**5.1: The Duty of Loyalty**

*Don't look so surprised. You've been telling me lies. True confessions.*[[1]](#footnote-0)

*Your depths made a pressure that punctured my works and all your fluids couldn't tolerate the force of my thirst. I love the place where we shared our tiny grace, but just because it’s real don't mean it’s gonna work.*[[2]](#footnote-1)

Attorneys have a fiduciary duty of loyalty to their clients, and attorneys who breach that duty of loyalty may be liable for malpractice. Typically, attorneys breach their duty of loyalty by ignoring or concealing a conflict of interest. A conflict of interest reflects an incentive to breach the duty of loyalty. And attorneys who act on that incentive have probably committed malpractice.

**The Scope of the Duty of Loyalty**

While attorneys owe their clients both a duty of care and a duty of loyalty, the duties are not the same. The duty of care requires reasonable care under the circumstances, but the duty of loyalty is an absolute duty. In other words, attorneys must always be vigilant for conflicts of interest. And if a conflict arises, attorneys must either resolve the conflict or withdraw from representation.

| [***Moguls of Aspen, Inc. v. Faegre & Benson*, 956 P. 2d 618 (Colo. App. 1997)**](https://scholar.google.com/scholar_case?case=3452530023091028309) |
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| **Summary:** While representing Moguls of Aspen in a dispute with its landlord, Faegre & Benson provided inaccurate legal advice, which caused Moguls of Aspen to lose its lease and go out of business. Moguls of Aspen sued Faegre & Benson for malpractice, but the trial court refused to instruct the jury on its claim for breach of the duty of loyalty, finding that the facts did not support the claim. The court of appeals affirmed, finding that Moguls of Aspen presented evidence of negligence, but did not present evidence of a conflict of interest. |

Plaintiffs, Moguls of Aspen, Inc. (MOA) and Mogul Shop, Inc. (MSI), appeal from the judgment entered upon a jury verdict in favor of defendants, Faegre & Benson, a law firm, and Christian Onsager, one of its members. We affirm.

Plaintiffs are two corporations wholly owned by Nancy Snell. MOA leased commercial space and subleased it to MSI, which operated a retail ski apparel shop on the premises.

Plaintiffs first contacted the defendant law firm as a result of a dispute between them and the lessor of the commercial space concerning the amount of rent owed. After receiving notice from the lessor that they were in default on their lease, plaintiffs’ real estate attorney contacted the law firm to discuss the possibility of filing a Chapter 11 bankruptcy petition.

A meeting was held with two attorneys of the law firm on June 25, 1991. Plaintiffs brought both the written lease and the lessor's notice of default to the meeting. At trial, their evidence sought to establish that an attorney-client relationship was established at this meeting. According to plaintiffs, while the plain language of the lease stated that the lessor could terminate the lease ten days after serving the notice of default, defendants did not advise them of this fact, nor did they disclose the legal effect of taking no immediate action to preserve the lease.

Plaintiffs asserted that, after this initial meeting, defendants performed no further work on plaintiffs’ behalf until August 7, 1991. At trial, plaintiff’s experts testified that these acts and omissions by defendants constituted professional negligence, as well as breaches of their fiduciary duties to act with “due diligence” and “in the client's best interest.”

On August 7, 1991, after the lessor had served a demand for payment or possession on them, plaintiffs again contacted one of the attorneys who had been present at the June 25, 1991, meeting. This attorney told plaintiffs that he was too busy to handle the matter, and he referred it to defendant Onsager. Onsager informed plaintiffs that the lessor could not obtain possession of the premises unless an additional three-day notice was served upon them. This advice was admittedly inaccurate.

On August 22, 1991, the lessor terminated plaintiffs’ lease. As a result, plaintiffs ceased doing business.

The original complaint in this case was filed a few days before the statute of limitations expired. At that time, because MSI, the owner of the business, was subject to a Chapter 7 bankruptcy proceeding and its trustee had elected not to pursue a legal malpractice claim against defendants, MSI was not made a party to the action. Nancy Snell was an original plaintiff. However, before trial, the trial court dismissed all of Snell's individual claims, concluding that there was no evidence to support a reasonable inference that Snell, the individual, as distinguished from the two wholly-owned corporations, had an attorney-client relationship with defendants.

