. App. 4th 204, 212–13, 12 Cal. Rptr. 3d 786, 792.

21. CAL. CIV. CODE § 3426.4; *see also* California's Consumer Legal Remedies Act, CAL. CIV. CODE § 1780(d).

22. See, e.g., ARIZ. REV. STAT. § 12-349; CAL. CIV. PROC. CODE § 128.5; GA. CODE ANN. § 9-15-14.

23. See, e.g., *Porous v. Pall Corp.*, 186 F.3d 1077, 1080 (8th Cir. 1999) (holding denial of motion for judgment as a matter of law fatally undermined later claim for malicious prosecution); *Roberts v. Sentry Life Ins. Co.*, 76 Cal. App. 4th 375, 383, 90 Cal. Rptr. 2d 408, 413 (Cal. App. 1999) (holding denial of summary judgment in the underlying case is a reliable indicator that probable cause was present); *but see Hite v. Triton Energy, Ltd.*, 35 Fed. App'x 434, 436–37 (9th Cir. 2002) (finding under Texas law that verdict in favor of plaintiff in underlying litigation that is reversed on appeal does not create a presumption that there was probable cause).

24. *Hydranautics v. Filmtec Corp.*, 204 F.3d 880, 886 (9th Cir. 2000).

# When the Walls Come Tumblin' Down: Impediments to Coverage for Subprime Mortgage Litigation

BY RICHARD J. BORTNICK AND PATRICK M. KENNEL

The subprime mortgage “meltdown” continues to generate litigation against mortgage bankers and brokers, commercial banks, investment banks, investment funds, ratings agencies, real estate investment trusts (REITs), law firms, and accounting advisors—in short, anyone and everyone who played a part, no matter how big or small, in the origination, evaluation, facilitation, or securitization of subprime mortgages. The typical lawsuit alleges that the defendants originated, sold, or bought high-risk mortgage loans while concealing over many years their poor performance. Of course, the individuals and entities who have been sued have turned to their directors and officers or errors and omissions carriers for insurance coverage. In turn, whether such insurance is available to them must be analyzed case by case and will be dependent on each situation’s unique facts and governing law. Depending on how the facts ultimately play out, it is possible that some individuals and institutions who built the subprime lending sector from the ground up may find that the walls will come tumbling down.

This article discusses a number of professional liability insurance policy provisions that may determine the availability of coverage for claims arising out of the subprime mortgage crisis, including those bearing on the people and entities that

- originated subprime mortgages (mortgage banks, commercial banks, brokers)
- capitalized or funded the subprime mortgage market (commercial banks, investment banks, REITs, investment funds)
- packaged or repackaged subprime mortgages and resold them as securities (again, investment banks, REITs)
- purchased the mortgage-backed securities for their own portfolios or for resale (investment funds, REITs, private and public investors)
- rated the entities involved in the subprime mortgage industry (ratings agencies)
- served as professional advisors to such persons and entities (lawyers, accountants, investment advisors)

Thus far, irrespective of the role played by each category of policyholder, the assertions being made in the underlying subprime lawsuits appear to potentially implicate policy exclusions relating to “bad acts” (i.e., fraud and profiteering), breach of contract, other available insurance, and, in some situations, securities law claims. More fundamentally, the

lawsuits bring into view whether coverage even exists in the first instance, that is, whether the underlying matters rise to the level of a “claim,” whether they involve a “wrongful act,” whether the remedies sought constitute a “loss,” and, in the errors and omissions (E&O) context, whether the allegations implicate “professional services,” as those terms are defined in a conventional professional liability policy.

In the more extreme situations, allegations of misfeasance or pervasive misconduct by the policyholder undoubtedly will cause a professional liability insurer to question the veracity of the statements and representations made during the policy application process and to assess whether the insurance policy should be rescinded. As a collateral matter, the number of parties involved in the underlying mortgage transactions and resulting collapse also could raise questions as to the priority of payments, if any, under the subject insurance policies.

## The Emerging Allegations

Although the term “subprime mortgage” has been in use for many years, it became part of the common vernacular when the industry members’ stock prices began to fall and the initial spate of lawsuits was filed in the summer of 2007. In the context of class action securities fraud litigation, the lawsuits generally contend that the defendant publicly traded companies and others, including directors and officers, disseminated or facilitated the dissemination of materially misleading financial statements that hid the existence, portfolio exposure, or true performance of high-risk subprime loans. When lenders and portfolio owners and managers were forced to publicly disclose the actual extent of the subprime loans they originated, sold, or continue to hold (thus contaminating their financial statements), their stock prices plummeted, enraging investors. Likewise, the directors and officers of REITs that invested in or repackaged subprime mortgages or lent vast sums of money to subprime lenders have been sued based on their alleged misrepresentations or failures to disclose the extent of their companies’ involvement in the subprime sector, including, in one case, the trust’s financial relationship with a now-defunct mortgage lender. Further, large institutional purchasers of securitized pools of subprime mortgages are pursuing recourse against the issuers, trustees, servicers, and insurers of subprime-related investments bonds based on allegations that the true nature and risks of the bonds were not disclosed. Indeed, in at least one well-publicized case, a life insurer, which purchased bonds of securitized subprime

mortgages, alleges that several major financial institutions, which served as trustees of the investment bonds, misrepresented the true worth and performance of the loans in their pools, going so far as to mask the magnitude of the default rates in their portfolios.

Eventually, as the deteriorating subprime mortgage market touched off the massive credit crunch of August 2007, a number of subprime lenders were forced into liquidation or reorganization, while others teetered on the edge of bankruptcy. In those cases, it would not be surprising if, eventually, directors and officers, securities underwriters, law firms, accountants, and others are sued by a bankruptcy trustee alleging that the defendants breached their duties to the now-bankrupt company.


### Prerequisites to Coverage

As with other forms of insurance, coverage under professional liability policies is potentially triggered only when the prerequisites to coverage have been satisfied. In complex transactions such as the subprime context, it is important to pay particular attention to a policy's fundamental definitions.

Directors and officers (D&O) liability policies indemnify a corporation and its D&Os for "loss" resulting from "wrongful acts" that cause financial harm to a third party (such as a shareholder) and result in a "claim." D&O insurance generally has two or three coverage parts:

- **Coverage A**, which indemnifies the corporation's directors and officers where the corporation does not or is unable to do so;
- **Coverage B**, which provides for corporate reimbursement where the corporation has indemnified its directors and officers; and, in many instances,
- **Coverage C**, which provides insurance for the corporate entity itself in the context of securities and sometimes employment practice liability claims.

These different coverages are generally subject to separate terms, conditions, and retentions, and may even have distinct policy limits or sublimits. In virtually all cases, D&O insuring agreements specify that coverage is limited to claims first made and reported to the insurer during the policy period.



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In turn, under a typical E&O policy, the insurer will indemnify the policyholder for its legal liability arising from a claim that is made against the policyholder during the policy period and that alleges a “wrongful act” in the provision of “professional services” for a client. As discussed below, this standard format is then tailored to specific industries or policyholders through variations on the definition of the term “professional services.”

