GOLDBERG SEGALLA

Professional Liability Monthly

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In this month's edition:

FEATURED ARTICLE

Is It Outrageous? Does an Attorney's Negligent Conduct Result in Damages For Emotional Distress in a Legal Malpractice Lawsuit?

Most American jurisdictions do not allow plaintiffs suing for legal malpractice to recover emotional distress damages in addition to their monetary losses. However, plaintiffs will frequently try to circumvent this general rule by adding separate and additional causes of action for either intentional or negligent infliction of emotional distress as part of their legal malpractice lawsuit.
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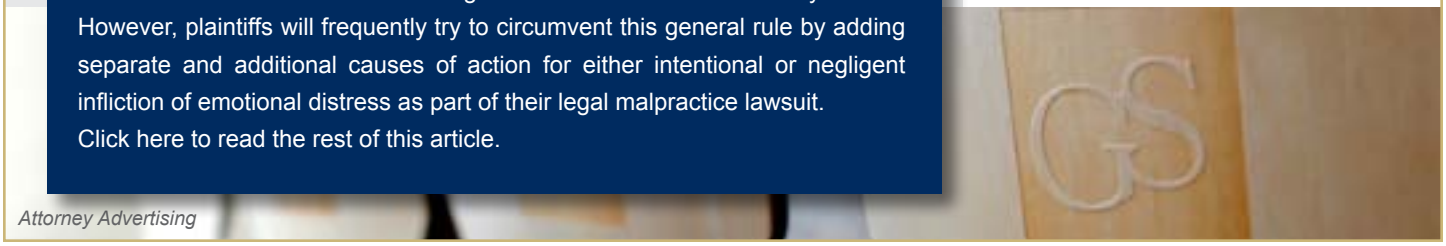

DIRECTORS AND OFFICERS

Sixth Circuit Holds Presumption of Prudence Does Not Apply at the Pleading Stage

GRIFFIN and GARDNER v. FLAGSTAR BANCORP, INC., ET AL.
(6th Circuit, July 23, 2012)

The plaintiffs each initiated putative class action lawsuits on behalf of themselves and other participants in and beneficiaries of the Flagstar Bank 401(k) plan (the plan) against Flagstar Bank and certain officials based upon their assertion that defendants had breached their fiduciary duties in violation of ERISA. The actions were eventually consolidated and defendants moved to dismiss the complaint pursuant to FRCP 12(b)(6), asserting that plaintiffs could not overcome the presumption of prudence. The district court granted the motion and this appeal followed.

The crux of the plaintiffs' complaint was that it was imprudent for the plan to have offered during a defined class period Flagstar stock as an investment option to plan participants. The plaintiffs' complaint stated three counts. The first count alleged defendants breached their fiduciary duties of loyalty and prudence by continuing to make Flagstar stock available as an investment option while concealing the risk of investing in Flagstar stock. The second count alleged breach of defendants' duty to avoid conflicts of interest by failing to engage independent fiduciaries. Count three asserted that defendants had failed to monitor each other for violations of their respective fiduciary duties.

On appeal, the plaintiffs claimed that the district court erred in concluding that defendants were protected by the presumption that investment in the stock of the employer is prudent and in accordance with ERISA requirements. This issue was resolved by intervening authority. In *Pfeil v. State Street Bank & Trust Co.*, 671 F.3d 585 (6th Cir. 2012), the Sixth Circuit determined that the presumption of prudence is evidentiary in nature and therefore does not apply at the pleadings stage.

The plaintiffs' second argument concerned the scope and applicability of the safe harbor which insulates fiduciaries from liability for damages occasioned by plan participants' exercise of control over their individual investment accounts. This issue, too, was resolved in *Pfeil* where the Sixth Circuit held that the safe harbor applies to partipants' allocation choices but does not insulate fiduciaries from potential liability for designating certain investment options from which participants could select.

Finally, the court concluded that the plaintiffs had met their burden of stating a plausible claim for breach of fiduciary duty and reversed the district court's dismissal, noting:

> After reviewing the factual allegations of the complaint – which go far beyond documenting a simple drop in stock price to recite announcements from Flagstar itself, statements by analysts and financial media publications, and actions taken by Flagstar suggesting a precarious financial situation – we must conclude that the complaint raises a plausible claim for breach of fiduciary duty.

Impact: This case clarifies the scope of the fiduciary duty owed by 401(k) Plan managers under ERISA. First, the presumption of prudence will not shield a fiduciary from liability at the pleading stage but rather requires an affirmative evidentiary showing. Secondly, while a safe harbor may protect a fiduciary from liability for damages from a plan participant's individual investment allocations, it will not apply insofar as the fiduciary's alleged failure to adequately monitor investment options.

LEGAL MALPRACTICE

Defendant Attorneys Not Liable to Client's Daughter for Malpractice Claims Despite Her Status as Beneficiary of Their Client Father's Estate

LITVACK v. ARTUSIO
(App. Ct. Conn., August 7, 2012)

The defendant attorneys were retained by the plaintiff's father to represent him in the prosecution of a federal court action sounding in conversion and theft. While the federal conversion action was still pending the plaintiff's father passed away. The federal action was dismissed shortly after the plaintiff's father passed away, and after the dismissal, the plaintiff was appointed executrix of her father's estate. The plaintiff then tried to revive the federal action by filing a motion to open and substitute herself as the named plaintiff. The federal district court denied her motion. The Second Circuit affirmed the denial of the plaintiff's motion.