Nevertheless, the court allowed the complaint to be amended to add MSI as a plaintiff. It also concluded that, because the claims that Snell had attempted to state were substantially the same as the claims now asserted by MSI, the latter claims would relate back to the date that Snell filed the initial complaint. Hence, it held that MSI's claim was not time-barred.

During the course of the later trial, the court submitted the claim of professional malpractice to the jury. It refused, however, to instruct upon any separate claim based upon an alleged violation of fiduciary duty. The jury rejected the claim submitted to it, and the court entered judgment upon that verdict.

MOA and MSI appeal from that judgment, asserting that the court erred in refusing to instruct the jurors with respect to their claim that defendants had violated certain fiduciary duties that defendants owed to them. We disagree.

The court here instructed the jurors upon the alleged professional malpractice of defendants consistent with the standard instruction. In accordance with this instruction, the jurors were required to determine whether defendants acted in a reasonably prudent manner, as measured against the acts or omissions of a reasonably careful attorney under the same or similar circumstances.

Plaintiffs tendered an instruction which set forth the elements of a claim based upon the violation of a fiduciary duty. In addition, they tendered an instruction describing the fiduciary duties that plaintiffs asserted defendants had violated. This instruction would have told the jurors that defendants owed the following duties to plaintiffs (none of the terms of which were further defined or described):

A duty to their client to employ that degree of knowledge, skill and judgment ordinarily possessed by members of the legal profession in carrying out the services for their client.

A duty to their client to act with due diligence in the affairs of their client.

A duty to their client to provide accurate information to their client regarding the status of legal matters intrusted to them.

A duty to their client of undivided loyalty and should exercise independent judgment on behalf of their client.

A duty to their client to the highest degree of fairness and good faith.

A duty to their client of full disclosure.

The trial court, however, determined that the evidence would support no claim beyond one based upon defendants’ alleged negligence and lack of due diligence, the claim for which was adequately covered in the other elemental instruction. Hence, it refused to instruct the jurors as plaintiffs requested. We conclude that such refusal was proper.

Plaintiffs assert that each of the duties described in their tendered instructions was violated because: (1) plaintiffs were not advised at the initial meeting as to the procedure pursuant to which the lease could be terminated or the effect of such termination upon the effectiveness of any later bankruptcy proceedings; (2) defendants failed adequately to investigate plaintiffs’ circumstances and failed to formulate a plan of action on their behalves from the initial meeting until plaintiffs contacted defendants again in August; and (3) on this latter date, the attorney who initially consulted with plaintiffs asserted that he was too busy with other matters to provide any further services and referred them to defendant Onsager.

All of these allegations, while serious, do not implicate defendants actions except in a negligence or malpractice context. There is no allegation or evidence that defendants’ acts or omissions, if any, resulted from an improper motive, a conflict of interest, or any other consideration beyond carelessness and lack of attention.

Under such circumstances, other courts have concluded that a claim for breach of a fiduciary duty is duplicative of a claim for professional malpractice and that only the latter claim should be the subject of adjudication. As stated in *Calhoun v. Rane*:

A fiduciary relationship exists as a matter of law between an attorney and his client. Thus, in effect any alleged malpractice by an attorney also evidences a simultaneous breach of trust; however, that does not mean every cause of action for professional negligence also sets forth a separate and independent cause of action for breach of fiduciary duty. In the present case, we find that the client has not pleaded a cause of action for breach of fiduciary duty distinct from the alleged malpractice case still pending in the trial court. A duplicative count may be properly dismissed.

No Colorado appellate court has yet addressed this issue with respect to the alleged breach of a fiduciary duty resulting from a lawyer's malpractice. There have been several instances in which a trial court has allowed both types of claims to be passed upon by a jury. But, the question whether, under the particular factual circumstances, the claims were duplicative was not addressed. In *Bailey v. Allstate Insurance Co.*, the issue presented was whether the damages awarded under each of the two claims were duplicative, not whether the claims themselves were separate.

Nevertheless, previous Colorado decisions with respect to claims asserted against members of the medical profession are consistent with the analysis adopted by other courts as to claims asserted against lawyers.

Further, each of the duties referred to in plaintiffs’ tendered instructions, insofar as the evidence would implicate any of them, is stated in absolute terms, i.e., duty “to provide accurate information.” Yet, where, as here, it is the attorney’s lack of due diligence and negligence that is the basis for the claim, the duty is not an absolute one. Rather, as the court properly instructed the jurors, the duty is to act with that care and diligence with which a reasonably careful attorney would act under the same or similar circumstances.

