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Interstate Securities Corp. v. Hayes Corp. : Should the Economic Loss Doctrine Apply to Actions Against Fiduciaries?

James G. Dodrill II
jim@jimdodrill.com

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***Interstate Securities Corp. v. Hayes Corp.* : Should the Economic Loss Doctrine Apply to Actions Against Fiduciaries?**

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It is one thing, though, to recognize and properly apply a sound principle. It is quite another to run that same sound principle into the ground. It is one thing for a dog to have a tail. It is quite another for the tail to wag the dog.*

I. INTRODUCTION

The economic loss doctrine provides that “without some conduct resulting in personal injury or property damage, there can be no independent tort flowing from a contractual breach which would justify a tort claim solely for economic losses.”¹ Initially, the doctrine arose in product liability actions for the sale of goods, but courts subsequently expanded its application to service contracts.² In *Interstate Securities Corp. v. Hayes Corp.*,³ the Eleventh Circuit recently expanded the economic loss doctrine further to bar claims for intentional torts and breach of fiduciary duty absent personal injury or property damage.⁴ In taking this substantial step, the Eleventh Circuit neglected the implications of the doctrine in cases involving a fiduciary relationship, focusing, instead, on the type of damages

* *Deal v. Morrow*, 197 F.2d 821, 826 (5th Cir. 1952), quoted in THE QUOTABLE LAWYER § 9.59 (David S. Shrager & Elizabeth Frost eds., 1986).

1. *AFM Corp. v. Southern Bell Tel. & Tel. Co.*, 515 So. 2d 180, 181-82 (Fla. 1987).

2. Michael A. Hanzman, *Interstate Securities Corporation v. Hayes Corporation: An Unprecedented and Improper Expansion of Florida's "Economic Loss" and "Independent Tort" Rules*, FLA. B.J., Apr. 1992, at 42.

3. 920 F.2d 769 (11th Cir. 1991).

4. *Id.* at 773-77.

sought by the litigants.⁵ *Interstate*, read broadly, seems to eliminate all tort actions for purely economic damages when the parties involved have any contractual relationship, except in the rare case when the injured party has no alternative means of recovery. This decision unjustifiably expands the doctrine to bar clearly appropriate tort claims.

The dispute in *Interstate* centered around the decrease in value of an investor's securities account by almost \$4 million in just over seven weeks.⁶ The securities broker filed suit, alleging that the investor owed the more than \$1.8 million that the broker had paid on behalf of the account.⁷ The investor counterclaimed, alleging that the broker's breach of its fiduciary duty caused the account's diminution in value.⁸

Fiduciary relationships arise in many situations. A fiduciary duty is defined as the "duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person."⁹ The capacity of a "fiduciary" is said to include "such offices or relations as those of an attorney at law, a guardian, executor, or broker, a director of a corporation, and a public officer."¹⁰ The broad ambit of the fiduciary concept leads to the conclusion that *Interstate* reaches far beyond the facts of the case or its holding's intended scope, touching lawsuits against many types of professionals.¹¹ In effect, *Interstate* could potentially limit all professional liability disputes to contractual causes of action.

This Note reveals the impropriety of extending the economic loss doctrine to actions involving fiduciary relationships. Specifically, it demonstrates the inappropriateness of applying *Interstate* to the fidu-

5. *Id.* at 776-77.

6. *Id.* at 771-72.

7. *Id.* at 772.

8. Although the client also brought breach of contract and negligence counterclaims, *id.* at 771-72, this Note focuses on the claims for breach of fiduciary duty.

9. BLACK'S LAW DICTIONARY 625 (6th ed., 1990).

10. *Id.*

11. Although *Interstate* seemingly bars malpractice actions against other types of professionals, this Note focuses on its impact on actions against legal practitioners. Other commentators have recognized the potentially catastrophic consequences of the *Interstate* decision:

Under the *Interstate Securities* decision, taken to its logical extreme, customers of professional services can no longer bring malpractice (i.e., negligence) claims or breach of fiduciary duty claims against attorneys, accountants, appraisers, or other professionals who render services to them pursuant to a contract no matter how egregious the conduct. Rather, the client's sole remedy is an action for breach of contract, and no exposure for punitive damages is present so long as the litigants are parties to a contract and the conduct involved happens to constitute a breach of the parties' agreement.

Hanzman, *supra* note 2, at 43-44.

ciary setting of the attorney-client relationship in legal malpractice actions. Part II recounts the development of the economic loss doctrine, discussing both its origin in product liability actions and its extension to service contracts. Part III reviews the *Interstate* decision by detailing the facts surrounding the dispute, outlining the Eleventh Circuit's decision, and analyzing the problems with its holdings. Part III further suggests that the economic loss doctrine should not insulate fiduciaries from tort liability. Part IV argues that application of the economic loss doctrine in legal malpractice actions would clearly contravene the policy underlying those actions—protection of the entrusting party. Part V concludes that courts should create an exception to the economic loss doctrine for actions involving parties to a fiduciary relationship.

II. DEVELOPMENT OF THE ECONOMIC LOSS DOCTRINE

A. *Origin of the Doctrine*

A thorough understanding of the economic loss doctrine must begin with the "two most prominent cases on economic loss:"¹² *Santor v. A & M Karagheusian, Inc.*,¹³ and *Seely v. White Motor Co.*¹⁴ In *Santor*, carpet sold to the plaintiff developed unusual lines on its surface. Santor sued the manufacturer, Karagheusian, for the carpet's cost.¹⁵ The Supreme Court of New Jersey held that Santor could proceed against the manufacturer under breach of implied warranty of fitness theory for the difference between the price paid and the actual value of the carpet, but it observed that an action based on strict liability would provide a simpler ground for liability even though the damage was limited to the product itself.¹⁶ The court recognized that strict liability had "been applied principally in connection with personal injuries sustained by expected users from products which are dangerous when defective," but felt "that the responsibility of the maker should be no different where damage to the article sold or to other property of the consumer is involved."¹⁷

In *Seely*, the plaintiff purchased a truck manufactured by White from a third party for use in plaintiff's business of heavy-duty hauling.¹⁸ When driven, the truck "galloped," or bounced violently. For

12. Timothy L. Bertschy, *Negligent Performance of Service Contracts and the Economic Loss Doctrine*, 17 J. MARSHALL L. REV. 249, 261 n.43 (1984).

13. 207 A.2d 305 (N.J. 1965).

14. 403 P.2d 145 (Cal. 1965).

15. *Santor*, 207 A.2d at 306.

16. *Id.* at 311-13.

17. *Id.* at 312.

18. *Seely v. White Motor Co.*, 403 P.2d 145, 147 (Cal. 1965).

the next eleven months, the seller unsuccessfully attempted to correct the problem.¹⁹ Finally, a brake failure caused the truck to overturn, leaving the plaintiff uninjured, but the truck damaged. Seely sued the seller and White for the expense of repairing the truck, for the amount paid toward the purchase price and for profits lost due to his inability "to make normal use of the truck."²⁰ At trial, Seely dismissed the case against the seller. The Supreme Court of California agreed with the trial court that Seely was entitled to reimbursement of the purchase price and damages for lost profits, but that, absent any evidence indicating that the galloping caused the accident, damages for the repair of the truck were improper.²¹ The court found White liable for breach of an express warranty. On appeal, White argued that the doctrine of strict liability had superseded warranty theory.²² The court disagreed, explaining that "[t]he history of the doctrine of strict liability in tort indicates that it was designed, not to undermine the warranty provisions of the sales act or of the Uniform Commercial Code but, rather, to govern the distinct problem of physical injuries."²³

The *Seely* court examined and rejected the *Santor* approach because "it would result in imposing liability without regard to what representations of quality the manufacturer made."²⁴ The court believed that *Santor* was rightly decided "only because the defendant in that case marketed the rug as Grade #1."²⁵ In a much-quoted excerpt, Justice Traynor explained the rationale for the court's decision:

The distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the "luck" of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. He can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risks of harm. He cannot be held for the level of performance of his products in the consumer's business unless he agrees that the product was designed to meet the

19. *Id.*

20. *Id.* at 147-48.

21. *Id.* at 148.

22. *Id.* at 149.

23. *Id.* The court also commented that "[p]hysical injury to property is so akin to personal injury that there is no reason to distinguish them." *Id.* at 152.

24. *Id.* at 151.

