Better Deal or No Deal: Causation in Transactional Malpractice Cases

by John M. Palmeri, Franz Hardy, and Nicole Salamander Irby

The Colorado Supreme Court provided instruction on the applicable standard for proving damages in transaction-based professional negligence cases in Gibbons v. Ludlow. *Causation requires proof of a "better deal" or "no deal," which implicates unique evidentiary considerations.*

Professional negligence claims arising from business transactions present a unique set of circumstances. These claims often involve sophisticated, complex, and high-risk agreements. Damages may be substantial, because the transacting parties have high expectations of returns. Even though traditional liability and damage theories apply in transactional settings, the elements and defenses—such as the proximate cause requirement of "case within a case"—have special application in transactional settings.

This article provides an overview of the basic legal concepts that surround transactional negligence claims. It also discusses the Colorado Supreme Court's recent pronouncement on this issue and raises practical considerations in bringing or defending such claims.

Overview of the Elements

The elements of a professional negligence cause of action are:

1) the duty of the professional owed to the plaintiff to use such skill, prudence, and diligence as other members of the profession commonly possess and exercise;
2) a breach of that duty;
3) a proximate causal connection between the negligent conduct and the resulting injury; and
4) actual loss or damage resulting from the professional's negligence.[1]

To establish the proximate cause element in a traditional legal malpractice case, the plaintiff must prove the case within a case, which requires proof that the case underlying the malpractice action would have been successful if the attorney had acted in accordance with his or her duty.[2] The Colorado Supreme Court recently extended the case within a case standard to a professional negligence action against a transactional real estate broker in *Gibbons v. Ludlow*.[3]

Overview of Case Within a Case in Transactional Claims

Courts have been asked whether case within a case applies to claims involving transactional negligence—that is, whether a plaintiff must prove that an excluded or unfavorable term in the underlying agreement would have been accepted by the other negotiating party if the professional had acted in accordance with his or her duty. The majority of courts addressing this issue have determined that the case within a case standard does apply to transactional malpractice claims.[4]

The *Viner v. Sweet* decision by the California Supreme Court is instructive.[5] The plaintiffs in *Viner* filed a lawsuit against the attorney who represented them in the sale of their business. The plaintiffs claimed that the defendant attorney had led them to believe several favorable terms were included in the sale agreement, which in fact were not included. A jury awarded the plaintiffs lost profits of more than $13 million. The defendant moved for judgment notwithstanding the verdict and for a new trial, arguing that the trial court erred in failing to instruct the jury that the plaintiffs had to prove they would have obtained those favorable terms in the sales agreement but for the defendant's negligence. The trial court denied the motions.

Coordinating Editor
Timothy Reynolds, Boulder, of Bryan Cave HRO—(303) 417-8510, timothy.reynolds@bryancave.com



About the Authors
John M. Palmeri, Franz Hardy, and Nicole Salamander Irby are attorneys at Gordon & Rees LLP. They practice in the firm's professional liability defense group and can be reached at (303) 534-5160 or jpalmeri@gordonrees.com, fhardy@gordonrees.com, and nsalamander@gordonrees.com.

The Civil Litigator articles address issues of importance and interest to litigators and trial lawyers practicing in Colorado courts. The Civil Litigator is published six times a year.

The California Court of Appeals affirmed and distinguished the standard for establishing causation in transactional malpractice claims as opposed to traditional litigation malpractice claims. The California Supreme Court addressed the court of appeals' rationale, which it summarized as follows:

> First, the court [of appeals] asserted that in litigation a gain for one side is always a loss for the other, whereas in transactional work a gain for one side could also be a gain for the other side. Second, the court [of appeals] observed that litigation malpractice involves past historical facts while transactional malpractice involves what parties would have been willing to accept for the future. Third, the court [of appeals] stated that "business transactions generally involve a much larger universe of variables than litigation matters." According to the Court of Appeals, in "contract negotiations the number of possible terms and outcomes is virtually unlimited," and therefore the "jury would have to evaluate a nearly infinite array of 'what-ifs,' to say nothing of 'if that, then whats,' in order to determine whether the plaintiff would have ended up with a better outcome 'but for' the malpractice."[6]

