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12 Statutes Affecting Lawyer Liability

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I. [12.1] CONSUMER FRAUD AND DECEPTIVE BUSINESS PRACTICES ACT

There have been many suits against attorneys that have included a count for an alleged violation of the Consumer Fraud and Deceptive Business Practices Act (Consumer Fraud Act), 815 ILCS 505/1, *et seq.* As discussed in §12.6 below, in 1998, the Illinois Supreme Court significantly limited the application of the Act to attorneys. *Cripe v. Leiter,* 184 Ill.2d 185, 703 N.E.2d 100, 234 Ill.Dec. 488 (1998). However, the Act still poses potential liability for certain attorney conduct.

A. [12.2] Scope of the Consumer Fraud Act

The purpose of the Consumer Fraud Act, as stated in the title of its enacting legislation (Laws 1961, p. 1867), is "to protect consumers and borrowers and businessmen against fraud, unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce." See Historical and Statutory Notes, S.H.A. (1999), 815 ILCS 505/1. The terms "trade" or "commerce," as defined in the Act, include "the advertising, offering for sale, sale, or distribution of any services and any property, tangible or intangible, real, personal or mixed, and any other article, commodity, or thing of value wherever situated, and shall include any trade or commerce directly or indirectly affecting the people of this State." 815 ILCS 505/1(f).

B. [12.3] Elements of a Cause of Action

The Consumer Fraud Act provides: "Any person who suffers damages as a result of a violation of this Act committed by any other person may bring an action against such person." 815 ILCS 505/10a(a). The elements of a claim under the Act are (1) a deceptive act or practice by the defendant, (2) the defendant's intent that the plaintiff rely on the deception, and (3) the deception occurring in the course of conduct involving trade or commerce. *Connick v. Suzuki Motor Co.,* 174 Ill.2d 482, 675 N.E.2d 584, 593, 221 Ill.Dec. 389 (1996). A valid claim under the Act must show that the consumer fraud proximately caused the plaintiff's injury. *Wheeler v. Sunbelt Tool Co.,* 181 Ill.App.3d 1088, 537 N.E.2d 1332, 1346, 130 Ill.Dec. 863 (4th Dist. 1989). Further, the Act must be liberally construed to effect its purpose. *Connick, supra,* 675 N.E.2d at 594. *See also Avery v. State Farm Mutual Automobile Insurance Co.,* 216 Ill.2d 100, 835 N.E.2d 801, 296 Ill.Dec. 448 (2005).

C. [12.4] Statute of Limitations

The Consumer Fraud Act provides that any action taken under §10a of the Act must be commenced within three years of the cause of action. 815 ILCS 505/10a(e).

D. [12.5] Claims Involving Attorneys

In relation to the applicability of the Consumer Fraud Act to the legal profession, there have been a number of court decisions, including the Illinois Supreme Court's decision in *Cripe v. Leiter,* 184 Ill.2d 185, 703 N.E.2d 100, 234 Ill.Dec. 488 (1998) (see discussion in §12.6 below), that have clarified this area of the law.

1. [12.6] *Cripe v. Leiter*

The most significant case in the application of the Consumer Fraud Act to attorneys is *Cripe v. Leiter,* 184 Ill.2d 185, 703 N.E.2d 100, 234 Ill.Dec. 488 (1998). In *Cripe,* the plaintiff, who was acting as guardian for her mother, Mrs. Schmitz, brought a claim against her attorneys under the Act. The plaintiff claimed that the fees of the defendant attorney and his firm were "outrageously excessive and unreasonable and bear no relationship to the actual time spent by Attorney Leiter in allegedly representing Mrs. Schmitz as her personal attorney and as her trust attorney." 703 N.E.2d at 102. The Illinois Supreme Court, however, held that the Act did not apply to the attorney.

After her husband's death, Mrs. Schmitz was the recipient of two irrevocable trusts valued at approximately $583,000. On February 12, 1992, Mrs. Schmitz discharged the family attorney and retained the defendants. Shortly afterward, Leiter transferred the trusts from First National Bank to South Side Trust and Savings Bank of Peoria.

On March 22, 1993, the plaintiff, Mrs. Schmitz's daughter, was appointed as successor guardian of Mrs. Schmitz by a Michigan probate court. The plaintiff filed suit against Leiter in her capacity as guardian of Mrs. Schmitz. The plaintiff alleged that the trust account was depleted in excess of $40,000 due to the defendants' overbilling for services. The plaintiff claimed that the Consumer Fraud Act applied to the defendants' conduct. The circuit court dismissed this count, but the appellate court reversed on appeal, holding that although the Act did not apply to the actual practice of law, it is applicable to the commercial aspects of law practice, which include billing for legal services. The defendants appealed.

The Illinois Supreme Court held that the Act is not applicable to claims arising out of the attorney-client relationship. The court reasoned that traditionally the regulation of attorneys has been within the court's domain. The court held that an attorney's billing for legal services could not be separated from the attorney-client relationship. Accordingly, an attorney's billing of a client is "not simply a 'business' aspect of the practice of law, but is tied to the attorney's fiduciary obligation to the client." 703 N.E.2d at 107.

In reaching this conclusion, the *Cripe* court examined the law of several other jurisdictions in efforts to apply consumer protection statutes to the legal profession. It considered the New Jersey appellate court ruling in *Vort v. Hollander,* 257 N.J.Super. 56, 607 A.2d 1339, 1342 (1992), that an attorney's services are not covered by the New Jersey consumer fraud statute, and that the practice of law is "in the first instance, if not exclusively," regulated by the New Jersey Supreme Court. 703 N.E.2d at 104.

Consistent with this analysis, the *Cripe* court concluded:

> **The legislature did not, in the language of the Consumer Fraud Act, specify that it intended the Act's provisions to apply to the conduct of attorneys in relation to their clients. Given this court's role in that arena, we find that, had the legislature intended the Act to apply in this manner, it would have stated that intention with**

> **specificity. See *Vort,* 257 N.J.Super. at 62, 607 A.2d at 1342. Absent a clear indication by the legislature, we will not conclude that the legislature intended to regulate attorney-client relationships through the Consumer Fraud Act.** 703 N.E.2d at 106.

2. [12.7] Additional Illinois Caselaw Involving Attorneys and the Consumer Fraud Act

Prior to *Cripe v. Leiter,* 184 Ill.2d 185, 703 N.E.2d 100, 234 Ill.Dec. 488 (1998), a number of Illinois appellate courts similarly concluded that the Consumer Fraud Act is not applicable to claims arising out of the attorney-client relationship. In *Frahm v. Urkovick,* 113 Ill.App.3d 580, 447 N.E.2d 1007, 69 Ill.Dec. 572 (1st Dist. 1983), the plaintiffs retained the services of the defendant attorney to facilitate the purchase and development of a certain piece of real estate. The defendant allegedly made a number of representations that he knew or should have known to be incorrect concerning the financing and construction of buildings on the property. According to the plaintiffs, the attorney failed to inform them about his professional and other ties with the project. Without the plaintiffs' knowledge, the defendant drew up additional documents providing for the sale of the property to a corporation set up by the defendant and his son. This agreement gave substantial benefit to the seller and left the plaintiffs with little or no recourse in the event of the seller's default. The plaintiffs alleged that, as a result of the defendant's actions and misrepresentations, they lost their entire investment in the property.

The plaintiffs included a claim under the Consumer Fraud Act in their complaint, which the trial court dismissed. On appeal, the plaintiffs claimed that under a liberal construction of the Act, they were consumers for the purposes of the Act. The court concluded that it did not believe "that even the most liberal statutory interpretation indicates the application of this consumer protection statute to the conduct of an attorney engaged in the actual practice of law." 447 N.E.2d at 1009. The court held that the plaintiffs did not "fall within the class of 'consumers' which the statute was designed to protect." *Id.*

In *Lurz v. Panek,* 172 Ill.App.3d 915, 527 N.E.2d 663, 123 Ill.Dec. 200 (2d Dist. 1988), the defendant represented the plaintiff in a personal injury case against a railroad company. The court ruled in the plaintiff's favor, and the railroad issued a check in the amount of $66,596.64. The defendant endorsed the check with the plaintiff's name and deposited it into his business account. The defendant allegedly did not tell the plaintiff that the judgment had been paid, misrepresented the status of the payment, and attempted to reduce the payment to the plaintiff. Seven months after receiving the check, the defendant issued a check to the plaintiff for the amount of $43,358.34, retaining the remainder to satisfy attorneys' fees and costs. The plaintiff sued the defendant, claiming fraud, breach of fiduciary duty, conversion, and violation of the Consumer Fraud Act. On appeal, the court followed the reasoning in *Frahm,* holding that "the misconduct perpetuated by defendant in his capacity as an attorney representing plaintiff does not fall within the ambit of the Act." 527 N.E.2d at 670.

The federal courts in Illinois also have not applied the Act to attorneys. In *Kirkland & Ellis v. CMI Corp.,* No. 95 C 7457, 1996 WL 559951 (N.D.Ill. Sept. 30, 1996), the court held that the Act does not apply when an attorney is engaged in the provision of legal services or the practice of law. Kirkland & Ellis represented CMI in two patent infringement lawsuits against one of its competitors. In a subsequent suit, CMI claimed that Kirkland & Ellis did not disclose a conflict of interest when it arose, which allegedly affected subsequent settlement discussions. The court followed *Lurz* and held: "Although the Act may apply when an attorney is not engaged in the provision of legal services or the practice of law, that is not the case here." 1996 WL 559951 at *13.

The court in *Shaffer v. Respect, Inc.*, No. 97 C 4482, 1999 WL 281345 (N.D.Ill. Mar. 30, 1999), applied the *Cripe* analysis, holding that an action based on the attorney's billing practices did not state a claim under the Act. The plaintiff in *Shaffer* was an attorney suing to recover for his unpaid fees. The defendant filed a counterclaim alleging breach of contract, breach of fiduciary duty, unjust enrichment, violation of the Act, and legal malpractice. The court dismissed the count under the Act.

The lawyer defendant in *Zanayed v. Gertler & Gertler, Ltd.*, No. 99 C 5150, 2000 WL 294183 (N.D.Ill. Mar. 17, 2000), was hired to assist a collection agency in collecting a debt from the plaintiff. The Gertler firm filed suit for recovery of the debt. The firm obtained a default judgment and sent a wage deduction notice to the plaintiff's employer. The plaintiff then sued, alleging that the law firm violated the Act by communicating with her employer without giving her five days' notice as required by Illinois law. In rejecting the claim, the court relied on *Cripe*, holding that there was "little dispute" that the Act did not apply to claims arising out of the actual practice of law. 2000 WL 294183 at *2, quoting *Cripe, supra*, 703 N.E.2d at 105.

In *Shalabi v. Huntington National Bank*, No. 01 C 2959, 2001 WL 777055 (N.D.Ill. July 11, 2001), the plaintiff alleged that a law firm violated the Act by allegedly attempting to collect late charges that its client, Huntington National Bank, was not entitled to recover. The court relied on *Cripe* and dismissed the claim. In doing so, it also noted that the Illinois Rules of Professional Conduct prohibit attorneys from engaging in fraudulent, dishonest, or deceitful misrepresentations, which is what the plaintiff was trying to prove. It further stated that "the Rules of Professional Conduct reach beyond the attorney-client relationship itself to regulate the conduct of attorneys with non-clients and potential or actual adversaries." 2001 WL 777055 at *3.

In *Wilbourn v. Advantage Financial Partners, LLC*, No. 09-CV-2068, 2010 WL 1194950 (N.D.Ill. Mar. 22, 2010), the plaintiff alleged that the attorney violated the Act via his participation in an equity-stripping scheme in which the defendants allegedly induced the plaintiff into a sale-leaseback of her home while purporting to refinance her mortgage. The court dismissed the claim against the attorney. In rendering its decision, the court relied on *Cripe* and reiterated that when allegations of misconduct arise from a defendant's conduct in his or her capacity as a lawyer representing a client, the Act is inapplicable. The court followed the reasoning of other federal courts within the district. 2010 WL 1194950 at *12. *E.g., Collins v. Sparacio*, No. 03 C 0064, 2003 WL 21254256 at *3 (N.D.Ill. May 30, 2003) (alleged fraudulent conduct of attorney retained by third party to file debt collection suit against plaintiff was exempt from Act).

E. [12.8] Circumstances in Which the Consumer Fraud Act May Apply to Attorneys

There may be circumstances in which the Consumer Fraud Act will apply to an attorney's conduct. For instance, in *Pucci v. Santi,* 711 F.Supp. 916, 926, *summary judgment granted sub nom. Pucci v. Stavriotis,* 723 F.Supp. 56 (N.D.Ill. 1989), the court stated that "the mere fact that a person has gained admission to the bar does not grant him an exclusion from the Act's proscriptions." In *Pucci,* the court granted a summary motion for the defendant as the alleged wrongs involved the provisions of legal services. However, the court's language indicates that the Act may have applicability to attorneys.

In *Pucci v. Litwin,* 828 F.Supp. 1285 (N.D.Ill. 1993), the court denied a motion to dismiss a consumer fraud count against an attorney whom the plaintiff alleged was sharing in the profits from a real estate tax shelter set up by the attorney. The court reasoned that all of the allegations against the attorney did not arise out of the provision of legal services. The court, therefore, refused to dismiss the claim under the Act merely because the defendant was an attorney.

In *Guess v. Brophy,* 164 Ill.App.3d 75, 517 N.E.2d 693, 115 Ill.Dec. 282 (4th Dist. 1987), an heir brought proceedings against a corporation and an attorney for alleged violations of the Act. The court held that the defendants were not granted the same immunity under the Act afforded to attorneys, as they were not acting in the capacity of lawyers representing clients.

F. [12.9] Summary

The Consumer Fraud Act generally will not apply to attorney-client relation issues. However, it may be applicable when attorneys are not acting in their capacity as attorneys or when they are not exclusively rendering legal services.

II. [12.10] ILLINOIS PUNITIVE DAMAGE STATUTE

Attorneys in Illinois have significant protection from punitive damage claims because of §2-1115 of the Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.* However, there is potential liability exposure if the attorney is not being sued for malpractice.

In 1985, and as part of the tort reform legislation, §2-1115 became law. See P.A. 84-7 (eff. Aug. 15, 1985). The statute precluded punitive damage claims in a wide array of actions against professionals. In relevant part, §2-1115 provides:

> **In all cases, whether in tort, contract or otherwise, in which the plaintiff seeks damages by reason of legal, medical, hospital, or other healing art malpractice, no punitive, exemplary, vindictive or aggravated damages shall be allowed.** 735 ILCS 5/2-1115.