We agree with plaintiffs that some duties owed by attorneys may be absolute. The duty of “undivided loyalty” may be one. However, contrary to plaintiffs’ assertions, here, the evidence does not implicate such a duty; the violations of duty alleged here were grounded upon the lawyers’ alleged negligence and lack of due diligence.

We recognize that circumstances may exist in which a lawyer may be guilty both of malpractice and of other violations of his or her fiduciary obligations. If a claimed fiduciary violation is separate and independent from any alleged negligence, separate claims may well be properly asserted. This, however, is not such a case. And, the trial court properly recognized that it was not.

**Questions:**

1. Why did Moguls of Aspen fail to state a claim for breach of the duty of loyalty? What additional allegations would have stated a claim for breach of the duty of loyalty?
2. How does the duty of care differ from the duty of loyalty? Is it possible to negligently breach the duty of loyalty?
3. Why did Moguls of Aspen want to claim a breach of the duty of loyalty rather than a breach of the duty of care?

**Breach of the Duty of Loyalty**

[***David Welch Co. v. Erskine & Tulley*, 203 Cal. App. 3d 884 (Cal. App. 1988)**](https://scholar.google.com/scholar_case?case=14696672928150872193)

**Summary:** David Welch Company was a collection agency. In 1972, Erksine & Tulley and Michael Carroll began providing legal representation to Welch. Among other things, they assisted Welch in collecting debts for employee-benefit trust funds from delinquent employers. In 1980, E&T and Welch ended their attorney-client relationship. Soon afterward, E&T began submitting proposals to collect debts for Welch’s clients, without Welch’s consent. Welch filed an action for breach of fiduciary duty and the trial court found for Welch. The appeals court affirmed, holding that E&T’s duty of loyalty to Welch required it to obtain informed consent before submitting proposals to Welch’s clients.

CHANNELL, J.

Following a court trial, defendants Erskine & Tulley (E&T) and Michael Carroll appeal from a judgment entered against them and in favor of David Welch Co. (Welch). The trial court held that E&T, a law corporation, and Attorney Carroll had breached their fiduciary duty towards Welch, their former client, and had received a benefit of $350,000, which defendants were deemed to hold in constructive trust for Welch. Defendants were ordered to disgorge that benefit to Welch. Welch cross-appeals from that portion of the judgment providing that its recovery shall be only from those defendants, and only in the amount of $350,000.

This controversy arises from the fact that after E&T and Welch terminated their attorney-client relationship in December 1980, E&T gradually acquired the collection business activities formerly performed by Welch in behalf of several employee benefit trust funds. The basic issue in the trial court was whether, in doing so, the law firm or any of its attorneys breached a fiduciary duty towards their former client.

I. FACTS

Welch is a licensed collection agency which, over several years, developed a highly profitable specialty in collecting delinquent employer contributions owed to 35 or more employee-benefit trust funds. From 1972 to 1980, E&T acted as counsel for Welch, with Attorney Carroll doing most of the work for them in the later years. Before undertaking the representation of Welch, neither E&T nor Carroll had experience in collection agency work for trust funds.

The evidence was in conflict as to how defendants acquired their knowledge for conducting this type of collection activity. Defendants presented evidence indicating that, from a legal standpoint, it was like any other collection work, and that no specialized knowledge or expertise was required. Welch presented evidence that the E&T attorneys were specially trained by the owner, David Welch, on these matters; they were entrusted with complete access to information about Welch's confidential and profitable business techniques; and they were introduced by Welch as its attorneys to the trustees of the various trust funds. All of the information so provided was intended by Welch to be confidential.

When collecting a debt, Welch had the trust fund assign legal title to it, with the trust fund retaining equitable title. If its own collection efforts proved unsuccessful, Welch had E&T file suit in Welch's name as assignee of the trust fund. Before turning a case over to its counsel, Welch would carry out its own collection efforts, investigate the financial status of the delinquent employer, and prepare a case file which included all of the background documents, suggestions for handling the matter, and a draft complaint ready for filing in court.

Because collecting for trust funds was so profitable, David Welch organized his business in a manner designed to preserve the confidentiality of its procedures. He separated the trust fund activity from his other collection activities, used only his most trusted employees, physically located the activity on a separate floor of his office, and took other steps to minimize dissemination of information and to protect against someone within his firm from breaking away and starting a competitive business.