25. *Id.*

consumer's demands. A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will. Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone.²⁶

The majority of jurisdictions addressing this issue adopted the *Seely* approach.²⁷ The United States Supreme Court eventually addressed this issue in *East River Steamship Corp. v. Transamerica Delaval, Inc.*,²⁸ a case arising under admiralty jurisdiction. The Supreme Court reviewed the various approaches to cases involving purely economic damages, including the majority (*Seely*) and the minority (*Santor*) approaches. The Court found that "[t]he minority view fails to account for the need to keep products liability and contract law in separate spheres and to maintain a realistic limitation on

26. *Id.*

27. *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 868 (1986). The Supreme Court noted that the high courts of California and New Jersey seemed to be moving "in the direction of the other since *Santor* and *Seely*." *Id.* at 869 n.4. (citing *J'Aire Corp. v. Gregory*, 598 P.2d 60 (Cal. 1979) and *Spring Motors Distribs., Inc. v. Ford Motor Co.*, 489 A.2d 672 (N.J. 1985)).

28. 476 U.S. 858 (1986). Transamerica had contracted to design, manufacture, and supervise the installation of turbines that would serve as the main propulsion units for four supertankers owned by East River. *Id.* at 859. Once put into service, each turbine malfunctioned due to design and manufacturing defects, causing damages to the turbines. Invoking admiralty jurisdiction, East River filed suit in the United States District Court for the District of New Jersey, alleging five counts of tortious conduct by Transamerica. *Id.* at 861. The first four counts alleged that Transamerica was strictly liable for design defects in the high pressure turbines of the four supertankers. *Id.* The fifth count charged Transamerica with negligently supervising the installation of the astern guardian valve on one of the supertankers. *Id.*

The Third Circuit affirmed *en banc* the district court's grant of summary judgment for Transamerica. *East River S.S. Corp. v. Delaval Turbine, Inc.*, 752 F.2d 903 (3d Cir. 1985). The court held that if a defective product creates an unreasonable risk of harm to persons or property other than the product itself, and harm arises, then damage solely to the defective product is actionable in tort. Conversely, "[d]isappointments over the product's quality . . . are protected by warranty law." *Id.* at 908.

The Supreme Court agreed with the Third Circuit that "whether principles of strict products liability are part of maritime law 'is no longer seriously contested,'" 476 U.S. at 865 (quoting *Ocean Barge Transport Co. v. Hess Oil Virgin Islands Corp.*, 726 F.2d 121, 123 (3d Cir. 1984)) but then proceeded to discuss the inappropriateness of tort claims in this situation. The court distinguished "the traditional 'property damage' cases," in which the defective product damaged other property, from the present case in which only the purchased product, the turbines, suffered damage. *Id.* at 867. The Court stated that "[o]bviously, damage to a product itself has certain attributes of a products-liability claim. But the injury suffered—the failure of the product to function properly—is the essence of a warranty action, through which a contracting party can seek to recoup the benefit of its bargain." *Id.* at 867-68.

damages."²⁹ It thus adopted the *Seely* view, holding "that a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself."³⁰

B. *Adoption and Expansion in Florida and the Eleventh Circuit*

One year after *East River*, the Florida Supreme Court expounded its position on purely economic damages in *Florida Power & Light Co. v. Westinghouse Electric Corp.*³¹ The parties had contracted for Westinghouse to design, manufacture, and furnish two nuclear steam supply systems, including six steam generators.³² Florida Power & Light alleged that all six generators leaked and sued Westinghouse under breach of express warranty and negligence theories, "seeking damages for the cost of repair, revision, and inspection of the steam generators."³³ The federal district court granted Westinghouse's motion for partial summary judgment on the negligence claim "on the grounds that Florida law precludes the recovery of economic loss without any claim of personal injury or property damage to other property."³⁴

On appeal, the Eleventh Circuit certified two questions to the Florida Supreme Court:

- (1) Whether Florida law permits a buyer under a contract for goods to recover economic losses in tort without a claim for personal injury or property damage to property other than the allegedly defective goods.
- (2) If Florida law precludes recovery for economic loss in tort without a claim for personal injury or property damage to other property, whether this rule should be applied retroactively in this case.³⁵

Following the majority approach, the Florida Supreme Court answered the first question in the negative. Turning to the second question, the court found that, because its approach was consistent with established Florida law, this rule would be applicable to all pending cases.³⁶

In answering the first question, the Florida Supreme Court accepted *Seely's* reasoning that contract principles are more appropri-

29. *Id.* at 870.

30. *Id.* at 871.

31. 510 So. 2d 899 (Fla. 1987).

32. *Id.* at 900.

33. *Id.*

34. *Id.*

35. *Id.* at 899-900.

36. *Id.* at 900.

ate than tort principles for resolving actions concerning economic loss without accompanying physical injury or property damage.³⁷ The court explained the policy behind the economic loss doctrine as "encourag[ing] parties to negotiate economic risks through warranty provisions and price."³⁸ The minority approach, on the other hand, "exposes a manufacturer to liability for negligence based on economic loss alone, replacing the freedom of bargaining and negotiation with a duty of care."³⁹ The court pointed to *East River's* emphasis that:

[a] duty of care . . . is particularly unsuited to the vagaries of individual purchasers' product expectations. As important, under the minority view, a manufacturer faced with this kind of liability exposure must raise prices on every contract to cover the enhanced risk. Clearly, product value and quality is covered by express and implied warranties, and warranty law should control a claim for purely economic losses.⁴⁰

Three months after rendering the *Westinghouse* opinion, the Florida Supreme Court expanded the economic loss doctrine in *AFM Corp. v. Southern Bell Telephone & Telegraph Co.*,⁴¹ another case before the court on a question certified from the Eleventh Circuit, to limit liability for negligently-rendered services.

AFM had contracted with Southern Bell to advertise in Southern Bell's Yellow Pages.⁴² When AFM moved its office, Southern Bell assigned it a new telephone number.⁴³ The parties agreed that Southern Bell would provide a referral service to assist AFM's prospective customers.⁴⁴ Southern Bell distributed the Yellow Pages with AFM's old, incorrect number listed rather than its new number.⁴⁵ Southern Bell exacerbated this mistake by assigning AFM's old number to a different customer, which resulted in the automatic disconnection of the referral system.⁴⁶ Although Southern Bell reconnected the referral system once AFM discovered the mistakes, Southern Bell subsequently disconnected it again.⁴⁷

AFM filed suit in Florida state court alleging negligence and

37. *Id.* at 902.

38. *Id.* at 901.

39. *Id.*

40. *Id.*

41. 515 So. 2d 180 (Fla. 1987). For an examination of the "shortcomings" of *AFM* and its progeny, see Matthew S. Steffey, *Florida's Economic Loss Rule: A Critical Look at the Cases*, FLA. B.J., May 1990, at 19, 21-23.

42. *AFM Corp. v. Southern Bell Tel. & Tel. Co.*, 796 F.2d 1467, 1468 (11th Cir. 1986).

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

breach of contract, and Southern Bell removed the case to the United States District Court for the Southern District of Florida.⁴⁸ At the close of the evidence, AFM's counsel decided to proceed solely in tort.⁴⁹ The jury returned a verdict in favor of AFM for both compensatory and punitive damages.

Southern Bell appealed to the Eleventh Circuit Court of Appeals, arguing that "the jury's award of compensatory damages [had to] be overturned because AFM waived its contract cause of action and therefore could not recover lost profits solely on its tort claim,"⁵⁰ and that AFM failed to establish a tort independent of the breach of contract and, therefore, was not entitled to punitive damages.⁵¹ Finding no Florida Supreme Court cases addressing these issues, the Eleventh Circuit certified three questions to the Florida Supreme Court. The Florida Supreme Court combined the three questions into one: "Does Florida permit a purchaser of services to recover economic losses in tort without a claim for personal injury or property damage?"⁵² The court answered the question in the negative, finding this answer "[c]onsistent with [its] decision in . . . *Westinghouse*."⁵³

In the court's view, AFM's attempt to recover economic losses for a negligent breach of contract under tort theory was incongruous with the fact that the parties had entered a contract "defin[ing] the limitation of liability through bargaining, risk acceptance, and compensation."⁵⁴ AFM's failure to prove the commission of a tort independent of the breach of contract removed any basis for the negligence claim.⁵⁵

III. *INTERSTATE SECURITIES CORP. V. HAYES CORP.*

Following the *Westinghouse* and *AFM* decisions, *Interstate Securities Corp. v. Hayes Corp.*⁵⁶ presented what appeared to be a case ripe for application of the economic loss doctrine—a tort claim for

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.* at 1469.

52. *AFM Corp. v. Southern Bell Tel. & Tel. Co.*, 515 So. 2d 180 (Fla. 1987).

53. *Id.*

54. *Id.* at 181.

55. *Id.* The court referred to *Lewis v. Guthartz*, 428 So. 2d 222, 223 (Fla. 1982), in which it affirmatively answered the following certified question: "Where the defendant flagrantly, unjustifiably, and oppressively breaches a contract, and attempts to conceal the breach by the criminal act of making false statements to the government, must the plaintiffs plead and prove that the defendant committed an independent tort against them in order to recover punitive damages?" The court held it imperative that a tort be "distinguishable from or independent of [the] breach of contract." *Id.* at 224.