A. [12.11] Caselaw Interpreting the Punitive Damage Statute

The constitutionality of 735 ILCS 5/2-1115 was challenged shortly after its passage. In *Bernier v. Burris,* 113 Ill.2d 219, 497 N.E.2d 763, 100 Ill.Dec. 585 (1986), the Illinois Supreme

Court reversed the trial court's finding that the statute violated a number of state and federal constitutional guarantees. The Supreme Court noted that many other states had adopted legislation prohibiting the recovery of punitive damages in various types of actions. Further, the court noted that the elimination of an award for punitive damages in this instance served the legislative goals of reducing damages generated against the medical profession.

In *Williams v. Chicago Osteopathic Medical Center,* 173 Ill.App.3d 125, 527 N.E.2d 409, 122 Ill.Dec. 911 (1st Dist. 1988), the plaintiff alleged that several doctors had committed fraud. The appellate court held that the statutory bar from punitive damages as set out in §2-1115 also applied to intentional fraud arising from the provision of medical services by healthcare providers.

In *Calhoun v. Rane,* 234 Ill.App.3d 90, 599 N.E.2d 1318, 175 Ill.Dec. 304 (1st Dist. 1992), the court held that §2-1115 prevented the plaintiff from seeking punitive damages. In *Calhoun,* the plaintiff alleged that his attorney had committed willful and wanton conduct by lying to the plaintiff to cover up his own negligence. The First District followed its earlier decision in *Williams.* Finding that the plaintiff's allegations of willful and wanton conduct related to the malpractice claim, the court held that §2-1115 provided a statutory prohibition to punitive damages. *See also Kennedy v. Grimsley,* 361 Ill.App.3d 511, 837 N.E.2d 131, 297 Ill.Dec. 351 (3d Dist. 2005) (claim that attorney fraudulently induced attorney-client relationship was claim for legal malpractice, not fraud, and, as such, punitive damages were statutorily barred); *Brush v. Gilsdorf,* 335 Ill.App.3d 356, 783 N.E.2d 77, 270 Ill.Dec. 502 (3d Dist. 2002) (in determining whether to apply statute precluding punitive damages, court must look to nature of behavior alleged in plaintiff's complaint and whether activities fall within term "legal malpractice").

In *Noonan v. Harrington,* No. 09-3191, 2010 WL 1797648 (C.D.Ill. May 5, 2010), stock owners alleged, in part, legal malpractice and breach of fiduciary duty arising out of advice rendered by an attorney in conjunction with a stock sale. They sought punitive damages from the attorney arising out of the alleged breach of fiduciary duty. The court concluded that the alleged breach constituted legal malpractice, and accordingly the statutory bar on punitive damages applied. *See also Scott v. Chuhak & Tecson, P.C.,* No. 09 C 6858, 2010 WL 2788174 at *4 (N.D.Ill. July 9, 2010) (finding that although plaintiff cloaked his legal malpractice claim as breach of fiduciary duty, plaintiff's claims "f[e]ll under the rubric" of legal malpractice, and therefore request for punitive damages was stricken).

B. [12.12] Potential Exceptions to the Prohibition Against Punitive Damages

In *Cripe v. Leiter,* 291 Ill.App.3d 155, 683 N.E.2d 516, 225 Ill.Dec. 348 (3d Dist. 1997), the appellate court declined to follow *Calhoun v. Rane,* 234 Ill.App.3d 90, 599 N.E.2d 1318, 175 Ill.Dec. 304 (1st Dist. 1992), and *Williams v. Chicago Osteopathic Medical Center,* 173 Ill.App.3d 125, 527 N.E.2d 409, 122 Ill.Dec. 911 (1st Dist. 1988). The plaintiff in *Cripe,* acting as guardian for Mrs. Schmitz, brought a claim against their attorneys for fraud, breach of fiduciary duty, and legal malpractice. She claimed that the defendants "made false statements with regard to the number of hours that were spent on the trust matters and the guardianship case." 683 N.E.2d at 518.

The factual background in *Cripe* was that after her husband's death, Mrs. Schmitz was the recipient of two irrevocable trusts valued at approximately $583,000. On February 12, 1992, Mrs. Schmitz discharged their family attorney and retained the defendants. Shortly afterward, the defendant attorney, Leiter, transferred the trusts from First National Bank to South Side Trust and Savings Bank of Peoria.

On March 22, 1993, the plaintiff, Mrs. Schmitz's daughter, was appointed as successor guardian of Mrs. Schmitz by a Michigan probate court. The plaintiff then filed the suit against the attorneys. She alleged that the trust account was depleted in excess of $40,000 due to the defendants' overbilling. The appellate court held that 735 ILCS 5/2-1115 did not prohibit a claim for punitive damages when the plaintiff's claim states a cause of action for common-law fraud.

The appellate court noted that the courts in *Calhoun* and *Williams* had focused on whether the conduct arose out of the defendants' provision of professional services rather than whether the conduct in question amounted to malpractice.

The appellate court concluded that the restriction §2-1115 places on recovery for punitive damages should not be so broadly read as to include claims that fall outside the scope of the exemption. Further, the court commented that the imposition of punitive damages for attorney misconduct is still appropriate in certain instances. The court noted that those who employ legal services place a great deal of trust in their attorneys, so the attorney-client relationship presents a considerable potential for abuse.

The appellate court's decision in *Cripe* was reviewed by the Illinois Supreme Court (*see Cripe v. Leiter,* 184 Ill.2d 185, 703 N.E.2d 100, 234 Ill.Dec. 488 (1998)), but the punitive damage issue was not considered. See the discussion in §12.6 above.

In *Interclaim Holdings Ltd. v. Ness, Motley, Loadholt, Richardson & Poole,* 298 F.Supp.2d 746 (N.D.Ill. 2004), a provision of an engagement agreement calling for application of South Carolina law was held to preclude application of §2-1115 to bar punitive damages against attorneys in a breach of contract action.

The court in *Happel v. Wal-Mart Stores, Inc.,* 286 F.Supp.2d 943 (N.D.Ill. 2003), held that under Illinois law a plaintiff's cause of action may contain both malpractice and intentional tort claims, punitive damages being recoverable from the latter.

In *Safeway Insurance Co. v. Spinak,* 267 Ill.App.3d 513, 641 N.E.2d 834, 204 Ill.Dec. 404 (1st Dist. 1994), the court reversed an order that had stricken a punitive damage claim against an attorney. The court noted that although it appears that §2-1115 is broad enough to cover any acts arising out of the provision of legal services, the court will look to the nature of the behavior alleged in the plaintiff's complaint to determine whether the activities fall within the terms of the malpractice.

It follows from these rulings that the prohibition against punitive damages in actions against attorneys found in §2-1115 may not eliminate these damages in an action for common-law fraud or some other cause outside the malpractice field.

In *Parus Holdings, Inc. v. Banner & Witcoff, Ltd.,* 585 F.Supp.2d 995 (N.D.Ill. 2008), a successor corporation brought an action against counsel for its predecessor, alleging that the law firm provided a former employee with confidential information about the predecessor corporation's application for a patent. The plaintiff alleged legal malpractice, breach of fiduciary duties, and trade secret violations against the defendant law firm. Pursuant to §2-1115, the court struck the plaintiff's prayer for punitive damages on all of the plaintiff's claims except its claim under the Illinois Trade Secrets Act (ITSA), 765 ILCS 1065/1, *et seq.* The court held that the plaintiff's misappropriation of trade secrets claim under ITSA was distinct from its legal malpractice claims because the existence of a trade secret was an element of the claim that was completely distinct from the legal malpractice claim. Therefore, §2-1115 did not apply to bar punitive damages pursuant to the plaintiff's ITSA claim.

In *Weidner v. Karlin,* 402 Ill.App.3d 1084, 932 N.E.2d 602, 342 Ill.Dec. 475 (3d Dist. 2010), a client brought an action against her attorney and his law firm for legal malpractice and fraud. The client alleged fraud against the law firm, contending that after the attorney failed to file her application within the statute of limitations, he knowingly made false representations related to various aspects of her claim. The client sought punitive damages for the alleged fraud. The court found that the fraud issue was not properly pleaded and therefore concluded that the court need not consider awarding punitive damages based on it. However, the court intimated that the award of punitive damages may be appropriate when fraud is pleaded properly. 932 N.E.2d at 606.

C. [12.13] Punitive Damages in the Underlying Cause of Action

An issue that has arisen around the country in lawyer liability cases is whether an attorney may be liable for punitive damages if these damages were recoverable in the underlying lawsuit that the attorney is alleged to have mishandled. The plaintiff argues that he or she can be made whole only if allowed to recover the entire value of the claim lost, which claim might include an amount for punitive damages. The defendant argues that collection of these "lost punitives" from attorneys runs counter to the deterrent and punitive purpose of the damages, namely, to punish the bad actor and deter others from engaging in like conduct. *Loitz v. Remington Arms Co.,* 138 Ill.2d 404, 563 N.E.2d 397, 401, 150 Ill.Dec. 510 (1990) ("Punitive, or exemplary, damages are not awarded as compensation, but serve instead to punish the offender and to deter that party and others from committing similar acts of wrongdoing in the future.").

This issue was resolved in favor of the attorney in Illinois. In *Tri-G, Inc. v. Burke, Bosselman & Weaver,* 222 Ill.2d 218, 856 N.E.2d 389, 305 Ill.Dec. 584 (2006), the plaintiff had retained the defendant to prosecute a complaint against Elgin Federal Bank alleging breach of contract, common-law fraud, and violations of the Consumer Fraud Act. On the day of trial, the attorney handling the plaintiff's case claimed that he was not prepared to proceed. The trial court dismissed the plaintiff's case with prejudice, and a legal malpractice case ensued, eventually resulting in a jury verdict for the plaintiff. Part of the plaintiff's award at trial consisted of lost punitive damages from the underlying case as a result of the malpractice. The defendant appealed this result, claiming the punitive award was contrary to 735 ILCS 5/2-1115. The appellate court held that the award of lost punitive damages was justified. The Illinois Supreme Court, in a matter of first impression, reversed the appellate court's decision regarding the award of punitive damages lost in the underlying case as compensatory damages in the malpractice action. In adopting the "sounder view" held by the courts of California and New York, the court stated:

> **If the General Assembly has determined that lawyers cannot be compelled to pay punitive damages based on their own misconduct, as section 2-1115 decrees, it would be completely nonsensical to hold that they can nevertheless be compelled to pay punitive damages attributable to the misconduct of others. Any construction of the law that permits such a result would be absurd and unjust.** 856 N.E.2d at 417 – 418.

The issue also has been addressed in other jurisdictions. In *Haberer v. Rice,* 511 N.W.2d 279 (S.D. 1994), the court held that in legal malpractice actions a client can recover what would have been punitive damages in an underlying action. Other courts have reached a similar conclusion. *See Jacobsen v. Oliver,* 201 F.Supp.2d 93 (D.D.C. 2002); *Scognamillo v. Olsen,* 795 P.2d 1357 (Colo.App. 1990); *Ingram v. Hall, Roach, Johnston, Fisher & Bollman,* No. 95 C 550, 1996 WL 54206 (N.D.Ill. Feb. 6, 1996); *Hunt v. Dresie,* 241 Kan. 647, 740 P.2d 1046 (1987).

In *Hunt,* the Supreme Court of Kansas noted that a negligent attorney's liability includes damages called punitive damages from the vantage point of the underlying lawsuit; however, from the vantage point of the malpractice lawsuit, all the damages are simply those that proximately resulted from the attorney's negligence. The court also held that while allowing recovery of so-called "lost punitives" against attorneys does not directly punish the wrongdoer, it may, at least in an indirect way, further the goal of deterrence. Attorneys who are aware that they could be exposed to punitive damages in malpractice actions will be motivated to exercise reasonable care in investigating or defending punitive damage claims. 740 P.2d at 1057.

In *Haymon v. Wilkerson,* 535 A.2d 880 (D.C.App. 1987), the court noted that permitting recovery of punitive damages as compensatory damages in a legal malpractice action is consistent with the court's jurisdiction regarding negligence. The court held: "The normal measure of tort damages is the amount which compensates the plaintiff for all of the damages proximately caused by the defendant's negligence." 535 A.2d at 885.

Other courts have held differently. In *Cappetta v. Lippman,* 913 F.Supp. 302 (S.D.N.Y. 1996), the court held that in a legal malpractice action against a former attorney, a client could not recover what would have been punitive damages in the underlying action. The same ruling was reached in other legal malpractice cases, including *Summerville v. Lipsig,* 704 N.Y.S.2d 598, 270 A.D.2d 213 (2000), *Piscitelli v. Friedenberg,* 87 Cal.App.4th 953, 105 Cal.Rptr.2d 88, 106 – 109 (2001), and *Ferguson v. Lieff, Cabraser, Heimann & Bernstein, LLP,* 95 Cal.App.4th 154, 115 Cal.Rptr.2d 342, 351 (2002), *aff'd,* 30 Cal.4th 1037 (2003). In *Piscitelli,* an award of punitive damages was overturned because the court believed that "punitive damages are not compensation for injury," but rather "[t]hey are 'private fines levied by civil juries to punish reprehensible conduct and to deter its future occurrence.' " 105 Cal.Rptr.2d at 107, quoting *Gertz v. Robert Welch, Inc.,* 418 U.S. 323, 41 L.Ed.2d 789, 94 S.Ct. 2997, 3012 (1974).

III. [12.14] FAIR DEBT COLLECTION PRACTICES ACT

The Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. §1692, *et seq.,* has resulted in a tremendous amount of litigation since the early 1990s. Attorneys have been included as liable, or at least potentially liable, targets under the FDCPA.

The FDCPA became law in 1977. See S.Rep. No. 382, 95th Cong., 1st Sess. 7 (1977), reprinted in 1977 U.S.C.C.A.N. 1695. It was enacted to eliminate abusive, deceptive, and unfair debt collection practices. *See Rutyna v. Collection Accounts Terminal, Inc.,* 478 F.Supp. 980 (N.D.Ill. 1979). The FDCPA provides for (a) individual statutory damages in an amount up to $1,000 or, in the case of a class action, for the lesser of $500,000 or one percent of the net worth of the debt collector; (b) any actual damages that the plaintiff or the class incurs; and (c) reasonable attorneys' fees and the costs of litigating the matter. 15 U.S.C. §1692k(a). The attorneys' fees provision has provided a powerful incentive for the prosecution of FDCPA claims, including a great number of FDCPA claims filed in the federal courts in Illinois.

