

Lawyer's Liability for Aiding and Abetting Fraud by Clients: A Lawyer Is Not A Bus

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Back in 1989, a bar review lecturer on professional responsibility taught that "a lawyer is not a bus." This colloquialism meant to capture the principle that, unlike a bus, which is obligated to take every paying customer, a lawyer can choose whether or not to represent a potential client. One pitfall of choosing wrong is the risk that a lawyer could be sued for aiding and abetting fraud perpetrated by that client.

To state a claim for aiding and abetting fraud, a plaintiff must allege:

1. The existence of the underlying fraud;
2. The defendant's actual knowledge of the fraud by the primary wrongdoer; and
3. The defendant's substantial assistance in carrying out the fraud. (*Oster v Kirschner*, 77 AD3d 51, 55, 905 N.Y.S.2d 69 (1st Dep't 2010); *Stanfield Offshore Leveraged Assets, Ltd. v Metro. Life Ins. Co.*, 64 AD3d 472, 476, 883 N.Y.S.2d 486 (1st Dep't 2009)).

In what should come as a relief to many lawyers who have assisted accused fraudsters in their transactions, the standard for attorney aiding and abetting fraud is a high one to meet. While an attorney or law firm gains access to information in the course of representing a client, the fact of the existence of legal representation, even as to transactions allegedly the subject of subsequent fraud, does not itself support the inference of the high degree of scienter necessary to extend fraud liability on an aiding and abetting theory. (*Chambers v Weinstein*, 44 Misc. 3d 1224(A), 1224A (N.Y. Sup. Ct. 2014))

"Actual Knowledge"

In a fraud context, actual knowledge need only be pleaded generally, cognizant that a plaintiff lacks access to the very discovery materials which would illuminate a defendant's state of mind at the pre-discovery stage. Participants in a fraud do not affirmatively declare that they are engaged in the perpetration of fraud, just as misrepresenters do not keep elaborate diaries of their fraud for the use of the defrauded in court. (*Oster v Kirschner*, 77 A.D.3d 51, 52 (N.Y. App. Div. 1st Dep't 2010)) While the knowledge element of an aiding and abetting fraud claim requires actual knowledge of the underlying fraud, such knowledge does not have to be based on the defendant's explicit acknowledgement of such fraud. (*Syncora Guar. Inc. v Alinda Capital Partners LLC*, 2013 N.Y. Misc. LEXIS 2943, *41-42 (N.Y. Sup. Ct. July 1, 2013)) This is particularly apt, given that guilty knowledge is a fact that is often particularly within the defendant's possession and is not susceptible to direct proof, but must instead be inferred from the circumstantial evidence. (*Id*)

In *Oster v. Kirschner* (77 AD3d 51, 55, 905 N.Y.S.2d 69 (1st Dep't 2010)), the Appellate Division- First Department broadly construed the "actual knowledge" element of an aiding-and-abetting cause of action against lawyers, holding that plaintiffs may be able to sufficiently allege actual knowledge by inferring it from the surrounding circumstances, such as the nature of the objectionable client conduct known to the lawyer at the time legal services are rendered, and the nature of legal services rendered. (*Id*)

New York courts have held that knowledge of bad actor's criminal backgrounds, and knowledge of misrepresentations in securities documents do not sufficiently allege actual knowledge. (*Supra* note 3.) Likewise, specific communications between parties are precisely the type of evidence expected to be within the defendant's possession. Such communications accompanied by sufficiently pled facts allow the court to infer that the party knew of, or at least consciously disregarded fraudulent representations and omissions made to the innocent party. Such knowledge, or conscious disregard thereof, satisfies the element of actual knowledge. (*Supra* note 4)

"Substantial Assistance"

The third element of attorney aiding and abetting fraud, "substantial assistance" in furtherance of the fraud, exists where (1) a defendant affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed, and (2) the actions of the aider/abettor proximately cause the harm on which the primary liability is predicated. (*Stanfield Offshore Leveraged Assets, Ltd. v. Metro. Life Ins. Co.*, 64 A.D.3d 472, 476 (N.Y. App. Div. 1st Dep't 2009)) Substantial assistance is more than mere performance of routine business services for the alleged fraudster. (*CRT Invs., Ltd. v BDO Seidman, LLP*, 85 AD3d 470, 472, 925 N.Y.S.2d 439 (1st Dep't 2011)) Even though the intent to commit fraud may be divined from the surrounding circumstances, this is not sufficient to constitute substantial assistance in the fraud. Under New York law, substantial assistance occurs when a defendant affirmatively assists, helps conceal, or fails to act when required to do so, thereby enabling the fraud to occur. The aider/abettor's actions must also proximately cause the harm on which the primary liability is predicated. Where the primary fraud claim is predicated on misrepresentations in documents, substantial assistance usually involves assistance in the preparation or dissemination of the documents. Where the fraud alleged involves a highly interdependent scheme in which both parties benefited, allegations that a defendant actively assisted and facilitated the fraudulent scheme itself, as opposed to assisting in the preparation of the documents themselves, are sufficient. A defendant's mere presence, even when accompanied by the passive receipt of emails, cannot constitute affirmative assistance. (*Nathel v. Siegal*, 592 F. Supp. 2d 452, 458 (S.D.N.Y. 2008))