The plaintiff then commenced a subsequent legal malpractice action in her individual capacity against her father's attorneys in the federal court action for their failure to timely file a motion to

substitute her into the federal action. The plaintiff claimed that because of the defendants' failure to file the motion to substitute in a timely fashion the case was dismissed. On the summons in her legal malpractice claim she named only herself individually and did not name herself in her capacity as executrix of the estate. Although at various points in her complaint in the legal malpractice action the plaintiff identified herself as the beneficiary of her father's estate and the legal representative, she never delineated that she was bringing the action in her representative capacity.

The defendants moved for summary judgment asserting that the plaintiff lacked standing to bring the action as a representative of the estate because she did not bring the claim in her capacity as a representative, but rather filed the action in her individual capacity. The defendants also claimed that she lacked standing to sue them in her individual capacity either as a third party beneficiary of the legal services contract between them and her father, or as an intended beneficiary of that contract. The trial court, treating the defendants' motion as a motion to dismiss for lack of subject matter jurisdiction, agreed with the defendants and dismissed the plaintiff's claims.

The plaintiff appealed the trial court's ruling and argued that the trial court had improperly dismissed the action because in her view she had alleged a legal interest in the action both in her capacity as executrix of her father's estate and in her individual capacity as an intended and foreseeable beneficiary of the legal services contract between her father and the defendants.

On appeal, the appellate court disagreed with the plaintiff and affirmed the trial court's ruling. In affirming the trial court, the appellate court first concluded that the trial court appropriately found that the plaintiff did not bring the suit in her capacity as executrix of her father's estate, and therefore lacked standing to bring the suit as the estate representative. In so holding, the court found that in the summons the plaintiff was named only in her individual capacity and that various counts in her complaint demonstrated that the plaintiff was seeking compensation for alleged misconduct by the defendants that caused her to suffer her own personal injuries. The court reasoned that both the summons and the allegations of the plaintiff's complaint demonstrated the propriety of the trial court's conclusion that the plaintiff sought recovery for alleged injuries that she suffered in her individual capacity, rather than injuries to the estate.

The appellate court then went on to conclude that the plaintiff lacked standing to pursue her claims individually as a third party beneficiary to the legal services agreement between the defendants and her father. In making this determination, the court described that as a general rule attorneys are not liable to non-clients for the negligent rendering of services. The court found that when making the exceptional determination that attorneys should be held liable to non-clients courts have looked principally to whether the primary or direct purpose of the legal transaction for services was to benefit that third party non-client. The court stated that a third party seeking to invoke a third party beneficiary claim in connection with a legal services contract must allege and prove that the attorney and his or her client specifically intended that the attorney should assume a direct obligation to the non-client.

The court then found that the plaintiff's pleading papers did not contain facts sufficiently demonstrating that when the defendants entered into a legal services contract with the plaintiff's father, the defendants also undertook and obligation to the plaintiff. The court reasoned that both the defendants and the plaintiff agreed that the defendants provided legal services for the benefit of her father as opposed to the plaintiff. The court also found that the retainer agreement between her father and the defendants never referenced the plaintiff and that the plaintiff's own assertions that the defendants orally agreed that their representation of the plaintiff's father would benefit her were worthless. In sum, the court found that nothing in the plaintiff's pleadings suggested that the defendants agreed to assume liability to the plaintiff.

The court also found the plaintiff's claim that she was a foreseeable third party beneficiary of the legal services contract between the defendants and her father unpersuasive. The court stated that while a third party beneficiary of a will or testamentary documents may have a cause of action against an attorney in conjunction with the drafting of those documents, there is no authority for imposing liability on attorneys who enter into a retainer and provide ordinary legal services to a third party's decedent. Additionally, the court noted that at the time the defendants agreed to represent the plaintiff's father in the action the plaintiff could not have been a foreseeable beneficiary of the contract as she was named as an adverse party in the underlying federal action.

Finally, the court declined to address the

plaintiff's argument that as an intended beneficiary of the legal services contract, she also may recover damages in tort based on the defendants' failure to substitute her as the named plaintiff in the federal action. The court concluded that she did not take the appropriate steps to preserve the issue for review and, therefore, it would not consider the issue. Accordingly, the court concluded that the plaintiff lacked standing to bring the claims in her individual capacity and any claim should have been brought in her capacity as an executrix of the estate. However, because she failed to appropriately bring the claims in that capacity, the court lacked subject matter jurisdiction over her suit, and the claims were properly dismissed.

Impact: Where the underlying malpractice claim does not involve the actual drafting of testamentary documents, attorneys are not liable to third parties for personal services rendered even if those services were rendered to that party's decedent and they are a beneficiary of estate. This ruling clarifies unsettled precedent regarding an attorney's duty to a beneficiary of an estate and makes clear that an attorney will not be held liable to that beneficiary unless the attorney drafted testamentary documents or the individual was explicitly named as a beneficiary of the legal services contract.

Affidavit of Merit Fails to Satisfy Expert Requirement in Malpractice Action

SCOTT v. CALPIN
(D.N.J., July 24, 2012)

The issue before the court in *Scott* was whether the plaintiff's legal malpractice claim could proceed past the summary judgment stage in the absence of a formal expert report. In New Jersey, a party asserting a malpractice claim, including one for legal malpractice, is obligated to submit an affidavit of merit, signed by an appropriate licensed professional, early on in the litigation. Additionally, "[u]nder New Jersey law, in all but the most obvious of malpractice claims, a plaintiff opposing summary judgment must submit an expert report or face dismissal." In the *Scott* case, the plaintiff had in fact filed the required affidavit of merit, but never submitted an expert report in support of his legal malpractice claim. The defendant filed for summary judgment on the ground that the plaintiff's legal malpractice claim failed, as a matter of law, in the absence of an expert report.

