

LAWYER LIABILITY TO NON-CLIENTS: REALIZING THE RISK

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Until only a relatively few years ago, the "citadel of privity"¹ that prevented liability of one not in direct relationship with another has protected lawyers from liability to non-clients arising out of legal services provided for a client. In only the last few years has this remaining sanctuary of the citadel begun to weaken and, in some areas, crumble. This paper describes briefly, without pretense of covering the extensive case law and literature extant on this subject, the historical view of privity and the exceptions that have developed to the protections afforded by the principle of privity. It also examines some recent developments in the law applying these exceptions, which may lead us to a clearer, if not altogether welcome, understanding of the risk and reality.

I. THE TRADITIONAL VIEW OF PRIVACY

To sustain and foster the overarching principle that a lawyer owes an undivided loyalty to the client's interests, courts have been unwilling traditionally to expose the lawyer in representing the client to risk of liability to other parties affected by the lawyer's conduct.

The traditional limitation was established by the United State Supreme Court in 1879 in *Savings Bank v. Ward*² where the defendant attorney was hired to examine title to a piece of real estate. The attorney's opinion of title given to the client was in turn presented by the client to a prospective secured lender. Contrary to the lawyer's opinion, title to the property was not good, and the disappointed secured lender sought recovery against the lawyer, on the basis that the lender had been injured in relying on the negligent opinion.

The Supreme Court ruled that in the absence of privity³ no duty was owed by the attorney to the injured non-client. The Court was persuaded by the concerns of Lord Abinger in *Winterbottom v. Wright* that if privity was abandoned, the scope of liability would be indeterminate.⁴

The Supreme Court's opinion gave no special significance to the fact that the defendant was an attorney, that there was a special duty of loyalty to the client, or that expending liability would undermine an attorney-client relationship. In the long journey of the case law from *Savings Bank* to date, it has been these factors, however, that have preserved the protection of privity for attorneys while a progression of actors, from repair persons to accountants, have been held liable to persons with whom they had no contract. Professor Hazard suggests⁵ that the notion of privity has lost its place as a limitation on liability in practically all spheres of tort liability except that of lawyer malpractice. His premise is that even in the law of legal malpractice, the privity requirement has been subject to so many exceptions it is virtually unintelligible and unworkable.

While privity has continued to serve as a protection almost absolutely in some jurisdictions, transactional lawyers have been held liable to third persons by way of one exception or another to the rule of privity. Some of these exceptions were noted in *Savings Bank v. Ward* itself.

II. LIABILITY NOTWITHSTANDING PRIVACY

A. Fraud and Negligent Misrepresentation

In its analysis of the facts and relationships in the case before it, the U.S. Supreme Court in *Savings Bank v. Ward* noted that there was no imputation of fraud, and observed:

Where there is fraud or collusion, the party will be held liable, even though there is no privity of contract; but where there is neither fraud or collusion nor privity of contract, the party will not be held liable, unless the act is one imminently dangerous to the lives of others. . . .⁷

What is fraud? Fraud is a misstatement of fact in contrast to "puffing" or a statement of opinion. The maker of the statement must know that it is false, and make it knowingly. The statement has to be material, and it has to be relied upon justifiably by the victim.

Statutory Concepts of Fraud

Statutory remedies for fraud, for example, have disregarded rules of privity. In *Savings Bank v. Ward*⁸ the Supreme Court noted that in some jurisdictions the liability of persons providing abstracts and certificates of title may be regulated and prescribed by statute. Many of these acts declare that the person providing a false or erroneous certificate, regardless of intent or knowledge, may be liable for loss or damage not only to the person or persons to whom the certificate was given, but to any person claiming title from them.

Securities laws which have sought to protect the buying public which depends on accurate information from issuers and various professionals also have created a different approach to third party liability. Under Rule 10b-5, promulgated under §10(b) of the Securities Exchange Act of 1934⁹ a person may be held liable if they have (1) made a misstatement or omission of material facts; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiffs relied; and (5) that the reliance proximately cause plaintiff's injuries.¹⁰

The "scienter" intent requirement is interpreted to mean that a statement must not be made "with reckless disregard for its truth or falsity," or with a lack of "genuine belief that the information disclosed was accurate and complete in all material respects." Therefore, an opinion that has been issued without a genuine belief or reasonable basis is an "untrue" statement which, if made knowingly or recklessly, is culpable conduct actionable under §10(b) and Rule 10b-5.¹¹

Negligent Misrepresentation

The common law liability for fraud has developed similarly. Professor Hazard describes this evolution as follows:

" Since lawyers are best equipped to supply the requisite technical knowledge and legal judgment, their participation becomes a practical necessity in financial and commercial transactions that are either, in an instance, large in scale or done on a mass production basis.

The positive aspect of lawyer participation is that lawyers become gatekeepers - that is, positioned to disallow transactions that do not meet the applicable disclosure requirements [whether of statute or common law]. The negative aspect of lawyer participation is that lawyers who neglect their gatekeeper roles become accessories to fraud."¹²

It is in this context that the common law of misrepresentation has been brought to bear on the activities of lawyers involved in transactions. The cause of action for negligent misrepresentation is set forth in its most succinct form in §552 of the Restatement (Second) of Torts¹³ where it is limited to the factual situation of information transfer by an attorney to a known party for a known purpose.

The tort of negligent misrepresentation was carefully examined in *Greycas, Inc. v. Proud*¹⁴ where an attorney, at the request of his brother-in-law who was in deep financial trouble, provided an opinion letter to the brother-in-law's prospective lender, acknowledging that he had been requested to prepare an opinion in connection with the proposed loan transaction and that the opinion was being delivered in accordance with the requirements of a certain loan agreement. The attorney reported that he had conducted a UCC, tax and judgment search with respect to the borrower, and stated that the collateral from the loan was free and clear of all liens or encumbrances other than the lender's perfected security interest. In fact, the attorney never conducted the lien search, but relied on a list that his brother-in-law had given him and the brother-in-law's assurance that there were no liens. The collateral was, in fact, subject to liens. The lender sued the lawyer not on the basis of fraud (although there was clearly a deliberate falsehood and a concealment of a relationship between the attorney and his brother-in-law) but rather for negligent misrepresentation.

