

## THE FIDUCIARY DUTY OF CARE: A PERVERSION OF WORDS.<sup>1</sup>

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### I. SUMMARY

This article begins by defining the problem of conflation of the duty of care and the duty of loyalty. In Part I the *Mothew* case is discussed. The confusion between the duty of loyalty and the duty of care is clearly explained by the court. Duty of care is a negligence concept, whereas duty of loyalty is a breach of the duty of loyalty. Part II is a discussion of the Delaware corporate law cases which ignore established legal concepts and jumble together negligence and intent. Part III is a discussion of the confusing cases called “fiduciary breach.”

### II. INTRODUCTION

The thesis of this article is that American courts and commentators have conflated the duty of care and the duty of loyalty.<sup>2</sup> This conflation may be the result of ignorance or mere confusion. This tendency is not a mere matter of semantics,<sup>3</sup> but threatens to obfuscate legal reasoning.

An agent owes its principal a duty of loyalty<sup>4</sup> as well as a duty of

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1. “But to say that simple carelessness in giving advice is such a breach [of duty] is a perversion of words.” (quoting from Southin, J. in *Girardet v. Crease & Co.* (1987) 11 B.C. L.R. (2d) 361, 362. 1998 Ch.1 (Eng. C.A.) at 16.

2. “The fiduciary’s duties go beyond mere fairness and honesty; they oblige him to further the beneficiary’s best interests.” Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 882 (1988).

3. “In my judgment this is not just a question of semantics. It goes to the very heart of the concept of fiduciary duty and the availability of equitable remedies.” *Mothew at 17.*

4. The Restatement of Agency, 2d lists the duties of loyalty in Sections 387-398. Section 387 is entitled, “General Principle.” The broader category is entitled, “Duties of Loyalty.” Comment (a) states that Sections 388-398 are applications of the rule stated in Section 387.

care.<sup>5</sup> The term “fiduciary” is frequently used to describe agents, officers, directors, and trustees.<sup>6</sup> “[I]t is obvious that not every breach of duty by a fiduciary is a breach of fiduciary duty.”<sup>7</sup>

It has become commonplace for courts and commentators to refer to the “fiduciary duty of care.”<sup>8</sup> The three most egregious examples of this confusing rhetoric are the Delaware corporate law cases,<sup>9</sup> the Uniform Partnership Act (1997),<sup>10</sup> and the legal malpractice cases that consider the concept of “fiduciary breach” by an attorney.

The Uniform Partnership Act (1997)<sup>11</sup> is a good example of confusion. Section 404(a) states: “The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c).”<sup>12</sup> Subsection (b) then sets out in three sections the partner’s duty of loyalty.<sup>13</sup> That is clear drafting because a duty of loyalty is fiduciary in nature. However, in

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RESTATEMENT (SECOND) OF AGENCY § 387-398 (1958).

5. The Restatement of Agency, 2d lists the duties of care and skill in Section 379. An agent has other duties to its principal beyond the duty of loyalty and the duty of care., e.g. Section 380, Duty of Good Conduct; Section 381, Duty to Give Information; Section 382, Duty to Keep and Render Accounts, Duty to Act Only as Authorized; Section 384, Duty Not to Attempt the Impossible or Impracticable; and, Section 385, Duty to Obey. *Id.* at § 379-384.

6. *See* RESTATEMENT (THIRD) OF TRUSTS § 5 cmt. g (2003) (comparing the fiduciary responsibilities of trustees, corporate officers and directors, and partners); RESTATEMENT (SECOND) OF AGENCY § 1 cmt. b (1958) (explaining how agency creates a fiduciary relationship).

7. *Mothew*, [1998] Ch.1 at 16.

8. *See* DeMott, *supra* note 2, at 879. Prof. Demott criticizes the metaphorical use of technical legal terms. Her article criticizes the use of words “like ‘contract’ or ‘agency’ or ‘fraudulent.’” *Id.* Her argument is that if technical legal terms are used metaphorically, there is a potential for confusion. *Id.* Her article is aimed at the law and economics theory that fiduciary obligations are merely the contract that parties would have bargained for. *Id.* at 885. That theory makes the mistake of confusing fiduciary duty and contract. *Id.* Likewise conflating duty of loyalty and duty of care makes the same mistake. *Id.*

9. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del.1993) and its progeny.

10. UNIFORM PARTNERSHIP ACT (1997) (sometimes referred to as the Revised Uniform Partnership Act).

11. *Id.*

12. *Id.* § 404(a).

13. *See Id.* § 404(b):

A partner’s duty of loyalty to the partnership and the other partners is limited to the following:

(1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;

(2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

Subsection (c) the language is: “A partner’s duty of care to the partnership and the other partners . . . .”<sup>14</sup> The problem is that a duty of care is not a fiduciary duty. One obvious problem is that a court might interpret the Uniform Partnership Act (1997) in the same fashion as the Delaware Supreme Court. Thus, the negligent conduct of a partner might result in a liability to the partnership even if the negligent partner had a good defense of no proximate cause. Since the language of fiduciary duty of care seems to have arisen in *Cede v. Technicolor*,<sup>15</sup> then the reasoning of *Cede* might follow it as well.

An agent owes various duties to its principal.<sup>16</sup> The duty of loyalty is the most significant of them. The courts have expanded the duties of an agent over the years by describing a duty to disclose and a duty of candor.<sup>17</sup> “The principal is entitled to the single-minded loyalty of his [agent.]”<sup>18</sup> The duty of care is a negligence concept quite unlike the duty of loyalty. Equating the duty of care with the duty of loyalty is bad law and worse semantics. Using legal terms with fixed meanings that have developed over centuries in different ways leads only to confusion and chaos.

To describe negligent acts as being breaches of fiduciary duty is misleading, because a breach of fiduciary duty “connotes disloyalty or infidelity. Mere incompetence is not enough.”<sup>19</sup>

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14. See *Id.* § 404(c):. “A partner’s duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.” Note that this language explicitly excludes intentional conduct. But, that should not be necessary since a duty of care standard denotes negligent acts, not intentional conduct.

15. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993).

16. See RESTATEMENT (SECOND) OF AGENCY (1958) cited *supra* notes 4-5.

17. The fiduciary duty of directors in connection with disclosure violations in Delaware jurisprudence was restated in *Lynch v. Vickers Energy Corp.*, Del., 383 A.2d 278 (1978). In *Lynch*, this Court held that, in making a tender offer to acquire the stock of the minority stockholders, a majority stockholder

owed a fiduciary duty . . . which required complete candor in disclosing fully all the facts and circumstances surrounding the tender offer. In *Stroud v. Grace*, we noted that the language of our jurisprudence should be clarified to the extent that candor requires no more than the duty to disclose all material facts when seeking stockholder action. (footnotes and internal quotations omitted).

*Miller v. Berkoski*, 297 N.W.2d 334, 340 (Iowa 1980). “Our decisions have enhanced the obligations of agents and fiduciaries, functioning in positions of trust and confidence, to perform their duties in complete candor, honesty, loyalty and good faith.” *Malone v. Brincat*, 722 A.2d 5, 11 (Del. 1998).

18. *Mothew*, 1998 Ch.1 (Eng. C.A.) at 18.

19. *Id.* at 18.

The nature of the obligation determines the nature of the breach. The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity. Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere

A. *Part I: The Mothew case*

A recent British case<sup>20</sup> discussed these concepts in a clear and straightforward fashion. The case<sup>21</sup> involved a solicitor, Mr. Mothew, the defendant, and the Bristol and West Building Society, the plaintiff.<sup>22</sup> Mr. Mothew acted for Mr. and Mrs. Towers in the purchase of a residence.<sup>23</sup> The purchase price of the property was £ 73,000. Mr. Mothew also acted for the Bristol & West Building Society.<sup>24</sup> The purchasers had applied for a loan of £ 59, 000 from the Society.<sup>25</sup> The down payment was to be provided by the purchasers personally without further borrowing.<sup>26</sup> Further, no second mortgage was to be permitted.<sup>27</sup> The instructions to the solicitors acting for the Society required them to report any second mortgage or other borrowing to the Society (the “lender”).<sup>28</sup> “Mr. and Mrs. Towers intended to provide the balance of the purchase price from the net proceeds ‘of their existing property’ after discharging a subsisting mortgage.”<sup>29</sup> They owed money to Barclays Bank, which was secured by a second charge on that property.<sup>30</sup> “They arranged with the bank to allow” £ 3,350 “to remain outstanding after the sale of the existing property and to be secured by a second charge on the new property.”<sup>31</sup> The solicitor was informed of these facts.<sup>32</sup> He failed to inform the lender in his report.<sup>33</sup> His report “confirmed that to the best of his knowledge and belief the balance of the purchase money was being provided by the [purchasers].”<sup>34</sup> The solicitor “conceded that his statements were untrue and that his failure to report the purchasers’ arrangements was a breach of his instructions.”<sup>35</sup> “The [lender] alleges that the defendant acted negligently and in breach of contract, and this is

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incompetence is not enough. A servant who loyally does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty.