## Relevant Policy Definitions

### *Claim*

Whether a particular subprime mortgage matter qualifies as a “claim” under a D&O or E&O policy is a threshold issue that could be determinative of the coverage question from the outset. The term “claim” typically is defined as a demand for money damages or the filing of a lawsuit. It also might include a demand for the policyholder to repurchase a mortgage that does not conform with the overall portfolio.

A number of the older form professional liability policies intentionally omit from the definition of “claim” a formal (and, by extension, informal) governmental investigation or subpoena for records or documents. For that reason, there would be no coverage for such matters. In turn, newer vintage policies may extend the definition of “claim” to include formal government investigations by way of the presentation of a formal order of investigation by a government regulatory agency. Conversely, informal investigations still typically are outside the scope of a professional liability policy’s definition of “claim.” Thus, to the extent formal government investigations of subprime matters are submitted by policyholders for coverage under their E&O or D&O programs, insurers should carefully examine whether those investigations meet the definition of a “claim” for purposes of assessing coverage.

At the same time, while shareholder securities fraud litigation has abated somewhat, shareholder derivative litigation has become increasingly popular and may find even more fertile ground in the subprime litigation arena. Most D&O policies provide coverage for amounts expended in defending derivative lawsuits, but many restrict from the definition of “claim” or otherwise exclude from coverage corporate investigations initiated in response to a shareholder demand letter. Similarly, when company boards form a “special litigation committee” to conduct an independent evaluation of a shareholder demand, the costs associated with the committee’s investigation and evaluation, including outside counsel fees, may not be covered, depending upon the language used in the policy form at issue.

In addition, some professional liability policy forms include in the definition of “claim” (or, alternatively, in the insuring agreement or the definition of “wrongful act”) the “capacity” prerequisite endemic to all such policies. Such provisions typically state that coverage is limited to those

proceedings or demands made against a policyholder only in his or her capacity as a director or officer of the corporation, and not in any other capacity.

### *Wrongful Act*

In the typical professional liability policy, the term “wrongful act” is generally defined as “any actual or alleged act, error or omission, misstatement, misleading statement, or breach of fiduciary duty or other duty by an Insured Person in his or her capacity as an Insured Person.” Again, the capacity requirement may be contained in this definition. To the extent the policyholder’s liability arises out of a contract or is based on intentional conduct, it may not constitute a “wrongful act.”

### *Loss*

Most D&O and E&O policies define the term “loss” to mean the amount an insured is “legally obligated to pay” as a result of a “claim.” In turn, they typically carve out from coverage multiplied damages, penalties, and fines.

In evaluating coverage for the subprime mortgage cases, insurers will look at the context of the allegations presented and the relief sought by the underlying plaintiffs. For example, coverage could exist where the plaintiff seeks damages or financial losses as a result of a “wrongful act.” On the other hand, there may not be coverage for a lawsuit that seeks only corporate governance changes or equitable relief. Similarly, to the extent a subprime lawsuit arises from a contract or similar business dispute or results purely from an attempt to recoup a bad investment in subprime portfolios, such suits would not seem to come within the purview of the definition of “loss” for coverage purposes.

In other cases, the relief sought by an underlying plaintiff or class could include the disgorgement of ill-gotten gains or payment of restitution. Several courts have held that disgorgement and restitution amounts do not constitute covered “loss” under D&O or E&O policies.

Although many newer vintage D&O policies include defense costs and other amounts associated with formal government investigations within the definition of “loss,” some do not. In any case, most D&O and E&O policies strictly prohibit insurance recovery for civil fines or penalties, as well as other amounts deemed uninsurable as a matter of law, defining such damages to be outside the scope of the term “loss.” We know from prior large-scale government investigations that have resulted in wide-ranging civil litigation that settlement agreements with government regulators often contain provisions expressly barring the recovery of those settlement amounts from insurance proceeds.

### **Professional Services**

In most cases, E&O policies are intended to cover claims of wrongdoing in the policyholder’s rendering or failure to render “professional services.” Although the term “profes-

sional services” is not always defined in an E&O policy, when it is defined, the definition is usually narrow and in concert with a specific litany of services offered by the policyholder. Depending on the policy form used, subprime lending practices and subprime mortgage securities sales or purchases may or may not come within the policy definition of “professional services.” Professional liability insurers will need to track closely the specific services at issue in a subprime lawsuit to determine whether corresponding E&O coverage exists in the first place.

Within the transactional chain between the origination of the subprime mortgage and its subsequent securitization, the definition of “professional services” may vary. Thus, mortgage bankers and brokers may obtain insurance that specifically contemplates coverage when they fail to originate a loan properly by, for instance, failing to obtain a property appraisal, failing to confirm that the underlying property is insured against damage due to fire or other causes, or failing to confirm the employment records or past credit history of the borrower. At the other end of the spectrum, investment banks may obtain coverage for “professional services” relating to the bank’s securitization of a book of subprime mortgages and its underwriting or sale of the resulting securities to third parties.

Moreover, in cases where the policyholder has been sued based on its alleg-

edly improper or intentionally misleading revenue model with respect to subprime mortgage risks, a professional liability insurer should explore the possibility that such suits do not involve the rendering of or failure to render “professional services” but, rather, implicate the policyholder’s corporate make-up or business model, that is, activities that are commercial in nature. The distinction can be subtle. If the lawsuit involves the way the company operated its day-to-day business, it may involve “professional services” for purposes of E&O coverage. On the other hand, if the lawsuit really takes to task, for example, the strategic decision to base most or all of the company’s revenue on the handling of subprime mortgages or securities, an argument could be made that such suits do not fall within the “professional services” E&O coverage afforded.

#### Potentially Applicable Exclusions

The accusations leveled to date in the context of subprime mortgage litigation necessarily mandate that professional liability insurers investigate and closely scrutinize the underly-

ing facts to evaluate whether certain D&O and E&O policy exclusions might apply. Although each situation is different, certain exclusions could serve to preclude or otherwise limit the insurance available, irrespective of the role allegedly played by the policyholder.

#### *Fraud and Profiteering “Conduct” Exclusions*

Virtually all D&O and E&O policies contain exclusions proscribing coverage for claims that arise from:

- any deliberately dishonest, malicious, fraudulent or criminal act or omission, or any willful violation of the law by any insured
- the gaining by any insured of any personal profit, remuneration, or advantage to which they were not legally entitled

Several variations of the relevant language include “in fact” or “final adjudication” conditions that confine the exclusion to those situations where there has been a finding of fact that the prohibited conduct occurred. This essentially prevents coverage from being denied at the outset of subprime litigation insofar as no such finding has yet been made and all that exists is a complaint asserting fraud or profiteering by the policyholders.

