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TEST # 49  
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LEGAL ETHICS

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### Unseen Risk: Duties to Non-Clients

#### *Two new cases expand lawyers' duties to non-client opponents in litigation and transactional matters*

By ELLEN R. PECK  
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California Joan shivered as a cold feeling moved up her spine. "Third party liability cases are like ghosts," she ruminated. "While a lawyer is working to protect the clients' best interests, a duty to opponents and others may be lurking in the matter, unseen by the lawyer, only to haunt the lawyer later with a lawsuit brought by a non-client. In 2004, two new cases expanded lawyers' duties to non-client opponents in litigation and transactional matters." (*Zamos v. Stroud* (2004) 32 Cal.4th 958 ("*Zamos*, p. \_") and *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282).

An ashen-faced Meryl Terpitude strode into California Joan's office shaking a sheaf of papers. "Cali! I think one of my cases has gone south on me! I need to know what to do!" Terpitude, a senior partner in her law firm, heaved himself into a chair and began his tale of woe.

"About six months ago, Kate Klient retained our firm to sue Sam Samos, her former attorney, for fraud and other claims. Kate claimed that Samos induced her to settle with some defendants in an underlying lawsuit arising from the foreclosure of her house, by representing that (1) he would continue to represent her against the nonsettling defendants in the foreclosure lawsuit, (2) he would substitute into and represent Kate in a separate malpractice already filed against her former attorneys, and (3) her house would be returned to her.

Kate claimed that Samos never intended to keep these promises; that he withdrew from representing her in the foreclosure action before the action was concluded; never substituted into or represented her in the malpractice lawsuit; and never tried to have her house returned to her. Before we filed the action, Kate presented two independent witnesses who corroborated her claims. (Cf. *Zamos*, pp. 961-962.)

"After we filed the lawsuit, Samos sent me reporters' transcripts of three hearings in the foreclosure lawsuit. The first two transcripts recorded the foreclosure settlement and clearly demonstrate that Kate understood and agreed to the release of all claims to her house and that Samos would not substitute into Kate's malpractice lawsuit. In the third transcript, the hearing on Samos' motion to be relieved as counsel, Samos proved that he had submitted all of the paperwork necessary for entry of default against the nonsettling defendant. Moreover, Kate did not oppose and agreed to Samos' withdrawal." Meryl said. (Id.)

"What about the corroborating witnesses?" asked Cali.

"At their depositions last week, they were unable to testify unequivocally that Samos' promises to Kate were made after the representations in the court hearings, thus constituting new promises. Except for Kate's claims inconsistent with her recorded statements at the time, I have no false representations to support the fraud claim," Meryl answered.

"Samos has just sent a letter threatening to file a malicious prosecution action against me and Kate for continuing to prosecute an action that I know has no merit. I'm concerned about the evidence going south on me. However, I think we are safe because I had probable cause to initiate the fraud action," Meryl said gruffly.

"Meryl, that's not enough any more," answered Cali. "In the recent case of *Zamos v. Stroud* (2004) 32 Cal.4th 958, 960, 973, the California Supreme Court held that the tort of malicious prosecution now includes continuing to prosecute a lawsuit discovered to lack probable cause. The facts of the case supporting the expansion were remarkably like yours," Cali responded.

Meryl's color returned to his face in a purple flush. "How could malicious prosecution be expanded? Isn't it a 'disfavored tort?'"

"The tort of malicious prosecution is disfavored. The courts have previously refused to extend its scope because of the potential to impose an undue 'chilling effect' on the ordinary citizen's willingness to report criminal conduct or to bring a civil dispute to court and because its ability to deter excessive and frivolous lawsuits is compromised by commencing yet another round of litigation.

"However, the court overcame the disfavored status finding it unfair to bar a legitimate cause of action or to invent new limitations on the substantive right, without support in principle or authority." (*Zamos*, p. 966.)

Meryl said, "The elements for a malicious prosecution action have required a plaintiff to plead and prove that the underlying action (1) was commenced by or at the direction of the defendant and was pursued to a legal termination in his, plaintiff's, favor; (2) was brought without probable cause; and (3) was initiated with malice. (*Zamos*, p. 965.) Why has that changed?"