*Id.*

20. See Mothew *supra* note 7.

21. *Id.*

22. Mothew, 1998 Ch.1 (Eng. C.A.) at 6.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. Mothew, 1998 Ch.1 (Eng. C.A.) at 6.

28. *Id.* at 7.

29. *Id.*

30. *Id.*

31. *Id.*

32. Mothew, 1998 Ch.1 (Eng. C.A.) at 7.

33. *Id.*

34. *Id.*

35. *Id.*

admitted. There is no allegation of dishonesty or bad faith, and if any such allegation were made it would be strongly resisted.”<sup>36</sup> The lender did not allege that the defendant made the statements knowing them to be untrue.<sup>37</sup> “It alleges only that he ‘knew or ought to have known’ that they were untrue. . . .”<sup>38</sup> The lender forwarded a check to the defendant in the amount of £ 59,000.<sup>39</sup> The advance was released to the vendor’s solicitors.<sup>40</sup> Ultimately, “the purchasers defaulted and the lender enforced its security.”<sup>41</sup> The property was sold and the net proceeds were slightly under £ 53,000.<sup>42</sup> The Society sued to recover its net losses based on three theories: breach of contract, negligence, and breach of trust (fiduciary duty).<sup>43</sup> Breach of contract and negligence were admitted, but breach of trust was denied.<sup>44</sup> Defendant’s contention was that the lender would have made the loan regardless of the second charge on the property and the failure to discuss the “relatively trivial indebtedness which did not even represent fresh borrowing.”<sup>45</sup> The Society’s theory was that while no damages could be recovered under common law unless it could show that it would not have made the loan if it had been aware of the facts, it could still sue for breach of trust because “causation and remoteness” did not apply to the theory of breach of fiduciary duty.<sup>46</sup> The district judge accepted these arguments and gave summary judgment for the Society for breach of trust for the sum of £ 59,000 less the sums received by the Society on the sale of the property.<sup>47</sup>

The Court of Appeals reversed the lower court on the issue of breach of fiduciary duty, reasoning as follows:

Despite the warning given by Fletcher Moulton L.J. in *In re Coomber*; *Coomber v. Coomber* [1911] 1 Ch. 723, 728, this branch of the law has been bedeviled by unthinking resort to verbal formulae. It is therefore necessary to begin by defining one’s terms. The expression “fiduciary duty” is properly confined to those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences

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36. *Id.*

37. *Mothew*, 1998 Ch.1 (Eng. C.A.), at 8.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Mothew*, 1998 Ch.1 (Eng. C.A.) at 8.

43. *Id.* at 16.

44. *Id.*

45. *Id.*

46. *Id.*

47. *Mothew*, 1998 Ch.1 (Eng. C.A.) at 16.

differing from those consequent upon the breach of other duties. Unless the expression is so limited it is lacking in practical utility. In this sense it is obvious that not every breach of duty by a fiduciary is a breach of fiduciary duty. I would endorse the observations of Southin J. in *Girardet v. Crease & Co.* (1987) 11 B.C.L.R. (2d) 361, 362:

The word “fiduciary” is flung around now as if it applied to all breaches of duty by solicitors, directors of companies and so forth. . . . That a lawyer can commit a breach of the special duty [of a fiduciary] . . . by entering into a contract with the client without full disclosure . . . and so forth is clear. But to say that simple carelessness in giving advice is such a breach is a perversion of words.

These remarks were approved by La Forest J. in *LAC Minerals Ltd. v. International Corona Resources Ltd.*(1989) 61 D.L.R. (4th) 14, 28 where he said: “not every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for breach of fiduciary duty.”

It is similarly inappropriate to apply the expression to the obligation of a trustee or other fiduciary to use proper skill and care in the discharge of his duties. If it is confined to cases where the fiduciary nature of the duty has special legal consequences, then the fact that the source of the duty is to be found in equity rather than the common law does not make it a fiduciary duty. The common law and equity each developed the duty of care, but they did so independently of each other and the standard of care required is not always the same.<sup>48</sup>

The court mentions two characteristics that are relevant to fiduciary duty. First, fiduciary relationships exist to protect persons subject to “disadvantage or vulnerability.”<sup>49</sup> Second, a fiduciary relationship has

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48. *Id.*

49. *See Mothew*, 1998 Ch.1 (Eng. C.A.) at 17:

The director’s duty to exercise care and skill has nothing to do with any position of disadvantage or vulnerability on the part of the company. It is not a duty that stems from the requirements of trust and confidence imposed on a fiduciary. In my opinion, that duty is not a fiduciary duty, although it is a duty actionable in the equitable jurisdiction of this court. . . . I consider that Hamilton owed P.B.S. a duty, both in law and in equity, to exercise reasonable care and skill, and P.B.S. was able to mount a claim against him for breach of the legal duty, and, in the alternative, breach of the equitable duty. For the reasons I have expressed, in my view the equitable duty is not to be equated with or termed a “fiduciary” duty.

*Id.* (quoting the comment of Ipp J, in *Permanent Bldg Soc’y v. Wheeler*, (1994) 14 A.C.S.R. 109, 157).

the obligation of loyalty.<sup>50</sup> If the duties of care and loyalty were identical in consequence, it would make no difference if the courts referred to a fiduciary duty of care. However, the consequence of a violation of the duty of care is quite different from a violation of the duty of loyalty. In *Mothew*, the consequence was the proximate cause defense. The Society could not recover damages if Mothew's failure to report the second mortgage did not matter.<sup>51</sup> That is, if the lender would have made the same decision if it had known of the second charge, then the lender would not recover damages. The district judge decided that the breach of trust theory did not require proof of causation.<sup>52</sup> On appeal, the Court of Appeal concluded that the breach of trust theory was invalid since at most there was only mere negligence by the solicitor.<sup>53</sup> Thus, the Court of Appeal had to determine whether the judgment would stand. The Court of Appeal decided that the solicitor was negligent but that a trial was necessary to determine whether damages should be paid by the defendant.<sup>54</sup> The claim based on negligence required an analysis of whether "the defendant's negligence caused the [plaintiff] to enter into the transaction."<sup>55</sup> Further, the plaintiff must show "what part of the loss was attributable to the defendant's negligence."<sup>56</sup> In determining the damages the trial court would have to consider what part of the loss was attributable to the decline in property values.<sup>57</sup>

The district judge believed that the solicitor had put himself in an actual conflict.<sup>58</sup> That may explain his conclusion that there was a

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50. A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary. As Dr. Finn pointed out in his classic work *Fiduciary Obligations* (1977), p. 2, he is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary. *Mothew*, 1998 Ch.1 (Eng. C.A.) at 18.

51. See *supra* note 45 and accompanying text.

52. *Mothew*, 1998 Ch.1 (Eng. C.A.) at 9.

53. *Id.* at 22.

54. *Id.*

55. *Id.* at 9.

56. *Id.*

57. *Mothew*, 1998 Ch.1 (Eng. C.A.) at 9.

58. *Id.*

breach of fiduciary duty.<sup>59</sup> The Court of Appeal disagreed with this conclusion.<sup>60</sup> The solicitor was authorized by both parties to complete the report accurately.<sup>61</sup> The solicitor had the duty to report the state of the title, as well as to confirm the absence of any further borrowing.<sup>62</sup> A breach of fiduciary duty might have existed if the solicitor had acted in bad faith or deliberately withheld information, but the court held that he did not do either of those things.<sup>63</sup>

The court's reasoning is quite sound. The duties of care and loyalty are quite different.<sup>64</sup> The conflation<sup>65</sup> of duty of care and duty of loyalty has occurred in the United States. The best example is *Cede v. Technicolor*.<sup>66</sup>

### B. Part II: The Delaware Corporate Law Cases

In *Cede*, the Delaware Supreme Court abolished the proximate cause defense to the duty of care, ignoring the traditional rule described in *Barnes v. Andrews*.<sup>67</sup> The court's statement to the effect that *Barnes* may still be good law, but as a tort action, it "does not control a claim for breach of fiduciary duty"<sup>68</sup> is silly.<sup>69</sup> A duty of care claim is always a tort action and is always based on negligence.<sup>70</sup> A duty of care claim can

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59. *Id.*

60. *Id.* at 20.

