Causation: The Forgotten Element of Conflict Malpractice

Edwin F. McPherson*

I. INTRODUCTION

In recent times, by far the most popular of all of the available species of legal malpractice claims has been and will most likely continue to be malpractice based upon a perceived conflict of interest. Particularly in the entertainment industry, such claims often arise from underlying transactional matters either because the attorney has entered into a business transaction with his or her client or because the attorney has represented two or more clients in the same transaction with competing interests.

Certainly, one could argue that there is nothing inherently unethical with "doing business with" one's own client. After all, many lawyers have clients that are quite educated and extremely sophisticated. In fact, some clients are often far more savvy than their attorneys, particularly in the entertainment and real estate fields, where the vast majority of these cases arise. This author has argued that it is not necessarily inherently unethical for an attorney to represent two or more clients in the same deal, when that "deal" is of a transactional nature and when the relationships that cause the "conflicts" actually enhance the deal.[1]

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* Partner of the entertainment and ligitigation firm of McPherson & Kalmansohn, Century City, California.

[1] Edwin F. McPherson, *Conflicts in the Entertainment Industry . . .Not!*, THE ENTERTAINMENT AND SPORTS LAWYER, Vol. 10, Number 4, Winter 1993; *cf.* J. Anderson and D. Miller, *Professional Responsibility 101 - A Response to "Conflicts*

II. RULES OF PROFESSIONAL CONDUCT

Notwithstanding the relative sophistication of some entertainment clients, there are rules that protect *all* clients from the appearance of gross impropriety that most commentators agree naturally accompanies such business relationships. Those guidelines appear in the California Rules of Professional Conduct, specifically Rules 3-300 and 3-310. The Rules provide standards by which all attorneys who are licensed in California must govern their conduct. Compliance with the Rules allows attorneys both to continue the privilege of practicing law in California and to avoid liability in a legal malpractice suit.

Of course, some experts maintain that the Rules set forth only a *minimum* standard. Strict compliance with the Rules will absolve attorneys of liability with the State Bar, but will not necessarily insulate them from legal malpractice liability.[2] In any event, one thing is clear: non-compliance with the express terms of the Rules *will* expose an attorney both to disciplinary action by the State Bar and to malpractice liability.

The first Golden Rule and the best advice in any situation potentially involving Rule 3-300 is "DO NOT ENGAGE IN BUSINESS ACTIVITIES WITH YOUR CLIENTS." The second Golden Rule in dealing with 3-300 is "DO NOT ENGAGE IN BUSINESS ACTIVITIES WITH YOUR CLIENTS." There is a concomitant Golden Rule with respect to

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in the Entertainment Industry . . . Not!," THE ENTERTAINMENT AND SPORTS LAWYER, Vol. 11, Number 2, Summer 1993.

[2] For instance, some expert witnesses maintain that, notwithstanding the general consensus that a requirement of a *written* disclosure has always been considered the better and more onerous means by which to ensure that a client knows and understands the nature of the conflict, a separate oral explanation of the nature of the conflict should also be required. However, there is no support for this proposition in the Rules of Professional Conduct and little, if any, support in the cases.

Rule 3-310. If one insists on violating the Golden Rule (which is designed only to *reduce* the likelihood of a malpractice claim, not to eliminate the possibility completely, which perhaps nobody can do with any degree of certainty), there are certain things that *must* be done *before* entering into the business relationship with your client.

Rule 3-300, which deals with attorneys entering into business transactions with their clients, provides as follows:

> An attorney shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:
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> (1) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and
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> (2) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and
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> (3) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.[3]

Rule 3-310, which deals with the representation of two or more clients with competing, potentially adverse interests, provides as follows:

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[3] CAL. RULES OF PROFESSIONAL CONDUCT Rule 3-300 (1994).

> A member shall not, without the informed written consent of each client:
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> (1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or
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> (2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or
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> (3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.[4]

Make no mistake about it, an attorney who does not do these things will get sued! There are many lawyers and clients in the entertainment industry who are conversant in the Rules. The instant that something goes wrong with a deal, they are quick to use the Rules to their advantage and to find a scapegoat for whatever went wrong. After all, who ever heard of a conflict/malpractice case arising out of a hugely successful motion picture or record that is destined to earn massive profits for years to come?

However, even the Golden Rules and pristine compliance with the Rules of Professional Conduct may not be enough to prevent malpractice suits in the first place, let alone insulate you from liability. But not to worry, there is still some semblance of hope, and that hope lies within the definition of malpractice itself.