The court, in evaluating the summary judgment motion, initially noted that while "[a]n affidavit of merit does not automatically satisfy the expert report requirement … ." it is at least possible that an appropriate affidavit of merit could fulfill this requirement. However, after analyzing the contents of the affidavit of merit plaintiff submitted in support of his legal malpractice claim, the court concluded that the affidavit of merit failed to satisfy the expert report requirement. In particular, the affidavit of merit was devoid of information pertaining to the controlling standard of care, how the defendant attorney's conduct deviated from this standard and the factual basis for the conclusions contained in the affidavit of merit. As a result, summary judgment was granted in the defendant's favor because the legal malpractice claim could not move forward in the absence of an expert report.

Impact: The decision in *Scott* is noteworthy for two reasons. First, the court reaffirmed the critical importance of an expert report in a legal malpractice claim under New Jersey law. A defendant attorney named in a legal malpractice claim typically will have a very strong basis for filing for summary judgment if the plaintiff fails to timely procure an expert report. Second, the opinion explicitly agreed with the general proposition that an affidavit of merit, in appropriate circumstances, could fulfill the expert report requirement. This means that a plaintiff, at least theoretically, could meet his or her obligation to produce an expert report in support of a legal malpractice claim by submitting an appropriately worded affidavit of merit early on in the litigation.

Superior Court Revives $500 Million Malpractice Claim Against Law Firm and Accounting Firm

KIRSCHNER v. K&L GATES
(Sup. Ct. Pa., May 14, 2012)

The Pennsylvania Superior Court has reinstated a $500 million malpractice suit against K&L Gates and accounting firm, Pascarella & Wiker, for their alleged failure to detect fraudulent activity at the now bankrupt beverage maker, Le-Nature's, Inc., when the firms conducted an internal investigation of the company years before the bankruptcy.

A three-judge panel overturned an Allegheny trial court's ruling and instead found K&L Gates did have an attorney-client relationship with Le-Nature's and not just the special committee that hired the firm to investigate allegations of fraud. The court also found Le-Nature's suffered actual damages, and that such

damages, as alleged in the complaint, were proximately caused by K&L Gates' actions.

"K&L Gates was retained to investigate the exact type of injury being inflicted upon Le-Nature's," the court ruled. "By negligently conducting its investigation, K&L Gates affirmatively caused harm to Le-Nature's by concealing the looting of the company and wrongdoing by [former CEO Gregory J.] Podlucky, and affirmatively representing that no evidence of fraud or misconduct existed … .The foregoing allegations are sufficient to establish that K&L Gates' malpractice was a substantial factor in causing harm to Le-Nature's in the form of increased liabilities, decrease in the value of assets, additional looting of the company and corporate waste, all of which were permitted to continue because of the malpractice."

Le-Nature's trustee Marc Kirschner sued K&L Gates, partner Sanford Ferguson, accounting firm Pascarella & Wiker and its principal, Carl A. Wiker, for failing to detect fraudulent behavior by Le-Nature's founder, Podlucky, when the firms were hired to conduct an internal investigation of the company in 2003. Kirschner alleged the firms' failure to detect the fraud allowed Podlucky to continue his fraudulent behavior, costing the company an additional $500 million in damages until its bankruptcy filing in 2006.

The firms were hired in 2003 after three senior financial professionals resigned from Le-Nature's over concerns of fraud. The company's accountants at Ernst & Young recommended the company conduct an internal investigation of the allegations. A special committee of the board of directors was created to lead the investigation and the committee hired K&L Gates and Pascarella & Wiker. The two firms issued a report that they found "'no evidence of fraud or malfeasance with respect to any of the transactions'" they investigated, according to the opinion.

Kirschner had sued K&L Gates and Ferguson for professional negligence, breach of contract, breach of fiduciary duty, and negligent misrepresentation. He also claimed Pascarella & Wiker was vicariously liable for negligent misrepresentation and breach of contract as it was hired by K&L Gates to help with the investigation.

The trial court dismissed Kirschner's professional negligence claim because of an absence of any obligations K&L Gates owed to Le-Nature's and the absence of any losses, he said. But the Superior Court said that while K&L Gates' engagement letter was executed by the special committee, it was investigating fraud by Le-Nature's and was set to recommend action to be taken by Le-Nature's if fraud was found. The court applied Delaware law on this issue because Le-Nature's was a Delaware corporation.

"As a committee to the board, the special committee had the fiduciary duty to act in the best interests of not only the shareholders, but also the corporation," the court ruled.

The court then looked to the issue of losses. The trial court had rejected Kirschner's claims for damages because Le-Nature's was insolvent at the time K&L Gates prepared its report in December 2003. Wettick had ruled the shareholders were not harmed by the increased insolvency between 2003 and 2006 because their interests had no value as of 2003. The trial court rejected "deepening insolvency" as a legal basis for an award of tort damages.

The Superior Court said, however, that Kirschner was not making a claim for deepening insolvency and the damages claimed were "cognizable and compensable." "Trustee does not allege that Le-Nature's insolvency at the time of the alleged tortious conduct created additional damages or negated the harm caused by the allegedly tortious conduct," the court said. "Rather, trustee seeks tort damages for Le-Nature's increased liabilities, decreased asset values and losses proximately caused by the professional negligence of K&L Gates."

