Negligence Liability to Nonclients

The Bermuda Triangle of Lawyer - Client - Nonclient

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Old concepts die hard, but the idea that a lawyer's liability for negligence is restricted to clients has had its day. Nonclients are suing and recovering with increasing frequency in an expanding number of practice areas. The purpose of this article is to provide an overview of these developments and offer some help on managing this blossoming risk of modern practice.

A Snapshot of the Situation

Lawyers always have been liable to nonclients for intentional torts. In a few specific situations nonclients have a statutory basis to sue lawyers for particular acts (e.g., securities laws, RICO, and more recently the Fair Debt Collection Practices Act). Lawyer malpractice liability for negligence, however, was limited for many years to clients on a privity of contract theory. The requirement of privity between lawyer and client before duties are created remains largely intact in litigation matters and arms length business transactions. The adversarial context of these situations mandates the lawyer's vigorous representation and strict observance of client confidentiality. Simply put, the lawyer owes no duty of reasonable care to a nonclient in these situations.

The push to enlarge lawyer exposure to nonclient claims has been two pronged. The first approach is a nonclient claim based on the lawyer's negligent misrepresentation of facts or information. This theory of liability is not based on an expansion of lawyer malpractice, but is based on common law tort principles. It is most effective in business transactions cases when the lawyer has provided information directly to third parties. Negligent misrepresentation claims are gaining strength based on the number of courts, including the Kentucky Court of Appeals[1], citing Section 552 Information Negligently Supplied for the Guidance of Others, Restatement (Second) of Torts. It provides in part:

One who, in the course of his ... profession ... 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 or competence in obtaining or communicating the information.

The second prong in the extension of lawyer negligence liability to nonclients is the increasing number of decisions that create duties to nonclients on the basis of lawyer malpractice in spite of the lack of privity.[2] These cases fall into three categories:

(a) Those that find lawyer duties to nonclients because the nonclient was intended to be benefited by the lawyer's services to the client;

(b) Those that use third party beneficiary contract principles to find duties owed to nonclients; and

(c) Those that use a hybrid "balancing of factors" theory that employs the following six part test to determine when duties are owed to nonclients:

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;

5. The policy of preventing future harm;

6. Whether recognition of liability under the circumstances would impose an undue burden on the profession.[3]

The practice areas in which malpractice remedies are increasingly granted to nonclients include wills, estate administration, trust administration, real property transactions, business deals, and loans. Malpractice claims by nonclients concerning domestic relations, debtor/creditor matters, organization representation, and criminal defense have not been as successful, but are growing in frequency. Of special concern are malpractice claims resulting from misapplication of nonclient money which is in the lawyer's possession. A lawyer holding nonclient money has a fiduciary duty to the nonclient and may be liable for negligence in disbursing this money.[4]

A Little Kentucky Law

I write a "little Kentucky law" because there is not a whole lot to analyze. What there is, however, indicates that we are with the national trend in expanding lawyer liability for negligence to nonclients. In *Rose v. Davis*, 288 Ky. 674; 157 S.W. 2d 284 (1941), Kentucky's highest court articulated the general rule that "An attorney is not ordinarily liable to third persons for his acts committed in representing a client. It is only where his acts are fraudulent or tortious and result in injury to third persons that he is liable." Kentucky then added the principle that "An attorney may be liable for damage caused by his negligence to a person *intended to be benefited* by his performance irrespective of any lack of privity..." *Hill v. Willmott*, Ky.App., 561 S.W. 2d 331(1978).

Most recently the Kentucky Court of Appeals in *Seigle v. Jasper*, Ky.App., 867 S.W. 2d 476 (1993) endorsed both a negligent misrepresentation theory and "intended to be benefited" malpractice theory for nonclient liability The accused lawyer missed an

easement on land when doing a title opinion for a bank considering a loan to the purchaser and was sued by the purchaser. The situation was the usual one where the lawyer is regularly retained by the bank to do title examinations and the purchaser agrees to pay the lawyer's fees through the loan closing costs paid to the bank. Here it was clear the lawyer knew the title opinion would be relied on by the purchaser. The lawyer won at the trial level on a summary judgment motion. The Court of Appeals reversed the summary judgment citing both Section 552 of the Restatement (Second) of Torts and *Hill v. Willmott*.

In addition to Kentucky case law the Kentucky Rules of Professional Conduct promulgated in 1990 added further emphasis to expanded lawyer responsibility to nonclients. Rule 2.3, Evaluation For Use By Third Persons, is a little noted, but new rule of professional responsibility for Kentucky lawyers. It provides:

(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 com-patible with other aspects of the lawyer's relationship with the client; and

(2) the client consents after consultation.

Two of the comments to the rule give guidance and alert lawyers to the issue of duties to nonclients:

Definition

(1) An evaluation may be performed at the client's direction but for the primary purpose of establishing information for the benefit of third parties; for example, an opinion concerning the title of property rendered at the behest of a vendor for the information of a prospective purchaser, or at the behest of a borrower for the information of a prospective lender. In some situations, the evaluation may be required by a government agency; for example, an opinion concerning the legality of the securities registered for sale under the securities laws. In other instances, the evaluation may be required by a third person, such as a purchaser of a business.

Duty to Third Person

(4) When the evaluation is intended for the information or use of a third person, a legal duty to that person may or may not arise. That legal question is beyond the scope of this Rule. However, since such an evaluation involves a departure from the normal client-lawyer relationship, careful analysis of the situation is required. ... [T]he lawyer should advise the client of the implications of the evaluation, particularly the lawyer's responsibilities to third persons and the duty to disseminate the findings.