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[4] CAL. RULES OF PROFESSIONAL CONDUCT Rule 3-310 (1994).

III. CAUSATION

The elements of a cause of action in tort for professional negligence are "(1) the duty of the professional to use such skill, prudence and diligence as other members of his profession commonly possess and exercise; (2) a breach of that duty; (3) a proximate causal connection between the negligent conduct and the resulting injury; and (4) actual loss or damage resulting from the professional's negligence."[5] In a legal malpractice action, as in most negligence cases, the lawyer's liability is limited to "all damages directly and proximately caused by his negligence."[6]

In a simple case of legal malpractice (if there is such a thing), causation is not hotly disputed. For example, in a case in which an attorney allows a statute of limitations to run on his or her client's claim, it is fairly easy to determine who caused the client's damages when a judge grants summary judgment and dismisses the client's underlying claim (assuming that the client had a good case in the first place--which he must also prove).

A conflict/malpractice case, however, is more complicated, by definition. First, it can be extremely difficult to ascertain particular facts which are normally very easy to discover. For example, it is a formidable task to find information suggesting when the malpractice was or should have been discovered and when the actual damage occurred, both for statute of limitations purposes.

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[5] Williams v. Wraxall, 39 Cal. Rptr. 2d 658, 663 (Ct. App. 1995) (citing Jackson v. Johnson, 7 Cal. Rptr. 2d 482, 484-85 (Ct. App. 1992)); *see also* Budd v. Nixen, 491 P.2d 433, 436 (Cal. 1971); Purdy v. Pacific Auto. Ins. Co., 203 Cal. Rptr. 524, 533 (Ct. App. 1984).

[6] Smith v. Lewis, 530 P.2d 589, 597 (Cal. 1975) (citing Pete v. Henderson, 269 P.2d 78, 79 (Cal. Ct. App. 1954)); DiPalma v. Seldman, 33 Cal. Rptr. 2d 219 (Ct. App. 1994).

In a conflict/malpractice case, as opposed to a standard malpractice case, causation is equally difficult to ascertain and equally important. Nevertheless, this overlooked element must be proven, whether the claim is pled in terms of negligence, breach of contract, or breach of fiduciary duty; and it must be proved by a preponderance of the evidence.[7] Even a fraud-based malpractice claim is not actionable without proximately-caused damage.[8]

When a claim for legal malpractice has been made, the operative question is: "What would have happened had the lawyer acted otherwise?"[9] The parties are compelled to conduct a trial within the trial, in order to establish that the defendant's conduct was a "substantial factor" in causing the plaintiff's damages,[10] and that "but for" the lawyer's professional negligence, the client would have prevailed in the underlying action.[11] This test of causation is something more than a "50-50 possibility or a mere chance,"[12] and must rise to

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[7] Skopp v. Weaver, 546 P.2d 307, 310 (Cal. 1976); United Community Church v. Garcin, 282 Cal. Rptr. 368, 373 (Ct. App. 1991); McDonald v. John P. Scripps Newspaper, 257 Cal. Rptr. 473, 475 (Ct. App. 1989).

[8] Agnew v. Parks, 343 P.2d 118 (Cal. Ct. App. 1959); *see also* Garcia v. Superior Court, 50 Cal. 3d 728, 737, 789 P.2d 960 (Cal. 1990); Committee on Children's Television, Inc. v. General Foods Corp., 673 P.2d 660, 674 (Cal. 1983); *Williams*, 39 Cal. Rptr. 2d at 664 ("A 'complete causal relationship' between the fraud or deceit and the plaintiff's damages is required."); Wallis v. Farmers Group, Inc., 269 Cal. Rptr. 299, 308 (Ct. App. 1990); Nagy v. Nagy, 258 Cal. Rptr. 787, 790 (Ct. App. 1989) ("Fraudulent representations which work no damage cannot give rise to an action at law.").

[9] *United Community Church*, 282 Cal Rptr. at 373.

[10] Mitchell v. Gonzales, 819 P.2d 872, 878-79 (Cal. 1991); Osborn v. Irwin Memorial Blood Bank, 7 Cal. Rptr. 2d 101, 107-08 (Ct. App. 1992).

[11] *Id.*; *see also Williams*, 39 Cal. Rptr. 2d at 658; Sukoff v. Lemkin, 249 Cal. Rptr. 42, 44 (Ct. App. 1988).

