Consent to Settlement Agreement May Not Bar Negligence Claim

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In *Guido v. Duane Morris LLP* , the New Jersey Supreme Court held in a June 8 opinion that a client's consent to settlement does not necessarily bar a malpractice action arising from that settlement. The court also held that the client need not seek to vacate the underlying settlement agreement as a prerequisite to the malpractice action. In so ruling, the New Jersey Supreme Court pulled back from an earlier decision that seemed to bar malpractice claims where the client consented to settlement.

Importantly from a practice standpoint, the *Guido* holding had limits. The law will still bar a malpractice claim arising from settlement where the parties make a clear court record as to the fairness of the settlement. The court reaffirmed that equitable estoppel bars malpractice claims where the client makes specific representations, on the record, that the settlement is fair, adequate and satisfactory. The court thus set down a roadmap for counsel to preclude a subsequent malpractice action based on allegedly negligent settlement advice.

The Settlement and Negligence Claim

The procedural history of *Guido* follows a not uncommon pattern in commercial cases. A shareholder dispute leads to litigation. The case appears to settle after initial negotiations, only to have the settlement collapse when the agreement is reduced to writing. After a respite, discussions resume and the case settles substantially along the lines of the initial settlement.

According to the New Jersey Supreme Court's opinion, the plaintiff, Joseph Guido, was the majority shareholder and chairman of the board of a shipping company based in New Jersey. Represented by Duane Morris, Guido sued the company and various of its officers and directors alleging corporate governance claims. The parties immediately began to discuss a settlement that, among other things, would include Guido's voluntary dismissal of the suit without prejudice.

According to the opinion, Guido's then-counsel, James J. Ferrelli of Duane Morris, strongly advised against entering into any settlement that would limit Guido's rights as majority shareholder or restrict his ability to vote his shares in corporate control and governance matters — terms at the heart of the corporate defendants' offer. The parties shortly thereafter entered into a settlement, and Guido voluntarily dismissed the suit. The parties, however, were unable to

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reduce their agreement to writing, leading the corporate defendants to withdraw their settlement offer.

Following the collapse of the initial settlement agreement, the opinion said, Guido commenced a second suit. This time, Guido was represented by different lawyers — Frank A. Luchak and Patricia Kane Williams — from Duane Morris, the same law firm that prosecuted his first action. The parties again entered into settlement negotiations, which culminated in an agreement. The trial court conducted a hearing, during which the judge questioned Guido concerning the settlement. In response to the judge's questioning, Guido testified on the record that he understood the terms of the settlement and agreed to be bound by it.

Alas, soon after settling, Guido had settlor's remorse. Nearly two years after settling, Guido filed a malpractice suit against Duane Morris and the lawyers who represented him in the second suit (i.e., the one that resulted in the final settlement agreement). Despite having consented to and approved of the settlement, Guido now alleged that the lawyer defendants in the second suit were negligent in advising him as to the impact of the voting restrictions incorporated in the settlement agreement, which Guido alleged materially affected the value of his shares.

The lawyer defendants moved for summary judgment in the malpractice action. Although the trial court found that there was a genuine issue of material fact as to whether the lawyer defendants had adequately advised Guido about the voting restrictions, it granted the motion, finding that (1) the plaintiff had testified under oath that he understood and agreed to be bound by the settlement and (2) the plaintiff never sought to vacate the challenged settlement before commencing the malpractice suit. Upon reconsideration, however, the trial court, too, had a change of heart. It vacated and reversed its ruling, finding that the plaintiff's statement that he agreed to be bound by the settlement did not bar a malpractice claim and that filing a motion to vacate the settlement was not a prerequisite to a legal malpractice claim.

The Appellate Division affirmed on interlocutory appeal, and the Supreme Court granted leave to appeal. The lawyer defendants raised two principal arguments on appeal. First, they contended that under the Supreme Court's then-most-recent 2005 decision concerning malpractice claims based on settlements, *Puder v. Buechel* , Guido's claim was precluded by the fact that he had twice entered the same settlement agreement. Second, they argued that *Puder* and its predecessors required as a precondition to commencing a malpractice suit that the plaintiff first seek to vacate the challenged settlement, which he did not do. Amici curiae, the Trial Attorneys of New Jersey and the New Jersey State Bar Association, also filed briefs arguing that a plaintiff's failure to seek to vacate the challenged settlement should absolutely preclude a subsequent malpractice suit.

The New Jersey Supreme Court rejected both arguments, thereby clarifying that *Puder* represented only a limited exception to the rule permitting malpractice claims for negligent settlement advice.

Agreement to Settlement No Bar to Malpractice Claim

The Supreme Court first held that a client's consent to a settlement did not preclude the client from later alleging that counsel negligently advised him to enter into a less than satisfactory

settlement. The court explained that New Jersey has long recognized legal malpractice claims against lawyers who counseled a challenged settlement, citing to its 1992 decision in *Ziegelheim v. Apollo* .

In *Ziegelheim* , the court specifically rejected the rule — then recently adopted by the Pennsylvania Supreme Court in 1991 in *Muhammad v. Strassburger, McKenna, Shilobod and Gutnick* — that limited such malpractice claims to instances where the client could prove actual fraud by the attorney. The New Jersey Supreme Court reasoned, "The fact that a party received a settlement that was 'fair and equitable' does not mean necessarily that the party's attorney was competent or that the party would not have received a more favorable settlement had the party's incompetent attorney been competent." (See *Ziegelheim* .) The court thereby opened the door to malpractice cases that result from "fair and equitable" settlements, but are not optimal. Recognizing the potential consequences of such a formulation, the *Ziegelheim* court expressly cautioned that it was not purporting to open the door to malpractice actions against attorneys who pursue reasonable strategies and handle their cases with reasonable knowledge, skill and diligence, though at times they may not secure optimum outcomes.