The *Greycas* court observed that the Illinois Supreme Court had earlier discarded the common law requirement of privity for professional malpractice.¹⁵ In order to avoid the indeterminate liability that has been traditionally feared when abandoning the privity requirement, the Illinois Supreme Court in *Pelham* required that for a non-client to succeed in a negligence action against an attorney, it must prove that the primary purpose and intent of the attorney-client relationship itself was to benefit or influence the third party.¹⁶ Here, the defendant had been retained for the sole purpose of rendering the opinion to induce Greycas to make the loan.

The court observed that labeling a suit as one for negligent misrepresentation would not by itself solve the problem of indeterminate and perhaps excessive liability which led the court in *Pelham* to place limitations on the duty of care owed to third parties. Citing another

Illinois Supreme Court decision¹⁷, the court noted that even in the decisions which established negligent misrepresentation as actionable despite absence of privity, the Illinois court had placed the same types of limitations on the scope of persons to whom the professional might be liable for such negligence, looking at the facts of the particular case to determine who would be likely to rely on it, and thus how broad might be the liability.

The court also cited Illinois cases finding negligent misrepresentation under §552 of the Restatement (Second) of Torts, applying the rule that one who in the course of its business conduct or profession supplies information for the guidance of others in their business transactions is liable for negligent misrepresentations that induce detrimental reliance.¹⁸

With these precedents, the court had little difficulty finding that a secured party receiving an opinion relative to the absence of other liens represents a fairly narrow, determinant scope of reliance and, hence, liability. Thus, whether applying an ad hoc test, such as suggested by the *Rozny* case¹⁹ or the broader test of §552 of the Restatement (Second) of Torts, the fears of indeterminate liability that have served to maintain the defense of privity are allayed by these facts.

The *Greycas* court considered the defendant's contention that the secured lender's reliance on the lawyer's opinion was not justifiable and that the secured lender was also negligent in failing to conduct its own secured lien search rather than rely on the third party opinion. Although there were factors pointing to certain peril in the making of this loan -- the borrower was in financial trouble, and the borrowing was at high risk rates and was secured - - the court did not find these reasons for duplicating a UCC search. The duty of care of the secured lender does not require an assumption that the person on the other side is careless or dishonest. Had the relationship between the opining attorney and his brother-in-law been made known or had the opinion merely said that there were no prior liens and cautioned that the scope of review was limited to a certificate of the borrower, then the lender might have been negligent in relying on the opinion.

In a more recent decision, the New Jersey Supreme Court²⁰ found a lawyer for the seller of property liable to the buyer, a non-client, for providing a composite report of some but not all percolation tests performed on the property, which was the subject of the transaction between the parties. The plaintiff purchaser had sued to recover the costs of land testing that it claimed would not have been undertaken had the entire scope of existing percolation tests been revealed. In reaching its conclusion, the New Jersey Court reviewed circumstances in which courts had relaxed the privity requirement by limiting a lawyer's duty to third persons to situations in which the lawyer intended or should have foreseen that the third party would rely on the lawyer's work.²¹ *Petrillo* represents the clearest application of a rule of foreseeable reliance independent of knowledge by or intent of the provider of the information or its clients that the information would be disseminated.

The Colorado Supreme Court in *Mehaffy, Rider, Windholz & Wilson v. Central Bank of Denver, N.A.*²² demonstrated a willingness to find an attorney who issued a misleading opinion letter liable to a recipient non-client based upon negligent misrepresentation. In this case, counsel had opined that a lawsuit challenging the validity of execution of certain

municipal notes was without merit, and that the notes were validly issued. In fact the notes had not been duly authorized, and the lawsuit did have merit. The court applied the concept of negligent misrepresentation provided by §552 of the Restatement (Second) of Torts²³ that one who in the course of his or her business or profession supplies information for the guidance of others in their business transactions is subject to liability for their pecuniary loss by reason of their justifiable reliance on the information if the provider fails to exercise reasonable care or competence in obtaining or communicating that information. This, according to the Colorado Supreme Court, requires knowledge by the provider that the information will be relied upon by the non-client.

Mehaffy makes clear that, in Colorado, a claim for negligent misrepresentation must be based on the misrepresentation of material fact, and not upon expressions of opinion.²⁴ In the court's view, the statement that a lawsuit had no merit and that the bonds were validly issued could constitute statements of fact not simple representations of law,²⁵ although the court noted that this was a question for the trier of fact.²⁶

This brief discussion in *Mehaffy* concerning opinions as statement of fact should be arresting. If the legal conclusions expressed (merit of a lawsuit and due execution) are regarded as statements of fact and not opinion, then much of what is written in a "legal opinion" is a "statement of fact".

B. Relationship Approaching Privity

With a foot firmly planted in the sanctuary of privity, the New York Court of Appeals found a theoretical basis for liability against legal professionals in *Prudential Insurance Company of America v. Dewey, Ballentine, Bushby, Palmer & Wood*.²⁷ The court summarized the case law as it developed in New York, to the effect that, in order to permit recovery for pecuniary loss sustained as a result of another's negligent misrepresentations, there must be a showing that there was either actual privity of contract between the parties; or a relationship "so close as to approach that of privity."²⁸

The court reviewed the criteria developed in prior decisions as distilled in *Credit Alliance Corp. v. Arthur Andersen & Co.*²⁹ to impose liability: (1) an awareness by the maker of the statement that it is to be used for a particular purpose (the "end and aim" of the actor's role); (2) reliance by a known party on the statement in furtherance of that purpose; and (3) some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance.³⁰ When these three criteria exist, there is a "relationship similar to privity", allowing a court to form the basis to allow for recovery -- even against an attorney.

