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ATTORNEY LIABILITY TO THIRD PARTIES: A LOOK TO THE FUTURE

*Donald B. Hilliker**

INTRODUCTION

In 1983, the American Bar Association declared that lawyers have an ethical obligation to represent their clients competently.¹ Surprisingly, this was the first time the profession affirmatively expressed that, as professionals, lawyers must apply reasonably necessary legal knowledge, skill, thoroughness and preparation to their work.² Also in 1983, the organized bar recognized that the lawyer was no longer the single-minded advocate counseling an individual client.³

Under the 1969 American Bar Association's Code of Professional Responsibility, the lawyer's role was essentially that of an advocate and counselor who represented individual clients and eschewed unseemly "commercialism."⁴ Less than ten years later, the American Bar Association, dissatisfied with the Code as a statement of a lawyer's professional obligations, established a commission to evaluate professional standards.

The product of that Commission's work was the 1983 Model Rules of Professional Conduct. The Model Rules express the complex role of the lawyer in the 1980s as follows:

A lawyer is a representative of clients, an officer of the legal system and a public citizen having special responsibility for the quality of justice.

As a representative of clients, a lawyer performs various functions. As advisor, a lawyer provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications. As advocate, a lawyer zealously asserts the client's position under the rules of the adversary system. As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealing with others. As intermediary between clients, a lawyer seeks to reconcile their

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1. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 (1983).

2. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 comment (1983). Until 1970, some viewed competence as not being one of the lawyer's professional duties. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 6101(A)(3) (1980) (Model Code prohibited neglect of a legal matter but was silent as to competence).

3. See MODEL RULES OF PROFESSIONAL CONDUCT Preamble (1983).

4. See Address to the Banking, Corporate, Business Law Section, New York Bar Association, January 24, 1974.

divergent interests as an advisor and, to a limited extent, as a spokesperson for each client. A lawyer acts as evaluator by examining a client's legal affairs and reporting about them to the client or to others.⁵

From the counselor and advocate of the past, the lawyer is now also regarded as a negotiator, intermediary and evaluator. These latter roles are far more complex as the lawyer's loyalties and focus are no longer solely on his or her specific client.

The recognition of these varying roles of the lawyer reflects the startling changes that have occurred within the legal profession over the past twenty to twenty-five years. Beginning in the 1960s, congressional legislation injected lawyers and the courts into the workplace, marketplace, schools and the environment in ways unknown to any previous generation. At the same time, the nation's economy shifted from a manufacturing-based one to an information- and service-oriented consumer society. Over this period, the number of attorneys increased dramatically to almost 700,000, or about one lawyer for every 340 Americans.⁶ By the turn of the century, there could be well over 1,000,000 lawyers in this country.

As a service provider, the legal profession's dramatic expansion should not have been unexpected. Lawyers have become central players in the financial markets because legal services are essential to the successful sale of securities and the takeover of companies. The most profitable law firm in the country, Wachtell, Lipton, Rosen & Katz of New York City, reportedly generated annual profits of almost \$1,500,000 per partner in 1986 on the strength of its reputation as a takeover firm.⁷ Litigation has become the prevalent, though often maligned, means of transferring assets to persons injured in our current technological society.

As an industry, lawyers in private practice probably generated well over \$60 billion in gross income in 1986.⁸ This figure compares with \$19 billion in 1977⁹ and \$10.9 billion in 1972.¹⁰ Law is big business even when compared to major manufacturing and service industries. During 1982, for example, the \$34 billion of lawyer revenues surpassed both the \$4.2 billion earned by the motion picture industry and the \$11 billion harvested by the tobacco industry. Even the computer-equipment field generated less revenues than private attorneys.¹¹

5. See MODEL RULES OF PROFESSIONAL CONDUCT Preamble (1983).

6. Report of the Commission on Professionalism to the Board of Governors of the American Bar Association, American Bar Association Commission of Professionalism (1986) at 6.

7. *The Am Law 100*, AM. LAW., Jul.-Aug. 1987, at 32.

8. N.Y. Times, May 3, 1987, Part 2 (Magazine), at 55.

9. *Id.*

10. Flaherty, *The \$38 Billion Dollar Legal Market*, NAT'L L.J., Jan. 30, 1984, at 2.

11. BUREAU OF THE CENSUS, U.S. INDUSTRIAL OUTLOOK 1984, at 27-7, 52-53, 39-1; See also Flaherty, *supra* note 10, at 2. The statistics vastly underestimate the impact of lawyers on the economy by omitting government attorneys and corporate counsel, who comprise almost one-third of the entire bar.

Increasingly, aggressive competition for legal work has become the norm. With lawyer advertising given constitutional protection in 1976,¹² lawyers and law firms have openly competed with each other for lucrative work. That competition has grown and expanded to the point that law firms frequently seek quality lawyers through lateral hirings or mergers with other firms to improve their "product mix" for the potential client. Because the client is approached continually by other lawyers eager to replace existing counsel, the lawyer and law firm are increasingly colored as a service provider without great client loyalty and to whom the client has no close ties.

This emphasis on competition and the "sale" of a "quality product" by the firm or lawyer will likely cause more persons adversely affected by lawyer conduct to seek redress. This Article will address one aspect of lawyer liability—liability to third parties—which may well expand in the near future. The Article will first place third party liability in historical context and then discuss third party liability as it has developed for manufacturers and accountants. At that point, trends in the law of lawyer liability to third persons will be examined.¹³

I. HISTORICAL BACKGROUND

Third party liability has its historical roots in the privity of contract theory. In the 1842 landmark case of *Winterbottom v. Wright*,¹⁴ a British court refused to find the manufacturer of a mailcoach liable to a coachman injured when the coach suddenly collapsed. The court came to this conclusion because the parties lacked privity of contract. The court stated: "Unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, to which I can see no limit, would ensue."¹⁵ Subsequently, American courts construed this statement to mean that a third party not in privity with a defendant-manufacturer could not pursue a contract or tort action against a manufacturer for physical injuries arising from the manufacturer's negligent conduct.¹⁶

In *National Savings Bank v. Ward*,¹⁷ decided in 1880, the United States Supreme Court followed the *Winterbottom* analysis and held that in the

12. *Bates v. State Bar of Arizona*, 433 U.S. 350, *reh'g denied*, 434 U.S. 881 (1977).

13. This paper will not address attorney liability premised on statutory liabilities, particularly the federal and state securities laws and the Racketeering Influenced Corrupt Organizations Act of the Organized Crime Control Act of 1970. Those statutes have been used effectively in imposing liability by third parties against lawyers.

14. 152 Eng. Rep. 402 (1842).

15. *Id.* at 405. In *Winterbottom*, the injured driver sued the defendant-manufacturer who had contracted with the postal office to keep the mailcoach in adequate repair. *Id.* at 402-03.

16. *See, e.g., Lebourdais v. Vitrified Wheel Co.*, 194 Mass. 341, 80 N.E.2d 482 (1907); *Curtin v. Somerset*, 140 Pa. 70, 21 A. 244 (1891); *Loop v. Litchfield*, 42 N.Y. 351 (1870). *See Note, Public Accountants and Attorneys: Negligence and the Third Party*, 47 NOTRE DAME LAW, 588, 589-90 (1972) [hereinafter *Note, Public Accountants and Attorneys*].

17. 100 U.S. 195 (1880).

absence of fraud, collusion or privity of contract, an attorney could not be held liable to a non-client in an action arising from the negligent performance of his professional duties. *Ward* involved a suit by a creditor against an attorney in which the creditor alleged that he was induced to make a loan to the attorney's client on the basis of a negligently issued title certificate. The bank accepted a trust deed to property purportedly owned by the client as security on a \$500 loan, and when the client defaulted on the loan, the bank discovered that the secured property had been conveyed through a deed that the attorney negligently had overlooked.¹⁸ The Supreme Court held that although the attorney should have discovered the sale, a third party could not recover on the basis of negligence because the obligation of the attorney was to his client and not to a third party.¹⁹ The Court's decision was based on the line of English cases expressing concern that liability beyond the confines of contractual privity could lead to an impracticable extreme.²⁰

By 1916, the doctrine of strict privity as a prerequisite for liability began to be undermined in a negligence action involving bodily injury. In *MacPherson v. Buick Motor Co.*,²¹ a plaintiff was injured when the wheel of his car fell apart. The plaintiff had purchased the car from a retail dealer, who in turn had purchased it from the defendant-manufacturer.²² The plaintiff submitted evidence that a defect in the wheel could have been discovered by a reasonable inspection and that no such inspection had occurred.²³ *MacPherson* was decided on the issue of whether the defendant-manufacturer owed a duty of care and vigilance to anyone other than its immediate purchaser.²⁴ Justice Benjamin Cardozo concluded that when the nature of a product is such that it is reasonably certain to be dangerous when negligently made and that use of the product by third parties is reasonably foreseeable, the manufacturer is under a duty to third parties.²⁵

18. *Id.* at 196-98.

