Professional Liability Defense QUARTERLY

Everybody Wants to Rule the World: Adverse Domination and Legal Malpractice Claims

Alice Sherren, *Minnesota Lawyers Mutual Insurance Company*
Donald Patrick Eckler, *Pretzel & Stouffer, Chartered*

The statute of limitations is among the most important tools for defending professional liability claims, and legal malpractice claims in particular. Most, if not all, states have adopted some form of discovery rule as an exception to the statute of limitations, and many other doctrines such as fraudulent concealment and equitable tolling have developed to extend or toll the statute of limitations. As legal malpractice claims are often at the intersection of professional liability and commercial disputes, adverse domination is a tolling theory that is often sought to be applied by plaintiff in such circumstances. The doctrine's contours and application vary greatly across the country and this article will provide a brief introduction to the doctrine and provide an analysis of a recent Illinois case that applied it, but which still resulted in dismissal of the plaintiffs' complaint against two lawyers and their law firm.

Basic Aspects of Adverse Domination

Applying in circumstances in which a corporation or business is controlled by individuals who are alleged to be committing illegal, and perhaps criminal acts, "[t]he premise behind the doctrine of adverse domination is that the culpable wrongdoers cannot be expected to bring suit against themselves on behalf of the institution." *FDIC v. Gantenbein*, 1992 U.S. Dist. LEXIS 15437, *10, 90-2303-V (D. Kan., September 30, 1992). The doctrine will apply to toll the statute of limitations as long as the institution is dominated by the same individuals against whom the claims exist. *FDIC* 1992 ¸U.S. Dist. LEXIS 15437 at *9; see also, *In re Verit Indus. v. Suitter Axland & Hanson* 1999¸U.S. App. LEXIS 3540, *7-8 (9th Cir. 1998).

Although often used against the officer and directors of failed financial institutions (there are a large number of cases arising out of the 1980's savings and loan crisis), it may also be applicable against lawyers, accountants, and others acting in their professional capacity who are alleged to have aided and abetted the wrongdoing officers and directors. *FDIC* ¸ 1992U.S. Dist. LEXIS 15437 at *10. The doctrine is inherently fact specific and often focuses on whether the lawyer exerted sufficient control of the entity to prevent a cause of action being brought against the lawyer or whether the wrongdoers failed to bring an action against the lawyer because doing so would expose their own wrongdoing. *Id*. at *11-12; see also *Smith v. Stacy*, 482 S.E.2d 115, 122 (1996) (Supreme Court of Appeals of West Virginia recognizing the doctrine in that state). Once adverse domination is established, the burden shifts to the defendants to show that "there was someone with the knowledge, ability, and motivation to bring the suit during the period in which the defendants controlled the entity." *Verit Indus.*, 1999 U.S. App. LEXIS 3540, *7-8 citing *Hecht v. Resolution Trust Corp.*, 635 A.2d 394, 408 (1994). The doctrine also requires notice before accrual as does the discovery rule. *Id*.

The doctrine of adverse domination has been adopted as part of the common law of the Tenth Circuit, but it has been rejected in other jurisdictions, such as Ohio. *FDIC* 1992 ¸U.S. Dist. LEXIS 15437 at *10. In *Antioch Co. Litig. Trust v. Moran*, 644 Fed Appx. 579, 582 (6th Cir. 2016) citing to *Chinese Merchants Ass'n v. Chin*, 823 N.E.2d 900 (Ohio Ct. App. 2004) and *Squire v. Guardian Trust Co.*, 72 N.E.2d 137 (Ohio Ct. App. 1947), the court stated "[t]he Ohio Court of

Appeals has twice rejected adverse domination as directly lacking support in Ohio's statutes and judicial decision." Though adverse domination "shares the same theoretical underpinnings as the discovery rule" several circuit courts have held that the doctrine "may be inconsistent with a particular state's tolling doctrines and policies regarding strict construction of its statutes of limitations." *Moran*, 644 Fed. Appx. at 892 (citations omitted).

