OPINION LETTERS (3d PARTY RELIANCE)

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Chapter 19

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I. INTRODUCTION

This paper surveys the recent cases relating to negligent misrepresentation in the legal malpractice context.

II. BACKGROUND

A. WHEN CAN A LAWYER BE HELD LIABLE TO NON-CLIENTS?

1. TEXAS STRICT PRIVITY RULE.

a. TRADITIONAL RULE. Traditionally, attorneys are accountable only to their clients, and only their clients may sue them for negligence. See, e.g., Barcelo v. Elliott, 923 S.W.2d 575 (Tex. 1996); First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin & Stewart, 648 S.W.2d 410, 413 (Tex. App. – Dallas 1983, writ ref'd n.r.e.) (refusing to extend attorney malpractice claims to parties not in privity with attorney). Texas and a majority of jurisdictions follow the view expressed by the U.S. Supreme Court in National Sav. Bank v. Ward, 100 U.S. 195 (1879), that absent fraud, collusion or privity of contract, an attorney cannot be held liable to a non-client for malpractice.

b. THIRD-PARTY BENEFICIARIES. Even a third-party beneficiary of the attorney's services cannot sue an attorney with whom he was not in privity. See, e.g., Dickey v. Jansen, 731 S.W.2d 581, 582-583 (Tex. App. – Houston [1st Dist.] 1987, writ ref'd n.r.e.); Barcelo v. Elliott, 923 S.W.2d at 575.

2. EXCEPTIONS TO THE STRICT PRIVITY RULE.

a. FRAUD.

(1) CLAIMS BY NON-CLIENTS. A non-client can sue a lawyer for fraud. If a lawyer intentionally misrepresents a material fact, his role as a lawyer is not a shield from liability. See, e.g., Likover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468, 472 (Tex. App. -- Houston [1st Dist.] 1985, no writ). Though there is little law on the issue, it appears that a lawyer can not be held liable to a non-client for fraudulently omitting to state a material fact. See Bernstein v. Portland Sav. & Loan Ass'n., 850 S.W.2d 694, 701-2 (Tex. App. – Corpus Christi 1993, writ denied).

(2) CIVIL CONSPIRACY TO DEFRAUD. An attorney can be liable for conspiracy to defraud if he knowingly agrees to defraud a third person. See, e.g., Bernstein v. Portland Sav. & Loan Ass'n., 850 S.W.2d at 706.

b. THE CARNAHAN DECISION.

(1) THE FACTS. In Parker v. Carnahan, the plaintiff's husband ("John") was indicted for the failure to file income tax returns. John's attorney referred the criminal case to a criminal defense specialist ("Carnahan"). 772 S.W.2d 151, 153 (Tex. App.–Texarkana 1989, writ denied). As part of his defensive strategy, Carnahan hired an accountant ("Jackson") to prepare tax returns for the missing years. Id. Jackson prepared joint returns. Carnahan told the plaintiff ("Martha") that the returns needed to be signed and filed, and Martha signed the returns. Id. When a tax return is filed "married filing jointly" (as in this case), the spouses are jointly and severally liable for all taxes, penalties, and interest. Id. If the returns in this case would have been filed "married filed separately," Martha would have been liable for half of the tax owed by the couple, but she would not have been jointly and severally liable for penalties and interest incurred by John's nonpayment. Id. Eventually, Martha's separate-property home was sold by the IRS in a forced sale, and she still owed $100,000 in taxes, penalties, and interest. Id.

Martha filed suit and asserted that (1) the attorneys were negligent in failing to advise her of her potential liability under a joint return because she was their client, or (2) alternatively, if she were not their client, they were negligent in failing to advise her to seek her own legal counsel. Id. The trial court granted Carnahan's motion for summary judgment. Id. at 153.

(2) THE HOLDING.

The Court of Appeals rejected Martha's assertion that an attorney-client relationship was established. Id. at 157. However, the court held that an attorney can be held liable for negligence if he fails to advise a party that he is not representing the party when the circumstances lead the party to believe otherwise. Id. The court stated that a fact issue existed on this point and remanded. Id.

c. NEGLIGENT MISREPRESENTATION.

Under cases recently decided by the Supreme Court of Texas and the Fifth Circuit, a non-client can bring a negligent misrepresentation claim against an attorney even in the absence of privity. McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 792 (Tex. 1999); First National Bank of Durant v. Trans Terra Corporation International, 142 F.3d 802, 809 (5th Cir. 1998). The remainder of this paper will focus on the negligent misrepresentation exception to the privity rule.