Impact: The case is notable because it explores who constitutes the "client" in the context of the attorney-client relationship, and to whom an attorney might owe a duty. It is further notable because of the large amount of damages at stake, and the high profile nature of the case.

Rules of Professional Conduct do not Constitute Valid Points for Jury Instruction in Legal Malpractice Action

SMITH v. MORRISON
(Sup. Ct. Pa., May 23, 2012)

The plaintiff/client appealed from a judgment entered in favor of the defendant/attorney in a legal malpractice action. On appeal, the plaintiff claimed that the trial court erred by not reading proposed jury instructions which were taken directly from the rules of professional conduct.

At trial, the court ruled that the rules of professional conduct add no independent cause of action and

thus could not be the basis of Smith's proposed jury instructions. Instead, the trial court instructed the jury on the concepts of fiduciary duty and professional negligence.

On appeal, the court noted that the Pennsylvania Supreme Court adopted the rules of professional conduct and the rules of disciplinary enforcement in order to exercise its exclusive constitutional authority to regulate and supervise the conduct of the attorneys who are its officers. Violation of a rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. The rules are designed to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability.

Furthermore, the purpose of the rules can be subverted when they are invoked by opposing parties as procedural weapons. The fact that a rule is a just basis for a lawyer's self-assessment, or for sanctioning a lawyer under the administration of a disciplinary authority, it does not imply that an antagonist in a collateral proceeding or transaction has standing to enforce the rule. Accordingly, nothing in the rules should be deemed to augment any substantive legal duty of lawyers or the extra-disciplinary consequences of violating such a duty.

Impact: The decision buttresses the rule throughout the vast majority of jurisdictions which hold that the violation of rules of professional conduct do not constitute evidence of per se negligence.

MEDICAL MALPRACTICE

Court Concludes That A Dentist is Not A "Healthcare Provider" Under The MCARE Act

FRATZ v. GORIN
(Phila.Ct.Com.Pl., June 18, 2012)

The plaintiff filed a complaint alleging medical professional negligence against Jack Gorin, D.D.S. and five other defendants. Specifically, it was alleged that Dr. Gorin negligently performed periodontal surgery and other dental procedures. Dr. Gorin's primary place of business is in Philadelphia, Pennsylvania. The other defendants maintain businesses in Montgomery County.

The plaintiff was treated by Dr. Gorin at his office in Philadelphia for placement of an upper bridge. Allegedly, Dr. Gorin failed to prescribe prophylactic antibiotics after this procedure was completed and plaintiff developed a high fever. The plaintiff later developed bacterial endocarditis, ventilator-dependent respiratory failure, bilateral pneumonia, anemia, and sepsis. She was treated by the other defendants for these ailments, who are all physicians.

Dr. Gorin filed preliminary objections to the complaint based upon improper venue, which was sustained. Subsequently, the case was transferred out of Philadelphia to Montgomery County. The plaintiffs appealed.

On appeal, the court referenced Pa.Civ.R.P. 1006(a)(1) that states, "A medical professional liability action may be brought against a healthcare provider for a medical professional liability claim only in a county in which the cause of action arose." A health care provider is defined in the MCARE Act, 40 Pa.Cons. Stat. § 1303.103 as, "A primary health care center or a person … licensed or approved by the Commonwealth to provide health care or professional medical services such as a physician, a certified nurse midwife, a podiatrist, hospital, nursing home, birth center … ."

The court found that a dentist is not a "healthcare provider" under the MCARE Act. Therefore, the plaintiff did not receive any treatment from a healthcare provider in Philadelphia. Consequently, it was appropriate to transfer this matter to Montgomery County because that is where she received medical treatment from a healthcare provider.

Impact: A dentist is not a healthcare provider under the MCARE Act. Therefore, in a medical malpractice matter, venue will be appropriate in the county where a plaintiff received care from an actual physician, nurse, midwife, podiatrist, hospital, or nursing home.

Apportioning Fault to Patient in Defense of Medical Malpractice Claim

RAGNIS v. MYERS
(Sup. Ct. Del., July 13, 2012)

One does not usually think of medical malpractice litigation as a forum in which the fault, or culpable conduct, of the plaintiff is raised in defense of the claim, in the same way as, in litigation over automobile accidents, the fault of the plaintiff-driver is commonly raised. In some limited cases, however, the fault of a plaintiff-patient can be successfully used to defeat the claim, or at least mitigate it by a verdict apportioning some degree of fault to the patient. One

such case is *Ragnis v. Myers*, from the Superior Court of Delaware/New Castle.

The widower of Mrs. Ragnis brought a wrongful death medical malpractice claim against Dr. Myers, her treating physician, claiming that he failed to diagnose low-level, yet chronic, hypertension, and failed to prescribe medication to control her blood pressure. Mrs. Ragnis sustained a spontaneous bleed in the pontine region of her brain and died from this hemorrhagic stroke. She was a two-pack per day cigarette smoker and had been for several years. Her medical records were replete with references to Dr. Myers (and other physicians who had cared for her) urging her to quit smoking, and offering to prescribe smoking cessation aides. She had refused all such offers, including her husband's pleas to stop smoking.

Mr. Ragnis' suit against Dr. Myers, however, only focused on a claim of failure to diagnose and treat her low-level, yet chronic, hypertension, claiming that the increased blood pressure in the vessels infusing the brain caused a breach in a vessel resulting in hemorrhagic stroke. Dr. Myers raised the affirmative defense of smoking, both as affirmative fault of Mrs. Ragnis in the face of medical advice to stop smoking, and in terms of a proximate cause defense. The court allowed the defense to stand in determining that Dr. Myers was entitled to partial summary judgment on the issue of the decedent's fault, though the court declined to rule that the only proximate cause of the stroke was smoking.