The California Supreme Court reversed and rejected the court of appeals' rationale in failing to apply the case within a case standard. The California Supreme Court disagreed that "in litigation a gain for one side necessarily entails a corresponding loss for the other."[7] The Court explained:

> Litigation may involve multiple claims and issues arising from complaints and cross-complaints, and parties in such litigation may prevail on some issues and not others, so that in the end there is no clear winner or loser and no exact correlation between one side's gains and the other side's losses. In addition, an attorney's representation of a client often combines litigation and transactional work, as when the attorney effects a settlement of pending litigation. The "but for" test of causation applies to a claim of legal malpractice in the settlement of litigation, even though the settlement is itself a form of business transaction.[8]

The California Supreme Court concluded:

> just as in litigation malpractice actions, a plaintiff in a transactional malpractice action must show that but for the alleged malpractice, it is more likely than not that the plaintiff would have obtained a more favorable result.[9]

Most commentators agree with the holding and rationale of the *Viner* decision. In a treatise on legal malpractice, the authors explain:

> Proof of causation requires analysis of the consequences of proper advice. Thus, the client needs to prove what should have been achieved had the "proper" advice been given. If the alleged error is the failure to obtain or advise of a provision, concession or benefit, the client must prove that the other party would have agreed. It is not sufficient to show that the other party "might have" agreed.[10]

A plaintiff must demonstrate that his or her position in the underlying transaction "was compromised or negatively impacted due to the purported negligence of the defendant-attorney."[11] Further:

> This means that the plaintiff must show that he or she would have been ultimately better off in the underlying transaction in a world where the defendant-attorney's purported negligence had never occurred.[12]

Case Within a Case is not Universally Applied

Application of the case within a case standard, although well recognized nationally, is far from uniform. In *Nicolet Instrument Corp. v. Lindquist & Vennum*, Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit held that proving case within a case is unnecessary in transactional claims.[13]

The plaintiff in *Nicolet* was represented by the defendant law firm in the sale of a wholly owned subsidiary. After the sale was complete, the plaintiff remained liable under the sales agreement for a building lease between the sold subsidiary and the lessor. Years after the sale, the former subsidiary defaulted on the lease and the plaintiff was required to pay $2.6 million to the lessor. The plaintiff alleged that the defendant law firm was negligent in failing to eliminate the plaintiff's contingent liability under the lease.

The district court granted the defendant's motion for summary judgment, concluding that the plaintiff had failed to prove that the purchaser would have agreed to accept the liability but for the defendant's failure to include it in the sales agreement. The Court of Appeals reversed based on its rationale that the traditional but for causation analysis did not apply in transactional legal malpractice settings:

> Proof of causation is even more difficult in a negotiating situation, because while there is (at least we judges like to think there is) a correct outcome to most lawsuits, there is no "correct" outcome to a negotiation. Not only does much depend on the relative bargaining skills of the negotiators, on the likely consequences to each party if the negotiations fall through, and on luck, so that the element of the intangible and the unpredictable looms large; but there is no single "right" outcome in a bargaining situation even in principle. Every point within the range bounded by the lowest offer that one party will accept and the highest offer that the other party will make is a possible transaction or settlement point, and none of these points is "correct" or "incorrect."[14]

Thus, the *Nicolet* plaintiff "was not required to prove that but for the law firm's negligence it would have avoided the $2.6 million rental expense that it incurred."[15] Further:

> All it had to show was that a rational trier of fact, confronted with the evidence produced in the summary judgment phase of the litigation, could conclude that, yes, [plaintiff] had suffered some harm as a consequence of the law firm's negligence and could quantify that harm to a reasonable, which is not to say a high, degree of precision.[16]

Nicolet may be criticized on grounds that it opens the door to speculation. Without the case within a case standard, courts invite speculation as to both the possible terms of an agreement and subsequent damages. Unless a trier of fact is required to apply the case within a case standard, it is permitted to speculate as to what the other negotiating party would have accepted as a proffered contract term.