Several courts have related the doctrine to the continuous course of negligent conduct to the doctrine of adverse domination. See *Smith v. Stacy*, 482 S.E.2d at 120-122; *Colgate v. Disthene Group, Inc.*, 86 Va. Cir. 218, 228-229 (2013) (in a case involving a claim against a corporation finding that Virginia courts have only held the continuous course of negligent conduct against professionals, such as lawyers). However, Illinois courts, which have adopted the adverse domination doctrine, have rejected the continuous course of negligent conduct theory with regard to claims against accountants and lawyers. See, *Maniscalco v. Porte Brown, LLC*, 2018 IL App (1st) 180716, ¶ 22; *Witt v. Jones & Jones Law Offices, P.C.* 269 ¸Ill. App. 3d 540, 544 (4th Dist. 1994).

Schrock v. Ungaretti & Harris, Ltd.

In *Schrock v. Ungaretti & Harris, Ltd.*, the plaintiffs, a member of a company and the business itself, sued a law firm and two of its lawyers for aiding and abetting the business, Baby Supermall, LLC ("BSM") and the individual that controlled BSM, Robert Meier ("Meier") in avoiding the effect of an injunction that the individual plaintiff obtained against Meier. 2019 IL App (1st) 181698, ¶ 1. Meier was the sole manager of BSM (a manager managed LLC) and the individual plaintiff, Edward Schrock ("Schrock"), was a member along with Meier and a Baby Supermall, Inc. *Id.* at ¶ 6. Under the operating agreement Meier had the sole power to make all decisions for the business. *Id.* ¶ 7. Meier controlled 87.5% of the stock of BSM, with Schrock controlling the remainder, which Meier attempted to purchase. *Id.* ¶ 8. When Schrock refused to sell his shares to Meier, Schrock alleged that Meier reduced Schrock's salary, increased his own salary, and refused to allow Schrock to be involved in any decision making regarding the business. *Id.* ¶ 9. According to Schrock, Meier then took other steps, under the guise of "profit sharing agreements" to increase his compensation and that of his family at the expense of the business. *Id.* ¶¶ 10-11.

As a consequence of these actions, in 2009 Schrock filed a breach of fiduciary duty claim against Meier wherein Meier was represented by the defendant lawyers. *Id.* ¶ 13. In May 2010, the court entered an injunction against Meier that barred him from making any payments to himself and his family and limited the salaries he and his family could be paid. *Id.* ¶ 15. In early 2011, Schrock filed a second motion for injunction when Meier drew on a BSM line of credit and again the defendant lawyers represent Meier in opposing the "baseless allegations" of Schrock's motion. *Id.* ¶ 16. Through 2012 and 2013 and a series of other motions and various requests for injunction, the attorneys continued to represent Meier against Schrock and claim that Meier had not violated the injunctions. *Id.* ¶ 17-20. Finally, on March 5, 2014, Schrock prevailed at trial against Meier and was awarded $10 million in punitive damages for Meier's breach of fiduciary duties. *Id.* ¶ 27.

On March 12, 2014, Schrock again filed a motion claiming that Meier had violated the injunction and quoted one of the defendant attorneys as stating that the injunction had been complied with. *Id.* ¶ 29. Shortly thereafter, and before judgment could be entered on the jury's award, Meier declared bankruptcy. An investigation in the bankruptcy allegedly revealed that Meier had violated the injunction, the automatic stay was lifted in July 2014, and, with the stay lifted, the circuit court entered an $11 million judgment against Meier. *Id.* ¶ 32. In July 2014, the defendant law firm filed a claim in the Meier bankruptcy seeking its fees. *Id.* ¶ 34. Schrock objected to the claim stating the law firm "was liable to Schrock for concocting Meier's … strategies to divest Schrock of his membership interest in [BSM]." *Id.* Schrock went

on to state in that same filing that the defendant law firm's claim "should be disallowed because of its misconduct in defending Meier." *Id*.

On October 21, 2014, BSM filed a complaint against Meier in the bankruptcy court and on November 7, 2014 Meier answered the complaint and admitted the allegations made by Schrock and that he had taken over $16.3 million from BSM. *Id*. ¶¶ 35-38.

