Derivative Liability Revisited

In previous columns, we looked at the concept known as "derivative liability," the notion that a lawyer who represents a fiduciary also stands in a special relationship with the person intended to benefit or to be protected by the fiduciary relationship, even though the lawyer has no formal lawyer–client engagement with that person.[1] Thus, the lawyer for a guardian was held to be liable to the guardian's ward after it was discovered that, apparently unknown to the lawyer, the guardian had misappropriated money intended for the ward's benefit.[2] The court cited a number of factors for justifying its decision, chief among which was the fact that the ward was essentially the intended beneficiary of the representation.

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Derivative liability was used again to disqualify a lawyer from representing a personal representative in an estate where another one of the lawyer's clients claimed as a beneficiary of the estate under a contested will.[3] The court there, in addition to denying the lawyer his fee, found that the lawyer's derivative duties of fairness and impartiality to the estate's beneficiaries as the personal representative's lawyer conflicted with his duties of undivided loyalty toward his other formally retained client.

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Although the concept has been applied mostly in the probate, trust, and estate areas of the law, other jurisdictions have used it in commercial contexts as well, finding lawyers of majority shareholders derivatively liable to minority shareholders, and lawyers representing officers and directors of corporations liable to the employing organizations, when their clients breached the fiduciary duties flowing from their respective relationships.[4]

As derivative liabilities became more widely recognized in Arizona, some plaintiffs attempted to expand their scope to include what might be described as "second tier" claimants.

Thus, a disinherited daughter sued the lawyer who represented her mother, alleging he had a derivative fiduciary duty not to harm her by changing, as directed by his client, the terms of a testamentary trust.[5] The daughter lost, the court distinguishing the case from the others because she (the daughter) was not the intended beneficiary of the representation and the lawyer had been hired specifically to undertake actions contrary to the daughter's interests. Then came the case of *Capital Indemnity Corp. v. Fleming*,[6] where the surety for a conservator who had stolen money from the protected party had been forced to make good on its obligation to underwrite the shortfall. The surety then tried to sue the conservator's lawyer, claiming he had a derivative duty to it as his client's insurer. The court found that the surety was not the intended beneficiary of the lawyer–conservator relationship and ruled in the lawyer's favor. It might be noted that neither the *Wetherill* or *Capital Indemnity* courts spent much time discussing whether there was a fiduciary relationship between the lawyers' clients and the plaintiffs in each case—which is the foundation upon which the concept of derivative liability was originally based.

Even though the lawyers in the later cases prevailed, the fact that attempts were being made to expand derivative liabilities—with attendant litigation and expensive defense costs—was apparently enough to prompt Arizona's probate, estate, and trust lawyers into action. The result was A.R.S. §14-5652 (Attorneys: fiduciary duties), now part of the Arizona Trust Code, that provides, in pertinent part:

> A. Except as prescribed pursuant to Section 14-1104 and absent an express agreement to the contrary, the performance by an attorney of legal services for a fiduciary, settlor or testator does not by itself establish a duty in contract or tort or otherwise to any third party.

A.R.S. §14-1104 (Prudent management of costs) provides, in pertinent part:

> 2. A guardian ad litem, fiduciary, fiduciary's attorney and attorney for the ward or protected person have a duty to: (a) act in the best interest of the ward or protected person.

The apparent purpose of the legislation, which became effective on Jan. 1, 2009, is to relieve from liability those lawyers who are otherwise ethically representing clients with fiduciary duties owed to others, from "derivative" duties to people who are not their clients except when there's an express agreement by the lawyer to undertake such duties or the duties involved are those contemplated by A.R.S. §14-1104.

But there is some question whether that's what will happen in every instance. A recent Superior Court ruling in Maricopa County[7] has held that the statute should not be read so broadly as to prevent *Fickett*-like claims from being pressed if the protected person can show "something more" than the fact

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that the lawyer simply provided legal services to a fiduciary. In the *Hansen* case, the "something more" was an allegation of the lawyer's "fraud and collusion" with the fiduciary. What else "something more" may include remains to be seen. And it's not clear whether the statute applies to cases other than those involving probate, trust, and estate matters. It's part of the Arizona Trust Code and arguably would not apply in the commercial context.[8]

It also should be noted that the statute will not have an effect on lawyer discipline to the extent that the lawyer breached an ethical duty. In *Fickett*, for instance, the lawyer clearly violated his ethical duties of competence and diligence in not investigating obviously suspicious circumstances implicating his guardian–client.[9] He would have been subject to discipline even though he might have arguably avoided civil liability under the statute. Moreover, the statute will not relieve lawyers of liability to third parties for violations of ER 1.2(d) (counseling a client to engage, or assisting a client, in criminal or fraudulent conduct) or ER 4.1(b) (failing to disclose facts to third persons when necessary to avoid assisting a criminal or fraudulent act by a client).

Finally, some of the situations intended to be covered by the statute can still result in trouble for the unwary by virtue of ER 1.7 (Conflict of Interest: Current Clients), especially ER 1.7(a)(2) and its concern for lawyers' duties to "third persons" separate and apart from representing a fiduciary. In *Shano*, for instance, the court didn't need to use derivative liability concepts to disqualify the personal representative's lawyer; he could not possibly counsel the personal representative on how to fairly and impartially deal with the competing estate beneficiaries when he additionally represented one of them, to whom he owed a duty of undivided loyalty.

In any context, and regardless of the Arizona Trust Code statutes, we need to be mindful of our ethical duties to persons who are not our clients.[10] There are civil liability and disciplinary considerations that exist separate and apart from any derivative liabilities that may now be forgiven by statute.

endnotes

1. *Obligations to Third Persons (Part 1)*, Ariz. Att'y (May 2012) at 8; and *Derivative Liabilities a Danger*, Ariz. Att'y (June 2005) at 10.
2. *Fickett v. Superior Court*, 558 P.2d 988 (Ariz. Ct. App. 1976).
3. *Estate of Shano*, 869 P.2d 1203 (Ariz. 1993).
4. A good discussion of these cases is found at Geoffrey C. Hazard, W. William Hodes & Peter R. Jarvis, The Law of Lawyering § 2.07 (4th ed. 2014). Note that some of the cases imply that the lawyers aided and abetted their clients' breaches of fiduciary duties and were liable on that basis.
5. *Wetherill v. Basham*, 3 P.3d 1118 (Ariz. 2000).
6. 58 P.3d 965 (Ariz. 2002).
7. *Hansen v. Gorman*, CV2015-000967, Hon. Joshua D. Rogers' Under Advisement Ruling dated April 19, 2016, denying Defendants' Motion to Dismiss. The minute entry can be found at superiorcourt.maricopa.gov/docket.civilcourtcases/casesearch and by then following the prompts.
8. *See, e.g., Reynolds v. Schrock*, 107 P.3d 52 (Or. 2005), where a lawyer for a joint venturer was held liable for damages in a business deal his client caused to a co-venturer to whom the client owed fiduciary duties.
9. ER 1.1 (Competence) and ER 1.3 (Diligence), Ariz.R. Prof.Conduct; Rule 42, Ariz.R.S.Ct. The facts leading up to *Fickett* can be found in *Guardianship of Styer v. Christoffel*, 536 P.2d 717 (Ariz. Ct. App. 1975).
10. *See* examples at *Obligations to Third Persons, supra* note 1, and *Obligations to Third Persons (Part 2)*, Ariz. Att'y (June 2012) at 8.