"The court followed the weight of authority in other jurisdictions, observing:

- "For 25 years, the Restatement Second of Torts (Restatement) §674 com. c, p. 453, has included the continuance of a properly begun civil proceeding or active participation in continuation for an improper purpose after learning that there is no probable cause, as an element to establish liability for malicious prosecution.

- "For almost 80 years, Corpus Juris has included the continuance of an original criminal or civil judicial proceeding as an element of malicious prosecution. (38 C.J. (1925) Malicious Prosecution, 5, p. 386; see 34 Am.Jur. (1941) Malicious Prosecution, 26, p. 718.)

- "Fourteen states are in accord with the Restatement's position on this question; no state has declined to adopt the Restatement view. (*Zamos*, pp. 966-967.) "The court disapproved the following cases as inconsistent with its holding: *Swat-Fame Inc. v. Goldstein* (2002) 101 Cal.App.4th 613, 627-629, 124 Cal.Rptr.2d 556; *Vanzant v. DaimlerChrysler Corp.* (2002) 96 Cal.App.4th 1283, 1290-1291, 118 Cal.Rptr.2d 48; *Morrison v. Rudolph* (2002) 103 Cal.App.4th 506, 514, 126 Cal.Rptr.2d 747," Cali added. (*Zamos*, p. 973.) Meryl asked, "What was the policy rationale supporting this change?" Cali explained that the court had several reasons supporting its holding:

- "Malicious prosecution actions exist to redress the harm individuals suffer from defending an action initiated without probable cause and the corresponding burden upon the efficient administration of justice. Continuing an action discovered to be baseless harms the defendant and burdens the court system just as much as initiating an action known to be baseless from the outset.

- "It is not logical to hold a lawyer liable for filing a baseless action, but not for the lawyer's knowledge of a lack of probable cause the day after the filing.

- "Attorneys' liability for a party's damages resulting from the attorneys' continuance of civil claims after discovery that the claims have no merit will encourage voluntary dismissals of meritless claims at the earliest stage possible.

- "An attorney would be liable only for the damages incurred from the time the attorney reasonably should have caused the dismissal of the lawsuit after learning it has no merit. Accordingly, an attorney can prevent liability by either promptly causing the dismissal of a lawsuit or withdrawing as attorney of record.

- "These actions will support the efficient administration of justice as well as reducing the likelihood of harm to individuals targeted by meritless claims." (*Zamos*, pp. 969-970.) Meryl protested, "These principles seem to impose duties on me to protect my client's adversary, the courts and even attorneys. What benefits are there for my client?" "Counseling a client that a case is without merit and recommending dismissal of a meritless case also protects the client's best interests:

- "The client can avoid the cost of fruitless litigation.

- "The client's exposure to liability for malicious prosecution will be limited," Cali said. (*Zamos*, p. 970.) "Isn't this unworkable and against the policy of having undivided loyalty to my client?" Meryl protested vehemently. "Instead of zealously representing my client, my attention will be continuously diverted to second-guessing the merits of the litigation and fearing retaliation for malicious prosecution if I argue for an extension of the law." "The Supreme Court did not think so," Cali answered. "The court remarked that only those actions that any reasonable attorney would agree are totally and completely without merit may form the basis for a malicious prosecution suit. Since the same standard would apply to the continuation of a lawsuit as to its initiation, it should be no more difficult to apply the decision whether to continue as to whether to initiate an action. (*Zamos*, pp. 969-970.) "Remember, Meryl, even before the malicious prosecution scope was expanded, California's professional standards created disciplinary liability for the continuation of a meritless lawsuit:

■ “A lawyer has a duty to maintain actions or proceedings which are legal or just (except in the defense of a person charged with a public offense). (Bus. & Prof. §6068(c).)

■ “A lawyer also cannot continue employment with actual or imputed knowledge that an objective is (1) to assert a litigation position without probable cause and for the purpose of harassing or maliciously injuring any person or (2) to present a litigation claim not warranted under existing law unless supported by good faith argument for its extension, modification or reversal.” (Rule 3-200, Rules of Professional Conduct of the State Bar of California (“CRPC”).)

“Cali, help me protect Kate’s interests while balancing Samos’, our firm’s and the courts’ interests,” Meryl pleaded with resignation.