19. *Id.* at 200. The court stated that "unless there is something in the circumstance of this case to take it out of that general rule, it seems clear that the proposition of the defendant must be sustained." *Id.*

20. *Id.* at 202-03 (quoting *Winterbottom*, 152 Eng. Rep. at 402). Although the outcome in *Ward* was consistent with the authority of the day, a dissenting opinion noted that the circumstances of the case should have satisfied the attorney that his certificate was to be used as evidence of the facts he certified in a transaction with a third party. *Id.* at 207 (Waite, C.J., dissenting). Given that the certificate foreseeably would be used by third parties, three justices would have held the attorney liable to the bank for losses sustained in reliance on the certificate. *Id.* at 208.

21. 217 N.Y. 382, 111 N.E. 1050 (1916).

22. *Id.* at 384, 111 N.E. at 1051.

23. *Id.* at 385, 111 N.E. at 1051.

24. *Id.*

25. *Id.* at 389, 111 N.E. at 1053. Justice Cardozo stated:

We have put aside the notion that the duty to safeguard life and limb, when the consequences of negligence may be foreseen, grows out of contract and nothing else. We have put the source of the obligation where it ought to be. We have put its source in the law.

Id. at 390, 111 N.E. at 1053.

In 1922, the New York Court of Appeals, again in an opinion by Justice Cardozo, held that public weighers hired by a seller to certify the weight of beans could be liable to a buyer who had relied on the certificate despite the absence of contractual privity.²⁶ In *Glanzer v. Shepard*,²⁷ a certificate of weight was paid for by the seller, with copies furnished to the plaintiff-buyer. In extending a duty on the part of the weighers to the buyer, Justice Cardozo emphasized that the use of the certificate was not an indirect or collateral consequence of the defendants' actions, but rather was a "consequence which, to the [defendants'] knowledge, was the end and aim of the transaction."²⁸ The *Glanzer* outcome rested on the fact that the defendants were aware that the buyer would only complete the transaction in reliance on the certificate.²⁹

Justice Cardozo distinguished *Ward* on the basis that the attorney there had no knowledge of how the certificate of title was to be used or to whom it was to be presented.³⁰ Justice Cardozo was careful to distinguish between a casual response and the performance of an act intended to sway conduct.³¹ Finally, it is important to recognize that Justice Cardozo expressly declined to ground the outcome in *Glanzer* in terms of a contractual third party beneficiary theory, but rather defined the obligation in terms of a duty.³²

In 1931, the New York Court of Appeals faced a claim by a third party seeking to impose liability on accountants for the performance of professional

26. *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922).

27. *Id.*

28. *Id.* at 238-39, 135 N.E. at 275.

29. *Id.* at 239, 135 N.E. at 276.

30. *Id.* at 240, 135 N.E. at 276.

31. *Id.* at 241, 135 N.E. at 276-77. The court stated:

Here the defendants are held, not merely for careless words . . . but for the careless performance of a service—the act of weighing—which happens to have found in the words of a certificate its culmination and its summary The line of separation between these diverse liabilities is difficult to draw. It does not lose for that reason its correspondence with realities. Life has relations not capable always of division into inflexible compartments. The molds expand and shrink.

Id. (citations omitted).

32. *Id.* Justice Cardozo stated:

We state the defendants' obligation, therefore, in terms, not of contract merely, but of duty. Other forms of statement are possible. They involve, at most, a change of emphasis If we fix our gaze upon the aspect, we shall stress the element of contract, and treat the defendants' promise as embracing the rendition of a service which, though ordered and paid for by one, was either wholly or in part the benefit of another These other methods of approach arrive at the same goal, though the paths may seem at times to be artificial or circuitous. We have preferred to reach the goal more simply. The defendants, acting not casually, nor as mere servants, but in the pursuit of an independent calling, weighed and certified at the order of one with the very end and aim of shaping the conduct of another. Diligence was owing, not only to him who ordered, but to him also who relied.

services. In *Ultramares Corp. v. Touche*,³³ the court was confronted with a case where the “end and aim” of the contractual relationship was, at least arguably, designed to influence an unknown class of third parties. The defendant-accountants were employed by a corporation to prepare and certify a balance sheet exhibiting the condition of the corporation’s business.³⁴ The defendants were aware that the corporation required extensive credit and that the certified balance sheet would be exhibited to “banks, creditors, stockholders, purchasers or sellers . . . as the basis of financial dealings.”³⁵ Defendants, however, had no knowledge as to whom the balance sheets would be shown, or the extent or number of the transactions in which they would be used.³⁶ The plaintiff in *Ultramares* was a creditor of the corporation that had extended credit on the basis of the certified balance sheets that were ultimately found to be inaccurate.³⁷

Contemplating the prospect of “indeterminate liability to an indeterminate class,” Justice Cardozo balked at extending *Glanzer*:

If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.³⁸

Justice Cardozo distinguished *Glanzer* on the ground that reliance by the third party in *Glanzer* was foreseen at the time of the transaction:

Here was something more than the rendition of a service in the expectation that the one who ordered the certificate would use it thereafter in the operations of his business as occasion might require. Here was a case where the transmission of the certificate to another was not merely one possibility among many, but the “end and aim of the transaction,” as certain and immediate and deliberately willed as if a husband were to order a gown to be delivered to his wife, or a telegraph company, contracting with the sender of a message, were to telegraph it wrongly to the damage of the person expected to receive it.³⁹

Although the court held that the accountants were not liable for negligent misrepresentation outside the boundaries of contractual privity, Justice Cardozo noted that:

The assault upon the citadel of privity is proceeding in these days apace. How far the inroads shall extend is now a favorite subject of juridical

33. 255 N.Y. 170, 174 N.E. 441 (1931).

34. *Id.* at 173, 174 N.E. at 442.

35. *Id.* at 173-74, 174 N.E. at 442.

36. *Id.* at 174, 174 N.E. at 442.

37. *Id.* at 175, 174 N.E. at 443.

38. *Id.* at 179-80, 174 N.E. at 444.

39. *Id.* at 182, 174 N.E. at 445 (citations omitted).

discussion. In the field of the law of contract there has been a gradual widening of the doctrine of *Lawrence v. Fox*, 20 N.Y. 268, until today the beneficiary of a promise, clearly designated as such, is seldom left without a remedy. Even in that field, however, the remedy is narrower where the beneficiaries of the promise are indeterminate or general. Something more must then appear than an intention that the promise shall redound to the benefit of the public or to that of a class of indefinite extension. The promise must be such as to "bespeak the assumption of a duty to make reparation directly to the individual members of the public if the benefit is lost."⁴⁰

The assault upon privity acknowledged by Justice Cardozo in 1931 has continued to the present day. In a post-industrial society, this development is most pronounced in the field of product liability. Today, persons injured by almost any manufactured product have theories available upon which to posit a claim, due primarily to creative plaintiff's attorneys and courts that are receptive to using tort concepts as a surrogate for social insurance.

II. PRIVACY AND PRODUCT LIABILITY

For sixty years following the *Winterbottom* decision, few inroads were made on the requirement of privity for liability for physical damage caused by a manufacturer's negligence. For example, in *Boyd v. Coca Cola Bottling Works*,⁴¹ the Tennessee Supreme Court held that privity was not required for a plaintiff to bring a cause of action sounding in negligence against a manufacturer for injury resulting from food or drink.⁴² The court abolished privity in this situation because of the danger to health or life that can result from the lack of care in the preparation of food and beverages.⁴³ Aside from this very limited exception for imminently dangerous products, privity remained the rule with regard to the manufacturer's product.

As noted above, New York virtually abolished the holding in *Winterbottom* in the 1916 *MacPherson* decision, which held that a plaintiff suffering physical harm could sue an auto manufacturer for negligence despite the fact that the two parties were not in privity.⁴⁴ In reaching this conclusion, Justice Cardozo recognized that the circumstances giving rise to a duty of care will change with the needs of society.⁴⁵

This observation reflected the dramatic shift from an agricultural-based economy to a more urbanized, industrialized nation then occurring in this country. Certainly, a basic reason that manufacturers lost their treasured protection of privity was due to a growing concern for and awareness of

40. *Id.* at 180-81, 174 N.E. at 445 (citations omitted).

41. 132 Tenn. 23, 177 S.W. 80 (1914).

42. *Id.* at 30-31, 177 S.W. at 81.

43. *Id.* at 28, 177 S.W. at 81.

44. *MacPherson*, 217 N.Y. at 394, 111 N.E. at 1054. See *supra* notes 14-15 and accompanying text.

45. *MacPherson*, 217 N.Y. at 391, 111 N.E. at 1053.

consumer safety and protection. By 1916, the industrialization of the nation combined with the development of ever larger companies and mass produced products reduced the "protectionist" sentiment for manufacturers found in cases such as *Winterbottom*. Thus, for the first time in American history, manufacturers were widely exposed to liability in suits brought by consumers claiming negligence.