When the New Jersey Supreme Court next returned to the issue in *Puder* , it appeared to adopt a different standard that was more generous to counsel involved in counseling a "fair" settlement. In *Puder* , the court found that a client was precluded from asserting a malpractice claim arising out of a settlement where the plaintiff had specifically represented to the trial court at the time of settlement that the agreement was fair, adequate and satisfactory. The court in that instance held that "'fairness and the public policy favoring settlements dictate that [the malpractice plaintiff] is bound by her representation to the trial court'" and therefore precluded from bringing a subsequent malpractice claim. (See *Guido* (quoting *Puder*).)

In *Guido,* however, the court retreated from the position it appeared to have adopted in *Puder* and instead elected to read *Puder* in conjunction with *Ziegelheim* , treating *Ziegelheim* as the rule and *Puder* as the exception. It reasoned:

"When viewed in its proper context — that *Puder* represents not a new rule, but an equity-based exception to *Ziegelheim* 's general rule — the rule of decision applicable here is clear: Unless the malpractice plaintiff is to be equitably estopped from prosecuting his or her malpractice claim, the existence of a prior settlement is not a bar to the prosecution of a legal malpractice claim arising from the settlement."

In other words, the effect of a client's statements concerning a settlement agreement has to be evaluated on a case-by-case basis. Some statements by the client expressing satisfaction with the settlement agreement will be sufficient to preclude a later malpractice claim, but the client's agreement to enter into the settlement, standing alone, is not enough. Rather, to preclude the client's subsequent malpractice claim, the client's representations must be sufficient to trigger equitable estoppel, i.e., "'to prevent injustice by not permitting a party to repudiate a prior course of action on which another party has relied to his detriment.'" (See *Guido* (quoting *Knorr v. Smeal* , 2003).)

With that framework in place, the court found that the client's statements about settlement did not preclude the plaintiff's malpractice claim in *Guido* . The court factually distinguished the

Guido case from *Puder* . Whereas the plaintiff in *Puder* testified that the settlement agreement was fair and adequate, in *Guido* the plaintiff testified only that he understood the terms of the settlement and agreed to be bound by them.

The court thus found that the client's understanding of and agreement to the settlement were not enough on their own to establish an estoppel. Rather, the client also had to testify that he believed the settlement to be fair and adequate. According to the court, there remained a genuine issue of material fact in *Guido* as to whether the lawyer defendants had adequately explained the terms of the challenged settlement to the plaintiff and whether a failure to do so constituted malpractice.

No Bright-Line Rule

The Supreme Court declined to adopt a bright-line rule that a client must first seek to vacate a settlement before pursuing a legal malpractice claim. It acknowledged that the plaintiffs in both *Ziegelheim* and *Puder* had first sought to vacate the challenged settlement before commencing their malpractice suits, and it noted that such efforts were a relevant factor in evaluating the malpractice claims. However, those efforts failed in both cases; and looking to the facts in *Guido* , the court found that the plaintiff had no reasonable expectation that moving to vacate the settlement would have succeeded. The court thus concluded that requiring a plaintiff to engage in a futile exercise before commencing suit would be both wasteful and unnecessary and thereby found that the plaintiff's claim was not precluded by his failure to pursue a remedy that had no reasonable chance of success.

The Court's Practice Pointers

Although the end result in *Guido* was to affirm and arguably broaden the availability of legal malpractice claims alleging negligent settlement advice, parsing the court's decision offers a useful roadmap for counsel to protect against that happening. The principal takeaway is that counsel must be sure to fully discuss with and explain to the client the terms and implications of a settlement and to create a record of that discussion.

Ideally, the record should be made in open court with the client testifying (1) that counsel explained the settlement's terms and the client understands them; (2) that the client understands any potentially problematic terms; and (3) that the client considers the terms of the agreement fair, adequate, and satisfactory — the key representations in *Puder* that were absent in *Guido* .

Of course, many if not most cases settle without a full colloquy on the record and judicial approval of the settlement. Nothing in *Guido* or *Puder* suggests that counsel cannot obtain a similar degree of protection by recording the client's understanding of the settlement and agreement that it is fair, adequate and satisfactory through other means. In those cases, counsel should be sure to confirm the key understandings in writing — preferably a writing signed by the client — but as that might often not be possible, at least in a letter to the client recounting counsel's explanation and the client's understanding and agreement that the settlement is fair, adequate and satisfactory.

Guido makes clear that, so long as counsel is diligent in explaining the terms and implications of the settlement and creates a clear record of the client's understanding and agreement that the

settlement was fair, adequate, and satisfactory, the courts are willing to preclude related malpractice claims. Moreover, the Supreme Court warns that without specific allegations of incompetence a plaintiff cannot recover merely by alleging that the settlement should have been better.

Reading *Ziegelheim* and *Puder* together, we understand the New Jersey Supreme Court to permit malpractice claims following a settlement when there are "particular facts in support of ... claims of attorney incompetence" but to preclude malpractice claims when a client merely seeks to "settle a case for less than it is worth ... and then seek[s] to recoup the difference in a malpractice action against [the] attorney."

In sum, in New Jersey, settling a case is not necessarily the end of the matter. Counsel may still have to worry about a malpractice claim. To avoid any unpleasant aftertaste to what seems like a tasty settlement, be sure to document — in open court or in writing — the client's agreement that he understands the settlement's terms and that they are what he wants.