Still, these “conduct” exclusions may be conclusive as to the ultimate availability of insurance coverage in the subprime litigation context. Of the lawsuits filed so far, several allege the dissemination of materially misleading or false financial reports, the fraudulent concealment of the existence or true performance of subprime loans on the books, and, in at least one case, insider selling of hundreds of millions of dollars in company stock shortly before the subprime walls began to crumble. Insurers’ investigations of the availability of coverage in these instances will focus on internal and insider communications so that the insurers can learn who knew what and when they knew it. Depending upon the severity of the conduct unearthed, the results of these investigations may compel a professional liability insurer to initiate a declaratory judgment action to determine the applicability of the “fraudulent acts” or “profiteering” exclusions in their policies.

#### *Prior Knowledge Exclusion*

Most professional liability policies exclude from coverage claims or ripening circumstances of which the policyholder had prior knowledge. Of course, evidence of a policyholder’s prior knowledge can be difficult to establish, which is probably why this coverage defense is successful only in the more clear-cut situations. Although some of the publicity surrounding the subprime litigation appears disconcerting, it does not necessarily implicate the level of collusion over lengthy periods that would or could implicate a professional liability policy’s prior knowledge exclusion. Nonetheless, professional

**Most professional liability policies exclude from coverage claims or ripening circumstances of which the policyholder had prior knowledge.**

liability insurers may focus on a policy's prior knowledge exclusion when investigating the availability of coverage for the subprime mortgage claims.

#### *Severability*

It is important that insurers and policyholders alike carefully review the entirety of their professional liability policy's exclusions section because virtually all such policies state that the conduct and knowledge exclusions are "severable." This means that the conduct or knowledge of one policyholder will not be imputed to another policyholder, absent extenuating circumstances. Such severability provisions are designed to protect uninvolved or innocent "white hat" individuals or policyholders.

#### *Breach of Contract Exclusion*

Many professional liability policies preclude coverage for liability under any contract or agreement, provided that such liability would not have attached but for the existence of a contract (i.e., under common law or by statute). In the subprime context, a number of the pending claims arise from contracts obligating securities underwriters or distributors to "buy back" securities sold to investors within a particular "look back" period. To the extent those underwriters or distributors seek coverage under their E&O policies for the "buy back" suits, coverage could be unavailable based on the breach-of-contract exclusion.

#### *Securities Claims Exclusion in E&O Policies*

E&O policies may prohibit coverage for matters involving allegations of "securities law violations," which typically are defined as claims for violations of the prominent federal securities acts, federal securities regulations promulgated thereunder, and state securities statutes or similar laws. Although the majority of subprime lawsuits filed to date seem to be classic securities class action litigation brought by shareholders of entities bearing the brunt of subprime mortgage losses (typically causing D&O policies to come potentially into play in the first instance), certain policyholders and certain claims may call for an examination of whether securities claims exclusions could apply.

Further complicating the situation, some professional liability policy forms provide coverage only to the individual directors and officers, on the one hand, or the entity, on the other, but not both, in the context of securities claims. Because most securities class action complaints in the subprime setting allege "wrongful acts" by individual directors and officers (whether as "controlling persons" or direct violators) as well as by the company they serve, the scope of each policy's securities coverage should be examined closely, separate and apart from whether any specific securities claim exclusion exists. In these situations, it may well be that the individuals have coverage but the entity does not, or vice versa.

#### *Other Available Insurance Exclusion*

Several different types of policies could come into play in the subprime litigation context. In all such cases, professional liability insurers should look to the policies' "other insurance" clauses.

Such provisions generally require a policyholder to access other available insurance before the professional liability policy will provide coverage. As a practical matter, if each potentially applicable policy has an "other insurance" provision (as most do) and there is genuinely no clear indication of which policy (e.g., D&O, E&O, comprehensive general liability, or credit risk) responds first, the policies could wind up as coinsurance, with the various insurers each contributing pro rata or through some formula that may not be defined by the policies. Alternatively, the insurers could wind up in coverage litigation among themselves in order to define the priority of coverages.

#### **Issues Concerning Rescission**

In cases involving some of the more extreme allegations of subprime mortgage wrongdoing, issues could arise as to the veracity of the representations and warranties contained in a policyholder's insurance application and supporting documents, including the accuracy of its financial statements. These provisions work in tandem with the "prior knowledge" exclusion discussed above.

Among other things, a D&O and E&O policy and its long-form application generally will include provisions whereby the policyholder represents and warrants that it has made no misstatement of any fact in its application or supporting materials. Virtually all long-form applications for profes-

sional liability insurance also require the applicant to produce copies of its financial statements as part of the underwriting process. Perhaps not surprisingly, many of the pending subprime securities class actions allege that the policyholder's financial statements contain materially misleading or flatly untrue statements about the company's financial health or the true extent of its involvement in subprime lending. To the extent these allegations are factually correct and proven, insurers may conclude that a breach of a policy representation or warranty provision, together with common-law principles of rescission, entitles it to seek a rescission of the policy. It is axiomatic that a professional liability insurer will investigate the veracity and materiality of the information in the policyholder's financial and other underwriting records to determine whether the policyholder's application submission, including its exhibits, contained a material misrepresentation or mis-

**Professional liability insurers and their policyholders should consider the effect of "severability" language when evaluating rescission.**

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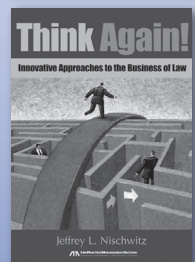
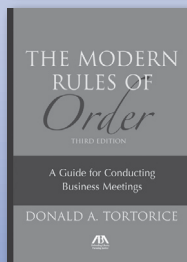
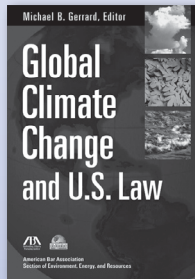
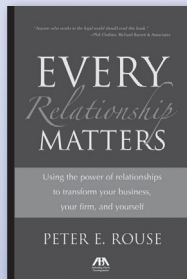
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statement of fact upon which the insurer's underwriter relied in binding and issuing the insurance policy at issue. Some jurisdictions also require a showing of fraud or bad faith on the part of the policyholder.

As with the conduct and prior knowledge exclusions discussed above, professional liability insurers and their policyholders should consider the effect of "severability" language when evaluating rescission because most policies contain a severability provision relevant to the representations and warranties made by the policyholder during the underwriting process.

**Priority of Payments**

An additional clause sometimes found in D&O policies with so-called Side A coverage may affect the availability or extent of coverage for subprime mortgage litigation. This "priority of payments" provision relates to the ordering of payments when multiple insuring clauses come into play. For example, when Side A coverage is provided to directors and officers, usually because their company is insolvent and unable to indemnify them, the "priority of payments" clause provides that they will receive direct reimbursement or indemnification first, before any coverage to the entity. This is in step with the purpose of Side A coverage: protecting otherwise unindemnified directors and officers from personally paying the usually exorbitant expense of defending a securities fraud or derivative lawsuit.