56. 920 F.2d 769 (11th Cir. 1991).

economic damages brought by one party to a contract against the other. Closer examination reveals, however, that the case should not fall within the doctrine's reach.

A. *Facts of the Case*

Hayes Corporation ("Hayes") and Interstate Securities Corporation ("Interstate"), a securities brokerage firm, entered into several contracts allowing Hayes to trade options, commodities, and commodities options through an account at Interstate.⁵⁷ The parties further agreed that Hayes could trade securities and write options on the margin,⁵⁸ provided that Roger Haendiges, the president and sole shareholder of Hayes, assumed personal responsibility for any debts incurred by the account.

The following month, Haendiges began writing uncovered options⁵⁹ through the account on behalf of Hayes.⁶⁰ In March of 1986, Haendiges opened a personal securities trading account at a second brokerage firm, in which he also began writing uncovered call options.⁶¹ On May 19, 1986, Haendiges wrote 1100 uncovered call options for Reebok International stock on the Hayes account and 1000 uncovered call options on his own account.⁶² When he attempted to write 1000 additional put options on his personal account, the second brokerage firm demanded that he increase the

57. *Id.* at 770.

58. *Id.* Trading "on the margin" indicates "that an investor only pays a portion of the price of a security and borrows the remainder from his broker." *Id.* at 770 n.1. Securities purchased "on the margin" are called "margin securities," BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 220 (2d ed., 1987) [hereinafter BARRON'S DICTIONARY], and are held by securities brokers in "margin accounts." *Id.* at 223. Federal regulations limit the amount of and conditions under which purchasing and trading of such investments can occur.

59. Options are contracts through which one purchases from another the right to either buy (call options) or sell (put options) stock at a certain price, the "exercise price," at or within a certain time period. BARRON'S DICTIONARY, *supra* note 58, at 272-73. The amount paid by an option buyer for the right to call or put the underlying security is the "option premium." *Id.* at 274. If the option buyer does not exercise her right within the specified period, the option expires and the option buyer forfeits the premium. *Id.* at 272. A person or financial institution that sells options, hoping to receive the premium without the option being exercised, is known as an "option writer." *Id.* at 274. If the call option writer owns shares in the underlying security, the option is considered "covered." *Id.* at 82. An uncovered, or "naked" option is written when one sells a call option for stock which the writer does not own. *Id.* at 244-45, 450. An investor typically exercises a call option only if the stock's price exceeds the exercise price. *Id.* at 272. Thus, if the option is exercised, the writer of an uncovered option must purchase the stock and immediately sell it to the optionholder at the lower exercise price.

60. *Interstate*, 920 F.2d at 771.

61. *Id.*

62. *Id.*

equity in the account by \$500,000 as a precondition to writing these options.⁶³ Instead, at Haendiges' request, Interstate combined the personal account with the Hayes account, and, on May 23, Interstate accepted the account "on the condition that Haendiges reduce his exposure and execute additional promissory notes pledging his personal property to cover any shortfall."⁶⁴

One week later, with the combined account's value between \$1.8 million and \$2 million, Interstate warned Haendiges that, if he failed to meet any margin call within twenty-four hours, Interstate would liquidate his account.⁶⁵ On the next trading day, June 2, 1986, Reebok's stock price rose substantially, depleting the equity in the account.⁶⁶ Interstate then issued Hayes a \$217,552 margin call,⁶⁷ and continued to issue margin calls on the account for the next fifty-one days.⁶⁸ Although the average call amounted to \$2 million, Haendiges placed only \$5,000, as a good faith deposit, in the account.⁶⁹ On July 18, 1986, Interstate liquidated the Hayes account, which then had a debit balance exceeding \$1.8 million.⁷⁰ During this period, Interstate opened more than forty-five new option positions⁷¹ in the account despite the account's negative liquidation value.⁷² Between June 1 and the date of liquidation of the account, Interstate charged the account with \$318,415 in commissions—nearly sixty percent more

63. *Id.* This investment strategy, known as "combination writing," involves selling both put and call options for the same stock. BARRON'S DICTIONARY, *supra* note 58, at 67.

64. *Interstate*, 920 F.2d at 771.

65. *Id.* "Margin call means a demand by a creditor to a customer for a deposit of additional cash or securities to eliminate or reduce a margin deficiency as required under this part." 12 C.F.R. § 220.2(n) (1992). A "[m]argin deficiency means the amount by which the required margin exceeds the equity in the margin account." 12 C.F.R. § 220.2(o) (1992).

66. *Interstate*, 920 F.2d at 771; *see supra* note 59 (explaining how writing uncovered options could force the investor to pay an additional amount immediately and unexpectedly).

67. *Interstate*, 920 F.2d at 772.

68. Initial Brief of Appellants, Defendants/Counter Plaintiffs Below at 11, *Interstate*, 920 F.2d 769 (Nos. 89-3620 and 89-3729).

69. *Id.* at 3-4.

70. *Interstate*, 920 F.2d at 772.

71. A position is simply an investor's stake in a particular security. BARRON'S DICTIONARY, *supra* note 58, at 296.

72. Initial Brief of Appellants, *supra* note 68, at 11. During most of this time the account had a negative value. One new position, opened when the account had a negative liquidation value of \$892,430, cost in excess of \$300,000. *Id.*

Controversy arose as to who caused these new positions to be taken. Hayes and Haendiges argued that on the day Regulation T allegedly required liquidation, *see infra* note 78, Interstate seized control of the account and began a new investment strategy using the account's funds. *Id.* at 12. They further argued that this assumption of control and "failure" to promptly liquidate the account caused the account's losses. Interstate argued that it simply acquiesced in its customer's requests to keep the account open. *Id.* at 11-13.

than the amount charged during the 150 days prior to June 1.⁷³ Notwithstanding Interstate's claim that Haendiges "repeatedly urged Interstate not to liquidate the Hayes account,"⁷⁴ Haendiges maintained that Interstate "improperly assumed control of his account as of June 2, 1986, and that he fully expected Interstate to liquidate the account at that time."⁷⁵

Interstate filed suit against Hayes Corporation the following month to recover the debit balance of the account at time of liquidation and against Haendiges as guarantor of the account.⁷⁶ Interstate claimed that Hayes and Haendiges had caused Interstate to accept the transferred account and allow it to remain open after the margin calls by making fraudulent misrepresentations.⁷⁷ Hayes and Haendiges counterclaimed against Interstate, alleging breach of fiduciary duty, negligent handling of accounts, and violation of Federal Regulation T. Regulation T regulates extensions of credit by brokers, imposing obligations regarding the amount of equity that must be maintained in an account.⁷⁸

After the presentation of evidence, the United States District Court for the Middle District of Florida ruled that *AFM Corp. v. Southern Bell Telephone and Telegraph Co.*⁷⁹ controlled, and that, "as a matter of law, Hayes Corporation's and Haendiges's counterclaim of negligence could not go forward."⁸⁰ Because the district court had earlier ruled that evidence of Regulation T violations was irrelevant and inadmissible, only the counterclaim for breach of fiduciary duty

73. *Id.* at 12. During the 150 days preceding June 1, 1986, Interstate's commissions totalled only \$200,000. *Id.*

74. *Interstate*, 920 F.2d at 772 (quoting Appellee's Brief at 8).

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* Regulation T governs issuance of credit by securities firms to investors trading on the margin. It requires that the equity in an account be at a safe level before new positions are opened in the account. Among its provisions, the regulation mandates that margin calls "shall be satisfied within 7 business days after the margin deficiency was created or increased," 12 CFR § 220.4(c)(3) (1992), and that if a margin call to eliminate a deficiency is not met in full, the broker "shall liquidate securities sufficient to meet the margin call or to eliminate any deficiency existing on the day such liquidation is required, whichever is less." *Id.* at § 220.4(d). Legislative reports on the regulation indicate the purpose of the margin regulations is the protection of investors by making it impossible to purchase securities on too thin a margin. STOCK EXCHANGE PRACTICES REPORT OF THE SENATE COMM. ON BANKING AND CURRENCY, S. REP. NO. 1455, 73d Cong., 2d Sess. 1 (1934), reprinted in WALL STREET AND THE SECURITIES MARKETS 11 (Vincent P. Caneso & Robert Sobel eds., 1975).

Although Hayes and Haendiges initially pursued a breach of contract counterclaim, the record is unclear as to its disposition other than that it was not pursued at trial. *Interstate*, 920 F.2d 772.

79. 515 So. 2d 180 (Fla. 1987).