In so ruling, the court noted that expert testimony submitted on the motion demonstrated that a hemorrhagic stroke in the pontine region of the brain does not normally result simply from hypertension. High pressure in intracranial blood vessels can result in hemorrhagic stroke in the lacunar region but not the pontine. Dr. Myers' experts further opined that the pontine hemorrhagic stroke suffered by Mrs. Ragnis was the result of her years of smoking which had degraded the structural integrity of the walls of the pontine vessels, likening them to pipes that were so rusty they could fissure.

The decision is notable for opening lines of defense on two fronts: the fault of the patient and the proximate cause of the injury (here, death). Even if a jury does not find that the plaintiff was affirmatively at fault in a case for whatever reason (i.e., smoking is an addiction, not an act of volition), the jury could still factor in smoking in rejecting the claim on the issue of whether the defendant proximately caused the death. In this case, the jury could find that the weakened vessels from years of smoking was the only proximate cause and rule for defendant even though they did not find fault with the smoker for smoking.

Impact: Few medical malpractice cases present facts in which some action of the patient can be fairly viewed as fault which proximately caused their claimed injury or death. The fact that some courts have, nonetheless, allowed the defense makes it worth considering in a factually appropriate case.

Court Upholds Ruling Regarding Jury Instruction

GUERRI v. FIENGO
(App. Ct., Aug. 14, 2012)

The plaintiff's decedent presented to the emergency room at Pequot Treatment Center complaining of chest pain and numbness in his left arm. An electrocardiogram was performed which indicated an abnormal result. The emergency room physician reviewed the EKG, examined the decedent and diagnosed him with atypical chest wall pain. The decedent was discharged. A few hours later, the defendant, who was the on-call cardiologist at Lawrence & Memorial Hospital, received and reviewed a copy of the decedent's EKG. The defendant concluded that no critical values were present and took no further action. Three days later, the decedent died of a myocardial infarction.

The plaintiff's complaint alleged, inter alia, that the defendant was negligent in failing to contact the Pequot Treatment Center and/or the treating emergency room physician to further discuss the decedent after the defendant's review of the EKG. At trial, the plaintiff offered the expert testimony of a board certified cardiologist. The plaintiff's expert testified that the standard of care required the reviewing physician to contact the treating physician to inform him of the critical findings. On cross examination, the plaintiff's expert testified that not every EKG with an abnormal result requires the reviewing physician to contact the treating physician. On re-direct, the expert explained that some abnormalities represent a critical value, and those abnormalities require the reviewing physician to contact the treating physician. The expert testified, "[T]here are certain abnormalities that rise to the level of being a critical value. And that is something that can be recognized by a cardiologist. And that when they see that critical value or type of abnormality that requires a call. That's the standard of care not for minor abnormalities or things that could reasonably be expected to be a non-serious problem."

At the close of evidence, the defendant objected to the court's proposed jury instructions regarding the allegation that the defendant was required to contact the Pequot Treatment Center and/or the treating physician, arguing that the broadness of the allegation would require the reviewing physician to contact the treating physician in every instance. The defendant argued that standard of care, as established by plaintiff's expert, only required such contact when a critical value was present. The trial court agreed and refused to instruct the jury on that particular allegation of negligence.

The appellate court upheld the trial court's ruling. The appellate court noted that the record contained no evidence that the standard of care required the reviewing physician to contact the treating physician in all situations; rather, the evidence demonstrated that the standard of care required such contact only when a critical value was present.

Impact: Unless there is evidence at trial that a particular allegation of negligence in the plaintiff's complaint constituted a breach of the standard of care, the trial court will not submit that allegation of negligence to the jury. Defense counsel should take care at the close of the plaintiff's evidence to object to all allegations of negligence that are not supported by expert testimony so that such claims are not submitted to the jury.

INTERNATIONAL

How Far The Duty to Defend May Extend

ARROWHEAD CAPITAL FIN. LTD. (in Liquidation) v. KPMG LLP
(Court of Appeal [2012] EWHC 1801)

This case takes a look at duty of care issues under English law and, particularly, how far such a duty can extend. The case also examines limitations issues and when "damage" occurs for the purpose of time bar.

Background

An English company, Dragon Futures Ltd (Dragon), sought to trade in branded mobile telephones in the grey market, which is a market outside the distribution channels authorised by the brand owners. The trades would constitute of Dragon buying consignments of mobile phones and then selling them onto other traders for a profit and recover the VAT (Value Added Tax) element Dragon paid on the purchase prices. To be profitable, Dragon had to recover the VAT from the UK tax authorities (Her Majesty's Revenue & Customs (HMRC).This type of trade, however, was highly risky because of the difficulty in recovering the VAT element. HMRC sought to combat fraud in the wholesale market in mobile telephones. There were schemes, known as carousel frauds or missing trade intra-community frauds, designed to obtain substantial repayment of sums which had never been paid as output tax, and, as such, HMRC considered that any transaction for which the VAT element was sought to be recovered, which was not genuine because it was part of a fraud, would not be capable of VAT recovery. HMRC prepared advices to traders on how to avoid being caught up in such frauds and the checks HMRC would expect a trader to make to ensure the integrity of the supply chain. If a transaction was not genuine, a trader could still recover the VAT element if he could show HMRC that he had the proper checks in place and that he made the appropriate checks.

