CONFLICTS ANALYSIS IN ESTATE PLANNING: A GUIDE TO THE DUTIES AND PRIVLEGES

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The conflict of interest analysis in estates, especially large, complex estates, can present a number of challenges for an attorney. Example: an attorney represents an 80 year old husband and his beautiful 45 year old (third) wife. The husband is the sole member of a limited liability company, which is the general partner for a limited liability corporation that owns valuable real property. The husband's children are limited partners in the LLC. Husband's interest will pass to the wife. The LLC leases the real property to a family business, a corporation. Husband owns 51% of the shares of the corporation and his children by a former marriage own the other 49%. There is no clear successor to run the business. The 50 year old daughter, who has worked at the company for 27 years, expects that she will be next in line. The new wife believes she should be in charge. Husband wants to placate his wife, so he names her executrix of his estate. That way, he believes, they will all have to learn to get along.

Over all of these conflicting interests and multiple client representations is another overarching relationship: that of the attorney. He drafted the estate plans for both spouses. He created the business entities. He explained the intricacies of the plan to his clients, using all of the correct legal and tax terminology.

Husband dies. As a result of self-dealing (she used company funds to purchase a private plane), the third wife cannot qualify as executrix. The court appoints an administrator, who does not understand why the lawyer did not set up trusts to shelter the assets, rather than have the estate pay millions in taxes. The attorney is confident he can explain a quite brilliant estate planning strategy to a jury of his peers.

This paper will provide an overview of key decisions affecting the attorney-client relationships with the various participants an update of recent cases that affect the attorney's duties and the conflicts among the various parties.

A. The ABC's of Conflicts Analysis

While dating back 20 years, the following cases still provide the major parameters of the duties and liabilities of attorneys in representation of clients in the estate planning area.

1. *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996).

Attorney-client privilege. The issue in *Huie* was whether the attorney-client privilege protected communications between a trustee and his attorney from discovery by a beneficiary. One of the trust beneficiaries sued the client Huie (C), the trustee, alleging he mismanaged the trust and converted trust property. He noticed the deposition of Huie's attorney. The attorney appeared at a deposition as part of that suit, but refused to answer questions related to trust management citing the attorney-client privilege.

The Supreme Court held that, notwithstanding the trustee's duty to the beneficiary, only the trustee, not the trust beneficiary, is the client of the trustee's attorney. The beneficiary, therefore, may not discover communications between the trustee and attorney otherwise protected by Rule 503 of the Texas Rules of Civil Evidence.

The Court explained that the trustee had a duty to disclose to the beneficiaries all material facts affecting their rights and that the attorney-client

privilege would not prevent the attorney from testifying about factual matters pertaining to the trust. However, the attorney could not be asked to testify as to any confidential communications with the client. The Court concluded that the trustee is the client and not the beneficiaries. The Court also held that because a trust is not a separate legal entity it cannot be a client.

2. *Barcelo v. Elliott*, 923 S.W. 2d 575 (Tex. 1996).

Negligence—no duty of care owed to beneficiaries. Just three months later, the Supreme Court addressed the question of whether an attorney owed a duty of care to the beneficiaries of the will or trust, even though the attorney never represented the beneficiaries.

Elliott, the attorney drafted a will and *inter vivos* trust agreement which the probate court later found to be invalid. Barcelo's grandchildren, who would have been the remainder beneficiaries of the trust, believed that they received a smaller share of the estate than they would have had the trust been valid and filed a malpractice action against Elliott, alleging his negligence resulted in their foreseeable injury.

Elliott moved for summary judgement on the ground that he did not owe a duty to the grandchildren because he had never represented them. The Texas Supreme Court agreed, holding that under common law, an attorney owes a duty of care to his client, but not to third parties who may be injured as a result of the attorney's negligent representation of the client. Applying the "privity barrier" in estate planning cases, the court declined to expand the attorney's duty to the specific, intended beneficiaries of the estate plan citing the conflicts that may arise as to a testator's intentions, instructions, and an attorney's ability to give advice that could later be second-guessed.

3. *McCamish v. F. E. Appling Interests*, 991 S.W.2d 787 (Tex. 1999).

Negligent misrepresentation. While Texas common law does not impose a duty on the part of an attorney to the beneficiaries of a trust, an attorney may be liable to non-clients for negligent misrepresentation. In *McCamish,* the law firm represented Victoria Savings Association in a settlement with Appling, a borrower, related to a development project which Victoria Savings had financed. The borrower would not agree to sign the settlement agreement without confirmation from the lender's attorneys that the agreement would be enforceable against the Federal Savings & Loan Insurance Corporation.

The law firm, its lender client, and the borrower all signed an agreement stating that the agreement met the statutory requirements and that it had been approved by Victoria Savings' Board of Directors. A federal court, however, found that the agreement was not binding on the FSLIC because the board approved the agreement after it had given up authority to do so. Without proper board approval the agreement did not meet the statutory requirements. Appling brought a claim against McCamish for negligently misrepresenting the validity of the board's approval.

Following *Barcelo*, the law firm argued that Texas law does not allow a non-client to sue an attorney for negligence arising out of the attorney's representation of a client because there is no privity between the attorney and non-client. The Supreme Court held, however, that Section 552(1) of the Restatement (Second) of Torts is applicable to professionals including attorneys. Sections 552(1) states:

> One who, in the course of his business, profession, or employment, or in any transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

In so doing, the Court distinguished a claim for malpractice, for which there must be privity,

from a claim for negligent misrepresentation, for which privity is not required. The Court pointed out that (1) in most cases, negligent misrepresentation is found based on the issuance of opinion letters or evaluations and (2) liability for negligent misrepresentation is limited to those instances in which the attorney who provides the information is both aware of the non-client and intends that the non-client rely on the information. The court noted that, in this case, allowing a third-party to bring a negligent misrepresentation claim would not cause the client to "lose control over the attorney-client relationship." Further, an attorney may minimize the risk by limiting the parties to whom the representation is directed, limiting the parties who should rely on it, or issuing disclaimers as to the accuracy and scope of the representation.

