

LITIGATION REVIEW

UP-TO-DATE ANALYSIS FOR CLIENTS AND FRIENDS OF THE FIRM

Transactional Malpractice

Causation

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When a lawyer is negligent in representing his or her client, the lawyer may be required to pay the client the damages caused by his or her negligence. Yet, determining what damages were “caused” by the lawyer’s negligence is not a simple task.

If a lawyer negligently represents a client in litigation, the courts usually require the client to prove that “but for’ the attorneys’ negligence, the client would have successfully defended or prosecuted the underlying suit.” Bartholomew v. Crockett, 131 Ill. App. 3d 456, 465, 475 N.E.2d 1035, 1041 (1st Dist. 1985). In other words, if a lawyer is negligent, but the case would have been lost even if the lawyer had provided top-notch service, the lawyer’s negligence did not cause the client’s loss. As is frequently stated, to establish causation, a malpractice plaintiff must prevail on the “case-within-a-case.” E.g., Claire Associates v. Pontikes, 151 Ill. App. 3d 116, 122, 502 N.E.2d 1186, 1190 (1st Dist. 1986).

The “case-within-a-case” formulation is so common that some courts write as if a malpractice plaintiff must prevail on its case within a case. E.g., Sheppard v. Krol, 218 Ill. App. 3d 254, 257, 578 N.E.2d 212, 214 (1st Dist. 1991) (“plaintiff is essentially required to prove a case-within-a-case”). This, however, cannot be correct because not all malpractice involves litigation.¹ Lawyers are frequently called on to advise their clients in transactional and other non-litigation contexts. In such settings, there is

usually no case within the malpractice case to win.

Surprisingly, little attention has been paid to the question of how a client can prove that a lawyer’s negligence “caused” damage in a transactional setting. It is clear, however, that causation must be proved in transactional malpractice contexts. For example, in Alper v. Altheimer & Gray, 65 F. Supp. 2d 778 (N.D. Ill. 1999), the court addressed a transactional malpractice case that it recognized “does not conform to the typical case-within-a-case model of malpractice litigation.” Id. at 785. There, the plaintiffs claimed that they did not wish to sell their entire business, but their lawyers drafted transactional documents that resulted in the entire business being sold. The clients sued the buyer alleging fraud and brought a separate suit against their law firm. The law firm argued that it could not be said that the clients had suffered damage until the case against the buyer was resolved. The court rejected that argument:

In sum, Defendants have not produced, and the court has not uncovered, a case in which 1) the underlying transaction or proceeding for which the attorneys were retained is complete, 2) the plaintiff has adduced evidence of a breach of duty and damages, 3) the plaintiff has at some point advanced more than one theory of causation, and 4) the court has held that the plaintiff cannot recover from the attorneys for negligence until they have exhausted other potentially viable causes of action to recover their loss. The court does not perceive a sound policy rationale for forcing a plaintiff to sue all other potentially responsible defendants before suing their attorneys; indeed, in oral argument Defendants’ counsel allowed

¹ Even in litigation-related malpractice, exceptions to the case within a case formula have been recognized in unusual situations. E.g., Interclaim Holdings Ltd. v. Ness, Motley, Loadholt, Richardson & Poole, 298 F. Supp. 2d 746, 756 (N.D. Ill. 2004) (damages based on lost value of confidential information; court concludes that case “does not present the typical situation in which the plaintiff asserts a ‘case-within-a-case’”).

that such a hard-and-fast rule would be “nutty.”
Id. at 787.

Thus, Alper rejected the notion that there must always be a case within a case. In Alper, however, the court did not address how damages could be proved.

In Peters v. Barrett, Twomey, Morris & Broom, 190 Ill. App. 3d 709, 546 N.E.2d 1099 (5th Dist. 1989), the Illinois Appellate Court addressed transactional malpractice causation. In Peters, an attorney represented the sellers of a marina. In connection with the sale, he filed defective financing statements on behalf of his clients. Subsequently, the attorney ceased representing the sellers and another attorney represented them. During the second attorney’s tenure, the defective financing statements lapsed. When the purchaser of the marina petitioned for bankruptcy, the sellers were deemed unsecured creditors because of the lapsed and defective financing statements. The seller sued the first attorney for filing defective statements and the second attorney for failing to file continuation statements. The Appellate Court affirmed a grant of summary judgment in favor of the first attorney. The court held that the first attorney did not cause the sellers’ unsecured status by filing defective statements:

Plaintiffs cannot say, however, but for the alleged negligence of [the first attorney] they would have been secured creditors in the bankruptcy proceedings. Even if the original statements had been letter perfect, plaintiffs still would be unsecured because the statements were allowed to lapse. 190 Ill. App. 3d at 711, 546 N.E.2d at 1100.