MacPherson also set the stage for courts to impose higher and more stringent standards of care on manufacturers by allowing those not in privity to pursue contract remedies. Specifically, this was accomplished through breach of warranty claims.⁴⁶ For example, in 1932, the Supreme Court of Washington, in *Baxter v. Ford Motor Co.*,⁴⁷ was the first court to recognize that a plaintiff not in privity with the defendant-manufacturer could sue the manufacturer for breach of an express warranty.⁴⁸

In 1960, the Uniform Commercial Code requirement of privity for the implied warranties of merchantability and fitness for a particular purpose was discarded in *Henningsen v. Bloomfield Motors, Inc.*⁴⁹ In *Henningsen*, the plaintiff was injured when the steering wheel failed on the car she was driving. The plaintiff's husband had purchased the auto from a car dealer. The court stated:

[W]here the commodities sold are such that if defectively manufactured they will be dangerous to life or limb, then society's interests can only be protected by eliminating the requirement of privity between the maker and his dealers and the reasonably expected ultimate consumer. In that way the burden of losses consequent upon use of defective articles is borne by those who are in a position to either control the danger or make an equitable distribution of the losses when they do occur.⁵⁰

Henningsen was the first United States case to find a manufacturer liable to third parties for breach of implied warranties.⁵¹

Three years later, the California Supreme Court made the injured consumer's burden even lighter by breaking out of contract-based theory to create the independent cause of action of strict liability in tort. In *Greenman v. Yuba Power Products, Inc.*,⁵² Justice Traynor explained the reasons for

46. See *supra* notes 21-25 and accompanying text.

47. 168 Wash. 456, 12 P.2d 409 (1932).

48. *Id.* at 463, 12 P.2d at 412.

49. 32 N.J. 358, 161 A.2d 69 (1960).

50. *Id.* at 379, 161 A.2d at 81.

51. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791 (1966). According to Dean Prosser, *Henningsen* reflects the fall of Cardozo's "citadel of privity in products liability." Prosser wrote: "In the field of products liability, the date of the fall of the citadel of privity can be fixed with some certainty. It was May 9, 1960, when the Supreme Court of New Jersey announced the decision in *Henningsen v. Bloomfield Motors, Inc.*". Wheeler, *A Brief History of the Development of Modern Product Liability Law*, 183 P.L.I. LITIGATION AND ADMINISTRATIVE PRACTICE 15, 22 (1981).

52. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962).

imposing strict product liability in tort on the manufacturer: "The purpose of such liability is to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves."⁵³

The recognition in product liability cases that injured parties can recover both personal and economic losses suffered from a defective product is instructive to providers of services. Important, too, is the development of a duty imposed on manufacturers to warn the public of the dangerous propensities of a product. The duty to warn, grounded in concepts of misrepresentation and disclosure, requires manufacturers to not only make safe products, but also to fully warn potential users of dangerous propensities.⁵⁴

As society has become more sophisticated and more dependent on technologically or chemically complex products, and as society has become more sophisticated in its ability to trace maladies to various sources—such as asbestos, Agent Orange, fertility and birth control drugs—the courts have been willing to fashion remedies for the injured. Similar developments can be expected for service providers such as accountants and lawyers.

III. PRIVACY AND THE ACCOUNTANT

In recent years, courts have reexamined the privity rule articulated in *Ultramares* in which Justice Cardozo expressed concern that the imposition of liability for negligent misrepresentation could threaten the viability of the accounting profession.⁵⁵

The initial deviation from Justice Cardozo's opinion in *Ultramares* came in 1968 in *Rusch Factors, Inc. v. Levin*.⁵⁶ In *Rusch*, a New York plaintiff loaned a Rhode Island corporation over \$337,000. Plaintiff made these loans based upon financial statements certified by the defendant-accounting firm. Although the financial statements showed the Rhode Island corporation to be in sound financial condition, the corporation soon went into bankruptcy.⁵⁷ Plaintiff filed suit against the accountant, alleging negligent preparation of

53. *Id.* at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701; Wheeler, *A Brief History of the Development of Modern Product Liability Law*, 183 P.L.I. LITIGATION AND ADMINISTRATIVE PRACTICE 15, 23 (1981). Barely twenty years later, product liability law has become one of the major sources of civil litigation. Law school tort classes in the 1960s scarcely devoted any time to product liability law, while today law schools offer whole courses to the discipline with treatises and case books devoted solely to the subject.

54. *Woodill v. Parke Davis & Co.*, 79 Ill. 2d 26, 402 N.E.2d 194 (1980) (in strict liability claim, requirement that plaintiff allege and prove that defendant knew or should have known of danger is limited to complaints that allege breach of the duty to adequately warn).

55. See *supra* notes 33-40 and accompanying text.

56. 284 F. Supp. 85 (D.R.I. 1968). See generally Note, *Public Accountants and Attorneys*, *supra* note 16 (detailed case-by-case analysis of development of accountant liability to third parties).

57. *Rusch*, 284 F. Supp. at 86-87.

the financial statements.⁵⁸ Citing *Ultramares*, the defendant immediately moved to dismiss the suit, claiming that plaintiff could not sue him because the two were not in privity of contract.⁵⁹

The *Rusch* court recognized the precedential weight of *Ultramares*,⁶⁰ but nevertheless criticized the decision:

The wisdom of the decision in *Ultramares* has been doubted . . . and this Court shares the doubt. Why should an innocent reliant party be forced to carry the weighty burden of an accountant's professional malpractice? Isn't the risk of loss more easily distributed and fairly spread by imposing it on the accounting profession, which can pass the cost of insuring against the risk onto its customers, who can in turn pass the cost onto the entire consuming public? Finally, wouldn't a rule of foreseeability elevate the cautionary techniques of the accounting profession? For these reasons, it appears to this Court that the decision in *Ultramares* constitutes an unwarranted inroad upon the principle that "[t]he risk reasonably to be perceived defines the duty to be obeyed."⁶¹

The court denied the defendant's motion to dismiss and held that accountants should be liable for negligent misrepresentations relied upon "by actually foreseen and limited classes of persons."⁶² However, the court reserved until trial the question of whether to extend an accountant's liability to the full limits of foreseeability.⁶³

Rusch was the first opinion to hold an accountant liable to third parties for negligent preparation of financial statements.⁶⁴ Although the court did not address the question of whether to extend liability of accountants to the full limits of foreseeability, it nevertheless greatly broadened accountants' exposure to liability in the absence of privity. *Rusch* was soon followed by the Iowa Supreme Court in *Ryan v. Kanne*.⁶⁵

58. *Id.* at 87.

59. *Id.*

60. The court stated, "The reluctance of the courts to hold the accounting profession to an obligation of care which extends to all reasonably foreseeable reliant parties is predicated upon the social utility rationale first articulated by Judge Cardozo in the *Ultramares* case." *Id.* at 90.

61. *Id.* at 90-91 (quoting *Palsgraf v. Long Island R.R. Co.*, 248 N.Y. 339, 344, 162 N.E. 99, 100 (1928)) (citations omitted). The court then proceeded to find that the facts in *Rusch* were qualitatively distinguishable from *Ultramares*. The court properly observed that in *Ultramares*, "the plaintiff was a member of an undefined, unlimited class of remote leaders and potential equity holders not actually foreseen but only foreseeable." *Id.* at 91. The plaintiff in *Rusch*, however, was "a single party whose reliance was actually foreseen by the defendant." *Id.* Thus, the court found this case far more analogous to *Glanzer* than to *Ultramares*.

62. *Id.* at 93.

63. *Id.*; Note, *Public Accountants and Attorneys*, *supra* note 16, at 598-99.

64. *Rusch*, 284 F. Supp. at 90; Note, *Public Accountants and Attorneys*, *supra* note 16, at 598.

65. 170 N.W.2d 395 (Iowa 1969).

Factually similar to *Rusch*,⁶⁶ *Ryan* criticized the rationale of *Ultramares*, stating that accountants should accept legal responsibility to known third parties who reasonably rely on financial statements negligently prepared and submitted.⁶⁷ The court based this holding on the rationale of *Rusch*,⁶⁸ *Glanzer*⁶⁹ and section 552 of the *Restatement (Second) of Torts*.⁷⁰ *Ryan*, like

66. *Ryan* was an action seeking recovery of fees filed by plaintiff-accountants, followed by a counterclaim back by one of the defendants, Kanne Lumber and Supply, Inc. Defendant James A. Kanne, owner of the lumber business, had hired the plaintiff-accountants to prepare his financial statement. Defendant informed plaintiffs that a corporation interested in taking over his business would examine the financial statement and therefore cautioned plaintiffs to "[u]se every conceivable means to determine the accounts payable." *Id.* at 397. Plaintiffs guaranteed that the accounts payable figure reflected on the financial statement was accurate within \$5,000. In examining accounts payable, however, plaintiffs reviewed nine months of records rather than the twelve months that defendant had requested. As a result, plaintiffs' financial statement showed that defendant had a net worth of almost \$45,000 when, in fact, defendant's business was over \$5,000 in deficit.

The Supreme Court of Iowa affirmed the trial court's decision holding that plaintiffs were negligent in their examination, preparation, and submission of the defendant's financial statement. The court stated that the lack of privity was not a valid defense to a claim for damages based upon the accountants' negligence. As the court explained, "We know of no good reason why accountants should not accept the legal responsibility to know third parties who reasonably rely upon financial statements prepared and submitted by them." *Id.* at 401.