**Conclusion**

As the walls of the subprime mortgage industry crack and fall away, litigation over who is responsible for this house of cards could seriously undermine or destroy many of the policyholders involved in constructing the complex and multilayered transactions that formed the foundation of the industry. In turning to their professional liability insurers, policyholders may find that coverage issues will arise, particularly when the underlying claims allege fraudulent or dishonest conduct or deliberately concealed schemes spanning several years. Policy definitions, exclusions, and conditions, as well as operations of law, may preclude coverage for some or many of these claims. In short, professional liability insurers and their policyholders should be prepared to cooperate with one another as the insurers investigate in good faith the availability of insurance coverage.

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# Diversity Jurisdiction and the Modern Corporation: A Mismatch Between Rule and Reality

BY DAVID S. CLANCY AND MATTHEW M.K. STEIN

We are all taught in law school the purpose of the federal courts' diversity jurisdiction: In a dispute between a local party and a non-local party, diversity jurisdiction gives the latter the option to litigate in federal court.

The premise is that, for non-home state parties, the federal courts are potentially a more neutral forum than are the state courts.<sup>1</sup>

Whether that premise is right or wrong (which depends on the jurisdiction and time), the Constitutional and Congressional "cure"—diversity jurisdiction—has at least one shortcoming.

Imagine this situation: Jasper Inc., an Alabama company employing many Alabama citizens, sues Martha's Vineyard Corp., a small company headquartered in Massachusetts. Jasper Inc. files suit in Alabama state court, and Martha's Vineyard Corp. removes to federal court, citing diversity jurisdiction. Seemingly, this is just the situation for which diversity jurisdiction was designed: Jasper, Inc. has an impressive and longstanding connection to Alabama, and Martha's Vineyard Corp. has no Alabama connection at all.

But Jasper Inc. nonetheless moves to remand, pointing to the fact that it and Martha's Vineyard Corp. are both incorporated under the laws of Delaware. And Jasper, Inc. will probably win that motion. Tracking Article III of the Constitution, the federal judicial code states that there is diversity jurisdiction in cases between "citizens of different States."<sup>2</sup> Under the federal judicial code, corporations are citizens of the state of their principal place of business and also of the state in which they are incorporated.<sup>3</sup> When corporations share a state of incorporation, courts have held that they are not "citizens of different States"—even if, like Jasper Inc. and Martha's Vineyard Corp., they have no other connection.<sup>4</sup>

So, Martha's Vineyard Corp. will likely end up litigating on Jasper Inc.'s "home court"—the Alabama state courts. There is an inconsistency here: If the intent of diversity jurisdiction is to give out-of-state defendants a federal court option, shouldn't Martha's Vineyard Corp. have that option?

This inconsistency cannot be shrugged off as simply something that imposes an odd but tolerable burden on out-of-state defendant corporations. It also has an impact on individuals. Go back to our hypothetical. Recall that Jasper Inc. can keep its case in state court, over Martha's Vineyard Corp.'s desire to remove. Now replace Jasper Inc. with an individual plaintiff—Joe Jasper. Joe Jasper can not keep his case in state court, because what prevented removal in hypothetical 1 does not exist in hypothetical 2—common incorporation in Delaware. (Joe Jasper is an

individual, and so he is not incorporated anywhere, much less in Delaware.) Strangely, the local individual is vulnerable to removal to federal court, while the local corporation is immune.

Overall, then, this is an odd wrinkle, with an impact on corporations and individuals, on defendants and on plaintiffs—and it appears to have its roots in 19th century facts that no longer exist.

It would be one thing if this situation were clearly intended by Congress or the courts, but instead it seems an accidental by-product of legal history.

In the 19th century, the Supreme Court—after a conceptual struggle—decided that, for purposes of Article III diversity jurisdiction, a corporation should be treated as a citizen of its state of incorporation, on the basis that it was fair to assume that the owners and operators of the corporation were residents of that state.<sup>5</sup>

That assumption reflected the then-existing reality because in the 19th century, corporations were very "local" in nature.<sup>6</sup> In the late 19th century, however, that began to change: Corporations started to incorporate in states other than their home—due in part to the successful "marketing" efforts of New Jersey and, later, Delaware.<sup>7</sup> Today, almost 60 percent of publicly traded American corporations are incorporated in Delaware, and it is the state of incorporation for 85 percent of those corporations that choose to incorporate outside their home state.<sup>8</sup>

But still we are left with the bedrock 19th-century rule that, for purposes of deciding diversity jurisdiction, corporations are citizens of their state of incorporation—a rule that defeats diversity jurisdiction in cases where adversary companies have no geographic connection at all, and the only connection between them is their state of incorporation.

Congress and the courts may wish to take a fresh look at this issue, and there is good precedent for doing so. Congress has already made one adjustment to the diversity jurisdiction rules in light of the changing nature of corporations. In 1958, Congress amended the judicial code to specify that "a corporation shall be deemed a citizen of any State by which it has been incorporated and of the State where it has its principal place of business."<sup>9</sup> The first part of that new legislative formulation was unsurprising, because it was consistent with the previously-described Supreme Court decisions (such as *Marshall*). But the second part of the formulation was new, and the reason for it is interesting. Congress had noticed that local corporations were suing other local corporations in federal court by pointing to the fact that they were incorporated elsewhere. Congress did not like this, and to prevent it, Congress gave corporations a second place of citizenship—the

state of their principal place of business.<sup>10</sup> That newly conferred local citizenship de-federalized lawsuits between local corporations.

In doing this, Congress was seeing through to, and seeking to implement, the essential purpose of diversity jurisdiction—providing a federal court forum for disputes that, viewed in practical terms, match a local presence against a nonlocal one and, therefore, present risk of home-court advantage. And Congress was recognizing the potential artificiality, in making this practical assessment, of relying too heavily on a company's place of incorporation.<sup>11</sup>

Viewed that way, 1958 is sound precedent for examination of “hypothetical 1” (*Jasper Inc. v. Martha's Vineyard Corp.*). We do not want local corporations suing local corporations in federal court merely because the plaintiff corporation chose to incorporate in Delaware—and that wrinkle was ironed out in 1958. But another wrinkle remains, which the 1958 Congress either did not notice, or did not see as a problem: Local corporations can sue nonlocal corporations without fear of removal to federal court, solely because of a shared nonlocal state of incorporation. If the idea is to provide federal court jurisdiction where—in practical terms—diversity exists, the modern Congress may wish to iron out this

wrinkle too. It could do so by making some appropriate textual amendment to the portion of the federal judicial code limiting diversity jurisdiction to “citizens of different States.” That provision is opaque and could be amended to give sound guidance on the scope of diversity jurisdiction in cases involving corporations and their dual citizenships.

Any such amendment would need to be carefully drawn, however. The issue we identify arises only when the suit is brought in a home-court state other than the shared state of incorporation. It is nonexistent if the suit is brought within the shared state of incorporation. In our hypothetical, Jasper Inc. brought suit in the state courts of Alabama, where it is headquartered. Imagine that Jasper Inc. instead brought suit in Delaware state court. In that different situation, why should Martha's Vineyard Corp. be entitled to remove? Jasper Inc. has no potentially bias-producing special connection to Delaware, and Martha's Vineyard Corp. did after all choose to incorporate in Delaware (presumably to avail itself of Delaware law and Delaware courts). An amendment, therefore, would need to carefully target the different issue noted in this article: suits brought in one corporation's home court, which cannot be removed to (or brought originally in) federal

court because of a common incorporation in some other state.