Thus, because they could not prove causation, the sellers lost their transactional malpractice case.²

In Glass v. Pitler, 276 Ill. App. 3d 344, 657 N.E.2d 1075 (1st Dist. 1995), the Illinois Court of Appeals dealt with an interesting transactional malpractice causation issue that, in a sense, did involve a case within a case. In 1984, a husband and wife started a business and were assured by their attorneys that their ERISA pension plan assets would not be subject to their business creditors’ claims. This advice was problematic because the law on that subject was, in fact, unsettled.

In 1988, the business suffered reverses and lenders brought suit against the husband and wife, who had personally guaranteed loans. The husband and wife consulted a bankruptcy attorney who advised them -- contrary to their first attorney’s advice -- that if they filed for bankruptcy relief, their ERISA pension fund would be subject to their creditors’ claims. As a result, the husband and wife settled the lenders’ claims and used their pension plan’s assets to fund the settlement.

The husband and wife then sued the first attorney who had advised them that their pension fund assets were not subject to their creditors’ claims. They argued that they would not have started their new business “but for” the lawyer’s advice that their pension assets were safe from creditors’ claims.

The case turned on whether the husband and wife could prove that the first attorney’s advice caused their losses. After rejecting the argument that the plaintiffs could not recover because they settled with their creditors, the Appellate Court addressed the uncertainty of the law regarding ERISA pension plans and creditors’ claims. Prior to 1992, there was disagreement among the United States Courts of Appeals whether ERISA pension fund assets were included or excluded from a debtor’s bankruptcy estate. It was not until 1992 that the United States Supreme Court

² The Peters court was faced with a situation where there were multiple causes of the plaintiff’s loss. In reality, the first and second attorneys both were negligent. Under the Peters court’s “but for” analysis, however, they both escaped liability because each attorney could blame the other attorney’s negligence for causing the loss and say that, even if he had acted properly, the loss would still have occurred. Note that each attorney’s negligence would have been sufficient to cause the seller’s loss -- if the other attorney had not also been negligent. This situation points out a difficulty with “but for” causation, but that issue is not unique to transactional malpractice and is beyond the scope of this article.

decided Patterson v. Shumate, 504 U.S. 753 (1992), and held that ERISA pension plans were excluded from debtor's bankruptcy estates.

In the Glass malpractice case, the Appellate Court held that, as a matter of law, the plaintiffs could not prove that they suffered damage caused by their lawyer's advice that their pension assets were not subject to creditor's claims:

Due to the conflicting case law on that issue, the plaintiffs could not establish with any degree of certainty that they would have lost their pension funds had they filed a petition for bankruptcy in 1989. 276 Ill. App. 3d at 352, 657 N.E.2d at 1080.

Further, the court refused to allow plaintiffs to attempt to prove how the "case-within-a-case" would have been resolved:

While every legal malpractice case requiring proof of the 'case-within-the-case' deals in some degree of speculation as to what the damages in the underlying claim would have been absent the attorney misconduct, the speculation required here is overwhelming. Added to the trial court's quandary was the fact that the court would not be called upon to ascertain the correct rule of law to be applied (as subsequently determined by the United States Supreme Court in Patterson v. Shumate (1992), 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519) but, rather to predict how a bankruptcy court judge would have viewed the law in light of existent conflicting and nonbinding case law. Ordinarily, in attempting to determine what law a particular court would have followed, it would be sufficient to determine what the correct law is. In other words, it could ordinarily be presumed that what would be followed would be the correct law. However, in the case sub judice, we are asked not to make such a presumption but to determine whether the bankruptcy court in our venue would have aligned

itself with the decisions of its sister courts in In re Di Piazza and In re Dagnall, characterized as the majority view (see In re Dagnall), and adopted the statutory interpretation ultimately repudiated by the United States Supreme Court in Patterson. 276 Ill. App. 3d at 354, 657 N.E.2d at 1081-82.

