Breach of Fiduciary Duty: The Nuclear Weapon of Fee Disputes

by Michael R. Caryl

Clients will be clients! When you handle serious problems for them, they tend to get stressed out, angry, frustrated, hurt, confused, and mistaken. For most of them, they are caught in an alien world replete with its own peculiar rules and jargon, and the process often leads to results or simply a process that the client simply cannot fathom or accept. Naturally, this often in turn causes suspicion, misunderstanding, and more anger, which boils over into the client relationship. This almost always ends up with severe griping about attorney's fees charged. This is the breeding ground for the attorney-client fee dispute.

If there is one thing that you learn by the time you have handled your second litigated fee dispute with a client, it is that clients get the benefit of almost every doubt. Despite the fact that judges under those robes are just lawyers like us, this fact looms small when the robe faces a client complaining about his or her former lawyer. Even the absurd contention seems to get a real hearing when the contender is an angry client complaining about that unscrupulous shyster who used to be his or her lawyer. It is for this reason that I have advocated above that in any post-termination relations with ex-clients, you are always on your best behavior. This extends beyond not writing nastigrams or acting like a horse's a** with your ex-client. It even extends backwards into the attorney-client relationship itself. For those reasons, in several earlier articles, I have urged an enormous amount of restraint, candor, and patience in dealing with unhappy clients.

WMDs (weapons of mass destruction, for those not really current) are a hot political topic today. What's that got to do with unhappy clients who terminate you, while owing a lot in back lawyers' fees? Do we really have something to worry about when our client flies off the handle and fires us? Well, depending on your pre-discharge conduct with your client, the answer is, "Well, just maybe." The client has his own WMD in any fee dispute with you. A client today is more likely to "go nuclear" in the post-termination dispute than at any prior time. And by "go nuclear" I mean, plainly and simply, to accuse the lawyer of breach of fiduciary duty. A discharged lawyer, whether on a contingency fee or on an hourly basis, is entitled to be paid his or her attorney's fee, regardless of who terminates. We all know that we are entitled to a reasonable fee, whether under RPC 1.5, RCW 4.24.005, or even the old rule of quantum meruit. Right? That's never really been challenged, you say. Well, not so fast. There is a strain of old law that seems to have gotten a shot of adrenaline in the past 15 years that threatens the discharged lawyer with losing most or all of the unpaid attorney's fee, or worse, disgorgement of paid fees. And that old strain of law with a new lease on life is the newly evolved breach of fiduciary duty rule.

The case law is there, and angry clients and their new lawyers are only too happy to use it to stuff your quantum meruit argument back into your mouth. Breach of fiduciary duty gives the client the ability to obtain a forfeiture of some or all of the fees that were otherwise wholly earned and reasonable. The tactical nuke is partial forfeiture; the strategic weapon is total forfeiture or disgorgement.

I have seen lawyers in the past five years make these fiduciary breach arguments where I have served as the arbitrator, when I was called as an expert witness for the hapless lawyer whose fees were threatened, or in several other cases where I represented the terminated lawyer, trying to save his fees. Some of the client's arguments can be ridiculous, while others can be made quite respectable. One excellent lawyer recently made such a fiduciary breach argument successfully in a King County case, one in which the unfortunate lawyer had his entire fee forfeited as a result. I have used breach of fiduciary duty arguments successfully to alleviate a client's burden from post-trial litigation billings where I thought the lawyer had crossed the fiduciary duty line. There are real lessons to be learned here.