67. *Id.* at 401. The court stated:

When the accountant is aware that the balance sheet to be prepared is to be used by a certain party or parties who will rely thereon in extending credit or in assuming liability for obligations of the party audited, the lack of privity should be no valid defense to a claim for damages due to the accountant's negligence. We know of no good reason why accountants should not accept the legal responsibility to know third parties who reasonably rely upon financial statements prepared and submitted by them.

68. *See supra* notes 60-62 and accompanying text.

69. *See supra* notes 30-32 and accompanying text.

70. The Restatement provides:

(1) One who, in the course of his business, profession or employment, or a 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 such information if he fails to exercise reasonable care or competence in obtaining or communicating the information.(2) Except as stated in subsection (3), the liability stated in subsection (1) is limited to loss suffered:

(a) by the person or one of a 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.

RESTATEMENT (SECOND) OF TORTS § 552 (1977), cited in *Ryan*, 170 N.W.2d at 403. In *White v. Guarente*, 43 N.Y.2d 356, 372 N.E.2d 315, 316 (1977), the court applied the *Glanzer* rationale to hold an accountant liable to limited partners in a tax shelter offering. In later cases, New York courts have been unwilling to extend accountant liability beyond *Glanzer* and have construed *White* quite narrowly. *But see* discussion in *Quintel Corp., N.V. v. Citibank, N.A.*, 589

Rusch, did not determine whether liability should be extended to the full limits of foreseeability because resolution of that issue was not necessary to the outcome of the case.⁷¹

The major break from *Ultramares* came in *H. Rosenblum, Inc. v. Adler*,⁷² a 1983 New Jersey Supreme Court decision. The *Rosenblum* plaintiffs claimed that they relied on audits of Giant Stores, Inc. in deciding to accept Giant common stock in exchange for the sale of their business to Giant.⁷³ Eventually, it was discovered that the financial statements were fraudulent and Giant's common stock was worthless.⁷⁴ Plaintiffs asserted that Touche Ross & Company's negligent misconduct in performing the audit of Giant was the cause of their financial loss.⁷⁵ The court held:

When the independent auditor furnishes an opinion with no limitation in the certificate as to whom the company may disseminate the financial statements, he has a duty to all those whom that auditor should reasonably foresee as recipients from the company of the statements for its proper business purposes, provided that the recipients rely on the statements pursuant to those business purposes.⁷⁶

To reach this landmark result, the unanimous court reviewed the history of accountant liability from *Ultramares*, the development of liability of product manufacturers⁷⁷ and the role of the accountant in modern day

F. Supp. 1235 (S.D.N.Y. 1984) (separate counsel for limited partner could not establish breach of duty by law firm representing limited partnership because no facts were alleged to support attorney-client relationship between the firm and the limited partner, there being no privity between the two nor any reasonable foreseeability that the limited partner would rely on the partnership's counsel to act as partner's lawyer).

71. *Ryan*, 170 N.W.2d at 403. Damages were limited to the difference between the reported and actual amounts payable minus the margin of error guaranteed by defendant, plus the reasonable cost of securing the corrected statement. *Id.* at 407. See generally Gormley, *The Foreseen, the Foreseeable, and Beyond—Accountants' Liability to Nonclients*, 14 SETON HALL 528 (1984) (exploration of the evolution of law governing accountants' liability to third parties and prediction of how recent developments and court decisions may affect the accounting profession).

72. 93 N.J. 324, 461 A.2d 138 (1983). Coincidentally, Touche Ross & Co. was the defendant in this action, as in *Ultramares* (each individual Touche Ross partner was named and served in this action; hence, the case caption). It is submitted that *Rosenblum* reflects the beginning of the decline, if not yet the actual obliteration, of the citadel of privity for accountants.

73. *Id.* at 329, 461 A.2d at 140.

74. *Id.*

75. *Id.*

76. *Id.* at 352, 461 A.2d at 153.

77. *Id.* at 334-41, 461 A.2d at 142-47. The court went on to say:

Why should a claim of negligent misrepresentation be barred in the absence of privity when no such limit is imposed where the plaintiff's claim also sounds in tort, but is based on liability for defects in products arising out of a negligent misrepresentation? If recovery for defective products may include economic loss, why should such loss not be compensable if caused by negligent misrepresentation?

financial markets.⁷⁸ The court noted that audits are no longer solely for management's use⁷⁹ and concluded, "The auditor's function has expanded from that of a watchdog for management to an independent evaluator of the adequacy and fairness of financial statements issued by management to stockholders, creditors and others."⁸⁰ The court explicitly acknowledged that accountants are critical to the financial marketplaces of the nation's economy.⁸¹

Less than a month after *Rosenblum*, the Wisconsin Supreme Court, in *Citizens State Bank v. Timm, Schmidt & Co., S.C.*,⁸² issued a similar decision. *Timm* explicitly rejected the limitations of the Restatement as too restrictive.⁸³ The court relied on *Auric v. Continental Casualty Co.*,⁸⁴ which had held an attorney liable to a will beneficiary not in privity with the attorney for negligent supervision of the execution of a will.⁸⁵ *Auric* reasoned that imposition of liability on attorneys would result in careful fulfillment of their duties to clients.⁸⁶ *Timm* concluded that *Auric's* rationale was applicable and offered additional policy reasons for the imposition of liability on accountants:

The maker of the product and the person making a written representation with intent that it be relied upon are, respectively, impliedly holding out that the product is reasonably fit, suitable and safe and that the representation is reasonably sufficient, suitable and accurate. The fundamental issue is whether there should be any duty to respond in damages for economic loss owed to a foreseeable user neither in privity with the declarant nor intended by the declarant to be the user of the statement or opinion.

Id. at 341, 461 A.2d at 147.

78. *Id.* at 332-47, 461 A.2d at 142-50.

79. *Id.* at 346, 461 A.2d at 149.

80. *Id.* For a contrary discussion on the impact of liability on accountants, see *Briggs v. Sterner*, 529 F. Supp. 1155, 1175-77 (S.D. Iowa 1981).

81. *Rosenblum*, 93 N.J. at 342-43, 461 A.2d at 147-48.

82. 113 Wis. 2d 376, 335 N.W.2d 361 (1983).

83. *Id.* at 386, 335 N.W.2d at 366. In *Timm*, the accounting firm prepared financial statements for Clintonville Fine Apparatus, Inc. (CFA) which included a comparative statement of financial condition, a statement of yearly income, and a statement of changes in financial position. Additionally, the firm sent an opinion letter to its client "which stated that the financial statements fairly presented the financial condition of CFA and that the statements were prepared in accordance with generally accepted accounting principles." The plaintiff-bank made a \$300,000 loan to CFA in 1975 after reviewing the financial statements defendant had prepared. Additional loans were made in 1976. In 1977, while preparing CFA's financial statement for 1976, defendant discovered that the 1974 and 1975 statements contained errors approximating \$400,000. The defendant corrected the errors and informed the plaintiff which called all of its loans due. CFA consequently went into receivership and was liquidated and dissolved. As of the date the complaint was filed, CFA's outstanding loans exceeded \$150,000.00. *Id.* at 378-79, 335 N.W.2d at 362.

84. 111 Wis. 2d 507, 331 N.W.2d 325 (1983).

85. *Timm*, 113 Wis. 2d at 384, 335 N.W.2d at 365 (citing *Auric*, 111 Wis. 2d at 514, 331 N.W.2d at 327).

86. *Id.* (citing *Auric*, 111 Wis. 2d at 513, 331 N.W.2d at 328).

If relying third parties, such as creditors, are not allowed to recover, the cost of credit to the general public will increase because creditors will either have to absorb the costs of bad loans made in reliance on faulty information or hire independent accountants to verify the information received. Accountants may spread the risk through the use of liability insurance.⁸⁷

Building on *Timm* and *Rosenblum*, a California appellate court early in 1986 held that an independent auditor owed a duty of due care to reasonably foreseeable plaintiffs who relied on negligently prepared audited financial statements.⁸⁸ The court concluded that the *Ultramares* rule protecting accountants from liability in the absence of privity was no longer valid because of the changed role of the accountant in modern society.⁸⁹ The court reasoned that the burden of the professional's malpractice should more appropriately be placed on the accounting profession rather than on the plaintiff because the profession is capable of passing the risk to its customers and the public. Such a shift of the risk of loss would, according to the court, provide "a financial disincentive for negligent conduct and will heighten the profession's cautionary techniques."⁹⁰

Although abolition of the privity requirement has not yet been accepted by all jurisdictions for accountant negligence, the trend is clear. With the growing realization that economic harm is as deserving of recompense as physical harm, it can be expected that courts will continue to expand accountant liability. Accountants will soon lose the benefits of the privity defense due to policy concerns for third parties who are economically harmed by accountant negligence.

87. *Id.* at 384, 335 N.W.2d at 365.

88. *International Mortgage Co. v. John P. Butler Accountancy Corp.*, 177 Cal. App. 3d 806, 223 Cal. Rptr. 218 (1986). In *International Mortgage Co.*, the defendant accounting firm entered into an agreement with Westside Mortgage Inc. to audit its financial statements for 1978. Defendant issued an unqualified audited financial statement in March 1979 and listed Westside's corporate net worth at \$175,000. The primary asset of the company was a \$100,000 note secured by a deed of trust on real property. The footnotes to the statement indicated that the fair market value of the realty was \$115,000.00 The note was, in fact, worthless since the deed of trust had been rendered invalid by a prior foreclosure of a superior deed of trust at a trustee's sale in 1977.

