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1 No. 51
AmBase Corporation,
 Appellant,
 v.
Davis Polk & Wardwell, et al.,
 Respondents.

William Greenberg, for appellant.
Roy L. Reardon, for respondents.

CIPARICK, J.:

In this appeal we are asked to determine whether a law firm that successfully litigated an Internal Revenue Service tax dispute nonetheless committed legal malpractice when it failed to question whether an agreement entered into between the client and a related company, may have relieved it of the tax liability in

dispute. We are also asked to determine whether defendants were properly awarded a money judgment where defendants had not answered or asserted a counterclaim. We conclude that defendants did not commit legal malpractice, and a money judgment was properly awarded to defendants.

I.

In 1985, plaintiff AmBase Corporation became an independent entity when its parent City Investing Company elected to liquidate.¹ In order to ensure payment of its post-liquidation liabilities, City Investing transferred substantial assets to City Investing Company Liquidating Trust (City Trust). At the same time, AmBase and its parent company entered into an Assignment and Assumption Agreement (the Agreement) that purportedly required AmBase to assume primary liability for City Investing's federal income taxes, and assume secondary liability as a "backstop" to City Trust for all other liabilities for which it was unable to pay.

Shortly thereafter, the IRS determined that City Investing was liable for having failed to withhold 30 percent of interest payments to a related entity, City Investing Finance N.V. (N.V.), for a period of six years from 1979 through September 1985. In 1991, Lester Mantell, a senior vice president of AmBase and trustee of City Trust, advised AmBase and the IRS

¹At the time of the liquidation, AmBase was known as The Home Group, Inc.

in a Tax Protest that AmBase was liable as N.V.'s agent for the withholding taxes in issue if such liability was ultimately determined to exist. Attempts to settle the tax matter failed and a year later, AmBase retained defendant Davis Polk & Wardwell to resolve this dispute with the IRS.²

In May 1995, the IRS issued a notice of deficiency for the tax years 1979 through 1985 for the withholding taxes in the sum of \$20,986,609, and in June, Davis Polk filed a petition in United States Tax Court challenging the alleged deficiencies. The matter was litigated and in May 2001, the Tax Court rendered a decision in AmBase's favor, rejecting the IRS's claim for the subject withholding taxes (see AmBase Corp. v Commissioner of Internal Revenue, TC Memo 2001-122). Following this victory on behalf of its client, Davis Polk requested payment of \$1,424,104 in outstanding legal fees pursuant to the terms of its retainer agreement.³ AmBase refused to pay and requested that Davis Polk return previously paid legal fees.

AmBase then commenced this action for legal malpractice alleging that, although it won the tax case, it suffered substantial damages as a result of defendants' failure to advise

²Plaintiff also individually named as defendants the Davis Polk attorneys assigned to the IRS matter, but we collectively refer to all defendants as Davis Polk.

³The retainer agreement provided that if Davis Polk were successful in resolving the tax matter with the IRS, AmBase would pay Davis Polk a "success fee" calculated at 150% of Davis Polk's billed time, subject to a 2 million dollar cap.

that it was only secondarily liable for payment of taxes as per the Agreement with its parent. Plaintiff further requested a declaration that it did not owe Davis Polk \$1,424,104 in outstanding legal fees. Davis Polk moved to dismiss plaintiff's amended complaint and for a declaration that AmBase was obliged to pay all fees owed as per its retainer agreement plus interest and for "such other and further relief as this Court may deem just and proper." AmBase cross-moved for partial summary judgment on the issue of liability for legal malpractice.

Supreme Court rejected AmBase's assertions, granted Davis Polk's motion to dismiss the complaint and awarded the firm a money judgment of \$1,424,104 representing outstanding legal fees plus statutory interest.⁴ The court found that Davis Polk was hired to resolve tax issues for liability that AmBase had assumed, and that even if Davis Polk had committed malpractice, AmBase's damages were "entirely speculative." Supreme Court then directed the parties to settle an order, and defendants submitted a proposed order directing the entry of a money judgment. AmBase did not submit a proposed counter-order, nor did it advise the court that the proposed money judgment was improper in the absence of a pleading seeking such a judgment, and it never requested an opportunity to litigate the matter.