The impact of the *Prudential* decision, however, is blunted by the fact that, although a duty of care was found to exist, the defendant attorneys were found not to have violated that duty. The decision has been criticized for moving New York's law into a state of flux by opening the theoretical door to attorney liability without answering hard questions about the potential

compromise in an attorney's duty to the client that may come with such liability, much less overruling court decisions that declined to extend liability in quite similar settings.³¹

The criteria of New York law enunciated in *Prudential* appear to be another means of expressing the "reasonable foreseeability of reliance" standard more clearly identified in the later *Petrillo* case and in *Kirkland Construction Company v. James*.³² In *Kirkland*, the Massachusetts Court of Appeals pointedly observed that its standard of liability, reasonably foreseeable reliance, was more lenient than that of §552(2)(b) of the Restatement (Second) of Torts, which requires an intention that there will be reliance.³³

III. SPECIAL RELATIONSHIP

Some courts have attempted to define what relationships should expose the lawyer to liability and what should not. As a result, there are cases that do not purport to create exceptions to privity, but focus on policy reasons as to why privity should not matter.

It is easy enough to see the liability to the third party found by the Supreme Court of California almost forty years ago in *Biakanja v. Irving*³⁴, regarded as a landmark departure from the rule of privity. In its deliberation, the court explored why privity should not stand in the way of liability: where the negligence places life and limb in peril; where the only foreseeable risk is of damage to tangible property; or where the "end and aim" of the transaction was the third person's interests. Where a liability has not been found for injuries to intangible interests, the only potential advantage to the plaintiff from the performance of the contract was collateral to the transaction or the injury to the particular person bringing the suit was not foreseeable.

In the *Biakanja* case, the plaintiff was a frustrated beneficiary under an improperly executed will prepared by the defendant, a notary public. In imposing liability on the negligent notary in favor of the beneficiary, the court provided six factors which were to be balanced in determining whether a defendant in a specific case would be held liable to a third person not in privity. These were: (1) the extent to which the transaction was intended to affect the plaintiff; (2) the foreseeability of harm to the plaintiff; (3) the degree of certainty that the plaintiff suffered injury; (4) the closeness of the connection between the defendant's conduct and the injury suffered; (5) the moral blame attached to the defendant's conduct; and (6) the policy of preventing future harm.³⁵

In this fact-oriented analysis, it was easy to find the defendant liable to the third party. Here there was no tension between carrying out the client's purposes and the interests of the third party: they were in complete alignment. Just how the court balanced the six factors it stated is not clear from the opinion. The "disappointed beneficiary" character can be regarded as an exception to the privity rule rather or its own rule. If the principle of *Biakanja* transports to lawyer conduct, the rule that can be derived from *Biakanja* is that a lawyer should be liable to any person for whom the client intended the benefit of the lawyer's engagement and who suffers loss of that benefit because of the lawyer's conduct.

Such a formulation easily leads to application of "third party beneficiary" principles -- either in a contract sense³⁶ or in the context of the right to claim malpractice equally available to the client. No reported case has viewed the rights of the disappointed beneficiary as derivative of the client's rights to bring a malpractice action against the attorney.

The label "third party beneficiary" was quickly attached to the *Biakanja* principle in *Lucas v. Hamm*,³⁷ which took the ultimate step of applying the rationale of *Biakanja* to an attorney. In its consideration, the California Supreme Court gave attention to the question of whether recognition of liability to beneficiaries under a will negligently drawn by an attorney would impose an undue burden on the profession.³⁸ The court concluded that extension of the attorney's liability to beneficiaries injured by a poorly drafted will does not place an undue burden on the profession. The court did not belabor the analysis of the six balancing points enumerated in *Biakanja*, effectively noting the virtual identicality of the two situations, changing only the actor.³⁹

In *Donahue v. Shughart, Thomson & Kilroy, P.C.*⁴⁰ the Missouri Supreme Court extended liability to an attorney who had negligently prepared an inter vivos trust. In *Donahue*, the *Biakanja* six balancing factors are slightly modified, but the court focused on the test of the client's purpose and specific intent to benefit the non-client claimant through the attorney-client relationship. Could it be that a settlor might have intended one set of beneficiaries to be favored over another, even as a result of what appeared to be negligent drafting? While it may be easy enough to conclude that there is an alignment of interests of the settlor and the beneficiaries in the will or trust setting, that is not always the case; and it is certainly a "slippery slope" in transactional settings if the intent of the client rather than the intent or foreseeability by the attorney of reliance by the non-client is made the analytical focus.

IV. STATEMENTS AND SOURCES OF THE "RULES"

The "rules" of attorney liability to non-clients derive from case law and statute, and are further expressed in several sources of authoritative value.

A. The Legal Opinion Accord

The Legal Opinion Accord ("Accord") is a part of the Third Party Legal Opinion Report of the Section of Business Law of the American Bar Association.⁴¹ Although the Accord may not have become the widely embraced solution for third party opinions desired by its creators, it is and continues to become a significant definitive statement of what an opinion is to accomplish, what is necessary to give it, and what the words of it mean (and do not mean). It has become the subtle "norm" in many contexts, and offers the point of reflection for any other opinion format, suggested meaning or process. The adaptation of the Accord to opinions given in real estate secured transactions was recommended in the Report on Adaptation of the Legal Opinion Accord of the Section of Business Law of the American Bar Association for Real Estate Secured Transactions of the American Bar Association Section of Real Property, Probate and Trust Law and the American College of Real Estate Lawyers.⁴²

The Accord begins with the statement that "[t]his Accord presumes avoidance by the Opinion Giver of any action that would constitute fraud or conscious deceit (*e.g.*, rendering an opinion that, while in technical compliance with this Accord, to the Opinion Giver's Actual Knowledge is wrong)."⁴³

The opinion giver's standard of care in providing an opinion is described in Accord §2:

"§2 Scope of Inquiry . The Opinion Recipient may assume that the Opinion Giver has reviewed such documents and given consideration to such matters of law and fact (in accordance with the principles set forth in this Accord) as the Opinion Giver has deemed appropriate, in its professional judgment, to render the Opinion. . . ." ⁴⁴

The term "professional judgment" is not expressly defined in the Accord, but some guidance is given in §1045 and §1646: that which "a lawyer in the Opining Jurisdiction exercising customary professional diligence would reasonably recognize."