B. NEGLIGENT MISREPRESENTATION

1. THE FIRST NATIONAL BANK OF DURANT DECISION.

a. THE FACTS. In 1993, Trans Terra Corporation International ("Borrower") approached the First National Bank of Durant ("Lender") for a $2 million loan. Id. at 805. In considering the loan request, Lender reviewed various title opinions that Borrower's attorney had prepared for Borrower. Id. Lender agreed to loan Borrower the money, but it requested a title opinion (addressed to Lender) regarding Borrower's collateral before the loan funded. Id. Borrower's attorney provided the opinion. Id. Although the opinion stated that the attorney had examined the applicable title records up to the date of the opinion, he had not done this. Id.

Borrower later defaulted on the loan. Id. When Lender attempted to foreclose on the collateral, it learned that the title opinions were incorrect because of the attorney's alleged negligence. Id. at 806. Lender then sued Borrower and its attorney. Id.

b. THE HOLDING. The Fifth Circuit's task in this diversity case was to decide the case as it believed the Supreme Court of Texas would. Id. Although the court followed Barcelo and ruled that there was no valid legal malpractice claim because of the privity rule, it relied on the intermediate appellate opinion in McCamish to hold that Lender was entitled to bring a negligent misrepresentation cause of action against Borrower's attorney. Id. at 808. A year later the Supreme Court of Texas confirmed that the Fifth Circuit decided this issue correctly under Texas law.

2. THE MCCAMISH SUPREME COURT DECISION.

a. THE FACTS. In McCamish, F.E. Appling Interests ("Appling") was a general partnership that served as the managing partner of Boca Chica ("Boca"), a joint venture formed to develop recreational property. McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d at 788. Boca obtained a loan from Victoria Savings Association ("VSA") in 1985 to finance a real estate project. Id. Boca accepted the loan based on VSA's oral representation that VSA would later expand the line of credit if the lot sales so justified. Id. However, in 1987, VSA decided not to extend the additional credit. Boca went bankrupt and eventually brought a lender liability suit against VSA. Id.

With the trial date in the lender liability suit approaching, Boca became anxious to settle the dispute because it was concerned that the FSLIC was going to declare VSA insolvent and take it over before a judgment could be obtained (if VSA were placed in receivership, Boca's claim would be unenforceable against VSA). Id. at 789. The parties reached a settlement agreement, but Appling agreed to sign the agreement only if VSA's lawyers (the McCamish law firm) would affirm that, pursuant to a federal statute, the agreement was enforceable against the FSLIC. Id. Subsequently, VSA was declared insolvent, and the FSLIC was appointed receiver. Id. at 790. A federal court later ruled that the settlement agreement was not binding on the FSLIC. Id. Upon receiving the ruling, Appling filed a negligent misrepresentation claim against the McCamish law firm. Id.

b. THE HOLDING. The Supreme Court began its analysis by holding that Section 552 of the Restatement (Second) of Torts applies to lawyers. Id. at 791. That section states, in pertinent part:

> One who, in the course of his business, profession or employment, or in any 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 or competence in obtaining or communicating the information.

Id.; Restatement (Second) Torts § 552. The Court distinguished the causes of action of legal malpractice and negligent misrepresentation and stated that, pursuant to Section 552, an attorney has an independent duty to a non-client based on his manifest awareness of the non-client's reliance on the misrepresentation and the lawyer's intention that the non-client rely on that misrepresentation. Id. at 792. The Court limited an attorney's potential liability to situations in which the attorney who provides the information is aware of the non-client and intends for the non-client to rely on the information. Id. at 794.

c. POLICY CONSIDERATIONS. Before McCamish, the Supreme Court of Texas stated that a bright line privity rule was justified in light of various policy considerations. See Barcelo v. Elliott, 923 S.W.2d at 577. The Court reasoned that without a bright line privity rule, clients would lose control over the attorney-client relationship and lawyers would be subject to almost unlimited liability. Id.