80. *Interstate*, 920 F.2d at 772.

reached the jury.⁸¹ The jury returned a verdict in favor of Interstate for the full debit balance of the liquidated account and rejected the counterclaim for breach of fiduciary duty.⁸² The district court augmented the award with interest and attorneys' fees, increasing the total amount to \$2,883,886.95.⁸³

B. *The Eleventh Circuit Decision*

The Eleventh Circuit framed the two primary issues on appeal as follows:

First, whether the district court properly applied the holding in *AFM* . . . to determine, as a matter of law, that Hayes Corporation and Haendiges cannot sue Interstate for negligence. Second, whether the district court erred in ruling that evidence of violations of regulation T is irrelevant and inadmissible and in failing to instruct the jury regarding regulation T in response to jury questions during deliberations.⁸⁴

The court affirmed the district court's holding that *AFM* barred the negligence claims, and further held that *AFM* barred claims for breach of fiduciary duty.⁸⁵ Based on the latter holding, the Eleventh Circuit declared the Regulation T issues moot.⁸⁶

Hayes and Haendiges conceded that they could not recover damages in tort unless they met an exception to the *AFM* decision.⁸⁷ They argued that they met an exception because they were seeking recovery for injury to "property" rather than solely economic losses and because Interstate's behavior constituted a tort separate and independent from any alleged breach of contract.⁸⁸

81. *Id.* During deliberations, the jury submitted the following questions to the court: "If it is a federal regulation that an account must be closed immediately, why was the account left open until 23 July, 1986 with marginal [sic] calls coming in almost daily? End of question. And, does this affect the fiduciary relationship?" *Id.* at 772-73. Although counsel for Hayes and Haendiges suggested the jury was referring to Regulation T, *see supra* note 78, the court agreed with counsel for Interstate that no regulation required the immediate liquidation of an account. *Interstate*, 920 F.2d at 773. The court responded to the inquiry: "There was no federal regulation requiring the account to be closed immediately. As to why the account was left open so long with marginal (adopting the jury's language) calls coming almost daily, that is something which you, the jury, must determine from the evidence before you." *Id.* On appeal, Hayes and Haendiges argued that these questions indicated that the jury had determined that Interstate breached its fiduciary duties but that the court's response misled the jury into changing its decision. Initial Brief of Appellants, *supra* note 68, at 37.

82. *Interstate*, 920 F.2d at 773.

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* at 774.

88. *Id.*

The first argument focused on the contention that the lost value of the account constituted injured property. Attempting to distinguish *AFM* on the ground that *AFM* sought lost profits, Hayes and Haendiges argued that they were "merely seeking the actual value of their trading account on the day that Interstate allegedly had a duty to liquidate it."⁸⁹

The Eleventh Circuit found this argument "fundamentally flawed because it ignores the policies underlying the *AFM* decision."⁹⁰ The court explained that, although *AFM* would allow recovery in tort for "conduct resulting in . . . property damage," prior cases under Florida law⁹¹ required that the injured property be outside the scope of the parties' contract.⁹² Here, the account "was the primary subject of the contract" between the parties, and thus could not constitute "property" within the meaning of *AFM*.⁹³ The court reasoned that, because the agreements entered into governed the parties' relationship regarding account management and risk allocation, damage to the account was not damage to property outside of the contract's scope, and no tort recovery was allowed.⁹⁴

Under their second argument, Hayes and Haendiges asserted that Interstate's failure to manage the account non-negligently constituted an independent tort.⁹⁵ The Eleventh Circuit affirmed the district court's decision not to submit this negligence claim to the jury because "the remedies . . . were negotiated or at least agreed upon by the parties in the various customer agreements."⁹⁶ The court believed it clear that *AFM* foreclosed negligent breach of contract claims and that permitting tort recovery in this case would "disturb the agreement signed by the parties, blur the distinction between contract and tort, and conflict fundamentally with the *AFM* decision."⁹⁷

In addition, Hayes and Haendiges claimed that Interstate breached its fiduciary duty as a securities broker under Florida law⁹⁸

89. *Id.* at 775.

90. *Id.*

91. See *Strickland-Collins Constr. v. Barnett Bank of Naples*, 545 So. 2d 476 (Fla. 2d DCA 1989); *Belle Plaza Condominium Assoc. v. B.C.E. Dev., Inc.*, 543 So. 2d 239 (Fla. 3d DCA 1989); *GAF Corp. v. Zack Co.*, 445 So. 2d 350 (Fla. 3d DCA 1984).

92. *Interstate*, 920 F.2d at 775.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 775-76.

98. *Id.* at 776; see Initial Brief of Appellants, *supra* note 68, at 41 (directing the court to *Henderson v. Usher*, 170 So. 846, 852 (Fla. 1936) and *Hayden, Stone Inc. v. Brown*, 218 So. 2d 230, 235 (Fla. 4th DCA 1969) for the proposition that a broker in Florida always owes a fiduciary duty to his customer).

“by failing to liquidate the account promptly, by taking control of the account prematurely, and by opening new positions in the account that resulted in additional losses.”⁹⁹ They argued that because common law, not the contract, provided the source of claims for breach of fiduciary duty and utmost good faith, those claims constituted torts separate and independent from the breach of contract.¹⁰⁰

Acknowledging that no Florida state court had applied *AFM* to claims for breach of fiduciary duty, the *Interstate* court did locate, and seemingly ignore, one Florida district court decision that dismissed a claim for negligence but remanded a claim for breach of fiduciary duty under *AFM*.¹⁰¹ The court explained that Hayes’ and Haendiges’ counsel stated at oral argument that a bar to the negligence claim would also bar the claim for the breach of fiduciary duty.¹⁰²

The court relied on *J. Batten Corp. v. Oakridge Inv. 85, Ltd.*,¹⁰³ which dismissed a fraud claim under *AFM*, for the proposition that *AFM* barred claims for breach of fiduciary duty.¹⁰⁴ The court reasoned that, “[i]f Florida courts dismiss fraud claims between parties to a contract under *AFM*, it is probable that the Florida courts would also dismiss fiduciary duty claims.”¹⁰⁵ The court emphasized two points. First, claims for breach of fiduciary duty are based upon a duty arising only when a contractual relationship has been established.¹⁰⁶ Second, a plaintiff may establish breach of fiduciary duty by showing the defendant’s failure to take necessary action.¹⁰⁷ The plaintiff is not required to show any affirmative action by the defendant.¹⁰⁸

The court distinguished fraud claims from those based on breach of fiduciary duty, stating that the former are “based upon a general duty of good faith and fair dealing that pervades all commercial dealings, regardless of the existence of a contract” and that one bringing a fraud claim must prove that the defendant engaged in affirmatively fraudulent conduct.¹⁰⁹ The court believed that these differences made fraud claims more likely to constitute separate and independent torts

99. *Interstate*, 920 F.2d at 776.

100. *Id.*

101. *Id.* (citing *Bankest Imports, Inc. v. ISCA Corp.*, 717 F. Supp. 1537 (S.D. Fla. 1989)).

102. *Id.*

103. 546 So. 2d 68 (Fla. 5th DCA 1989).

104. *Interstate*, 920 F.2d at 776.

105. *Id.*

106. *Id.* at 777.

107. *Id.*

108. *Id.*

109. *Id.*

under Florida law.¹¹⁰ Thus, because *AFM* foreclosed fraud claims, the court held that it further barred claims for breach of fiduciary duty, and, therefore, the district court erred in submitting the claim to the jury.¹¹¹

The court distinguished those Florida cases allowing tort recovery for economic damages by explaining that the plaintiffs in those cases had no alternative means of recovery.¹¹² Conversely, in *Interstate*, the parties had recourse under contract theory, but Hayes and Haendiges “apparently abandoned the breach of contract claim.”¹¹³ Thus, the court found that Florida courts would permit tort recovery for purely economic loss only when alternative means of recovery are unavailable.¹¹⁴

C. *A Pothole in the Interstate*

The major problem in the *Interstate* decision is the court’s failure to perceive the fundamental difference between the facts in *Interstate* and in the other cases in the line of development of the economic loss doctrine. The court ignored the special implications of the fiduciary relationship the parties held despite its previous holding that brokers specifically owe their clients fiduciary duties of care and loyalty.¹¹⁵ The court did not rely on any case involving a fiduciary relationship. Rather, the court simply assumed that the rules governing arms-length contractual transactions and, consequently, the economic loss doctrine applied to the fiduciary setting.¹¹⁶

As courts have recognized for at least three-quarters of a century,¹¹⁷ fiduciary relationships should not be treated identically to arms-length contractual relationships.¹¹⁸ In classic contractual relationships, the parties are in conflict, each one attempting to “protect himself from the other’s self-interested behavior.”¹¹⁹ Neither party

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049-50 (11th Cir. 1987).

116. *See supra* text accompanying note 105.

117. Benjamin Cardozo, while Chief Judge of the New York Court of Appeals, opined that “[m]any forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties.” *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

118. *See generally* Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983) (comparing fiduciary relationships with contract and status relationships, advocating recognition of fiduciaries as a group and their governance under a distinct body of legal policies, principles, and rules).