61. *Id.*

62. *Mothew*, 1998 Ch.1 (Eng. C.A.) at 20.

63. *Id.*

64. *Id.* at 19.

65. "Technicolor's conflation of care and loyalty doesn't clarify matters any..." PROFESSOR MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 269 (1995). (Professor Dooley first uses this term in this book.)

66. It stated:

The Chancellor's reliance on *Barnes* is misguided. While *Barnes* may still be "good law," *Barnes*, a tort action, does not control a claim for breach of fiduciary duty. In *Barnes*, the court found no actionable negligence or proof of loss—and granted defendant's motion for a nonsuit or grant of judgment for defendant on the merits. Here, the court was determining the appropriate standard of review of a business decision and whether it was protected by the judicial presumption accorded board action. The tort principles of *Barnes* have no place in a business judgment rule standard of review analysis.

*Cede*, 634 A.2d at 370. (footnotes omitted).

67. *Barnes v. Andrews*, 298 F. 614, 616 (S.D. N.Y. 1924).

68. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 370 (Del. 1993).

69. See FRANKLIN A. GEVURTZ, CORPORATION LAW, 302 (2000). "The *Cede* court's rejection of tort law causation principles, in favor of a sort of reverse application of the business judgment rule, seems bizarre. Indeed, it appears to illustrate the power of the so-called business judgment rule to confuse courts." *Id.*

70. See generally RESTATEMENT (SECOND) OF AGENCY § 379 (1958) (explaining that a

never be a breach of fiduciary duty. Justice Horsey, who wrote the *Cede* opinion, is confusing two concepts that are far different. His opinion offers no sensible reason for doing this.<sup>71</sup> The opinion accuses the Court of Chancery of “rewriting the Delaware business judgment rule’s requirement of due care.”<sup>72</sup> The opinion further states that “[t]he court has erroneously subordinated the due care element of the rule to the duty of loyalty element.”<sup>73</sup> It is difficult to imagine how the Court of Chancery could have done anything else. A duty of care claim is based on negligence, and negligence includes proximate cause as an element.<sup>74</sup> The Court of Chancery could only have predicted the Supreme Court’s reversal if it had been clairvoyant. The argument that the Court of Chancery has subordinated the duty of care to the duty of loyalty is unpersuasive. The duties of a director have no priorities. The duty of care is not lower or higher than the duty of loyalty. Injecting the requirement of proximate cause is not an innovation of the Court of Chancery. The Court of Chancery merely recognized that the duty of care is based on the traditional negligence law.<sup>75</sup> The astonishing innovation of the Delaware Supreme Court is to destroy the distinction between intentional conduct and negligent conduct.<sup>76</sup> The Supreme Court’s reasoning is mere smoke and mirrors. It speaks of the “triad of their fiduciary duty—good faith, loyalty or due care.”<sup>77</sup> Good faith is a fiduciary duty. Loyalty is a fiduciary duty.<sup>78</sup> Due care is not. Good faith,

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breach of an agent’s duty of care and skill results in a tort action for negligence).

71. “The fact remains that no clear and reasoned prior authority exists for the [*Cede*] holdings that director breach of the duty of care results” in a breach of fiduciary duty. Lyman Johnson, *Rethinking Judicial Review of Director Care*, 24 DEL. J. CORP. L. 787, 801 (1999).

72. *Cede*, 634 A.2d at 371.

73. *Id.*

74. *See supra* note 70.

75. “Applying standard tort principles, Chancellor Allen noted that a plaintiff alleging a breach of due care must show not only lack of due care, but also causation and damages,” and then he goes on to say that “[i]n [*Cede*], even if the board had not exercised due care . . . , the shareholders received more than fair value for their shares and had therefore suffered no injuries.” He then dismissed the due care charge. Lawrence A. Cunningham and Charles M. Yablon, *Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?)*, 49 BUS. LAW. 1593, 1598 (1994) (footnotes omitted).

76. “[*Cede*] is clear in its novel holding that violations of duty of care imply substantially the same consequences as violations of the duty of loyalty.” *Id.*

77. *Cede*, 634 A.2d at 361.

78. *See* Gevurtz, *supra* note 69, at 321. Professor Gevurtz clearly distinguishes the duty of care from the duty of loyalty.

We depart now from cases in which the complaint is that directors or officers breached their duty of care—in other words, they were lazy or dumb. In this section, we consider complaints that directors or officers breached their duty of loyalty—in other words they were greedy and put their financial interests ahead of the interests of the corporation and

loyalty, and due care is a duo, not a triad. Misusing language to justify results that a court prefers simply erodes confidence in the courts. The Delaware courts are free to use whatever terminology they like.<sup>79</sup> But it is foolish for other courts to adopt defective and misleading terminology. It can only mislead others. The Delaware Supreme Court could have announced a new rule of liability for directors. It could have stated that mere negligence would be sufficient to create liability. The result would have been the same without the confusion. *Cede* mystifies corporate law even further when Justice Horsey stated: “Duty of care and duty of loyalty are the traditional hallmarks of a fiduciary who endeavors to act in the service of a corporation and its stockholders.<sup>80</sup> Each of these duties is of equal and independent significance.”<sup>81</sup> It is certainly true that a fiduciary has a duty of care and a duty of loyalty. But to say that the duties of care and loyalty are of equal and independent significance is meaningless. Perhaps the Delaware Supreme Court is simply building a rhetorical argument based on the theory that equal duties, however dissimilar, should be made identical. That might explain the Court’s conflation of care and loyalty.<sup>82</sup> Another explanation is that Delaware corporate law lacks a real duty of care. The Delaware cases suggest that

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its shareholders.

*Id.*

79. See Cunningham and Yablon, *supra* note 75, at 1595. One explanation of *Cede* might be a desire to make Delaware law “more unified and coherent.” *Id.* The authors state that, “Before 1985, casebooks and commentators divided fiduciary duties into the two broad categories of duty of care and duty of loyalty, but everyone knew that only the duty of loyalty mattered.” *Id.* The authors make the same mistake as the Delaware Supreme Court. They consider the duty of care a fiduciary duty, but it is clearly not. The authors point out that “Technicolor and QVC both blur the distinction between duty of care and duty of loyalty.” *Id.* at 1625. Although the article does not discuss whether the conflation of duty of care and duty of loyalty is prudent, it clearly acknowledges that conflation is occurring. *Id.*

80. *Cede*, 634 A.2d at 367.

81. *Id.*

82. See Johnson, 24 DEL. J. CORP. L. at 801.

The failure by the *Cede* court to elaborate policy rationales for stringently reviewing care claims in the manner of loyalty claims may simply be because adjudicated breaches of the duty of care have been so rare in Delaware that the courts have had little occasion to develop more nuanced standards for addressing them. Or, it may reflect an overly hasty zeal for embracing a coherent and unified fiduciary analysis, such zeal leading the court to treat all duty breaches the same, as if their policy roots were indistinguishable. Two deeper reasons for the confusion are developed shortly but warrant mention here. The first is the court’s faulty equating of a director’s informedness with a director’s duty of care (thereby not grasping the genuine fullness of a due care inquiry). The second reason is Justice Horsey’s overarching quest—seen as well in his lecture-article—to give Delaware’s duty of care a shot in the arm, to the point of inappropriately applying a novel heightened burden of proof in what amounts to a carelessness claim.

*Id.* (footnotes omitted)

the Business Judgment Rule is the premise from which the duties of loyalty and care derive.<sup>83</sup>

### C. Part III: Fiduciary Breach

The case of *Klemme v. Best*<sup>84</sup> is a good example of a breach of fiduciary duty by an attorney.<sup>85</sup> Mr. Best represented the city of Columbia, the Joint Communications Center and seven police officers, including Byron Klemme.<sup>86</sup> According to Klemme's petition, "Best discussed with opposing counsel the identity of each officer involved in the shooting."<sup>87</sup> Best informed opposing counsel that one of the officers did not participate in the shooting, and that officer was eliminated from the draft complaint. Klemme had not participated as well, yet he was not eliminated from the complaint.<sup>88</sup> Best knew that Klemme did not participate in the shooting, but he did not tell the opposing counsel.<sup>89</sup> Klemme asserted in his claim that Best had violated the "fiduciary duties of fidelity, loyalty, devotion, and good faith."<sup>90</sup> The court defined the elements of legal malpractice<sup>91</sup> as follows: "(1) an attorney-client relationship; (2) negligence or breach of contract; (3) proximate causation of plaintiff's damages, and (4) damages to the plaintiff."<sup>92</sup> The court stated that "an attorney has the basic fiduciary obligations of undivided loyalty and confidentiality . . . A breach of a fiduciary obligation is constructive fraud."<sup>93</sup> The court then pointed out that these claims are labeled as breach of fiduciary duty.<sup>94</sup> The court defined the elements of breach of fiduciary duty as follows: "(1) an attorney-client

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83. See *Cede*, 634 A.2d at 367. "In decisional law of this Court applying the rule [the business judgment rule] this Court has consistently given equal weight to the rule's requirements of duty of care and duty of loyalty." *Id.*

84. *Klemme v. Best*, 941 S.W.2d 493 (1997).