A. [12.15] Scope of the FDCPA

The Fair Debt Collection Practices Act applies to those individuals or businesses that fall within the definition of "debt collector." The FDCPA defines a "debt collector" as

> **any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another.** 15 U.S.C. §1692a(6).

Most often, the defendant in an FDCPA case will be a collection agency or law firm. However, liability may attach to the individual collector or an attorney and perhaps even owners and operators of the collection agency or firm.

Courts have devoted much attention to the issue of whether the FDCPA should apply in the context of state court proceedings. Although the Seventh Circuit has not specifically addressed the FDCPA's application to state court pleadings, several courts have discussed whether the FDCPA governs claims challenging state court procedures. In *O'Rourke v. Palisades Acquisition XVI, LLC,* 635 F.3d 938 (7th Cir. 2011), the consumer brought a putative class action against a debt collector, claiming a materially false and deceptive means to collect a debt occurred when the creditor presented a statement that was not a true copy of a credit card statement to a judge in the underlying state court proceeding. The court determined that nothing in 15 U.S.C. §1692e provides that the FDCPA applies to statements made to judges and accordingly found that the FDCPA does not extend to communications that would confuse or mislead a state court judge. 635 F.3d at 944. *But cf. Beler v. Blatt, Hasenmiller, Leibsker & Moore, LLC,* 480 F.3d 470, 473 (7th Cir. 2007) (stating "it is far from clear that the FDCPA controls the contents of pleadings filed in state court"). In *Eichman v. Mann Bracken, LLC,* 689 F.Supp.2d 1094 (W.D.Wis. 2010), the plaintiff brought suit against a debt collector, alleging violations, in part, of the FDCPA. The plaintiff alleged that the debt collector violated the FDCPA by filing frivolous counterclaims in the plaintiff's state court action, which sought to vacate an arbitration award in favor of a bank. Specifically, the plaintiff contended that the debt collector should have known that no debt was owed, because the bank issued a form to the plaintiff canceling her debt after the arbitration award. The court explained that an attorney's alleged misrepresentation of a fact or filing of a frivolous counterclaim could be a sufficient basis for an FDCPA suit. The court continued, however, that the mere filing of a counterclaim to recover a debt does not constitute harassment or deception under the FDCPA simply because the debtor alleges that the creditor failed to adduce sufficient evidence of the debt's existence. Rather, the plaintiff must go beyond alleging that counterclaims were filed and allege that the defendant's counterclaims were frivolous, based on blatant lies, or misrepresented a key fact. The court concluded that the plaintiff met this burden, drawing on the form issued by the bank. 689 F.Supp.2d at 1101. *See Jenkins v. Centurion Capital Corp.,* No. 07 C 3838, 2007 WL 4109235 at *2 (N.D.Ill. Nov.15, 2007) (stating that "present Seventh Circuit case law does not preclude a claim based on false representation in a state-court complaint under the FDCPA.").

B. [12.16] Summary of 2006 Amendments to the FDCPA

On October 13, 2006, the President signed into law the Financial Services Regulatory Relief Act of 2006, Pub.L. No. 109-351, 120 Stat. 1966, which added three amendments to §809 of the Fair Debt and Collection Practices Act. The first amendment states:

> **Collection activities and communications that do not otherwise violate this subchapter may continue during the 30-day period referred to in subsection (a) of this section unless the consumer has notified the debt collector in writing that the debt, or any portion of the debt, is disputed or that the consumer requests the name and address of the original creditor. Any collection activities and communication during the 30-day period may not overshadow or be inconsistent with the disclosure of the consumer's right to dispute the debt or request the name and address of the original creditor.** 15 U.S.C. §1692g(b).

This amendment makes it clear that creditors may collect undisputed debts within the 30-day validation period.

The second amendment states:

> **A communication in the form of a formal pleading in a civil action shall not be treated as an initial communication for purposes of subsection (a) of this section.** 15 U.S.C. §1692g(d).

An official pleading does not constitute an "initial communication" within the meaning of the FDCPA and, thus, does not trigger a debt collector's obligation to provide a validation notice to the debtor.

The third amendment states:

> **The sending or delivery of any form or notice which does not relate to the collection of a debt and is expressly required by the Internal Revenue Code of 1986, chapter 94 of this title [**15 U.S.C. §6801, *et seq.,***] or any provision of Federal or State law relating to notice of data security breach or privacy, or any regulation prescribed under any such provision of law, shall not be treated as an initial communication in connection with debt collection for purposes of this section.** 15 U.S.C. §1692g(e).

Notifications by the creditor of a breach of the debtor's privacy (required by the Internal Revenue Code and other federal laws) do not constitute initial communications within the scope of debt collection.

C. [12.17] Application to Attorneys

The Fair Debt Collection Practices Act originally included an exemption for attorneys. Under the exemption, an attorney at law collecting a debt as an attorney on behalf of and in the name of a client was excluded from coverage under the FDCPA. In 1986, the FDCPA was amended to remove the attorney exemption. See Pub.L. No. 99-361, 100 Stat. 768, amending 15 U.S.C. §1692a(6). While attorneys were no longer exempt under the FDCPA after 1986, it was not until *Heintz v. Jenkins,* 514 U.S. 291, 131 L.Ed.2d 395, 115 S.Ct. 1489 (1995), that it was determined that the FDCPA applies to a lawyer who regularly through litigation tries to collect consumer debts.

In *Heintz,* the plaintiff defaulted on a loan, and the bank, through its attorney, filed suit to recover the balance on the loan. The bank's attorney sent a letter to the plaintiff's attorney in an attempt to settle the case. The plaintiff filed suit against the bank's attorney under the FDCPA, contending that the attorney's letter sought to collect an amount not authorized by the agreement creating the debt and falsely represented the amount of the debt.

The defendant filed a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), arguing that the FDCPA did not apply to lawyers involved in litigation, as opposed to more traditional collection activities. The district court granted the motion, and the Seventh Circuit reversed. The Supreme Court granted certiorari and affirmed the Seventh Circuit's ruling. In determining that the FDCPA applies to attorneys engaged in litigation, the Court stated that (1) "a lawyer who regularly tries to obtain payment of consumer debts through legal proceedings is a lawyer who regularly 'attempts' to 'collect' those consumer debts" and (2) since Congress amended the FDCPA and repealed the attorney exemption "without creating a narrower, litigation-related, exemption to fill the void . . . one would think that Congress intended that lawyers be subject to the Act whenever they meet the general 'debt collector' definition." 115 S.Ct. at 1491.

D. [12.18] Regularly Collecting Debts

Although it is clear that the Fair Debt Collection Practices Act applies to lawyers, an attorney is not a debt collector under the FDCPA unless the attorney "regularly collects or attempts to collect" debts. 15 U.S.C. §1692a(6). Thus, the analysis often becomes: What constitutes the regular collection of debts?

In *Goldstein v. Hutton, Ingram, Yuzek, Gainen, Carroll & Bertolotti,* 374 F.3d 56 (2d Cir. 2004), a consumer brought a putative class action against a law firm alleging violations of the FDCPA. The trial court held that the defendant was not a debt collector under the FDCPA. Although the defendant law firm derived only 0.05 percent of its previous year's revenue from debt collection, the court of appeals remanded for factual determinations because the evidence showed that (1) the defendant issued 145 three-day notices in a year; (2) the notices were issued at least once a month; (3) more than 10 notices were issued in each of seven months; (4) more than 15 notices were issued during three individual months; and (5) over 140 of the notices in the record were issued on behalf of the plaintiff's landlord. The court held that these factors could support a finding of regular debt collection practices such that the defendant was a debt collector under the FDCPA.

In *Fox v. Citicorp Credit Services, Inc.*, 15 F.3d 1507 (9th Cir. 1994), the court held that an attorney whose practice was at least 80-percent debt collection was a debt collector under the FDCPA. Similarly, in *Scott v. Jones*, 964 F.2d 314 (4th Cir. 1992), when at least 70 percent of an attorney's legal fees were generated from the collection of debts, the attorney was considered a debt collector.

If debt collection does not form the principal part of an attorney's practice, the court still may consider the amount of work being performed in the area of collection matters when deciding whether to find the FDCPA applicable to the attorney. For example, in *Cacace v. Lucas,* 775 F.Supp. 502 (D.Conn. 1990), an attorney filed 144 small claims suits in collection matters in a two-year period and had used the collection letter at issue 125 to 150 times in 14 months. More than 60 percent of the attorney's work for a credit union involved collection matters. The attorney was considered a debt collector under these circumstances.

On the other hand, in *Nance v. Petty, Livingston, Dawson, & Devening,* 881 F.Supp. 223 (W.D.Va. 1994), debt collecting cases made up only 0.61 percent of a partner's practice and 1.07 percent of the firm's cases over an 18-month period. The court held that the law firm and its partners were not considered debt collectors. Similarly, in *Mertes v. Devitt,* 734 F.Supp. 872 (W.D.Wis. 1990), an attorney averaged less than two collection matters per year, and debt collection comprised less than 1 percent of his practice. The court held that he was not a debt collector under the FDCPA.

In *Heller v. Graf,* 488 F.Supp.2d 686, 693 (N.D.Ill. 2007), the court held that an issue of fact existed as to whether the defendant attorney was a debt collector as defined by the FDCPA and thus denied the plaintiff's motion for summary judgment on this issue. The court noted that although courts generally had found that when an attorney's practice is approximately one-percent debt collection, that is not sufficient to satisfy the definition of a "debt collector," courts have also found that if the volume of an attorney's debt collection services is great enough, he or she will be deemed a debt collector even though the services amount to a small fraction of his or her actual business activity. Because the defendant stated that (1) his debt collection activity comprised less than one percent of his overall practice; (2) he generated less than one percent of his overall fees from this activity; (3) the majority of his litigation was spent defending clients in lawsuits brought by third-party vendors, landlords, and creditors; (4) he had spent no time on debt collection activities other than on litigation, for which he spent less than one hour a week; and (5) he did not employ a person full-time for the purpose of debt collection activity, nor did he have a system in place for such activity, an issue of fact existed as to the defendant's status as a debt collector under the FDCPA. Of note, the court stated that the FDCPA covers only those attorneys who are acting as debt collectors to consumers; therefore, the defendant's testimony that he assisted his clients in collecting amounts of money from both entities and persons was relevant to whether the defendant was a debt collector under the FDCPA.

To avoid liability under the FDCPA, the attorney should either ensure that collection does not comprise a regular part of the firm's practice or be aware of and work to stay in compliance with the numerous provisions of the FDCPA.

E. [12.19] Law Firms and Partners

The liability of a partner for debt collection activity may be imputed to his or her partnership. *See Miller v. McCalla, Raymer, Padrick, Cobb, Nichols, & Clark, L.L.C.*, 214 F.3d 872 (7th Cir. 2000). In *Miller*, the plaintiff filed suit against two law firms, the McCalla firm and the Echevarria firm, for violating the Fair Debt Collection Practices Act by failing to state the amount of his debt in a collection letter sent to him by the McCalla firm. The Echevarria firm argued that it was not liable for the Miller firm's violation. In rejecting the argument, the Seventh Circuit stated that "partners, unlike corporations, do not enjoy limited liability. The liability of a partnership is imputed to the partners, and so the plaintiff was entitled to sue the partners as well as the partnership." 214 F.3d at 876.

However, upon remand, the Echevarria firm was determined to be liable only under partnership principles for any judgment against the McCalla firm. *See Miller v. McCalla, Raymer, Padrick, Cobb, Nichols & Clark, L.L.C.*, 198 F.R.D. 503 (N.D.Ill. 2001). The Echevarria firm was not itself considered a debt collector under the FDCPA as to the plaintiff or class claims simply due to the conduct of its partner, the McCalla firm. This was important because one percent of the Echevarria firm's net worth was not considered in determining the amount of potential damages the class could recover.

See also Schutz v. Arrow Financial Services, LLC, 465 F.Supp.2d 872 (N.D.Ill. 2006) (holding that debt buyer may be vicariously liable for collection practices of collection agency it retained); *Scally v. Hilco Receivables, LLC*, 392 F.Supp.2d 1036 (N.D.Ill. 2005) (holding that debt buyer was not liable for collection agency it retained).

F. [12.20] Owners and Shareholders

Corporate law principles provide greater protections to the owners or operators of a collection agency. For instance, the Fair Debt Collection Practices Act has been held not to apply to shareholders of the debt collection agency. *White v. Goodman*, 200 F.3d 1016 (7th Cir. 2000). In *White*, the plaintiff filed suit against the North Shore Collection Agency (the debt collector), the Book-of-the-Month Club (the creditor), the company that stuffed and mailed North Shore's envelopes, and a shareholder of North Shore. In a sharply worded opinion, the court cautioned:

> **So far as the joinder of defendants other than North Shore and Book-of-the-Month Club is concerned, the suits are frivolous and the plaintiffs, represented by an experienced practitioner in consumer finance litigation, should have been sanctioned for what amounts to malicious prosecution. The Fair Debt Collection Practices Act is not aimed at the shareholders of debt collectors operating in the corporate form unless some basis is shown for piercing the corporate veil, which was not attempted here . . . or at companies that perform ministerial duties for debt collectors, such as stuffing and printing the debt collector's letters. [**Citation omitted.**]**
> 200 F.3d at 1019.

Similarly, in *Pettit v. Retrieval Masters Creditors Bureau, Inc.*, 211 F.3d 1057 (7th Cir. 2000), the Seventh Circuit affirmed the district court's granting of summary judgment in favor of Russell Fuchs, the largest shareholder and president of Retrieval Masters. The court noted that regardless of the degree of control Fuchs exercised over Retrieval Masters, when the corporate veil had not been pierced, "the Act does not contemplate personal liability for shareholders or employees of debt collection companies who act on behalf of those companies." 211 F.3d at 1059.

G. [12.21] Form of the Entity

The form of the entity and the individual state law pertaining to vicarious liability may be important in determining whether a debt collector's liability will extend to the business or to other individuals. In Illinois, lawyers who practice in partnerships are vicariously liable for the acts of their partners. Even if the law firm is incorporated, under Illinois Supreme Court Rule 721, shareholders and members of the law firm are jointly and severally liable for the acts of other shareholders or members. Thus, an attorney regularly engaging in debt collection should be aware of the potential for vicarious liability if his or her law firm is also named in the suit.

