Professional Liability Defense QUARTERLY

Use of Federal Law in Defense of State Legal Malpractice Claims

Alice Sherren
Minnesota Lawyers Mutual Insurance Company

Donald Patrick Eckler
Pretzel & Stouffer, Chartered

A couple of years ago we wrote on the use of *Rooker-Feldman* and *res judicata* in federal cases against lawyers that arose out of underlying state litigation. See *"Unusual Names, Powerful Doctrines: Use of Rooker-Feldman and Res Judicata in Defending Federal Lawsuits Brought Against Attorneys Arising from Litigation in State Court,"* PLDF Quarterly, Vol. 10, No. 4, Alice Sherren, James J. Sipchen, and Donald Patrick Eckler. Two recent cases, *Zander v. Carlson*, 2019 Il App (1st) 181868 and *Ritchie Capital Management, LLC v. McGladrey & Pullen, LLP*, 2020 IL App (1st) 180806, show how federal law can be used to defeat legal malpractice claims filed in state court.

Zander v. Carlson

In a case of first impression, the Illinois Appellate Court, First District in *Zander v. Carlson* ruled in favor of a labor union and a union attorney in a legal malpractice lawsuit arising out of an arbitration hearing in which the plaintiff challenged his termination as a police officer. *Zander*, 2019 IL App (1st) 181868, ¶ 1. The plaintiff, Zander, alleged legal malpractice against the attorney, Carlson, and negligence against the union. *Id*. The court affirmed the dismissal of Zander's complaint against Carlson on the ground that he was immune from suit. *Id*. The court also held that the Illinois Labor Relations Board (ILRB) had exclusive jurisdiction over Zander's claims against the union. *Id*.

Zander alleged that he was placed on administrative leave by the police chief and that eventually formal charges were filed against him recommending that he be terminated. *Id*. ¶ 3. Zander requested counsel from the union and the union assigned Carlson to represent him. *Id*. There was no retainer agreement executed and Carlson was paid only through Zander's union dues. *Id*. Pursuant to the collective bargaining agreement Zander could challenge his discharge either before the police board or through the collective bargaining agreement's ordinary grievance arbitration procedure. *Id.* ¶ 4. Upon Carlson's advice, Zander chose the arbitration procedure and after a two-day hearing the arbitrator upheld the decision to terminate Zander. *Id*.

Zander alleged that Carlson had inadequately represented him because he advised him to waive his right to a hearing before the police board and inadequately represented him at the arbitration hearing. *Id*. ¶ 5. Zander also alleged that the union was liable to him because it assigned him inadequate representation and was vicariously liable for Carlson's alleged malpractice. *Id*. The trial court dismissed the complaint against Carlson finding him immune and dismissed the claims against the union finding that the ILRB has exclusive jurisdiction over those claims. *Id*. ¶ 6.

The *Zander* Court premised its ruling in favor of Carlson on the United States Supreme Court decision of *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238 (1962), in which the Court held that union officers and employees are immune from personal liability for acts undertaken as union representatives on behalf of the union. *Id*. ¶ 11. In *Atkinson*, the

Supreme Court held that the Taft-Hartley Act, which amended the National Labor Relations Act, provided that "a union's agents may not be held individually liable for actions taken on behalf in the collective bargaining process." *Id*.

This has become known as the *Atkinson* Rule. Courts across the country have subsequently applied the *Atkinson* Rule to bar legal malpractice claims brought by union members against union attorneys for acts performed in the collective bargaining process.

For example, in *Peterson v. Kennedy*, 771 F.2d 1244 (9th Cir. 1985), the Court held that the *Atkinson* Rule applies to a union's in-house counsel, as well as to its retained outside counsel:

> When the union uses its regular outside counsel, the services are sometimes covered under an overall retainer agreement, and there is no additional fee or charge to the union for the law firm's handling of the matter. In any event, whether it be house counsel or outside union counsel, where the union is providing the services, the attorney is hired and paid by the union to act for it in the collective bargaining process. *Peterson*, 771 F.2d at 1258.