Such an amendment might face a constitutional challenge, with critics arguing that it undercuts a 19th-century Supreme Court determination that shared place of incorporation automatically defeats diversity jurisdiction. But again, those Supreme Court holdings did not arise in today's very different world, and Congress could decide in good faith that an amendment of the kind described in this article would survive contemporary judicial scrutiny. ■

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## Local corporations can sue nonlocal corporations without fear of removal to federal court because of a shared nonlocal state of incorporation.

1. See, e.g., H.R. Rep. No. 85-1706, at 15 (Congressional committee report discussing proposed code revisions concerning diversity jurisdiction); *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 553–54 (2005) (“[T]he purpose of the diversity requirement . . . is to provide a federal forum for important disputes where state courts might favor, or be perceived as favoring, home-state litigants.”).

2. 28 U.S.C. § 1332(a)(1).

3. 28 U.S.C. § 1332(c)(1).

4. See, e.g., *Deere Credit, Inc. v. Kaufman Grain Co.*, No. 08-2022, 2008 WL 597264, at \*2 (C.D. Ill. 2008) (dismissing case solely on basis that Iowa-based plaintiff corporation and Illinois-based defendant corporation were both incorporated in Delaware).

5. See, e.g., *Marshall v. Baltimore & Ohio Ry. Co.*, 57 U.S. (16 How.) 314, 328–29 (1853) (holding that alleging a company's state of incorporation was “a sufficient averment that the real defendants are citizens of that State,” because “the habitat of a corporation in the place of its creation [is] conclusive as to the residence or citizenship of those who use the corporate named and exercise the faculties conferred by it”).

6. See CHRISTOPHER GRANDY, *NEW JERSEY AND THE FISCAL ORIGINS OF MODERN CORPORATION LAW* 11 (1993).

7. See Edward Q. Keasbey, *New Jersey and the Great Corporations*, 13 HARV. L. REV. 198, 200, 207 (1899); Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 896 (1990).

8. Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 567, 578 (2002).

9. Act of July 25, 1958, Pub. L. No. 85-554, § 2, 72 Stat. 415 (1958) (now codified as 28 U.S.C. § 1332(c)(1)).

10. See Act of July 25, 1958 § 2, 72 Stat. at 415.

11. See H.R. Rep. No. 85-1706, at 4 (1958) (referring to “the evil whereby a local institution, engaged in a local business and in many cases locally owned, is enabled to bring its litigation into the Federal courts simply because it has obtained a corporate charter from another State”).



## Specific Engagement Letters

(Continued from page 1)

tax deficiency, it committed malpractice. Specifically, AmBase argued that Davis Polk was negligent in failing to consider whether an agreement between AmBase and an affiliated company might have relieved AmBase of primary liability for any potential tax deficiency, such that AmBase would not have had to maintain a large loss reserve on its books. (AmBase alleged that the loss reserve resulted in lost business opportunities because of the appearance of a negative net worth.)

The Court of Appeals of New York affirmed the trial court's dismissal of AmBase's complaint. The court's reasoning was based in part on the limited scope of Davis Polk's engagement letter: "The plain language of the retainer agreement indicate[d] that Davis Polk was retained to litigate the amount of tax liability and not to determine whether the tax liability could be allocated to another entity."<sup>4</sup> Had Davis Polk used a boilerplate engagement letter describing itself as representing AmBase "in connection with certain tax matters," for example, AmBase would have had less difficulty arguing that Davis Polk was negligent in failing to render advice regarding the possibility that AmBase potentially had no primary liability for any alleged deficiency.

Other decisions are analogous. In *Smookler v. Kronish Lieb Weiner & Hellman LLP*,<sup>5</sup> plaintiffs engaged defendant law firm Kronish Lieb in connection with the formation of a broker-dealer business and the preparation of a private placement memorandum for that business. In its engagement letter, Kronish Lieb specifically carved out from the scope of its representation "regulatory matters," which it described as "[National Association for Security Dealers (NASD)] filings and the like," and noted its understanding that plaintiffs would hire another, less expensive law firm to handle such issues (which plaintiffs did hire).<sup>6</sup> When the NASD later commenced a proceeding against plaintiffs for their alleged violation of the NASD's rule against "selling away," plaintiffs brought suit against Kronish Lieb for malpractice.<sup>7</sup> The New York Supreme Court granted Kronish Lieb's summary judgment motion, reasoning that Kronish Lieb owed no duty to plaintiffs with respect to NASD regulatory matters because Kronish Lieb specifically had carved such matters out of the scope of its engagement.<sup>8</sup>

Likewise, in *Kansas Public Employees Retirement System v. Kutak Rock*,<sup>9</sup> the Supreme Court of Kansas upheld summary judgment in favor of the defendant law firm in part on the basis of a narrow engagement letter. In that case, the Kansas Public Employees Retirement System's malpractice claim was based on a theory that Kutak Rock owed it a duty to render advice regarding the financial wisdom of a transaction. Kutak Rock's engagement letter, however, specifically delineated the services that were to be performed, which list did not include an independent financial analysis of the transaction.<sup>10</sup>

In contrast, courts that have decided malpractice claims in which lawyers failed to secure an engagement letter (or failed

to specify the scope of engagement) have been appropriately reluctant to make dispositive decisions that hinged on questions of the scope of the engagement. One recent example is *Deep v. Boies*,<sup>11</sup> in which plaintiffs brought a malpractice claim against Boies Schiller & Flexner alleging that the firm's negligence in protecting plaintiffs' intellectual property rights resulted in the misappropriation of plaintiffs' interests in certain software assets. The court refused to grant summary judgment for defendants on statute of limitations grounds because there was a question of fact as to the scope and timing of the particular engagement at issue, such that the court could not summarily reject plaintiffs' invocation of the "continuous representation" exception to the statute of limitations. The court reasoned as follows:

"In the absence of any retainer agreement, letter of engagement or other objective indicia concerning the nature and scope of the agreed-upon representation, the Court has no record basis for rejecting, as a matter of law, plaintiff's sworn statement that defendants' representation in the copyright litigation was one component of a specific, comprehensive course of representation from which the malpractice claim asserted herein arose."<sup>12</sup>

The experience of legal malpractice defendants should inspire a certain degree of introspection among other lawyers toward the end of encouraging best practices aimed at avoiding problems that have plagued other attorneys. In the case of engagement letters, the case law provides helpful guidelines as to how to use a defined scope of engagement as a risk management tool.

### Be Specific

Do not be a slave to your form letter. Spending a few minutes to tailor a retention agreement to address a specific client and a particular matter is a prudent investment. For example, if you have been engaged to review a resale price policy, do not describe yourself as providing "antitrust counseling" lest you be deemed to have had a duty to flag any conceivable pricing issue that might arise.