119. *Id.* at 799.

has an obligation to protect the other or to expect protection.¹²⁰ Conversely, "fiduciary relations are designed not to satisfy both parties' needs, but only those of the entrustor."¹²¹ In this role, the fiduciary acts on behalf of and as a substitute for the entrusting party. The fiduciary's needs are subordinated to those of the entrustor.

In *Bankest Imports, Inc. v. ISCA Corp.*,¹²² the case so quickly dismissed by the *Interstate* court, the United States District Court for the Southern District of Florida recognized these distinctions between arms-length transactions and transactions involving fiduciary relationships.¹²³ The *Bankest Imports* court emphasized the distinction that "[i]n an arms-length transaction . . . there is no duty to act for the benefit or protection of the other party."¹²⁴ A fiduciary relationship, on the other hand, includes "some degree of dependency on one side and some degree of undertaking on the other side to advise, counsel, and protect the weaker party."¹²⁵

Ignoring this distinction, the Eleventh Circuit, in *Interstate*, relied instead on *J. Batten*,¹²⁶ which affirmed the dismissal of a fraud claim by a general contractor against a property owner with whom the contractor had contracted.¹²⁷ From this proposition the Eleventh Circuit leapt to the rule that a client could not sue its securities broker in tort for breach of fiduciary duty despite the fact that, in contrast to the facts in *Interstate*, no fiduciary relationship existed in *J. Batten*.

The *J. Batten* court relied on *AFM* to justify its decision to bar the fraud claim.¹²⁸ *AFM*, like *J. Batten*, involved neither a fiduciary relationship nor an independent duty. However, in cases involving fiduciaries, such as securities brokers or attorneys, the law imposes independent duties on the professional to the client because of the professional's position of trust and dependence regardless of the specific language of any contract between the parties. In sum, the contracts in *J. Batten* and *AFM* provided the only possible source of any duty. This is not the case with brokers, attorneys or other fiduciaries.

Much of the rationale for the economic loss doctrine in the settings of product liability and general service contracts vanishes in the presence of a fiduciary relationship. The attorney-client relationship

120. *Id.* at 800.

121. *Id.* at 801. Frankel coined the term "entrustor" because no general term presently exists to describe the "other" party in all fiduciary relationships.

122. 717 F. Supp. 1537 (S.D. Fla. 1989).

123. *Id.* at 1541.

124. *Id.*

125. *Id.*

126. *J. Batten Corp. v. Oakridge Inv. 85, Ltd.*, 546 So. 2d 68 (Fla. 5th DCA 1989).

127. *Id.* at 69.

128. *Id.*

exemplifies the distinction between fiduciary situations and traditional contractual relationships, in that the attorney does not warrant or promise results, and the parties do not bargain for services even though the client agrees to pay fees.¹²⁹ The inherent, underlying agency relationship transforms any element of the bargained-for commercial expectations of the parties.¹³⁰ In light of this, applying the economic loss doctrine to mandate contractual solutions to disputes between fiduciaries and clients, as opposed to commercial situations or arms-length transactions, is inherently unjust. The client must surrender much—a tort cause of action—in return for very little—a possible decrease in the professional's fee. The economic loss doctrine was not designed to protect parties from tort liability simply because the parties had entered a contractual relationship.

Two further examples illustrate this point. First, parties to a joint venture typically draw up detailed contracts to govern their relationship. Often, one party holds the funds for the venture as a fiduciary.¹³¹ *Interstate* permits such a fiduciary to misapply the funds and, if caught, rely on the economic loss doctrine to avoid tort liability and corresponding punitive damages.¹³² Second, stockbrokers can contractually agree to manage a client's portfolio. If such a stockbroker misrepresents certain investments, "churns" the investor's account to generate excessive commissions, or engages in acts of self-dealing, the stockbroker should face liability in contract, tort, or both.¹³³ Allowing the economic loss doctrine to bar tort actions in these situations encourages wrongful conduct because the wrongdoer faces only a minimal risk—the *possibility* of paying compensatory damages.¹³⁴ This application of the doctrine wrongly extends its protection to classes of individuals never intended to reap its benefits.¹³⁵

Judicial supervision of parties to a contract and parties in a fiduciary relationship also differs markedly in two respects. First, "a salient feature of fiduciary law is that it regulates only one of the

129. Blanche M. Manning, *Legal Malpractice: Is it Tort or Contract?*, 21 LOY. U. CHI. L.J. 741, 754 (1990). Contingency fee arrangements, on the other hand, are, in a sense, an agreement that the client need not compensate the attorney unless a certain result actually is achieved.

130. *Id.* at 750.

131. See Hanzman, *supra* note 2, at 44.

132. *Id.*

133. *Id.* at 45.

134. *Id.* The wrongdoer may also be subject to liability under federal and state securities statutes. However, fraud and breach of fiduciary duty claims have often been critical because of the short limitations periods imposed by the statutes. *Id.* at 45 n.7.

135. *Id.* at 44.

parties—the fiduciary,”¹³⁶ whereas contract law regulates both parties. Second, courts rarely interfere with a contract freely made by the parties unless it is unconscionable.¹³⁷ In fiduciary relationships, however, courts will intervene and require the fiduciary to act “with loyalty and skill, in the entrustor’s best interests.”¹³⁸ Furthermore, courts have at times intervened to “assert the power to interpret the delegated powers of fiduciaries and the purpose of the delegation.”¹³⁹

The Eleventh Circuit’s decision in *Interstate* implies that solely the terms of the parties’ contract should govern any fiduciary relationship between them. Assuming its correctness, the Eleventh Circuit’s decision dispenses with the need for a concept of “fiduciary duty.” Complete contractual control of a fiduciary’s power and actions, however, is not a viable alternative to employing independent standards of care and accountability specifically designed to deal with the broad discretionary powers of fiduciaries. Even if a contract could provide for all discretionary uses of power within the relationship and specify the fiduciary’s required course of action under all possible scenarios, the transaction costs associated with making such a contract would be enormous and probably outweigh the benefits of the relationship.¹⁴⁰ Conversely, attempting to avoid the transaction costs by drawing up a less detailed document would leave the entrustor more susceptible to abuses of the given power.¹⁴¹

One could argue that the less detailed, transaction-cost-saving document could be combined with direct control or supervision of the fiduciary to prevent the abuses of power. Direct control, however, reduces efficiency and might undermine the purpose of the fiduciary relationship.¹⁴² For example, clients often employ fiduciaries, such as securities brokers and attorneys, for their expertise. Direct client control may reduce the value of such expertise.¹⁴³ Furthermore, if the client possessed the expertise necessary to efficiently monitor the fiduciary’s actions, the client would have had no reason to enter the relationship in the first place.¹⁴⁴ Even so, monitoring the fiduciary does

136. Frankel, *supra* note 118, at 819. Frankel cites the entrustor’s duty to reimburse the fiduciary for expenses as an example of a duty the law imposes on the entrusting party, but explains that the entrustor’s duties serve to “facilitate the performance of [the fiduciary’s] services by giving him an incentive to act diligently.” *Id.*

137. *Id.* at 823.

138. *Id.*

139. *Id.*

140. *Id.* at 813.

141. *Id.*

142. *Id.* at 813-14.

143. *Id.* at 813.

144. *Id.*

not prevent abuse of power but simply serves as a policing mechanism.¹⁴⁵ The fiduciary may still hide the abusive activities, adding to the costs of the relationship.¹⁴⁶

The legal and practical distinctions between fiduciary and traditional contractual relationships flatly rebut any notion that they should or can be merged. These differences require a distinction in applying the economic loss doctrine depending on which type of relationship is present. *Interstate* failed to make this distinction.

One commentator has suggested that *Interstate*, taken to its logical extreme, would eliminate all claims of malpractice or breach of fiduciary duty by customers of professional services, regardless of how egregious the conduct, if the services were rendered pursuant to a contract.¹⁴⁷ Part IV recognizes this threat and reveals the unsuitability of the economic loss doctrine specifically in the context of legal malpractice claims. In legal malpractice actions, courts have traditionally acknowledged the special implications of the attorney's fiduciary obligations stemming from the extensive duties owed by fiduciaries in general. Accordingly, courts have drawn from both tort and contract law to protect those entrusting the fiduciary. Application of the economic loss doctrine to limit entrustors claiming purely economic damages to contractual causes of action against fiduciaries contravenes this policy.

IV. FEAR OF FURTHER EXPANSION: THE INAPPROPRIATENESS OF APPLYING THE ECONOMIC LOSS DOCTRINE TO LEGAL MALPRACTICE ACTIONS

As tort claims arising from a contractual setting, legal malpractice actions face the danger of foreclosure under *Interstate*. Legal malpractice rarely results in personal injury or property damage. Most often, the claimed damages are economic or pecuniary losses allegedly caused by the attorney's breach of duty to the client.¹⁴⁸ Under *Interstate*, the presence of a fiduciary relationship and the corresponding duties imposed on the fiduciary provide no additional protection to the entrusting party. The sole inquiry concerns the type of damages sought. If those damages are purely economic, *Interstate* confines the injured party to a contractual cause of action. Foreclo-

145. *Id.* at 814.