85. See Melissa A. Thomas, *When is an Attorney's Breach of Fiduciary Duty in Missouri Not Legal Malpractice?*, 60 MO. L. REV. 595 (1998) (containing a good discussion of the *Klemme* case).

86. *Klemme*, 941 S.W.2d at 495.

87. *Id.* at 495.

88. *Id.*

89. *Id.*

90. *Id.* at 495.

91. The court's category of legal malpractice is essentially a duty of care analysis. The theory of breach of contract is based on the theory that the attorney agrees to perform his task competently. Some courts give the plaintiff a choice of the contract theory or the negligence theory. Commonly the different theories affect the statute of limitations. See generally Thomas, 63 MO. L. REV. 595 (1998).

92. *Klemme*, 941 S.W.2d at 495. (citing *Donahue v. Shughart, Thomson and Kilroy, P.C.*, 900 S.W. 2d 624, 626 (Mo. Banc 1995).)

93. *Id.*

94. *Id.* at 495-496.

relationship; (2) breach of a fiduciary obligation by the attorney; (3) proximate causation; (4) damages to the client; and (5) no other recognized tort encompasses the facts alleged.”<sup>95</sup> The court’s reasoning is that “if the alleged breach can be characterized as both a breach of the standard of care . . . and a breach of a fiduciary obligation,” then the only claim permitted is legal malpractice.<sup>96</sup> The court gives no reasoning to support this distinction, other than to base it on earlier precedents.<sup>97</sup> The court concluded that Klemme had alleged facts that would support the theory of breach of fiduciary duty or constructive fraud. The court stated, “Best breached his fiduciary obligation by placing the interests of other clients before Klemme’s. . . .”<sup>98</sup> The case is significant since it approves the theory of breach of fiduciary duty. However, the court’s decision is mere dictum since Klemme had not filed his suit before the statute of limitations had expired.<sup>99</sup> The court’s discussion of breach of a fiduciary obligation and constructive fraud seems to imply that both theories are essentially the same. It is true that an attorney, as with all agents, owes a duty to disclose to his client. Thus, in a case where the attorney does not disclose a material matter to a client, he has committed fraud. His deceit is his failure to disclose the true state of affairs. Klemme had contended that “[w]hen an attorney intentionally commits an act of misconduct in representing his or her client’s interest. . . an action may lie for breach of fiduciary duty or constructive fraud.”<sup>100</sup> Surprisingly, the court disagrees with that contention. The court overrules the quoted language and states, “[p]roof of an attorney’s intent is not required to establish breach of fiduciary duty or constructive fraud.”<sup>101</sup> *Fix v. Fix*<sup>102</sup> gives a more complete explanation of the proof necessary to establish constructive fraud: “[I]t is only necessary to prove the acts of fraud.”<sup>103</sup> Fraud is difficult to prove because the state of mind required is intent (scienter). The doctrine of constructive fraud is necessary to protect those in a confidential relation. Constructive fraud is an ancient doctrine. In effect, intent is presumed because the attorney is in a dominant position.

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95. *Id.* at 496.

96. *Id.*

97. *Klemme*, 941 S.W.2d at 496.

98. *Id.*

99. *Id.* at 497.

100. *Id.* at 496 (quoting *Arana v. Koerner*, 735 S.W.2d 762, 735 (Mo.App.1987)).

101. *Id.*

102. *Fix v. Fix*, 847 S.W.2d 762, 765 (Mo. 1993).

103. *Id.*

Hence, the law, with a wise providence, not only watches over all the transactions of parties in this predicament, but it often interposes to declare transactions of parties void, which, between other persons, would be held unobjectionable. It does not so much consider the bearing or hardship of its doctrine upon particular cases, as it does the importance of preventing a general public mischief, which may be brought about by means, secret and inaccessible to judicial scrutiny, from the dangerous influences arising from the confidential relation of the parties. By establishing the principle, that, while the relation of client and attorney subsists in full vigor, the latter shall derive no benefit to himself from the contracts, or bounty, or other negotiations of the former; it supersedes the necessity of any inquiry into the particular means, extent, and exertion of influence in a given case a task often difficult, and ill supported by evidence, which can be drawn from any satisfactory sources.<sup>104</sup>

Many cases discuss the concepts of negligence and breach of fiduciary duty. However, the reasoning of the courts is confusing and inconsistent.<sup>105</sup> Most courts find the concept of the duty of loyalty difficult since most of the decided cases deal with negligence. Professor Duncan recognizes the inadequate job the courts have been doing, and she proposes a solution to the problem that would result in more consistent treatment.<sup>106</sup> That might well be an advantage over the current state of the law, but the present author would prefer a broader scope for breach of fiduciary duty.<sup>107</sup> The purpose of this article is not to

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104. 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE 306, § 310 (10<sup>th</sup> Ed. 1870) (footnotes omitted).

105. See Meredith J. Duncan, *Legal Malpractice By Any Other Name: Why a Breach of Fiduciary Duty Claim Does Not Smell as Sweet*, 34 WAKE FOREST L. REV. 1137, 1139 (1999).

Permitting clients to pursue breach of fiduciary duty claims against their former attorneys is a critical development in the law of lawyering for several reasons. Although an important development in the law, courts have nonetheless, at times, done an inadequate job of creating and applying fiduciary law to the attorney-client relationship. To make matters worse, courts have, at times, failed even to distinguish breach of fiduciary duty claims from traditional professional negligence claims. The failure of the courts to discuss and emphasize the distinctions between the two have led to a sloppy body of law that fails to consider, in any meaningful manner, the impact of these novel theories of recovery on the ever-expanding law of lawyering. Because the ramifications of each of these actions are unique, clearly distinguishing between the two is critical.

*Id.*

106. Professor Duncan proposes that a client can sue her attorney for breach of fiduciary duty when one of three conditions are met: "(1) committed a criminal offense victimizing the client, (2) perpetrated a scheme to defraud the client, or (3) caused actual harm to a client by virtue of the breach of a fiduciary duty." *Id.* at 1140.

107. See *Sargent v. Buckley*, 697 A.2d 1272, 1275 (Me. 1997). The duty of loyalty of an attorney is well established. *Id.* "We have held that an 'attorney and client necessarily share a

determine the exact scope and details of the remedy for a breach of fiduciary duty, but rather to make it clear that a theory of breach of fiduciary duty (duty of loyalty) is far different from mere negligence.<sup>108</sup> Too many cases simply state that the plaintiff is trying to use a different name because the negligence theory would fail. Many of the decisions simply treat a violation of the duty of loyalty as being identical to a violation of the duty of care. Others seem to acknowledge that a violation of the duty of loyalty is different from a violation of the duty of care,<sup>109</sup> but state that if the plaintiff pleads his case in language of duty of loyalty to avoid some consequences of a duty of care case, then the court will treat the duty of loyalty count as being duplicative of the duty of care count.<sup>110</sup> The fact that the counts in a complaint may seem similar does not mean they are duplicative.<sup>111</sup>

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fiduciary relationship of the highest confidence.” *Anderson v. Neal*, 428 A.2d 1189, 1191 (Me. 1981). In *Peaslee v. Pedco, Inc.*, 388 A.2d 103 (Me. 1978), an attorney’s breach of the duty of loyalty supported an action for rescission of a land contract. The fiduciary obligations of an attorney are derived from common law and equity independent of professional rules of conduct. 2 RONALD E. MALLIN & JEFFREY M. SMITH, *LEGAL MALPRACTICE*, § 14.1 (4th ed. 1996). “[T]he basic fiduciary obligations are two-fold: undivided loyalty and confidentiality. . . . These common-law duties predate and exist despite independent, codified ethical standards.” *Id.*

108. *James v. Chase Manhattan Bank*, 173 F. Supp. 2d 544, 550 (N.D. Miss. 2001). “The Mississippi Supreme Court recognized a distinction between the duty of care and the duty of loyalty owed the client; the latter is fiduciary in nature while the former is not.” *Id.*

109. *Moguls of Aspen, Inc. v. Faegre & Benson*, 956 P.2d 618, 621(Colo. Ct. App. 1997). “We recognize that circumstances may exist in which a lawyer may be guilty both of malpractice and of other violations of his or her fiduciary obligations. If a claimed fiduciary violation is separate and independent from any alleged negligence, separate claims may well be properly asserted.” *Id.* (footnotes omitted).