Kentucky Rule of Professional Conduct 1.15, Safekeeping Property, makes several references to responsibilities owed to nonclients when a lawyer holds funds. The most important guidance is in Comment 3:

Third parties, such as a client's creditors, may have just claims against funds or other property in a lawyer's custody. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client, and accordingly may refuse to surrender the property to the client. However, a lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party.

While it is true that the Rules of Professional conduct are not supposed to establish a standard of care for determining lawyer negligence, you can count on seeing these two rules cited in claims if a nonclient thinks a lawyer was negligent in an opinion letter or when disbursing funds.

What's a Competent Lawyer to Do?

What follows are some ideas on how to assess your exposure to negligence liability to nonclients and what to do about it. First, be alert to these risky situations:

- The farther you get from the adversarial court room the greater the risk that a nonclient will claim reliance on your actions. Friendly business transactions where nonclients are not represented are especially treacherous.

- When you provide information verbally or in writing directly to a nonclient in a business transaction there is always the risk that your role will be misunderstood and the nonclient will later claim reliance on your "advice."

- When you provide information and opinion letters to clients that you know will be passed on to nonclients it is reasonable to expect the nonclient to rely on that information. This usually exposes you to liability for erroneous or misleading representations.

- When you represent a business entity client there is always the risk of giving nonclient officers and employees the erroneous impression that you are their lawyer and acting in their interest.

- When you do a legal service favor for a nonclient "just" to facilitate your client's business there is a risk that this favor will justify the nonclient's reliance on you as if they were also a client.

- When you disburse all funds to the client with the understanding that the client will pay amounts due nonclients there is a risk that you will end up with the nonclient bill.

Now for some risk management ideas:

- Make sure everyone (including you) knows who your client is. In any ambiguous situation clarify your role early. If necessary to make your position perfectly clear, advise nonclients to get counsel. Make sure that officers and employees of business entity clients no matter how high ranking understand you represent the business -- not them.

- Avoid tempting reliance on you by nonclients through your affirmative conduct (accommodative minor legal service to get the deal done) and passive conduct (allowing impressions to stand that you are acting in the nonclient's interest as well as your client's).

- In appropriate circumstances caution your client that your advice is offered in the client's best interest and should not be passed on as "good advice" to nonclients involved in the same business transaction.

Carefully prepare opinion letters by:

- Specifying the scope of the opinion, its purpose, authorized uses and restrictions.

- Setting out the facts and assumptions on which the opinion is based. Be specific about facts based on your own knowledge and those provided by others who bear responsibility for their accuracy. If others are preparing evaluations on other aspects of the transaction, clearly exclude those parts from your opinion. If you are relying on an expert opinion as part of your analysis (e.g., an environmental assessment), spell it out in your opinion.

- Being complete -- include the pro's and con's of the matter. Do not expose yourself to the accusation that you misled by omission. Material limitations must be disclosed.

- Establish office procedures for quality control of opinion letters. Procedures should indicate who is authorized to sign and release opinion letters for the firm, provide for a formal and cold review before opinion release, and require careful screening for prior inconsistent firm opinion letters. Unrealistically short deadlines for the production of opinion letters should not be accepted from clients and requests for additional information from the client should be made without hesitation. Because opinion letters carry a high risk for claims against both you and the client, they require extra time and often much more than the client anticipates. Be sure the client understands this and is prepared for the high billing that usually goes with a good opinion letter.

- If you deliver documents to a nonclient for your client, be sure you know what information is in them. If the documents do not contain some semblance of truth, you will in all likelihood be held responsible for their accuracy along with the client.

- Be sure to cover with the client in writing (preferably a letter of engagement) precisely how client funds are to be disbursed.

- Get written authority to pay creditors with an interest in the recovery or settlement. This is particularly important for those you have personally engaged such as medical services required to develop a personal injury case. If your client gets all the recovery proceeds and stiffs those people, you could be liable. Maybe as bad, it is your credibility that suffers on the next case when you try to get needed services.

- Get client approval before hiring experts and incurring other high expense aspects of a case or transaction. At final disbursement don't surprise your client with a huge nonclient claim on funds.

- Consider getting the client to pay large expenses directly while the case or transaction is ongoing and prior to final disbursement. This simplifies things at the conclusion of the matter for all concerned.

If you have a need to look further into the issue of liability to nonclients, the place to start is the ABA/BNA Lawyers' Manual On Professional Conduct, *Malpractice, Liability to Nonclients* at 301-601. Then go to Chapter 7, *Liability To The Nonclient -- Negligence*, in 1 Legal Malpractice 3rd (Mallen & Smith). 61 ALR4th has two extensive articles on attorney nonclient negligence liability at pages 464 and 615 with the usual good roll up of case authority. A recent New Jersey case, *Petrillo v. Bachenberg*, 655 A. 2d 1354(N.J. 1995), is an outstanding recent opinion that includes a comprehensive review of this issue. Whatever you do keep your eye on developments in this area of malpractice. It's moving fast!

Endnotes

Seigle v. Jasper, Ky.App., 867 S.W.2d 476(1993).

2 See generally, Chapt. 7 Liability To The Nonclient -- Negligence, 1 Legal Malpractice 3rd Ed. (Mallen & Smith).

3 Section 7.11 Duty Beyond Privity -- General Rules, 1 Legal Malpractice 3rd Ed. (Mallen & Smith).

4 ABA/BNA Lawyers' Manual On Professional Conduct, Malpractice, Liability to Nonclients at 301-609 through 301:625.