146. *Id.*

147. Hanzman, *supra* note 2, at 43-44.

148. Manning, *supra* note 129, at 742. The damages have been described as loss of the expected benefits from the attorney's services and any expenses incurred due to the attorney's failure to achieve that benefit. 1 RONALD E. MALLIN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 16.1, at 890 (3d ed. 1989).

sure of tort-based remedies for these injured parties is clearly inappropriate. Undeniably, the attorney-client relationship is, in a sense, "contractual." It is the fiduciary duty, however, that provides the foundation of this relationship.¹⁴⁹ At least one court has explicitly recognized that this relationship necessitates an "extracontractual duty."¹⁵⁰ Indeed, the attorney's fiduciary obligation to an individual can arise even in the absence of the attorney-client relationship, such as in a consultation with a prospective client.¹⁵¹ The contractual relationship between attorney and client in no way diminishes the attorney's fiduciary duties.¹⁵² Thus, regardless of the contractual or tort nature of a legal malpractice claim, the attorney's fiduciary obligation imposes duties to which the attorney must conform.¹⁵³ These fiduciary obligations extend beyond the technical termination of the relationship.¹⁵⁴ *Interstate* suggests that courts ignore this duty and confine injured parties to contractual causes of action simply because the parties entered into a contract and the injured party claimed purely economic damages.

Every American jurisdiction recognizes a cause of action for legal malpractice.¹⁵⁵ There is little consensus, however, regarding the

149. 1 MALLEN & SMITH, *supra* note 148, § 11.1 at 633. Both the Model Code of Professional Responsibility and the Model Rules of Professional Conduct recognize that an attorney owes each client a fiduciary duty. This duty is recognized primarily through rules restricting the attorney's ability to reveal confidential information, *see* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 and cmt. (1991); MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 and EC 4-1 - 4-6 and DR 4-101 (1983), or to engage in conduct that would create a conflict of interest between the attorney and client or impair the attorney's judgment on behalf of a client, *see* MODEL RULES, *supra* at Rule 1.7 and cmt. - 1.9 and cmt.; MODEL CODE, *supra* at Canon 5 and EC 5-1 - 5-24 and DR 5-101 - 5-107.

150. 2314 Lincoln Park West Condominium Assoc. v. Mann, Gin, Ebel & Frazier, Ltd., 555 N.E.2d 346, 353 (Ill. 1990). The court indicated that the appropriate cause of action to address a breach of duty has traditionally been in tort. One commentator has interpreted this label of "extracontractual duty" to mean that "the court implied that an attorney's obligation to his client is not based solely on the contract existing between them. Rather, the nature of the lawyer's undertaking and the lawyer's 'traditional responsibilities' create a duty to render legal services with due care." Manning, *supra* note 129, at 753 (citations omitted).

151. 1 MALLEN & SMITH, *supra* note 148, § 11.2, at 638.

152. Jonathan M. Albano, *Contorts: Patrolling the Borderland of Contract and Tort in Legal Malpractice Actions*, 22 B.C. L. REV. 545, 565 (1981).

153. The Florida Supreme Court has explicitly stated that "attorneys owe a fiduciary duty to their clients." Florida Bar v. Padgett, 481 So. 2d 919 (Fla. 1986).

154. *See, e.g.,* Connelly v. Special Rd. & Bridge Dist. No. 5, 126 So. 794, 799 (Fla. 1930) (quoting Trice v. Comstock, 121 F. 620, 625 (8th Cir. 1903)):

The duty of an attorney to be true to his client, or of an agent to be faithful to his principal, does not cease when the employment ends, and it cannot be renounced at will by the termination of the relation. It is as sacred and inviolable after as before the expiration of its term.

See also 1 MALLEN & SMITH, *supra* note 148, § 11.2, at 638.

155. 1 MALLEN & SMITH, *supra* note 148, § 1.1, at 1-2.

meaning of the phrase "legal malpractice."¹⁵⁶ Some commentators consider claims of legal malpractice to lie in "the borderland" of contract and tort with no clear division between the two causes of action.¹⁵⁷ This confusion has caused courts difficulty in selecting the appropriate theory to apply in legal malpractice actions. Some courts view legal malpractice actions as arising in tort from the attorney's breach of a duty of due care.¹⁵⁸ Conversely, other courts see the action as grounded upon the contractual relationship created when the parties agree to the representation.¹⁵⁹ The imprecise contours of this "borderland" leave legal malpractice claims a prime target for attack by the economic loss doctrine.

Although plaintiffs commonly allege breach of fiduciary duty against attorneys,¹⁶⁰ plaintiffs have shared the courts' difficulty in discerning the cause of action under which to bring their legal malpractice claims. In the majority of legal malpractice cases, "no specific basis [of liability] is actually articulated."¹⁶¹ Although this confusion may not impact some aspects of the lawsuit,¹⁶² it may radically affect others.¹⁶³ When the court determines the theory of liability based on the plaintiff's neglect to state a theory or the court's foreclosure of certain alternatives, the plaintiff may find her relief limited or foreclosed.¹⁶⁴

Classification of the claim as tort or contract may influence such instrumental issues as the length of the statute of limitations, the date of accrual of the cause of action, survivability of the action, and the

156. *Id.*, § 1.1, at 2.

157. See GRANT GILMORE, *THE DEATH OF CONTRACT* 87-93 (1974); William L. Prosser, *The Borderland of Tort and Contract*, in *SELECTED TOPICS ON THE LAW OF TORTS* 380 (1953); Eric M. Holmes, *Is There Life After Gilmore's Death of Contract?: Inductions from a Study of Commercial Good Faith in First Party Insurance Contracts*, 65 *CORNELL L. REV.* 330 (1980).

One commentator referred to the action for legal malpractice as a "two-headed creature, one head born of the breach of an implied contractual relationship, the other growing from a violation of the fiduciary duty owed by an attorney to his client." Albano, *supra* note 152, at 546.

158. See, e.g., *FDIC v. O'Melveny & Meyers*, 969 F.2d 744 (9th Cir. 1992); *RTC v. Boynar, Norton & Blair*, 796 F. Supp. 1010 (S.D. Tex. 1992); *Marias v. Marano*, 813 P.2d 350 (Idaho 1991); *Pelham v. Griesheim*, 440 N.E.2d 96 (Ill. 1982).

159. See, e.g., *Zanders v. Jones*, 680 F. Supp. 1236 (N.D. Ill. 1988), *aff'd*, 872 F.2d 424 (7th Cir. 1989); *McConico v. Romeo*, 561 So. 2d 523 (Ala. 1990); *Jones v. Wadsworth*, 791 P.2d 1013 (Alaska 1990).

160. 1 *MALLEN & SMITH*, *supra* note 148, § 8.1, at 401.

161. DAVID J. MEISELMAN, *ATTORNEY MALPRACTICE: LAW AND PROCEDURE* § 2.3 (1980).

162. See, e.g., *id.* ("the same essential standard applies regardless of theory and regardless of how the cause of action is phrased").

163. See *infra* notes 165-207 and accompanying text.

164. *Id.*

type of damages recoverable.¹⁶⁵

Although Florida has adopted a single statute of limitations for contract- and tort-based professional malpractice actions,¹⁶⁶ other jurisdictions have not.¹⁶⁷ In jurisdictions lacking a uniform statute, selecting the theory under which to bring the legal malpractice claim may be crucial because tort statutes of limitations are typically shorter than those for contract.¹⁶⁸ The different limitations periods gain importance if the plaintiff is not permitted to choose between tort or contract actions, but instead must await the court's decision regarding which statute governs.¹⁶⁹

The issue of when the legal malpractice action accrues is intertwined with the issue of determining the appropriate statute of limitations. Contract actions typically accrue at the time of breach and allow recovery of at least nominal damages.¹⁷⁰ The drawback, however, is that the statute of limitations may bar the cause of action before the plaintiff becomes aware of the attorney's breach.¹⁷¹ Fortunately, most jurisdictions have recognized this problem and abandoned use of this theory.¹⁷²

Accrual of a tort action, conversely, does not commence until the

165. See Prosser, *supra* note 157, at 421, 422 n.204; see also William L. Prosser, *The Assault upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1127-33 (1960); William L. Prosser, *The Fall of the Citadel*, 50 MINN. L. REV. 791 (1966).