Practice tip: Include provisions in the engagement letter (1) limiting the scope of the representation to named clients and (2) stating that no one other than the named clients is entitled to rely on a representation made by the firm.

4. *Burrows v. Arce*, 997 S.W.2d 229 (Tex. 1999)

Fiduciary duty—forfeiture of fees for breach. The principal question in the case was whether an attorney who breaches his fiduciary duty to his client may be required to forfeit all or part of his fee, irrespective of whether the breach caused the client actual damages. The case arose out of the attorneys' representation of 126 plaintiffs in a chemical plant explosion. The case settled for $190 million, of which the attorneys received more than $60 million. Some of the plaintiffs sued because the law firm had signed up plaintiffs through a union steward and settled all claims in the aggregate, allocating dollar figures to plaintiffs without regard to individual conditions and damages. (The plaintiffs were also disgruntled by rumors of higher settlements paid to co-workers represented by different attorneys in other law suits.) The trial court found that the settlement was fair and reasonable and that the plaintiffs suffered no actual damages as a result of misconduct by the attorneys. *Burrows* at 233. The court did not resolve the factual dispute over whether the attorneys had engaged in any misconduct, however.

Plaintiffs contended that the attorneys' breaches of fiduciary duty required a forfeiture of the fees even if they did not prove actual damages. The court considered the issue of whether the plaintiffs had to prove actual damages as a condition to obtaining forfeiture of the fees. The court held that they did not. *Id*. at 238. Citing the Restatement (Second) of Trusts, the court stated that if a trustee commits a breach of trust, the court may in its discretion deny him all compensation or allow him a reduced compensation or allow him full compensation. "An agent is entitled to no compensation for conduct which is disobedient or which is a breach of the duty of loyalty; if such conduct constitutes a willful and deliberate breach of the contract service, he is not entitled to compensation." *Id*.

The court also cited comment b to section 490 of the *Restatement (Third) of The Law Governing Lawyers*, explaining that "a lawyer's clear and convincing violation of a duty to a client destroys or severely impairs the client-lawyer relationship and thereby the justification of the lawyer's claim to compensation." *Id*. at 238. The court found that "the remedy of forfeiture removes any incentive for an agent to stray from his duty of loyalty based on the possibility that the principal will be unharmed or may have difficulty proving the existence or amount of damages." It is the agent's disloyalty, not the harm, that violates the fiduciary relationship. *Id*.

Forfeiture is not automatic, however. *Id*. at 243. The court is to consider "the gravity and timing of the violation, its willfulness, its effect on the value of the lawyer's work for the client, and any other threatened or actual harm to the client, and the adequacy of other remedies." *Id*. In addition, the court should consider public interest in maintaining the integrity of attorney-client relationships. *Id*. at 244.

The question of forfeiture is within the discretion of the court since, as a rule, a jury

does not determine equitable relief. *Id*. When contested fact issues must be resolved, however, a party is entitled to have that resolution determined by a jury. *Id*. Whether the lawyer acted with culpability, intentionally, or with gross negligence, or the act was inadvertent are questions for the jury. The adequacy of other remedies and the public interest in protecting the integrity of the attorney-client relationship present legal policy issues for the court. *Id*. at 245.

5. *Belt v. Oppenheiner, Blend, Harrison & Tate, Inc.*, 192 S.W. 3d 780 (Tex. 2006).

<u>Shift in client—Representative of deceased client can sue for malpractice</u>. While a non-client, including the beneficiaries, cannot bring a claim for malpractice against an attorney, the client's representative can. In *Belt*, the independent executors of the decedent's estate sued the lawyer for malpractice alleging that the lawyer's negligence in preparing estate planning documents resulted in a tax liability of more than $1.5 million in estate taxes.

The Texas Supreme Court recognized that a legal malpractice claim in Texas may only be maintained by the estate planner's client. It noted, however, that an estate's personal representative can bring a survival action on behalf of a decedent's estate. Following this, the court found that (1) the alleged negligence of the lawyer occurred while the client was alive; (2) a client, under *Burrow v. Arce*, 997 S.W.2d 229, 240 (Tex. 1999) could have brought suit against the estate planner to recover fees paid (client need not prove actual damages in order to obtain *forfeiture* of attorney's fees for the attorney's 'clear and serious' *breach of fiduciary duty* to the client; the *injury* occurs during the client's lifetime; (3) a *malpractice* claim in the estate-planning context survives a deceased client; and (4) the representatives of the client's estate may assert the *malpractice* claim on the client's behalf. The representative "stands in the shoes" of a decedent.

The court distinguished *Barcelo*, which involved a claim against an attorney by a beneficiary. In this case, the claim was not by "disappointed heirs" disputing the size of their request, but damages incurred by the estate itself. *Id*. At 787.

The court held that "in accordance with the long-standing, common-law principle that actions for damage to property survive the death of the injured party, we hold that legal malpractice claims alleging pure *economic loss* survive in favor of a deceased client's estate, because such claims are necessarily limited to recovery of property damage." *Id*. at 785. Damages are, therefore, limited to economic loss.

<u>Practice point</u>: Paper the file. If a client declines to follow a recommendation that would provide tax savings, write a letter stating this and consider asking the client to sign it.

Although the case does not discuss the attorney-client privilege, if the representative "stands in the shoes of the deceased client," she would own the attorney-client privilege and would be entitled to the attorney's file. The attorney should make copies of necessary documents at his own expense.

B. <u>Update of Recent Cases</u>

1. *LAN/STV v. Martin K. Eby Constr. Co*, 435 S.W.3d 234 (Tex. 2013).

<u>Economic loss rule-no limitation of damages to lawyers</u>. While this is not a case involving estate planning, it explains the economic loss rule and liability for negligent misrepresentation.