110. *Majumdar v. Lurie*, 653 N.E.2d 915, 920 (Ill. App. Ct. 1995):

Admittedly, count II has seven more paragraphs than count I, one of which is an allegation that the plaintiffs performed all aspects of their contract with defendants, but the six additional paragraphs contain nothing by way of factual allegation that had not already been stated in count I. Counts I and II of the plaintiffs’ second –amended complaint are not plead in the alternative; they are duplicative. Further, although an action for legal malpractice is conceptually distinct from an action for breach of fiduciary duty because not all legal malpractice rise to the level of a breach of a fiduciary. . .when, as in this case the same operative facts support actions for legal malpractice and breach of fiduciary resulting in the same injury to the client, the actions are identical and the later should be dismissed as duplicative.

*Id.* (citations omitted).

111. See *Goffney v. Rabson*, 56 S.W.3d 186 (Tex. Ct. App. 2001). Rabson had contended that she had a good breach of contract claim rather than a malpractice claim. *Id.* at 191. The court was not persuaded by this argument because most of the testimony concerned whether Goffney had done an adequate of job of representation. *Id.* at 192. Since Rabson had abandoned her malpractice claim, the court regarded it as “nothing more than a legal malpractice claim.” *Id.* The conduct alleged of Goffney was that she had refused to prepare for trial and abandoned Rabson on the day of trial. *Id.* at 189-90. Such conduct looked like intentional conduct, a breach of her duty of loyalty; Goffney put her own self interest ahead of her client’s best interest. *Id.*

The Supreme Court of California has stated that “the fact that a client lacks awareness of a practitioner’s malpractice implies, in many cases, a second breach of duty by the fiduciary, namely, a failure to disclose material facts to his client.”<sup>112</sup>

The theory that alleging both negligence and breach of the duty of loyalty is mere duplication<sup>113</sup> is not very persuasive since intentional conduct should be punished more harshly than mere negligence. Since attorneys are agents,<sup>114</sup> they should have the same duties as all agents. An agent always has a duty of care<sup>115</sup> to its principal as well as a duty of loyalty.<sup>116</sup> It is arguable that the disciplinary rules in effect in a particular jurisdiction may have changed the common law result. Many courts have held that the disciplinary rules may be introduced into evidence to prove malpractice.<sup>117</sup> This seems a sensible result. But to argue that the disciplinary rules change the common law of agency is not very persuasive. The state bars should have the right to discipline careless and disloyal attorneys. But a client who is harmed should have the right to sue his attorney for money damages regardless of what action the state bar may take. The most common theories used to sue attorneys are contract theory, duty of care theory (negligence), and breach of fiduciary duty (duty of loyalty).<sup>118</sup>

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112. Neel v. Magana, Olney, Levy, Cathcart & Gelfand, 491 P.2d 421, 429 (Cal. 1971).

113. Seyfarth, Shaw, Fairwether & Geraldson v. Wintz, No. C 1536, 1999 U.S. Dist. LEXIS 19233 (N.D. Ill. Dec. 3, 1999) suggests failure to advise of potential conflicts would not be duplicate, but that the count would have to elaborate on the substance of the alleged conflict of interest. Further, failure to allege sufficient facts describing the alleged divergence of interests would be essential. Lacking appropriate facts, the court dismissed the count, stating, “A bare allegation of a conflict of interest unsupported by facts describing the conflict, fails to support a breach of duty claim.” *Id.* at 28.

114. Am. Family Mut. Ins. Co. v. Zavala, 302 F. Supp. 2d 1108 (D. Ariz. 2003). “In Arizona, an attorney is the agent of a client. A lawyer is the agent of his client, and the rules of agency law generally apply to the attorney-client relationship.” *Id.* at 1121 (citations omitted).

115. RESTATEMENT (SECOND) OF AGENCY § 379.

116. See generally RESTATEMENT (SECOND) OF AGENCY § 387-398.

117. Allen v. Lefkoff, 453 S.E.2d 719, 721 (Ga. 1995):

First, some courts hold that professional ethical standards conclusively establish the duty of care and that any violation constitutes negligence per se. Second, a minority of courts finds that a professional ethical violation establishes a rebuttable presumption of legal malpractice. Third, a large majority of courts treats professional ethical standards as evidence of the common law duty of care. Finally, one court has found professional ethical standards inadmissible as evidence of an attorney’s duty of care.

*Id.* (citing Note, *The Inadmissibility of Professional Ethical Standards in Legal Malpractice After Hizey v. Carpenter*, 68 WASH. L. REV. 395, 398-401 (1993) (emphasis added)). “For the following reasons, we agree with the majority rule and we hold that pertinent Bar Rules are relevant to the standard of care in a legal malpractice action” (footnotes omitted). *Id.*

118. See generally Daniel J. Pope & Suzanne Lee, *Breach of Fiduciary Duty and Punitive Damages*, 66 DEF. COUNS. J. 257 (1999) (providing a survey of current malpractice complaints

The legal issues that arise in suits against attorneys are the requirement of expert testimony, the elements of the action, e.g, the requirement of proximate cause, and the nature of damages, compensable or punitive.<sup>119</sup> Some courts use the remedy of disgorgement based on the agency doctrine<sup>120</sup> which permits a principal to sue his agent to obtain any compensation.<sup>121</sup> The law of agency

against lawyers).

119. *Id.* at 265, n. 44. Several jurisdictions permit punitive damages for breach of fiduciary duty. *Smith v. Lightning Bolt Productions*, 861 F.2d 363 (2d Cir. 1988) (New York law); *Bank Saderat Iran v. Telegen Corp.*, No. C-94-2330-VRW, 1997 WL 685247 (N.D. Cal. Oct. 16, 1997) (California law); *In re Legal Econometrics Inc.*, 191 B.R. 331 (N.D. Tex. 1995) (Texas law); *Home Ins. Co. v. Wynn*, 493 S.E.2d 627 (Ga. App. 1997) (Georgia law); *Fairfax Savings, F.S.B. v. Weinberg & Green*, 685 A.2d 1189 (Md. Spec. App. 1996) (Maryland law); *Fiedler v. Adams*, 466 N.W.2d 39 (Minn. App. 1991) (Minnesota law); *Rizzo v. Haines*, 555 A.2d 58 (Pa. 1989) (Pennsylvania law).

120. *See Rockefeller v. Grabow*, 39 P.3d 577 (Idaho 2001). “Although this Court has not addressed whether an agent automatically forfeits his entire commission upon breaching his fiduciary duties, several other states have addressed the issue.” *Id.* at 582. The *Rockefeller* court noted that in *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999), the Texas Supreme Court “rejected the theory of automatic full forfeiture,” finding that, “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.” *Id.* *Burrow* ultimately held that

Texas law requires a consideration of several factors in determining the amount of forfeiture, including: ‘the gravity and timing of the violation, its willfulness, its effect on the value of the [agent’s] work for the [principal], and other threatened or actual harm to the [principal] and the adequacy of other remedies.

*Id.* (bracketed text in original). *Rockefeller* also cited to the Oregon case of *Marnon v. Vaughan Motor Co.*, 194 P.2d 992, 1020-21 (Or. 1948), in which the Oregon Supreme Court recognized the rule that a disloyal agent “forfeits all right to recover for services rendered on his principal’s behalf,” but found that the rule “is not an inflexible one”; whether compensation is denied a fiduciary “ultimately rests in the discretion of the court.” *Id.* It also drew attention to a more recent Oregon Supreme Court decision, stating that, “[t]he remedy of restoration of compensation is an equitable principle and its application is dependent upon the individual facts of each case.” *Id.* at 583 (citing *Am. Timber & Trading Co. v. Niedermeyer*, 276 Or. 1135, 1155, 558 P.2d 1211, 1223 (1976)). The *Rockefeller* court also felt that the RESTATEMENT (SECOND) OF AGENCY § 469 (1958) has proved useful:

An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a willful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned.