The McCamish Court reasoned that these policy concerns were not sufficiently significant for the Court to preclude a negligent misrepresentation claim against an attorney by a non-client. McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d at 793. The Court reasoned that a negligent misrepresentation cause of action would not result in clients' losing control over the attorney-client relationship because, under the Texas Disciplinary Rules of Professional Conduct, an attorney cannot give an evaluation to a third party unless he reasonably believes that making the evaluation is compatible with other aspects of the attorney-client relationship and the client consents after consultation. TEX. GOVT. CODE, Article 10, Section 9, State Bar Rule 2.02; McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d at 793. Moreover, the Court stated that a negligent misrepresentation cause of action does not present the possibility of unlimited liability because the class of potential claimants is narrowed by the elements of justifiable reliance and the communicating of false statements regarding material facts. Id. at 793-94.

3. HOW TO MINIMIZE RISK OF NEGLIGENT MISREPRESENTATION LIABILITY. In McCamish, the Court stated that a lawyer may avoid or minimize the risk of liability to a non-client by setting forth (1) limitations as to whom the representation is directed and who should rely on it, or (2) disclaimers as to the scope and accuracy of the factual investigation or assumptions forming the basis of the representation or the representation itself. Id.

4. IS EVERY STATEMENT MADE BY AN ATTORNEY ACTIONABLE? The answer is no. To begin with, it has already been established in the case law that supplying information that is merely "misleading" (as opposed to "false") will not support a claim for negligent misrepresentation. See, e.g., Continental Sav. Ass'n. v. Collins, 814 S.W.2d 829, 833 (Tex. App. – Houston [14th Dist.] 1991, writ denied). In addition, a misrepresentation that constitutes a promise of future conduct will not support a claim for negligent misrepresentation. See, e.g., Smith v. Sneed, 938 S.W.2d 181 (Tex. App. – Austin 1997, no writ). Therefore, there must be a false statement of an existing fact in order to support an allegation of negligent misrepresentation. See, e.g., Airborne Freight Corp. v. C.R. Lee Enterprises, 847 S.W.2d 289, 294-95 (Tex. App. – El Paso 1992, writ denied).

a. JUSTIFIABLE RELIANCE. In addition, the Court in McCamish believed that a significant limitation on potential liability is the requirement that a non-client "justifiably rely" on a lawyer's representation of material fact. Id. at 794. The Court stated:

> [S]ection 552 guards against exposure to unlimited liability by requiring that a claimant justifiably rely on a lawyer's representation of material fact. Thus, not every statement made by an attorney to a non-client is actionable under section 552. For example, an attorney's statements communicating her client's negotiating position are not statements of material fact . . . In determining whether section 552's justifiable reliance element is met, one must consider the nature of the relationship between the attorney, client and non-client. Generally, courts have acknowledged that a third party's reliance on an attorney's representation is not justified when the representation takes place in an adversarial context.

Id. Therefore, it appears that negligent misrepresentation claims against attorneys are limited to instances where the claimant is a non-adversary of the lawyer or his client.

(1) EXAMPLES OF JUSTIFIABLE RELIANCE.

(a) THE CENTRAL BANK DECISION.

(1) THE FACTS. The attorneys for a town and its development authority issued an opinion letter to a bank stating that a lawsuit against their clients had no merit. Mehaffy, Rider, Windholz & Wilson v. Central Bank Denver, N.A., 892 P.2d 230, 233 (Colo. 1995). The plaintiffs in the lawsuit had claimed that there was a defect in the adoption of the town's urban renewal plan. Id. Although the bank purchased notes in reliance on the opinion letter, it also submitted a private placement letter (a "comfort letter") to the town and the authority stating that the bank was relying on its own investigation of the material facts relating to the transaction. Id. at 234. When the approval of the

renewal plan was later invalidated and the bonds went into default, the bank sued the attorneys for negligent misrepresentation. Id.

(2) THE HOLDING. The court stated that the attorneys may have been liable for the alleged negligent misrepresentations made in the opinion letters and held that the issue of whether the "comfort letter" disclaimed the bank's reliance on the opinion letters was a fact issue that precluded summary judgment. Id. at 237 and 239. But see Garcia v. Rodey, Dickason, Sloan, Akin & Robb, 750 P.2d 118, 123 (N.M. 1988) (stating "The very nature of the adversary process precludes justifiable reliance by an opposing party").