As a result, despite the lawyer's failure to properly advise the client that the law was unsettled, the Court refused to allow plaintiffs to attempt to prove that the attorney's bad advice caused them to lose their pension funds.

UNANSWERED QUESTIONS

Although it is clear that causation must be established in a transactional malpractice case, transactional malpractice raises a variety of questions that Illinois courts have not resolved. For example, if a client claims that a lawyer's bad advice led it to agree to a deal that did not contain certain provisions the client would have insisted on if it had been properly advised, must the client establish that the other side to the transaction would have agreed to the revised deal that the client now says it would have wanted? In other words, does the client have to prove that it would have "won" the "negotiation within a negotiation?" Is such a claim too speculative, just as the court found the malpractice claim to be in Glass? Another interesting question is whether, if the client understood and agreed to the "bad" deal, does its agreement to the bad deal break the causal chain? Both of these questions have been approached but not resolved, by Illinois courts.

THE DEAL WITHIN A DEAL

Whether and how a malpractice plaintiff must prove that it would have "won" the negotiation within a negotiation raises a host of interesting questions that have not been addressed in Illinois. For example, it would seem reasonable to assume that, in most negotiations, all sides are attempting to obtain the best possible deal for themselves. The final agreement presumably represents what all sides thought was the best deal they could make at the time. Assume, however, that after the deal is done,

a malpractice plaintiff says it would have asked for and received “provision X” if it had been better advised. If provision X is costless to the other side of the deal, it might be reasonable to assume that provision X would have been agreed to. But what if provision X would impose a cost on the other side? Presumably, provision X would not have been agreed to unless the malpractice plaintiff gave up something else or otherwise paid for provision X. In an actual negotiation, the perceived value of provision X to the malpractice plaintiff and its perceived cost to the other side would interact and determine whether it was included in the deal. Thus, predicting the outcome of a negotiation is complicated.

Despite the importance of the negotiation within a negotiation issue to cases of transactional malpractice, few Illinois cases have addressed it.

In *York v. Stiefel*, 109 Ill. App. 3d 342, 440 N.E.2d 440 (3d Dist. 1982), the Appellate Court held that the plaintiff had provided inadequate evidence of causation, but the Supreme Court reversed. 99 Ill. 2d 312, 458 N.E.2d 488 (1983). *York* involved an auto dealership that had borrowed money from a lender. The lender discovered that the dealership had been selling cars without remitting proceeds to the lender, as required by the dealership’s loan documents. The lender threatened to close the dealership unless the dealership’s owners gave the dealership second mortgages on their homes. Allegedly without reading the relevant documents, the dealership’s attorney advised the owners to execute the mortgages because they already were personally liable for the debt anyway. That advice was incorrect. When the dealership failed, the owners sued their lawyer for malpractice because they had personally assumed debt that they allegedly would not have assumed had he reviewed the relevant documents and determined that they were not already personally liable for the debt. A jury found in favor of the plaintiffs.

The Appellate Court reversed the judgment. It found that there was no evidence that the lawyer’s negligence (not reading the relevant documents) caused plaintiffs’ loss. The court noted that there was no evidence as to the negotiation

within a negotiation, and indeed, the plaintiff’s expert:

could not say that an examination of the documents would have made any difference. No testimony was offered that there was a causal relationship between the only alleged act of negligence supported by expert testimony and the damages suffered by plaintiffs. 109 Ill. App. 3d at 351, 440 N.E.2d at 447.

The Appellate Court’s decision was based on the argument that the dealership’s owners might have agreed to sign the mortgages, even if they knew they were not already personally liable. The Appellate Court noted that the dealership’s owners wanted to orderly liquidate the dealership themselves, rather than have it shut down by the lender and its assets sold at a distress sale. They also wanted to avoid criminal sanctions for converting the proceeds of secured goods. *Id.* Thus, according to the Appellate Court:

The fact that plaintiffs’ experts were unable to testify that had the defendant [lawyer] chosen an alternative course of action the result would have been different negates the requisite proximate cause which must exist for a recovery to occur. 109 Ill. App. 3d at 352, 440 N.E.2d at 447.

In effect, the Appellate Court asked the plaintiffs to prove that, if they had been given proper advice, they would have won the negotiation and not personally guaranteed the debt. The Appellate Court held that Plaintiffs had produced no evidence on this point.