Although a review of the actual or missing terms of the agreement seems logical, under the *Nicolet* opinion, evidence as to whether the plaintiff could have met or the third party would have agreed to the terms is not essential. Under this rationale, a jury need only

> conclude that, yes, [plaintiff] had suffered some harm as a consequence of the law firm's negligence and could quantify that harm to a reasonable, which is not to say a high, degree of precision.[17]

This standard presumes that the other party would have agreed no matter how burdensome the terms. It focuses on the professional's alleged negligence—that is, whether the professional should have attempted to negotiate the missing terms. Without the case within a case concept, transactional professionals would become the guarantor of any contract, where in hindsight, a term could have reduced or eliminated the client's liability or loss.[18]

Colorado Adopts the *Viner* Causation Standard

The Colorado Supreme Court recently clarified that the case within a case standard applies to both legal malpractice and real estate broker negligence claims in *Gibbons v. Ludlow*.[19] The plaintiffs filed suit against the attorneys and real estate brokers who represented them in the sale of real property.

The plaintiffs received three unsuccessful offers to purchase the land. A fourth company made an offer of $6.55 million, which, after negotiations, was accepted. The original written offer contained a provision that allowed the deduction of identified infrastructure costs from the purchase price. The offer included this provision because the purchaser wanted to purchase the land inclusive of certain infrastructure. If the plaintiffs did not complete the infrastructure by the time of closing, the purchaser wanted a setoff to the purchase price. This provision remained in the final purchase agreement.

Installment of the infrastructure was not completed by closing. At closing, the plaintiffs discovered that the final purchase price would be set off by $1.6 million due to the infrastructure credit provision. On advice of counsel, the plaintiffs nevertheless completed the sale. A lawsuit followed, in which the plaintiffs alleged that their attorneys and real estate brokers did not inform them of the infrastructure credit provision. The plaintiffs asserted that the brokers' and attorneys' negligence caused them to sell their property for $1.6 million less than it was worth. The plaintiffs settled with their attorneys. The brokers moved for summary judgment on grounds of causation and damages, *inter alia*. The trial court granted summary judgment.

The plaintiffs appealed and, in a split decision, the Colorado Court of Appeals reversed the trial court, finding that genuine issues of material fact existed as to causation. The Colorado Supreme Court

> granted certiorari to review whether a licensed professional can be liable for damages to a seller of real estate when, through the alleged negligence of the professional, the seller sells his property for less than its appraised value, in the absence of proof of any buyer willing to pay that higher amount.[20]

In answering the question on review, the Colorado Supreme Court evaluated past opinions in Colorado and *Viner*'s progeny regarding transactional legal malpractice claims. The Court explained the similarities between transactional brokerage and legal transactional professional practices:

> [B]oth transactional brokerage and legal transactional practices involve preparing documents for a business transaction. Both transactional brokerage and legal transactional practices also involve negotiating the terms of, and giving advice for, a business transaction. . . . Moreover, professional negligence claims

against a transactional broker and legal malpractice claims both have at their core an underlying transaction that the plaintiff asserts resulted in a financial loss due to a breach of the professional's duty of care.[21]

In light of these similarities, the Court restated the law regarding legal malpractice claims arising from transactions. In Colorado, to prevail on a legal malpractice claim, a plaintiff "must prove causation by showing that the claim underlying the malpractice action would have been successful 'but for' the attorney's negligence."[22] Likewise, "[i]n cases involving an alleged unfavorable transaction, a plaintiff must show that he would have obtained a more favorable result in the underlying transaction but for the professional's negligence."[23] The Court described two scenarios memorialized by *Viner* in which a plaintiff could prove that he or she would have obtained a more favorable result: the "better deal" scenario and the "no deal" scenario.[24]

The Court reiterated the basic principle of causation in any negligence case, that "the plaintiff must show by a preponderance of the evidence that the injury would not have occurred but for the defendant's negligent conduct."[25] Further, as to negligence claims seeking economic damages, "the plaintiff must be able to show that he in fact suffered economic damages."[26] With these legal principles in mind, the Court held that the case within a case standard applies in a professional malpractice claim against a transactional real estate broker:

> Consistent with professional malpractice cases in Colorado, we hold that to sustain a professional malpractice claim against a transactional real estate broker, a plaintiff must show that, but for the alleged negligent acts of the broker, he either: (1) would have been able to obtain a better deal in the underlying transaction; or (2) would have been better off by walking away from the underlying transaction.[27]

Better Deal or No Deal

The Colorado Supreme Court described the two causation scenarios set forth in *Viner* and adopted in *Gibbons* as "better deal" or "no deal."[28] Application of the better deal scenario, in which the plaintiff must show that, but for the acts of the professional, he or she "would have been able to obtain a better deal in the underlying transaction," requires the plaintiff to prove that the other party to the transaction would have agreed to the better provision.[29]

In *Gibbons*, it was undisputed that the purchasing party would not have purchased the property without the infrastructure credit provision.[30] The president of the purchasing party testified to this effect: without the credit provision, "the property was too expensive for unserviced land."[31] Accordingly, the Court found that the plaintiffs could not show that they would have received a better deal in the underlying transaction but for the broker's negligence.[32]

Similarly, to meet the no deal causation standard, a plaintiff must prove that he or she "would have obtained a more favorable result by foregoing" the transaction at issue.[33] This scenario contemplates that the plaintiff "would have been better off by walking away from [the deal] and would have done so had they known about the [allegedly negligent] provision."[34]

In *Gibbons*, the plaintiffs maintained that had they known about the infrastructure credit provision, they would have forgone the property purchase deal.[35] Thus, the *Gibbons* plaintiffs claimed lost profit damages of $1.6 million, the amount of the purchase price set off by the credit provision.[36] The Court found that the plaintiffs' proof of lost profit damages was too speculative, because plaintiffs failed to present

> any actual evidence, whether in pleadings or other supporting documents, showing that they would have realized a sale price of $6.6 million on the property but for the [professionals'] negligence.[37]

The Court upheld the trial court's entry of summary judgment in favor of the brokers.[38]

Damages

The better deal and no deal scenarios are both linked to the fact of damages:

> When a business transaction goes awry, a natural target of the disappointed principals is the attorney who arranged or advised the deal. Clients predictably attempt to shift some part of the loss and disappointment of a deal that goes sour onto the shoulders of persons who were responsible for the underlying legal work. Before the loss can be shifted, however, the client has an initial hurdle to clear. It must be shown that the loss suffered was in fact caused by the alleged attorney malpractice. . . . Courts are properly cautious about making attorneys guarantors of their clients' faulty business judgment.[39]

Although courts and commentators focus on the legal concept of proximate cause in transactional negligence cases, there is a practical acknowledgement that such claims often involve speculative agreements where parties expect high returns that make proof of damages a concern. Indeed, as in *Gibbons*, transactional claims often involve asserted damages in the form of future profits, which must be proved by showing "either the amount of the profits that would have been earned or the fact that the plaintiff would have earned the profits."[40]

It is well recognized that a plaintiff in a legal malpractice action should be compensated only for his or her actual losses.[41] Actual damages, whether alleged in a legal malpractice or professional negligence matter generally, cannot be based on mere speculation or conjecture.[42] The Colorado Supreme Court's holding in *Gibbons* provides clarity to both plaintiffs and defendant professionals with regard to proving causation and damages to establish negligence.

Practical Considerations

Although the question on review was stated in narrow terms, the Colorado Supreme Court's holding in *Gibbons* is applicable to negligence cases arising from transactions generally. As set forth above, the Court looked to prior opinions regarding transactional legal malpractice claims to inform its determination regarding transactional brokerage negligence claims. The Court indicated that the same reasoning could extend to professional negligence claims generally, which arise from "an underlying transaction that the plaintiff asserts resulted in a financial loss due to a breach of the professional's duty of care."[43]