“Unless you have evidence that Samos made the claimed promises after each of Kate’s statements at the hearings, it seems that there is no probable cause to continue with the fraud action. Kate’s statements at the hearings demonstrate that she knew that Samos would not get her house back, would not represent her in the separate malpractice action and would not continue to represent her in the foreclosure action against the non-settling defendant,” Cali pointed out. (Cf. *Zamos*, pp. 970-972.)

“Do I already have liability since I waited to see how the independent witnesses would do at their depositions, since their testimony ultimately did not support Kate’s claims?” Meryl asked.

“Probably not,” Cali said. “The court observed that if a lawyer re-ceives interrogatory answers appearing to present a complete defense, it would be reasonable to take the defendant’s deposition in order to determine whether on testimonial examination, the defense would prove less than solid. (*Zamos*, p. 970, fn. 9.) By the same token, having your witnesses’ depositions taken to test their recollection under oath was reasonable conduct under the circumstances.” (See Vapnek, et al., (The Rutter Group 1997) 1 *Calif. Pract. Guide — Professional Responsibility*, §6:432.5)

“Can I can wait until they bring a motion for summary judgment? I can create a triable issue of fact by presenting Kate’s version of the facts in a declaration. We might just get to a jury,” Meryl suggested.

“This plan poses substantial risks, Meryl,” Cali warned. “If you lose the motion for summary judgment, you could subject Kate, yourself and the firm to at least malicious prosecution liability. Samos could plead and prove that you continued the fraud case after discovery that it lacks probable cause and the essential element of a legal termination in Samos’ favor. He could then infer the element of malice from the surrounding facts and circumstances.” (See *Zamos*, pp. 965.)

“But if I win the summary judgment motion, that establishes probable cause!” Meryl crowed, relying upon *Roberts v. Sentry Life Insurance* (1999) 76 Cal.App.4th 375, 384, 90 Cal.Rptr.2d 408.

“That could backfire on you, Meryl,” Cali warned again. “If you submit Kate’s declaration containing statements that materially differ from her recorded statements at the hearing in the underlying foreclosure action, and which are unsupported by her own witnesses, you and Kate may face a number of risks including (1) losing credibility with the trial court, (2) the court may find that the prior recorded statements in litigation created an estoppel to testify differently, or (3) the court may suspect that Kate is committing perjury, and that you are suborning perjury.” (Cf. *Zamos*, pp. 962-963.)

Cali went on: “Even if these risks do not materialize, a summary judgment ruling in Kate’s favor does not ensure that you will not ultimately have malicious prosecution liability. In *Zamos*, Mr. Zamos lost the summary judgment motion based upon the plaintiff’s declaration, inconsistent with her recorded statements at the earlier hearings in the underlying action but he won at trial. He sued Lawyer Stroud for malicious prosecution; Stroud countered with an anti-SLAPP motion (C.C.P. §425.16). Zamos’ opposition argued that Stroud obtained the summary judgment by materially false facts. The Court of Appeal remanded the matter to the trial court, agreeing that if the trier of fact believed Mr. Zamos’ evidence, the denial of Zamos’ summary judgment motion was procured by materially false facts, and the Roberts rule does not apply. Since this was not appealed, the Supreme Court did not disturb the ruling. (*Zamos*, pp. 973, fn. 10.)

“Even if you win on summary judgment based upon Kate’s declaration, particularly if her statements differ materially from her recorded statements at the hearings in the underlying foreclosure action, a court could still find that the summary judgment was procured by materially false facts and the Roberts rule would not provide a safe harbor,” Cali warned.

“What should I do?” Meryl asked.

“Protect Kate’s interests as well as those of third parties. The lack of probable cause to go forward and the attendant risks are significant developments in her case, which you have a duty to discuss with her. (Bus. & Prof. Code §6068(m); CRPC 3-500.) You should also advise her of your duties to cause a dismissal of the action or, if she is unwilling, to withdraw from representation. (*Zamos*, p. 970.) However, dismissal may not protect Kate or you, so explore a settlement with Mr. Samos with mutual releases,” Cali urged.

As Meryl left to contact Kate Klient, Terry Transaction, the transactional partner, rushed in with another matter involving the firm's duties to opposing parties arising in a transaction.

"Cali, our firm is representing DrugCo in the acquisition of Small research and development drug company. Part of the terms of the transaction are an exchange of Small's stock for some DrugCo stock. We have given Small's attorneys all documents they requested and have presented to their attorneys an outline of the transaction. However, we have not specifically disclosed details of the pre-acquisition financing of DrugCo stock," Terry began.