In late 1979, the collection agency was sold, and Welch was taken over by Philip W. Coyle. In 1980, Welch stopped referring collection matters to E&T. The parties thereafter agreed to terminate their relationship, effective after December 31, 1980. At approximately the same time, notices were sent by Coyle to Welch's trust fund clients indicating that Welch soon would be increasing its fees for those clients for the first time since 1968.

In mid-1981, the Sheet Metal Workers Trust severed its relationship with Welch, and transferred its collection business to E&T. At the time, Welch viewed this as an isolated incident. During 1982 and early 1983, several more trust funds did likewise. The evidence indicates that E&T did not solicit these particular clients, but instead responded to inquiries from each trust fund requesting a proposal. On the other hand, there was no evidence that E&T disclosed to Welch, its former client, that it was submitting these proposals, nor that E&T sought to secure Welch's consent to take over these accounts. In each instance, Welch learned it had lost its account from someone other than E&T, usually in the form of a letter from the trust fund announcing as a fait accompli that their business was being transferred to E&T.

By the time Welch filed its complaint against E&T in February 1983, the law firm had obtained the collection accounts of at least 10 of Welch's former trust fund clients, with annual billings approximating $156,715.

II. DISCUSSION

A. Breach of Fiduciary Duty

Defendants' first set of contentions relates to whether substantial evidence supports the trial court's findings that they breached their fiduciary duty towards Welch. With respect to a cause of action alleging breach of a fiduciary duty, the existence of the duty is a question of law. “The relation between attorney and client is a fiduciary relation of the very highest character, and binds the attorney to most conscientious fidelity — uberrima fides.”

There is no dispute that a fiduciary duty did exist in this case. The issue is whether defendants breached that duty towards Welch, which is a question of fact. As in other claims of lack of evidence, the question is “whether there is any substantial evidence contradicted or uncontradicted which will support the finding of fact.”

Defendants’ initial contention concerning this issue is that the trial court erred in finding a breach of fiduciary duty based on alleged violations of rules 4-101 and 5-101 of the Rules of Professional Conduct. Before trial, defendants had successfully moved for summary judgment as to the first cause of action, which had alleged that a violation of the rules, as a matter of law, provided a basis for civil liability. Nevertheless, these rules, together with statutes and general principles relating to other fiduciary relationships, all help define the duty component of the fiduciary duty which the attorney owes to his or her client.

In their argument, defendants cite rules 4-101 and 5-101 and then proceed to argue why their conduct neither fits within one of those rules nor otherwise constitutes a breach of a fiduciary duty. Defendants repeatedly suggest that the trial court concluded that their “mere acceptance of legal work from plaintiff's former clients” constituted such a breach. But more than that is required to establish a breach, and more than that was proven.

For example, the trial court found that defendants “breached their fiduciary duty owed to plaintiff by accepting employment adverse to plaintiff without plaintiff's informed and written consent relating to a matter in reference to which defendants had obtained confidential information by reason of or in the course of their employment by plaintiff.”

This finding was patterned after rule 4-101, a rule which on its face applies to former as well as present clients. The primary purpose of that rule is to protect the confidential relationship which exists between attorney and client. It has been said that an attorney may not “at any time use against his former client knowledge or information acquired by virtue of the previous relationship.” The actual use or misuse of confidential information is not determinative; it is the possibility of the breach of confidence which controls. This duty to protect confidential information continues even after the formal relationship ends.

Although neither party is able to cite a case involving a fact pattern analogous to this one, rule 4-101 seems to apply literally to this case. The typical case falling within the rule arises in the context of legal representation of a client whose interests are adverse to another client or former client of the attorney. But "adverse" also connotes being “opposed to one's interest” or “unfavorable.” The acquisition by an attorney of business clientele of a former client operates to the economic advantage of the attorney and unfavorably upon the former client. Concerning access to confidential information, David Welch testified as to his company's efforts to maintain the confidentiality of this portion of Welch's business, including its fees schedules, its methods of operation, and other information. Nevertheless, all of this information was shared with defendants. Finally, defendants accepted the new employment without first notifying or in any way seeking the informed consent of Welch before submitting its proposals to the various trust funds.