The Court's analysis in *Gibbons* demonstrates the complexities of proof in prosecuting or defending transactional negligence claims. For example, courts adopting the case within a case standard in transactional legal malpractice settings differ on whether expert witness testimony alone is sufficient for a plaintiff to meet this burden.[44] In *Gibbons*, the Colorado Supreme Court found that the plaintiffs failed to prove their claim of lost profit damages.[45] As part of its analysis, the Court noted that the plaintiffs did "not offer, for example, any expert testimony regarding the market conditions in the area at the time of the sale," which could have established a genuine issue of material fact as to damages, thereby overcoming a motion for summary judgment.[46]

The *Gibbons* Court considered an affidavit from an appraiser who valued the property at issue, evidence regarding three unconsummated offers previously made to the plaintiffs, and deposition testimony of the purchasing party's president.[47] Noticeably absent, however, was "any evidence that a future sale of the property would have been better or different than the actual sale of the property."[48] The plaintiffs did not present evidence of a buyer willing to pay the price they contended was due, nor did they show evidence of the sale of other similar properties at the relevant time that reflected their value of the property at issue.[49] These evidentiary deficiencies resulted in the Court rejecting their claim of lost profit damages.[50]

It may be difficult to show the adoption or rejection of a term during contract negotiations; however, evidence of the underlying negotiation may be available. This evidence includes testimony of the individuals who negotiated the underlying contract, prior negotiations, previous drafts of the contract, the significance or effect of the term at issue, the relative bargaining strength of the participants, the experience of the negotiators, the relationship of the participants, and the importance to the other contracting party of completing the transaction. Further, market evidence presented by an expert or through establishment of a pattern of market activity may show that similar transactions would or would not have required a disputed provision. With regard to lost profit damages, demonstrating the existence of an alternate viable purchaser or seller may overcome the speculation inherent in such claim. Practitioners on either side of a disputed transaction should be mindful that what is not presented to the jury or the court can be just as important as what is proffered.

A plaintiff must be prepared to present evidence proving the better deal or no deal scenarios, which likely would include evidence of the underlying transaction. If obtaining direct evidence from the underlying transaction, such as witness testimony or agreement drafts, is unfruitful, plaintiffs may have to rely on expert testimony. On the other hand, defendants in transactional professional negligence cases likely will rely more heavily on evidence of the underlying negotiations than on expert testimony. Defendants may focus on factual investigation and fact witness depositions to show that the plaintiff cannot prove the better deal or no deal scenarios.

Conclusion

Under the broad umbrella of professional negligence, transactional claims are unique. The speculative nature of damages arising from these deals and the high potential value of the transaction can add to the challenge of bringing or defending such cases. The Colorado Supreme Court's holding in *Gibbons* regarding the better deal or no deal scenarios as to causation and damages provides valuable instruction for Colorado professionals and their clients, as well as to counsel for transacting parties.

Notes

1. *City of Westminster v. Centric-Jones Constructors*, 100 P.3d 472, 485 (Colo.App. 2003), *citing United Blood Servs. v. Quintana*, 827 P.2d 509 (Colo. 1992).

2. *Bebo Constr. Co. v. Mattox and O'Brien, P.C.*, 990 P.2d 78, 83 (Colo. 2000).

3. *Gibbons v. Ludlow*, 304 P.3d 239, 2013 CO 49 (Colo. 2013).

4. *See, e.g., Viner v. Sweet*, 70 P.3d 1046 (Cal. 2003), *on remand at* 12 Cal.Rptr.3d 533 (Cal.App. 2004); *Serafin v. Seith*, 672 N.E.2d 302 (Ill.App. 1996); *Blackhawk Building Systems, Ltd. v. Aspelmeier, Fisch, Power, Warner and Engberg*, 428 N.W.2d 288 (Iowa 1988); *Jerry's Enters., Inc. v. Larkin, Hoffman, Daly & Lindgren, Ltd.*, 711 N.W.2d 811 (Minn. 2006); *Froom v. Perel*, 872 A.2d 1067 (N.J.Super. 2005); *Hazel and Thomas, P.C. v. Yavari*, 465 S.E.2d 812 (Va. 1996); *Cannata v. Wiener*, 789 A.2d 936 (Vt. 2001). *But see Nicolet Instrument Corp. v. Lindquist & Vennum*, 34 F.3d 453 (7th Cir. 1994).