The Humble Beginnings of the Fiduciary Duty Defense

Dailey v. Testone, 72 Wn. 2d 662, 435 P.2d 24 (1967), is one of the earliest fiduciary duty cases. Dailey, the wife's attorney in a divorce, had to sue his client for payment of his attorney's fees at the end of the case when she refused to pay. In the trial court's decision, neither party was awarded fees against the other. The trial court determined the reasonable amount of the wife's fees (at $1,750), but the court did not provide for an attorney's lien. Lawyer Dailey filed a lien anyway and encumbered his client's real property and bank account in his efforts to get paid. His former client countersued for fraud and improper attachment. The Washington State Supreme Court weighed the evidence and tested it against a standard of fraudulent acts or gross misconduct and, in so doing, discussed cases that dealt largely with attorneys performing illegal acts, or lawyers entering into illegal contracts.1 The Court in Testone upheld the attorney's conduct as not "fraudulent or malicious" but rather just simply improper. The Court then weighed this impropriety against the fee originally allowed by the trial court and determined on quantum meruit grounds that Dailey would get only $750, not $1,750, awarded by the trial court in fees. The words "breach of fiduciary duty" or forfeiture are not found in the Dailey opinion anywhere. Nonetheless, Dailey opened the door.

A decade later, in In re Loomos, 90 Wn.2d 98, 579 P.2d 350 (1978), a disciplinary matter, the Washington State Supreme Court was faced with a lawyer handling a probate who had completely neglected his engagement and client. The lawyer was disciplined for not cooperating with the Bar investigation and not closing the estate as he had been ordered by the Disciplinary Board. When Loomos ignored the Board's orders, the Court suspended Loomos, and required him to disgorge an earlier fee for handling the probate, $750, on the grounds that "an agent who willfully and deliberately breaches his contract of service is entitled to no compensation." 90 Wn.2d at 104. The Court did not mention breach of fiduciary duty and in fact cited the Restatement (Second) of Agency as the basis for forfeiting the fee. No mention was made in Loomos of the Code of Professional Responsibility or any disciplinary rules. Loomos is not really a breach of fiduciary duty case but rather one where the fee had not been earned. Nonetheless, again the concept of fee forfeiture was exercised as a remedy in an egregious

situation, and Loomos now serves as a legal precursor supporting this new weapon of clients.

The Rule Begins to Emerge — Ross v. Scannell

Ross v. Scannell, 97 Wn.2d 598, 647 P.2d 1004 (1982), again presented the Washington State Supreme Court with egregious facts. Attorney Ross was hired by client Scannell originally to assist in the purchase of a parcel of real property. Ross became a joint venturer in the prospective purchase with his client. The sale fell through, and Scannell, on Ross's advice, sued the sellers for specific performance and damages. The fee arrangement for this lawsuit was contingency fee. Because he was involved in the underlying transaction, Ross found himself in a position where he was both counsel and a potential witness. Yet he did not withdraw until just before trial, when he hired another lawyer to handle the trial on an hourly basis. With Ross's assistance, Scannell prevailed in the lawsuit and was awarded specific performance of the real estate deal and damages. Some additional legal work was required of Ross in order for Scannell to obtain title to the property. When Scannell went to sell the property, Ross claimed an interest in the damages obtained (to which he was clearly entitled), as well as one-third of the profits from the anticipated sale of the property (to which he was not entitled). When Ross refused to perform those legal services to clear the title, Scannell had to obtain other legal help to obtain clear title before he sold. When Scannell refused to part with a third of the profits from the sale to Ross, Ross filed an attorney's lien, which purported to lien the real property Scannell was trying to sell. Scannell's sale fell through due to Ross's attorney's lien clouding the title.

The real issues in this case were whether an attorney's lien can create a lien on real property in Washington and whether Ross was entitled to the contingency fee.2 The Court ruled against Ross on both of these issues. However, Scannell, a client scorned, did not take Ross's legal maneuverings in the spirit of good, clean fun. He accused Ross of unethical conduct. The Court could not determine on the evidence of record whether such misconduct had in fact been proved, and remanded, although the Court stated, "the charges of unethical conduct herein are grave." 97 Wn.2d at 610. Quoting from Dailey v. Testone, the Court stated, "Such charges are normally heard by a disciplinary committee of the Washington State Bar Association. However, a trial court may consider such allegations in determining attorney's fees." Id. The Court concluded:

Accordingly, on remand, we instruct the trial court to consider the charges of unethical conduct in relation to several principles enunciated by this court in determining the amount of fees due Ross. Professional misconduct may be grounds for denying an attorney his fees.