[12] Duarte v. Zachariah, 28 Cal. Rptr. 2d 88, 91 (Ct. App. 1994); *see also* Bromme v. Pavitt, 7 Cal. Rptr. 2d 608, 614 (Ct. App. 1992); Dumas v. Cooney, 1 Cal. Rptr. 2d 584, 589 (Ct. App. 1991).

the level of a *reasonable probability.*[13]

Where reasonable minds cannot differ regarding the causation issue, the question may be considered as a matter of law.[14] A motion for nonsuit may therefore lie when, despite the presentation of ample evidence of negligence, the plaintiff cannot prove that the malpractice caused the damages now sought. In that case, it may be possible to exclude certain evidence of negligence by a motion *in limine.*

In a conflict/malpractice case involving an underlying entertainment transaction, it is not easy to prove that the plaintiff would not have lost all his money in the deal "but for" the conflict of interest and the failure to disclose adequately that conflict. This is not like proving an underlying personal injury claim after the defendant lawyer let the statute of limitations run.

As stated by the California Supreme Court in *Budd v. Nixen*:[15]

> If the allegedly negligent conduct does not cause damage, it generates no cause of action in tort. [Citation] *The mere breach of a professional duty*, causing only nominal damages, speculative harm, or the threat of future harm--not yet realized--*does not suffice to create a cause of action for negligence.* [Citations] Hence, until the client suffers appreciable harm *as a consequence of his attorney's negligence*, the client cannot establish a

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[13] Budd v. Nixen, 491 P.2d 433, 436 (Cal. 1971); Bromme v. Pavitt, 7 Cal. Rptr. 2d at 614; Cottle v. Superior Court, 5 Cal. Rptr. 2d 882, 897 (Ct. App. 1992); Dumas v. Cooney, 1 Cal. Rptr. 2d at 589.

[14] *Budd*, 491 P.2d at 436.

[15] *Id.* at 433.

cause of action for malpractice.[16]

In another case, *Sprigg v. Garcin*,[17] the court held that even if negligence is conclusively proved by the former client, that negligence must be shown to have proximately caused the precise damages of which the plaintiff complains, or the action will fail as a matter of law. The Court of Appeal concluded that the trial court erred in denying the defendant lawyers' motion for judgment notwithstanding the verdict. The court ruled that there was no evidence whatsoever from which a jury could determine that the defendants' activities, albeit negligent, legally caused the injuries for which the plaintiff sought redress.[18]

After determining that the defendants' negligence could be inferred from the facts of the case, the *Sprigg* court noted:

> But the record simply is *devoid of any evidence from which it can be inferred that the defendants' negligent acts caused any injury* to plaintiff. No statute of limitations ran or affirmative defense assertable by [the adverse party in the underlying action] was raised by reasons of defendants' activities . . . . [The attorney] testified that the amended complaint which he filed included allegations sufficient for the plaintiffs' recovery of all damages suffered by them, including damages for loss of use during the restoration period, and there was no evidence that the settlement which [the attorney] eventually negotiated with [the other

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16 *Id.* at 436 (emphasis added); *see also* Alhino v. Starr, 169 Cal. Rptr. 136, 147 (Ct. App. 1980); Commercial Standard Title Co. v. Superior Court, 155 Cal. Rptr. 393, 398 (Ct. App. 1979).

17 164 Cal. Rptr. 677, 680 (Ct. App. 1980).

18 *Id.*

> side] was in an amount smaller than it would have been except for defendants' activities . . . .[19]

The court concluded that, as a matter of law, the absence of causation precluded any recovery whatsoever by plaintiffs.[20]

Similarly, in *In re Easterbrook*,[21] the plaintiff/client failed to make "any showing of actual harm." In that case, the court ruled that:

> [D]amages may not be based on sheer speculation or surmise, and the mere possibility or even probability that damage will result from wrongful conduct does not render it actionable.[22]

Accordingly, the complaint for legal malpractice was stricken at the pleading stage for failure to state a cause of action.

A. *Analogous Securities Cases*

Bastian v. Petren Resources Corp.[23] discussed extensively the causation requirement in tort cases where the loss of an investment has been alleged. This Seventh Circuit securities case is very instructive--and should be completely dispositive--with respect to conflict/legal malpractice cases.

In *Bastian*, the plaintiffs invested $600,000 in oil and gas limited partnerships that were promoted by the non-lawyer defendants. The plaintiffs took the position in the trial court that it was enough to allege under the securities laws that they would not have invested "but for" the fraud. This is, not

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19 *Id.* (emphasis added).