The trial court further found that “defendants breached their fiduciary duty owed to plaintiff by knowingly acquiring a pecuniary interest adverse to plaintiff without first obtaining plaintiff's informed written consent.” This finding highlights what we consider to be a critical factor in finding a breach of duty in this case, namely, the fact that defendants, who previously had been privy to Welch’s confidential information, in no way informed Welch that they were preparing proposals designed to undercut Welch's business relationships.

We agree with defendants that the various trust funds were free to send their business to any entity they chose, as absent a contract to that effect, they were under no continuing duty to continue business with Welch. Similarly, any law firm, other than E&T, was free to make proposals at the request of those trust funds in an effort to obtain their business, as E&T did in this case. But, due to the preexisting attorney-client relationship during which defendants were in a position to and did obtain confidential information about Welch's business, these defendants had a higher duty, which was to refrain from acquiring any pecuniary interest involving collection work for these trust funds unless they first notified and obtained the informed consent of Welch to submit their business proposals. As they did not do so, the trial court properly found that they had breached their fiduciary duty towards Welch.

**Questions:**

1. Why was it a breach of the duty of loyalty for E&T to submit proposals to Welch’s clients without Welch’s consent? What if Welch unreasonably refused consent?
2. Why is breach of the duty of loyalty a question of fact, rather than a question of law? What is the question of fact in this case? Did Welch prove the question of fact?
3. Why did it matter that Welch allegedly shared confidential information with E&T? If Welch had not shared confidential information with E&T, would it still have been a breach of the duty of loyalty for E&T to submit proposals to Welch’s clients without Welch’s consent?
4. When E&T provided collection services to Welch’s former clients, did it create an attorney-client relationship? Does it matter for the purpose of the duty of loyalty?
5. After the attorney-client relationship between E&T and Welch ended, could E&T compete with Welch for business without Welch’s consent? Are there circumstances where it could and circumstances where it couldn’t?

**Remedies for the Breach of the Duty of Loyalty**

[***Maxwell v. Gallagher*, 709 A. 2d 100 (DC App. 1998)**](https://scholar.google.com/scholar_case?case=2285898167739256604)

**Summary:** Gallagher & Co., Real Estate, Inc. was a closely-held corporation. In 1987, Maxwell & Bear provided legal advice to Gallagher and its owners in connection with the division of ownership shares in the corporation. In the transaction, 11 of the 100 shares in the corporation were transferred to Maxwell & Bear, which filed a declaratory judgment action to claim its shares. The corporation and its owners counterclaimed, seeking recission of the transfer for breach of fiduciary duty. The trial court found that the transaction created a conflict of interest that Maxwell & Bear did not resolve, causing a breach of the duty of loyalty, and ordered recission. The trial court found no actual damages, but awarded $75,000 in punitive damages to the plaintiffs. The appellate court affirmed the recission, but reversed the punitive damages award, because the trial court found no actual damages.

FARRELL, Associate Judge:

This appeal from a judgment and award of damages for breach of fiduciary duty requires us, *inter alia*, to consider once again the relationship between compensatory (or actual) and punitive damages. Because the trial judge as factfinder expressly found that the appellees (counter-claimants) had not proven a basis for an award of actual damages, we hold that the judge's award of punitive damages was impermissible. We reverse that award but otherwise affirm the judgment.

I.

Plaintiff James S. Maxwell sought a declaratory judgment in Superior Court confirming the right of the law firm Maxwell & Bear to retain its ownership of eleven shares of stock in Gallagher & Co., Real Estate, Inc., of which Maxwell and Robert H. Bear had been directors and Maxwell an officer. The remaining owners of the corporation, Eugene J. Gallagher and Daniel J. O’Lone, as well as the corporation, answered and filed a counterclaim adding Bear as a counter-defendant. They sought rescission of the stock transfer to Maxwell & Bear primarily on grounds of breach of fiduciary duty by the firm in providing legal representation to the corporation and the other owners. Following a bench trial, Judge Mitchell—Rankin issued an exhaustive written order and opinion concluding that Maxwell and Bear each had furnished legal representation to the corporation and Messrs. Gallagher and O'Lone during the relevant times and had breached their resultant fiduciary duty by placing their personal interest in controlling the corporation ahead of the interests of the clients. The judge ordered rescission of the stock held by Maxwell & Bear, awarded $1 in nominal damages to the appellees after finding no support for an award of actual damages, and ordered Maxwell and Bear to pay $75,000 in punitive damages.