The Supreme Court reversed. It held:

The appellate court erred in reversing the judgment for [plaintiff] on the ground of insufficient evidence. There was expert testimony for [plaintiff] that it was a violation of the required standard of care for the defendant to give the advice concerned without consulting the

. . . documents. The advice the defendant gave, and [plaintiffs] decision to follow it, were both based upon the erroneous assumption that under the [documents plaintiff] had already assumed a personal liability. The damage to York that was alleged was this assumption of a corporate debt. The verdict of the jury in favor of plaintiff should stand. 99 Ill. 2d 312, 321, 458 N.E.2d 488, 493.

Notably, while the Appellate Court held that there was “no testimony” of a causal relationship between the defendant’s negligence and the plaintiff’s damages, the Supreme Court noted that plaintiffs’ decision to follow the defendant’s advice was based upon the assumption that they already were personally liable. It is not clear from the decision, but this may mean that the plaintiffs testified: “if the defendant had not told us we were already subject to personal liability, we would not have signed the mortgages.” On the other hand, it may mean that the Supreme Court inferred as much without any actual testimony. In short, it is unclear whether the Supreme Court relied on evidence the Appellate Court missed, or whether the Supreme Court was willing to infer the existence of causation where the Appellate Court was not.

The negotiation within a negotiation issue also was partially addressed in Horn v. Croegaert, 187 Ill. App. 3d 53, 542 N.E.2d 1124 (5th Dist. 1989). There, plaintiff alleged that she would have insisted on a written business deal with her partner but for her lawyer’s advice that “You can’t get an oil man to sign anything in writing. They can’t read.” 187 Ill. App. 3d at 54, 542 N.E.2d at 1125.

The Circuit Court granted summary judgment for the defendant lawyer and the Appellate Court reversed. As to the question of whether the plaintiff could have gotten a written agreement with her partner, the court held that “it is for a jury to decide if she would have gotten a written agreement had she pursued one.” 187 Ill. App. 3d at 57,

542 N.E.2d at 1126. Thus, the Appellate Court recognized the need for proof of proximate cause and would apparently have required the plaintiff to offer proof that she would have won the negotiation within a negotiation and gotten her partner to sign an agreement. Interestingly, the Appellate Court did not address the question of how the plaintiff could prove beyond speculation whether she would have gotten a written agreement and what that agreement would have said.

The California Supreme Court has specifically addressed the negotiation within a negotiation question. In Viner v. Sweet, 30 Cal. 4th 1232, 70 P. 3d 1046 (2003), the California Supreme Court reversed an appellate court decision that a transactional malpractice plaintiff need not prove “but for” causation:

The Court of Appeal here held that a plaintiff suing an attorney for transactional malpractice need not show that the harm would not have occurred in the absence of the attorney’s negligence. We disagree. We see nothing distinctive about transactional malpractice that would justify a relaxation of, or departure from, the well-established requirement in negligence cases that the plaintiff establish causation by showing either (1) but for the negligence, the harm would not have occurred, or (2) the negligence was a concurrent independent cause of the harm.³ 30 Cal. 4th at 1240-41, 70 P.3d at 1051.

The Viner court then addressed the difficulties of proving “but for” causation in a transactional setting. It held that a transactional malpractice plaintiff must (and can) prove how the negotiation within a negotiation would have concluded:

The Viners also contend that the “but for” test of causation should not apply to transactional

³ In California, in situations where there are multiple sufficient causes of loss -- as in Peters (see note 2, supra) -- the plaintiff is only required to prove that the negligence was a concurrent independent cause of harm.

malpractice cases because it is too difficult to obtain the evidence needed to satisfy this standard of proof. In particular, they argue that proving causation under the “but for” test would require them to obtain the testimony of the other parties to the transaction, who have since become their adversaries, to the effect that they would have given the Viners more favorable terms had the Viners’ attorneys not performed negligently. Not so. In transactional malpractice cases, as in other cases, the plaintiff may use circumstantial evidence to satisfy his or her burden. An express concession by the other parties to the negotiation that they would have accepted other or additional terms is not necessary. 30 Cal. 4th at 1242-43, 70 P.3d at 1053.