Plaintiff approached Westside "for the purpose of buying and selling loans on the secondary market." Westside provided plaintiff with copies of its financial reports from defendant. Without the note secured by the deed, Westside was capitalized at under \$100,000 and, therefore, was not qualified to do business in the FHA loans included in its agreement with plaintiff. Defendant was aware at the time of the audit that Westside needed a capitalization of at least \$100,000 to qualify for FHA business. In 1980, Westside entered into a series of contracts to sell government loans to plaintiff. However, it failed to deliver the trust deeds, causing a loss to plaintiff of \$475,000. Westside issued a promissory note for the amount in question. It paid \$40,000 and defaulted on the balance. *Id.* at 809-10, 223 Cal. Rptr. at 219-20.

89. *Id.* at 812, 223 Cal. Rptr. at 221.

90. *Id.* at 820, 223 Cal. Rptr. at 227.

IV. PRIVACY AND THE ATTORNEY

Three early California decisions forged the way in extending the scope of attorney liability beyond the bounds of contractual privity.⁹¹ In *Biakanja v. Irving*,⁹² the California Supreme Court held that a notary public who agreed to prepare a will could be held liable to the intended beneficiaries of the will despite the absence of contractual privity.⁹³ The court recognized a duty to an intended beneficiary outside the bounds of a contractual relationship.⁹⁴ The court held that the determination of liability to third parties in the absence of privity is a matter of public policy in which various factors must be balanced: 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.⁹⁵ The court concluded that, in the context of a negligently drafted will, the "end and aim" of the transaction was to provide for the passage of the estate to the intended beneficiaries.⁹⁶ Here, Justice Cardozo's reasoning in *Glanzer* resurfaced in that third party liability was held appropriate where the very purpose of the transaction was to benefit the third person.⁹⁷

Three years after *Biakanja*, the California Supreme Court reached the same conclusion in a case involving negligent drafting of a will. In *Lucas v. Hamm*,⁹⁸ the court ruled that the factors that had led *Biakanja* to extend liability of a notary public beyond contractual privity were equally applicable in a case involving an attorney.⁹⁹ Because the defendant in *Lucas* was a

91. See *infra* notes 92-104 and accompanying text.

92. 49 Cal. 2d 647, 320 P.2d 16 (1958).

93. *Id.* at 651, 320 P.2d at 19.

94. The court expressed disapproval of *Buckley v. Gray*, 110 Cal. 339, 42 P. 900 (1895), an 1895 case that had relied on *Ward*, in reaching the contrary result in the context of a suit brought by an intended beneficiary. *Biakanja*, 49 Cal. 2d at 648-49, 320 P.2d at 18. See *supra* notes 17-20 and accompanying text for a discussion of *Ward*. The court noted that at the time of the decision in *Buckley*, with few exceptions, there was no liability for negligence committed in the performance of a contract without privity. The court recognized that since that time, however, courts had liberalized the privity rule to a significant extent in other areas of the law such as products liability. *Biakanja*, 49 Cal. 2d at 648-49, 320 P.2d at 18. The court stated: "Liability has been imposed, in the absence of privity, upon suppliers of goods and services which, if negligently made or rendered, are 'reasonably certain to place life and limb in peril.'" *Id.* at 649, 320 P.2d at 18 (citing *MacPherson* 217 N.Y. 382, 389, 111 N.E. 1050, 1053 (N.Y. 1916)).

95. *Id.* at 650, 320 P.2d at 19.

96. *Id.*

97. *Id.* As Justice Cardozo stated in *Glanzer*, 233 N.Y. 236, 242, 135 N.E. 275, 277 (1922): "Diligence was owing, not only to him who ordered, but to him who also relied."

98. 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961).

99. *Id.* at 588-59, 364 P.2d at 687-88, 15 Cal. Rptr. at 823-24. *Biakanja* involved a notary who was not a licensed attorney. *Id.* at 588, 364 P.2d at 687, 15 Cal. Rptr. at 823. In

licensed attorney, the court considered the additional factor of whether the extension of liability would impose an undue burden on the legal profession.¹⁰⁰ The court concluded that, although the extension of liability could be extensive and unpredictable, it would not place an undue burden on the profession, particularly where a contrary conclusion would place the entire burden of loss on an innocent plaintiff.¹⁰¹ *Lucas* noted that an intended beneficiary of a will could recover as a third party beneficiary to the contract between the attorney and client, and also recognized a duty sounding in tort.¹⁰²

In *Heyer v. Flaig*,¹⁰³ the California Supreme Court ruled that the availability of a contractual third party beneficiary remedy is conceptually superfluous in light of the fact that the heart of the *Lucas* decision recognized recovery in tort for a breach of a duty owed directly to a third party.¹⁰⁴

The California Supreme Court next addressed the issue of liability to third parties arising out of the rendering of legal advice. *Goodman v. Kennedy*¹⁰⁵ addressed the question of whether an attorney's duty of care in rendering legal advice extends to persons with whom the attorney's client deals at arm's length. In *Goodman*, plaintiff-stock purchasers alleged that the defendant-attorney had negligently advised corporate officers that certain shares of their company's stock could be issued to them as dividends and sold to third parties without jeopardizing a statutory registration exemption.¹⁰⁶ The advice proved to be incorrect, and the plaintiff-purchasers suffered damages resulting from a decline in the value of the stock when the exemption was disqualified.¹⁰⁷ The court concluded that an attorney owes no such duty in

Lucas, the beneficiaries of a testamentary trust brought action for damages against the attorney who had prepared the will. Defendant-attorney negligently prepared testamentary instruments resulting in monetary loss to plaintiffs. *Id.* at 586, 364 P.2d at 686-87, 15 Cal. Rptr. at 822.

100. *Id.* at 589, 364 P.2d at 688, 15 Cal. Rptr. at 824.

101. *Id.* However, the defendant was not held liable either to his client or to a beneficiary under a will for the errors of the kind alleged. *Id.* at 591, 364 P.2d at 689, 15 Cal. Rptr. at 825.

102. *Id.* As the court explained:

Since, in a situation like those presented here and in the *Buckley* case, the main purpose of the testator in making his agreement with the attorney is to benefit the persons named in his will and this intent can be effectuated, in the event of a breach by the attorney, only by giving the beneficiaries a right of action, we should recognize, as a matter of policy, that they are entitled to recover as third party beneficiaries.

Id.

103. 70 Cal. 2d 223, 449 P.2d 161, 74 Cal. Rptr. 225 (1969).

104. *Id.* at 226-29, 449 P.2d at 164-65, 74 Cal. Rptr. at 227-29. In *Heyer*, plaintiffs brought an action under a negligence theory against an attorney for failure to advise testatrix of the consequences of a post-testamentary marriage and failure to include in a will any provision related to intended marriage. *Id.* at 224-25, 449 P.2d at 162-63, 74 Cal. Rptr. at 226-27.

105. 18 Cal. 3d 335, 556 P.2d 737, 134 Cal. Rptr. 375 (1976).

106. *Id.* at 339, 556 P.2d at 740, 134 Cal. Rptr. at 378.

107. *Id.*

the absence of a showing that the legal advice was foreseeably transmitted to or relied on by a third party or that the third party was an intended beneficiary of a transaction to which the advice pertained.¹⁰⁸

Goodman rejected the purchasers' claims because the defendant had no relationship with the plaintiffs that would result in a duty of care arising out of advice to his client.¹⁰⁹ The court noted that there was no indication that the attorney's advice was ever communicated to the plaintiffs or that the plaintiffs relied on this advice in purchasing the stock.¹¹⁰ Furthermore, the court pointed out that the advice was not given for the purpose of enabling the clients to discharge any obligation to the plaintiffs.¹¹¹ The court also noted the risk that a contrary result would inject undesirable self-protective reservations into the attorney's counseling role. The attorney could become preoccupied with the possibility of claims based on negligence by anyone with whom the client might deal. This could hinder the attorney's devotion of energies to the client, resulting in "an undue burden on the profession." Consequently, the court reasoned, the quality of legal services received by the client would be diminished.¹¹²

The California Supreme Court was careful to distinguish *Goodman* from a situation where legal advice is foreseeably transmitted or relied on by a third party.¹¹³ In *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*,¹¹⁴ a plaintiff creditor was alleged to have been induced to make substantial loans to a partnership on the basis of a letter given to a member of the partnership by the defendant-attorneys.¹¹⁵ The letter stated that in the law firm's professional

108. *Id.* at 343-44, 556 P.2d at 743, 134 Cal. Rptr. at 381.

109. *Id.*

110. *Id.* at 345, 556 P.2d at 744, 134 Cal. Rptr. at 382

111. *Id.* at 344, 556 P.2d at 743, 134 Cal. Rptr. at 381. The court stated:

[P]laintiffs were not persons upon who defendant's clients had any wish or obligation to confer a benefit in the transaction. Plaintiffs' only relationship to the proposed transaction was that of parties with whom the defendant's clients might negotiate a bargain at arm's length. Any buyer's "potential advantage" from the possible purchase of the stock "was only a collateral consideration of the transaction" . . . and did not put such potential buyers into any relationship with defendant as "intended beneficiaries" of his clients' anticipated sales.