Id. (emphasis added). Bingo – there it is. The Court finally instructs the trial court on its power to punish the egregious conduct of a miscreant attorney. Again, the phrase "breach of fiduciary duty" is not mentioned in Scannell, but the genie is out of the bottle.

Eriks v. Denver — The Rule Is Now Out

Egregious facts usually pave the way for strong rules. Are you a believer yet? Eriks v. Denver, 118 Wn.2d 451, 824 P.2d 1207 (1992), a case successfully handled by Seattle lawyers Dexter Washburn and Chris Pence, afforded truly egregious facts. Certain promoters sold allegedly tax-sheltered investments in

Master Sound Recordings in the 1970s and 1980. One had to live through the days of abusive tax shelters to understand how this stuff came about. The promoters of such tax shelters advertised large tax benefits, deductions, and investment tax credits to persons with larger incomes that might be sheltered. In those days, the IRS was more active and vigilant. In 1981, the IRS began treating these Master Recordings tax shelters as "abusive" and began challenging the tax benefits to investors. The promoters created the Master Recording Trust Fund to provide a defense to both the promoters and the individual investors.

The promoters hired attorney Denver to provide joint legal defense to investors as well as these promoters before the IRS and in tax cases. The rub there should be immediately obvious. Denver already knew when he took this engagement that the IRS was disallowing the tax benefits, that every investor would be audited and that the IRS would probably disallow their tax benefits. When he undertook this joint representation, he knew that his investor clients could have civil claims against his promoter clients if the investments' tax benefits were ultimately disallowed. In fact, Denver discussed these potential conflicts of interest with the promoters but not with his investor clients. After a Tax Court determination went against the investors, Denver advised them to settle with the IRS (and pay the taxes) but did not advise them of their potential claims against the promoters. When the investors finally got independent legal counsel, some of them filed a class action against Denver for negligence and breach of fiduciary duty, for failing to advise them of the conflicts of interest and the potential claims against his investor clients.

The trial court in that lawsuit granted the investors summary judgment, holding that Denver had breached fiduciary duties to his investor clients as a matter of law, and ordered disgorgement of all attorney's fees he had been paid, along with pre-judgment interest. The Washington State Supreme Court affirmed, initially holding that the determination of a violation of ethical duties is a question of law, not one of fact. The Court then performed an analysis of the conflict of interest rules of the old Code of Professional Responsibility, and held that Denver had violated them as a matter of law.3 In affirming the trial court's order requiring disgorgement of all attorney's fees, the Court did not mention any other previously discussed Washington cases. The Court premised its ruling as follows:

The trial court ordered Denver to return all of the fees, plus prejudgment interest, paid by his investor clients. Denver maintains that the court's order is in error absent a finding of damages and causation. The only Washington case Denver cites for the proposition that the court must find damage and causation before ordering return of fees is Sherry v. Diercks, 29 Wn. App. 433, 628 P.2d 1336, review denied, 96 Wn.2d 1003 (1981). However, Diercks only holds that causation and damage must be shown to establish a legal malpractice claim against an attorney. 29 Wn. App. at 437-38, 628 P.2d 1336.

The trial court did not decide that Denver committed malpractice. The trial court ruled as a matter of law that, because of the conflict of interest, Denver could not adequately represent both investors and promoters. The malpractice and negligence issues were reserved for phase two of the trial. Thus, Denver's reliance on malpractice cases is misplaced.

The trial court specifically relied on Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262, 61 S. Ct. 493, 85 L. Ed. 820 (1941), and Silbiger v. Prudence Bonds Corp., 180 F.2d 917 (2d Cir.1950), cert. denied, 340 U.S. 831, 71 S. Ct. 37, 95 L. Ed.