20 *Id.*

21 244 Cal. Rptr. 652 (Ct. App. 1988).

22 *Id.* at 654.

23 892 F.2d 680 (7th Cir.), *cert. denied*, 496 U.S. 906 (1990).

insignificantly, a typical allegation in legal malpractice cases.

The trial court disagreed with the plaintiffs and dismissed the entire action, holding that the contention that they would not have invested was irrelevant. The Court of Appeals affirmed, stating that

> . . . it is an instance of the common law's universal requirement that the tort plaintiff prove causation. [Citation]. No hurt, no tort . . . .
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> The plaintiffs alleged that they invested in the defendants' limited partnerships because of the defendants' misrepresentations, and that their investment was wiped out. But they suggest no reason why the investment was wiped out. *They have alleged the cause of their entering into the transaction in which they lost money but not the cause of the transaction's turning out to be a losing one.* It happens that 1981 was a peak year for oil prices and that those prices declined steadily in succeeding years. [Citation.] If the plaintiffs would have lost their investment regardless of the fraud, any award of damages to them would be a windfall . . . .
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> "Loss causation" is an exotic name--perhaps an unhappy one--for *the standard rule of tort law is that the plaintiff must allege and prove that, but for the defendant's wrongdoing, the plaintiff would not have incurred the harm of which he complains* . . . . No social purpose would be served by encouraging everyone who suffers an investment loss because of an unanticipated change in market conditions to pick through offering memoranda

> with a fine-tooth comb in the hope of uncovering a misrepresentation. Defrauders are a bad lot and should be punished, but Rule 10b-5 *does not make them insurers* against national economic calamities.[24]

Similarly, *McGonigle v. Combs*[25] involved alleged securities violations in connection with the private placement of stock in a company named Spendthrift Farms, Inc. Several investors sued co-owners of the company, as well as attorneys, consultants, an investment bank, an accounting firm, and a commercial bank. The trial court dismissed all of the claims against the "professional defendants," including the attorneys, some pursuant to the defendants' motion for summary judgment and the rest on a directed verdict.

The Ninth Circuit Court of Appeals affirmed the judgment in all respects. In its decision, the court engaged in a lengthy discussion concerning the securities law concept of "transaction causation" versus "loss causation," which, without the labels, is identical to the concept used in legal and other malpractice cases.

Transaction causation refers to a situation in which, absent the misrepresentation or omission, the plaintiff would not have invested in the stock, or that "the violations in question caused the plaintiff to engage in the transaction."[26] In order to show transaction causation:

> [A] plaintiff must demonstrate that he relied on

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24 892 F.2d at 684-86 (emphasis added).

25 968 F.2d 810 (9th Cir. 1992).

26 *Id.* at 820 (citing Hatrock v. Edward D. Jones & Co., 750 F.2d 767, 773 (9th Cir. 1984); *see also* Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461, 1467 (9th Cir. 1990), *rev'd on other grounds sub nom.*, Holmes v. Securities Investor Protection Corp., 503 U.S. 258 (1992).

> the misrepresentations in question when he entered into the transaction which caused him harm.[27]

Loss causation refers to a situation in which the misrepresentations or omissions actually cause the harm, i.e., the loss in value of the stock, property, or other investment:

> "Loss causation" is simply a label used to describe the standard rule of tort law that a plaintiff must allege and prove a sufficient causal connection between the defendant's wrongdoing and the plaintiff's harm.
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> . . .
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> "[L]oss causation" is the standard common law fraud rule (on which see Prosser and Keeton on the Law of Torts § 110, at p. 767 (5th ed. 1984)), merely borrowed for use in federal securities fraud cases.[28]

The following jury instruction in the *McGonigle* case was later endorsed by the Court of Appeals:

> Each plaintiff must show that except for the misrepresentation or omission the loss would not have occurred, and the loss was either a direct result or a reasonably foreseeable result of the misleading statements or omissions. It is not enough for the plaintiffs to show that but for the misrepresentations or concealments they would not have made their investments. The plaintiffs must show that the difference in this value of their

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27 *Vigman*, 908 F.2d at 1467.

28 *Id.* at 1467-68 (citing *Bastian*, 892 F.2d at 686).