H. [12.22] Damages

The Fair Debt Collection Practices Act clearly delineates the amount of damages available under the FDCPA, providing that a debt collector under the FDCPA is liable to an individual plaintiff for (1) any actual damage sustained by the individual and (2) additional damages not to exceed $1,000. 15 U.S.C. §§1692k(a)(1), 1692k(a)(2)(A). If a class is certified, the debt collector is liable for (1) up to $1,000 for the named class representative and (2) a class recovery in an amount not to exceed the lesser of $500,000 or up to one percent of the net worth of the debt collector. 15 U.S.C. §1692k(a)(2)(B). Regardless of whether it is an individual case or a class action, the debt collector is liable for reasonable attorneys' fees and costs. 15 U.S.C. §1692k(a)(3).

I. The Class Action

1. [12.23] Generally

Suits for violations of the Fair Debt Collection Practices Act often lend themselves to class claims. Fed.R.Civ.P. 23(a) provides the following prerequisites to a class action: (a) numerosity; (b) commonality; (c) typicality; and (d) adequacy. In addition, a class action must be a superior method for adjudicating the controversy. Fed.R.Civ.P. 23(b)(3).

The FDCPA class need not be nationwide in scope. *See Mace v. Van Ru Credit Corp.,* 109 F.3d 338 (7th Cir. 1997). For example, in *Wells v. McDonough*, 188 F.R.D. 277, 278 (N.D.Ill. 1999), the court certified a class consisting of Illinois residents who were sent the same form letter as the plaintiff within one year prior to the filing of the lawsuit and a subclass of those class members who did not receive a written demand of payment by certified mail. Once a class is certified, it is difficult to decertify the class. As the court in *Mace* stated, even when the class is large and the potential for recovery is small, a de minimis recovery should not automatically bar a class action. Thus, the *Mace* court stated that even if each potential class member would receive a mere 28 cents apiece, such a small recovery would not necessarily defeat class certification. 109 F.3d at 344. Other district court judges have not been so inclined to certify a class when the recovery is so small.

In *Sonmore v. CheckRite Recovery Services, Inc.,* 206 F.R.D. 257 (D.Minn. 2001), class action was not the superior method of adjudication because the class members had a substantial interest in bringing individual actions, since class treatment would limit the maximum amount of recovery to $25 per class member while an individual action could result in up to $1,000. "[T]he interest of class members in individually controlling the prosecution of their claims prevails over any efficiency objectives that may be achieved through management of the litigation as a class action." 206 F.R.D. at 265 – 266.

In *Jones v. CBE Group, Inc.,* 215 F.R.D. 558 (D.Minn. 2003), applying the reasoning of *Sonmore, supra,* the court held that the plaintiff failed to meet the superiority requirement of Fed.R.Civ.P. 23. After review of the defendant's net worth, the court determined that "the potential recovery for unnamed class members is, at most, de minimis." 215 F.R.D. at 570. *But see Hernandez v. Midland Credit Management, Inc.,* 236 F.R.D. 406 (N.D.Ill. 2006); *Kalish v. Karp & Kalamotousakis, LLP,* 246 F.R.D. 461, 464 (S.D.N.Y. 2007) (notwithstanding possibility of higher individual recoveries, litigating as class retains substantial value because it encourages prosecution of claims en masse that would not be prosecuted individually).

2. [12.24] Maximum Recovery in a Class Action

The class is entitled to recover only the lesser of some amount up to $500,000 or one percent of the debt collector's net worth. There has been litigation over how "net worth" should be defined under the Fair Debt Collection Practices Act, and what financial documents sufficiently determine the debt collector's net worth. The FDCPA does not explicitly define "net worth." The seminal case on the issue is *Sanders v. Jackson,* 209 F.3d 998 (7th Cir. 2000), in which the court squarely addressed the question of how net worth should be determined under the FDCPA. The court held that net worth under the FDCPA is book net worth (*i.e.,* a balance sheet net worth), assets minus liabilities. 209 F.3d at 1002, 1004. Goodwill is not factored into the calculation of the defendant's net worth. 209 F.3d at 1004. The court allowed this determination to be made based on the audited financial records of the company.

J. [12.25] Attorney Involvement in Debt Collection

Once the Fair Debt Collection Practices Act applies to an attorney, the issue often becomes: How does an attorney violate the FDCPA? There are several areas of attack. A number of common liability pitfalls are discussed in §§12.26 – 12.28 below.

1. [12.26] Meaningful Involvement

An attorney who is not meaningfully involved in reviewing or sending out a dunning letter, but who otherwise allows a letter to be sent out to a debtor on his or her letterhead, faces potential liability under the Fair Debt Collection Practices Act. *Boyd v. Wexler,* 275 F.3d 642 (7th Cir. 2001). Under 15 U.S.C. §1692e(3), a debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt, including "[t]he false representation or implication that any individual is an attorney or that any communication is from an attorney." This means that unless an attorney actually spent time personally reviewing a dunning letter or file, and the letter is not merely a mass-produced mailing, the attorney may be in violation of 15 U.S.C. §1692e(3) if a letter is sent out on the attorney's firm's letterhead. *Avila v. Rubin,* 84 F.3d 222 (7th Cir. 1996); *Nielsen v. Dickerson,* 307 F.3d 623 (7th Cir. 2002).

In *Avila,* the court held that the attorney violated 15 U.S.C. §§1692e(3) and 1692e(9). The court found that the attorney's name was on the letters sent to debtors but the attorney (a) was not personally or directly involved in deciding when or to whom a dunning letter should be sent, (b) did not review the debtor's file, (c) did not determine when particular letters should be sent, (d) did not approve the sending of particular letters based on the recommendation of others, (e) did not see particular letters before they were sent, and (f) did not know the identities of the debtors to whom the letters were sent. The Seventh Circuit agreed with the district court and affirmed judgment for the plaintiff and class. The court reasoned that the "collection letters create the false and misleading impression that the communications were from an attorney when, in fact, they were not really 'from' an attorney in any meaningful sense of the word." 84 F.3d at 229.

The Seventh Circuit reversed summary judgment for the defendant attorney in *Boyd, supra.* In *Boyd,* the defendant attorney's affidavit stated that a lawyer from the law firm reviewed every individual file before a letter was sent and reviewed the plaintiff's letters before they were sent. However, the Seventh Circuit Court of Appeals held that, based in part on the volume of letters sent out by the firm, a jury could find that the defendant did not meaningfully review the letters. The court focused on the fact that pretrial discovery revealed that the defendant's law firm sent out 439,606 pieces of mail in an eight-and-one-half-month period for an average of 51,718 letters a month. The court noted that the firm consisted of three attorneys, and that if each of the three lawyers spent four hours a day reviewing collection letters at 15 minutes per file, the firm would only send out 1,000 letters a month rather than nearly 50,000 letters per month. The court questioned the credibility of the affidavit filed in support of summary judgment.

In *Greco v. Trauner, Cohen & Thomas, L.L.P.,* 412 F.3d 360 (2d Cir. 2005), the court of appeals affirmed a decision that dealt with the issue of false representation of attorney involvement, based on a collection letter sent out by the defendant law firm. The court reached the conclusion that attorneys do not violate 15 U.S.C. §1692e(3) when they send out debt letters to persons whose debt has not been personally reviewed, provided a proper disclaimer is contained therein.

> **Put another way, our prior precedents demonstrate that an attorney can, in fact, send a debt collection letter without being meaningfully involved as an attorney within the collection process, so long as that letter includes *disclaimers* that should make clear even to the 'least sophisticated consumer' that the law firm or attorney sending the letter is not, at the time of the letter's transmission, acting as an attorney. [**Emphasis in original.**]** 412 F.3d at 364.

The disclaimer at issue read, "although 'this office represents [creditor] . . . [a]t this time, *no attorney with this firm has personally reviewed the particular circumstances of your account.*' "[Emphasis in original.] 412 F.3d at 365.

In *Berg v. Blatt, Hasenmiller, Leibsker, & Moore LLC,* No. 07 C 4887, 2009 WL 901011 at *13 (N.D.Ill. Mar. 31, 2009), the court denied the defendants' motion for summary judgment on the plaintiff's claim that the defendant credit card company falsely represented that its communications were from an attorney. The defendant law firm sent two initial collection letters and then filed suit against the plaintiff. A discrepancy existed between the amount of the debt set forth in the complaint and that in the affidavit attached to the complaint. The defendants set forth detailed evidence of procedures regarding the process of preparation and three-step review involved in generating an affidavit for a collection suit, but the court stated that they failed "to demonstrate any meaningful attorney review of the affidavit's contents as compared to the balances set forth on the face of the complaint or the correctness of the calculated interest." 2009 WL 901011 at *12. The court focused on the "gross discrepancy" between the debts stated in the affidavit and complaint, and the fact that this was not the first time this mistake was made. *Id.* Therefore, the court held that a genuine issue of fact existed as to whether the defendant law firm engaged in meaningful review of the collection complaint and affidavit, and summary judgment in the defendants' favor was denied. The court also denied the defendants' motion for summary judgment on their bona fide error defense because the defendants did not offer an explanation of how or why such error occurred, the method the defendant law firm used to calculate interest, or why, in spite of an alleged careful process, the defendant law firm could generate an incorrect affidavit three times, as it did here.

In *Kistner v. Law Offices of Michael P. Margelefsky, LLC,* 518 F.3d 433 (6th Cir. 2008), the court of appeals reversed the district court's granting of summary judgment to the defendant law office. A form collection letter, printed on the law office letterhead, was sent to the plaintiff. The court noted that the letter was printed on law firm letterhead, made repeated reference to a law firm, and directed remittance to an individually named lawyer, but also explicitly stated that the letter was from a debt collector and was "signed" by an unnamed "Account Representative." 518 F.3d at 440 – 441. Based on these conflicting aspects of the letter, the court of appeals reversed the district court's granting of summary judgment on behalf of the defendant law office. The court adopted the Second Circuit's " 'more than one reasonable interpretation' standard," which states that collections notices can be deceptive if they are open to more than one reasonable interpretation, at least one of which is inaccurate. 518 F.3d at 441. Thus, the "question for the jury becomes whether one can reasonably conclude that the letter . . . is susceptible to a reading by the least sophisticated consumer that it is from an attorney, even though [the defendant] has admitted that he had no direct role in sending the letter." *Id.*

2. [12.27] False Threats

Another problem attorneys face is whether a collection letter contains a false threat of litigation. 15 U.S.C. §1692e(5) provides that it is a violation of the Fair Debt Collection Practices Act to threaten "to take any action that cannot legally be taken or that is not intended to be taken." A threat of litigation can be implicit, and to violate the FDCPA, it only needs to meet the criteria of whether an unsophisticated consumer would consider the language to be a threat of litigation. The "unsophisticated consumer" standard is "low, close to the bottom of the sophistication meter." *Avila v. Rubin,* 84 F.3d 222, 226 (7th Cir. 1996).

Clark v. Retrieval Masters Creditors Bureau, Inc., 185 F.R.D. 247 (N.D.Ill. 1999), involved a false threat claim, although not made by an attorney. In *Clark,* the court held that the language that a debt collector has been "authorized . . . to take appropriate legal measures to obtain payment," and that "[t]his is your final opportunity to settle your account without incurring additional problems" could lead the unsophisticated consumer to "believe litigation was authorized and imminent." 185 F.R.D. at 250 – 251.

This is not to say that a threat of litigation in and of itself violates the FDCPA. However, to avoid liability under the FDCPA, if an attorney makes a statement that could be construed as a threat of litigation by an unsophisticated consumer, the attorney should have the authority to follow through with the intention to sue if the debt is not paid, and there should be no legal impediment to filing suit.

The following cases do not address debt collection involving attorneys. These cases provide that a false statement must be material to support a claim under 15 U.S.C. §1692e. Attorneys and law firms should be aware of this developing concept when drafting and sending collection letters.

In *Hahn v. Triumph Partnerships LLC,* 557 F.3d 755, 756 (7th Cir. 2009), a debt collector sent the plaintiff a debt collection letter that stated the total "amount due." The plaintiff did not deny that she owed that total amount, but alleged that the defendant misrepresented the character of her debt by stating that the interest due was a certain amount of the total, when the interest owed by the plaintiff was actually a greater amount of the total than that stated. The court held that "[m]ateriality is an ordinary element of any federal claim based on a false or misleading statement" and thus was required in an action under §1692e. 557 F.3d at 757. Here, the defendant's statement regarding interest was true (the plaintiff did owe at least that amount of interest, even if she owed more), and although the plaintiff had not alleged that the statement was misleading, the statement was not materially misleading. The court explained that the FDCPA is designed to provide information that helps consumers make intelligent decisions, and "by definition immaterial information neither contributes to that objective (if the statement is correct) nor undermines it (if the statement is incorrect)." 557 F.3d at 757 – 758. *See also Wahl v. Midland Credit Management, Inc.,* 556 F.3d 643, 645 – 646 (7th Cir. 2009) (false letter does not violate FDCPA unless is it also misleading).

Other circuits have also required materiality for FDCPA claims. *See Donohue v. Quick Collect, Inc.,* 592 F.3d 1027 (9th Cir. 2010) (false but nonmaterial representations are not likely to mislead least sophisticated consumer and therefore are not actionable under §1692e or §1692f); *Miller v. Javitch, Block & Rathbone,* 561 F.3d 588, 597 (6th Cir. 2009) (rejecting plaintiff's claims on materiality grounds).

3. [12.28] Overshadowing

The Fair Debt Collection Practices Act provides that within 5 days of the initial communication with the debtor, the debt collector must send out a validation notice to the debtor. The validation notice informs the debtor that he or she has 30 days to verify or dispute the debt. 15 U.S.C. §1692g (setting forth requirements for validation notice). In order to meet the 5-day requirement, debt collectors usually include the validation notice in the initial collection letter.

The problem frequently confronted by the debt collector is whether other language in the letter overshadows the validation notice. The letter must contain language informing the debtor of his or her right to dispute the debt within 30 days, or, if the debt is not disputed, the debt collector will assume that the debt is valid. The overshadowing standard is low, and the standard is merely whether the letter is confusing to an unsophisticated consumer. *Johnson v. Revenue Management Corp.,* 169 F.3d 1057 (7th Cir. 1999). The language in the letter need not be contradictory, but rather merely confusing. 169 F.3d at 1060. For example, when the letter demands payment "now," "today," "immediately," or "within 10 days," this language will overshadow the validation notice that gives the debtor 30 days to dispute the debt. *See Vasquez v. Gertler & Gertler, Ltd.,* 987 F.Supp. 652 (N.D.Ill. 1997) (collecting cases).

