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Laws Regarding Fiduciary Duties of HOA Boards and their Attorneys

"However, the court said, the privilege of rendering professional services is not absolute, and lawyers should not be free to substantially assist their clients in committing tortious acts". David D. Dodge, *Derivative Liabilities a Danger*, Arizona Attorney, June 2005, p. 10 (Arizona Bar Assn. 2005). (Former Chair of the Disciplinary Comm. of the Ariz. Supreme Ct.) View entire article online at Fiduciary**.**

1. Restatement (Second) Torts § 876 (1979)

"For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he
"(a) does a tortious act in concert with the other or pursuant to a common design with him, or

"(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or

"(c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person."

2. Synposis of Cases

Reynolds v. Schrock, 107 P.3d 52; (Or. App. 2005).
Markley's joint liability to Reynolds.

The [***9] precise legal issue at the core of this dispute is whether anattorney can be jointly liable to a third party toward whom the attorney's client, but not the attorney, owes a fiduciary duty if the attorney, knowing of the client's fiduciary duty, substantially aids, encourages, or acts in concert with the client in the client's breach of that fiduciary duty. The parties agree that, in such a situation, the attorney owes no primary fiduciary duty to the third party; the argument centers, rather, on whether the attorney shares the client's culpability and is liable more or less as an accessory.Reynolds contends that such liability can exist; Markley contends that it cannot. Both parties' arguments focus on *Granewich v. Harding*, 329 Ore. 47, 985 P.2d 788 (1999).

The plaintiff in that case, the minority shareholder in a corporation, brought an action against the corporation, its majority shareholders, and its attorney for breach of fiduciary duty. The plaintiff alleged that the corporation's attorney was jointly liable for the majority shareholders' breach because he assisted in the ousting of the minority shareholder and the devaluation of his stock with knowledge [***10] that those actions constituted a breachof the majority shareholders' fiduciary duty.

The Supreme Court reversed, holding that the corporation's attorney could be jointly liable with the majority shareholders for the breach of fiduciary duty and that, therefore, the plaintiff had stated a claim. *Granewich*, 329 Ore. at 59. The court began its analysis by reciting section 876 of the *Restatement (Second) of Torts* (1979) . . . "

We understand subsection (a) to require an affirmative agreement between attorney and client to aid each other in what the attorney knows is a breachof the client's fiduciary duty to a third party. Thus, for example, an attorney's advice to the client outlining the range of options and the consequences that might flow from them does not amount to a "common design" if, after hearing the advice, the client chooses on his or her own to engage in conduct that results in a breach of duty. Similarly, under subsection (b), "substantial assistance" or "encouragement" of the client's breach of fiduciary duty would consist of, for example, affirmative conduct that actually furthers the client's breach of fiduciary duty, done by the attorney with knowledge that he or she is furthering the breach.

The court further explained that, on application of the principles in either subsection (a) or (b), the minority shareholder in *Granewich* had stated a claim against the corporation's attorney for breach of fiduciary duty:

"Legal authorities * * * are virtually unanimous in expressing the proposition that one who knowingly aids another in the breach of fiduciary duty is liableto the one harmed thereby. That principle readily extends to lawyers. Noneo f those authorities even implies that liability for participants in the breach of fiduciary duty is [**57] confined to those who *themselves* owe such duty. * * * We hold, therefore, that a defendant personally need not have committed a tortious act as a prerequisite to liability for actingin concert with another person who did commit that tortious act."