Id.

112. *Id.*

113. *Id.* at 343 n.4, 556 P.2d at 743 n.4, 134 Cal. Rptr. at 381 n.4. The *Goodman* court explained:

We are therefore not concerned with such cases as *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 57 Cal. App. 3d 104, 110-111, 128 Cal. Rptr. 901 (1976), in which an attorney gives his client a written opinion with the intention that it be transmitted to and relied upon by the plaintiff in dealing with the client. In that situation, the attorney owes the plaintiff a duty of care in providing the advice because the plaintiff's anticipated reliance upon it is "the end and aim of the transaction" (*Glanzer v. Shepard*, 233 N.Y. 236, 238-239, 135, N.E. 275) (1922)).

Id.

114. 57 Cal. App. 3d 104, 128 Cal. Rptr. 901 (1976).

115. *Id.* at 108, 128 Cal. Rptr. at 904.

opinion, the partnership was a general partnership consisting of fourteen members. The plaintiff-creditor subsequently sustained damages in an attempt to establish the liability of the partners as general partners.¹¹⁶ The court concluded that the harm to the plaintiff was clearly foreseeable since the purpose of the opinion concerning the partner status was given to influence the plaintiff's conduct.¹¹⁷

From these relatively early California decisions, lawyer liability to third parties has developed slowly. The reluctance of courts to extend lawyer liability reflects concern over compromising the attorney's counseling and advisory role as an advocate and representative of an individual client's interests.¹¹⁸ For example, in *Pelham v. Griesheimer*,¹¹⁹ the Illinois Supreme Court held that although privity of contract is not an indispensable element in establishing a duty of care between a non-client and an attorney in a suit for legal malpractice, the better approach is to require that plaintiffs allege and prove that the intent of the client to benefit the non-client third party was the primary or direct purpose of the transaction or relationship.¹²⁰ In *Pelham*, the children of divorced parents brought an action against their mother's attorney. The children alleged that the attorney negligently failed to take steps necessary to have them named beneficiaries of their father's group life insurance policy as required by a divorce decree. Following the divorce, the father died, the new wife collected the policy benefits.¹²¹ The key consideration, according to the court, was whether the attorney acted at the direction or on behalf of the client to benefit or influence a third party.¹²²

Although *Pelham* acknowledged that the analogy to a contractual third party direct beneficiary provides for a narrower scope of liability than the balancing approach used in California, the court maintained that even under the California test the predominant inquiry is generally the extent to which services are intended to affect the third party.¹²³ The court acknowledged that under either theory courts are far less inclined to extend an attorney's

116. *Id.*

117. *Id.* at 111-12, 128 Cal. Rptr. at 906.

118. Some courts have rejected extension of the lawyer's liability to anyone beyond the client. See *First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin and Stewart*, 648 S.W.2d 410 (Tex. App. 1983) (attorney owes no duty to third party in absence of privity of contract). See also *Chalpin v. Brennan*, 559 P.2d 680 (Ariz. 1977) (no cause of action for malpractice to an individual who is not a client or in privity with the attorney), criticized in *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 677 P.2d 1292 (Ariz. 1984) (express disapproval of blanket denials without the use of a foreseeability standard); *Page v. Frazier*, 383 Mass. 55, 445 N.E.2d 148 (1983) (attorney not liable to mortgagors given lack of contractual relation).

119. 92 Ill. 2d 13, 440 N.E.2d 96 (1982).

120. *Id.* at 24-25, 440 N.E.2d at 99.

121. *Id.* at 16-17, 440 N.E.2d at 97.

122. *Id.* at 21, 440 N.E.2d at 100.

123. *Id.* at 22, 440 N.E.2d at 100.

duty to non-clients in an adversarial context.¹²⁴ This results from a concern that, where a client's interests are involved in an adversarial setting, an extension of a duty to a third party would interfere with the undivided loyalty that an attorney owes a client and would detract from achieving the most advantageous position for a client.¹²⁵ Accordingly, the court held that in cases of an adversarial nature, an intent to directly confer a benefit on a third party must clearly be shown.¹²⁶

Pelham concluded that, under its test, the plaintiffs had failed to establish the existence of a duty between the parties. In reaching its conclusion, the court reasoned that the attorney had been hired primarily to obtain a divorce and related relief for the client rather than to represent the interests of the children.¹²⁷ Given the potential for conflicting interests, the court refused to impose a duty in the absence of a clear intent to benefit the children. *Pelham* noted that its conclusion could have been different had plaintiffs alleged that the attorney had undertaken to notify the insurance carrier or employer of the terms of the divorce decree.¹²⁸

In 1983, the Supreme Court of Pennsylvania dealt with the issue of attorney liability to third parties in *Guy v. Liederbach*.¹²⁹ The court recognized that important policies mandated the preservation of the privity requirement in a negligence action for professional malpractice. Nevertheless, it held that a plaintiff could bring suit as an intended third party beneficiary of a contract between an attorney and a testator for negligent drafting of a will that specifically named the plaintiff as a recipient of the estate.¹³⁰ The Pennsylvania Supreme Court was persuaded not to abandon the requirement of contractual privity in professional malpractice actions based on negligence by what it perceived as *ad hoc* determinations and inconsistent results in the California courts, as well as the policy considerations originally expressed by Justice Cardozo in *Ultramares*.¹³¹ The Pennsylvania court, however, declined to elaborate on why these considerations led to its conclusion.¹³²

124. *Id.*

125. *Id.*

126. *Id.* at 23, 440 N.E.2d at 100.

127. *Id.* at 19, 440 N.E.2d at 99.

128. *Id.* at 24, 440 N.E.2d at 101.

129. 501 Pa. 47, 459 A.2d 744 (1983).

130. *Id.* at 63, 459 A.2d at 752-53.

131. See *supra* notes 33-40 and accompanying text.

132. A dissenting opinion in *Guy* notes that the majority's reliance on the policy concerns expressed in *Ultramares* is anomalous, considering that the New York Court of Appeals held that those policies are inapplicable where the negligence of a professional is directed to a known third party. The policy concerns expressed by Justice Cardozo dealt with the potential hazards of liability to an indeterminate class. Putting aside the continuing validity of this rule, it is clear that not every third party will be a member of such a class. The clearest example involves cases similar to the one in *Guy*. Intended beneficiaries are clearly identifiable at the time a will is drafted. Consequently, *Ultramares* is simply not relevant. *Guy*, 501 Pa. at 68, 459 A.2d at 755-56 (McDermott, J., dissenting).

While the Supreme Courts of Illinois and Pennsylvania have been reluctant to expand lawyer liability, other courts have not shared in this reluctance.¹³³ For example, the United States Court of Appeals for the Third Circuit, in *Eisenberg v. Gagnon*,¹³⁴ found that an attorney could be held liable to tax shelter investors based upon an opinion that certain tax deductions were available under applicable law.¹³⁵ Following the reasoning of the recent cases involving accountants, the court held that the attorney's liability for negligent misrepresentations extended to a class of persons intended to rely on those misrepresentations.¹³⁶ Similarly, in *Bradford Security Processing Services, Inc. v. Plaza Bank & Trust*,¹³⁷ the Oklahoma Supreme Court held that bond counsel could be held responsible to a pledgee of the bonds for a faulty opinion so long as the pledgee was among the class of persons whose reliance the lawyer could reasonably foresee.¹³⁸

In a case that reflects the uncertainty of courts today over the scope of lawyer liability, a federal district judge, in *Hackett v. Village Court Associates*,¹³⁹ was asked to apply Wisconsin law in a lawyer malpractice claim.¹⁴⁰ Investors sought to recover from a limited partnership's law firm for alleged misrepresentations and malpractice.¹⁴¹ The court reviewed Wisconsin law, including the Wisconsin Supreme Court decision in *Timm*,¹⁴² which extended accountant liability to foreseeable third parties. The court declined to "push Wisconsin law beyond its present frontiers," reasoning that a sufficiently compelling public policy did not exist in a commercial setting involving securities to justify an extension of liability.¹⁴³

Would the break be so dramatic? The answer appears to be no. Only one case in the last several years has broken the trend to expand third party

133. See *Flaherty v. Weinberg*, 303 Md. 115, 492 A.2d 618 (1985) (Maryland Supreme Court adopted the third party beneficiary approach of Illinois and Pennsylvania). See also *Briggs v. Sterner*, 529 F. Supp. 1155 (S.D. Iowa 1981) (attorney not liable to third party investors when the investors were foreseeable but not actually foreseen by attorney at time of allegedly negligent dispensation of legal advice); *Brody v. Ruby*, 267 N.W.2d 902 (Iowa 1978) (in order to proceed successfully in legal malpractice action, third party must be a direct and intended beneficiary of lawyer's services).

134. 766 F.2d 770 (3d Cir. 1985).

135. *Id.* at 779-80.

136. *Id.*

137. 653 P.2d 188 (Okla. 1982).