There is no set criteria for determining whether language is confusing. *See Walker v. National Recovery, Inc.,* 200 F.3d 500, 503 (7th Cir. 1999) ("Whether a given message is confusing is . . . a question of fact, not of law or logic." [Citations omitted.]). The overshadowing issue likely is not one to be determined by the trial court. The Seventh Circuit has held that this is an issue that should be submitted to the finder of fact and can be presented via survey evidence. *See Walker, supra. But see Chuway v. National Action Financial Services Inc.,* 362 F.3d 944, 948 (7th Cir. 2004) ("If it is apparent just from reading the letter that it is unclear . . . and the plaintiff testifies credibly that she was indeed confused and that . . . she is representative of the type of people who received that or a similar letter, no further evidence is necessary to create a triable issue." [Citations omitted.]); *Taylor v. Cavalry Investment, L.L.C.,* 365 F.3d 572, 575 – 576 (7th Cir. 2004) (if reading of dunning letter makes it apparent that significant fraction of population would not be misled by it, court should reject plaintiff's contention without requiring evidence beyond letter itself); *Olson v. Risk Management Alternatives, Inc.,* 366 F.3d 509, 512 – 513 (7th Cir. 2004) (phrase "Now Due" in context of letters at issue, even to unsophisticated consumer, meant, simply, that debt collector was willing to accept less than total balance of debt to bring account to current status).

K. [12.29] Statute of Limitations

Under 15 U.S.C. §1692k(d), an action alleging a violation under the Fair Debt Collection Practices Act must be commenced within one year from the date on which the violation occurs. Although there have been no decisions regarding whether the discovery rule applies to the FDPCA, the United States Supreme Court considered the issue of whether the discovery rule applies to toll the statute of limitations under the Fair Credit Reporting Act (FCRA), 15 U.S.C. §1681, *et seq.,* an analogous consumer statute. *TRW Inc. v. Andrews,* 534 U.S. 19, 151 L.Ed.2d 339, 122 S.Ct. 441 (2001). In *TRW,* the Supreme Court held that a general discovery rule did not apply to the FCRA because the Act itself provides "that the two-year statute of limitations runs from 'the date on which the liability arises,' subject to a single exception for cases involving a defendant's willful misrepresentation of material information." 122 S.Ct. at 447, quoting 15 U.S.C. §1681p. Note that 15 U.S.C. §1681p was subsequently amended by the Fair and Accurate Credit Transactions Act of 2003, Pub.L. No. 108-159, 117 Stat. 1952, to provide that an action under the Act must be brought "not later than the earlier of" the following:

> **(1) 2 years after the date of discovery by the plaintiff of the violation that is the basis for such liability; or**

> **(2) 5 years after the date on which the violation that is the basis for such liability occurs.**

Although the FDCPA does not contain language that would limit application of the discovery rule, the courts have held that the statute of limitations begins to run from the time the letters are mailed. *See Mattson v. U.S. West Communications, Inc.,* 967 F.2d 259 (8th Cir. 1992). As a rule of thumb, a complaint that is filed over one year after the collection letter at issue was mailed is subject to attack as being untimely.

In *Mangum v. Action Collection Service, Inc.,* 575 F.3d 935, 941 (9th Cir. 2009), the court held that the discovery rule generally applied to statutes of limitation in federal litigation. The court refused to depart from its precedent applying this rule, even though that precedent had been undermined by later U.S. Supreme Court authority. 575 F.3d at 941 (discussing U.S. Supreme Court's disagreement with and reversing of Ninth Circuit's application of discovery rule to FCRA in *TRW, supra, rev'g TRW Inc. v. Andrews,* 225 F.3d 1063 (9th Cir. 2000)). The *Mangum* court also acknowledged the Eighth Circuit's decision in *Mattson,* which considered the FDCPA statute of limitations provision to be jurisdictional. The court dismissed that proposition by stating that "that statement was made without any real analysis" and went on to hold that the statutory time limit was not jurisdictional. 967 F.2d at 940 n.14. Thus, the court held that the plaintiff's FDCPA action was timely when the first time she discovered or could have discovered the alleged violation was on December 15, 2004, and she filed her FDCPA action on December 14, 2005. *See Stone v. Washington Mutual Bank,* No. 10 C 6410, 2011 WL 3678838 at **7 – 8 (N.D.Ill. Aug. 19, 2011) (finding it possible that plaintiffs could not have reasonably discovered basis of their claims until sometime after banks filed foreclosure complaints and therefore declining to dismiss FDCPA claims on statute of limitations grounds).

L. [12.30] Defenses

There is one primary defense built into the Fair Debt Collection Practices Act. 15 U.S.C. §1692k(c) provides:

> **A debt collector may not be held liable in any action brought under this subchapter if the debt collector shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.**

This is commonly referred to as the "bona fide error defense." In the seminal Seventh Circuit case *Jenkins v. Heintz,* 124 F.3d 824 (7th Cir. 1997), the court considered the assertion of the bona fide error defense by an attorney. In *Heintz,* the court held that a debt collector is not liable for an FDCPA violation if the collector shows that the violation was unintentional, and it maintained procedures reasonably adapted to avoid the violation. *See also Jenkins v. Union Corp.,* 999 F.Supp. 1120, 1140 (N.D.Ill. 1998).

In *Heintz,* the plaintiff asserted claims under 15 U.S.C. §1692e, complaining that the defendant law firm had attempted to collect premiums for forced-placed insurance that were not authorized by her automobile installment contract. Upon remand from the United States Supreme Court, the district court granted summary judgment in favor of the law firm based on the bona fide error affirmative defense. In regard to policies designed to avoid violations of the sort alleged, the firm demonstrated that it provided compliance training to its employees, and that it verified all disputed components of a deficiency with its clients before proceeding to judgment. The Seventh Circuit found that these procedures satisfied the requirement under 15 U.S.C. §1692k(c) as safeguards reasonably adapted to avoid the violations alleged. Significantly, the Seventh Circuit found that the affidavit of a partner of the firm filed in support of the firm's motion for summary judgment established that the firm did not know that the challenged insurance premiums were unauthorized.

To establish the bona fide error defense, an attorney should have a procedure in place designed to avoid violations of the FDCPA and should be prepared to explain why the procedure failed and how that failure was unintentional. *Nielsen v. Dickerson,* 307 F.3d 623 (7th Cir. 2002).

In *Hyman v. Tate,* 362 F.3d 965 (7th Cir. 2004), the plaintiff erroneously received a collection notice from the defendant after she had filed for bankruptcy protection — a technical violation of the FDCPA. However, in sending the letter, the defendant had a bona fide error and was relieved of liability for the act. In *Hyman,* the defendant's reliance on its creditor to not refer debtors who were in bankruptcy, coupled with the immediate cessation of collection efforts upon learning of a bankruptcy filing, were reasonable procedures to avoid such erroneous collection efforts. 362 F.3d at 967.

In *Kort v. Diversified Collection Services, Inc.,* 394 F.3d 530 (7th Cir. 2005), the plaintiff, representing a class of individuals, sued the defendant, claiming violations of the FDCPA by mailing allegedly misleading garnishment notices. Attached to the notices were response forms enabling delinquent account holders to claim exemptions under the Higher Education Act of 1965 (HEA), Pub.L. No. 89-329, 79 Stat. 1219. One such exemption was the unemployment exemption, 20 U.S.C. §1095a(a)(7), which, when successfully invoked, averts garnishment of wages during the first 12 months under new employment after being "involuntarily separated" from past employment. 394 F.3d at 533. Specifically, the plaintiff alleged that the defendant's requirement that debtors take affirmative action (*i.e.,* fill out the response forms attached to the garnishment notices claiming exemption from collection) was a violation of the FDCPA because the HEA allegedly did not require this action. The court held that even if the defendant violated the FDCPA as the plaintiff claimed, the defendant was entitled to the bona fide error defense as a matter of law because (1) it did not intentionally violate the FDCPA, (2) any such presumed violation resulted from a bona fide error, and (3) it maintained reasonable procedures designed to avoid any such assumed error (the defendant relied on the Department of Education's interpretation of the HEA and language for the letter).

In *Jerman v. Carlisle, McNellie, Rini, Kramer, & Ulrich LPA,* 538 F.3d 469, 472 (6th Cir. 2008), *rev'd,* 130 S.Ct. 1605 (2010), a debt collection law firm sent the consumer a collection letter that allegedly violated the FDCPA because it stated that the consumer had to dispute the debt in writing when the FDCPA does not require this. The debt collector claimed it should not suffer liability for the violation because the error was unintentional and resulted from a bona fide error. The Sixth Circuit Court of Appeals affirmed the district court's holding in favor of the defendant, concluding that the bona fide error defense applies to mistakes of law.

The court recognized there was a split among other circuits. While a majority of courts, including the Second, Eighth, and Ninth Circuits, have concluded the bona fide error defense applies only to clerical errors, other circuits, such as the Tenth and Seventh Circuits, have found the defense applies to mistakes of law. *Id.*

The United States Supreme Court reversed the Sixth Circuit's decision and held that the FDCPA does not provide debt collectors and their attorneys with a good-faith defense to liability for mistakes of law. 130 S.Ct. at 1624. The Court focused first on the maxim that ignorance of the law provides no excuse for violating it. 130 S.Ct. at 1611. Finding support through textual and legislative historical analysis, the Court stated that liability under the FDCPA was not confined to "willful" conduct, which often excludes mistakes of law from liability. 130 S.Ct. at 1613. Further, the Court noted that the bona fide error defense in the Act was modeled on the 1968 Truth in Lending Act (TILA), 15 U.S.C. §1601, *et seq.* 130 S.Ct. at 1615. In 1977, when the FDCPA was passed, three courts of appeal had interpreted the TILA bona fide error defense to refer to clerical — not legal — errors. Three years later, when Congress amended the TILA to include legal errors in its defense, it could have amended the FDCPA in the same way but chose not to do so. By not doing so, the Court reasoned that Congress did not wish to extend the bona fide error defense to mistakes of legal interpretation under the Act. 130 S.Ct. at 1616. Thus, the Court held that the FDCPA's bona fide error defense did not shield debt collectors from liability for mistakes of law. 130 S.Ct. at 1624.

IV. [12.31] RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT

Claims under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §1961, *et seq.,* are filed against attorneys, but less frequently now than had been previously.

A. [12.32] Elements of a Cause of Action

18 U.S.C. §1962(c) states that it is "unlawful for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs, through a pattern of racketeering activity or collection of unlawful debt." Four elements are required to sufficiently state a cause of action under the Racketeer Influenced and Corrupt Organizations Act. A claimant must demonstrate "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *McDonald v. Schencker,* 18 F.3d 491, 494 (7th Cir. 1994), quoting *Midwest Grinding Co. v. Spitz,* 976 F.2d 1016, 1019 (7th Cir. 1992).

The attorney need not have been an employee of the enterprise to participate in the conduct of its affairs. 2 Ronald E. Mallen and Jeffrey M. Smith, LEGAL MALPRACTICE §12.2 (2012). Typically, a RICO "enterprise" is a corporation or other form of business organization, but it may be any individual, partnership, association, corporation, or other entity or group of individuals associated in a business activity. *Id.*

A pattern of racketeering activity consists of at least two predicate acts of racketeering committed within a ten-year period. 18 U.S.C. §1961(5). RICO defines "racketeering activity," also known as "predicate acts," as acts indictable under any of several federal or state offenses, including mail fraud under 18 U.S.C. §1341 and wire fraud under 18 U.S.C. §1343. *Midwest Grinding, supra,* 976 F.2d at 1019.

B. Statute of Limitations

1. [12.33] Generally

The Racketeer Influenced and Corrupt Organizations Act does not provide an express statute of limitations for civil claims. The Supreme Court held that the four-year statute of limitations applicable to actions under the Clayton Act, 15 U.S.C. §12, *et seq.,* also applies to civil RICO claims. *Agency Holding Corp. v. Malley-Duff & Associates, Inc.,* 483 U.S. 143, 97 L.Ed.2d 121, 107 S.Ct. 2759 (1987).

2. [12.34] Accrual of the Statute of Limitations

The limitations period begins when there is a violation of the Racketeer Influenced and Corrupt Organizations Act, and the plaintiff knows or has reason to know of the injury. *McCool v. Strata Oil Co.,* 972 F.2d 1452, 1465 (7th Cir. 1992); *Electronic Relays (India) Pvt. Ltd. v. Pascente,* 610 F.Supp. 648, 653 (N.D.Ill. 1985). In *McCool,* the court stated that the RICO limitations period begins to run when a plaintiff discovers an injury, even if the plaintiff has not yet discovered the pattern of racketeering. 972 F.2d at 1465.

The Supreme Court eliminated the Third Circuit's "last predicate act" rule for determining when civil RICO claims accrue. *See Klehr v. A.O. Smith Corp.,* 521 U.S. 179, 138 L.Ed.2d 373, 117 S.Ct. 1984 (1997). The "last predicate act" rule had stated that an action accrues when a plaintiff knows or reasonably should know of an injury or predicate act in a pattern of racketeering activity.

C. [12.35] Damages

The computation of damages under the Racketeer Influenced and Corrupt Organizations Act is somewhat unclear. However, in *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 87 L.Ed.2d 346, 105 S.Ct. 3275 (1985), the Court stated in dicta that it may accept a predicate-act-based damage model. *Sedima* suggests that RICO damages are reserved for the predicate acts that cause the injury. 2 Ronald E. Mallen and Jeffrey M. Smith, LEGAL MALPRACTICE §12.14 (2012). In *Liquid Air Corp. v. Rogers,* 834 F.2d 1297, 1310 (7th Cir. 1987), the Seventh Circuit likewise ruled that the "measure of damages under civil RICO is the harm occasioned as a result of the predicate acts." The court also stated that a plaintiff injured by civil RICO actions deserves a "complete recovery." *Id.,* quoting *Carter v. Berger,* 777 F.2d 1173, 1176 (7th Cir. 1985).

D. RICO Claims Based on Securities Issues

1. [12.36] Supreme Court

The Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 128 L.Ed.2d 119, 114 S.Ct. 1439 (1994), decreased the number of claims under the Racketeer Influenced and Corrupt Organizations Act filed against attorneys based on securities-related issues. 2 Ronald E. Mallen and Jeffrey M. Smith, LEGAL MALPRACTICE §12.5 (2012). The Supreme Court held that aiding and abetting was not a cause of action under §10(b) of the Securities Exchange Act of 1934 (1934 Act), 15 U.S.C. §78a, *et seq.* (15 U.S.C. §78j(b)), or Rule 10b-5 of the Securities and Exchange Commission (SEC) under the 1934 Act (17 C.F.R. §240.10b-5). 114 S.Ct. at 1455.