The issue in LAN/STV was whether a contractor (Eby) could recover from an architectural firm (LAN/STV) for negligent misrepresentations in the plans and specifications prepared by the architect. The owner of the project was the Dallas Area Rapid Transit Authority ("DART"). DART contracted with LAN/STV to prepare plans, drawings and specifications for the construction of a light rail transit line. Due to numerous errors in the design, the contractor incurred $14 million in losses on the project. [Note: economic loss is defined as a monetary

loss such as lost wages or lost profits. Black's Law Dictionary, Eighth Edition.]

The contractor asserted a claim for negligent misrepresentation against the architect. The Supreme Court denied recovery, holding that recovery was barred by the economic loss rule. In announcing its ruling, the court distinguished damages in injury cases. Where there is a physical injury to a claimant or his property, such as lost wages or medical bills, the damages are limited by the scope of the injury. Where there is an economic loss, such as lost profits, there is no such limitation. The court noted that economic losses proliferate more easily than other losses. For example, a single negligent utterance can cause economic loss to thousands of people who rely on it. The court also noted that the risks of economic loss tend to be well suited to allocation by contract.

In this case, DART, the owner of the project, contracted with the architect for the professional services. The architect is most often hired as the agent of the owner. DART was, in turn, responsible for providing accurate plans to the contractor for the job. The contractor can pursue a claim against the owner; therefore, the court refused to recognize a cause of action for negligence by the contractor against the architect. The court also noted that the parties could allocate responsibility for loss by contract.

Application to attorneys. Would the economic loss rule bar recovery by a non-client, such as a borrower or a beneficiary, against a lawyer? No. The Supreme Court noted that professional malpractice cases are an exception to the economic loss rule. *See LAN/STV* at 243-244. "A client can recover purely economic losses from a negligent lawyer, regardless of whether the lawyer and client have a contract. Lawyer malpractice is actionable as negligence no doubt because agreements regarding legal representation are not required in Texas, except for contingent fees, and until recently have not been the norm. Also, the standards governing legal representation are deeply developed and their application uniform and well-settled. These factors also support negligence actions against other professionals." The court cites *Murphy v. Campbell*, 964 S.W. 265, 269 (Tex. 1997) ("A plaintiff may obtain full redress [for accounting malpractice] in an action for negligence or breach of contract.'); *Tex. Civ. Prac. & Rem Code* 150.001-.003 (negligence suits against licensed or registered professionals, defined to include an architect, professional engineer, surveyor, landscape architect , or their business entities, such as corporations, limited liability corporations, partnerships, joint ventures etc.]

Discussing *McCamish*, the court stated that "while a non-client cannot recover against a lawyer for negligence, a lawyer may be liable for negligent misrepresentation to a non-client, but only in narrow circumstances, when information is transferred by an attorney to a known party for a known purpose', liability is not expressly limited or disclaimed but invited, and the claimant has 'justifiably reli[ed] on a lawyer's representation of material fact', which cannot ordinarily occur in an adversarial context." *Id.* at 245. (Emphasis added).

Practice point: Limit the liability for negligent misrepresentation by contract. Include a provision in the engagement letter identifying the client and stating that all representations are for the sole and exclusive benefit of the client only, not beneficiaries or other third parties. Question: Could an attorney contractually limit the scope of damages to exclude the economic loss rule?

2. *Cantey Hanger, L.L.P. v. Byrd*, 467 S.W.3d 477 (Tex. 2015).

Fraud—attorney immunity from civil liability to non-clients. This case concerns the scope of attorneys' immunity from civil liability to non-clients. The underlying case involved an acrimonious divorce in which the wife was to receive title to three aircraft as her separate property, including a Piper Seminole that had been owned by a leasing company controlled by the husband. The wife was responsible for all *ad valorem* taxes, liens and assessments on the aircraft. The parties to execute any documents necessary to effectuate the transfers within 10 days of the execution of the decree, including

documents necessary to transfer ownership of the airplanes. The attorney for the non-signing party was to draft the documents necessary to effectuate the transfers.

Over a year after the decree was entered, the wife allegedly falsified a bill of sale transferring the Piper Seminole from the leasing company to a third party. This had the effect of transferring the tax liability from the wife to the husband. The bill of sale was signed by the wife under her married name as a manager of the leasing company. She had never been an officer of the leasing company. The lawyer representing the wife, Cantey Hanger, prepared the allegedly falsified bill of sale.

The husband, the leasing company and another company awarded to the husband in the decree sued the wife and Cantey Hanger for fraud and aiding and abetting. Cantey Hanger answered that the claim was barred by the litigation immunity defense and filed a motion for summary judgment under the attorney-immunity doctrine, arguing it had no duty to the husband. The trial court granted the motion for summary judgment and dismissed all claims against the firm with prejudice. The court of appeals reversed as to the fraud, aiding and abetting, and conspiracy claims relating to the sale of the plane.

In a 5-4 decision, Justice Lehrmann, writing for the majority, reversed. Citing *Barceloe* and *McCamish,* the court stated that an attorney does not owe a professional duty of care to third parties who are damaged by the attorney's negligent representation of a client. The lack of privity precludes the attorneys' liability to non-clients for legal malpractice. The court noted that the attorney-immunity defense is intended to ensure "loyal, faithful, and aggressive representation by attorneys employed as advocates," citing *Mitchell v. Chapman*, 10 S.W.3d 810, 812 (Tex. App.—Dallas 2000, pet. denied.) Moreover, attorneys are immune from civil liability in connection with representing a client in litigation. *Cantey Hanger*, at 481(Emphasis added.)