II.

The trial judge found that Maxwell & Bear undertook to represent the corporation and its principals at meetings in December 1987 and January 1988 during which the division of ownership shares in the closely-held corporation was negotiated and agreed upon, resulting in the allocation of eleven of the one hundred shares to the law firm of Maxwell & Bear. The judge further found that Maxwell undertook the representation “under circumstances where the interest between the members including Maxwell & Bear and the corporate client were not compatible, and under circumstances where the law firm fostered and exploited the divergence.” In particular, the stock division, including “the equity interest solicited and obtained by the law firm was not consummated to facilitate the best interest of the corporation, but only to satisfy the demands of individual members and the law firm.” Moreover, from the beginning of the attorney-client relationship, Maxwell had never disclosed to, or discussed with, the other principals the possible conflicts of interest that relationship entailed. By engaging in this course of “double dealing” designed to insure themselves effective control of the corporation, the judge found that Maxwell and Bear breached fundamental attorney-client obligations as reflected in multiple provisions of the District of Columbia Code of Professional Responsibility.

On appeal, Maxwell and Bear primarily dispute the trial judge's finding that they undertook legal representation of the other principals in connection with the division of the stock. They concede that they represented Gallagher, O’Lone, and Pollard on other matters (indeed, they so stipulated at trial), but argue that when it came to the pivotal meetings at which the stock division was negotiated, all present knew that Maxwell and Bear “were there for their own business reasons.”

Significant first is that Maxwell and Bear do not deny that they purported to represent the corporation with regard to the stock division. They contend that “there is no evidence to support any finding that the attorneys ever undertook any professional responsibility in connection with the issuance of the stock other than to the corporation.” Yet in that admitted capacity, they concede that they owed a fiduciary duty, and the trial judge expressly found that they had placed their private interest in securing control of the corporation above the interests of the corporate client.

Moreover, there is ample record support for the judge's finding that the law firm purported to represent the other principals at the stock division meetings. Those meetings took place against the background of a course of dealing starting in 1984 during which Maxwell and Bear played the “dual/multiple roles” of business associates and legal counsel to Gallagher, including when jointly forming a predecessor company in 1986. As a later illustration, the judge found that Gallagher “sought and received legal advice from Mr. Maxwell as to the most appropriate time to resolve Mr. Pollard’s interest in the company,” an important issue because Pollard faced collateral legal (and potential criminal) liability at the time he joined the corporation. Indeed, the December 18, 1997 meeting at which the stock division became the paramount subject was originally called by Maxwell, at Gallagher's request, to discuss a real estate commission dispute the company had had with another real estate firm, “a matter in which Maxwell & Bear served as legal counsel for Messrs. Gallagher, Pollard, and O’Lone.” According to testimony by O'Lone, Maxwell expressly justified the law firm's demanded percentage ownership as payment for the ongoing representation it was providing to and on behalf of the company and its principals. In short, we find no reason to disturb the finding of a legal relationship between Maxwell & Bear and the others extending through the stock division and beyond.

Nor will we disturb the finding that appellants breached the duties imposed by that relationship by failing to disclose the business advantages they sought which “might affect the firm's legal judgment vis-a-vis Mr. Gallagher” and by acting repeatedly to effectuate their own interests at the expense of the other principals.

The relation of attorney and client is one of the highest trust and confidence, and demands the utmost good faith on the part of the attorney. This relation is not only highly confidential, but presents so many opportunities for the reaping of special benefits at the expense of the client by an attorney so disposed, that courts will closely scrutinize any transaction in which the attorney has assumed a position antagonistic to his client. In thus “scrutinizing” the relationship at hand, the trial judge found ample reason, as do we, to conclude that

the law firm acted in complete disregard of the interests of the corporate client and Mr. Gallagher. The law firm made no disclosures to any client, obtained no informed consents from any client, and sought by its disregard of its ethical and fiduciary duties to its corporate client to benefit itself.

We therefore sustain the judge's rescission of the stock transfer "as the tangible product of the breaches of fiduciary duty."

III.

