Lawyer Liability for Assisting in Breach of Fiduciary Duty: Privilege or Peril?

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On September 8, the Oregon Supreme Court issued its opinion in 
*Reynolds v. Schrock*, ___ Or ___, ___ P3d ___, 2006 WL 2578330 (SC S52503 Sept. 8, 2006), a major lawyer liability case for anyone who advises fiduciaries—whether they are in formal roles such as trustees or informal ones such as joint venture partners. In *Reynolds*, the Supreme Court reversed the Court of Appeals (197 Or App 564, 107 P3d 52 (2005)), which held that a lawyer could be liable for assisting in a client’s breach of fiduciary duty by giving the client legal advice on evading a fiduciary duty and then helping the client implement that advice. The Supreme Court recognized a privilege for lawyers who give clients otherwise lawful advice and assistance that exempts them from liability in this situation.

In doing so, however, the Supreme Court also reaffirmed its own earlier decision in *Granewich v. Harding*, 329 Or 47, 985 P2d 788 (1999), where the Supreme Court upheld the more general proposition that a lawyer could be held liable for assisting in breaching a fiduciary duty to a third party if the lawyer was acting outside the scope of advising the lawyer’s client. *Granewich*, in turn, drew on Section 876 of the Restatement (Second) of Torts (1979), which deals with tortiously acting in concert with another resulting in injury to a third person. The central facet of the Supreme Court’s *Reynolds* decision offers an important shield
for lawyers who advise fiduciaries. At the same time, the Supreme Court’s reaffirmation of *Granewich* means that lawyers must still proceed with caution in many circumstances in which they may be drawn out of the protective confines of the attorney-client relationship.

In this article, we’ll look at five aspects of lawyer liability for assisting in a breach of fiduciary duty. First, we’ll first briefly review Section 876. Second, we’ll examine the *Granewich* decision. Third, we’ll look at the Court of Appeals’ decision in *Reynolds*. Fourth, we’ll contrast that with the Supreme Court’s decision in *Reynolds*. Finally, we’ll discuss what lawyers can do to protect themselves from liability under *Granewich*.

**Section 876**

Section 876 isn’t aimed at lawyers. Rather, it sets out three broad categories where someone acting in concert with another can be liable for resulting harm to a third person:

“For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he

(a) does a tortious act in concert with the other or pursuant to a common design with him, or

(b) knows that the other’s conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or
(c) gives substantial assistance to the other in accomplishing a
tortious result and his own conduct, separately considered,
constitutes a breach of duty to the third person.”

The Supreme Court in *Granewich* found that prior Oregon case law
recognized each element of Section 876 and noted that “to state that this court
recognizes section 876 as reflecting the common law of Oregon breaks no new
ground.”¹ The Supreme Court went on to “conclude that persons acting in
concert may be liable jointly for one another’s torts under any one of the three
theories identified in *Restatement* section 876.”²

Depending on the circumstances, subsections (a) and (c) can create risks
for lawyers. But, subsection (b) poses the greatest practical risk to lawyers
because it potentially creates liability to a *nonclient* for advice and other legal
work. *Granewich* and *Reynolds* both focused on subsection (b).

**Granewich**

*Granewich* involved a “minority squeeze out.” Granewich and two
business associates, Harding and Alexander-Hergert, formed a closely held
financial corporation in 1992. All three were directors, officers and employees of
the company and each owned one-third of its shares. About a year later,
Harding and Alexander-Hergert had a falling out with Granewich and began
planning to remove him from the company. At that point, they hired a law firm to
represent the company. The complaint alleged, however, that the law firm soon
exceeded this neutral role as corporate counsel and began to advise and assist Harding and Alexander-Hergert individually in their efforts to oust Granewich by amending the company’s bylaws and calling special meetings that resulted in Granewich’s removal.

After he was forced out, Granewich sued his fellow owners, the corporation and the lawyers. The two other owners and the corporation settled, leaving only the lawyers. The charge against them was that they allegedly assisted in the two majority owner-directors in breaching their fiduciary duties to Granewich. The trial court dismissed on the pleadings and the Court of Appeals affirmed, holding that if the lawyers had no direct fiduciary duty to Granewich they could not be vicariously liable for the majority owner-directors’ asserted breach. The Supreme Court reversed.

Relying on Section 876, the Supreme Court found that the complaint stated a claim against the lawyers:

“There is no Oregon law directly addressing whether someone can be held liable for another’s breach of fiduciary duty. Legal authorities, however, virtually are unanimous in expressing the proposition that one who knowingly aids another in the breach of a fiduciary duty is liable to the one harmed thereby. That principle readily extends to lawyers.” 329 Or at 57 (emphasis added; footnotes omitted).

Reynolds at the Court of Appeals

Reynolds was painted against the backdrop of a real estate joint venture. Reynolds and Schrock purchased two parcels—one was commercial timber and the other was recreational. They had a falling-out and later entered into a
settlement agreement to wind-up the joint venture. Under the settlement, Reynolds conveyed his interest in the recreational parcel to Schrock and, in return, Reynolds was to receive all proceeds from the sale of the timber. Reynolds had invested $500,000 in the joint venture by that point. To make Reynolds whole, the settlement provided that if the timber sale did not net him at least $500,000, Schrock would pay Reynolds any deficiency and Reynolds would have a lien on the recreational parcel to secure the deficiency.