The key issue in the case was whether the action was taken within the scope of the law firm's representation of the wife in the divorce proceeding or independent of the divorce. While "some courts of appeals have broadly stated that attorney immunity does not extend to an attorney's knowing participation in fraudulent activities on his client's behalf; but others have taken a narrower approach to this fraud exception, holding that the *attorney's knowing commission of a fraudulent act "outside the scope of his legal representation of the client" is actionable*. *Id*. at 483. (Emphasis added.). The Supreme Court adopted the narrower view.

The court reasoned that a lawyer should not have the inevitable conflict that would arise if he were forced to constantly balance his own potential exposure against his client's best interest. Merely labeling an attorney's conduct as "fraudulent" should not remove it from the scope of client representation. While the lawyer has the burden of establishing the immunity defense, there is no burden shifting, however. Rather, the court held that:

> [t]he defense does not extend to fraudulent conduct outside the scope of an attorney's legal representation of his client, just as it does not extend to other wrongful conduct outside the scope of representation. An attorney who pleads the affirmative defense of attorney immunity has the burden to prove that his alleged wrongful conduct, regardless of whether it is labeled fraudulent, is part of the discharge of his duties to his client.

Id. at 484. The court held that Cantey Hanger had conclusively established that its conduct was within the scope of its representation of the wife, "was not foreign to the duties of an attorney, and is thus protected by immunity." *Id*.

In his dissent, Justice Paul Green, citing the *Restatement (Third) of the Law Governing Lawyers*, Section 56 (2000), note that lawyers should be "subject to civil liability when a non-lawyer would be [subject to liability] in similar circumstances." The privilege arises in the litigation context and is known as "litigation immunity." For example, statements made in a

courtroom, cannot serve as the basis for defamation. The dissent found there was evidence that the conduct did not occur in the litigation context. Cantey Hanger was to draft the documents to effectuate the transfer of the airplane from the leasing company to the former wife. This transaction involved the transfer from the wife to a third party over one year after the entry of the divorce decree. The dissent would hold that Cantey Hanger had no protection from the plaintiffs' claims of fraud, conspiracy, and aiding and abetting arising out of the allegedly falsified bill of sale.

3. *Royston, Rayzor, Vickery & Williams, LLP v. Lopez*, 467 S.W.3d 494 (Tex. 2015).

Arbitration provisions in attorney/client agreements are enforceable. This case involved the enforceability of an arbitration provision in an attorney-client employment contract.

Royston Rayzor represented the husband in a divorce action against his alleged common-law wife who won $11 million in the lottery. After the divorce action was settled, the husband sued the firm alleging it induced him to accept an inadequate settlement. The law firm moved to compel arbitration under both the Texas Arbitration Act and common law. The trial court denied the enforceability of the agreement and the Thirteenth Court of Appeals affirmed on the grounds the agreement was substantively unconscionable.

Citing TEX. CIV. PRAC. REM. CODE 171.001, the Supreme Court reversed, holding that arbitration clauses in attorney-client employments are not presumptively unconscionable. The court stated that "absent fraud, misrepresentation, or deceit, one who signs a contract is deemed to know and understand its contents and is bound by its terms. *Royston Rayzor*, at 500.

The court noted that public policy is not solely established through legislative enactments and may be informed by the *Disciplinary Rules*. In this case, the Legislature addressed the matter, thus the court "decline[d] to impose, as a matter of public policy, a legal requirement that attorneys explain to prospective clients, either orally or in writing, arbitration provisions in attorney-client employment agreements. Prospective clients who enter such contracts are legally protected to the same extent as other contracting parties from, for example, fraud, misrepresentation, or deceit in the contracting process. [citation omitted] But prospective clients who sign attorney-client employment contracts containing arbitration provisions are deemed to know and understand the contracts' content and are bound by their terms on the same basis as are other contracting parties. *Royston Rayzor*, at 504-505.

In the concurring opinion, Justice Guzman, citing the Texas Disciplinary Rules of Professional Conduct, Rule 1.03(b), stated that attorneys have an ethical obligation to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." She agreed that the failure to timely and adequately explain the consequences of a mandatory arbitration provision in a legal services contract does not render the arbitration provision unenforceable, but emphasized the need for rules more specifically delineating the means and methods by which attorneys can discharge their ethical responsibilities in this context. The *Disciplinary Rules* require attorneys to provide enough information about a matter so the client can make informed decisions regarding the representation. *Tex. Dis. Rule of Prof. Conduct* 1.08(a). The majority did not discuss what constitutes "enough information" so the client can make informed decisions, thus the concurring opinion recommended this be done through the rule making process.

Justice Guzman recognized:

> As a court, we are constitutionally and statutorily charged with promoting and enforcing ethical behavior by attorneys. [citing *Tex. Const. art*. V. 31; *Tex. Gov't Code* 81.024, .071-.072.]
> …
> Certainly, an attorney has an ethical responsibility to fully and fairly discuss an arbitration agreement with a client, but the Disciplinary Rules lack clear

> guidance for discharging that responsibility. The potential for abuse at the earliest stages of the attorney-client relationship is a genuine concern.:

Expect more guidance through the rule making process.

> 4. *Camp Mystic, Inc. v. Eastland*, 399 S.W.3d 266, 2012 (Tex. App.–San Antonio 2012, no pet.).

<u>Joint representation, conflicts of interest, limitations, discovery rule, duty of client to read documents</u>. Camp Mystic, an exclusive camp for girls, was owned by the Eastland family for many years. Dick Eastland owned 38% of Camp Mystic, Inc. He and his wife ran the camp. His brother, Stacy, an attorney, and other family members owned the remaining interests. Concerned about liability, Stacy advocated the reorganization of the corporation. He drafted the reorganization documents and represented all sides in the transaction.

Under the reorganization, the old corporation, Camp Mystic, Inc. was renamed Natural Fountains Properties, Inc. (NFP). NFP owned the real estate. The new corporation, also called Camp Mystic, Inc (NM) operated the camp and leased the real property from NFP. Stacy drafted the lease agreement. Dick and his wife continued to operate the camp, but had greater latitude to do so. Each year, the board, consisting of Dick, Stacy, Nancy (their sister) and other family members proposed the rent.