In §7, the Accord states:

"The Opinion Recipient may rely upon the Opinion, without taking steps to verify the conclusion reached, with respect to the specific legal issues that the Opinion Letter affirmatively addresses. The Opinion Recipient may not rely on the Opinion or the Opinion Giver for any legal or other analysis beyond that set forth in the Opinion Letter, such as the broader guidance and counsel that the Opinion Giver might provide to the Client." ⁴⁷

Beyond recognizing that the opinion recipient is intended to rely on the opinion, an important step under §552 of the Restatement (Second) of Torts, the Accord does not purport to suggest, beyond its introductory statement about avoiding fraud, that there is a duty of the opinion giver to the opinion recipient. Nor does the Accord address the subject of liability of the opinion giver to the recipient. As §7 points out, however, the third party legal opinion should not be a substitute for the recipient's reliance upon its own counsel for legal advice. Does the Accord suggest that the recipient's reliance on the third party opinion is really upon "factual" advice?

B. Restatement, Third, The Law Governing Lawyers⁴⁸

This proposed new Restatement attempts to draw into a single source the rules of lawyer conduct derived from lawyer codes and judicial interpretation of them, directly and indirectly. Chapter 4 of the Restatement addresses the subject of lawyer civil liability, and, in §73, the specific subject of liability to non-clients:⁴⁹

§73. Duty of Care to Certain Non-Clients

For purposes of liability under §71, a lawyer owes a duty to use care within the meaning of §74:

...

(2) to a non-client when and to the extent that:

(a) the lawyer or (with the lawyer's acquiescence) the lawyer's client invites the non-client to rely on the lawyer's opinion or provision of other legal services, and the non-client so relies, and

(b) the non-client is not, under applicable tort law, too remote from the lawyer to be entitled to protection;

(3) to a non-client when and to the extent that:

(a) the lawyer knows that a client intends as one of the primary objectives of the representation that the lawyer's services benefit the non-client;

(b) such a duty would not significantly impair the lawyer's performance of obligations to the client, and the absence of such a duty would make enforcement of those obligations unlikely;

(4) to a non-client when and to the extent that:

(a) the lawyer's client is a trustee, guardian, executor, or fiduciary acting primarily to perform similar functions for the non-client;

(b) circumstances known to the lawyer make it clear that appropriate action by the lawyer is necessary with respect to a matter within the scope of the representation to prevent or rectify the breach of a fiduciary owed by the client to the non-client, where (i) the breach is a crime or fraud or (ii) the lawyer has assisted or is assisting the breach;

(c) the non-client is not reasonably able to protect its rights; and

(d) such a duty would not significantly impair the performance of the lawyer's obligations to the client. . . .

Subsection (2) of the current draft of the Restatement bases its duty to care to a non-client on the invitation to the non-client to rely on the lawyer's opinion.⁵⁰ Subsection (3) of §73 provides also that a lawyer will be liable to a non-client that the lawyer knows the client intends as one of the primary objectives of the representation for which the lawyer's services are obtained by the client. Subsection (3) deals with cases in the nature of the disappointed beneficiary, such as *Lucas v. Hamm*⁵¹ but is more broadly drafted.

The rationale behind Restatement §73 is that lawyers regularly act in settings involving non-clients who foreseeably would be harmed by inappropriate acts of those lawyers. In Comment b to §73,⁵² the Restatement recognizes that it may be difficult to distinguish between harm resulting from inappropriate lawyer conduct and detriment resulting from the lawyer fulfilling the proper function of helping the client through lawful means. It is this difficulty that causes the Restatement to suggest liability to non-clients will arise only in transactional settings, but not in litigation; and, even in transactional reference, the

Restatement suggests only certain limited circumstances in which a lawyer may be held liable to non-clients. One such area is the inviting of reliance on the lawyer's work by non-clients. In Comment e,⁵³ the Restatement observes that the lawyer's client typically benefits from the non-client's reliance on a lawyer's opinion given pursuant to a contractual obligation, and that recognition of the claim by the non-client against the lawyer does not conflict with the duties of the lawyer properly owed to the client. The lawyer may, of course, avoid presenting an opinion letter that withholds critical information, resulting in negligent misrepresentation, by declining to represent the client whose direction places the lawyer in a position of potential misrepresentation.

The Restatement notes that the cause of action of a non-client is in substance identical to a claim of negligent misrepresentation.⁵⁴ The duty of a lawyer providing an opinion is ordinarily limited to using care to avoid making or adopting misrepresentation, and does not require the lawyer to use care in preventing misrepresentations by others even in documents that the lawyer has helped draft. Of course if a lawyer knows that particular representations are false, the lawyer may not rely upon them in the opinion.⁵⁵

A lawyer may avoid liability to non-clients by limitations or qualifications within the opinion.⁵⁶ Such limitations might make it clear who may rely on the opinion, or that the lawyer is relying on facts provided by the client without independent investigation, or define the scope of law and other similar limitations. These are discussed in greater detail in Section V, below. The effectiveness of the limitation or disclaimer depends on whether it was reasonable under the circumstances to conclude that those who receive the opinion also receive the limitation or disclaimer and understand its import under the circumstances.⁵⁷ Relevant circumstances include customary practices known to the recipient regarding the construction of opinions, and whether the recipient is represented by counsel or a similarly experienced agent.

C. Restatement, Second, The Law of Torts⁵⁸

§552 of the Restatement (Second) of Torts, may serve as a functional statement of the liability of a lawyer to anyone. In part, §552 states:

§552. Information Negligently Supplied for the Guidance of Others

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care of or competence in obtaining or communicating the information.

(2) . . . [T]he liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of the limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction." (Emphasis added)

It might be argued that §552(1) of the Restatement (Second) of Torts, is designed principally to protect persons in the nature of "clients", and is merely duplicative of the rules otherwise governing the conduct of lawyers, such as those found in the Model Rules of Professional Conduct. The principle of §552(1), however, has no limit -- it applies to the supplying of false information for the guidance of "others" in their business transactions, as long as these "others" justifiably rely upon the information. The Restatement (Second) of Torts, does not go on to describe what is justifiable reliance, but instead focuses on identifying "others" suffering pecuniary loss. They are the person or one of a limited group of persons for whose benefit the provider of the information intends to supply that information or for whom that provider knows that the recipient intends, in turn, to supply it, where the loss is suffered through the reliance upon that information in a transaction that the information provider intended to influence or knows that the recipient intended to influence. The requirement of intent under the Restatement (Second) of Torts is a meaningful limitation on the standard of "reasonably foreseeable" reliance expressed in some recent case law.