166. FLA. STAT. ch. 95.11(4)(a) (1983) provides:

(4) WITHIN TWO YEARS.—

(a) An action for professional malpractice, other than medical malpractice, whether founded on contract or tort; provided that the period of limitations shall run from the time the cause of action is discovered or should have been discovered with the exercise of due diligence. However, the limitation of actions herein for professional malpractice shall be limited to persons in privity with the professional.

167. See generally, Joseph H. Koffler, *Legal Malpractice Statutes of Limitations: A Critical Analysis of a Burgeoning Crisis*, 20 AKRON L. REV. 209, 229-36 (1986) (analyzing various states' approaches to determining the applicable statutes of limitations in legal malpractice actions). One court has observed that in jurisdictions lacking a specific statute governing malpractice actions "most courts permit a plaintiff to elect between the contract and tort limitations periods depending on how the complaint is framed." *Fitzgerald v. Congleton*, 583 A.2d 595, 598 (Vt. 1990).

168. Albano, *supra* note 152, at 546.

169. *Id.* at 546-48 (reviewing cases using "arbitrary, unconvincing factors" to determine whether a tort or contract statute of limitations applies); see also *Fitzgerald v. Congleton*, 583 A.2d 595 (Vt. 1990) (splitting legal malpractice claim and finding part of the claim time-barred by applying: (1) three-year statute of limitations governing actions for personal injuries to extent claim sought damages for mental anguish, emotional distress, and personal humiliation, and (2) six-year statute of limitations to extent claim sought compensation for economic loss).

170. JOHN EDWARD MURRAY, JR., *MURRAY ON CONTRACTS* § 233 (2d rev. ed., 1974).

171. See, e.g., *Wilcox v. Plummer*, 29 U.S. (4 Pet.) 172, 181 (1830).

172. 2 MALLEEN & SMITH, *supra* note 148, § 18.10, at 100.

plaintiff has suffered an actual loss or damage.¹⁷³ The result under this rule may not differ from the "date of breach" rule, as the plaintiff may be prohibited from seeking relief before learning of the injury. To counter this result, courts have increasingly used a "date of discovery" rule: the action does not begin to accrue until the plaintiff discovers or reasonably should have discovered the defendant's action.¹⁷⁴

Most jurisdictions now use the discovery rule for accrual of tort actions,¹⁷⁵ and several states, including Florida,¹⁷⁶ have explicitly adopted it for legal malpractice actions.¹⁷⁷ Courts adopting the discovery rule for professional malpractice actions typically emphasize the special position the professional holds in relation to the client, the client's reliance on the professional's work, and the fact that most of this work is completed out of the client's view.¹⁷⁸

One obvious disadvantage of the discovery rule is its hypothetically indefinite extension of liability.¹⁷⁹ Such a rule is necessary, however, to maintain the integrity of the attorney-client relationship. Granting attorneys the prodigious protection afforded by the other rules would generate distrust by clients, who might have no remedy if the attorney commits a long-undiscovered error.¹⁸⁰ The discovery rule best serves justice by tolling the statute of limitations until the client should reasonably have learned of the harm.¹⁸¹

The distinctions between tort and contract also dramatically influence the survival of the legal malpractice cause of action. Under traditional tort theory, the cause of action would not survive the death of either party.¹⁸² The action would survive, however, if characterized in contract.¹⁸³ Some states allow all except enumerated tort actions to survive.¹⁸⁴ At the extreme, Florida allows all causes of action to survive the death of a party.¹⁸⁵ Thus, an action for breach of fiduciary duty would survive in Florida and many other states as if it

173. WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS § 30, at 144 (4th ed., 1971).

174. Albano, *supra* note 152, at 548.

175. 2 MALLEN & SMITH, *supra* note 148, § 18.14, at 132.

176. See FLA. STAT. ch. 95.11(4)(a) (1983).

177. Albano, *supra* note 152, at 558.

178. *Id.*

179. 2 MALLEN & SMITH, *supra* note 148, § 18.14, at 136.

180. *Id.*

181. Albano, *supra* note 152, at 558.

182. *Id.* at 549-50; see PROSSER, *supra* note 173, § 126, at 899.

183. Albano, *supra* note 152, at 549.

184. See, e.g., DEL. CODE ANN. tit. 10, § 3701 (1991) ("All causes of action, except actions for defamation, malicious prosecution, or upon penal statutes, shall survive . . .").

185. FLA. STAT. ch. 46.021 (1991) ("No cause of action dies with the person. All causes of

were a contract action. Other courts, however, have employed creative interpretations of survivability statutes to preserve the classic tort-contract distinctions and prohibit survival of the action.¹⁸⁶

The choice between contract and tort also influences the recovery of damages. Traditional contract damages leave a majority of victims of breached contracts undercompensated.¹⁸⁷ Recognition of this injustice has been widespread.¹⁸⁸ Courts usually limit recovery in contract actions to damages in the contemplation of the parties when the contract was made.¹⁸⁹ Conversely, tort actions allow the recovery of consequential damages.¹⁹⁰ Also, in contract actions courts usually require that the amount of loss be established with a reasonable degree of certainty.¹⁹¹ By applying foreseeability and certainty requirements in contract actions, courts often prevent the jury from considering whole elements of claimed losses.¹⁹² These requirements are designed to prevent the victim from being overcompensated by assuring that he is not better off following the breach than he would have been after full performance of the contract.¹⁹³ The risk of undercompensation is compounded by rules that specifically deny the injured party access to damages for nonpecuniary losses.¹⁹⁴ For example, plaintiffs in contract actions usually may recover for emotional distress only infrequently and in highly restricted circumstances.¹⁹⁵ In contrast, tort victims generally are permitted to claim damages for pain and suffering, thus reducing the possibility that the

action survive and may be commenced, prosecuted and defended in the name of the person prescribed by law.”).

186. Albano, *supra* note 152, at 550.

187. John A. Sebert, Jr., *Punitive and Nonpecuniary Damages in Actions Based upon Contract: Toward Achieving the Objective of Full Compensation*, 33 UCLA L. REV. 1565, 1571-73, 1647 (1986). See also Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443 (1980).

188. Sebert, *supra* note 187, at 1565-66.

189. CHARLES T. MCCORMICK, *HANDBOOK ON THE LAW OF DAMAGES* §§ 137, 138 (1935). *Hadley v. Baxendale*, 156 Eng. Rep. 145 (1854) provides the basis for this rule that, in actions for breach of contract, damages are “such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.” *Id.* at 145. See also, *RESTATEMENT (SECOND) OF CONTRACTS* § 351 (1979) (restating the *Hadley* rule). I will refer to this as the foreseeability requirement.

190. See MCCORMICK, *supra* note 189, at §§ 137, 138. Consequential damages generally include, among other things, pain and suffering, mental anguish, and injury to reputation.

191. See generally *RESTATEMENT (SECOND) OF CONTRACTS*, *supra* note 189, at § 352. I will refer to this as the certainty requirement.

192. Sebert, *supra* note 187, at 1567.

193. *Id.* at 1647.

194. *Id.* at 1584-1600.

195. See generally *RESTATEMENT (SECOND) OF CONTRACTS*, *supra* note 189, at § 353.

victim will not receive full compensation.¹⁹⁶ One of the most significant differences between the two actions is the rule that punitive damages generally are not recoverable in contract actions,¹⁹⁷ but are in tort.¹⁹⁸ This difference alone has prompted the view that tort actions are "more advantageous" than contract actions in most cases.¹⁹⁹

Commentators have attributed the restriction of punitive damages to tort actions to society's perception that the tortfeasor is more morally culpable than the contract-breaker.²⁰⁰ This view stems from tort law's evolution from moral obligations. Contract law, on the other hand, denies any relationship between ethics and the law.²⁰¹ Oliver Wendell Holmes wrote: "Every man has the right to 'break' his contract if he so chooses—to pay damages instead of performing his contractual obligation. The wicked contract breaker should pay no more than the innocent and pure at heart."²⁰²

Exceptions to the general rule prohibiting recovery of punitive damages in contract actions are recognized in Florida²⁰³ and other jurisdictions.²⁰⁴ These exceptions indicate that Holmes' proposition is no longer authoritative. Courts have consistently deemed actions

196. Sebert, *supra* note 187, at 1568.

197. RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 189, at § 355. McCormick explains the purpose of punitive damages, to which he also refers as "smart money," as "visiting a punishment upon the defendant and not as a measure of any loss or detriment of the plaintiff." MCCORMICK, *supra* note 189, at § 77. As part of an extensive explanation of the concept, Black's Law Dictionary defines punitive damages as "[d]amages other than compensatory damages which may be awarded against [a] person to punish him for outrageous conduct." BLACK'S LAW DICTIONARY, *supra* note 9, at 390.

198. W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 2, at 9-15 (5th ed. 1984).

199. Prosser, *supra* note 157, at 424.

200. Leslie E. John, *Formulating Standards for Awards of Punitive Damages in the Borderland of Contract and Tort*, 74 CAL. L. REV. 2033 (1986).

