

Law Firm Not Entitled to Summary Judgment After Failing to Advise CEO of Unauthorized Loans by CFO

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Aug 7, 2013

[Whitney Group, LLC v Hunt-Scanlon Corporation, et al., ___ N.Y.S.2d ___, 2013 WL 2341049 \(N.Y. 2013\)](#)

Brief Summary

Plaintiff client brought a legal malpractice action against defendant, its outside counsel, due to counsel's failure to notify it about unauthorized loans made by the client's chief financial officer (CFO). Counsel moved for summary judgment on the grounds that because the client knew of the loans, counsel's failure to advise the client of the loans was not the proximate cause of the client's loss. The court denied the motion, finding that there was an issue of fact as to whether the client had such knowledge. The court also found that there were issues of fact precluding summary judgment as to counsel's *in pari delicto* affirmative defense and that counsel could not assert the defense of comparative fault because there was nothing about the manner in which the company operated that would lead a factfinder to conclude that the client had interfered with counsel's ability to carry out the fiduciary duties it owed the company.

Complete Summary

The CFO made a series of unauthorized loans to defendant corporation and sought legal advice from defendant counsel about the loans. When counsel learned that the loans had not been approved by the client, they advised the CFO to inform the client's chief executive officer (CEO) and board of directors of the unauthorized loans. Counsel did not, however, advise the client themselves or confirm that the CFO had done so.

The client sued counsel for legal malpractice. Counsel moved for summary judgment, arguing that their failure to notify the client about the loans was not the proximate cause of the loss because the client knew about the loans and had done nothing to prevent the CFO from issuing more. The appellate division held that the trial court

properly denied the motion because there was an issue of fact as to whether the client had such knowledge. It also agreed with the trial court that the apportionment of liability was a trial matter.

The court also held that there was an issue of fact as to whether counsel had established that the *in pari delicto* defense defeated the client's claims. Not only was there an issue of fact as to whether the client knew of the loans and allowed them to continue, but there was also an issue of fact as to whether the CFO had acted solely for his own interests and had thereby totally abandoned the client's interests.

Finally, the court held that counsel's affirmative defense of comparative fault should be dismissed because the client's alleged failure to discover or prevent the CFO's fraud did not prevent counsel's performance of their own professional obligations to the client. There was simply no basis for a finding that anything the client did or did not do was the reason for counsel's failure to carry out their fiduciary duties.

Significance of Opinion

This case is significant because the court held that the duty to report impropriety by an officer of an entity cannot be satisfied by merely reporting to that officer. A law firm must ensure that it properly advises its client's governing body of any malfeasance of which it becomes aware.

For more information, please contact [Terrence P. McAvoy](#).

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