*Id.* A Washington Court of Appeals decision, interpreting the reason that this section does not result in automatic forfeiture, stated that:

The word “entitled” used in § 469 is defined to mean “To give a right to.” A reading of § 469 in light of this definition, would indicate a disloyal agent does not have a *right* to compensation by virtue of a breach of his duty of loyalty, but a breach does not exclude the exercise of the court’s discretion granting him compensation.

*Williams v. Queen Fisheries, Inc.*, 469 P.2d 583, 588 (Wash. App. 1970) (citation omitted).

121. *Rice v. Perl*, 320 N.W.2d 407, 411 (Minn. 1982). *See also* *In re Estate of Lee*, 214 Minn. 448, 460, 9 N.W.2d 245, 251 (1943), stating:

It is equally well settled that an attorney at law who is unfaithful in the performance of

permits forfeiture of fees if the agent is disloyal.<sup>122</sup>

Attorney William Denver represented the promoters and the investors of a tax shelter scheme.<sup>123</sup> The scheme involved selling investments in master sound recordings.<sup>124</sup> Ultimately, the investors brought a class action lawsuit against Denver. The investors alleged both claims based on negligence and claims based on breach of fiduciary duty.<sup>125</sup> The trial court decided as a matter of law that there was a conflict of interest between the promoters and the investors.<sup>126</sup> The judge then ruled that Denver's failure to disclose the conflict to the investors was a breach of his fiduciary duty.<sup>127</sup> Denver had discussed his potential conflicts of interest with the promoters, but not with the investors.<sup>128</sup> The court then ordered Denver to disgorge all fees paid by the investors.<sup>129</sup>

The court held that Denver had violated his duty of loyalty as a matter of law.<sup>130</sup> Denver had explained to his promoter clients the conflict of interest but had not given the same explanation to the investor clients.<sup>131</sup> When the investor clients came to Denver after the IRS had denied their deductions, Denver advised them to obtain independent counsel but did not advise them as to possible recourse against the promoters.<sup>132</sup>

Denver contended that the court's order was erroneous since it failed to prove causation.<sup>133</sup> The Supreme Court of Washington dismissed that contention since the causation requirement applied only to malpractice claims.<sup>134</sup> The court stated that "[t]he general principal

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his duties forfeits his right to compensation. An attorney is an officer of the court, sworn to aid in the administration of justice and to act with strict fidelity to both his clients and the courts. Unquestioned fidelity to their real interests is the duty of every attorney to his clients. When a breach of faith occurs, the attorney's right to compensation is gone.

*Id.* (quoting accord, *Faber v. Enkema*, 180 Minn. 493, 231 N.W. 410 (1930)). Furthermore, "[t]hese consequences follow even though the principal, ignorant of the duplicitous agency, cannot prove actual injury to himself or that the agent committed an intentional fraud." *Rice*, 320 N.W.2d at 411 (quoting *Anderson v. Anderson*, 293 Minn. 209, 216, 197 N.W.2d 720, 724 (1972)).

122. RESTATEMENT (SECOND) OF AGENCY § 469 (1958). *See supra* note 120.

123. *Eriks v. Denver*, 118 Wash. 2d 451, 453, 824 P.2d 1207, 1208 (1992).

124. *Id.* at 1209.

125. *Id.*

126. *Id.*

127. *Denver*, 824 P.2d at 1209.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Denver*, 824 P.2d at 1212.

132. *Id.*

133. *Id.* at 1213.

134. *Denver*, 824 P.2d at 1213.

that a breach of ethical duties may result in denial or disgorgement of fees is well recognized.”<sup>135</sup> “Disgorgement of fees is a reasonable way to ‘discipline specific breaches of professional responsibility and to deter future misconduct of a similar type.’”<sup>136</sup>

The court’s reasoning is sound. Breach of a fiduciary obligation or disloyalty to a client is conduct quite different from mere malpractice.<sup>137</sup> Malpractice<sup>138</sup> denotes negligence not intentional conduct. Carelessness is a lesser offense than intentional conduct. Denver’s conduct was a breach of his duty of loyalty.<sup>139</sup> He chose to favor one class of clients over another.<sup>140</sup> He chose to disclose his conflict of interest to the promoters, but not the investors.<sup>141</sup> Such decisions were not made inadvertently. The trial court knew the difference between malpractice and breach of fiduciary duty.<sup>142</sup> The malpractice and negligence claims were to be tried in phase 2 of the trial.<sup>143</sup>

In *Smith v. Mehaffy*,<sup>144</sup> the plaintiff, W. Dean Smith, sued his attorney in a legal malpractice action. The plaintiff won a jury verdict, although the trial court denied his request for attorney fees.<sup>145</sup> Smith and his partner terminated a business relationship.<sup>146</sup> They had signed personal guaranties to various creditors. Smith and his partner retained John R. Mehaffy, and Martin & Mehaffy, LLC to represent them in connection with the severance of their business relationship.<sup>147</sup> Smith testified that he told Mehaffy that he had sent out notices of revocation on his personal behalf to the old business’s creditors by first class

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135. *Id.*

136. *Id.* (quoting *In re E. Sugar Antitrust Litig.*, 697 F.2d 524, 533 (3d Cir. 1982)).

137. *Boyd v. Garvert*, 9 P.3d 1161, 1163 (2000). The *Boyd* court found that, in that case, “the duties and the facts supporting the two claims were not the same.” *Id.* “In the professional negligence claim, the duty the attorney owed to her clients was that of a reasonably careful attorney,” objectively “measured against what an attorney would have done under the same or similar circumstances, using the knowledge and skill of attorneys practicing at the same time, in the same community.” *Id.* The court explained that “the breach alleged in the professional negligence claim was attorney’s failure to advise plaintiffs of the availability of relinquishment counseling.” *Id.* Therefore, “the alleged breach of fiduciary duty was based on an assertion of attorney’s self-interest and conflict of interest.” *Id.*

138. *See Tyson v. Moore*, 613 So.2d 817, 823 (Miss.1993) (classifying a claim based on “breach of the duty of loyalty [as] a species of malpractice”).

139. *Denver*, 824 P.2d at 1212.

140. *Id.*

141. *Id.*

142. *Denver*, 824 P.2d at 1213.

143. *Id.*

144. *Smith v. Mehaffy*, 30 P.3d 727 (Colo. App. 2000).

145. *Id.*

146. *Id.* at 729.

147. *Id.* at 729.

mail.<sup>148</sup> He then asked Mehaffy if certified mail was necessary.<sup>149</sup> Mehaffy said certified mail was not necessary, because “notice is notice.”<sup>150</sup> Mehaffy did not recall giving Smith that advice.<sup>151</sup> Smith’s former partner defaulted on some of the business debts and filed for bankruptcy.<sup>152</sup> Smith retained a different attorney to defend himself against the creditors’ claims, but he lacked any evidence to prove that he had sent the notices.<sup>153</sup> Smith settled the claim and then sued Mehaffy and his firm for malpractice.<sup>154</sup> The trial court granted a directed verdict on the issue of negligence, and held that Smith’s settlement with his creditors was prudent under the circumstances.<sup>155</sup> The major issue before the appellate court was whether the plaintiff was entitled to attorney fees.<sup>156</sup> Under Colorado law a claim for attorney fees would be proper if the suit was brought against a fiduciary for breach of trust.<sup>157</sup>

The Colorado Court of Appeals analyzed this issue correctly. The court acknowledged that the attorney-client relationship involved a fiduciary relationship.<sup>158</sup> The court rejected the contention that every plaintiff in a legal malpractice action is entitled to attorney fees under the breach of fiduciary exception to the American Rule.<sup>159</sup> The court stated, “[l]egal malpractice is a generic term for at least three distinct causes of action available to clients who suffer damages because of their lawyers’ misbehavior.”<sup>160</sup> The court listed the three causes of action as (1) breach of contract, (2) breach of fiduciary duty, and (3) negligence.<sup>161</sup> The court carefully distinguished a breach of the duty of loyalty from mere negligence: “Legal malpractice actions based on negligence concern violations of a standard of care, whereas legal malpractice actions based on breach of fiduciary duty concern violations of a standard of conduct.”<sup>162</sup> The court cited a treatise for this

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148. *Id.*

149. *Smith*, 30 P.3d at 729.

150. *Id.*

151. *Id.*

152. *Smith*, 30 P.3d at 729.