The Appellate Division unanimously affirmed, holding

⁴ Supreme Court was mistaken when in its decision from the bench it referred to "the counterclaim," as no counterclaim was ever filed. Neither party sought to correct the court.

that since "[d]efendants successfully represented plaintiff in a tax dispute with the [IRS]," the claim that the dispute could have been "resolved in a more expeditious fashion, was properly dismissed as speculative" (30 AD3d 171, 172). The court further held that "[d]efendants were entitled to a money judgment . . . in light of [plaintiff's] failure, throughout these proceedings, to contest the amount, which was based on calculations consistent with the retainer agreement" (id.). We granted leave to appeal, and now affirm.

II.

We need not answer the question whether a legal malpractice claim is precluded by virtue of a complete victory in an underlying action. What is before us is whether a cause of action for legal malpractice lies under the circumstances of this particular case. We hold it does not. In order to sustain a claim for legal malpractice, a plaintiff must establish both that the defendant attorney failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession which results in actual damages to a plaintiff (see McCoy v Feinman, 99 NY2d 295, 301-302 [2002]), and that the plaintiff would have succeeded on the merits of the underlying action "but for" the attorney's negligence (see Davis v Klein, 88 NY2d 1008, 1009-1010 [1996]).

The gravamen of this legal malpractice claim is that defendants failed to advise plaintiff that the Agreement

allegedly provided that AmBase was not primarily liable for the subject taxes in the underlying Tax Court proceeding -- that primary liability rested with City Trust. Plaintiff claims that defendants were provided with a copy of the Agreement but never fully reviewed the document to determine what effect, if any, it had on the underlying dispute with the IRS, thereby failing to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession. AmBase further asserts that "but for" Davis Polk's negligence, it would not have had to maintain the multi-million dollar loss reserve on its books, creating the appearance that it had a negative net worth, which caused it to lose business opportunities and incur monetary damages.

Defendants dispute AmBase's claim that its liability for the taxes was only secondary. In addition, they assert that they were retained to litigate only whether taxes were due, not to determine who was responsible for such taxes. Defendants further argue that they had not advised AmBase to carry the loss reserve and that AmBase publicly acknowledged that it was responsible for the withholding taxes at issue since 1985, seven years before Davis Polk was retained.

The retainer agreement states that AmBase has "engaged [Davis Polk] to represent [it] as agent for City Investing to resolve the tax issues currently before" the IRS. The plain language of the retainer agreement indicates that Davis Polk was

retained to litigate the amount of tax liability and not to determine whether the tax liability could be allocated to another entity. Thus, the issue whether plaintiff was primarily or secondarily liable for the subject tax liability was outside the scope of its representation. As such, defendants exercised the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession when they focused their efforts on the controversy between AmBase and the IRS -- the subject of the retainer agreement -- resulting in a most favorable outcome, which was publicly praised by AmBase principals (see Darby & Darby, P.C. v VSI Intl., 95 NY2d 308, 313 [2000]).

Furthermore, AmBase understood that it was primarily liable for the subject withholding taxes. For approximately seven years prior to Davis Polk's retention in this matter, both AmBase and the IRS took the position -- privately and in public filings -- that AmBase was responsible for all of the subject tax obligations. AmBase now takes the position that it relied on an erroneous interpretation of the Agreement that equated "federal income taxes" and the subject "withholding taxes" as one and the same. Nevertheless, language in the Agreement suggests that the intent of the parties was for AmBase to assume all of City Investing's tax liability. A contrary interpretation of the Agreement may be possible, but no such interpretation has been given to the language of the Agreement by any court or arbitrator to date and none need be given here. We have observed that "[a]

legal malpractice action is unlikely to succeed when the attorney erred because an issue of law was unsettled or debatable" (Darby, 95 NY2d at 315 [citations omitted]). A speculative assertion as to which entity was primarily liable for the subject taxes -- AmBase or City Trust -- cannot support a legal malpractice claim.