610 (1950), in ordering disgorgement. In Woods a unanimous Court noted:

Where [an attorney] was serving more than one master or was subject to conflicting interests, he should be denied compensation. It is no answer to say that fraud or unfairness were not shown to have resulted . . . .

. . . A fiduciary who represents [multiple parties] may not perfect his claim to compensation by insisting that, although he had conflicting interests, he served his several masters equally well . . . . Only strict adherence to these equitable principles can keep the standard of conduct for fiduciaries "at a level higher than that trodden by the crowd." See Mr. Justice Cardozo in Meinhard v. Salmon, 249 N.Y. 458, 464; 164 N.E. 545 [(1928)].

Woods, 312 U.S. at 268-69, 61 S.Ct. at 497. The general principle that a breach of ethical duties may result in denial or disgorgement of fees is well recognized. S. Gillers & N. Dorsen, Regulation of Lawyers: Problems of Law and Ethics 265 (2d ed. 1989); Ross v. Scannell, 97 Wash.2d 598, 610, 647 P.2d 1004 (1982) ("[p]rofessional misconduct may be grounds for denying an attorney his fees").

There it is — the rule we now live with. We will see how this rule has been used more recently in the following section.

Potential Applications of Breach of Fiduciary Duty to Defeat Attorney's Fees: My Own Experiences

In my own practice, I have seen this argument used on many occasions as a rationalization by the client to defeat or reduce attorney's fees. One creative lawyer used this argument successfully when the former lawyer, who withdrew because the client had repeatedly failed to make good on promises to pay attorney's fees relating to a purchase and sale, allegedly interfered with the client's ability to obtain another lawyer as a substitute. In that case, the withdrawing lawyer allegedly discouraged a Canadian lawyer who had been associated on the transaction by the withdrawing lawyer from taking over the representation of the client who didn't believe in paying lawyer's fees. In that case, a local trial judge forfeited all of the withdrawing attorney's fees.

In my own case, Taylor v. Shigaki, supra at n.2, the client who fired his lawyer to defeat the contingency fee unsuccessfully and argued (not terribly articulately) that the lawyers' alleged negligent failures and tactical decisions rose to the level of fiduciary duty breaches. In a case of mine recently decided by Division I of the Court of Appeals, my lawyer-client was terminated in his representation after he had fully performed his contingency but the money had not yet been paid. The new lawyer for this brain-injured client contended, wholly unsuccessfully, that my client's representation of a husband and wife created a conflict of interest, that the allowance of the client to execute a durable power of attorney was improper, and that the failure of the lawyer to render "a time and billing statement" in a contingency fee case was a substantial depreciation; all of these were bootstrapped into "breach of fiduciary duty" arguments, solely aimed at a total forfeiture of all fees. The trial court brushed these arguments aside. See Barrett v. Freise, 119 Wn. App 823, 82 P.3d 1179 (2004). While the courts won't always buy these fiduciary duty breach arguments, my lawyer client in the latter case needed six years of litigation in order to prevail.

Recent Case Examples

In Simburg, Ketter v. Olshan, 109 Wn. App. 436, 988 P.2d. 467 (1999), the Court of Appeals reversed a summary judgment for some $102,000 in attorney's fees awarded to a lawyer on an hourly basis. In that case, the defendant client contended that the lawyer had breached fiduciary duties to him by not fully advising him of billing practices, including the hourly rates of various lawyers, a firm policy of a minimum time entry of 3/10 of an hour, and the allegation of changing hourly rates without notice to the client. The court held that there were genuine fact issues underlying the fiduciary duty breach claims, and reversed the summary judgment.

In Perez. v. Pappas, 98 Wn.2d 835, 659 P.2d 475 (1983), an attorney obtained a structured settlement. As a result, he should have received a fraction of the stream of payments. However, he renegotiated his fee arrangement to obtain a $350,000 cash fee, and the lawyer never disputed that he failed to give the clients a proper accounting. Later, the clients challenged the actual value of the structure, and hired accountants to value it. As a result of this valuation, Pappas offered to repay the clients $37,500, and they accepted. The clients later were dissatisfied and sued for disgorgement of the fee. The Washington State Supreme Court held that the renegotiation of the fee without full disclosure to the clients and without providing a proper accounting constituted a breach of fiduciary duty. 98 Wn2d at 842. However, the Court declined to forfeit the attorney's fee, as it felt that the repayment of $37,500 was an accord and satisfaction.