Dick decided to expand the camp by creating a second camp on the property. When a neighbor heard the new camp would be near his property, he went to Dick and proposed giving the camp money to <u>not</u> put the camp on the proposed site. A dispute arose over how much of these proceeds should go to New CM and how much would go to NFP. This dispute then caused Stacy to reevaluate the amount New CM was paying in rent to NFP. He determined that the rent formula set forth in the lease was not being followed and that Dick was in default of the lease.

New CM and Dick filed a suit to declare the rights of the parties under the lease. Stacy counterclaimed, alleging that Dick had improperly used the Camp Mystic trademark, had breached the lease and his fiduciary duties owed to NFP and was in conflict of interest because of his ownership and positions in both New CM and NFP.

New CM and Dick then countersued Stacy for professional negligence, breach of fiduciary duty, and negligent misrepresentation. They made complaints about the lease term; the rent provision; the enforceability of the lease, the trademark and conflicts of interest not disclosed by Stacy.

Dick also alleged that Stacy, who was his lawyer, represented to him that his lease was renewed every year for an additional five years and that if his lease was terminated, he would have five years to vacate the premises. The lease did not include such a provision. Dick further alleged that Stacy told him how to prepare and calculate the rent New CM owed NFP under the lease. He claimed that he did not know Stacy and other NFP minority shareholders believed that New CM owed an additional $2.8 million in rent and was in default until he received a demand letter from Stacy's lawyer.

New CM and Dick further alleged that Stacy improperly represented all sides in negotiating and preparing the lease and conveyance without disclosing or obtaining a waiver of conflicts. Stacy put Dick in a position that would create conflict by the way Stacy crafted the reorganization so that Dick owned 100% of New CM and 38% of NFP and served on its board.

Stacy filed a traditional motion for summary judgment on the basis of limitations. He also filed a no-evidence motion for summary judgment on the grounds there was no evidence of the breach, causation, or damages elements of New CM and Dick's claims for legal malpractice, breach of fiduciary duty and negligent misrepresentation. The trial court granted both of Stacy's motions and then severed New CM and Dick's claims against

Stacy from the underlying case. New CM and Dick appealed.

The court of appeals reversed and remanded. The court noted that the "special relationship between an attorney and client further justifies imposition of the discovery rule." A fiduciary relationship exists between attorney and client. As a fiduciary, an attorney is obligated to render a full and fair disclosure of facts material to the client's representation. The client must feel free to rely on his attorney's advice. Facts which might ordinarily require investigation likely may not excite suspicion where a fiduciary relationship is involved. Further, "breach of the duty to disclose is tantamount to concealment." The court held that the statute of limitations for legal malpractice does not begin to run until the claimant discovers or should have discovered through the exercise of reasonable care and diligence the facts establishing the elements of his cause of action.

Moreover, the court, citing *S.V. v. R.V.*, 933 S.W.3d 1, 8 (Tex. 1996), stated that "a person to whom a fiduciary duty is owed is either unable to inquire into the fiduciary's actions or unaware of the need to do so…a person to whom a fiduciary duty is owed is relieved of the responsibility of diligent inquiry into the fiduciary's conduct so long as the relationship exists." The court of appeals then concluded that "New CM and Dick had no duty to read the Lease and could rely on Stacy's alleged misrepresentations [regarding the five-year extension of the lease].

On the no-evidence motion for summary judgment, the court found there was some evidence of negligent misrepresentation regarding the lease's rent provisions. On the legal malpractice and breach of fiduciary claims, the court found that a "reasonably prudent attorney drafting a lease should be aware of controlling law that every piece of real estate is unique and, therefore, can have no 'replacement' cost." The court found there were fact issues regarding whether there were conflicts of interest Stacy should have disclosed to Dick. The case was remanded to the trial court for further proceedings.

5. LeBlanc v. Lange, 365 S.W.3d 70 (Tex. App.−Houston [1st Dist.] 2011, no pet.).

Formal representation/special relationship. Lange, an attorney, went into business with LeBlanc, a businessman and long-time friend. They met when Lange was with a law firm and LeBlanc was with client of the firm. Lange left his law firm to join LeBlanc as an equal manager of a hospital. Lange, through a trust, and LeBlanc became minority limited partners.

LeBlanc was presented with the opportunity to resolve a dispute by the sale of the company. LeBlanc was represented in the negotiations by separate counsel. An agreement was reached for the sale of LeBlanc's related business for more than $500 million. The sale required execution of a non-competition agreement by LeBlanc for a period of five years and a one-year extension of that business' lease at the hospital.

Lange believed the noncompetition agreement was harmful to the hospital. LeBlanc signed a settlement agreement drafted by Lange, so that his sale of the related business could proceed. LeBlanc then signed the non-competition agreement and received his first installment for the sale of the business. A dispute arose over the non-compete agreement. Lange contended he was not representing LeBlanc as an attorney in that matter. The trial court granted summary judgment in Lange's favor. LeBlanc appealed.

The parties agreed that Lange represented LeBlanc in the acquisition of the hospital. He claimed he never represented LeBlanc personally after that. LeBlanc has separate counsel to represent him in a suit against the related company. While LeBlanc may have asked Lange to review some documents, there was no evidence Lange agreed to represent LeBlanc in the transaction with a third partyLeBlanc's affidavit in support of his claim that Lange represented him did not state that Lange agreed to represent him. Further, there was no summary judgment evidence that Lange counseled LeBlanc as his attorney with respect to the non-competition agreement. The court

found no evidence of a formal attorney-client relationship.

The court then addressed whether a special relationship gave rise to a fiduciary duty. The court stated that it is well settled in Texas that not every relationship involving a high degree of trust and confidence to the stature of a fiduciary relationship. An informal fiduciary duty arises from a "moral, social, domestic or purely personal relationship of trust and confidence." To impose such an informal fiduciary duty in a business transaction, the special relationship must exist prior to and apart from the agreement made the basis of the suit.