Compare the approach of the Restatement of the Law Governing Lawyers, discussed above, that requires invitation by a client to others or intention of a client for services to benefit a non-client.

D. Restatement, Second, The Law of Agency⁵⁹

Professor Hazard suggests that the appropriate balance of responsibility and immunity for the transactional lawyer "is as aptly stated under agency law as it is under the law of privity with its amorphous exceptions."⁶⁰ The principles of agency law Hazard suggests as forming the basis for lawyer liability would be these:

- An agent is liable to the agent's principal for assisting someone other than the principal in committing a legal wrong against the principal.⁶¹
- An agent is liable to the agent's principal for assisting, or failing to interdict conduct of which the agent is aware and which is within his domain of responsibility, on the part of someone purporting to act for the principal in a course of action that results in the principal being held legally liable to some third party.⁶²
- An agent who does an act otherwise a tort is not relieved from liability by the fact that he acted at the command of the principal or on account of the principal, except where he is exercising a privilege of the principal, or a privilege held by him for the protection of the principal's interest . . .⁶³

Hazard also suggests that a principle of third party liability under contract law should be added: an agent is responsible to a third person, directly or by way of subrogation to the right

of the principal, for negligently or intentionally failing to carry out an undertaking on behalf of the principal that was intended to benefit a third person.⁶⁴

Finally, Professor Hazard cautions that there should be a general exception to the result of application of the foregoing principles, as follows: "A transaction lawyer should not be liable for injury to a third person resulting from action or inaction in the course of practice if such liability is incompatible with conduct by the lawyer that would further legally permissible or privileged conduct or objectives of the lawyer's client."⁶⁵ Application of the agency principles with the proposed exception provides a set of rules focusing attention on the causal consequences flowing from specific lawyer engagements rather than looking at the relationship between the lawyer and the client.

E. ABA Model Rules of Professional Conduct⁶⁶

The ABA Model Rules of Professional Conduct ("MRPC") were originally adopted by the American Bar Association House of Delegates in 1983, and have been amended on numerous occasions thereafter. These rules replaced the Model Code of Professional Responsibility, which in turn had replaced the Canons of Professional Ethics. In themselves, MRPC and their predecessors have no authoritative value, as the American Bar Association has no regulatory power or authority over lawyers. As model rules, these are intended for adoption and adaptation by the states and territories; and, accordingly, the rules from state to state vary from the MRPC and its predecessors.⁶⁷

MRPC 2.3 provides as follows:

Evaluation for Use by Third Persons

(a) A lawyer may undertake an evaluation of a matter affecting a client for the use of someone other than the client if:

(1) the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client; and

(2) the client consents after consultation.

(b) Except as disclosure is required in connection with report of the evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.⁶⁸

Comment 4 to MRPC 2.3 observes that a legal duty to the person for whom the evaluation is intended may or may not arise, and that legal question is beyond the scope of the rule. Indeed, the Model Rules of Professional Conduct do not provide the basis for legal duty, but rather ethical conduct.⁶⁹

MRPC 4.1 requires truthfulness in statements to others. It provides:

In the course of representing a client a lawyer shall not knowingly:

- (a) make a false statement of material fact or law to a third person; or
- (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

The Model Rules themselves acknowledge the tension between a duty to maintain confidentiality as required under Rule 1.6 and the duty not to provide fraudulent or misleading information to those who rely on the lawyer's evaluation under Rule 4.1. Disclosure of client confidences in an evaluation report results in the loss of confidentiality.

Rule 2.3 also requires the lawyer to express whatever limitations may exist that are material to the evaluation. Commentary to MRPC 2.3 ("Access to and Disclosure of Information") agrees with the Accord in stating that a lawyer should have whatever latitude of investigation is deemed necessary as a matter of professional judgment in order to render the evaluation.⁷⁰

Rule 4.1 confirms as a matter of ethical standard the rule of civil liability based on intentional misrepresentation (now extended to negligent misrepresentation, see above) established in *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*.⁷¹ The *Roberts* case involved an opinion that a client was a general partnership whereas a lawyer knew, but did not disclose, that several of the supposed partners disputed their status as such. The court found that because the lawyer issued an opinion letter intending to secure a benefit for the client, the lawyer owed a duty of care to the persons receiving that letter whose action the lawyer sought to influence. This is very much the same rule enunciated in Restatement (Second) of Torts, §552.

V. SUGGESTIONS TO AVOID OR LIMIT LIABILITY

A. Qualifications and Disclaimers

Short of presenting a false statement (intentional misrepresentation), qualifications and limitations appear to be given due regard and effectiveness when tested.

In *Washington Electric Cooperative, Inc. v. Massachusetts Municipal Wholesale Electric Co.*,⁷² the court indicated its willingness to permit assertion of a claim for negligent misrepresentation against an attorney issuing an opinion to a non-client. The court declined to find a basis for liability in malpractice based on privity. The attorney had given an opinion that certain utilities had the authority to enter into power sales agreements containing "take or pay" terms. Later, the state court determined, as a matter of first impression in the state, that the utilities had acted beyond their authority in entering into these contracts.

In examining whether the attorney giving an opinion of authority to a non-client could be liable for negligent misrepresentation, the court observed that all but two of the opinion letters issued by the lawyers contained a qualification warning that "the obligations of the Participants under the power sales agreements and the enforceability thereof may be subject to judicial discretion." The court went on to observe that the opinion letters attested to the

status of the law at the time they were rendered, and the lawyers disclaimed liability for future changes in the law or uncertainty in interpretation of the law. The qualification was consistent with accepted legal principles⁷³ and it was found effective to bar the claim for negligent misrepresentation. A question can be raised about whether such a typical disclaimer⁷⁴ sufficiently alerts an opinion recipient to the fact that the issue of whether a contract of a particular nature may be fundamentally enforceable, a matter not decided by the courts. On the other hand, a sophisticated recipient, knowing that a "take or pay" contract has been often regarded as problematical by courts, should probably ask the question specifically, or be wary of a "judicial discretion" qualification.