Cotton v. Kronenberg

The recent decision in Cotton v. Kronenberg, 111 Wn. App. 258, 44 P.3d 878 (2002), makes clear how far the courts are willing to go in fee forfeitures where egregious facts are presented. Cotton dealt with an attorney's representation of a client in a criminal case. In refusing to enforce the attorney fee agreement and ordering disgorgement of all of the lawyer's fees, Judge Armstrong in King County determined that the attorney had committed serious ethical breaches, including keeping a retainer where the lawyer was forced to withdraw as a result of his own misconduct, renegotiating his attorney's fee without advising the client to get independent counsel, and taking a deed to real property as security for his fee and thereafter selling the property improperly. One needs only to read this opinion to see the kind of attorney actions, when added cumulatively, and considered against the backdrop that the client gets the benefit of every doubt, will result in the total loss of fees.

Conclusions

Breach of fiduciary duty arguments today add to the client's quiver of arrows, a weapon that is the equivalent of a smart bomb, which burrows through the layers of hard work, skill, and tenacity to get to the soft underbelly of attorneys' fees. While many of the typically advanced fiduciary breach arguments border on the absurd or the comical, in my experience, they raise the risk level to lawyers enormously. As mentioned above, this fiduciary breach argument is often used as a means of extorting fee concessions from a terminated lawyer or at the end of an engagement. Unfortunately, there are those who are prepared to use this weapon where it has no application. In this client-friendly climate in which we find ourselves, breach of fiduciary duty will always get my attention. Hard-nosed tactics with clients, such as using liens improperly, as in Ross v. Scannell, will result in disaster. Ignoring obvious

conflicts, as in Eriks v. Denver, will be dealt with harshly. Taking fees clearly not earned, or renegotiating fees with clients after the work is complete, is the kind of bad business that can end up costing you fees. Forewarned is forearmed!

Michael Caryl, who joined the WSBA in 1977, is a member of the Seattle firm Mikkelborg, Broz, Wells and Fryer PLLC. You can contact him at mcaryl@mbwf.com.

NOTES

1 For instance, in Callahan v. Jones, 200 Wash. 241, 93 P.2d 326 (1939), the Washington State Supreme Court forfeited the attorney's fee allegedly earned by a lawyer who, while acting as a county prosecutor on theft cases, brought civil actions on behalf of the victims to recover stolen shares of stock. The Court relied on the fact that a Washington statute forbade prosecutors from receiving fees in connection with civil actins for any party in criminal proceedings arising under the same facts. The Court did not even mention fiduciary duties; rather the decision went off on the illegality of the prosecutor seeking to work related civil actions for attorney's fees while employed as a prosecuting attorney.

2 Ross v. Scannell is the legal starting point in any dispute over whether an attorney is entitled to a contingency fee when the client terminates his or her services. As such, it is the precursor to Barr v. Day, 124 Wn.2d 318, 979 P.2d 912 (1994), and Taylor v. Shigaki, 84 Wn. App. 723, 930 P.2d 340 (1997), which announced the substantial performance exception to the quantum meruit rule in the case of termination before the full contingency has been performed.

3 The Court stated: "Thus the evil the rules were designed to prevent actually came about in this case. Denver could not advise his clients as to an appropriate course of action. His inability to properly advise his clients violated Denver's duty of loyalty to those clients. Model Rules of Professional Conduct, RPC 1.7 comment, at 73 (1984). Both the investor and promoter clients were forced to obtain new counsel, with all the resulting hardships and expenses such actions inevitably entail." 118 Wn.2d at 460.

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