2. [12.37] Seventh Circuit Court of Appeals

In *Brouwer v. Raffensperger, Hughes & Co.,* 199 F.3d 961 (7th Cir. 2000), investors filed a lawsuit against an underwriting firm and a law firm due to work they did for a corporation. The law firm's main duty was to perform due diligence. The investors alleged violations of the Racketeer Influenced and Corrupt Organizations Act. The court held that a RICO conspiracy requires one to "knowingly agree to perform services of a kind which facilitates the activities of those who are operating the enterprise in an illegal manner." 199 F.3d at 967. The court reversed the district court's judgment and remanded the case to consider the defendants' (including the attorneys') liability for conspiracy to violate RICO.

3. [12.38] District Court

In *HGN Corp. v. Chamberlain, Hrdlicka, White, Johnson & Williams,* 642 F.Supp. 1443 (N.D.Ill. 1986), a lender brought a claim under the Racketeer Influenced and Corrupt Organizations Act against a law firm, alleging that the firm engaged in fraudulent misrepresentations in connection with an opinion on a tax shelter transaction. The court held that the RICO claim was barred by Illinois' two-year statute of limitations (now codified at 735 ILCS 5/13-202) because it was filed more than two years after the tax-benefit transfer fell through. 642 F.Supp. at 1451.

In *Lipin Enterprises, Inc. v. Lee,* 625 F.Supp. 1098 (N.D.Ill. 1985), *aff'd,* 803 F.2d 322 (7th Cir. 1986), a purchaser of stock in two companies brought a RICO claim against a law firm and others, alleging that they participated in a scheme to defraud the purchaser by inducing it to purchase stock at an inflated price. The court held that the complaint failed to state a cause of action because it ignored the element of continuity of enterprise. 625 F.Supp. at 1100.

E. RICO Claims Based on Other Conduct Involving Attorneys

1. [12.39] Seventh Circuit Court of Appeals

In *McDonald v. Schencker,* 18 F.3d 491 (7th Cir. 1994), a client brought an action under the Racketeer Influenced and Corrupt Organizations Act against her attorney, alleging that the defendant's excessive bill and other actions taken by him to secure payment violated RICO. The plaintiff alleged that the defendant committed mail fraud, hoping to assert a predicate act of racketeering for purposes of stating a cause of action under RICO. The court held that the plaintiff did not properly allege mail fraud as a predicate act for the following reasons: (a) the plaintiff did not demonstrate that the number of hours listed on the defendant's bill had not been expended and (b) the plaintiff did not allege that the defendant failed to credit her with advance payments made toward the fee with fraudulent intent in doing so. The court also held that the plaintiff had not adequately alleged a pattern of racketeering activity, reasoning that the use of the mail was neither related to the alleged misuse of the legal fees nor connected in any other manner to any predicate act.

In *Hartz v. Friedman*, 919 F.2d 469 (7th Cir. 1990), clients brought a RICO claim against the attorneys that represented them in a medical malpractice action, alleging that the attorneys committed mail and wire fraud. The court held that the plaintiffs' allegations did not have sufficient "continuity" or "relationship" to constitute a RICO pattern. 919 F.2d at 474. The court reasoned that the predicate acts occurred over a short period of time and did not injure any parties other than the attorneys' clients in this action. *Id.*

In *United States v. Genova,* 167 F.Supp.2d 1021 (N.D.Ill. 2001), *rev'd in part,* 333 F.3d 750 (7th Cir. 2003), the mayor and city prosecutor allegedly were involved in an attorneys' fees kickback scheme, in which the prosecutor attempted to bribe the mayor in return for the continued selection of him as the city prosecutor and as an attorney who received payment for nonexistent legal work purportedly done on the city's behalf. The court held that the city prosecutor's attorneys' fees kickback scheme violated RICO, reasoning that a pattern was established by the "multiple [and varied] predicate racketeering acts of mail fraud, bribery and official misconduct committed by [the mayor and city prosecutor] over the course of a substantial period of time in excess of three years and within a ten-year period." 167 F.Supp.2d at 1042.

In *Elliott v. Chicago Motor Club Insurance,* 809 F.2d 347 (7th Cir. 1986), the plaintiffs and their five family members were injured in a car accident. One driver had no liability insurance. The defendant failed to settle the plaintiffs' claim under the uninsured motorist provisions in their policy. The plaintiffs brought a civil RICO action against their insurance company and its attorney, alleging that their conduct constituted a scheme to defraud the plaintiffs via use of the mail. The court held that the plaintiffs failed to state a civil cause of action under RICO, reasoning that "these predicate acts all clearly relate to the same transaction involving a single insurance policy and arising out of one accident." 809 F.2d at 350. They did not demonstrate a pattern of racketeering activity.

In *United States v. Yonan,* 800 F.2d 164 (7th Cir. 1986), the court upheld the RICO conviction of an attorney who bribed a state's attorney with the expectation of receiving favorable dispositions in some of his cases. The court held that the defendant was associated with that office for purposes of RICO. The Seventh Circuit held that, to be participating in the affairs of an enterprise, "the defendant need not have a stake in the enterprise's 'goals,' but can associate with the enterprise by conducting business with it, even if in doing so the defendant is *subverting* the enterprise's goals." [Emphasis in original.] 800 F.2d at 167. The business of the state's attorney's office is to prosecute criminal cases, and the defendant's business was to deal with the office in representing criminal defendants. The court stated that this relationship was sufficient to find that the defendant was associated with the office. 800 F.2d at 168.

In *United States v. Ginsburg,* 773 F.2d 798 (7th Cir. 1985), the district court found that an attorney was guilty of bribing employees at the Cook County Board of Tax Appeals to obtain favorable treatment in his cases. The district court ordered the attorney to forfeit his one-half interest in his firm's legal fees. The issue on appeal was whether the government must prove beyond a reasonable doubt the existence, at the time of a defendant's conviction, of any interest that the defendant has acquired in violation of 18 U.S.C. §1962. 773 F.2d at 799. The court held in the negative.

In *Jay E. Hayden Foundation v. First Neighbor Bank, N.A.,* 610 F.3d 382 (7th Cir. 2010), the Seventh Circuit held that two law firms and a bank could constitute an enterprise and meet the longevity requirement, but the allegations did not support that the embezzling attorney "used" the enterprise to engage in a pattern of racketeering activities. 610 F.3d at 389.

2. [12.40] District Court

In *Miyano Machinery USA, Inc. v. Zonar,* 1993-1 Trade Cas. (CCH) ¶70,145 (N.D.Ill. 1993), the plaintiff sued one of the defendant's attorneys under the Racketeer Influenced and Corrupt Organizations Act due to a commercial transaction. The court held that the plaintiff's RICO claim must be dismissed because the plaintiff relied solely on the predicate acts of mail fraud, which showed no signs of threatening to continue into the future.

In *Sassoon v. Altgelt, 777, Inc.,* 822 F.Supp. 1303 (N.D.Ill. 1993), investors brought a RICO claim against attorneys representing issuers in a public offering. The court held that the defendant's conduct, consisting of providing legal services to general partners and to the limited partnership, was not sufficient to support liability under 18 U.S.C. §1962(c). 822 F.Supp. at 1307.

In *Doe v. Roe,* 756 F.Supp. 353 (N.D.Ill. 1991), a client brought a RICO action against her attorney, alleging that he misused his position by demanding sexual favors from her in exchange for his legal services. The court held that the plaintiff failed to allege injury to business or property as required to state a RICO claim. The court stated that physical injury and mental suffering do not constitute RICO injury because there must be an injury to business or property. 756 F.Supp. at 358.

In *United States v. Finley,* 705 F.Supp. 1272 (N.D.Ill. 1988), the federal government charged the defendants, two of whom were unlicensed attorneys, with racketeering violations (among other claims). The government alleged that the defendants attempted to procure Chicago and Cook County contracts for Systematic Recovery Services, a private debt collections firm. Certain defendants moved to dismiss the RICO count, arguing that there was no association with an enterprise, there was no pattern of racketeering, and the complaint failed to sufficiently describe the predicate acts. The court denied the motion.

In *Sutherland v. O'Malley,* 687 F.Supp. 392 (N.D.Ill. 1988), the plaintiff attorney contracted with the defendant attorneys to represent a client in a personal injury action. The plaintiff disputed the proper allocation of the attorneys' fees, resulting in the lawsuit. First, the court held that the plaintiff's allegation of the predicate act of fraud was insufficient since no evidence showed her client was damaged, or that statements were made to or intended to be relied on by the plaintiff. 687 F.Supp. at 395. Second, the court held that the predicate act of extortion was insufficient because the plaintiff could not show that the threats made by the other attorney were intended to put the plaintiff in fear, or that her fear was reasonable. 687 F.Supp. at 396.

In *United States v. Roth,* 669 F.Supp. 1386 (N.D.Ill. 1987), the defendant, a private attorney, brought pretrial motions after the government's decision to supersede the indictment, which charged the defendant with violations of RICO in connection with the alleged bribery of state court judges. The court held that a private attorney could be associated for RICO purposes with the charged enterprise, the Circuit Court of Cook County. The court based its decision on the Seventh Circuit's holding in *United States v. Yonan,* 800 F.2d 164 (7th Cir. 1986), in which the court held that a lawyer's payment of bribes to a state prosecutor constituted association with the state's attorney's office under RICO. 669 F.Supp. at 1388.

In *Stone v. Washington Mutual Bank,* No. 10 C 6410, 2011 WL 3678838 (N.D.Ill. Aug. 19, 2011), the plaintiffs were current or former defendants in various state court mortgage foreclosure lawsuits. The defendants were banks, mortgage-servicing agents, law firms, and individuals. The plaintiffs alleged that the defendants engaged in a conspiracy to fraudulently foreclose on and seize properties belonging to the plaintiffs and other similarly situated individuals, thereby violating RICO. The court dismissed the RICO count, finding that the plaintiffs failed to support their contentions that the defendants' foreclosure actions constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). The court further explained that the plaintiffs failed to distinguish among the defendants as Fed.R.Civ.P. 9(b) requires. 2011 WL 3678838 at *11.

3. [12.41] Illinois Appellate Court

In *Abrams v. State Farm Fire & Casualty Co.,* 306 Ill.App.3d 545, 714 N.E.2d 92, 239 Ill.Dec. 534 (1st Dist. 1999), attorneys were sued for allegedly participating in a scheme to defraud an auto insurer by staging sudden stop accidents. The trial court found for the defendants, the auto insurers.

4. [12.42] Other Jurisdictions

In *Jackson v. Bellsouth Telecommunications,* 372 F.3d 1250 (11th Cir. 2004), the court of appeals held that employees who sued their attorneys and employer under the Racketeer Influenced and Corrupt Organizations Act had failed to establish a pattern of racketeering activity. The alleged pattern consisted of misconduct on the part of the attorneys over a closed-ended nine-month period; this did not constitute a substantial period of time, according to the court.

In *Holst v. Oxman,* No. Civ.A. 05-CV-0220, 2006 WL 724520 U.S.Dist. LEXIS 11384 (E.D.Pa. Mar. 17, 2006), a Pennsylvania federal district court found that an attorney who filed a frivolous suit against a doctor for medical malpractice could not then in turn be sued by the doctor under RICO.

In *Seippel v. Jenkens & Gilchrist, P.C.,* 341 F.Supp.2d 363 (S.D.N.Y. 2004), the Southern District of New York held that a law firm that gave favorable opinions for an impermissible tax avoidance scheme could be liable under fraud but not RICO, as the scheme involved the sale of securities.

In *Kelly v. Palmer, Reifler, & Associates, P.A.,* 681 F.Supp.2d 1356 (S.D.Fla. 2010), the plaintiffs alleged that the defendant law firm violated RICO in connection with its services involving recovery under civil theft recovery statutes. The plaintiffs alleged that the defendant law firm went beyond providing legal services and actively participated in directing the enterprise. The court held that the enterprise element was not met because the law firm was an agent of its corporate client, and its services were not separate and apart from its client, which was seeking to obtain civil recovery from the plaintiffs. The court also noted that the plaintiffs failed to establish that the defendant law firm participated in the operation or management of the enterprise, which, in addition to distinctiveness, was necessary to state a RICO claim. Thus, the court granted summary judgment in favor of the defendant law firm on the plaintiffs' RICO claims. *See also Crooked Creek Properties, Inc. v. Ensley,* No. 2:08-CV-1002-WKW[WO], 2009 WL 3644835 at *22 (M.D.Ala. Oct. 28, 2009) (holding that defendant attorney could not be liable under RICO because allegations of plaintiff's complaint "merely target his services as an attorney").

V. SECURITIES VIOLATIONS

A. [12.43] Elements of a Cause of Action

To establish a cause of action for securities fraud under Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. §240.10b-5), promulgated under §10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)), "a plaintiff must allege that the defendant (1) made a misstatement or omission, (2) of material fact, (3) with scienter, (4) in connection with the purchase or sale of securities, (5) upon which the plaintiff relied, and [that] (6) that reliance proximately caused plaintiff's injuries." *Wafra Leasing Corporation 1999-A-1 v. Prime Capital Corp.,* 192 F.Supp.2d 852, 859 (N.D.Ill. 2002), quoting *In re HealthCare Compare Corp. Securities Litigation,* 75 F.3d 276, 280 (7th Cir. 1996).

B. [12.44] Statute of Limitations

The Supreme Court has held that the statute of limitations for litigation under Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. §240.10b-5) derives from §§9(e) and 18(c) of the Securities Exchange Act of 1934 (15 U.S.C. §§78i(e), 78r(c)). *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 115 L.Ed.2d 321, 111 S.Ct. 2773, 2780 (1991). A cause of action under SEC Rule 10b-5 must be brought within one year after the discovery of the facts constituting the violation or within three years of the violation itself. 111 S.Ct. at 2782.

C. [12.45] Damages

In enacting the Private Securities Litigation Reform Act of 1995, Pub.L. No. 104-67, 109 Stat. 737, which amended the Securities Exchange Act of 1934, adding §21D, Congress included a provision relating to the issue of damages. Section 21D(e)(1) states:

> **Except as provided in paragraph (2), in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by**

the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market. 15 U.S.C. §78u-4(e)(1).

D. Securities Cases Involving Attorneys

1. [12.46] Supreme Court

In *United States v. O'Hagan,* 521 U.S. 642, 138 L.Ed.2d 724, 117 S.Ct. 2199 (1997), a client retained a law firm to represent it regarding a tender offer for a target company's common stock. The respondent in *O'Hagan* was a partner at the law firm who purchased call options on that company's stock and shares of the stock. After the client announced the tender offer, the price of the target company's stock increased significantly, and the respondent sold his call options and stock for a large profit. The Supreme Court held that the defendant, who traded in securities for personal profit and used confidential information in breach of a fiduciary duty, could be found liable for securities fraud in violation of Rule 10b-5 of the Securities and Exchange Commission Rule (17 C.F.R. §240.10b-5) and §10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)).