201. Albano, *supra* note 152, at 565.

202. OLIVER W. HOLMES, THE COMMON LAW 236 (Howe ed., 1963).

203. See, e.g., Singleton v. Foreman, 435 F.2d 962 (5th Cir. 1970) (applying Florida law) (allowing punitive damages where acts contributing to breach of fiduciary duty also constitute an independent tort); Campbell v. Government Employees Ins. Co., 306 So. 2d 525 (Fla. 1974) (allowing punitive damages for bad faith breach of insurance contract); Goldstein v. Young, 23 So. 2d 730 (Fla. 1945) (damages for breach of promise to marry are not limited by rules governing damages in a single contract action); Comfort Makers, Inc. v. Estate of Kenton, 515 So. 2d 1384 (Fla. 5th DCA 1987) (punitive damages are recoverable in case involving breach of fiduciary duties). See generally Phyllis G. Coleman, *Punitive Damages for Breach of Contract: A New Approach*, 11 STETSON L. REV. 250 (1982) (exploring the ways in which Florida courts have used, and confused, these exceptions).

204. See, e.g., Brown v. Coates, 253 F.2d 36 (D.C. Cir. 1958) (allowing punitive damages where breach of contract merges with a willful tort); Gruenberg v. Aetna Ins. Co., 510 P.2d 1032 (Cal. 1973) (allowing recovery of punitive damages for bad faith breach of insurance contract); Stanard v. Bolin, 565 P.2d 94 (Wash. 1977) (holding damages for mental anguish, lost reputation and injury to health recoverable in action for breach of promise to marry). A comprehensive discussion of the nationwide developing exceptions may be found in Timothy J.

alleging breach of fiduciary duty an exception,²⁰⁵ indicating a belief that the breaching fiduciary is more culpable than the general contract-breaker and that breach of a fiduciary duty constitutes more than a simple breach of contract.²⁰⁶ In contrast to the freedom to act solely for one's self interest in the world of contract, the fiduciary must answer to a high standard of morality.²⁰⁷

The above practices reveal a distinct policy of fully protecting injured parties in legal malpractice actions. Courts have implicitly recognized the "borderland" and ignored traditional contract-tort distinctions in favor of choosing the aspects of each theory that best serve this policy. For example, many jurisdictions, including Florida, have adopted the longer contract statute of limitations to give clients more time to bring their action for legal malpractice.²⁰⁸ States, including Florida, often combine this contract statute of limitations with a tort rule defining when the cause of action accrues.²⁰⁹ Many jurisdictions, including Florida, allow the cause of action to survive the death of a party—a benefit previously available only in contract actions.²¹⁰ Additionally, Florida and other jurisdictions have allowed punitive damages in legal malpractice actions alleging breach of fiduciary duty—a clear break from traditional contract law.²¹¹

Application of the economic loss doctrine to legal malpractice actions would contravene the policy underlying these developments—the protection of the entrusting party. In the areas of statute of limitations,²¹² date of accrual,²¹³ survivability of the action,²¹⁴ and damages,²¹⁵ the Florida courts have adopted procedures beneficial to plaintiffs. Expansion of *Interstate* to legal malpractice claims would

Sullivan, *Punitive Damages in the Law of Contract: The Reality and the Illusion of Legal Change*, 61 MINN. L. REV. 207 (1977).

205. See, e.g., *Miley v. Oppenheimer & Co., Inc.*, 637 F.2d 318 (5th Cir. 1981); *Singleton v. Foreman*, 435 F.2d 962 (5th Cir. 1970); *Kubin v. Miller*, 801 F. Supp. 1101 (S.D.N.Y. 1992); *Duggan v. Rooney*, 749 F. Supp. 234 (D. Kan. 1990); *Wagman v. Lee*, 457 A.2d 401 (D.C. 1983), cert. denied; 464 U.S. 849 (1983); *Silverman v. Pitterman*, 574 So. 2d 275 (Fla. 3d DCA 1991); *Comfort Makers, Inc. v. Estate of Kenton*, 515 So. 2d 1384 (Fla. 5th DCA 1987).

206. Albano, *supra* note 152, at 565.

207. Cardozo, in one of his most often quoted statements, asserted that a fiduciary duty is a "duty of the finest loyalty," and that "[n]ot honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

208. See *supra* notes 166-169 and accompanying text.

209. See *supra* notes 170-181 and accompanying text.

210. See *supra* notes 182-186 and accompanying text.

211. See *supra* notes 187-207 and accompanying text.

212. See *supra* notes 166-169 and accompanying text.

213. See *supra* notes 170-181 and accompanying text.

214. See *supra* notes 182-186 and accompanying text.

215. See *supra* notes 187-207 and accompanying text.

disregard this policy decision by eliminating tort claims for purely economic damages, and would thus effectively restrict the bulk of legal malpractice recoveries to contract damages.

Probably the source of greatest harm to plaintiffs from the abrogation of this policy would lie in the issue of damages. Contractual rules more strictly limit recovery than tort rules.²¹⁶ Under *Interstate*, a plaintiff's inability to liquidate damages may bar recovery. In contrast, the fact-finder in tort cases frequently assigns values to uncertain damage elements, such as pain and suffering, seemingly out of thin air. Actions for breach of fiduciary duty are likely to generate similarly vague and indeterminate damage elements. Elimination of the tort jury instructions deals a harsh blow to plaintiffs and lacks justification in the face of the policy of fully protecting plaintiffs. Additionally, although courts in Florida have recently found that breach of a fiduciary duty can provide a basis for allowing punitive damages in contract actions,²¹⁷ courts may interpret the *Interstate* court's abrogation of tort claims as an indication that traditional contract rules should be followed and that this exception should no longer be allowed.

The Supreme Court of Illinois recently acknowledged the inappropriateness of applying the economic loss doctrine to legal malpractice actions,²¹⁸ thereby creating an exception to the doctrine, which in Illinois, like in Florida and the Eleventh Circuit, is based on the principles articulated in *Seely*. The court recognized that it had previously been attempting to distinguish between recovery in tort and contract "by looking to the nature of the damage suffered rather than to the relationship between the parties or to the act which caused the damage" and that this "analysis began at the end of the transaction and reasoned in reverse."²¹⁹ The concurring opinion pointed out that in each expansion of the doctrine, the "court ha[d] noted the commercial or contractual nature of the parties' relationship and the appropriateness of limiting the plaintiff to a contract-based remedy."²²⁰ The concurring opinion concluded that "there is simply no reason—in logic or in custom—to extend that doctrine to the field of lawyer malpractice. The attorney-client relationship is not the sort of commercial context in which limits on the recovery of economic losses are

216. See *supra* notes 187-99 and accompanying text.

217. See, e.g., *Silverman v. Pitterman*, 574 So. 2d 275 (Fla. 3d DCA 1991); *Comfort Makers, Inc. v. Estate of Kenton*, 515 So. 2d 1384 (Fla. 5th DCA 1987).

218. *Collins v. Reynard*, 607 N.E. 2d 1185 (Ill. 1992).

219. *Id.* at 1186.

220. *Id.* at 1188 (Miller, C.J., concurring).

either necessary or properly applied."²²¹

V. CONCLUSION

Although the economic loss doctrine is appropriate in actions involving product liability and some service contracts, the doctrine's rationale breaks down when expanded to cover relationships involving fiduciary duties. *Westinghouse* interpreted *East River* as emphasizing that "[a] duty of care . . . is particularly unsuited to the vagaries of individual purchasers' product expectations."²²² However, courts have consistently imposed an extracontractual duty of care on fiduciaries, such as brokers and attorneys. The *Interstate* court denied tort recovery to avoid "blur[ring] the distinction between contract and tort,"²²³ but actions against fiduciaries have traditionally fallen in that indistinct "borderland" between tort and contract.

Notwithstanding the fact that *Interstate* involved a dispute for purely economic damages, the inherent differences between fiduciary and arm's-length transaction relationships, and the existing policy of protecting those entrusting fiduciaries render the application of the economic loss doctrine to actions between parties in a fiduciary relationship wholly unjustified. This judgment leads to the conclusion that *Interstate* was wrongly decided. In situations similar to *Interstate*, the courts should recognize that the fiduciary has a special relationship with the client. This relationship places independent extracontractual duties on the fiduciary requiring the fiduciary to act with loyalty and care and subordinate his interests to those of the entrustor irrespective of the language of any contract between them. The courts must protect the vulnerable client who has placed trust in the fiduciary. The policing mechanism of tort liability best provides this protection.

JAMES G. DODRILL II

221. *Id.* at 1189 (Miller, C.J., concurring).

222. 510 So. 2d 901.

223. *See Interstate Sec. Corp. v. Hayes Corp.*, 920 F.2d 769, 775-76 (11th Cir. 1991).