The facts LeBlanc relied on to impose a fiduciary relationship upon Lange were (1) long-term business and personal relationship; (2) hunting trips, golf outing, and attendance at family funerals and weddings; and (3) LeBlanc's asserts that he considered Lange his lawyer, friend and business partner. The court found this insufficient. The court cited the Texas Supreme Court decision in *Meyer v. Cathey*, 167 S.W.3d 327, 330 (Tex. 2005), in which a business associate controlled the financing and the books, was a friend of the plaintiff and had lunch with him every day. Such facts were insufficient to establish an informal fiduciary duty. Subjective trust is not determinative of a "special relationship." The court found that, in this case, there was no disparity of position. Lange and LeBlanc were equal partners and there was no evidence Lange held any superior position with regard to sophistication of business acumen.

6. *Isaacs v. Schleier*, 356 S.W.3d 548 (Tex. App.−Texarkana 2012, pet. denied).

<u>Joint representation; legal malpractice v. breach of fiduciary duty</u>. The Isaacs purchased a racetrack from Ken Hall in 1998. Schleier prepared the documents for the sale including the promissory note and deed of trust between the Isaacs and Hall. In 2002, the Isaacs wanted to sell the race track to Bishop. They retained Schleier to prepare the documents for the sale in the same manner as in the Hall transaction. After meeting with Isaacs and Bishop, Schleier prepared the documents, charging both parties a fee.

The version of the deed of trust signed by Bishop contained an "insecurity clause," which could have allowed the Isaacs to deem themselves insecure concerning the prospects for Bishop's repayment of the indebtedness. It would have allowed the Isaacs to accelerate the debt and declare it wholly due. This provision was not included in the deed of trust signed by the Isaacs and was absent from the 1998 deed of trust from the Isaacs in favor of Hall.

A few months after the sale was completed, an altercation took place at the racetrack. The Isaacs family, including father, mother, son and daughter visited the track and were involved in a brawl with a handicapped track worker and his wife. Bishop got involved in attempting to break it up. Bishop called the police, who arrested John Isaacs. When released from jail, Joh Isaacs reportedly called Bishop and attempted to get him to change his version of events to shift blame away from Isaacs. He allegedly threatened violence to Bishop. "Hard feelings" between John Isaacs and Bishop prompted an investigation into the operations of the racetrack. The investigation led to the conclusion that Bishop was in violation of ther terms of the security agreement and deed of trust for failure to deliver insurance policies naming the Isaacs as additional insureds. As a result Schleier issued a notice of default on the Isaacs' behalf.

Bishop's attorney responded to the notice of default, stating that Schleier had represented both sides of the deal and that his client objected to Schleier's representation of the Isaacs in this matter and asked him to withdraw. Schleier denied he had represented bishop when drafting the sale purchase documents.

Bishop filed suit against the Isaacs for assault and battery against John and real estate fraud for "failing to disclose that the Schleier Defendants had been counsel for the Isaacs Defendants for the past four years; for falsely promising that the Schleier Defendants would represent both parties to the transaction; for falsely representing

the status of title and failing to disclose known defects in the title; and other related tort claims.

Bishop sued Schleier and his firm for real estate fraud; professional negligence/breach of fiduciary duty in failing to disclose that he had represented the Isaacs in the past; failing to disclose how the terms of the documents presented for execution varied from those discussed; and failing to explain the significant conflicts of interest that existed when representing the parties on both sides, and other tort claims.

The Isaacs asserted causes of action against Schleier and his firm for breach of contract (duty of loyalty to the principal/client) in including the on-demand feature in the deed of trust; negligence in not following instructions to be included in the promissory note; placing the on-demand clause in the note undertaking to represent the conflicting interests of both parties; failing to obtain informed consent of the Isaacs before undertaking adverse representation; filing to obtain something in writing from Bishop stating Schleier was only acting as an attorney for the Isaacs; and breach of fiduciary duty.

The jury found that an attorney-client relationship existed between Bishop and Schleier. They found Schleier was negligent and "but for" this negligence, Bishop would have prevailed on his claim against the Isaacs. They also found that Schleier failed to comply with his fiduciary duty to Bishop and that $171,000 would compensate Bishop for Schleier's tortious actions. Schleier settled with Bishop.

There was evidence that the Isaacs and Bishop met with Schleier; that they jointly planned to use the same terms and documents used when the Isaacs had purchased the track four years earlier. Isaacs agreed to all of this, but contacted Schleier two days before the documents were to be mailed to change the terms to include the demand feature in the note. Isaacs admitted this.

Legal malpractice is one cause of action in which a client can recover from the attorney. When the facts of a case support claims against a lawyer for something <u>other than professional negligence</u>, the claims may be allowed. Texas law does not, however, permit a plaintiff to divide or fracture his or her legal malpractice claims into additional causes of action. In general, courts do not allow a case arising out of an attorney's alleged bad legal advice or improper representation to be split out into separate claims for negligence, breach of contract or fraud, because the real issue remains one of whether the professional exercised that degree of care, skill and diligence that professionals or ordinary skill and knowledge commonly posses and exercise. If a lawyer's error or mistake is actionable, it should give rise to a cause of action for legal malpractice with one set of issues which inquire if the conduct or omission occurred.

Schleier and his firm contended here that the Isaacs' claims were malpractice claims and were barred by a two-year statute of limitations. The court concluded that the breach of contract claim was improper fracturing of legal malpractice and was subject to the two-year statute of limitations and that the negligence claims (including those involving conflicts) were malpractice claims.