### Don't Under-Commit

Efforts to avoid confusion as to the scope of representation and to limit exposure to malpractice claims must be balanced with the need to abide by the Rules of Professional Conduct and local rules of court. Although most states condone efforts to limit the scope of representation "if the limitation is reasonable under the circumstances and the client gives informed consent"<sup>13</sup> be careful that your proposed limitations comply with other rules and codes of conduct.

One area in which a tension arises is in the context of efforts to limit the scope of a local counsel engagement. Given the very limited role that local counsel often play, local counsel should explore the possibility of specifically limiting the scope of their representation in the engagement letter. Before doing so, however, local counsel should consult local rules and

case law to be sure that such a limitation is not trumped by local rules mandating that all counsel will be held responsible for the management of the case.<sup>14</sup>

### Don't Over-Commit

The flip side of the specificity coin is that you likely will be held accountable for those services that you itemize in an engagement letter. Don't agree to standards that will be difficult to meet or as to which an objective observer would have a difficult time discerning whether you performed as promised. For example, be wary of making promises to lead or handle a particular matter "personally."<sup>15</sup>

### Amend, If Need Be

Remember that you can (and sometimes should) amend or replace the engagement letter as the representation progresses.

Amending to include additional matters not only clears up confusion as to the nature of the engagement but may be necessary to obtain an additional retainer and may provide helpful evidence in a fee dispute that the services rendered were within the scope of the engagement.<sup>16</sup>

Amending to exclude matters that you have not agreed to handle (or as to which the client

affirmatively has decided not to seek legal advice) may limit your exposure to malpractice claims in the future, as memories get fuzzy and disgruntled clients seek someone on whom to pin blame for their business misfortunes.

### Follow Your Gut

Be guided by your relationship with your client (or lack thereof). If you do not know your client well (or if you recognize your client to be an aggressive litigant generally), formal communications about the scope of engagement are your best bet. If you know and trust your client, you may be less apt to formalize decisions as to the scope of an engagement. Even if formal communications do not seem appropriate, though, you may consider writing a confirming email to the client, or at least an internal note to file, as to any material decisions about what your services will and will not include.

### Use Non-Engagement Letters

Once a representation has ended, memorialize that fact with a letter to your client so that both you and the client understand that the engagement has ended. Such a letter clarifies

the absence of an ongoing attorney-client relationship and may help set time parameters for a statute of limitations defense if a claim arises in the future.<sup>17</sup> Don't be reluctant to send such a letter because you hope to obtain additional business from the client; rather, you can use the letter as an opportunity to remind the client that now that a particular engagement has ended, you are ready, willing, and able to take on additional matters.

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Remember that you can amend or replace the engagement letter as the representation progresses.

1. Another reason is to help defend against disqualification attempts and other ethical challenges that are becoming inevitable as issues of conflicts of interest grow more and more complex. See *Cliff Sales Co. v. Am. S.S. Co.*, 2007 U.S. Dist. LEXIS 74342 (N.D. Ohio Oct. 4, 2007) (noting, in the context of a disqualification motion, that matter-specific engagement letters "are necessary in today's business world because so many companies are related in some way that law firms would have substantial conflict issues if a law firm was considered to have an attorney-client relationship with all of a client corporation's related corporations and entities); see also *Avocent Redmon Corp. v. Rose Elecs.*, 491 F. Supp. 2d 1000 (W.D. Wash. 2007) (inclusion of the word "affiliates" in an engagement letter led to disqualification of law firm for conflicts reasons).

2. See Emma Schwartz, *Law Firms Face Sharp Rise in Malpractice Suits*, LEGAL TIMES, May 10, 2005, available at <http://www.law.com/jsp/article.jsp?id=1115642113700>.

3. 866 N.E.2d 1033, 1036-37 (N.Y. 2007).

4. *Id.* at 435. The retainer agreement provided that AmBase had "engaged [Davis Polk] to represent [it] . . . to resolve the tax issues currently before' the IRS." *Id.* Because of that limitation, the court concluded, "defendants exercised the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession when they focused their efforts on the controversy between AmBase and the IRS—the subject of the retainer agreement—resulting in a most favorable outcome . . ." *Id.*

5. 2006 N.Y. Misc. LEXIS 3982 (N.Y. Sup. Ct. Jan. 11, 2006).

6. *Id.* at \*2.

7. *Id.* at \*8.

8. *Id.* at \*10.

9. 44 P.3d 407, 415 (Kan. 2002).

10. For a further discussion of *Kutak Rock*, see 1 MALLEN & SMITH, LEGAL MALPRACTICE § 2.10, at 122-23 (2008 ed.) (noting that if Kutak Rock's engagement letter had been even more specific, it might have avoided litigation altogether). For another example of a court granting summary judgment for lawyer defendants on the basis of an engagement letter, see *Heller v. Donaldson*, 1998 Mich. App. LEXIS 2505 (Mich. Ct. App. Mar. 13, 1998) (affirming the grant of summary judgment to the law firm, where plaintiff sued for failure to advise as to a potential

malpractice claim against his former attorney notwithstanding that the engagement letter specifically excluded such claims from the scope of representation and noted that plaintiff should consult with separate counsel about such a claim).

11. No. 6453-05, 2007 WL 2296502 (N.Y. Sup. Ct. Aug. 9, 2007).

12. *Id.* at \*6; see also generally *Cohen v. Morgan Schiff & Co. (In re Friedman's Inc.)*, 2008 U.S. Dist. LEXIS 2145, at \*153 (S.D. Ga. Jan. 10, 2008) (stating, in the context of denying a motion to dismiss a malpractice claim, that “the specific duties owed normally turns [sic] on the agreement between attorney and client,” and lamenting that “[b]ecause the Court does not have the engagement agreement between [plaintiff and defendant-law firm] to reference, an examination of the services that [defendant-law firm] did provide is necessary to determine the scope of its representation”); *In re Estate of Spencer*, 2008 N.J. Super. LEXIS 90, at \*37 (N.J. Super. Apr. 23, 2008) (reversing lower court’s decision that no attorney-client relationship existed between plaintiff estate and defendant attorney, in part because the defendant “did not formalize his retention with any written agreement confining his representation solely” to the decedent’s foundation, as he contended was the case, as opposed to including the foundation as well as the decedent’s estate, executor, and beneficiaries, as plaintiff contended).

13. *E.g.*, MODEL RULES OF PROF’L CONDUCT R. 1.2(c).

14. For further discussion of this issue, see Mazie & Seligman, *Contractually Narrowing the Duties and Liability of a Mail Drop Local Counsel*, N.J. LAW. (Feb 2006).

15. See, *e.g.*, *Morgan, Lewis & Bockius, LLP v. IBuyDigital.com, Inc.*, 836 N.Y.S.2d 486, 2007 NY Slip Op. 50149U, at \*7 (Sup. N.Y. Ct. Jan. 11, 2007) (allowing former client to proceed with a claim for breach of an engagement letter where the engagement letter stated that a particular partner would “personally lead the IPO,” because whether the partner did personally lead the IPO was a triable issue of fact, despite Morgan’s submission of bills showing substantial involvement by that partner).