5. *Viner*, 70 P.3d 1046.

6. *Id.* at 1050 (citations omitted).

7. *Id.* at 1052 (citations omitted).

8. *Id.*

9. *Id.* at 1054. *See also Viner*, 12 Cal.Rptr.3d 533 (applying the California Supreme Court's holding on remand).

10. Mallen and Smith, *Legal Malpractice* § 23.5 at 469 (2006 ed.).

11. Mahaffey, "Cause-In-Fact and the Plaintiff's Burden of Proof with Regard to Causation and Damages in Transactional Legal Malpractice Matters: The Necessity of Demonstrating the Better Deal," 37 *Suffolk U. L.Rev.* 393, 436-37 (2004).

12. *Id.*

13. *Nicolet*, 34 F.3d at 456.

14. *Id.* at 455.

15. *Id.*

16. *Id. See also Keywell Corp. v. Piper and Marbury, LLP*, 1999 U.S. Dist. LEXIS 1445 at *15-16 (W.D.N.Y. Feb. 11, 1999) (in transactional legal

malpractice claim, requiring proof of loss "with reasonable certainty under the circumstances").

17. *Nicolet*, 34 F.3d at 455.

18. *See Simko v. Blake*, 506 N.W.2d 258, 259-60 (Mich.App. 1993) (because no amount of work can guarantee a favorable result, attorneys would never know when the work they do is sufficiently adequate to protect not only their clients from error but themselves from liability), *aff'd*, 532 N.W.2d 842 (Mich. 1995).

19. *Gibbons*, 2013 CO 49.

20. *Id.* at ¶ 10.

21. *Id.* at ¶ 15 (internal citations omitted).

22. *Id.* at ¶ 16, *citing Bebo Constr. Co.*, 990 P.2d at 83 and *Bristol Co. v. Osman*, 190 P.3d 742, 744 (Colo.App. 2007).

23. *Id., citing Viner*, 12 Cal.Rptr.3d at 538.

24. *Id.*

25. *Id.* at ¶ 14, *citing Kaiser Found. Health Plan of Colo. v. Sharp*, 741 P.2d 714, 719 (Colo. 1987).

26. *Id.*

27. *Id.* at ¶ 17.

28. *Id.* at ¶ 16.

29. *See id.* at ¶ 19.

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.* at ¶ 20.

34. *Id.*

35. *Id.*

36. *Id.* at ¶¶ 20-21.

37. *Id.* at ¶ 27.

38. *Id.* at ¶ 33.

39. Bauman, "Damages for Legal Malpractice: An Appraisal of the Crumbling Dike and Threatening Flood," 61 *Temple L.Rev.* 1127, 1154-55 (1988).

40. *Gibbons*, 2013 CO 49 at ¶ 22, *citing Republic Nat'l Life Ins. Co. v. Red Lion Homes, Inc.*, 704 F.2d 484, 489 (10th Cir. 1983).

41. *Kituskie v. Corbman*, 714 A.2d 1027, 1030 (Pa. 1998).

42. *Gibbons*, 2013 CO 49 at ¶ 22, *citing Vanderbeek v. Vernon Corp.*, 40 P.3d 866, 874 (Colo. 2002) and *Roberts v. Holland & Hart*, 857 P.2d 492, 496-97 (Colo.App. 1993).

43. *Id.* at ¶ 15.

44. *Compare Hazel and Thomas, P.C. v. Yavari*, 465 S.E.2d 812 (Va. 1996) (it is insufficient for a plaintiff to prove causation with only expert testimony; the plaintiff must produce evidence from the underlying transaction to sustain this burden) *with Froom v. Perel*, 872 A.2d 1067 (N.J. Super. 2005) (proper expert testimony would have been sufficient).

45. *Gibbons*, 2013 CO 49 at ¶ 32.

46. *Id.*

47. *Id.* at ¶¶ 28-31.

48. *Id.* at ¶ 31.

49. *Id.* at ¶ 32.

50. *Id.* at ¶ 33. ■