Two of the opinion letters, however, did not contain the disclaimer, and the court remanded the claim for negligent misrepresentation for further consideration by the lower court. In its discussion, the court considered the argument by the opining lawyer that regardless of the absence of the disclaimer, the law was unsettled, and an attorney who in good faith honestly believes that his advice and acts are well founded and in the client's best interest is not answerable for a mere error of judgment or a mistake in a point of law that has not been settled, and on which reasonable doubt may be entertained by well informed lawyers. The court agreed that an attorney would be absolved of liability where the law was unsettled, but the lawyer "must nevertheless show that he performed reasonable research in an effort to ascertain relevant legal principles and to make an informed decision as to a course of conduct based upon an intelligent assessment of the problem."⁷⁵ What the lower court was asked to determine was whether the opining attorney's diligence and reasonable conduct in preparing the opinion could withstand the claim of negligent misrepresentation.

In *Resolution Trust Corporation v. Latham & Watkins*,⁷⁶ the attorney opinion to a non-client reached a conclusion based on Florida law. The opinion letter specifically assumed for purposes of the opinion that Florida law would govern the question being opined about, but advised that choice of law principles could result in the application of the laws of a state other than Florida. The court noted that the four-page opinion letter contained only one sentence that asserted an opinion, and the rest of the letter qualified and limited that opinion. In the presence of such cautionary language, courts have been reluctant to find fraud, as was this court.⁷⁷

The RTC contended that the opinion giver should have addressed Texas law to render its opinion. In applying Rule 10b-5, the court observed that an omission may be fraudulent if the omitted information is necessary to make express assertions not misleading. In the opinion, however, the opining law firm noted that "choice of law principles could result in the application of the laws of a state other than Florida." The question then considered by the court was whether the opinion giver could render a non-misleading opinion without specifically mentioning the potential applicability of, and possibly adverse result under, Texas law. The court stated that a law firm cannot immunize itself from liability simply by issuing sweeping disclaimers that certain subjects are beyond the scope of the opinion, but found that it was reasonable to limit the opinion to the law of Florida.

Even a misstated disclaimer or qualification has had an effect. In *Mark Twain Kansas City Bank v. Jackson, Brouillette, Pohl & Kirley, P.C.*,⁷⁸ a negligent misrepresentation claim was

barred where the lawyer's opinion stated "we take no responsibilities to [sic] any information or opinions contained herein". The obvious typographical error that caused such statement to have been made, as well as the effect of such a statement to nullify any opinion expressed, might have led a court not to honor this as a disclaimer entitled to legal effect. Instead, the Court found that the recipient, a sophisticated investor, should have questioned the disclaimer before relying on the letter.⁷⁹

A disclaimer that an opinion is based on "assumed facts" did not bar Rule 10b-5 liability or prevent reasonable reliance on the part of the non-client recipient when the lawyer had good reason to know of material inaccuracy.⁸⁰ And in *Gilmore v. Berg*⁸¹ an attorney's opinion that a \$5.3 million price of real property was fair "as determined by the general partner", when the attorney knew the property had been purchased for less than half that amount, was found to be fraudulent regardless of the disclaimer.

B. Restrict Scope of Reliance

The danger of applying §552 of the Restatement (Second) of Torts, is that there may be a less than determinate group of "others" who may rely justifiably on the work product of a lawyer for another person. While §552(2) attempts to circumscribe the group of "others", it might be easy for a court to expand the group beyond that which the opinion giver finds desirable.

The Accord, in §20, establishes that

[o]nly the Opinion Recipient is entitled to rely upon or to assert any legal rights based upon the Opinion Letter, and the Opinion Recipient may rely on the Opinion only for the purpose contemplated by the Transaction Documents. If a different arrangement is intended, then the Opinion Letter or a separate writing signed by the Opinion Giver should specify any other person entitled to rely, and (if relevant) under what circumstances and to what extent.⁸²

This rule provides a presumptive, narrow scope of what "others" may justifiably rely on the opinion, or may be reasonably expected by the opinion giver to so rely. The Accord's rule is more restrictive than the scope of the Restatement of the Law Governing Lawyers §73 and the Restatement (Second) of Torts, §552. In opinions claiming to be Accord-based, the scope of reliance is limited automatically. It is up to the opinion recipient to request authorization to provide the opinion to a prospective participant or purchaser, and the opinion giver agreeing to broaden the reliance group should consent to that broader reliance group in writing.

When a non-Accord opinion is provided, the opinion giver must craft and negotiate a limitation on use or otherwise be willing to have the common law rules and interpretations of statute (for example, in the case of Rule 10b-5) apply. A negotiated or stated scope of reliance should be significant in the decision of any court seeking to apply the "rules" of liability to non-clients.

V. CONCLUSION

There is no uniform or national rule of attorney liability to non-clients, including those who are in a direct relationship with the lawyer's client, applied by the courts. The rule of privity is highly revered in some jurisdictions, such as Texas and New York, while "discarded" in others, such as Illinois and Michigan, and eroded significantly in others, such as California.

In those jurisdictions where foreseeable reliance by a non-client is sufficient to overcome reservations about privity, the standards of foreseeability range from simply "reasonable", to "invited" or "known" to rely, to "justifiably" rely. Studious sources, such as the Restatement (Second) of Torts or Restatement of the Law Governing Lawyers aid this variability; and, in addition, their pronouncements are each open to broad interpretive latitude.

Policy arguments for and against privity abound,⁸³ and courts clearly agonize and rationalize without giving clear guidance to conduct. When the rules of professional conduct are layered into the mix, the tensions between duty to client and avoidance of liability to third persons increase. It is that tension, undoubtedly, that caused Professor Hazard to suggest that the rules of liability to third persons can and should apply only to transactional lawyers, since they do not work at all in the litigation setting.