Courts across the country have repeatedly looked to *Atkinson* and *Peterson* to hold that an attorney hired by a union to defend a union member covered under a collective bargaining agreement is an agent of the union and is therefore immune from suit. *Montplaisir v. Leighton*, 875 F.2d 1, 5-7 (1st Cir. 1989); *Best v. Rome*, 858 F. Supp. 271, 274 (D. Mass. 1994); *Mamorella v. Derkasch*, 276 A.D.2d 152, 716 N.Y.S.2d 211, 213 (App. Div. 2000); *Sellers v. Doe*, 99 Ohio App. 3d 249, 650 N.E.2d 485, 487-88 (Ohio Ct. App. 1994); *Collins v. Lefkowitz*, 66 Ohio App. 3d 378, 584 N.E.2d 64, 65 (Ohio Ct. App. 1990) (holding that an attorney who is handling a labor grievance under a collective bargaining agreement has not entered into an attorney-client relationship with the union member). This also holds true in the context of a local government employee where a state public labor relations act applies. *Weiner v. Beatty*, 121 Nev. 243, 248-250 (2005) (holding that Nevada Employee Management Relations Act immunized lawyers supplied by unions from legal malpractice claims).

The Court rejected Zander's argument that the protection should not extend to union lawyers. *Id*. ¶ 14. The Court, relying on *Arnold v. Air Midwest, Inc.*, 100 F.3d 857 (10th Cir. 1996 and *Carino v. Stefan*, 376 F.3d 156 (3rd Cir. 2004), stated that courts "have uniformly concluded that *Atkinson* prohibits claims made by a union member against attorneys employed by or retained by the union to represent the member in a labor dispute." *Id*. ¶ 16.

Zander attempted to avoid *Atkinson* by asserting that he had an attorney-client relationship with Carlson, but this failed as well because he did not have a retainer agreement with Carlson, he did not directly pay for Carlson's services, and his mere acquiescence of the relationship was foreclosed by *Peterson*. *Id*. ¶ 17. In *Peterson* the court recognized an exception where the employee and the lawyer "specifically agreed … to provide direct representation to [the union member] as an individual client" and was not merely "acting pursuant to [his] obligation to provide representation for or on behalf of the union," but those were not the facts in this case. *Id*. ¶ 18.

The *Zander* decision has application for the defense of union lawyers in actions brought by union employees and should be explored wherever such a claim is made.

Ritchie Capital Management v. McGladrey & Pullen, LLP

Though an accounting malpractice case, the *Ritchie Capital Management, LLC v. McGladrey & Pullen* decision may have impact across professional liability claims, including legal malpractice claims. The Ritchie plaintiffs wanted to pursue malpractice claims against the McGladrey defendants, who were accountants who performed audit work for an

entity in which they invested, but did not bring their claims until more than two years after they knew of them. *Ritchie, LLP*, 2020 IL App (1st) 180806, ¶ 1. The *Ritchie* court dismissed the claims as time barred, despite an automatic stay in the bankruptcy of the investment entity, after determining that the time to file was not tolled. *Id.*

The plaintiff unsuccessfully argued for the application of one of Illinois' statute of limitations tolling provision, 735 ILCS 5/13-216, which states:

> When the commencement of an action is stayed by injunction, order of a court, or statutory prohibition, the time of the continuance of the injunction or prohibition is not part of the time limited for the commencement of the action.

Identical language is found in statutes in California (Code of Civil Procedure Section 356), Virginia (§ 8.01-229), North Carolina (G.S. 1-23), Idaho (§5-234), Wisconsin (§ 893.23), Utah (§ 88-12-41), and South Dakota (§ 15-2-25). It is likely that other states have similar statutes or doctrines.

The Ritchie plaintiffs invested in Lancelot Funds which purported to invest in short term trade notes and purchase order financing, principally with Petters Company, Inc. (Petters). *Id*. ¶ 3. On October 20, 2008, Petters filed for Chapter 11 bankruptcy following the arrest of Thomas Petters on federal fraud and money laundering charges; Lancelot then filed for Chapter 7 bankruptcy. *Id*. Following the filing of the Lancelot bankruptcy, several investors (though not the Ritchie plaintiffs) sued McGladrey, but the bankruptcy trustee obtained the application of the automatic stay under Section 362(a)(3) of the Bankruptcy Code against those claims asserting that the claims against the McGladrey defendants were the property of the Lancelot bankruptcy estate. *Id*. ¶ 5.

The Ritchie plaintiffs were not subject to the stay, in part, because they had not filed a lawsuit against McGladrey defendants at that time. *Id*. In July 2009, the bankruptcy court enforced the stay against another investor, McKinley, who sought to pursue McGladrey. *Id*. ¶ 6. The bankruptcy court also entered an injunction against McKinley under Section 105 of the Bankruptcy Code, which prevented McKinley from pursuing its claims against McGladrey. *Id*. ¶¶ 6-7. The injunction was dissolved on September 15, 2015. *Id*. ¶ 7.