After Reynolds had deeded his interest in the recreational parcel to Schrock, Schrock asked her lawyer if the settlement agreement required her to keep the recreational property pending the timber sale. Schrock’s lawyer concluded that the settlement agreement contained no such obligation and advised Schrock accordingly. Schrock then sold the recreational parcel with the lawyer’s assistance. Schrock later prevented the timber sale—leaving Reynolds without either his interest in the recreational property or his share of the timber sale proceeds.

Reynolds sued Schrock. Reynolds framed the primary claim against Schrock as breach of fiduciary duty. He argued that Schrock had a fiduciary duty to wind-up the joint venture as contemplated by the settlement agreement and that her failure to do so—notwithstanding the apparent loop-hole in the settlement agreement allowing the sale of recreational property—constituted a breach of that duty. Reynolds also sued Schrock’s lawyer. Reynolds did not
contend that Schrock’s lawyer had an independent fiduciary duty to him. Rather, he argued that the lawyer was jointly liable with Schrock for the breach of Schrock’s fiduciary duty to Reynolds by providing the advice and assistance in implementing that advice to Schrock. Schrock settled with Reynolds. Her lawyer moved for summary judgment, which the trial court granted. The Court of Appeals reversed.

Relying principally on Section 876 and Granewich, the Court of Appeals concluded that a lawyer advising a client to act contrary to a fiduciary duty may be liable to a nonclient to whom that duty is owed even if the act would otherwise be permitted by an associated contract: “[i]f the attorney knows that the fiduciary relationship imposes a higher standard of conduct than the agreement, then the attorney who advises the client that he or she may do an act that the contract permits but that is incompatible with the fiduciary relationship may be liable for the breach of fiduciary duty.”

Reynolds at the Supreme Court

In reversing the Court of Appeals, the Supreme Court wove together three primary threads.

First, the Supreme Court distinguished Granewich by noting that the law firm there had exceeded its role as corporate counsel and began offering its advice and assistance to the two majority shareholders who were not its clients.
Second, the Supreme Court recognized a privilege against joint liability for a lawyer assisting in a client's breach of fiduciary duty. The Supreme Court found that both Restatement Section 890 ("One who otherwise would be liable for a tort is not liable if he acts in pursuance of and within the limits of a privilege[.]") and prior Oregon case law suggested that in some narrow circumstances a shield from joint liability should be recognized to vindicate important public policy goals. It then found that protection of the lawyer-client relationship was one such goal. In particular, the Supreme Court stressed the importance of having a lawyer's advice unhindered by the specter that the lawyer might be sued by a nonclient for rendering that advice to the lawyer's client. Therefore, the Supreme Court created a limited shield against liability in this circumstance:

“We extend those well-recognized principles to a context that we have not previously considered and hold that a lawyer acting on behalf of a client and within the scope of the lawyer-client relationship is protected by such a privilege and is not liable for assisting the client in conduct that breaches the client's fiduciary duty to a third party. Accordingly, for a third party to hold a lawyer liable for substantially assisting in a client's breach of fiduciary duty, the third party must proved that the lawyer acted outside the scope of the lawyer-client relationship.” 2006 WL 2578330 at *7.

Third, the Supreme Court outlined several exceptions to the shield. In doing so, it focused on situations where the lawyer is acting outside the lawyer-client relationship, is acting contrary to the client's interests or is otherwise advising the client on future unlawful or fraudulent conduct:
“[T]he rule protects lawyers only for actions of the kind that permissibly may be taken by lawyers in the course of representing their clients. It does not protect lawyer conduct that is unrelated to the representation of a client, even if the conduct involves a person who is a client. Because such unrelated conduct is, by definition, outside the scope of the lawyer-client relationship, no important public interest would be served by extending the qualified privilege to cover it. . . For the same reason, the rule does not protect lawyers who are representing clients but who act only in their own self-interest and contrary to their clients’ interest. Similarly, this court would consider actions by a lawyer that fall within the ‘crime or fraud’ exception to the lawyer-client privilege, OEC 503(4)(a), and Rule of Professional Conduct 1.6(b)(1), to be outside the lawyer-client relationship when evaluating whether a lawyer’s conduct is protected.” Id. (Citation omitted.)

**Lessening the Continued Risks Under Granewich**

Although the Supreme Court’s decision in *Reynolds* creates a shield when advising fiduciaries, the Supreme Court’s reliance on *Granewich* underscores that the risks identified in that more common situation remain. Lawyers advising closely held corporations, family groups, partnerships and other joint ventures are often put in situations which invite them to step beyond their role as lawyers for the entities involved to give advice to individual shareholders, family members or partners as was the case in *Granewich*. Under *Reynolds*, they would not have the protective shield of privilege for advice beyond their clients.

*Granewich* and *Reynolds* heighten the importance of clearly spelling out in an engagement letter who the lawyer is representing and then acting in conformance with that agreement. In situations like *Granewich*, if a law firm confines its role to entity counsel only it will lessen the risk of being accused later
of having “taken sides” and, in doing so, assisting one camp in an internal
dispute in breaching fiduciary duties to the other.5

**Summing Up**

*Reynolds* is a very important decision for lawyers and law firms. In taking
comfort from *Reynolds*, however, law firms need to continue to keep *Granewich’s*
cautionary tale in mind.

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1 329 Or at 54.
2 Id. at 55.
3 197 Or App at 577.
4 This approach is consistent with OSB Formal Ethics Opinion 2005-92, which concludes that a lawyer can generally advise a client to breach a contract as long as the conduct suggested does not constitute fraud or is otherwise unlawful.
5 RPC 1.13 deals specifically with entity representation.