In no case has a lawyer who has fully and ably fulfilled its duty to its client been found liable to a third person. But it certainly is not the case that only if the lawyer commits malpractice as to its client, and in the process harms a third person, will the lawyer be found liable. In *Petrillo*,⁸⁴ the lawyer might well have violated only the rules of agency that Professor Hazard suggests to be the basis of a coherent approach⁸⁵ for failing to carry out properly an undertaking for the principal.

If the tort of fraud, or its modern realization, negligent misrepresentation, can apply only to factual matters and not legal opinions, is this a safe harbor for the opinion giver? Superficially, it would seem so in Colorado; yet the *Mehaffy* court's suggestion that whether the content of an opinion is opinion or fact is an issue to be decided by the trier of fact demonstrates how unsafe that harbor is. It would seem only a matter of degree in proving whether the community standard of work and knowledge were applied in saying there are no liens on collateral or saying the transaction documents are enforceable. The distinction between fact and opinion is hardly a bright line.

The law is moving in the direction of the Restatement (Second) of Torts or more liberally. The wise practitioner will do well to live by that warning, and not rely on principles of privity in the typical third party opinion setting, where all of the elements of §552 are typically satisfied as to the recipient. The practitioner should use limitations on the scope of reliance whenever possible. When the Accord's §20 limitation cannot be adopted, the opinion's circulation should be restricted expressly. It is likely, however, that restrictions unsuitable for the transaction known to exist may be subject to disregard or, at least, critical scrutiny. Under §73 of the Restatement of the Law Governing Lawyers, the remoteness of the relying party is relevant. Under §552 of the Restatement (Second) of Torts, what the recipient intends for distribution is critical, regardless of remoteness.

The risk of liability to non-clients is more clear and present. The citadel of privity has been successfully attacked in many settings and for many reasons. The risk is reality.

NOTES

1 So termed by Judge Cardozo in *Ultramares v. Touche*, 255 N.Y. 170 at 180, 174 N.E. 441 at 445 (1931), observing a continuing assault thereon, and refusing to join what he saw as a national trend toward expanding liability.

2 100 U.S. 195, 25 L. Ed. 621.

3 Privity is defined as "that connection or relationship which exists between two or more contracting parties." Black's Law Dictionary, 1199 (6th Ed. 1990).

4 *Savings Bank*, at 203, reviewing *Winterbottom v. Wright*, 152 Eng. Rep. 402, 405 (Ex. 1842) in which Lord Abinger reasoned: "[I]f we hold that the plaintiff can sue in such a case, there is no point at which such actions will stop. The only safe rule is to confine the right to recover to those who enter into the contract; if we go one step beyond that, there is no reason why we should not go fifty."

5 Geoffrey C. Hazard, Jr., *The Privity Requirement Reconsidered*, 37 S. Tex. L. Rev. 967 (1996) at 967.

6 In Texas, for example, application of the rule of privity barred liability of a trustee to residual beneficiaries of a testamentary trust against a claim of negligent misrepresentation in *Thompson v. Vinson & Elkins*, 859 S.W. 2d 617, 623 (Tex. Civ. App. 1993). See, also, a similar decision in a similar setting in *Huie v. DeShazo*, 922 S.W. 2d 920 (Tex. 1996).

7 *Savings Bank*, *supra*, note 2, at 205-206.

8 *Savings Bank*, *supra*, note 2, at 206.

9 Rule 10b-5, found at 17 C.F.R. §240.10b-5 provides: [i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, and the light of the circumstances under which they were made, not misleading, or (c) to engage in act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

10 See, e.g., *In re Phillips Petroleum Securities Litigation*, 881 F. 2d 1236, 1244 (3d Cir. 1989).

11 *Kline v. First Western Government Securities, Inc.*, 24 F. 3d 480, 486 (1994), quoting *Eisenberg v. Gagnon*, 766 F. 2d 770, 776 (3d Cir. 1985), cert. denied sub. nom. *Wasserstrom v. Eisenberg*, 474 U.S. 946, 106 S. Ct. 342, 88 L. Ed. 2d 290 (1986).

12 Hazard, Privity Reconsidered, *supra*, note 5, at 972.

13 American Law Institute (1977). The Restatement is discussed in Section IV.C. of this article.

14 826 F. 2d 1560 (7th Cir., 1987).

15 *Pelham v. Griesheimer*, 440 N.E. 2d 96 (Ill., 1982).

16 *Pelham* at 100.

17 *Rozny v. Marnul*, 250 N.E. 2d 656 (Ill. 1969).

18 *See*, Section IV.C., *infra*.

19 *supra*, note 16.

20 *Petrillo v. Bachenberg*, 139 N.J. 472, 655 A. 2d 1354 (1995).

21 Such a "foreseeability" factor was foreshadowed in *Savings Bank v. Ward*, *supra*, note 2 in references to the fact that the title certificate preparer had no reason to know that the title certificate would be given to the plaintiff third party. Thus, even in a case widely attributed as establishing the rule of privity in non-client suits against attorneys, the very seeds of an exception based on reasonable foreseeability existed.

22 892 P. 2d 230 (1995).

23 *See*, Section IV.C. *infra*.

24 *Mehaffy*, at 237.

25 *Mehaffy*, at 238.

26 Plaintiff's malpractice claim was dismissed on the basis of lack of an attorney-client relationship. Without using the term "privity", the Colorado court said that malpractice is a "particular type of negligence" that is contained to that relationship. *Mehaffy* at 240.

27 80 N.Y.S. 2d 377, 605 N.E. 2d 318, 590 N.Y.S. 2d 831 (1992).

28 *Prudential* at 382. The court cited *Vereins-Und Westbank AG v. Carter*, 691 F. Supp. 704 (S.D.N.Y. 1988).

29 65 N.Y. 2d 536, 493 N.Y.S. 2d 435, 483 N.E. 2d 110 (1985).

30 *Credit Alliance* at 551, 493 N.Y.S. 2d at 443, 483 N.E. 2d at 118.