16. See MALLEN & SMITH, *supra* note 10, § 2.10, at 119.

17. See *Maloo v. Benesch, Friedlander, Coplan & Aronoff*, 2004 Ohio App. LEXIS 5808 (Ohio Ct. App. Nov. 24, 2004) (holding that the statute of limitations on a malpractice claim began to run on the date of the non-engagement letter and therefore affirming the trial court’s decision that the suit was untimely); *Richard v. Colucci*, 2004 Ohio App. LEXIS 1045, at \*11 (Ohio Ct. App. Mar. 10, 2004) (“A signed and properly worded non-engagement letter normally protects an attorney from a claim that an attorney-client relationship exists.”); see also *Jones v. Bresset*, 47 Pa. D. & C.4th 60, 72 (Ct. Com. Pl. 2000) (noting that one treatise concluded that “a lawyer may insulate himself from inadvertently assuming implied duties by providing the client with ‘a non-engagement letter [that] should refer in general to statutes of limitations’ and which encourages the client ‘to consult another attorney.’”) (quoting in part 1 R. MALLEN & J. SMITH, *LEGAL MALPRACTICE* § 2.11, at 135 (4th ed. 1996)).



## Fee Disgorgement

(Continued from page 1)

cordingly, attorneys pressing or defending against a claim for disgorgement can find themselves on unfamiliar, and potentially dangerous, ground.

### Most Courts Have Rejected an “Automatic Disgorgement” Rule

Many plaintiffs in breach-of-fiduciary-duty cases take the position that once a court finds that a lawyer has breached his or her fiduciary duty, complete disgorgement of all fees is not only permitted but required.<sup>5</sup> A handful of courts have followed this approach, at least for some types of breaches.<sup>6</sup> An “automatic disgorgement” rule, however, can lead to abuse and to inequitable results. First, such a rule would create a great deal of uncertainty, which could bog down attorneys, clients, and the court system. An attorney’s fiduciary duties are expansive and not particularly well defined. They include “maintaining confidentiality, avoiding conflicts of interest, operating competently, safeguarding client property and honoring the client’s interests over the lawyer’s.”<sup>7</sup> In any breach-of-fiduciary-duty action involving a complex representation, the parties and the court could find themselves combing through the most minute details of attorney work product and attorney-client communications for potential breaches. Few courts will relish having to decide the issue of whether a lawyer took too long to answer a client’s phone call, whether the lawyer was as solicitous of the client’s concerns as he or she should have been, or whether the lawyer’s work in drafting a winning motion was, despite the win, not entirely competent. Under a regime in which any breach of a fiduciary duty would lead to the automatic disgorgement of all fees, however, a plaintiff would have every incentive to ask a court to perform this analysis.

Second, an automatic disgorgement rule could lead to unfair windfalls for clients. In theory, under this rule, a client could receive years of competent representation, achieve an excellent result, and then also be awarded all of its fees. Third, it is possible that a sophisticated client could manipulate such a rule to receive free legal services. For example, a client might understand that although it and its attorney knew of a potential conflict, its attorney had not secured an adequate waiver. The client could choose to wait, receive the benefit of the attorney’s services, sue for breach of fiduciary duty, and argue that it should be awarded all of its fees.

Recognizing these serious drawbacks to the “automatic disgorgement” rule, most courts that have addressed the issue in recent years have adopted a far less rigid test. Perhaps the most comprehensive opinion on the subject is *Burrow v. Arce*,<sup>8</sup> a 1999 decision of the Supreme Court of Texas. The *Burrow* court noted that the “automatic disgorgement” rule could lead to inequities and inefficiencies:

[A]utomatic and complete forfeiture [is not] necessary for the remedy to serve its purpose. On the contrary, to require an agent to forfeit all compensation for every breach of fiduciary duty, or even every serious breach, would deprive the remedy of its equitable nature and would disserve its purpose of protecting relationships of trust.<sup>9</sup>

....

It would be inequitable for an agent who had performed extensive services faithfully to be denied all compensation for some slight, inadvertent misconduct that left the principal unharmed, and the threat of so drastic a result would unnecessarily and perhaps detrimentally burden the agent's exercise of judgment ...<sup>10</sup>

The *Burrow* court also noted the danger that an unscrupulous client, who had suffered no damages, could unfairly take advantage of the disgorgement remedy, and held that a court must have the discretion to deny recovery to such a client.<sup>11</sup>

The *Burrow* court thus rejected the "automatic disgorgement" rule and adopted the flexible, multifactor test set forth in Section 37 of the *Restatement (Third) of the Law Governing Lawyers*:

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. Considerations relevant to the question of forfeiture 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.

The *Burrow* court added another element to this test: "the public interest in maintaining the integrity of attorney-client relationships."<sup>12</sup>

A key element of the *Restatement's* flexible approach to disgorgement is that not every breach of fiduciary duty merits disgorgement; this serious remedy is available for only the most serious transgressions. "The remedy of fee forfeiture presupposes that a lawyer's clear and serious violation of a duty to a client destroys or severely impairs the client-lawyer relationship and thereby the justification of the lawyer's claim to compensation."<sup>13</sup> The lawyer must be able to understand that he or she is acting wrongfully: "A violation is clear if a reasonable lawyer ... would have known that the conduct was wrongful."<sup>14</sup> And the violation "must also be serious. Minor violations do not justify leaving the lawyer entirely unpaid for valuable services ..."<sup>15</sup> Relevant factors include whether the conduct was isolated or continuing, whether it was willful, and whether it involved actual disloyalty to the client.<sup>16</sup>

The flexible approach to disgorgement set forth in the *Restatement* has been adopted by nearly every court that has considered the issue in recent years.<sup>17</sup> Although some courts have awarded complete fee forfeiture without much discussion of the *Restatement* factors, these cases have involved serious, pervasive disloyalty that, indeed, "destroy[ed] or severely impair[ed] the client-lawyer relationship."<sup>18</sup> In *Ulico v. Wilson*,

*Elser, Moskowitz, Edelman & Dicker*, for example, the basis for the multimillion-dollar disgorgement was that the law firm had bent its efforts to putting one client out of business in order to build up another client.<sup>19</sup>

### The Court Has Discretion over the Amount of Disgorgement

Under the *Restatement* test, even when a court finds that an attorney has violated fiduciary duty in a way that is "clear and serious" enough to merit disgorgement, it will not necessarily require the attorney to disgorge all of his or her fees.<sup>20</sup>

Ordinarily, forfeiture extends to all fees for the matter for which the lawyer was retained ... Sometimes forfeiture for the entire matter is inappropriate, for example when a lawyer performed valuable services before the misconduct began, and the misconduct was not so grave as to require forfeiture of the fee for all services. Ultimately the question is one of fairness in view of the seriousness of the lawyer's violation and considering the special duties imposed on lawyers, the gravity, timing, and likely consequences to the client of the lawyer's misbehavior, and the connection between the various services performed by the lawyer.<sup>21</sup>

For all but the most egregious breaches of duty, courts generally tailor disgorgement to the tasks and the periods involved.<sup>22</sup> Courts also look to the harm the client actually suffered, the value of the services actually rendered, and whether the client has been compensated in other ways.<sup>23</sup> A lawyer should never be required to disgorge costs that the lawyer has advanced on the client's behalf: "Forfeiture does not extend to a disbursement made by the lawyer to the extent it has conferred a benefit on the client."<sup>24</sup>

### Conclusion

As courts continue to refine and apply the factors set forth in the *Restatement*, the disgorgement remedy will likely lose much of its appeal to plaintiffs in run-of-the-mill malpractice cases. In theory, complete disgorgement should occur only in the most serious of cases, in which the lawyers have made a deliberate and willful attempt to undermine their own client's core interests. Lesser breaches might lead to disgorgement of smaller amounts of fees or to no disgorgement at all. Attorneys litigating these claims can expect, however, a great deal of uncertainty as to what factors are relevant and how courts are to weigh them.