In light of the above, it was therefore central for Dragon to demonstrate to potential investors that it had proper checks in place so that it could recover the VAT element of its trades. Dragon engaged KPMG's services to establish rigorous operating procedures. To bolster its potential offering, Dragon referred to KPMG's independent due diligence exercise in its business plan, which it distributed to potential investors. As such, Dragon secured a loan facility with Arrowhead. Although Dragon referred to KPMG in its business plan, Arrowhead never actually met with the relevant personnel at KPMG.

Unfortunately, the systems put in place by Dragon were not enough and HMRC rejected all Dragon's claims for VAT returns, resulting in Dragon having to cease trading and defaulting on its loan repayments. Arrowhead sought to claim against KPMG for negligence.

The Issues

The main issue was whether KPMG did owe a duty of care to an investor, which was an entity it did not deal with directly. The court referred to an earlier case, *Customs & Excise Commissioners v Barclays Bank Plc* [2007] 1 AC 181, which set out a test to establish whether a duty of care exists or not. The test is as follows:

(a) Has there been an assumption of responsibility?;
(b) Has the threefold test of foreseeability,

proximity and "fairness, justice and reasonableness" been satisfied?;
(c) Would the alleged duty be incremental to previous cases?

In the circumstances, the court found that, based on the facts, KPMG did not assume responsibility voluntarily. This was because KPMG set out its services in an engagement letter addressed to Dragon only and which contained specific limitations to the extent of the responsibility which KPMG was prepared to accept. Further, although KPMG knew of Arrowhead's existence, there had been no contact between KPMG and Arrowhead.

The court further held that, although Arrowhead could potentially satisfy the foreseeability and proximity requirements in the threefold test, it would be unjust and unfair to impose such a duty on KPMG. This finding was based on the same reasons as stated above. The parties agreed that there was no need to opine on the third arm of the above test. As a result of these findings, the court held that KPMG did not owe a duty to its client's investors.

The other issue was whether Arrowhead's claim was time barred and, particularly, when Arrowhead did sustain damage. Section 2 of the Limitation Act 1980 stipulates that "an action founded on tort shall not be brought after the expiration of six years from the date on which the cause of action accrued". An action in negligence accrues when the victim sustains damage.

Damage in context of claims for purely financial loss means actual damage, or measurable, relevant loss. To establish when actual damage was suffered, the court set out the following principles:

(a) there must be actual damage, the mere possibility of damage is not enough;
(b) the mere fact that a lender enters into a transaction by making a loan, which it would not have done otherwise, does not necessarily amount to damage;
(c) the comparison between the value of the loan and the value of the rights which the lender acquires will indicate whether the loan constitutes damage;
(d) a certain degree of factual certainty is necessary when making the above comparison.

On the facts, the court thought that Arrowhead sustained damage when it made the loans to Dragon, which happened more than six years before the claim was issued. As such, Arrowhead's claim against KPMG was in any event time barred.

Impact: The case above illustrates how important it is for professionals to have a well-drafted engagement letter prior to taking on work. Particular focus should be also applied on the limitation of liability aspects of the engagement letter.

The Victims of a Taxi Driver, Mr. John Worboys, Who Drugged Women Before Sexually Assaulting Them, Could Not Claim Against His Insurers

AXN AND OTHERS v. (1) JOHN WORBOYS AND (2) INCEPTIUM INS. CO. LTD. (formerly known as HSBC Insurance (UK) Ltd)
(Court of Appeal [2012] EWHCC 1730 (QB))

The criminal aspect of this case has been widely reported in the English press when Mr. Worboys was finally arrested in 2008 and sent to prison in 2009. Mr. Worboys carried out attacks on 12 women by offering them a lift late at night, and after his legitimate work as a taxi driver was finished. Once a target was in his taxi he would then offer her a drugged drink and would assault her once the drug took effect. The victims commenced a civil lawsuit against Worboys and also his insurers. This case examined whether the victims had a valid cause of actions against the insurers who provided cover for Worboys' taxi.

The issues in this case arise from two sections in the RTA 1988, section 151, which deals with insurers' duty to satisfy judgments against persons insured and section 145 (3) (a), which deals with requirements in respect of policies of insurance. In short, the victims sought to argue that the policy provided to Worboys pursuant to section 145 of RTA 1988 was in respect of his liability to them for the matters of which complaint was made by the victims. If a judgment was entered against Worboys, the insurers would be liable to pay the judgment sums to the victims as stipulated in section 151 of RTA 1988.

The key question, therefore, was whether the bodily injuries suffered by the victims arose out of the use of Worboys' vehicle on road or other public space within the meaning of RTA 1988, and, in particular, whether the act of administering sedatives and committing sexual assaults were causally connected with the use of the taxi on the road. Interestingly, because of a paucity of UK case law on this issue, the court had to revert to Australian and Canadian courts decisions to reach its own decision.

In its review of the facts and the law, the court held that the words "arising out of" involved a causal and consequential relationship short of a "direct and

proximate relationship." Further, to determine whether the injuries suffered arose out of the use of the vehicle, one also had to look at the essential character of the journey. The court concluded that the claimants suffered injuries because Worboys wanted to poison them, not because they wished to continue their journey. As such, the poisoning of the victims was not connected to the use of the taxi on a road.

