

Firm's Opinion Letter Supports Third Party Malpractice Complaint

BY LAZAR EMANUEL

In *Reich Family LP v. McDermott, Will and Emery* (NYLJ Oct. 29, 2003), New York Cty. Supreme Court Justice Sheila Abdus-Salaam considered the circumstances under which a law firm may be liable in malpractice and breach of fiduciary duty to a party to a transaction who not a client of the law firm. Plaintiff Reich ("Reich") was the general partner of an investor in SpectruMedix Corporation, a client of McDermott, Will and Emery ("McDermott"). In 2002 SpectruMedix was in need of additional funds. Reich agreed to lend \$1 million to the company, on condition that he take control of the company and that Joseph Alderstein ("Alderstein") the chairman of the company, be removed. McDermott, as general counsel to the company, provided Reich with information about the company, negotiated the terms of the contract, and issued its opinion letter to plaintiff.

In his complaint against McDermott, Reich alleged that McDermott had arranged a meeting of the company's board at which the loan was approved. He also alleged that McDermott had advised the members of the board that they did not need to tell Alderstein that the loan transaction would be taken up at the board meeting. At the meeting, Alderstein was removed and replaced by Reich. After approval of the loan transaction, Reich was elected chairman of the board and Alderstein was ousted from the board.

Alderstein sued the company and its board in Delaware's Chancery Court to invalidate the actions taken at the board meeting. After trial, the court issued an order undoing the board's actions and restoring Alderstein to his position as chairman. In his complaint against McDermott, Reich alleged that as a direct consequence of the Delaware court's decision and of the litigation and settlement negotiations which followed, he was forced to invest an additional \$2.5 million in the company and to fund the payment by the company to Alderstein of \$1.85 million dollars.

Malpractice Claim

Reich alleged that McDermott had a duty to him to render competent legal advice in its opinion letter, that the letter contained legal advice which was incorrect, and that he relied on the letter to his detriment. McDermott responded that it was clear from the opinion letter that it was acting for the company and that there was no contractual privity between the law firm and Reich. In upholding Reich's cause of action for legal malpractice, Judge Abdus-Salaam relied on the decision of the Court of Appeals in *Prudential Ins. Co. v. Dewey, Ballantine, Bushby, Palmer & Wood*, 80 NY2d 377. In *Prudential*, the Court had cited its decision in *European American Bank v. Strauhs & Kaye* (65 NY2d 536), a case involving the duty of an accounting firm to a third party. The European American Court found that a cause of action for negligence against the accounting firm satisfied four prerequisites: (1) the defendant accountants had been aware of the purpose of their advice to plaintiff; (2) they had known the identity of the plaintiff; (3)

they had known that the plaintiff would rely on their advice; and (4) they had "evinced their understanding of that reliance."

McDermott argued that the Prudential case had turned on a claim for negligent misrepresentation, not legal malpractice. But Judge Abdus-Salaam found no distinction between the two as they applied to these facts.

...when there is no contractual privity between the parties, a party can assert a negligence claim against an attorney when there is an awareness that an attorney's statement is to be used for a specific purpose, reliance on the statement, and some conduct linking the attorneys to the non-client evincing their understanding of that reliance.

Breach of Fiduciary Duty

Judge Abdus-Salaam also upheld Reich's cause of action against McDermott for breach of fiduciary duty.

The Judge noted that the complaint recited the following allegations: that McDermott was acting as special counsel to the company when its opinion letter was issued; that it had worked with Reich on the transaction; that McDermott had "orchestrated" the directors' meeting at which the transaction with Reich was approved, Alderstein was ousted and Reich was elected chairman; and that it had advised the directors that Alderstein did not need to be advised of the Reich transaction or that the transaction would be voted on at the directors' meeting. The Judge pointed out that the Delaware Court of Chancery had concluded that Alderstein was entitled to advance notice that the transaction would be taken up at the meeting, stating: "this right to advance notice derives from a basic right of our corporation law that boards of directors conduct their affairs in a manner that satisfies standards of fairness."

Judge Abdus-Salaam rejected McDermott's argument that the qualification clause in its opinion letter precluded any reliance on the letter by Reich. It was not necessary for Reich to show that there had been a misrepresentation or that a misrepresentation was the cause of Reich's injury.

Reich's cause of action for fraud was dismissed except to the extent that it alleged misrepresentations of fact in the opinion letter.