Although the trial judge ordered cancellation of the stock transfer, she also found “no record evidence of any meaningful evaluation of the stock” at the time it was divided. Nor did the appellees present at trial any evidence of the dollar value of the stock. This exemplified what the trial judge found to be a complete failure of the appellees to present proof of loss from the breach of duty for which compensatory damages could be awarded. Maxwell and Bear argue that, in the absence of such proof, it was error for the trial judge to award punitive damages. We are constrained to agree. Despite some uncertainty in our decisions over the years, the principle we derive from them is that, before punitive damages may be awarded, there must be a basis in the record for an award of actual damages, even if nominal. Since the trial judge expressly found no such basis in the record of this case, punitive damages will not lie.

A.

In her original opinion, the judge denied the counterclaim “with respect to compensatory damages, in the absence of proof of the same,” but awarded $75,000 in punitive damages for the breach of fiduciary duty. The appellees then moved to amend the judgment “solely for the court to make an express finding that they are entitled to compensatory damages in at least a nominal amount.” The judge modified her order by awarding appellees “nominal damages in the amount of $1.00,” but she made explicit that this was not an award for actual damages because the appellees had shown no basis for such compensation. The judge distinguished between proof of “injury” and “evidence of any loss occasioned by” the injury. Referring to her original finding that “the harm caused to the corporation as a client and to Mr. Gallagher as a client by the law firm’s cavalier and self-interested approach to its ethical and fiduciary duties is amply demonstrated by the facts in this case,” she continued:

Although this Court does agree there is ample justification for a finding of injury as provided in the original order, it does not concur with appellees that they are entitled to compensatory damages. The reason is simple: they have failed to produce evidence of any loss occasioned by Maxwell’s and Bear’s conduct for which they should be compensated. Having proven only breach of fiduciary duty, and hence injury, appellees are entitled only to a nominal damage award but are not equally entitled to a corresponding compensatory damage award.

The judge thus awarded nominal damages of $1.00 as what she believed to be the required—and sufficient—predicate for punitive damages to a “plaintiff whose legal right has been technically violated but has proved no real damage.” In a word, the breach of fiduciary duty without more supplied the basis for the punitive damage award.

B.

First of all, we reject the appellees’ assertion that the trial judge found actual damages but was merely unable to quantify them—the $1.00 in nominal damages being a proxy for that indeterminate but actual loss. The appellees alleged only economic damages, something not inherently impossible to quantify if they had been proven. More importantly, the judge took pains to state repeatedly that the appellees had “failed to produce evidence of any loss”— hence any compensable damage—resulting from the breach of fiduciary duty. We therefore must decide whether the award of punitive damages was permissible without proof that actual damages were warranted.

We think the essence of our case law is this: A plaintiff must prove a basis for actual damages to justify the imposition of punitive damages. The amount of such damages may be nominal, stemming from the difficulty of quantifying them or from some other cause. But without proof of at least nominal actual damages, punitive damages may not be awarded.

Our most recent statement of this rule was in *Ayala v. Washington*. There we said:

Under the law of the District of Columbia, although there must be a basis for compensatory damages before punitive damages will be considered, a plaintiff need not prove anything more than nominal actual damages to justify the imposition of punitive damages.

In awarding punitive damages despite the absence of a basis for actual damages, the trial judge relied partly on the following passage from *Brown v. Coates*:

Once it has been shown that one trained and experienced holds himself out to the public as worthy to be trusted for hire to perform services for others, and those so invited do place their trust and confidence, and that trust is intentionally and consciously disregarded, and exploited for unwarranted gain, community protection, as well as that of the victim, warrants the imposition of punitive damages.

The cogency of this reasoning is indisputable but *Brown* does not bear upon the issue presented here of the necessity *vel non* of proof of actual damages before punitive damages may be awarded. We hold that, because the trial judge expressly found that appellees had proven no actual damages, punitive damages could not be awarded.

**Questions:**

1. Why did the court find that Maxwell & Bear violated its duty of loyalty? How could Maxwell & Bear have avoided violating its duty of loyalty?
2. Did Maxwell & Bear owe a duty of loyalty to the corporation or to the owners of the corporation? Could Maxwell & Bear represent all of the owners of the corporation?
3. Why did the court find no actual damages? Was it right?

**Further Reading:**

* [Lisa G. Lerman, *Lying to Clients*, 138 U. Pa. L. Rev. 659 (1990)](https://scholarship.law.upenn.edu/penn_law_review/vol138/iss3/8/)

1. The Undertones, *True Confessions* (1979). [↑](#footnote-ref-0)
2. The Blow, *True Affection*, Paper Television (2006). [↑](#footnote-ref-1)