Additionally, the record provides no support for plaintiff's assertion that "but for" Davis Polk's failure to advise it that it may not have been primarily liable for the subject taxes, the loss reserve would have been removed earlier and it would not have suffered loss of business opportunities. Indeed, the loss reserve had been in place for years before Davis Polk was even retained. After Davis Polk reviewed the case, it promptly informed AmBase's accountants of its belief that AmBase had a very strong case and that it was probable that it had no liability for the subject taxes. Davis Polk reiterated this opinion to AmBase's board of directors as well. Despite this advice, AmBase and its accountants continued to maintain the loss reserve. Thus, AmBase has also failed to produce any evidence that Davis Polk's lack of advice was the "but for" cause of the loss reserve remaining on AmBase's financial statements.

In this matter, there is no way to know whether the advice not given -- that AmBase may have been only secondarily as opposed to primarily liable for the subject taxes -- "would have altered the [duration] of the [underlying] action" (N.A. Kerson Co. v Shayne, Dachs, Weiss, Kolbrenner, Levy and Levine, 45 NY2d

730, 732 [1978]; see also Carmel v Lunney, 70 NY2d 169, 173 [1987]). Therefore, any effect of such lack of advice is purely speculative and cannot support a legal malpractice claim.

III.

A second argument also merits review: whether the award of a money judgment to defendants, when no proceeding for the recovery of a money judgment had been commenced, (nor counterclaim interposed) violated plaintiff's procedural due process rights under the Federal and New York State Constitutions, which require notice and an opportunity to be heard (see Armstrong v Manzo 380 US 545, 550 [1965]; Consumers Union of U.S., Inc. v State of New York, 5 NY3d 327, 358 [2005]).

AmBase asserts that it was not presented with an opportunity to contest the amount of the success fee, since Davis Polk's request for relief did not place it on notice that the amount owed was in issue. Defendants respond that AmBase had ample notice of the amount awarded since AmBase itself raised the issue in the first instance, and had numerous opportunities throughout the litigation to contest the amount of the outstanding legal fees.

A party is required to bring all of its claims arising out of a transaction in a single complaint. Here, AmBase, in its amended complaint, specifically identified the amount of the fee as \$1,424,104 and thus was undeniably on notice of its exact amount. AmBase had numerous opportunities throughout the

litigation to challenge the calculation of the fee, but did not. It failed to dispute the amount claimed in its opposition to Davis Polk's motion to dismiss, and did not request a hearing on the issue. AmBase also had an opportunity to question the amount and award of the fee at the time Supreme Court rendered its decision from the bench. It also failed to raise any question whatsoever about the unorthodox procedure of entering a money judgment in the absence of a pleading demanding one. AmBase additionally could have raised the question as to the amount of the award in a subsequent filing -- a proposed order perhaps -- which it did not, nor did it ever request a hearing to determine the reasonableness of the calculation.

Thus, having failed to challenge the amount of the legal fees in its complaint or at any time throughout the proceedings that followed, and also having failed to challenge the procedure leading to entry of judgment against it, including correcting Supreme Court's mistaken impression that a counterclaim had been filed, AmBase is now precluded from doing so. Under these circumstances, the order of Supreme Court awarding defendant a money judgment for the outstanding legal fees was proper (see CPLR 3017 [a], [b]). We have examined plaintiff's remaining contentions and find them to be without merit.

Accordingly, the order of the Appellate Division should be affirmed, with costs.

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Order affirmed, with costs. Opinion by Judge Ciparick. Chief Judge Kaye and Judges Graffeo, Read, Smith, Pigott and Jones concur.

Decided April 26, 2007