31 Silecchia, *New York Attorney Malpractice Liability to Non-Clients: Toward a Rule of Reason and Predictability*, 15 Pace L. Rev. 391 (1995) at 434.

32 39 Mass. Ct. App. 559, 658 N.E. 2d 699 (1995).

33 *Kirkland*, *supra*, note 31, FN 6 at 563, 658 N.E. 2d at 701.

34 49 Cal. 2d 647, 320 P. 2d 16 (1958).

35 *Biakanja*, at 650, 320 P. 2d at 19. The six factors have been referred to in many cases as the "Biakanja balancing tests".

36 *See*, Restatement (Second) of Contracts §302 (1981) which provides: (1) Unless otherwise agreement between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance; and (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

37 56 Cal. 2d 583, 364 P. 2d 685, 15 Cal. Rptr. 821 (1961).

38 *Lucas, supra*, note 36, at 589, 364 P. 2d at 688.

39 The attorney was not found liable because the alleged negligence involved did not violate the standard of care required of a lawyer. The trust created under the instrument was invalid because it violated the rule against perpetuities -- a rule deemed perplexing and difficult to most members of the bar. *Lucas*, at 592, 364 P. 2d at 690.

40 900 S.W. 2d 624 (Mo. Banc 1995).

41 47 Bus. Law. 167 (1991).

42 29 Real Prop. Prob. & Tr. J. 569 (1994).

43 Accord, *supra*, note 40, at 179

44 Accord, *supra*, note 40, at 183.

45 Accord, *supra*, note 40, at 199.

46 Accord, *supra*, note 40, at 210.

47 Accord, *supra*, note 40, at 194.

48 American Law Institute Restatement of Law (Third): The Law Governing Lawyers, Council Draft No. 12, 1996, herein "Restatement". All references to the "Restatement" are to Council Draft No. 12, which has not been adopted by the Institute and therefore does not represent the position of the Institute at this time. A new Tentative Draft of the Restatement is expected to be released in April, 1997, providing ALI Council revisions to Council Draft No. 12.

49 *Id.*, at 26.

50 Restatement, *supra*, note 47, §73(2) at 26.

51 *Lucas, supra*, note 36.

52 Restatement, *supra*, note 47, at 28.

53 Restatement, *supra*, note 47, at 29.

54 Restatement, *supra*, note 47, §73 Comment e, at 30.

55 *See, Accord, supra*, note 40, §5, at 190.

56 Restatement, *supra*, note 47, §73, Comment e, at 31.

57 *Id.*

58 American Law Institute, Restatement of the Law, Second: Torts, 1977 ("Restatement (Second) of Torts").

59 American Law Institute, 1958.

60 Hazard, *supra*, note 5, at 993.

61 Restatement (Second) of Agency §391 (1958).

62 *Id.*

63 Restatement (Second) of Agency §343 (1958).

64 Hazard, *supra*, note 5, at 993.

65 Hazard, *supra*, note 5, at 994.

66 American Bar Association, 1983 (as amended).

67 For this reason, lawyers must review the applicable rules in their own jurisdiction on the subjects discussed herein.

68 MRPC 1.6 deals with the confidentiality of information relating to representation of the client, which the lawyer is forbidden to reveal except for disclosures impliedly authorized in order to carry out the representation.

69 ABA Model Rules of Professional Conduct, preamble: "Violation of a Rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. The Rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability." Annotated Model Rules of Professional Conduct, Third Edition, American Bar Association, 1996 at xvii.

70 *Accord, supra*, note 40, §2 at 183.

71 128 Cal. Rptr. 901 (Ct. App. 1976).

72 894 F. Supp. 777 (D. Vt. 1995)

73 *See*, Ronald E. Mallen & Jeffrey Smith, *Legal Malpractice* (3d ed., 1989), §14.1 at 811-12 ("[the] law is not an exact science. What an attorney thinks the law is today may not be what a court decides tomorrow Because of those concerns, the rule that an attorney is not liable for an error of judgment or unsettled proposition of law is universally recognized.").

74 *See, Accord, supra*, note 40 §13, at 205.

75 *Washington Electric*, at 791, citing *Smith v. Lewis* 118 Cal. Repr. at 627, 530 P. 2d at 595 (1975).

76909 F. Supp. 923 (S.D. N.Y. 1995)

77 *In re Donald J. Trump Casino Securities Litigation*, 7 F. 3d 357, 371 (3d Cir. 1993), cert. denied 114 S. Ct. 1219 (1994) ("cautionary language, if sufficient, renders the alleged omission or misrepresentations immaterial as a matter of law"); *I. Meyer Pincus & Assoc. v. Oppenheimer & Co.*, 936 F. 2d 759, 763 (2d Cir. 1991) (Courts will not impose liability on the basis of statements that "bespeak caution").

78 912 S.W. 2d 536 (Mo. Ct. App. 1995)

79 It is noteworthy that the lender had in its own file evidence that the opinion was wrong, and chose to close the loan anyway. The Court made little of this, but the presence of this factor may have had some influence.

80 *Kline v. First Western Government Securities, Inc.*, 24 F. 3d 480 (3d Cir. 1994), cert. denied US 130 L. Ed. 2d 522, 115 S. Ct. 613 (1995). *See, also, Accord, supra*, note 4 §5, at 190.

81 761 F. Supp. 358 (D.N.J. 1991).

82 *Accord, supra*, note 40, §20, at 217.

83 Hazard, *supra*, note 5; John H. Bauman, *A Sense of Duty: Regulation of Lawyer Responsibility to Third Parties by the Tort System*, 37 S. Tex. L. Rev. 995 (1996); Ronald E. Mallen, *Duty to Nonclients: Exploring the Boundaries*, 37 S. Tex. L. Rev. 1147 (1996), and other articles appearing in Volume 37, No. 4 (October, 1996) of the South Texas Law Review devoted entirely to a report of, and some reactions to, its Symposium on the Lawyer's Duties and Liabilities to Third Parties.

84 *supra*, note 19.

85 Hazard, *supra*, note 5, at 993.