Similarly, in Hazel & Thomas, P.C. v. Yavais, 251 Va. 162, 167, 465 S.E. 2d 812, 815 (1996), the Virginia Supreme court required proof of the deal within a deal. It reversed a judgment in favor of a malpractice plaintiff in part because there was no evidence on this issue:

Furthermore, [plaintiff-buyer] is unable to point to any evidence that [seller] would have agreed to bind himself to obtain his lien creditors’ unconditional consent to extend the maturity dates on his preexisting notes to match the maturity date on [plaintiff-buyer’s] purchase money note. More importantly [plaintiff-buyer] never testified that he would not have signed the contract without the inclusion of the two provisions specified above had his attorney insisted on them and had [seller] refused to agree to them. 251 Va. at 167, 465 S.E. 2d at 815.

See also Cannata v. Wiener, 173 Vt. 528, 530, 789 A.2d 936, 939 (2001) (affirming denial of transactional malpractice claim because plaintiff failed to prove that “there were avenues for plaintiff to explore that were left uncharted because of [his attorney’s] advice”).

EFFECT OF PLAINTIFF’S AGREEMENT TO DEAL

There are other interesting questions that arise in the context of transactional malpractice. In Georgia, there is authority for the proposition that a client who knowingly signs a document breaks the causal chain between the attorney’s negligence and damages. In Berman v. Rubin, 138 Ga. App. 849, 227 S.E.2d 802 (1976), a client alleged that his attorney negligently advised him regarding the terms of a divorce settlement agreement. The court held that because the client was educated and the agreement was not complicated, his signature broke the causal link between the attorneys’ negligence and any damage. The court held:

Our decision should not be read to state or imply that an attorney may not be held responsible for his negligent draftsmanship whenever the client can or does read the document. Indeed, where the document requires substantive or procedural knowledge, is ambiguous, or is of uncertain application, the attorney may well be liable for negligence, notwithstanding the fact that his client read what was drafted. This holding is simply that when the document’s meaning is plain, obvious, and requires no legal explanation, and the client is well educated, laboring under no disability, and has had the opportunity to read what he signed, no action for professional malpractice based on counsel’s alleged misrepresentation of the document will lie. Appellant Berman having failed to show that Mr. Rubin’s actions, and not his own, were the cause of his alleged injury, the grant of summary judgment to defendant Rubin was not error. 138 Ga. App. at 854, 227 S.E.2d at 806.

Berman, thus, holds that, even if a lawyer misrepresents the terms of a contract to his or her client, if the client reads the contract and is capable of understanding the contract,

the lawyer's misrepresentation cannot cause the client's loss.⁴

In a different context, the Illinois Appellate Court had an opportunity to address the effect of Berman. Whereas Berman involved a client who knowingly signed a document, Sutton v. Mytich, 197 Ill. App. 3d 672, 678, 555 N.E.2d 93, 97 (3d Dist. 1990), involved a client who did not read a document. The Appellate Court noted that:

As between parties, in contractual relationships, a person who deliberately signs a written agreement without awareness of his obligations is nevertheless bound. . . . There appears to be no Illinois authority as to whether this rule is applicable to a situation where a client relies on his attorney to advise him about the contents of a contract. Id.

The court discussed Berman, but ducked the causation issue. It held:

A client ordinarily relies upon the representations of his attorney. Whether the failure of a client to read a particular document necessarily defeats a malpractice action is dependent upon the particular circumstances. We express no view as to the ultimate merits of the instant case. 197 Ill. App. 3d at 679, 555 N.E.2d at 98.

Similarly, in Alper v. Altheimer & Gray, No. 97 C 1200 2002 U.S. Dist. LEXIS 18191, at *119 (N.D. Ill. Sept. 27, 2002), the court discussed Berman, but distinguished it because, in Alper, the clients only received and signed signature pages -- not the entire document. Thus, in Illinois, it remains an open question what effect a client's failure to read a written agreement has on a malpractice action.

CONCLUSION

A significant amount of legal advice is given in transactional context. While there is no reason to assume that malpractice is any less prevalent in transactional contexts than in litigation contexts, Illinois courts have had few opportunities to address the unique issues that arise in such contexts. Nonetheless, those involved in transactional malpractice cases should consider such differences and consider whether cases that address litigation-related malpractice are applicable in such situations.

⁴ In contrast, in McWorker Ltd. v. Irvin, 150 Ga. App. 89, 267 S.E.2d 630 (1980), a client who did not read a document was allowed to sue his attorney for negligence.

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