Schrock filed his lawsuit against the defendant lawyers and their law firm on November 18, 2016, just over two years after Meier answered the complaint filed by BSM. *Id*. ¶ 40. The defendants filed a motion to dismiss arguing, among other allegations, that the complaint was barred by Illinois' two-year statute of limitations for legal malpractice claims. *Id*. ¶ 41. The trial court granted the motion to dismiss finding that based upon the allegations of the complaint filed in the bankruptcy court Schrock "had actual knowledge of [Meier's] violations of the injunction" no later than November 7, 2014. *Id*. ¶ 42.

The court easily disposed of Schrock's individual claims against the defendant lawyers based upon the statute of limitations because he plainly was aware of their allegedly improper conduct no later than November 7, 2014, more than two years before the filing of the case against the defendant lawyers. *Id*. ¶¶ 54-69.

However, with regard to the business, BSM, the analysis was a bit more complicated. BSM alleged that the statute of limitations with respect to it was tolled by the doctrine of adverse domination. *Id*. ¶ 72. The court explained that adverse domination is "an equitable doctrine that tolls the statute of limitations for claims by a corporation against its officers and directors during the time the corporation is controlled by those wrongdoing officers or directors." *Id*. ¶ 73 (citations omitted). Citing to *Resolution Trust Corp. v. Chapman* 895 ¸F. Supp. 1072, 1077-78 (C.D. Ill. 1995), the court stated that the doctrine creates "a 'rebuttable presumption 'that the corporation does not 'know 'of the injury as long as it is controlled by the wrongdoing officers and directors. "*Id*. The doctrine applies not only to claims against the wrongdoing officers and directors, but also those that aided and abetted the wrongdoers. *Id*. ¶ 75 citing *Independent Trust Corp. v. Stewart Information Services Corp.*, 665 F.3d 930, 936-37 (7th Cir. 2012). The rebuttable presumption may be rebutted by "evidence that someone other than the wrongdoing directors had the 'knowledge of the cause of action and the ability and motivation to bring the suit.'" *Id*. ¶ 77 citing *In re Emerald Casino, Inc.*, 867 F.3d 743, 760-61 (7th Cir. 2017).

Applying these principles to this case, the court held that the presumption had been successfully rebutted. *Id*. ¶ 78. Specifically, the court found that Schrock was someone with the knowledge of the cause of action against the defendant lawyers and motivation to bring the suit. *Id*. Indeed, he had already filed two suits seeking to recover the damages sought in the legal malpractice action. *Id*.

Turning to whether Schrock had the ability to bring the suit against the defendant lawyers, the court found that he did. *Id*. ¶ 79. Under Illinois' Limited Liability Company Act, as a shareholder, Schrock could have brought the action against the defendant lawyers as a derivative action. *Id*. Given the nature of the allegations (that Meier had looted the company with the assistance of the defendant lawyers) and that Meier retained sole control of BSM, the court concluded that there was no possibility that Meier would have authorized the action against the defendant lawyers. *Id*. ¶¶ 80-83. As a result, a request by Schrock to Meier to file the suit against the defendant lawyers was "hopelessly futile" and the court held that Schrock had the authority to bring the action against the defendant lawyers on behalf of BSM. *Id*. ¶ 84. Because all of the elements of the rebuttal presumption were met by the defendants, the adverse domination doctrine did not toll the statute of limitations and the case was properly dismissed by the trial court. *Id*. ¶ 85.

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Conclusion

In certain cases, a plaintiff may try to use the doctrine of adverse domination to avoid the effect of the statute of limitations. Courts across the country vary widely as to whether and how they apply the doctrine in legal malpractice cases. In order to succeed in overcoming the rebuttable presumption of the knowledge of the entity, it is likely that defense counsel will need to explore the agreements under which the entity is organized and the applicable state statutes governing the entity. It is a fact intensive analysis that, while it worked in the *Schrock* case on a motion to dismiss, may, in other cases, require discovery and a motion for summary judgment or a jury trial to prevail.

About the Authors

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

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

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