On May 12, 2017, nearly nine years after Petters filed for bankruptcy, the Ritchie plaintiffs filed their complaint against the McGladrey defendants alleging that Lancelot had contracted with the McGladrey defendants to perform audits and prepare financial statements. *Id*. ¶ 9. The Ritchie plaintiffs alleged that there was direct communication between their representatives and the McGladrey defendants, that the audited financial statements were used to solicit investors, and that the McGladrey defendants knew that the audits would be used in this fashion. *Id*. ¶ 10. The Ritchie plaintiffs claimed negligent misrepresentation, fraudulent misrepresentation, common law fraud, fraudulent concealment, aiding and abetting, conspiracy for one of the auditors having pled guilty to federal charges, breach of contract, and violation of the Illinois Consumer Fraud Act. *Id*. ¶¶ 11-15.

The McGladrey defendants moved to dismiss the case arguing that the Ritchie plaintiffs had violated the two-year statute of limitations and the five-year statute of repose. *Id*. ¶17. The trial court granted the motion finding that the plaintiffs were required to have filed their claims when they knew of them in 2008, and rejected the plaintiffs' argument that the automatic stay provision of the Bankruptcy Code applied because the McGladrey defendants were not the party who had filed bankruptcy. *Id*. ¶ 18.

In the appellate court, the Ritchie plaintiffs claimed that the statutes of limitations and repose were tolled between October 20, 2008 and September 15, 2015. *Id*. ¶ 20. In rejecting this argument, the Court held because the Ritchie plaintiffs were not subject to the injunction they were not prevented from pursuing their claims and, as held by the Seventh

Circuit in *Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998), neither did the automatic stay order preclude them from filing their claims against the McGladrey defendants. *Id*. ¶¶ 23-24. The plaintiffs relied on 735 ILCS 5/13-216, which tolls the statute of limitations when claims are stayed or enjoined. *Id*. ¶ 24.

In *Ritchie,* the non-debtor McGladrey defendants were allegedly liable for the scheme to defraud. To aid in its analysis in determining whether the claims against the McGladrey defendants were time barred, the *Ritchie* court turned to *Fisher*, in which the Seventh Circuit held that an injunction under Section 105 precluded claims against non-debtors who were allegedly involved in the scheme to defraud (like McGladrey was in the *Ritchie* case), but that the automatic stay under Section 362 did not apply. *Id*. ¶ 25. Applying the reasoning of *Fisher*, the *Ritchie* court held that the tolling provision of Section 13-216 was not triggered by the stay. *Id*. ¶ 25. The court then reviewed the injunction and found that it did not apply to the plaintiffs and therefore could not trigger tolling of the statute of limitations. *Id*. ¶¶ 26-30. As a result, the plaintiffs' lawsuit, which was not filed until nine years after they knew of potential wrongdoing, was not timely and the dismissal was affirmed. *Id*. ¶ 33.

A further explanation of the power of a bankruptcy court is seen in *Cappuccilli v. Lewis*, 2010 U.S. Dist. LEXIS 119658, *16-17 which cited to *Fisher*, *In re Mountain Laurel Resources Co*., 2000 U.S. App. LEXIS 6137 (4th Cir. 2000), and *In re Philadelphia Newspapers, LLC*., 407 B.R. 606 (E.D. Pa. 2009). In *Cappuccilli*, which dealt with claims against a lawyer, the court stated:

> A bankruptcy court's jurisdiction to stay actions in other courts extends beyond claims by and against the debtor to include suits to which the debtor need not be a party but which may affect the amount of property in the bankrupt estate or the allocation of property among creditors. To protect this jurisdiction, [t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title . . . including a stay. (citations and internal quotations omitted)

Given this explanation of bankruptcy court jurisdiction, courts will likely view the effect of a stay or injunction on a case by case basis after a determination of what is "necessary or appropriate."

Conclusion

Most legal malpractice claims will not involve the invocation of federal law as a defense. However, defense practitioners should be on the lookout for situations in which the invocation of federal law may provide an appropriate defense. The *Zander* and *Ritchie* cases provide two examples where the potential is more likely: labor and bankruptcy.

About the Authors

Alice M. Sherren is a Claim Attorney with *Minnesota Lawyers Mutual Insurance Company.* Ms. Sherren directs the defense of LPL claims and speaks on risk management and ethics matters. Ms. Sherron may be reached at asherren@mlmins.com.

Donald Patrick Eckler is a partner at *Pretzel & Stouffer, Chartered*, in Chicago. Mr. Eckler defends doctors, lawyers, architects, engineers, appraisers, accountants, mortgage and insurance brokers, surveyors and others. Mr. Eckler may be reached at deckler@pretzel-stouffer.com.

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