[Additional citations]

n4 Several other courts have adopted the principles of *Restatement* section 876(b) to assign liability to attorneys who have aided clients in the client's breach of duty to a third party. *E.g.*, *Morganroth & Morganroth v. Norris, McLaughlin & Marcus* , 331 F.3d 406, 412, 414 (3d Cir 2003) (judgment creditor plaintiffs stateda claim against judgment debtor's attorneys for joint liability for aiding clients in obstructing plaintiffs' efforts to execute judgment; allegations that attorneys "were active participants and planners in the scheme to obstruct"execution of judgment by recording a sham lease and misrepresenting court order to clerk, if proved, "went beyond the bounds of permissible advocacy"and constitutes knowing participation in client's conduct to delay enforcement of judgment of a court); *Thornwood, Inc. v. Jenner & Block*, 344Ill. App. 3d 15, 27-29, 799 N.E.2d 756, 767-69, 278 Ill. Dec. 891 (2003)(stating that attorney may not "use his license to practice law as a shield to protect himself from the consequences of his participation in an unlawful or illegal conspiracy" and that policy "should prevent an attorney from escaping liability for knowingly and substantially assisting a client in the commission of a tort"; applying *Restatement* section 876(b), plaintiff stated claim against attorney for joint liability in client's breach of fiduciary duty against plaintiff when complaint alleged that attorneys substantially assisted client, who was plaintiff's former partner, in appropriating partnership opportunity and inducing plaintiff to release rights to assert breach of duty claims against former partner and attorneys); *Cacciola v. Nellhaus* , 49 Mass App Ct 746, 748, 754, 733 N.E.2d 133, 136, 139-40 (2000) (attorney for an individual partner and the partnership advised client partner that he could purchase a second partner's share without approval of the third partner; court held that third partner stated claim against attorney for joint liability in client's breach of fiduciary duty; allegations that attorney wrongly advised client that he could sell his share without required consent,served as attorney in transaction that conflicted with client's duty to other partners, and refused to give third partner information concerning the sale sufficed to state claim that attorney aided in client's breach of fiduciary duty); *Kurker v. Hill*, 44 Mass App Ct 184, 190 n 5, 689 N.E.2d 833,837 n 5 (1998) (although plaintiff did not argue the matter on appeal, court employed *Restatement* section 876(b) and determined that plaintiff stated a claim against attorney for joint liability in shareholders' breach of fiduciary duty owed to plaintiff; attorney of majority shareholder was aware of freeze-out plans and assisted those events, including assisting sale designed to deflate value of corporate assets and securing vote to approvesale*); see also Noel v. Hall*, 2000 U.S. Dist. LEXIS 2504, *20, No 99-649-AS, WL 251709 at *7 (D Or, Jan 18, 2000), *rev granted*, 2000 U.S. Dist. LEXIS 15054, WL 1364227 (D Or, Sep 15, 2000) (interpreting *Granewich* to permit plaintiff to state a claim against defendant attorney for joint liability in assisting his client, a partner, to breach fiduciary duty to co-partner/plaintiff by advising client to disclose contents of wiretap tapes to customers of partnership; allegations supported conclusion that

attorney'sconduct "went beyond mere representation of his clients, but included intentto harm plaintiff").

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Fickett v. Superior Court, 558 P.2d 988; (Ariz. App. DIv. 2 1976)

The general rule for many years has been that an attorney could not be liableto one other than his client in an action arising out of his professionalduties, in the absence of fraud or collusion. **7 Am.Jur.2d, Attorneys at Law,§ 167** . In denying liability of the attorney to one not in privity of contractfor the consequences of professional negligence, the courts have relied principallyon two arguments: (1) That to allow such liability would deprive the partiesto the contract of control of their own agreement; and (2) that a duty tothe general public would impose [**3] a huge potential burden of liabilityon the contracting parties. An annotation of cases dealing with an attorney'sliability to one other than his immediate client for the consequences ofnegligence in carrying out his professional duties may be found in Annot.,**45 A.L.R.3d 1181 et seq.**

We believe the following statement in *Heyer v. Flaig*, 449 P.2d 161 (1969), as to an attorney's duty to an intended testamentary beneficiary is equally appropriate here:

"The duty thus recognized in *Lucas* stems from the attorney's undertaking to perform legal [6] services forthe client but reaches out to protect the intended beneficiary. We imposethis duty because of the relationship between the attorney and the intendedbeneficiary; public policy requires that the attorney exercise his positionof trust and superior knowledge responsibly so as not to affect adverselypersons whose rights and interests are certain and foreseeable.**

Although the duty accrues directly in favor of the intended testamentarybeneficiary, the scope of the duty is determined by reference to the attorney-clientcontext. Out of the agreement to provide legal services to a client, theprospective testator, arises the duty to act with due care as to the interestsof the intended beneficiary.

