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Federal Court in Texas Affirms Dismissal of Negligence and Breach of Fiduciary Duty Claims Against a Law Firm, But Revives Aiding and Abetting Claim

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Milligan v. Salamone, 1:18-CV-327-RP (W.D. Tex. Mar. 14, 2019)

Brief Summary

The U.S. District Court for the Western District of Texas recently upheld the bankruptcy court's order dismissing plaintiff's negligence and breach of fiduciary duty causes of action against a law firm ("the Firm") for failing to state a claim. However, the court reversed the dismissal of the aiding and abetting claim, on the basis that "considered in context," a finder of fact could conclude the Firm knew of underlying breaches of fiduciary duty.

Complete Summary

Milligan, a Chapter 7 bankruptcy trustee for Westech, brought an action against the Firm for professional negligence, breach of fiduciary duty, and aiding and abetting a breach of fiduciary duty. The action arose out of work the Firm performed before and during litigation for control of Westech's board. Milligan claimed the Firm assisted the board members in taking actions adverse to the company. The bankruptcy court granted the Firm's motion to dismiss all three causes of action, and Milligan appealed.

The parties analyzed the issues according to both Texas and Delaware law. On appeal, the district court first noted that contrary to Milligan's assertions, it should determine choice of law before ruling on the merits. The district court found both Texas and federal law look to the Restatement to resolve conflicts of laws. After conducting a fact-based analysis pursuant to the Restatement's approach, the district court held that Texas law applied.

Milligan based his breach of fiduciary duty claim on (a) the Firm's drafting of a cancellation agreement to a board member's employment agreement and (b) failing to recommend that Westech enforce a non-competition provision against that same board member. Both claims were based on the theory that the Firm had a conflict of interest in allegedly advocating for the board member while also representing Westech. The court held that no conflict existed as a matter of law because the board member was also part of Westech's management group,

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which was completely aligned with the company and was therefore not a separate representation which could create a conflict.

Milligan's professional negligence claim was based on six alleged breaches due to the same conflict of interest. With regard to some of the alleged breaches, the district court reiterated that since there was no conflict while the board member was still part of the company, there could be no negligence. With regard to allegations of negligence after the board member was removed, the district court found that Milligan had failed to plead any facts that the breaches caused any harm. The last set of allegations involved failing to advise the company to sue the former board member for looting the business and opposing a non-compete clause. The district court found that the allegations might be sufficient to properly allege a breach of duty, but Milligan did not allege proximate causation or damages. Therefore, all the allegations related to professional negligence failed to state claim.

Milligan also alleged that the Firm aided and abetted the board members in breaching their fiduciary duty to the company. The district court found that while the Texas Supreme Court has not explicitly recognized a cause of action for aiding and abetting, the Texas appellate courts have found liability for tortfeasors who "knowingly participates in another's breach of fiduciary duty." The district court determined that Milligan had plausibly alleged that the Firm had knowledge that the board members' agreements with Westech were not in the company's interests, and were executed in a suspicious fashion and without proper authority. The district court held that when considered in context, a factfinder could infer that the Firm knew that [the agreement] was a sweetheart deal for the board member. The district court thus vacated the Bankruptcy Court's order as to the aiding and abetting claim.

Significance of Opinion

Although plaintiff's allegations were insufficient to state causes of action for professional negligence or breach of fiduciary duty against the Firm, the court found that plaintiff alleged sufficient facts to plausibly demonstrate the Firm knew the board members were acting in breach of their fiduciary duties. The dismissal of plaintiff's aiding and abetting claim was thus improper.

For more information please contact Casey A. Hatton or Terrence P. McAvoy.