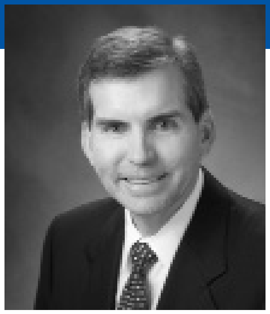
Collateral Estoppel Can Apply in Context of a Legal Malpractice Claim

Avoiding Liability



By Jeffrey P. Lewis

Jeffrey P. Lewis is a member in the Philadelphia office of the law firm of Eckert Seamans Cherin & Mellott LLC. He serves on the PBA Professional Liability Committee.

Collateral estoppel, otherwise known as issue preclusion, is an equitable doctrine that can be applied to preclude a party from relitigating an issue that has been decided in a prior proceeding. Pennsylvania case law recognizes that, under appropriate circumstances, it can be applied in the context of a legal malpractice claim. See, e.g., *Nelson v. Heslin*, 806 A.2d 873 (Pa.Super. 2002). For it to apply, however, four strictly construed elements must be established: "1) An issue decided in a prior action is identical to one presented in a later action; 2) The prior action resulted in a final judgment on the merits; 3) The party against whom collateral estoppel is asserted was a party to the prior action, or is in privity with a party to the prior action; and 4) The party against whom collateral estoppel is asserted had a full and fair opportunity to litigate the issue in the prior action." *Id.* at 877 (citing, *Frederick v. Action Tire Company*, 744 A.2d 762, 765 (Pa.Super. 1999)). These elements are so strictly construed, for example, that an attorney representing a client in the prior action is not deemed as standing in privity with his client for purposes of applying this doctrine. A recent Illinois intermediate appellate court decision illustrates the strict construction given these elements to apply collateral estoppel in the context of a legal malpractice claim.

In *Stevens v. McGuireWoods LLP*, 2014 IL App (1st) 133952-U, an "unpublished" opinion, a defendant law firm attempted to apply collateral estoppel against its former clients in a legal malpractice action. The defendant law firm's former clients were minority members in a limited liability company. The defendant law firm had represented them in a suit against the company's managers to assert both individual claims on behalf of themselves and derivative claims on behalf of the company. In the underlying action the clients contended that the managers "had misappropriated [the company's] trademarks and other intellectual property … [and] that [they] had caused [the company] to enter into an ill-advised deal … causing [the company] harm." The former clients also alleged that their former attorney had failed to timely sue the company's corporate lawyer, who had not been joined as a defendant until he was named in the second amended complaint, which occurred after the defendant law firm had been replaced. There the clients alleged several counts against the company's corporate lawyer based upon the premise that he " 'had become a pawn of [one of the managers] to breach his fiduciary duties to [the company]' and 'aided and abetted' and 'conspired' with [one of the managers] to breach his fiduciary duties to [the company]."

The court in the underlying action granted the motion to dismiss made by the company's corporate lawyer on the basis that the claims were time-barred. In what the court in the current action characterized as "a comprehensive written memorandum," the court in the underlying matter went on to analyze each of the claims asserted against the company's corporate lawyer on the merits, finding that all of them failed to state a cause of action as a matter of law. It held that the company's corporate lawyer only owed a duty of care to the company itself and not to the individual members. Accordingly, it dismissed as untimely the counts where the former clients were asserting claims as individuals and not derivatively on the company's behalf, also finding that they had no individual claims on the merits. The court also dismissed the derivative claims against the company's corporate lawyer on the basis that the minority members had "failed to allege sufficient facts to state the requisite elements of those causes of action." The court in the underlying matter dismissed the derivative claims without prejudice and the direct claims with prejudice. Thereafter the parties to that action settled.

In the current action by the minority members against their former counsel's law firm in the underlying matter, they filed a one-count complaint in which they asserted a claim for "breach of fiduciary duty." Notwithstanding the label used to describe the tort, in substance under Pennsylvania law the minority members were asserting a legal malpractice claim. They contended that they were forced to "settle the litigation for significantly less money than it was originally worth" because of their former counsel's negligence.

In response to the complaint, the defendant law firm filed a motion to dismiss on the basis that its failure to file a lawsuit against the company's corporate lawyer in a timely manner caused no harm since the court in the underlying matter found that the minority members lacked standing. Therefore, argued the defendant law firm, the minority members' claim against it was barred by collateral estoppel. The trial court in the current action denied the motion. "In so doing, the court found that there remained issues of fact as to whether [the defendant law firm] breached a fiduciary duty owed to the plaintiffs and, if so, whether that breach was the proximate cause of the injury allegedly sustained by the plaintiffs."

Later the parties filed cross-motions for summary judgment, where the defendant law firm argued that "plaintiffs' allegations impermissibly sought to overturn rulings made by the trial judge in the underlying case," and, accordingly, that collateral estoppel barred them from doing so. The trial court granted the defendant law firm's summary judgment motion, finding that the court in the underlying action had already determined that the minority members lacked standing to assert individual claims against the company's corporate law firm.

In a unanimous decision the Appellate Court of Illinois reversed with respect to the derivative claims. Because the trial court in the underlying matter had dismissed six of the seven counts involving derivative claims without prejudice, "for purposes of collateral estoppel, the court never made a final decision on the merits." Therefore, for collateral estoppel purposes, the court found dismissal of claims without prejudice does not equate to a final judgment on the merits.

The court also rejected the defendant law firm's argument that, for purposes of derivative claims, it was in effect representing the company and not the minority shareholders. Instead the court found that the lawyer is at all times representing the shareholder and not the corporation (or in this case the minority member and not the LLC).

The Supreme Court of Illinois has granted a petition for allowance of appeal in this matter. Therefore, this dispute is not over. And it will be interesting to see whether the Illinois high court will strictly construe the requirements necessary for applying collateral estoppel in this matter as did the Appellate Court of Illinois.