"Terry, before you go any further, I urge you to counsel DrugCo to permit you to disclose all details of the pre-acquisition financing of DrugCo stock and any other material facts relating to the transaction. A new case, *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 291, 17 Cal.Rptr.3d 26, held that an opposing party can state a cause of action for fraud against another party's transactional lawyer for partially but not fully disclosing all material facts. Although the case sustained a demurrer, and the fraud may never be proven in that case, it permitted the opposing party's action for fraud against their opponent's transactional lawyers to go forward. It also held that the opposing party's ability to access the same information publicly did not change the duty of disclosure. (Vega, p. 295.) Therefore, if our firm made partial disclosures about one aspect of the company's stock, we have a duty to the opposing party to make a full and complete disclosure of all material facts or risk exposure to litigation for fraud from the opposing party. "

Terry dashed out of her office to make the necessary client contacts and disclosures, thanking Cali for the tip.

Three weeks later, Meryl Terpitute advised Cali that he had worked out a settlement in Kate's case for dismissal of the action and mutual releases. Terry Transaction reported that DrugCo disclosed every material fact possible regarding its finances, including everything about pre-acquisition financing and that all of the parties seemed very satisfied. California Joan breathed a sigh of relief. For now, protecting the firm's clients could be harmonized with lawyers' duties to third parties.

■ *Ellen R. Peck, a sole practitioner from Escondido, is a former judge of the State Bar Court, a member of the State Bar's Commission for the Revision of the Rules of Professional Conduct and a co-author of The Rutter Group's California Practice Guide — Professional Responsibility.*

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## Test — Legal Ethics

### 1 Hour MCLE Credit

1. California courts have refused to expand lawyers' duties to non-clients.
2. A lawyer who has probable cause to initiate a lawsuit who thereafter discovers that the action lacks probable cause cannot be liable for malicious prosecution.
3. Malicious prosecution is a disfavored tort.
4. California courts have previously refused to extend the scope of malicious prosecution because of the potential to impose an undue 'chilling effect' on the ordinary citizen's willingness to report criminal conduct or to bring a civil dispute to court.
5. The tort of malicious prosecution's ability to deter excessive and frivolous lawsuits is compromised by commencing yet another round of litigation.
6. Even if it is unfair to bar a legitimate cause of action, malicious prosecution will not be extended.
7. One element to establish a malicious prosecution cause of action is that the underlying action was commenced by or at the direction of the defendant and was pursued to a legal termination in plaintiff's favor.
8. Another element to establish a malicious prosecution cause of action is that the underlying action was continued for the purpose of harassing the plaintiff.
9. Malicious prosecution actions exist to redress the harm individuals suffer from defending an action initiated without probable cause and the corresponding burden upon the efficient administration of justice.
10. Continuing an action discovered to be baseless does not harm the defendant or burden the court system as much as initiating an action known to be baseless from the outset.
11. Only those actions that any reasonable attorney would agree are totally and completely without merit may form the basis for a malicious prosecution suit.
12. A lawyer has no duty to maintain actions or proceedings which are legal or just.
13. A lawyer may present a litigation claim not warranted under existing law if it is supported by good faith argument for its extension, modification or reversal.
14. A lawyer need not withdraw from employment even if the lawyer knows that an objective is to assert a litigation position without probable cause and for the purpose of harassing or maliciously injuring another person.
15. If a lawyer receives interrogatory answers appearing to present a complete defense, it would be reasonable to take the defendant's deposition in order to determine whether on testimonial examination, the defense would prove less than solid.
16. A favorable ruling on a summary judgment in the underlying action conclusively establishes probable cause.
17. An anti-SLAPP motion (C.C.P. Â§425.16) may be filed by a defendant subject to a malicious prosecution action.
18. A lawyer who commences a lawsuit properly but then discovers that it is not supported by probable cause must cause dismissal of the lawsuit or withdraw from employment.
19. A lawyer's discovery that a properly commenced lawsuit lacks probable cause to go forward is a significant development in a client's case.
20. No other state imposes liability upon parties for malicious prosecution, where a lawsuit is properly commenced but it is later discovered that the action lacks merit.

# MCLE ON THE WEB

## TEST #49 — Unseen Risk: Duties to Non-Clients

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