Turning to the breach of fiduciary duty claims, the court stated that the focus of breach of fiduciary duty is whether an attorney obtained an improper benefit from representing a client, while the focus of a legal malpractice claim is whether an attorney adequately represented a client. The essence of a breach of fiduciary duty involves the "integrity and fidelity" of an attorney. A breach of fiduciary duty occurs when an attorney benefits improperly from the attorney-client relationship by, among other things, subordinating his client's interests to his own, retaining the client's funds, using the client's confidences improperly, taking advantage of the client's trust, engaging in self-dealing, or making misrepresentations.

Unlike a claim for breach of fiduciary duty, legal malpractice is based on negligence, because such claims arise from an attorney's alleged failure to exercise ordinary care. A cause of action for legal malpractice arises from an

attorney giving a client bad legal advice or otherwise improperly representing the client.

The court stated that the Isaac's complaints regarding breach of fiduciary duty concerned the conflict of interest, failure to disclose the dual nature of the representation, and failure to obtain informed consent and waiver of any conflicts of interest. These claims do not without more, allege the type of dishonesty or intentional deception that will support a breach of fiduciary duty claim.

C. Other Fiduciary Relationships

1. *In re: Estate of Boyle*, 2014 LEXIS 13553, Tex. App.-Eastland, December 18, 2014).

Definition of self-dealing/burden of proof. A beneficiary sued Chase Bank for alleged breaches of common-law fiduciary duties and violations of provisions of the Texas Probate Code. They alleged self-dealing and conflicts of interest by the bank through its mismanagement of the assets. The trial court ruled that the claims were barred by the *D'Oench Duhme* doctrine and limitations.

In affirming the trial court's judgment, the court of appeals set out the definition of self-dealing:

> [W]hen a plaintiff alleges self-dealing by the fiduciary as part of a claim for breach of a fiduciary duty, a presumption of unfairness arises…Self-dealing can be generally defined as an occurrence in which the fiduciary uses the advantage of his position to gain a benefit at the expense of those to whom he owes a fiduciary duty."

Boyle at 17.

The presumption of unfairness applies to transactions between a fiduciary and a principal in which the fiduciary profits or obtains a benefit.." *Id*. at 17-18.

Some examples of self-dealing in recent cases:

2. *In re: Estate of Montemayor*, Tex. App. LEXIS 3991, Tex. App.—San Antonio 2015, Son moves into house owned by estate and fails to list house for sale. Court finds gross misconduct and conflict of interest warrant his removal.

3. *Gossett v. Back*, 2014 Tex. App. LEXIS 8531; 2014 WL 3828217, Tex. App.—Dallas August 5, 2014)

Daughter deeded house to herself. This conflict of interest prevented her from qualifying to serve as executrix of the estate.

4.. *Ablon v. Campbell*, 457S.W.3d 604 (Tex. App. Dallas 2014, 2015).

Parties and standing—virtual representation is invalid where there is a conflict of interest. Fred Ablon had three children, Bari, Rachelle and Baron. Bari and Rachelle (sisters) filed an application for appointment of a permanent guardian of their father in probate court. Baron (the brother) opposed the guardianship. The court appointed an attorney *ad litem* and guardian *ad litem.* The attorney *ad litem* joined in the application for guardian. The *ad litem*, Baron, Bari and Rachelle entered into a Rule 11 Agreement to transfer Fred's accounts and assets to Frost Bank. The agreement was to "remain in place pending further orders of the Court or agreement of all parties to modify the agreement.

On May 14, 2012, the guardian *ad litem* filed an application to create a management trust under Section 867 of the probate code. Three days later, Fred signed documents purporting to create his own trust (the "Family Trust"). Frost Bank was named trustee for the Family Trust and Baron and his sisters were named as remainder beneficiaries. The same day, the attorney *ad litem* file a motion to fund an account relating to the alleged Family Trust, asking the court to transfer the assets governed by the Rule 11 Agreement. Baron joined in this request.

Bari and Rachelle were not served with citation or given notice of the hearing. At the time of the hearing, the amended application for appointment of a permanent guardian were still

pending before the court. The court held the hearing, ruled that Fred had capacity to create the Family Trust and ordered the transfer of the funds that were subject to the Rule 11 Agreement to the alleged Family Trust. The court subsequently dismissed the application for guardian of Fred's estate.

Ten months later, Bari filed a motion to set aside the order under a bill of review. She argued the court lacked jurisdiction to enter the order and committed substantial error by circumventing the right to a trial on the application for guardian of the estate and creation of the management trust. The court held another hearing and granted Bari's requested relief. He ordered Frost Bank, as trustee of the Family Trust, to transfer the funds to itself as trustee of the Management Trust.

The court concluded that Bari and Rachelle were not virtually represented with regard to the motion [to dismiss the application for guardian and transfer the funds] due to conflicts of interest between them and the other parties to the motion. Since they were not given notice of the hearing, the court did not have jurisdiction over Bari and Rachelle and the order was void. He found that Bari was an interested person with standing to file a statutory bill of review under the Probate Code.

The court of appeals affirmed, holding that Bari's interests were impaired and impeded by her lack of joinder with regard to the motion. Baron did not establish that the notice provisions in the probate control and that Rule 39 of the rules of civil procedure did not apply. Distinguishing *Wojcik v. Wesolick*, 97 S.W.3d 335, 337 (Tex. App.—Houston [14th Dist.] 2003, no pet.), the court stated that the probate code does not expressly require that a will contestant join or give notice to any party and that the rules of procedure apply only to the extent they do not differ from the procedure established by the probate code. Citing *Bank of Texas, N.A., Trustee v. Mexia*, 135 S.W.3d 356, 362 (Tex. App.—Dallas 2004, pet. denied), the court held that the probate code does not require notice of probate proceedings unless the probate code "expressly so provides." This case, however, involved the validity of the Family Trust, a trust not created pursuant to the probate code. Bari's interests were not virtually represented at the hearing. Under the doctrine of virtual representation, the minor beneficiaries to a will are necessary and indispensable parties, but the trustee of the will, who had full power to manage and control the estate, represented the interest of the minor beneficiaries. (citing *Mason v. Mason*, 366 S.W.2d 554-55 (Tex. 1963)("[w]here a suit is brought to cancel a trust instrument the beneficiaries are considered to be adequately represented by the trustee if their interests are not conflict.") A trust beneficiary is a necessary party, however, where the suit involves a controversy or conflict of interest between the trustee and beneficiaries or among the beneficiaries. In this case, Bari's adverse interest did not exist until after the guardian *ad litem's* motion was filed. Baron failed to establish, under *Texas Probate Code* Section 642, that Bari's interest in having the Family Trust held invalid deprived her of standing because the issue arose during the guardianship proceeding.

