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# When Non-Clients Attack

**By Julian Waldo and Amy Bomse**

Business deals sometimes disappoint, and when they do, disappointed investors may be inclined to look to hold the other side's lawyer liable. For example, a law firm recently agreed to pay $25 million to settle a suit filed by investors who contended that the firm assisted its client in defrauding the investors of hundreds of millions through an alleged Ponzi scheme.

When an attorney acts entirely behind the scenes, advising the client and drafting written communications intended purely for the client's internal use, the potential grounds for third parties to hold the attorney liable are quite narrow. Attorneys have a strong defense to claims for negligence, because, with only limited exceptions, attorneys owe no duty of care to non-clients who may be affected by the client's use of the attorney's advice. *B.L.M. v. Sabo & Deitsch,* 55 Cal. App. 4th 823, 830-34 (1997). So, for example, when an attorney mistakenly, even negligently, advises a client that a sale of securities is exempt from registration, the non-client purchasers have no legal basis for a negligence or malpractice claim against the lawyer. *Goodman v. Kennedy*, 18 Cal. 3d 335, 342-45 (1976).

There are two limited exceptions to this general rule. The lawyer may have a duty to a non-client if the client's engagement of the lawyer explicitly provided that the non-client third party was the intended third-party beneficiary of the legal services, as when the non-client stands to benefit from a will the attorney is drafting. A lawyer also may have a duty of care to a non-client if the non-client's interest is bound up with and dependent on the client's interest, such as one spouse's potential loss of consortium claim is with the client spouse's medical malpractice claim. But absent one of these situations, attorneys are not liable to non-clients for negligence.

Straight negligence being unavailable, disappointed investors may instead attempt to state a claim for fraud or negligent misrepresentation against the other side's lawyer. But an essential element in either claim is that the attorney made a representation to the plaintiff. See, e.g., *Vega v. Jones, Day, Reavis & Pogue*, 121 Cal. App. 4th 282, 291 (2004). Where the lawyers are merely providing advice behind the scenes, investors would likely be unable to satisfy this requirement.

The investors may seek to assert a claim for conspiracy to commit fraud to avoid this limitation. Under the agent's immunity rule, an attorney cannot usually be sued for conspiring with his client unless the attorney acts for financial gain (beyond the attorney's usual fees), or the attorney's acts violate a duty the attorney independently owes to the plaintiff. This rule protects attorneys against claims for conspiring with clients to violate fiduciary, statutory and contractual duties that are peculiar to the client. But because attorneys, like their clients, have an independent duty not to commit fraud, the agent's immunity rule does not bar claims against attorneys for conspiracy to commit fraud. *Favila v. Katten Muchin Rosenman LLP*, 188 Cal. App. 4th 189, 210 (2010). Thus, even an attorney who diligently confines his communications to his own client could find himself defending against a conspiracy to defraud claim by a non-client, although the pleading standards for such a claim are high and the plaintiff will have to plead and prove that the lawyer intended to aid in the fraud. Id. at 206.

An attorney's risks of potential liability to non-clients may be greater when the attorney drafts opinion letters, disclosures, or prospectuses and placement memoranda to be provided to third parties. In one frequently cited case, an appellate court found a lender had properly stated a negligent misrepresentation claim against a law firm by alleging the firm drafted an opinion letter designed to assist its client in securing a loan but failed to disclose additional facts that would have cast doubt on the firm's opinion. The court found the firm's intent to influence the lender's decisions with its letter gave rise to a duty to ensure the letter was not misleading. *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz,* 57 Cal. App. 3d 104,111 (1976).

In *Courtney v. Waring*, attorneys prepared a franchise prospectus for a client, but the prospectus allegedly misrepresented the experience of the franchisor's management, the franchisor's financial health, and the past and future success of franchisees. The court found that the complaint alleged sufficient facts to pursue a claim that the attorneys drafted the prospectus with the intent to induce the plaintiffs to buy franchises from the client. 191 Cal. App. 3d 1434, 1437-38, 1443-44 (1987). Though the plaintiffs actually sued for negligence ("legal malpractice"), the court purported to follow *Roberts* and treated the claim as if it were for negligent misrepresentation. As a result, *Courtney*'s continued relevance, if any, is likely limited to negligent misrepresentation claims.

In a more recent case, an Internet services company issued $2.84 million in bridge financing notes using offering documents drafted by the company, its placement agent, and their respective lawyers. The investors sued the placement agent and the law firms when the company defaulted on the notes and declared bankruptcy. *Apollo Capital Fund, LLC v. Roth Capital Partners, LLC*, 158 Cal. App. 4th 226 (2007). The firms' demurrers to the fraud and negligent misrepresentation claims were sustained and the firms settled when the plaintiffs appealed. The clients' demurrers to fraud and negligent misrepresentation claims against them were overruled on appeal.

Attorneys have other defenses to these claims as well. One predicate issue is whether an attorney can be said to have made a statement or representation at all. The Supreme Court held last year that only those with ultimate authority over the issuance and content of a statement can be liable under federal securities laws for "making" the statement. See *Janus Capital Grp. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011). No California appellate court has yet applied *Janus* to a negligent misrepresentation claim, however.

Additionally, an essential element of any claim for fraud or negligent misrepresentation is the plaintiff's justifiable reliance on the alleged misrepresentation, and courts may rightly be skeptical of a third party's claim that it justifiably relied on the opposite side's attorneys' statements. In *B.L.M. v. Sabo & Deitsch*, 55 Cal. App. 4th 823, 838-41 (1997), for example, the court held a non-client's reliance on an adverse party's attorney's opinion on a question of law was unjustified, since the attorney could not have provided the legal opinion directly to the non-client because that would create a conflict of interest. Where the investor-plaintiff was represented by its own counsel, courts may be dubious of a subsequent claim by the investor that it justifiably relied on the seller's counsel's advice. Id. at 836-37.

Finally, the statute of limitations for claims for negligent misrepresentation against attorneys is one year from the date of actual injury, tolled until the plaintiff's reasonable discovery of the facts constituting the wrongful act or omission, with an outside four-year limitations period. Code Civ. Proc. Section 340.6. Negligent misrepresentation claims are covered by this statute. *Quintilliani v. Mannerino*, 62 Cal. App. 4th 54, 69 (1998).

In sum, the risks of suits by non-clients increase when lawyers communicate directly with investors or other third parties, particularly when lawyers make factual representations. Ensuring that the representations are correct to the best of the lawyer's ability, including appropriate caveats and cautions, and encouraging investors to rely on their own counsel are all appropriate measures to take to reduce these risks.

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