153. *Id.*

154. *Id.*

155. *Id.* at 730.

156. *Smith*, 30 P.3d. at 732.

157. *Id.* at 733.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Smith*, 30 P.3d. at 733.

162. *Id.*

distinction.<sup>163</sup> The court was clearly correct in its analysis, but the phrase, “standard of conduct”<sup>164</sup> is somewhat ambiguous. From the context of the case, the court really meant to say “duty of loyalty” rather than “standard of conduct.” The court’s distinction is clearly based on the distinction between mere negligence as opposed to intentional behavior. The court points out that Mehaffy’s conduct was mere negligence, the failure to advise on the proper method of giving notice, and that there was no evidence at all of breach of standard of conduct, “such as the duty of undivided loyalty or confidentiality. . . .”<sup>165</sup>

A lawsuit against an attorney based on a breach of the duty of loyalty may not require the element of proximate cause if the plaintiff seeks only fee disgorgement. In *Hendry v. Pelland*,<sup>166</sup> three clients sued their former attorney and law firm for punitive damages, compensatory damages, and disgorgement of legal fees.<sup>167</sup> The plaintiffs’ claims were based on breach of fiduciary duty, and they sought compensatory and punitive damages.<sup>168</sup> The district court granted Pelland’s motion for judgment as a matter of law on punitive damages.<sup>169</sup> The district court granted Pelland’s motion for judgment as a matter of law on both fiduciary counts as well.<sup>170</sup> The Hendrys appealed these rulings.<sup>171</sup> On appeal, the appellate court agreed with the district court as to the claim for punitive damages.<sup>172</sup> The standard was “fraud, ill will, recklessness, wantonness, oppressiveness, or willful disregard of the client’s rights.”<sup>173</sup> The allegations of the Hendrys fell far short of this standard.<sup>174</sup> As to the fiduciary duty question, the appellate court concluded that Pelland had violated his duty of loyalty.<sup>175</sup> There were five members of the Hendry family, the mother, her son and daughter, and the daughter’s infant children.<sup>176</sup> Pelland was in the impossible

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163. *Id.* (citing ROBERT E. MALLIN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 14.2 (4<sup>th</sup> ed. 1996))

164. *Smith*, 30 P.3d. at 734.

165. *Id.*

166. *Hendry v. Pelland*, 73 F.3d 397 (D.C. Cir. 1996).

167. *Id.* at 398.

168. *Id.*

169. *Hendry*, 73 F.3d 397 at 400.

170. *Id.*

171. *Id.*

172. *Id.*

173. *Hendry v. Pelland*, 73 F.3d 397, 400 (quoting *Dalo v. Kwitz*, 596 A.2d. 35, 41 & n.15 (D.C. 1991), quoting in turn *Washington Medical Ctr., Inc. v. Holle*, 573 A.2d. 1269, 1284 (D.C. 1990) (internal quotation marks omitted)).

174. *Id.*

175. *Id.* at 401.

176. *Id.*

position of representing parties with conflicting interests.<sup>177</sup> The mother wanted to keep a house on the land.<sup>178</sup> The son and daughter wanted to protect the trees on the land, and the grandchildren had an interest in maximizing the long term value of the land.<sup>179</sup> Pelland never discussed these conflicts with the Hendrys.<sup>180</sup> The court considered this evidence sufficient to go to the jury.<sup>181</sup> The court agreed with the Hendrys that they needed to prove only that Pelland had breached his duty of loyalty.<sup>182</sup> The Hendrys did not have to prove proximate cause.<sup>183</sup> If the Hendrys sought compensatory damages, proximate cause was a required element.<sup>184</sup> The court cited case law and the Restatement (Second) of Agency § 469 cmt. a (1958). It is important to note that the court assumed that the attorney was an agent, and therefore, the law of agency applied.<sup>185</sup> The ordinary agency rule in § 469 requires a disloyal agent to forfeit compensation.<sup>186</sup> The court gives several reasons for distinguishing between compensatory damages and forfeiture of fees.<sup>187</sup> First, fee forfeiture deters attorney misconduct.<sup>188</sup> Second, it ensures that fiduciaries do not profit from their disloyalty.<sup>189</sup> Third, the representation provided is of decreased value.<sup>190</sup>

*D. The problem of duplicativeness.*

In *Resolution Trust Company v. Holland & Knight*,<sup>191</sup> the RTC sued Holland & Knight, a law firm, on two separate counts. Count I alleged Legal Malpractice-Negligence, and Count II alleged Breach of Fiduciary Duty.<sup>192</sup> The RTC claimed that Holland & Knight was both incompetent and disloyal in its representation of CenTrust.<sup>193</sup> The RTC alleged that

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177. *Id.*

178. *Hendry*, 73 F.3d 397 at 400.

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Hendry*, 73 F.3d 397 at 400.

184. *Id.*

185. *Id.* at 402. The court cited case law and the RESTATEMENT (SECOND) OF AGENCY § 469 cmt a (1958)).

186. *Hendry*, 73 F.3d 397 at 402.

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

191. *Resolution Trust Co. v. Holland & Knight*, 832 F. Supp. 1528 (S.D. Fla. 1993).

192. *Id.*

193. *Id.* at 1530.

Holland & Knight misconstrued a guaranty agreement, overvalued assets and failed to discover the personal liability of Mr. Paul under the guaranty agreement.<sup>194</sup> David Paul was the principal shareholder and Chairman of the Board of Directors of Centrust's predecessor.<sup>195</sup> Count I thus was based on a theory of duty of care. Count II alleged that Holland & Knight breached its duty of loyalty to Centrust by favoring Paul's interests over Centrust's.<sup>196</sup> Holland & Knight sought dismissal of Count II on the grounds that it was duplicative of Count I.<sup>197</sup> The theory of Holland & Knight was that the sole cause of an action against an attorney was legal malpractice, and that such action included breach of fiduciary duty.<sup>198</sup> The court disagreed and quoted a treatise<sup>199</sup> to the effect that the breach of fiduciary duty is distinct and independent from professional negligence, but still legal malpractice. The court then cited the *Martin*<sup>200</sup> case in which an attorney was alleged to have violated his fiduciary duty by failing to disclose material information that the firm was aware of. The *Martin* decision<sup>201</sup> permitted the plaintiff to plead both malpractice theories: breach of the duty of care, and breach of fiduciary duty. The court in Resolution Trust Corporation followed *Martin* and concluded that the two counts did not duplicate each other, "[r]ather, the counts represent[ed] two distinct theories of malpractice pled in the alternative. . . ."<sup>202</sup>

The disturbing language in the court's opinion is the reference to pleading in the alternative. It certainly is possible for a law firm to commit breach both the duty of care and the duty of loyalty. On the facts of this case, Holland & Knight may have misconstrued the guaranty as a result of mere incompetence. Or the failure to discover Paul's personal liability may not have been a failure, but a conscious decision by the firm to favor Paul over Centrust. If this were the case, the court is correct; it's either one option or the other, so pleading in the alternative should be permitted.

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194. *Id.* at 1530.

195. *Id.*

196. *Resolution Trust Co.*, 832 F. Supp. at 1530.

197. *Id.*

198. *Id.*

199. *Id.* at 1531 (quoting ROBERT E. MALLIN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 11.1 (3d ed. 1989)).

200. *FDIC v. Martin*, 801 F. Supp. 617 (M.D. Fla.1992).

201. *Id.* at 620. The court stated that, "The elements of a legal malpractice cause of action are the attorney's employment and his neglect of a reasonable duty which proximately causes a loss to his client." *Id.* (citation omitted). It also stated that a lawyer has an implicit duty to inform his or her client of matters material to the representation. *Id.* (citation omitted).

202. *Resolution Trust Corp.*, 832 F. Supp. at 1533.

However, what if Holland & Knight was simply careless, and mere incompetence is what caused the failure to discover the guaranty? That conduct should be a breach of the duty of care. Assume some time goes by and Holland & Knight learns of its own negligence. If the firm decides not to notify the Centrust special committee, that decision would be a breach of the duty of loyalty. In those circumstances, the court's decision tells us nothing. Does the Resolution Trust Corporation now have two causes of action? It should. Are those two causes of action essentially the same? They should not be so considered since there are two different acts, and the negligent act is far different from the intentional act. Disloyalty deserves greater punishment than mere incompetence.