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1. See *Huber v. Taylor*, 469 F.3d 67, 77 (3d Cir. 2006) (surveying cases). There is less consensus on whether a plaintiff must show loss causation to recover other types of damages. In some jurisdictions, proof of causation is not required at all; in others, causation is required, but the standard is more relaxed than in legal malpractice claims; still others apply a standard that is the same as in legal malpractice claims. For an in-depth discussion of these issues, see Charles W. Wolfram, *A Cautionary Tale: Fiduciary Breach as Legal Malpractice*, 34 *HOFSTRA L. REV.* 689 (Spring 2006).

2. *Burrow v. Arce*, 997 S.W.2d 229, 237-38 (Tex. 1999).

3. *Id.* at 238.
4. *Ulico Cas. Co. v. Wilson, Elser, Moskowitz, Edelman & Dicker*, 843 N.Y.S.2d 749, 763–66 (N.Y. Sup. 2007).
5. *See, e.g., Burrow*, 997 S.W.2d at 240 (summarizing plaintiff’s argument).
6. *See, e.g., Rice v. Perl*, 320 N.W.2d 407, 411 (Minn. 1982) (“[A]n attorney (or any fiduciary) who breaches his duty to his client forfeits his right to compensation.”); *Silbiger v. Prudence Bonds Corp.*, 180 F.2d 917, 920–21 (2d Cir. 1950) (complete disgorgement for disloyalty); *Pessonni v. Rabkin*, 633 N.Y.S.2d 338, 338–39 (N.Y. App. Div. 1995) (complete disgorgement for conflicted representation); *Estate of Brandon*, 902 P.2d 1299, 1317 (Alaska 1995) (ethical violations); *Estate of McCool*, 553 A.2d 761, 769 (N.H. 1988) (clear conflicts of interest); *Lurz v. Panek*, 527 N.E.2d 663, 669 (Ill. App. Ct. 1988) (any breach of fiduciary duty).
7. *Ulico*, 843 N.Y.S.2d at 758.
8. *Burrow*, 997 S.W.2d 229 (Tex. 1999).
9. *Id.* at 241.
10. *Id.*
11. *Id.* at 240.
12. *Id.* at 244.
13. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 cmt. b. *See also, e.g., International Materials Corp. v. Sun Corp.*, 824 S.W.2d 890, 895 (Mo. 1992) (“Complete forfeiture . . . is warranted only when a lawyer’s clear and serious violation of a duty to a client is found to have destroyed the client-lawyer relationship and thereby the justification for the lawyer’s claim to compensation.”); *Sullivan v. Dorsa*, 27 Cal. Rptr. 3d 547, 560 (Cal. Ct. App. 2005); *Fairfax Savings, F.S.B. v. Weinberg & Green*, 685 A.2d 1189, 1208–9 (Md. Ct. Spec. App. 1996).
14. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 cmt. d; *see International Materials*, 824 S.W.2d at 895 (“Whether the breach in the lawyer-client relationship involves knowing violation or disloyalty to a client is also a factor.”).
15. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 cmt. d.
16. *Id.*
17. *See, e.g., Burrow*, 997 S.W.2d at 242 n.45 (collecting cases); *Pringle v. La Chapelle*, 87 Cal. Rptr. 2d 90, 94 (Cal. Ct. App. 1999); *Lindseth v. Burkhart*, 871 S.W.2d 693, 695 (Tenn. Ct. App. 1993); *Kidney Ass’n of Or., Inc. v. Ferguson*, 843 P.2d 442, 447 (Or. 1992); *In re Marriage of Pagano*, 607 N.E.2d 1242,

1249–50 (Ill. 1992) (“[W]hen one breaches a fiduciary duty to a principal the appropriate remedy is within the equitable discretion of the court. While the breach may be so egregious as to require the forfeiture of compensation . . . such will not always be the case.”); *In re Life Insurance Trust Agreement of Julius F. Seeman*, 841 P.2d 403, 405 (Colo. Ct. App. 1992) (“[A] conflict of interest is only one of many factors to be considered in determining the award of fees; it does not mandate a denial of all compensation.”); *Searcy, Denney, Scarola, Barnhart & Shipley, P.A. v. Scheller*, 629 So.2d 947, 952–53 (Fla. Dist. Ct. App. 1993).

18. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 cmt. b.

19. *Ulico Cas. Co. v. Wilson, Elser, Moskowitz, Edelman & Dicker*, 843 N.Y.S.2d 749, 759 (N.Y. Sup. 2007)

20. The *Burrow* court found that the amount of disgorgement is an equitable matter to be decided by the judge, not the jury. “[F]actors like the adequacy of other remedies and the public interest in protecting the integrity of the attorney-client relationship, as well as the weighing of all other relevant considerations, present legal policy issues well beyond the jury’s province . . . The ultimate decision on the amount of any fee forfeiture must be made by the court.” *Id.* at 245.

21. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 cmt. e.

22. *See Ulico*, 843 N.Y.S.2d at 764 (limiting disgorgement to period of disloyalty); *id.* at 765 (discussing possibility of apportionment of forfeiture to tasks directly relating to disloyalty); *Musico v. Champion Credit Corp.*, 764 F.2d 102, 112–13 (2d Cir. 1985) (noting trend in New York law away from full forfeiture toward forfeiture limited to specific services that an agent performed wrongfully); *In re Life Ins. Trust Agreement*, 841 P.2d at 405 (denial only of fees for services directly affected by conflict).

23. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 cmt. e; *see, e.g., Fairfax Savings, F.S.B. v. Weinberg & Green*, 685 A.2d 1189, 1209 (Md. Ct. Spec. App. 1996) (courts should allow for reasonable value of services); *Cal Pak Delivery, Inc. v. UPS*, 60 Cal. Rptr. 207, 216 (Cal. Ct. App. 1997) (partial fee recovery appropriate to avoid client’s unjust enrichment, even though counsel’s misconduct was egregious); *Searcy, Denney*, 629 So.2d at 953–54 (court must consider alternative remedies).

24. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 37 cmt. e.



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