> investment was connected to and a result of the misrepresentations or concealments of the defendants, and not from some other cause or causes. In other words, *each plaintiff must prove not only that the misrepresentations or concealments caused him to make his purchase, but also that they were the reasons why the value of the stock turned out to be less than the plaintiff thought it was going to be.*[29]

B. *Practical Application to Legal Malpractice Cases*

These principles are applicable to legal malpractice cases and other negligence cases. If a plaintiff chooses to sue an attorney for malpractice because that attorney either misrepresented something to him relative to the deal or because the attorney had a conflict of interest, that plaintiff must prove not only that he would not have invested in the deal but for the misrepresentation or conflict, but also that the value of the deal was diminished because of the misrepresentation or conflict.

From a defense perspective, the key to these cases is the last sentence of the previously cited *Bastian* passage, in which the court concluded that ethical rules should not make negligent defendants insurers against adverse market conditions[30] That sentiment should apply to all professionals including attorneys. An attorney who has been alleged to have a conflict of interest does not become the *de facto* insurer of his client's investment. This should be true whether or not he failed to give adequate conflict disclosures and whether or not he failed to advise the client to seek the advice of independent counsel.

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29 *McGonigle*, 968 F.2d at 820 n.9 (emphasis added).

30 *Bastian*, 892 F.2d at 686.

The facts of the aforementioned securities cases are not dissimilar to the facts of conflict/malpractice cases in the entertainment industry, and the proof requirements in those cases should equally apply to entertainment cases. However, unlike securities caselaw, there have been few, if any, conflict/malpractice cases involving the entertainment industry that have been reported at the appellate level. This is not surprising because these cases are extremely expensive to litigate and they generally engender considerable adverse publicity.

Nonetheless, the plaintiff/client must prove that *but for* the lawyer's negligent conduct, the loss in value would not have occurred. In this particular situation, one could argue that, as a practical matter, the burden essentially shifts to the plaintiff to prove that it was not a "bad film" or a "bad record" that caused the loss of the plaintiff's investment, but the negligence of the defendant/attorney.[31] This is not much different from the requirement of proving the viability or a claim that is ultimately dismissed on statute of limitations grounds.

Theoretically, a plaintiff/client would have to prove that the defendant/attorney did something to benefit himself (if he is also a principal in the deal) or to benefit his other client(s) (if he is representing more than one client in the deal), or both, *to the detriment of the plaintiff/client*, and that this act actually caused the precise detriment of which the client complains.

In the aforementioned hypothetical situation, the attorney may have drafted a limited partnership agreement that allocated 99 percent of all of the anticipated profits in a film (or 99 percent of the royalties on a record) to the attorney/principal (or

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[31] There is support for this in *McGonigle*, 968 F.2d at 820 n.9, wherein the trial court's instruction to the jury was adopted by the Ninth Circuit as follows: "The plaintiffs must show that the difference in this value . . . was . . . a result of the misrepresentations . . . of defendants, *and not from some other cause or causes*." (emphasis added).

other client) for minimal work and/or capitalization, and one percent to the plaintiff/client for the majority of the work and/or capitalization. Most observers would agree that such a deal would be grossly unfair *and* a violation of Rule 3-300.

However, while the attorney may be subject to disciplinary action by the State Bar as a result of his violation of the Rule, he will not be subject to liability for malpractice if the loss of the client's investment had nothing to do with the relative split of the profits from the venture. The client's loss may be the result of a poor quality film which therefore performs poorly at the box office. Thus, where there are no profits or royalties paid, the issue of who would have received those profits or royalties if they did exist is irrelevant.

Similarly, an attorney may represent two clients who both have net profit participations in the same picture. If one of the clients later sues, claiming that the deal was unfair because she had fewer points than a lesser-known co-star, she will not prevail if the picture made no net profits to divide. However, there are situations in which the attorney might lose. The attorney might have had something to do with the failure of the picture, or he might have also represented a gross profit participant who, by definition, takes money away from the net profit participants. But as before, if the client's loss is the result of forces outside the attorney's control, the client will lose a conflict/malpractice suit.

IV. CONCLUSION

Although nobody likes to admit it, legal malpractice cases, even in the entertainment industry, are nothing more than a subset of negligence or fraud cases. They have the same requirements of pleading and proof. Potential plaintiffs in these cases must be prepared to play by the same rules that control in

generic negligence and fraud cases. In a time when everyone is overanxious to sue everyone else, over anything, and most people are especially eager to "blame it all on the lawyer" (or the personal manager, business manager, or agent), it is especially useful to learn that entertainment lawyers are held to the same standards as all other attorneys.