#### *E. Proximate cause and Legal Malpractice*

Some courts state that legal malpractice includes negligence as well as breach of fiduciary duty (duty of loyalty), but the problem of this terminology is that the next step is to treat duty of care cases and duty of loyalty cases alike.<sup>203</sup> Whether the element of proximate cause should be required for both negligence and disloyalty is at stake. Proximate cause is a negligence concept and should be a required element of a duty of care case. Proximate cause should not be required in a duty of loyalty case.<sup>204</sup> *Kilpatrick v. Wiley*<sup>205</sup> is a case that discusses this issue.

The plaintiffs in *Kilpatrick* were plaintiffs in a general partnership, Mountain West Television Company ("MWTC"), formed for the purpose of obtaining an FCC license for a new VHF television station.<sup>206</sup>

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203. Robert E. Mallen & Jeffrey M. Smith endorse this conclusion in their influential treatise (LEGAL MALPRACTICE § 14.4 (5<sup>th</sup> ed. 2000)). The authors stated that "the standard of care concerns negligence and the standard of conduct concerns a breach of loyalty or confidentiality. This approach uses the model for negligence, substituting the particular fiduciary obligations for the duty of care. Thereby, rules of causation, damages and the burden of proof remain the same." *Id.* (footnotes omitted). Although Mallen & Smith draw the distinction between negligence and breach of duty of care, they give no persuasive reasons why the rules of causation should be identical. *See id.*

204. *See Duncan*, 34 WAKE FOREST L. REV. at 1154-55. The article states that there is no causation requirement. *Id.* (citing n.111, HAZARD & HODES, THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT § 1.5:108 (2d ed. Supp. 1997)). The reason is that the breach of loyalty is the harm. *Id.*

205. *Kilpatrick v. Wiley*, 909 P.2d 1283 (Utah Ct.App.1996). The decision of the Court of Appeals was reversed and remanded by the Supreme Court of Utah, 37 P.3d 1130 (Utah 2001). Among the errors committed by the trial court was the grant of plaintiffs' motion for a partial directed verdict. *Id.* at 1139. The Supreme Court held that the grant of the motion was improper because the wrong legal standard was used. *Id.*

206. *Kilpatrick*, 909 P.2d at 1286.

MWTC was ranked second of the five applicants.<sup>207</sup> MWTC eventually decided to buy out its four competing applicants.<sup>208</sup> In early 1986, the defendant law firm represented another client with an interest in the new TV license, Northstar Communications (“Northstar”).<sup>209</sup> Northstar was owned by the Allstate Insurance Company.<sup>210</sup> According to the allegations of the plaintiffs, the defendant law firm chose to represent Northstar because it was the more lucrative client. The law firm attempted to obtain consent from MWTC but failed to obtain it.<sup>211</sup> One of the partners refused and two of the partners were never contacted.<sup>212</sup> The law firm negotiated on behalf of the plaintiffs in regard to certain financing proposals.<sup>213</sup> The law firm also represented both MWTC and Northstar when the two partnerships formed a limited partnership.<sup>214</sup>

The plaintiffs eventually brought suit against the defendants claiming breach of fiduciary duty.<sup>215</sup> The trial court granted a partial directed verdict on the ground that plaintiffs had failed to prove that the breach of fiduciary duty proximately caused any damage to plaintiffs.<sup>216</sup> The Court of Appeals reversed since there was sufficient evidence for the plaintiffs to go to the jury.<sup>217</sup> The Court of Appeals held that “the standard of causation for legal malpractice is the same regardless of whether the cause of action was based on contract, breach of fiduciary duty, or negligence.”<sup>218</sup> The plaintiffs had contended that a lesser standard of causation should be applied, relying on *Milbank, Tweed, Hadley & McCloy v. Boon*.<sup>219</sup> One reason the Court of Appeals rejected that argument is because the plaintiffs had failed to show that the lesser standard (substantial factor test) was any different from the “established standard of causation in Utah.”<sup>220</sup> Further, the Court of Appeals cited a treatise<sup>221</sup> that states that the same proximate cause standard should

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207. *Id.*

208. *Id.*

209. *Id.*

210. *Id.*

211. *Kilpatrick*, 909 P.2d at 1286.

212. *Id.* at 1287.

213. *Id.*

214. *Id.* at 1288.

215. *Id.*, at 1289.

216. *Kilpatrick*, 909 P.2d at 1289.

217. *Id.* at 1293.

218. *Id.*

219. *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537, 543 (2d Cir. 1994).

220. *Kilpatrick*, 909 P.2d at 1291.

221. 1 MALLEN & SMITH, LEGAL MALPRACTICE § 8.3.

apply to breaches of fiduciary duty as to duty of care cases.<sup>222</sup> In *Milbank*<sup>223</sup> the court relied on the reasoning of an agency case, *ABKCO Music, Inc. v. Harrisongs Music, Ltd.*<sup>224</sup> The *ABKCO* case involved a situation in which a former agent used confidential information to benefit itself at the expense of the former principal. The agent contended that a breach of fiduciary duty required proximate cause.<sup>225</sup> The *ABKCO* court rejected that contention.<sup>226</sup> The court stated that “[a]n action for breach of fiduciary duty is a prophylactic rule intended to remove all incentive to breach—not simply to compensate for damages in the event of a breach.”<sup>227</sup>

The *Milbank* case was similar, but it involved a client and attorney. In *Milbank*, the law firm of Milbank, Tweed, Hadley & McCloy, (“*Milbank*”) represented Mrs. Leo. *Milbank* subsequently represented Chan, Mrs. Leo’s agent. *Milbank* failed to get Mrs. Leo’s consent to its representation of Chan.<sup>228</sup> Mrs. Leo was interested in acquiring a Swiss bank.<sup>229</sup> The acquisition of the bank was to be accomplished in two stages. The first required that Mrs. Leo place \$8.5 million in escrow.<sup>230</sup> Deak & Co. owned the Swiss bank, but Deak was in Chapter 11. The two stage agreement provided that Mrs. Leo would get the \$8.5 million back if she was not the successful purchaser in the second stage.<sup>231</sup> Deak could not solicit competing bids.<sup>232</sup> However, Mrs. Leo came to doubt Chan’s true intentions, and terminated the agency.<sup>233</sup> The *Milbank* firm began to represent Chan without the consent of Mrs. Leo, despite the fact that Mrs. Leo’s attorney advised *Milbank* that she had never given consent for *Milbank* to represent Chan.<sup>234</sup> The second stage assets were ultimately sold to Chan for \$10.5 million. The trial jury found for Mrs. Leo on the theory that *Milbank* had breached its fiduciary duty, and awarded Mrs. Leo \$2 million in damages.<sup>235</sup> The Court of Appeals upheld the verdict for Mrs. Leo, finding that “*Milbank*’s representation

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222. *Kilpatrick*, 909 P.2d at 1291.

223. *Milbank*, 13 F.3d 537.

224. *ABKCO Music, Inc. v. Harrisongs Music, Ltd.*, 722 F.2d 988 (2d Cir. 1983).

225. *Id.* at 995.

226. *Id.*

227. *Id.* at 995-996.

228. *Milbank*, 13 F.3d at 539.

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.*

233. *Milbank*, 13 F.3d at 540.

234. *Id.* at 541.

235. *Id.* at 542.

of Chan was a substantial factor in preventing Mrs. Leo from acquiring the second stage assets.<sup>236</sup> Milbank's conduct also interfered with Mrs. Leo's negotiating posture.<sup>237</sup> The Milbank decision is clearly consistent with *Mothew*.<sup>238</sup> The court in *Milbank* clearly recognized that this was a breach of loyalty, and thus, the rules of duty of care do not apply. Proximate cause is a negligence concept and is irrelevant to duty of loyalty cases. Although there are many cases that require proximate cause as an element for legal malpractice, *Milbank* is better reasoned. The substantial factor test enunciated in *Milbank* is a sensible compromise.<sup>239</sup> Indeed, the reasoning of *Mothew* suggests that neither proximate cause nor the substantial factor test is necessary in a duty of loyalty case.

### III. CONCLUSION

The conflation of negligence (duty of care) and intent (duty of loyalty) began by the Delaware Supreme Court should be condemned, because it destroys clear legal concepts and substitutes vague terminology. The *Mothew* decision should be seen as a lodestar that leads toward clarity and precision. The muddled state of the law of fiduciary breach can be improved if the courts realize that negligence and intent are quite different concepts.

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236. *Id.* at 543.

237. *Id.* at 544.

238. *See generally* Bristol & W. Bldg. Soc'y v. Mothew, 1998 Ch.1 (Eng. C.A.).

239. *Milbank*, 13 F.3d at 543.