138. *Id.* at 191.

139. 602 F. Supp. 856 (E.D. Wis. 1985).

140. *Id.* at 857-58.

141. *Id.*

142. See *supra* notes 82-87 and accompanying text.

143. *Hackett*, 602 F. Supp. at 858.

liability for attorneys.¹⁴⁴ The courts implicitly acknowledge the varying roles of the attorney.¹⁴⁵

Outside the area of the lawyer as advocate—and particularly in situations involving lawyer opinions—it is difficult to see how lawyer liability will not soon reach the limits of foreseeability. It is a small step for courts like the Illinois and Wisconsin Supreme Courts to so extend lawyer responsibility.

For example, the Illinois Supreme Court in *Pelham v. Griesheimer*¹⁴⁶ required that, in order for an attorney to be liable to a third party, the conduct must have been intended to benefit or influence the third party.¹⁴⁷ Under *Pelham*, an attorney who rendered an opinion to help a client obtain a loan would arguably have a duty to the potential lender.¹⁴⁸ Although the representation of the client certainly is not intended to benefit the lender, the particular action of writing the opinion could effectively influence the lender to provide money to the attorney's client. The argument could be made that such conduct by a lawyer would fall within the scope of the duty to third parties established in *Pelham*.

Whether the party to be benefited must be known at the time of the representation is an open question. *Pelham* can be read to limit the duty to known persons. Yet, the policy for requiring an intent to benefit or influence would be undercut if only identified persons could recover. For example, what if the lawyer in the *Pelham* situation knows his or her opinion will be

144. See *First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin and Stewart*, 648 S.W.2d 410 (Tex. App. 1983) (where attorneys had been hired by assignors of an equipment lease to issue opinion as to validity of sales contract, corporation could not recover because opinion was issued after corporation took assignment and thus there could have been no reliance on opinion of attorneys).

145. For example, the privity requirement has been virtually abandoned with respect to suits brought against attorneys by the intended beneficiaries of negligently drawn wills. See, e.g., *Needham v. Hamilton*, 459 A.2d 1060 (D.C. 1983) (intended beneficiary of will could bring malpractice cause of action against drafting attorneys despite lack of privity between attorneys and beneficiary) and cases cited therein. With the exception of New York and Nebraska, no jurisdiction that has recently addressed the issue has denied recovery to an intended beneficiary based on the absence of privity. See *Victor v. Goldman*, 74 Misc. 2d 685, 344 N.Y.S.2d 672 (1973) (absent privity of contract, omission by attorney to prepare new will or codicil naming new beneficiary of some part of decedent's estate did not by itself, render attorney liable to alleged beneficiary), *aff'd*, 43 A.D.2d 1021, 351 N.Y.S.2d 956 (1974); *Lilyhorn v. Dier*, 214 Neb. 727, 335 N.W.2d 554 (1983) (where no attorney-client relationship existed between attorney and heir with respect to drafting a will, attorney owed no duty to heir to exercise reasonable care or skill in drafting of will); *St. Mary's Church of Schuyler v. Tomek*, 212 Neb. 728, 325 N.W.2d 164 (1982) (attorney who prepared testator's last will and testament owed no duty to purported beneficiaries of the will); *Ames Bank v. Hahn*, 205 Neb. 353, 287 N.W.2d 687 (1980) (lawyer owes duty to his client to use reasonable care and skill in the discharge of duties but ordinarily this duty does not extend to third parties).

146. 92 Ill. 2d 13, 440 N.E.2d 96 (1982). See *supra* notes 119-28 and accompanying text.

147. *Id.* at 21, 440 N.E.2d at 100.

148. *Id.* at 22, 440 N.E.2d at 100.

delivered to a potential lender to help obtain a one-million dollar loan but does not know that the client submitted the opinion to a second lender and received part of the desired total from each institution? Little reasoned difference can be drawn between the two lenders, and the attorney was not compromised by the presence of the second lender.¹⁴⁹

A lawyer's opinion in connection with securities offerings is as central to the integrity of the process as is an auditor's certification. It is difficult to see how the analysis of the New Jersey Supreme Court in *Rosenblum*¹⁵⁰ will not be largely applicable to tax or other legal opinions given in connection with a securities offering, whether public or private. Like the accountant, the attorney faces liability under section 11 of the Securities Act of 1933 for opinions given.¹⁵¹ This liability was a factor noted by the New Jersey court.¹⁵² Also important was the recognition by the Securities and Exchange Commission (SEC) and the court of the key role accountants play in the integrity of the securities markets.¹⁵³

For lawyers, the role is rightly viewed as being even more crucial. The Second Circuit Court of Appeals wrote in *Securities and Exchange Commission v. Spectrum*:¹⁵⁴

The legal profession plays a unique and pivotal role in the effective implementation of securities laws. Questions of compliance with the intricate provisions of these statutes are ever present and the smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters.¹⁵⁵

In 1974, SEC Commissioner A. A. Sommer, Jr., stated:

We are consistently reminded that historically the attorney has been an advocate, that his professional ethics have over the years defined his function in those terms that such a role includes unremitting loyalty to the interests of his client (short of engaging in or countenancing fraud). Whenever the effort is made to analogize the responsibilities of the attorney to those of the independent auditor, one is reminded that the federal securities law system conceives of the auditor as independent and defines his role specifically, whereas the attorney is not and cannot be independent. It has been asserted by very eminent counsel that, "The law, so far [this was in 1969], is very clear. The lawyers' responsibility is exclusively to their own client." If this distinction is clear to lawyers, it is less clear to others.

149. Similar situations exist in the context of wills and trusts. Should a distinction exist between the rights of a known named legatee and the children of deceased named legatee whose gift was given *per stirpes*?

150. See *supra* notes 78-81 and accompanying text.

151. 15 U.S.C.A. § 77k (West Supp. 1981).

152. *Rosenblum*, 93 N.J. at 348-49, 461 A.2d at 151.

153. 15 U.S.C.A. § 78r (West Supp. 1981); *Rosenblum*, 93 N.J. at 348, 461 A.2d at 151.

154. 489 F.2d 535 (2d Cir. 1973).

155. *Id.* at 541-42.

I would suggest that the security bar's *conception* of its role too sharply contrasts with the *reality* of its role in the securities process to escape notice and attention—and in such situations the reality eventually prevails. Lawyers are not paid in the amounts they are to put the representations of their clients in good English, or give opinions which assume a pure state of facts upon which any third year law student could confidently express an opinion.¹⁵⁶

Therefore, in the role of evaluator (as stated in the Model Rules) or opinion giver, it seems inevitable that lawyer liability will be extended in the coming years to the limits of foreseeability.

Not as clear, however, is the liability of the lawyer as advocate and in the somewhat grayer area of negotiator. To be sure, the requirement of privity remains the absolute standard in suits brought by non-clients in the litigation context.¹⁵⁷ The principal policy reason for denying these claims is the vital importance of the attorney as advocate in this relationship. When representing a client in a litigation setting, an attorney is ethically required to represent the client zealously. Imposing a duty towards non-clients on attorneys would create a conflict of interest. It is this conflict that gives courts pause.

Though the traditional remedy against opposing counsel—an action for malicious prosecution—remains unavailing, courts are becoming more willing to use court rules to impose liability on attorneys to their opponents in the litigation context. The most significant development has been the increased use of Rule 11 of the Federal Rules of Civil Procedure to impose sanctions on lawyers. Since August 1, 1983, every lawyer filing a pleading in federal court has had to certify that “[to] the best of [the lawyer’s] knowledge, information and belief formed after reasonable inquiry, [the pleading was] well grounded in fact and . . . warranted by existing law or a good faith argument for extension or reversal of existing law.”¹⁵⁸ Additionally, the

156. Address to the Banking, Corporate, Business Law Section, New York Bar Association, Jan. 24, 1974 [hereinafter *Address of Commissioner Sommer*].

157. Courts have been in universal accord in upholding the privity requirement in the context of litigation. Certainly, the rule has been that an attorney has no liability to protect the interests of an adverse party in litigation for an attorney's negligence. *See, e.g., Fox v. Pollack*, 181 Cal. App. 3d 954, 226 Cal. Rptr. 532 (1986) (attorney has no duty to protect interest of adverse party); *St. Paul Title Co. v. Meier*, 181 Cal. App. 3d 948, 226 Cal. Rptr. 538 (1986) (attorney's liability for professional negligence does not ordinarily extend beyond the client except in situations where a third party is the intended beneficiary of the attorney's services, or the foreseeability of harm to the third person is not outweighed by other policy considerations). Malicious prosecution remains the only available theory, but the burden is difficult to meet and the remedy provides little solace to plaintiffs. *See, e.g., Berlin v. Nathan*, 64 Ill. App. 3d 940, 381 N.E.2d 1367 (1978) (the law looks unfavorably on malicious prosecution suits and there are strict limitations on the availability of such suits).