As a result of the decision on the first key question, the natural consequence was that, because the injuries sustained did not arise out of Worboys' use of his taxi on a road, these injuries were not required to be covered by insurance as stipulated in section 145(3)(a) of RTA 1988. Further, it was clear from the facts that Worboys' activities fell outside the ambit of the insurance policy covering his taxi. Therefore, the insurers were not liable to pay the victims for judgments entered into against Worboys. In conclusion, Mr. Worboys' was not entitled to coverage because:

(a) the injuries suffered by the victims did not "arise out of the use of the [taxi driver's] vehicle on a road or other public place" within the meaning of section 145 (3) (a) of the Road Traffic Act 1988 ("RTA 1988");
(b) Mr Worboys' acts of poisoning and sexual assaults were not required by section 145 (3) (a) RTA 1988 to be covered by a policy of insurance and, in any event, were not covered by the taxi driver's insurance policy;
(c) the use of the taxi by the perpetrator at the material times was not a use insured by his policy; and
(d) as a result of the above findings, the insurers were not liable to pay the victims any sum payable pursuant to a potential judgment obtained against the taxi driver as set out in section 151 of RTA 1988.

Impact: Although this decision is logical, it must come as a relief to insurers who could potentially have faced a floodgate of claims had it gone the other way. The decision also highlighted the government's interventions when it comes to insurance needs, in this case, the RTA 1988 and the importance for insurers in understanding these requirements to ensure that insurance coverage provided by them comply with these."

FEATURED ARTICLE

Is It Outrageous? Does an Attorney's Negligent Conduct Result in Damages For Emotional Distress in a Legal Malpractice Lawsuit?

Most American jurisdictions do not allow plaintiffs suing for legal malpractice to recover emotional distress damages in addition to their monetary losses. However, plaintiffs will frequently try to circumvent this general rule by adding separate and additional causes of action for either intentional, or negligent infliction of emotional distress as part of their legal malpractice lawsuit. The factual basis for the emotional distress claims is the same set of circumstances that constitutes the alleged legal malpractice.

Plaintiffs are rarely successful in their attempt to thwart this general rule. This is so because courts have dismissed the additional counts sounding in emotional distress because the plaintiffs cannot make out a prima facie case when they forge their claims from the very same facts used to support the legal malpractice count. This is the case for Connecticut, New York and New Jersey that all have case law holding emotional distress damages are not recoverable in legal malpractice actions.

Connecticut follows the majority rule and does not allow for emotional distress damages as part of a legal malpractice claim, unless the plaintiff can present a viable claim for either intentional or negligent infliction of emotional distress as separate and distinct causes of action. In cases where the plaintiff includes additional counts for emotional distress in the legal malpractice lawsuit, the defendant attorney usually challenges the legal sufficiency of those claims in a pre-answer motion to strike. While there is no Connecticut supreme or appellate authority on this issue, the trial court considers whether the claim for emotional distress stands alone as a separate count, even though it is based on factual allegations of the attorney's negligence. *Borla v. Guion, Stevens, & Ryback, Conn. Super.* LEXIS 2670 (October 19, 2011).

In order for the attorney's negligent conduct to constitute intentional infliction of emotional distress, it must be "extreme and outrageous," exceed all boundaries tolerated by a decent society and be calculated to cause mental distress of a severe kind. *Stacuna v. Schaffer*, 122 Conn. App. 484 (2010). The defendant attorney must have known or should have known that emotional distress would result from his conduct. The Connecticut trial courts almost always strike these emotional distress counts because the attorney's negligent conduct does not meet the high standard required to make out the prima facie case. *Pipkin v. Glenn, Conn.* Super LEXIS 2589 (September 25, 2009). For example, a mere breach of contract by the attorney is not the type of conduct that can support a claim for intentional infliction of emotional distress. *Noon v. Brencher*,

Conn. Super. LEXIS 1522 (June 12, 2012) Allegations of fraud against an attorney do not amount to extreme and outrageous conduct, nor is the attorney's failure to notify the clients about a pending action. *Flamengo v. Burgdorf*, Conn. Super LEXIS 3343 (December 19, 2007)(and citations therein). Even allegations that an attorney pressured or coerced the client to accept a settlement of a custody dispute does not meet the standard required for intentional infliction of emotional distress.

Applying similar reasoning, Connecticut courts have also stricken negligent infliction of emotional distress claims. The legal standard for meeting a prima facie case for negligent infliction of emotional distress is lower than one for intentional infliction of emotional distress. Negligent infliction of emotional distress requires the conduct of the actor to create an unreasonable risk of causing emotional distress. *Parsons v. United Technologies Corp*., 243 Conn. 66 (1997). However, the conduct must also result in bodily harm. Id; *Giovanelli v. Cantor, Floman, Gross, Kelly & Sacramone*, 44 Conn. L. Rptr 802 (2008). The courts examining the viability of a negligent infliction of emotional distress claims note that the attorney's negligent conduct rarely results in any physical harm.

Like Connecticut, the courts in New York have a general prohibition against allowing a plaintiff to recover damages for emotional distress in legal malpractice cases, and generally reject all such claims. *Dirito v. Stanley*, 203 AD2d 903 (4th Dept. 1994); *Taylor v. Paskoff & Tambler, LLP* 908 N.Y.S.2d 861 (N.Y. Sup. Ct. 2010). Very recently, the New York Court of Appeals rejected a claim for nonpecuniary damages where the attorney's malpractice in a criminal matter resulted in a conviction. *Dombrowski v. Bulson,* 212 N.Y. LEXIS 1244 NY Slip Op 4203 (Court of Appeals of New York). After his motion to vacate his conviction was denied, he then brought a writ of habeas corpus. There, the plaintiff urged that the defendant attorney failed to investigate or present evidence concerning an allegedly meritorious defense, failed to interview certain potential witnesses, and failed to cross-examine the victim regarding discrepancies in his testimony. An evidentiary hearing was held at which the defendant attorney explained the reasoning behind his professional decisions regarding the conduct of the trial. The magistrate found errors by the defense counsel made it difficult for the jury to make a reliable assessment of the critical issue of the victim's credibility. The prosecution did not re-prosecute the plaintiff and the indictment was dismissed. Even though the attorney's malpractice resulted in a loss of liberty, the Appellate Division did not depart from the general prohibition against awarding emotional distress damages.