5. *Ward v. Stanford*, 443 S.W.3d 334 (Tex. App. Dallas 2014, pet. denied).

Trustees' business dealings with grantor created conflicts of interest. Travis Ward and his then-wife created an irrevocable trust for the benefit of their four children. The trustees of the trust were business associates of the father. The father obtained a loan from the trust and signed a promissory note in the amount of $1,200,000. The father never repaid the note and the trustees never took action to collect on the note. One of the trustees resigned and sent a letter to the others stating that he learned that important trust business had been conducted without his knowledge and that he was concerned that the business issues of the trust were being intentionally ignored and mishandled due to the conflicts of interest on the trustees' parts.

The letter came to light years later. One of the children sued the trustees for breach of the trust for failing to collect on the note. The trustees argued the affirmative defense of limitations. Fraudulent concealment is an affirmative

defense to the statute of limitations. The court held the trustees were required to establish, as a matter of law, the date the causes of action accrued and to negate the discovery rule on proving, as a matter of law, when appellant discovered or should have discovered the nature of the injury. *Id*. at 354. Regarding claims not related to the note, the beneficiary alleged that the trustees' close business relationship with the father/settlor of the trust created "irreconcilable conflicts of interest with their fiduciary duties to the Trust." The court found that a genuine issue of material fact existed and sustained the beneficiary's challenges to the summary judgment on fraudulent concealment and conflicts of interest, and remanded the case to the trial court for further proceedings.

6. *In re: XTO Energy Inc*., 471 S.W.3d 126 (Tex. App. Dallas 2015, no pet.).

<u>Beneficiary may not bring derivative action on behalf of trust</u>. This case involves a publicly traded trust. In 1998, XTO Energy Inc. created the Hugon Royalty Trust with Bank of America. The trust assets consisted of net profit interests that entitled the trust to receive 80% of the net proceeds XTO received from the sale of oil and gas from certain properties. The net profit interests were conveyed to the trust by XTO under conveyances.

Goebel became a unitholder of the trust and sent a letter to the bank, as trustee, demanding that it bring suit against XTO, a gathering company and Bank of America for wrongful acts she claimed resulted in damages to the trust. She alleged that XTO and its wholly owned subsidiary misappropriated $60 million in royalties that should have been paid to the trust and that XTO was obligated to correct the overpayments to its subsidiary by renegotiating the sales contracts to reflect current market rates.

Goebel brought suit "on behalf of, and for the benefit of the trust, asserting the claims against XTO, its subsidiary and Bank of America. In essence, the beneficiary asserted a derivative claim on behalf of the trust. At issue was the scope of a trustee's authority to determine whether to pursue litigation on behalf of the trust.

Texas courts have held that a trust beneficiary may enforce a cause of action that the trustee has against a third party "if the trustee cannot or will not do so." *XTO* at 131, citing *In re Estate of Webb,* 266 S.W.3d 544, 552 (Tex. App.-Fort Worth 2008, pet. denied). *XTO* at 130. The court stated:

> Despite the broad language, a beneficiary may not bring a cause of action on behalf of the trust merely because the trustee has declined to do so. To allow such an action would render the trustee's authority to manage litigation on behalf of the trust illusory.

Id. The beneficiary must prove that trustee's refusal is wrongful. *Id*., citing *Restatement (Second) of Trusts* 282 (1959)(if trustee *improperly* refuses or neglects to bring an action against a third person, beneficiary can maintain suit in equity against trustee and third person.) (Emphasis added). The court held that when a trustee is given discretion with respect to the exercise of a power, a court may not interfere except in cases of fraud, misconduct, or clear abuse of discretion. *Id*. at 131-132. Allowing a beneficiary to bring suit on behalf of a trust when the trustee has declined to do so amounts to a substitution of judgment by the court. Thus, unless the beneficiary pleads and proves that the trustee's refusal to pursue litigation constitutes fraud, misconduct or a clear abuse of discretion, the court will not interfere. *Id*. at 132

In this case, Goebel argued that Bank of America had a conflict of interest. She alleged that Bank of America was faced with personal liability for not monitoring XTO's conduct and discovering its malfeasance. The court rejected the argument as "circular," (i.e. the bank's decision could not have been made in good faith because it faced personal liability for failing to pursue the claims earlier.) Under the conflict of interest claim that the trustee could be liable if it did not bring suit, discretionary authority would be rendered illusory. Id. at 135-136.

The court found that nothing in Texas law allows a beneficiary to sue a trustee derivatively on behalf of the trust. *Id*. at 137. The Texas Trust Code provides the mechanism by which a beneficiary may sue a trustee. An "interested person" may bring an action to construe a trust instrument and determine the liability of a trustee. *Id*. An interested person is defined as a "trustee, beneficiary, or any other person having an interest in or a claim against the trust or any person who is affected by the administration of the trust." *Id*. at 138, citing TEX. PROP. CODE 11.004. The code defines "person" to include a "two or more persons having a joint or common interest, including an individual acting as a *personal representative or in any other fiduciary capacity.*" *Id*. Citing the *Restatement (Third) of Trusts* (2012), the court held that the only person who can bring the claim is the person acting as a fiduciary.

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