In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 128 L.Ed.2d 119, 114 S.Ct. 1439 (1994), a public building authority defaulted on public improvement bonds that were secured by landowner assessment liens. Subsequent to the default, the bondholders sued the public building authority, underwriters, developer, and indentured trustee. The Supreme Court held that a private plaintiff may not maintain an aiding and abetting suit under §10(b) of the 1934 Act. 114 S.Ct. at 1455.

2. [12.47] Seventh Circuit Court of Appeals

In *Ackerman v. Schwartz,* 947 F.2d 841 (7th Cir. 1991), investors in a fraudulent tax shelter brought a cause of action for securities violations against a lawyer who wrote an opinion letter stating that investors were entitled to a tax credit of $20,000 and a deduction of $10,000 touted by promoters. The facts cited in the opinion letter were fictitious because the lawyer failed to verify the facts.

The court held that an attorney is not a "seller" within the meaning of §12 of the Securities Act of 1933 (1933 Act), 15 U.S.C. §77a, *et seq.* (15 U.S.C. §77*l*), which creates a remedy against those who sell unregistered securities or who sell securities via a false prospectus or oral communication. The *Ackerman* court relied on *Pinter v. Dahl,* 486 U.S. 622, 100 L.Ed.2d 658, 108 S.Ct. 2063, 2075 (1988), in which the Supreme Court held that sellers do not include attorneys who facilitated the sale and were not statutory sellers. 947 F.2d at 844. The *Ackerman* court also held that there is no liability for aiding or abetting a violation of §12 of the 1933 Act. 947 F.2d at 845. In considering the issue of whether the attorney had a duty to the investors, the court also held that the attorney could not evade responsibility to the extent that he permitted promoters to release his letter to investors' accountants, attorneys, and tax advisors on the ground that he owed no duty to investors. 947 F.2d at 848.

In *Renovitch v. Kaufman,* 905 F.2d 1040 (7th Cir. 1990), investors in a fraudulent cattle leasing program sued, among others, the attorneys for the program's marketer, alleging liability for aiding and abetting, a violation of §10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)) and Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. §240.10b-5). Before the marketers distributed a brochure about the cattle leasing program to investors, their attorneys scanned it, failing to verify the truth of the representations made in the brochure. The court held that the attorneys could not be liable for aiding and abetting securities fraud because they failed to commit manipulative or deceptive acts. The court stated that the only acts committed were related to the misrepresentations in the brochure, but neither attorney prepared the brochure, authorized preparation of the brochures, or sold the securities offered in the brochure. 905 F.2d at 1046.

First Interstate Bank of Nevada, N.A. v. Chapman & Cutler, 837 F.2d 775 (7th Cir. 1988), involved a bond investor's suit against bond counsel, alleging that its legal opinions in connection with bond issues were based on assumptions that counsel either knew to be false or recklessly assumed to be true. The court held that bond counsel's opinion as to the tax-exempt status of bonds did not constitute an aiding and abetting violation of §10(b) of the 1934 Act, SEC Rule 10b-5, and §17(a) of the 1933 Act (15 U.S.C. §77q(a)). 837 F.2d at 778. The court also held that conclusory assertions that bond counsel was engaged in a fraudulent common plan were insufficient to state a claim for violation of the securities laws on the ground that counsel issued a fraudulent opinion on the tax-exempt status of bonds. 837 F.2d at 780.

3. [12.48] District Court

In *Wafra Leasing Corporation 1999-A-1 v. Prime Capital Corp.,* 192 F.Supp.2d 852 (N.D.Ill. 2002), an investor brought a securities fraud action against its attorneys, alleging that they misrepresented information in connection with a closing. The court held that the investor stated a claim against the attorney who was the senior partner of the corporation's general counsel by alleging that he acted as a director, officer, and major shareholder; knew of and directed the corporation's kiting scheme; and was a "controlling person." 192 F.Supp.2d at 869. The court also held that the corporation's general counsel was not insulated from liability because its opinion letter contained cautionary language that was not a mere opinion or prediction, but a misrepresentation of "hard fact." 192 F.Supp.2d at 870. The court also held that the investor's allegations were sufficient to plead fraud by the corporation's general counsel. *Id.*

The attorney defendant in *Securities & Exchange Commission v. Jakubowski,* 912 F.Supp. 1073 (N.D.Ill. 1996), allegedly induced several account holders of financial institutions that were converting from mutual to stock ownership to purchase stock for him. It was claimed that he falsely indicated that the stock was being purchased by an account holder. The court held that a securities fraud claim was stated against the attorney.

The *Jakubowski* court considered that to bring an action pursuant to §10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)) and Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. §240.10b-5), five elements must be proved by a preponderance of the evidence: (a) the defendant, directly or indirectly, made an untrue statement of fact or (alternatively) omitted to state a material fact when he or she had a duty to speak; (b) the statement or omission was material; (c) the statement or omission was made "in connection with" the purchase or sale of a security; (d) the defendant made the statement or omission knowingly or recklessly; and (e) the transaction involved interstate commerce, the mails, or a national securities exchange. 912 F.Supp. at 1079. The *Jakubowski* court found that the first element was met because, in filling out and submitting the stock order form, the defendant represented that the account holder was the buyer of shares, while in reality the buyer was an associate who was not an account holder and was ineligible to purchase shares. The second element was met because the defendant's misrepresentation of the identity of the buyer of shares affected the institution's investment decision to sell shares to the non-account holder, rather than to qualified holders of conversion rights. The third element was met because the defendant's misstatement "touched" an actual sale of securities in that it was the "means of accomplishing the purchase of securities." 912 F.Supp. at 1086, quoting *Superintendent of Insurance of State of New York v. Bankers Life & Casualty Co.,* 404 U.S. 6, 30 L.Ed.2d 128, 92 S.Ct. 165, 169 (1971), and *Securities & Exchange Commission v. Rana Research, Inc.,* 8 F.3d 1358, 1362 (9th Cir. 1993). The plaintiff did not dispute that the fourth and fifth elements were met.

Investors in *Sassoon v. Altgelt, 777, Inc.,* 822 F.Supp. 1303 (N.D.Ill. 1993), brought a securities claim against attorneys representing issuers in a public offering. The court held that the investors' claim under §10(b) of the 1934 Act based on the attorneys' silence as to facts with the purchase or sale of limited partnerships was time-barred by the three-year limitations period. 822 F.Supp. at 1305.

In *Scholes v. Stone, McGuire & Benjamin,* 786 F.Supp. 1385 (N.D.Ill. 1992), a receiver of partnerships and a class of partnership investors brought a lawsuit against law firms and individual attorneys, alleging securities violations. The court held that the law firm could not be liable under §12(2) of the Securities Act of 1933 (15 U.S.C. §77*l*(2)) for substantially participating in or leading members to purchase securities because the law firm did not pass title to the securities or solicit the purchase of the securities. 786 F.Supp. at 1399. The court also held that there was no cause of action for aiding and abetting liability because the statutory provision expressly limits liability to offerors and sellers. *Id.* The court also held that the plaintiffs did state a claim for primary liability against the law firm under §10(b) of the 1934 Act and SEC Rule 10b-5, reasoning that there were material omissions in documents drafted for implementing rescission offers, and the firm perpetuated the partner's fraudulent schemes by concealing the plaintiff's criminal record and advising him how to continue his business. 786 F.Supp. at 1400.

In *United States v. Elliott,* 711 F.Supp. 425 (N.D.Ill. 1989), the defendant, a former partner in a law firm, was charged with misusing confidential client information for his personal benefit. The indictment stated that he used the nonpublic information he learned at his firm to purchase stock in certain companies. The court held that the defendant could be charged with securities fraud based on the misappropriation theory. The court also held that the confidential client information was sufficiently material to the defendant's purchase of the stock to support a securities fraud charge based on the misappropriation theory. 711 F.Supp. at 433.

In *Excalibur Oil, Inc. v. Sullivan,* 616 F.Supp. 458 (N.D.Ill. 1985), an oil and gas lease buyer brought a cause of action against the seller's attorney for misrepresentations of encumbrances. The court held that the plaintiff's allegations were sufficient to sustain a claim under the 1934 Act and the 1933 Act. The court stated that the defendant's representations as to title were a substantial factor in causing the transactions to take place, establishing him as more than a "mere participant" in the securities sale. 616 F.Supp. at 465. The court also held that the defendant was not a "salesperson" subject to suit under §13 of the Illinois Securities Law of 1953, 815 ILCS 5/1, *et seq.,* reasoning that other people, not the defendant, solicited the plaintiff and induced it to invest in the wells at issue. 616 F.Supp. at 466.

In *Armstrong v. American Pallet Leasing Inc.,* 678 F.Supp.2d 827 (N.D. Iowa 2009), the plaintiffs alleged a claim against the defendant attorney pursuant to §11 of the 1934 Act (15 U.S.C. §78k) based on the fact that the attorney gave a legal opinion on some aspect of the reverse merger transaction at issue. The court held that because the plaintiffs had not alleged that the defendant attorney's opinion was prepared with the registered statement, or that he prepared or certified any portion of the registered statement, the defendant attorney did not fall within any of the categories enumerated in §11. Thus, the court granted the defendant attorney's motion to dismiss this claim.

In *Wendt v. Handler, Thayer & Duggan, LLC,* 613 F.Supp.2d 1021 (N.D.Ill. 2009), investors brought an action against investment consulting firms and trusts, as well as various officers of the firms and trusts, alleging violations of §10(b) of the 1934 Act and SEC Rule 10b-5, in addition to state law violations. The court found that the plaintiff beneficiaries did not have standing under Rule 10b-5 because the trusts made the investment decisions. The court continued, however, that the estate did state a cause of action for legal malpractice. 613 F.Supp.2d at 1034 – 1035.

4. [12.49] Illinois Appellate Court

In *Competitive Food Systems, Inc. v. Laser,* 170 Ill.App.3d 606, 524 N.E.2d 207, 120 Ill.Dec. 442 (2d Dist. 1988), a corporation filed a lawsuit against a law firm for breach of contract and legal malpractice. The firm prepared an offering circular for a private offering of the corporation's stock. The corporation claimed that it was damaged because the firm did not prepare the circular by a certain date. The defendants argued that the projections contained material misstatements and that they could not be liable for failing to help the plaintiff commit an illegal act. The court held that the evidence raised a genuine issue of material fact as to whether the financial projections made by the corporation in the circular contained material misstatements that made the projections misleading and illegal under Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. §240.10b-5).

In *Conroy v. Andeck Resources '81 Year-End Ltd.,* 137 Ill.App.3d 375, 484 N.E.2d 525, 92 Ill.Dec. 10 (1st Dist. 1985), purchasers of a private offering of securities filed a lawsuit against securities sellers and the sellers' attorneys from an Oklahoma law firm. They charged the defendant attorneys with negligence for failure to register the transaction. The court held that the trial court lacked personal jurisdiction over the attorneys. 484 N.E.2d at 537.

5. [12.50] Other Jurisdictions

In *Media General, Inc. v. Tomlin,* 387 F.3d 865 (D.C.Cir. 2004), the District of Columbia Circuit held that a law firm could be in violation of Rule 10b-5 of the Securities and Exchange

Commission (17 C.F.R. §240.10b-5) and common-law fraud for failing to disclose a possible suit against its client in merger transactions.

In *Ferer v. Erickson & Sederstrom, P.C.,* 272 Neb. 113, 718 N.W.2d 501 (2006), the Nebraska Supreme Court found that corporate counsel, who acted as transfer agent of stock, could be liable to the owner of a security for wrongful registration under Nebraska's state statute governing stock transfers. This was the case even though there was no strict attorney-client relationship between the shareholder and the law firm in question.

In *In re Enron Corporation Securities, Derivative & "ERISA" Litigation,* No. MDL-1446, 2005 WL 3704688 (S.D.Tex. Dec. 5, 2005), the Southern District of Texas held that a law firm that gave legal opinions that were used by Arthur Anderson in the falsification of Enron's transactions was not liable to investors in Enron securities under SEC Rule 10b-5. According to the court, the plaintiffs had failed to state a claim; also relevant was the nonpublic nature of the opinion, and the plaintiffs' failure to show that the firm had directed or materially assisted Arthur Anderson or Enron in their fraud.

In *Clayton v. Heartland Resources, Inc.,* No. 1:08CV-94-M, 2009 WL 790175 at *6 (W.D.Ky. Mar. 24, 2009), the plaintiffs were shareholders who bought oil and gas securities. The plaintiffs alleged that the defendant attorney knew that the offering materials that the attorney prepared on behalf of his client contained false or misleading information and thus violated §10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)). The defendant attorney moved to dismiss this claim, arguing that (a) he did not make any representations in the documents and (b) if he did make any representations, he was absolved of liability for misrepresentations because of a disclaimer that he placed in the offering documents, which stated that the attorney made no representation of the accuracy of the materials. The court denied the defendant attorney's motion to dismiss the plaintiffs' claim because the plaintiffs had sufficiently alleged that the attorney had knowingly made various misstatements and omissions in the offering documents. The court rejected the defendant attorney's disclaimer argument, stating that the attorney could not escape liability merely by disclaiming the accuracy of the material contained in those offering documents.

In *Thompson v. Paul,* 547 F.3d 1055, 1062 (9th Cir. 2008), the court considered whether attorneys could be liable under §10(b) of the 1934 Act for statements made to third parties, specifically, persons, or entities other than the attorneys' clients. The court cited various courts that held that attorneys could be liable under §10(b) for such actions and denied the defendant attorneys' motion to dismiss the plaintiff's claim on that issue. 547 F.3d at 1061 – 1063, citing *Rubin v. Schottenstein, Zox & Dunn,* 143 F.3d 263 (6th Cir. 1998), *Trust Company of Louisiana v. N.N.P. Inc.,* 104 F.3d 1478 (5th Cir.1997), *Kline v. First Western Government Securities, Inc.,* 24 F.3d 480 (3d Cir.1994), *Ackerman v. Schwartz,* 947 F.2d 841 (7th Cir.1991), and *Securities & Exchange Commission v. Coffey,* 493 F.2d 1304, 1315 (6th Cir. 1974).