Fiduciary Servs. v. Shano (In re Estate of Shano), 869 P.2d 1203; (Ariz. 1993).
Maksym's Derivative Fiduciary Duty To Thelma

We conclude that because Maksym represented conflicting interests, the probate court did not abuse its discretion in disqualifying Maksym. As attorney for the special administrator, Maksym owed a derivative fiduciary duty to the successors to decedent's estate, including the surviving spouse, Thelma. Maksym's representation of Garrison, one of the beneficiaries named in decedent's holographic will, materially limited Maksym's [1208] [*555] ability to carry out his fiduciary duty to Thelma.**

We begin by observing that the special administrator has a fiduciary duty to those who succeed to decedent's estate. A.R.S. § 14-3703(A) ("A personal representative is a fiduciary" and "shall use the authority conferred upon him . . . for the best interests of successors to the estate."); A.R.S. § 14-1201(32) (personal representative includes special administrator). An estate's successors are "those persons, other than creditors, who are entitled to property of a decedent under his will or [Title 14]." A.R.S. § 14-2101(45). Under Title 14, Thelma was entitled, as surviving spouse, to receive from the estate an allowance in [*10] lieu of homestead, an exempt property allowance, and a family allowance. A.R.S. §§ 14-2401, -2402, and -2403. Thus, although Thelma was not a named beneficiary in decedent's holographic will, she was by definition a successor to decedent's estate.**

3. Arizona Laws (see your state laws)

A.R.S. Title 10, Chapter 31, Art 3. Nonprofit, membership board duties
10-3830. General standards for directors
A. A director's duties, including duties as a member of a committee, shall be discharged:
1. In good faith.

2. With the care an ordinarily prudent person in a like position would exercise under similar circumstances.
3. In a manner the director reasonably believes to be **in the best interests of the corporation**.

Ariz. R. Supreme Ct.

V. Regulation of the Practice of Law
D. LAWYER OBLIGATIONS
ER 1.13. Organization as Client

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, **the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so**, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action or refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization,

then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) **In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.**

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of ER 1.7. If the organization's consent to the dual representation is required by ER 1.7 , the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

ER 1.16. Declining or Terminating Representation

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, **shall withdraw from the representation of a client if:**

(1) **the representation will result in violation of the Rules of Professional Conduct or other law;**

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or

(3) the lawyer is discharged.

(b) **Except as stated in paragraph (c), a lawyer may withdraw from representing a client if:**

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;

(2) **the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;**

(3) **the client has used the lawyer's services to perpetrate a crime or fraud;**

(4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;

(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

(6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

(7) other good cause for withdrawal exists.

(c) A lawyer shall comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering documents and property to which the client is entitled and refunding any advance payment of a fee that has not been earned. Upon the client's request, the lawyer shall provide the client with all of the client's documents, and all documents reflecting work performed for the client. The lawyer may retain documents reflecting work performed for the client to the extent permitted by other law only if retaining them would not prejudice the client's rights.

ER 3.3. Candor Toward the Tribunal

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

(3)

(4) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client or a witness called by the lawyer has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by ER 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer which will enable the tribunal to make an informed decision, whether or not the facts are adverse.

ER 4.1. Truthfulness in Statements to Others

In the course of representing a client a lawyer shall not knowingly:

(a) **make a false statement of material fact or law to a third person;** or

(b) **fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client**, unless disclosure is prohibited by ER 1.6.