(b) It is helpful to note how the concept of justifiable reliance has been construed in the context of negligent misrepresentation claims against accountants. Regarding this issue, the Fifth Circuit has stated:

> As the words of the phrase imply, justifiable reliance comprises two elements: (1) the plaintiff must in fact rely on the information; and (2) the reliance must be reasonable. The justifiableness of the reliance is judged in light of the plaintiff's intelligence and experience. For purposes of the tort of negligent misrepresentation, reliance is unjustified when the relying party is negligent.

Scottish Heritable Trust, PLC v. Peat Marwick Main & Co., 81 F.3d 606, 615 (5th Cir. 1996) (holding that a shareholder's reliance on accountant's alleged negligent misrepresentations was unjustified because the shareholder was extremely sophisticated, had virtually complete access to the financial records of the company in question, and already suspected that a problem existed with regard to the company's book value).

5. RECENT DECISIONS.

a. THE VILLASANA DECISION. In 1999, the Houston Court of Appeals, citing McCamish, stated that an attorney can be subject to a fraud claim even when that attorney would not be subject to a legal malpractice claim. Villasana v. Patout, Cannon & Co., 1999 WL 1018160 (Tex. App. – Houston [1st Dist.] 1999, no writ) (affirming a take-nothing summary judgment in favor of attorney who did not represent plaintiff or make any statements to plaintiff during the course of a corporate sale and dissolution). This extension of McCamish was probably unnecessary because of the Bernstein line of cases. See A.2.(a)(1) above.

b. THE CHAPMAN DECISION. In this case, an unsuccessful litigant sued the attorney who represented his opponent on the grounds that the attorney wilfully or negligently withheld a document from discovery (and denied its existence). Mitchell v. Chapman, 2000 WL 92073 (Tex. App. – Dallas 2000, pet. filed). The court of appeals distinguished McCamish, holding that the non-client did not have a valid cause of action against the attorney because (1) the relationship between the non-client and the attorney was "clearly adversarial" during the prior litigation, (2) the attorney did not provide false information for the guidance of the non-client in the context of a business transaction (under Section 552), and (3) the non-client did not fall within the "narrow class" of potential claimants listed in Section 552.

6. OTHER ISSUES.

a. WHAT IS A BUSINESS TRANSACTION? As mentioned above, Section 552 limits the scope of negligent misrepresentation by stating that it occurs when a person supplies false information for the guidance of others in business transactions. Texas case law provides little guidance with regard to the meaning of "business transactions" under

Section 552. Because of McCamish, we know that Section 552 applies when a lawyer undertakes to provide an opinion letter to an unrepresented third party for use by the third party in commercial business. In addition, the tort of negligent misrepresentation has been applied to a number of "personal business" transactions. See, e.g., Baskin v. Mortgage and Trust, Inc., 847 S.W.2d 743 (Tex. App. – Houston [14th Dist.] 1992, no writ) (personal homeowner claims); Chausee v. Dallas Cowboys Football Club, Ltd., No. 05-96-00429-CV (Tex. App. – Dallas 1997) (unpublished opinion) (football tickets).

b. CAN PRO BONO ADVICE BE THE BASIS FOR A NEGLIGENT MISREPRESENTATION CLAIM? The comment to Section 552 is helpful regarding this issue. It states:

> The fact that the information is given in the course of the defendant's business, profession or employment is a sufficient indication that he has a pecuniary interest in it, even though he receives no consideration for it at the time.

Restatement (Second) Torts § 552, Comment. However, "party talk" and "curbside legal advice" are probably not actionable:

> [W]hen one who is engaged in a business or profession steps entirely outside of it, as when an attorney gives a casual and offhand opinion on a point of law to a friend whom he meets on the street, or what is commonly called a "curbstone opinion," it is not to be regarded as given in the course of his business or profession; and since he has no other interest in it, it is considered purely gratuitous. The recipient of the information is not justified in expecting that his informant will exercise the care and skill that is necessary to insure a correct opinion and is only justified in expecting that the opinion will be an honest one.

Id.

III. CONCLUSION

A. HOW TO AVOID LIABILITY FOR NEGLIGENT MISREPRESENTATION.

1. Don't make any representations to non-clients. Tell everyone in the room that the representation that you are making is limited and directed only to your client.

2. If you must make representations to a non-client, first make sure that the non-client understands that you do not represent him. Then, do not provide any false information, make sure that it is clear to the non-client that he should not rely on your representation, and (if the representation is in writing) add a disclaimer regarding the scope and accuracy of the representation and the assumptions upon which you have made the representation.