The Required Nexus

New York case law stipulates that a nexus must exist between the aider and abettor and the primary fraud. This "nexus" can be made out by allegations as to the proposed aider's knowledge of the fraud, and what he can therefore be said to have done with the intention of advancing the fraud's commission. The nexus is not made out simply by allegations that would be sufficient to state a claim against the principal participants in the fraud. (*National Westminster Bank USA v. Wechsel*, 124 A.D.2d 144, 149 (N.Y. App. Div. 1st Dep't 1987))

In *National Westminster*, the court found that the circumstances of the primary fraud were alleged in sufficient detail, but were not sufficiently detailed to support the further inference of aider and abettor liability on the part of the defendant law firm. (*Id*) The only circumstances of the wrong allegedly committed by the firm was that it represented the bad actor. The court then stated that in the course of such representation, the firm learned of the defendant's fraudulent design and thereafter stood by silently as the bank loaned money in reliance upon what the law firm knew were misrepresentations. Doubtless, in the course of representing a client, a lawyer gains access to information about his client's affairs, but the fact of legal representation does not itself support the inference of the high degree of scienter necessary to extend fraud liability on aiding and abetting theory. Where the actual assistance allegedly given the fraud is not clearly substantial, the allegations of scienter must be all the more detailed if the requisite connection of the purported aider and abettor with the fraud is to be made out. Here, of course, where the only assistance fairly alleged by plaintiff is that of the law firm's nondisclosure, the cause of action was fatally flawed and not even a more detailed pleading of scienter would suffice to rescue it. (*Id*)

Failure to Plead Fraud with Particularity

Aiding and abetting fraud must be pleaded with the specificity sufficient to satisfy CPLR 3016(b). This requirement is met when the material facts alleged in the complaint are sufficient to permit a reasonable inference of the alleged conduct in light of the surrounding circumstances. This includes the adverse party's knowledge of, or participation in the fraudulent scheme. (*Kirschner v. Bennett*, 648 F. Supp. 2d 525, 540 (SDNY 2009)) A defendant may consider whether the complaint adequately alleges the existence of the underlying activity that was aided and abetted. The adequacy of the inquiry will be specific to the claims in issue, but should not be overlooked. (*Kirschner v. Bennett*, 648 F. Supp. 2d 525, 540 (SDNY 2009) (dismissing claims of aiding and abetting against lawyers and accountants because the claim of fraud against the company were defective even though several principals had pled guilty to various financial crimes.)

Failure to Adequately Allege Knowledge or Substantial Assistance

While the requisite level of knowledge necessary for aiding and abetting varies by state, New York and many other states require actual knowledge. The defendant attorney may try to rebut the presumption that he or she "knew" about the fraud. To combat this defense, plaintiffs may attach communications or e-mails indicating that the terms of the transaction had been communicated amongst the defendant and others involved to show actual knowledge. (See *Chambers v Weinstein*, 44 Misc. 3d 1224(A), 1224A (N.Y. Sup. Ct. 2014)) Likewise, a plaintiff may fail to state a cause of action for aiding and abetting fraud if the alleged conduct does not constitute substantial assistance in the commission of the underlying fraud. In *Learning Annex, LP. V. Blank Rome, LLP* (*Learning Annex, L.P. v. Blank Rome LLP*, 106 A.D.3d 663 (N.Y. App. Div. 1st Dep't 2013)), the plaintiff failed to state a cause of action against the defendant law firm because the alleged conduct, the defendant's failure to disclose a voting agreement entered into between non-parties at a time when defendants did not represent plaintiff, did not constitute substantial assistance.

Given the zeal with which plaintiffs' attorneys will sue just about anyone who touched a fraudulent transaction, lawyers who represent potential fraudsters should be careful about their level of involvement in a transaction so as to avoid being dragged into a lawsuit as an alleged aider/abettor.

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