158. FED. R. CIV. P. 11; Essentially the same rule now applies to action filed in Illinois state courts. ILL. REV. STAT. ch. 110A, para. 2-611 (1986).

lawyer must certify that the pleading is not being filed in order to harass, unnecessarily delay or needlessly increase the cost of litigation.¹⁵⁹

In Rule 11 cases, courts have noted that the lawyer's conduct need not be so egregious as to constitute bad faith. The United States Court of Appeals for the Seventh Circuit, in *Rodgers v. Lincoln Towing Service*,¹⁶⁰ stated:

Most importantly, the previous requirement that the attorney against whom sanctions were imposed must have acted in bad faith was eliminated. "The new language is intended to reduce the reluctance of courts to impose sanctions . . . by emphasizing the responsibilities of the attorney and reinforcing those obligations by the imposition of sanctions." The standard used is an objective "one of reasonableness under the circumstances," rather than a subjective one.¹⁶¹

In *Florida Monument Builders v. All Faiths Memorial Garden*,¹⁶² the district court imposed joint and several liability of \$25,000 in attorney's fees for filing an action alleging conspiracy to violate the antitrust laws. The lawyer's failure to conduct an independent investigation of his client's allegations provided the basis for the sanctions.¹⁶³ Similarly, in *Hudson v. Moore Business Forms, Inc.*,¹⁶⁴ lawyers and their law firm were assessed nearly \$15,000 by a California district court for filing a counterclaim without factual or legal support and with the motive of harassing plaintiff and deterring other possible claimants.¹⁶⁵ Noting that counsel had earlier been warned by the court about asserting unjustifiable claims, the court stated that "[i]f these counsel persist in stepping over the line of permissible advocacy, more severe sanctions must be considered. Opposing parties and their counsel, the firm's own clients and the court should not be forced to expend time and money on these lawyers' reckless adventures."¹⁶⁶

In a somewhat similar vein, a New Jersey appellate court has recently recognized a cause of action brought by an attorney against opposing counsel for misrepresenting that the hearing of a case would be postponed. In *Malewich v. Zacharias*,¹⁶⁷ an attorney was sued by his client for failing to appear at trial in a divorce action. The attorney filed a third party complaint against opposing counsel, alleging that he would have appeared at the trial had opposing counsel not represented that he would call him if the case were not adjourned.¹⁶⁸ Apparently, opposing counsel was allowed to proceed

159. FED. R. CIV. P. 11.

160. 771 F.2d 194 (7th Cir. 1985).

161. *Id.* at 205 (citations omitted).

162. 605 F. Supp. 1324 (S.D. Fla. 1984).

163. *Id.* at 1326.

164. 609 F. Supp. 467 (N.D. Cal. 1985).

165. *Id.* at 484.

166. *Id.* at 485.

167. 196 N.J. Super. 372, 482 A.2d 951 (1985).

168. *Id.* at 374, 482 A.2d at 952.

in the attorney's absence after informing the court that the attorney would not appear.¹⁶⁹

Malewich held that if opposing counsel had capitalized on the attorney's negligence by misrepresenting what had transpired, opposing counsel could be held liable for all or part of a claim advanced by his opposing counsel's client in a malpractice action.¹⁷⁰ The court stated that a member of the bar should well understand that an adversary might reasonably rely upon representations made to him, and thus a duty to the adversary could arise.¹⁷¹ The court concluded that the duty owed to the attorney stemmed from disciplinary rules requiring attorneys to make only true statements to a court and forbidding counsel from proceeding *ex parte* without notice to an adversary.¹⁷² According to the court, reliance upon such untrue statements that subjected an attorney to civil liability could result in a damage award.¹⁷³

From these cases and Rule 11, the development of a reasonableness standard for attorney conduct towards an opponent emerges. In an adversarial but non-litigious context, a California appellate court found a lawyer potentially liable to another lawyer for misrepresentations made during a contract negotiation. In *Cicone v. URS Corp.*,¹⁷⁴ the plaintiff-sellers sued their attorney for malpractice resulting from negotiations for the sale of their business.¹⁷⁵ The defendant-attorney filed a cross-claim alleging, among other things, negligent misrepresentation on the part of the buyer's attorney.¹⁷⁶ The trial court sustained a general demurrer to the cross-complaint, and dismissed with prejudice. The appellate court reversed.¹⁷⁷

Before the court of appeals, the plaintiff maintained that the factual allegations contained in the cross-complaint could be amended.¹⁷⁸ The *Cicone*

169. *Id.* at 374-75, 482 A.2d at 952.

170. *Id.* at 376, 482 A.2d at 953. Contribution claims by lawyers against opposing counsel will likely be a source for a developing liability of lawyers to adverse parties in the context of both litigation and negotiation. In addition to the *Malewich* case discussed above, a New York appellate court acknowledged such a claim in *Corva v. United Services Auto. Ass'n*, 108 A.D.2d 631, 485 N.Y.S.2d 264 (1985). The court approved a third party claim for contribution by a lawyer charged with misrepresenting to his opponent the amount of insurance coverage available. The attorney said that at least part of the loss was attributable to the failure of plaintiff's counsel to inquire fully into the limits of the defendant's policy in the underlying case.

171. *Malewich*, 196 N.J. Super. at 397, 482 A.2d at 953.

172. *Id.* at 376, 482 A.2d at 953.

173. *Id.* at 377, 482 A.2d at 954.

174. 183 Cal. App. 3d 194, 227 Cal. Rptr. 887 (1986).

175. *Id.* at 198, 227 Cal. Rptr. at 888-89.

176. *Id.* at 189, 227 Cal. Rptr. at 889.

177. *Id.* at 213, 227 Cal. Rptr. at 899.

178. In early September of 1981, the seller and buyer entered into a preliminary agreement for the sale of the seller's stock and assets. The final agreement was to be prepared by counsel for the buyer and the defendant attorney was subsequently hired to represent the seller at the closing. Some time prior to October 13, 1981, the buyer presented the seller with the proposed final agreement, providing in part that the seller would warrant the accuracy of an unaudited

court concluded that a duty of care logically flowed from the holding in *Roberts*¹⁷⁹ and *Goodman*:¹⁸⁰

If the issuance of a legal opinion intended to secure a benefit for a client must be issued with due care toward third persons who the attorneys attempt or expect to influence on behalf of their clients, then *a fortiori* why should such a duty of care not exist toward the third party's attorney where an affirmative misrepresentation of fact is made directly to the attorney for the purpose of influencing his client.¹⁸¹

The court stated that the policy factors identified in *Biakanja*,¹⁸² *Lucas*¹⁸³ and *Heyer*¹⁸⁴ supported this conclusion.¹⁸⁵ The court also noted that persons such as the cross-defendant have or can readily obtain insurance against such a risk.¹⁸⁶ Finally, the court concluded that the imposition of a duty of care under these circumstances was unlikely to pose any real threat to the professional relationship between the attorney and client.¹⁸⁷

From these cases and Rule 11, the beginnings of an attitudinal shift in assessing attorney conduct emerges, even in the adversarial context. It is submitted that, in coming years, courts will more frequently fashion remedies for non-clients against attorneys in all contexts. The fear of treading even slightly on the attorney's zeal and advocacy is abating. Concern now focuses more on harm to the public and legal system from reputedly overzealous counsel. As SEC Commissioner Sommer noted only twelve years ago:

We live in the age of the consumer. All of the old articles of faith which frustrated him in efforts to achieve equity have fallen or are falling: cognovit notes are repudiated in most places; the sale of installment paper

balance sheet. Other warranties contained in the agreement were made subject to the best of the seller's knowledge. On October 13, 1981, the defendant attorney advised the parties representing the buyer that the seller was unwilling and unable to guarantee the accuracy of the balance sheet in question. The attorney for the buyer replied that the buyer would deem the seller to be guaranteeing the information only to the seller's best knowledge and belief. The defendant alleged that the buyer's attorney made this representation in order to induce the defendant to advise his client to close the transaction immediately. He further alleged that the representation was untrue, that the cross-defendant had no reasonable basis for believing it to be true, and that the defendant and his client were intended to rely and did in fact rely upon the negligent misrepresentation. Shortly after the transaction was consummated, the buyers filed a claim against the sellers based on a \$200,000.00 underestimation of deferred tax liabilities of which the sellers had been unaware. The seller settled the claim for \$125,000.00 and filed a legal malpractice action against his attorney. *Id.* at 199, 227 Cal. Rptr. at 889.

179. *See supra* notes 114-17 and accompanying text.

180. *See supra* notes 105-13 and accompanying text.

181. *Cicone*, 183 Cal. App. 3d at 210, 227 Cal. Rptr. at 897.

182. *See supra* notes 92-97 and accompanying text.

183. *See supra* notes 98-102 and accompanying text.

184. *See supra* notes 103-14 and accompanying text.

185. *Cicone*, 183 Cal. App. 3d at 210, 227 Cal. Rptr. at 897.

186. *Id.* at 210, 227 Cal. Rptr. at 897.

187. *Id.* at 211, 227 Cal. Rptr. at 897-98.

no longer immunizes the paper purchaser from responsibility for the shoddiness of the merchandise; people pressured into purchases on their doorstep have time to think over their decision; the real costs of borrowing and purchases on installments must be disclosed

I would suggest that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. This means several things. It means he will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means he will have to be.¹⁸⁸

188. *Address of Commissioner Sommer, supra* note 156.