There is no case law in Pennsylvania that directly addresses whether emotional distress damages are allowed in a legal malpractice case. In 2011, the Pennsylvania Supreme Court decided in *Toney v. Chester County Hospital*, 36 A.3d 83 (2011) that it was possible for a plaintiff to have a case for negligent infliction of emotional distress based upon the special relationship between the doctor and the patient. In doing so the Pennsylvania Supreme Court held that the plaintiff in such cases must prove causation, and where the emotional injury did not result in a physical injury, the plaintiff must still prove the emotional injury was "genuine" and that "damages" resulted. Id. In those such cases the Pennsylvania Supreme Court noted that the task of determining whether the plaintiff could prove that actual damages resulted was left to the trial courts. Id. However, this case does not address negligent infliction of emotional distress in a legal malpractice action. Therefore, in the absence of any case law directly involving a legal malpractice action, it appears that Pennsylvania follows "[t]he prevailing rule that damages for emotional injuries are not recoverable if they are a consequence of other damages caused by the attorney's negligence." See 2 Ronald E. Mallen & Jeffery M. Smith, Legal Malpractice, § 19.11, at 612 (4th Ed. 1996).

New Jersey follows Connecticut and New York in the majority, noting that there should not be any award for emotional distress damages at "least in the absence of egregious or extraordinary circumstances." *Guatam v. DeLuca,* 521 A2d. 1343 (App. Div. 1987). The prevailing view is to limit the damages in legal malpractice cases to "recompensing the injured party for his economic loss." This court noted that even if such damages were allowed, they should only be awarded if there was medical evidence to clearly establish that the attorney's conduct resulted in bodily harm or "severe and demonstrable psychiatric sequelae proximately caused by the tortfeasor's misconduct."

The type of "severe and demonstrable" harm described by the New Jersey Appellate Division is evident in the New Jersey Federal District Court in *Lawson v. Nugent,* 702 F. Supp. 91 (D.N.J. 1988). In *Lawson*, the attorney's negligent representation in a criminal matter that resulted in an extra twenty months of incarceration also warranted damages for emotional distress because the malpractice resulted in a loss of the plaintiff's freedom. It was clear that the client in that case suffered emotional

distress that was not only a direct result of the attorney's malpractice, but was also a foreseeable result of that negligent conduct. The district court reasoned that the client's "loss of liberty" that resulted from the attorney's malpractice was a compelling reason to depart from the general prohibition. The same "loss of liberty" exception is also applied in the First Circuit in a case out of Massachusetts. In *Wagenmann v. Adams*, 829 F.2d 196 (1st Cir. 1987), the First Circuit allowed emotional distress damages where the attorney's conduct caused the client to be incarcerated. In that case, the court appointed attorney's misrepresentations to the court resulted in the client getting committed into a psychiatric hospital, even though he was later found to be perfectly sane.

While the foregoing federal court decisions are not alone in holding that there are certain exceptions to the general rule, they do stand firmly in the minority when it comes to application of that exception. In Iowa, the Supreme Court specifically declined to apply an exception in *Lawrence v. Grinde*, 534 N.W.2d. 414 (Iowa 1995). In that case, the Iowa Supreme Court held that emotional distress damages could be allowed if the attorney's negligence caused the client to suffer a social stigma, or if the malpractice involved a "peculiar, personal subject matter." That said, the court in *Lawrence v. Grinde*, supra, declined to extend the exceptions even though the attorney mismanaged the client's bankruptcy, a matter that the Court acknowledged was clearly "personal" in nature. Ultimately, the Iowa Supreme court stated that a bankruptcy was not so personal a subject matter as to allow the plaintiff in *Lawrence v. Grinde* to recover for emotional distress.

More recently, the Iowa court of Appeals likewise declined to apply that exception to a case where the attorney's negligent conduct caused the client to lose her home, even though it left open the possibility for emotional damages in other "appropriate" cases. *Crone v. Nestor,* 789 N.W.2d (Iowa App. 2010). In *Crone*, the former client alleged that an attorney committed malpractice when he failed to establish a trust provided for in a divorce settlement. As a result, the client lost her home and claimed that loss caused her emotional distress. The court analyzed the issue of emotional distress damages under Iowa tort law and concluded the client could not recover emotional-distress damages because she did not present evidence of physical injury and the attorney-client contract did not concern a subject that would carry with it a "deeply emotional response in the event of a breach."

These cases demonstrate the difficulty a plaintiff will have in persuading a court to deviate from the general prohibition against awarding damages for emotional distress against the negligent attorney. Although some jurisdictions, like New Jersey and Iowa carve out distinct exceptions, the recent cases indicate that those jurisdictions are not willing to deviate from the general rule. Moreover, these decisions provide defense counsel in a legal malpractice case with specific and clear examples of the kind of negligent conduct that will arguably be considered "extreme and outrageous" and outside the boundaries tolerated in a civilized society. Accordingly, defense counsel in the legal malpractice suit faced with a claim for emotional distress is almost certain to have such claims for damages dismissed.

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