VI. EMPLOYEE RETIREMENT INCOME SECURITY ACT

A. [12.51] Fiduciary Status

The Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §1001, *et seq.*, was enacted to protect employee benefit plans. ERISA established standards of conduct, responsibility, and obligations for fiduciaries of these plans. *Pilot Life Insurance Co. v. Dedeaux,* 481 U.S. 41, 95 L.Ed.2d 39, 107 S.Ct. 1549, 1551 (1987). Under 29 U.S.C. §1109, a fiduciary is personally liable for breaches of duty to an ERISA-covered plan. The fiduciary is also subject to "such other equitable or remedial relief as the court may deem appropriate." 29 U.S.C. §1109(a).

An attorney is generally considered a fiduciary to his or her client during a legal representation. However, an attorney is not necessarily a "fiduciary" pursuant to ERISA terminology simply because the legal representation involves a plan covered by ERISA. A "fiduciary" for the purposes of ERISA is defined as one who (1) exercises discretionary authority or control over plan management, administration, or disposition of plan assets or (2) renders investment advice for a fee or other compensation. 29 U.S.C. §1002(21)(A). ERISA fiduciary status in the latter category requires, according to the regulations issued pursuant to ERISA, that the investment advice be rendered (1) by one having "discretionary authority or control . . . with respect to purchasing or selling securities" or (2) on a "regular basis." 29 C.F.R. §2510.3-21(c)(1)(ii).

Fiduciary status may also be imparted to persons "named" in the plan instrument or "identified" as such by an employer or employee organization. 29 U.S.C. §1102(a)(2). Attorneys who service a plan are rarely designated in the plan documents.

B. [12.52] Attorneys and Fiduciary Status

In *Yeseta v. Baima,* 837 F.2d 380, 385 (9th Cir. 1988), the court held that attorneys must perform more than the "usual professional" services to be considered a fiduciary under the Employee Retirement Income Security Act. The court stated that an inquiry into whether an attorney is a fiduciary for the purposes of ERISA involves a functional examination of the lawyer's service.

The retention of an attorney will not normally create a fiduciary duty under ERISA. However, there have been a number of cases in which an attorney's conduct has invoked ERISA fiduciary status. In *Bouton v. Thompson,* 764 F.Supp. 20, 22 (D.Conn. 1991), the court held that because the attorney had the authority to make withdrawals from a bank account that held ERISA plan assets, he had the requisite degree of control over the plan to be a fiduciary. The attorney in *Mason Tenders District Council Pension Fund v. Messera,* 958 F.Supp. 869, 892 (S.D.N.Y. 1997), provided regular advice concerning plan investments. The court found from this conduct that he was a fiduciary for the purposes of ERISA. *But see Great-West Life & Annuity Insurance Co. v. Smith,* 180 F.Supp.2d 1311 (M.D.Fla. 2002) (law firm for personal injury plaintiff covered by ERISA health plan was not fiduciary even though it received settlement proceeds to which plan claimed subrogation rights). In *In re Mushroom Transportation Co.,* 382 F.3d 325 (3d Cir. 2004), a bankruptcy attorney, his law firm, and a bank were sued by a Chapter 7 trustee in an adversary proceeding as bankruptcy attorney and escrow agents regarding the holding of proceeds from the sale of the debtor's assets. The claims included breach of fiduciary duty, wrongful conversion, negligence, breach of contract, and fiduciary breaches under ERISA. The Third Circuit affirmed the determination that the bank and the law firm that served as escrow agents with the sale of the debtor's assets were not fiduciaries under §409(a) of ERISA, 29 U.S.C. §1109(a). The court held that custody or possession over plan assets, without more, does not render one a fiduciary under ERISA.

In *Clark v. Feder Semo & Bard, P.C.,* 634 F.Supp.2d 99 (D.D.C. 2009), the court held that a law firm hired by an employer to provide legal services related to the employer's retirement plan was not a "fiduciary" with respect to the retirement plan under ERISA when the law firm did not have discretionary authority with regard to the retirement plan's management, the disposition of its assets, or the administration of the plan and did not provide investment advice for the plan. 634 F.Supp.2d at 105.

C. [12.53] Party in Interest

Attorneys can be liable under the "party in interest" provisions of the Employee Retirement Income Security Act even if they are not fiduciaries pursuant to ERISA. A "party in interest" is defined as "a person providing services" to a covered plan. 29 U.S.C. §1002(14)(B). An attorney can become liable as a party in interest for legal services provided to the plan. *See Concha v. London,* 62 F.3d 1493, 1503 – 1504 (9th Cir. 1995); *Great-West Life & Annuity Insurance Co. v. Smith,* 180 F.Supp.2d 1311, 1313 (M.D.Fla. 2002) (court denied law firm's motion to dismiss claim for equitable relief brought by assignee of plan, stating that "[w]hile the law firm is correct that it cannot be considered an ERISA fiduciary . . . a cause of action pursuant to §1132(a)(3) can be stated against a non-fiduciary" [Citation omitted.]).

Party-in-interest liability originates from 29 U.S.C. §1106, which prohibits certain transactions involving ERISA-governed plans. The prohibited transactions occur when the fiduciary causes the plan to (1) engage in a loan between the plan and a party in interest, (2) pay excessive compensation for legal services, or (3) transfer plan assets to a party in interest.

29 U.S.C. §1106(a) has been extended to non-fiduciary parties, such as attorneys. In *Neito v. Ecker,* 845 F.2d 868, 873 – 874 (9th Cir. 1988), the court interpreted 29 U.S.C. §1106(a) to allow claims against non-fiduciary parties in interest, including attorneys. The trustees of an ERISA-covered plan sued the attorney for allegedly failing to collect contributions from employers who were participants in the plan. The plaintiffs also alleged that the attorney had received excessive compensation for legal services performed on behalf of the plan. The court held that these allegations stated a cause of action under 29 U.S.C. §1106(a) and that it would be difficult or impossible to undo the prohibited transaction unless it had jurisdiction over all participants.

D. [12.54] Expanded Liability Concerns

The remedies available under the Employee Retirement Income Security Act to plaintiffs against a "party in interest" and other non-fiduciary liability theories have been limited to equitable remedies, such as injunctive relief and restitution. Compensatory damages under 29 U.S.C. §1109(a) has extended only to fiduciaries. However, that may be changing. *See Harris Trust & Savings Bank v. Salomon Smith Barney Inc.,* 530 U.S. 238, 147 L.Ed.2d 187, 120 S.Ct. 2180 (2000).

In *Harris Trust & Savings Bank,* the defendant was a broker-dealer involved in an investment for a plan and was considered a non-fiduciary. The investment manager, who was a fiduciary of an ERISA plan, directed the defendant to sell interests in several properties that were part of the plan. The transaction, though, was prohibited under 29 U.S.C. §1106.

The Supreme Court held that a non-fiduciary could be liable under §502(a)(3) of ERISA (29 U.S.C. §1132(a)(3)). Section 502(*l*)(1)(B) authorizes a civil penalty against a "fiduciary or other person in an amount equal to 20 percent of the applicable recovery amount." 29 U.S.C. §1132(*l*)(1)(B). Accordingly, a monetary remedy was available against a non-fiduciary under ERISA's party-in-interest liability provision. *Harris Trust & Savings Bank* exposes attorneys to a new level of liability. *See Great-West Life & Annuity Insurance Co. v. Smith,* 180 F.Supp.2d 1311, 1313 (M.D.Fla. 2002) (following reasoning of *Harris Trust & Savings Bank* Court).

E. [12.55] Preemption

A claim under the Employee Retirement Income Security Act supersedes "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." 29 U.S.C. §1144(a). The preemption provision is deliberately expansive. Claims brought under state law doctrines that do not even expressly refer to employee benefit plans have been preempted when they arise directly or indirectly from the administration of employee benefit plans. *Ellenburg v. Brockway, Inc.,* 763 F.2d 1091, 1095 (9th Cir. 1985); *Great-West Life & Annuity Insurance Co. v. Smith,* 180 F.Supp.2d 1311, 1313 (M.D.Fla. 2002).

However, the courts have held that the ERISA preemption does not apply to state law malpractice and other tort claims involving professional services dealing with an ERISA plan. *See Painters of Philadelphia District Council No. 21 Welfare Fund v. Price Waterhouse,* 879 F.2d 1146 (3d Cir. 1989) (involving claim against auditors); *Pappas v. Buck Consultants, Inc.,* 923 F.2d 531 (7th Cir. 1991) (involving claim against actuaries); *Custer v. Sweeney,* 89 F.3d 1156, 1168 (4th Cir. 1996) (state law malpractice claim against plan's attorney was not preempted even though claim depended on proof that attorney provided negligent advice concerning ERISA's fiduciary standards); *Harmon City, Inc. v. Nielsen & Senior,* 907 P.2d 1162, 1170 (Utah 1995) (negligent advice regarding compliance with ERISA laws did not "relate to" plan so as to compel preemption). The reason for this exemption is that without it, the client would be left with only the limited relief available under ERISA.

VII. [12.56] SARBANES-OXLEY ACT

The purpose of the Sarbanes-Oxley Act of 2002, Pub.L. No. 107-204, 116 Stat. 745, as stated in the title of the enacting legislation, is to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws." Although much of the

Sarbanes-Oxley Act is not strictly applicable to attorneys, attorney conduct is specifically addressed. Section 307 of the Sarbanes-Oxley Act (15 U.S.C. §7245) directs the Securities and Exchange Commission to issue rules setting forth minimum standards of professional conduct for attorneys who represent the issuers of securities before the SEC.

Effective August 5, 2003, the SEC adopted final rules (17 C.F.R. pt. 205) governing the standards of conduct for attorneys appearing and practicing before the SEC. See SEC Release No. 33-8185, 79 SEC Docket 1351 (Jan. 29, 2003). Notably, the SEC deferred consideration of its "noisy withdrawal rule," extending the comment period on its proposal. An alternative proposal (SEC Release No. 33-8186, 79 SEC Docket 1392 (Jan. 29, 2003)), was offered for comment during that time. The SEC has not taken action with respect to the noisy withdrawal rule or the alternative proposal.

For further information pertaining to compliance with the Act and the scope of its rules, see SARBANES-OXLEY MANUAL: A HANDBOOK FOR THE ACT AND SEC RULES (2d ed. 2005), and James Hamilton and Ted Trautmann, SEC CORPORATE DISCLOSURE REFORMS: COMPENDIUM (2004).

A. [12.57] Application to Attorneys

There is not much caselaw involving attorneys violating the Sarbanes-Oxley Act, but there have been several enforcement actions by the Securities and Exchange Commission against lawyers. *See Securities & Exchange Commission v. Hill,* SEC Litigation Release No. 19617, 87 SEC Docket 1830 (Mar. 21, 2006) (former general counsel for Inso Corporation charged with creating sham transaction with Malaysian software distributor to inflate stock price); *SEC v. Yuen,* SEC Litigation Release No. 19047, 84 SEC Docket 2599 (Jan. 21, 2005) (SEC charged that former general counsel of Gemstar was involved in fraudulently overstating stated revenues); *SEC v. Dooley,* SEC Litigation Release No. 18896, 83 SEC Docket 2678 (Sept. 24, 2004) (former general counsel for Electro Scientific Industries, Inc., was charged with omitting material facts from independent auditors). These judgments have been concluded by consent, and "the reason for the unanimity of these resolutions by consent is that the lawyer's reputation and livelihood have already been devastated by the charges alone, and the lawyer has little to gain from a long and expensive fight against the government." 4 Alan R. Bromberg and Lewis D. Lowenfels, BROMBERG AND LOWENFELS ON SECURITIES FRAUD AND COMMODITIES FRAUD §7:395.40, p. 7-768 (2d ed. 2007).

Section 307 of the Sarbanes-Oxley Act requires that, whatever other rules are issued, the SEC is to include a rule "requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company." 15 U.S.C. §7245. If the chief legal or executive officer does not respond appropriately by adopting remedial measures or sanctions, the corporate attorney is required to report the evidence of wrongdoing to one of three bodies:

1. the audit committee of the board of directors of the issuer of the securities;

2. another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer; or

3. the board of directors. *Id.*

By specifically identifying certain committees to which the corporate wrongdoing must be reported, §307 of the Sarbanes-Oxley Act adds to the existing ethical rules, as discussed in §12.58 below, that outline how a lawyer should respond to corporate wrongdoing.

B. [12.58] Existing Ethical Rules

The existing ethical rules, which apply to all lawyers representing entities and not just those that issue securities, impose on lawyers a duty to act. Unlike §307 of the Sarbanes-Oxley Act (15 U.S.C. §7245), however, the existing ethical rules do not mandate any specific action. See §12.57 above.

RPC 1.13(b) provides:

> **If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a crime, fraud or other violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.**

In determining how to proceed under paragraph (b), the lawyer should give due consideration to the seriousness of the misconduct and its consequences, the responsibility in the organization and the apparent motivation of those involved, the policies of the organization concerning such matters, and any other relevant considerations. RPC 1.13(b) further directs that any measures taken should, to the extent practicable, minimize the risk of revealing information relating to the representation to persons outside the organization.

RPC 1.13(b) gives the lawyer two suggestions as to the measures to be taken by the lawyer: (1) asking reconsideration of the matter and (2) referring the matter to a higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act on behalf of the organization as determined by applicable law.

RPC 1.13(b) does not require that the lawyer take any of these specific measures, but rather that the lawyer take measures that are "reasonably necessary" to protect the corporate client.

While sometimes the only way to protect the entity is to go to the highest authority, such as the board of directors, that action is required only when it is reasonably necessary. Section 307 of the Sarbanes-Oxley Act, however, requires the lawyer to report the wrongdoing to specific individuals, committees of the board of directors, or the board of directors itself.

What happens if the board of directors does not take any remedial action after the lawyer brings the wrongdoing to its attention? Section 307 of the Sarbanes-Oxley Act does not provide any direction, and it remains to be seen what rules will be issued by the Securities and Exchange Commission.

RPC 1.13(c), however, allows a lawyer to resign if the highest authority insists on an action or a refusal to act that is clearly a violation of the law and is likely to result in substantial injury to the organization. Resignation is also allowed by RPC 1.16(b)(1) when a client seeks to pursue an illegal course of conduct or if the client insists that the lawyer pursue an illegal course of conduct.

Under RPC 1.16(a)(1), however, a lawyer might be required to resign if he or she knows that continued employment will result in violation of the Rules of Professional Conduct, such as RPC 1.2(d), which prohibits a lawyer from assisting a client in conduct that the lawyer knows is criminal or fraudulent. A lawyer does not assist a corporate client in criminal or fraudulent conduct merely by failing to withdraw, so withdrawal is not necessarily required.