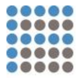

FLETCHER | FARLEY
CONFLICT RESOLVED

NEGLIGENT MISREPRESENTATION: "MAY A NON CLIENT THIRD PARTY *REALLY* SUE ME FOR RELIANCE ON SOMETHING I TOLD MY CLIENT"?

By: Paul W. Bennett
Kenneth Lambert

April 19, 2013

Contents

A. Introduction 1

B. Why Should I Worry About Non-Clients, Anyway? 2

C. *But I Never Intended For Anyone Else To Rely On My Opinion. That Makes It Okay . . . Right?* .. 3

D. What About States That do not Follow Section 552? 7

E. But I can fix all that with a Disclaimer, Can't I? Isn't That my Ace in the Hole? 8

F. Let's sum up: Disclaimers Rock! (Most Places, but Maybe not so Much in Arizona). 10

About The Authors: 11

Information presented in each article is accurate as of date of publication. The information provided is not legal advice and use of this information does create an attorney-client relationship. You should always consult an attorney for more current information, changes in the law or any other information specific to your situation.

NEGLIGENT MISREPRESENTATION
"May a Non-Client Third Party *Really* Sue Me for Reliance on Something I told my Client?"[1]

A. INTRODUCTION

You are buying a piece of real estate, and need a loan to finance the purchase. The bank obtains an appraisal of the property to support issuance of the loan. Can you, the purchaser, rely on the facts and opinions contained in the appraisal?

You are a professional appraiser, and a bank retains you to appraise a piece of property on which they are considering loaning money to finance the purchase. Are you liable to the actual purchaser (as opposed to the bank) if you make mistakes in your appraisal?

You are an investor purchasing a company. The company's books have been reviewed by professional auditors. Can you, the investor, rely on the opinions given by the auditor and pursue a claim for any errors?

You are a professional surveyor, and you survey a property for a landowner. Are you liable to a purchaser of the property for errors in the survey?

The answer to these questions is a resounding "Maybe!"

Certainly, there is no doubt that a professional owes duties to the client that actually retains him or her to provide the professional service. However, a question arises when a third-party seeks to make a claim against the professional: what duty, if any, does the professional owe to a non-client third-party for mistakes in an opinion?

---

[1]This paper was prepared by Kenneth J. Lambert and Paul W. Bennett, attorneys in the Dallas office of Fletcher, Farley, Shipman & Salinas, L.L.P. (http://FletcherFarley.com). Mr. Lambert practices in the Insurance Coverage and Appellate Section, while Mr. Bennett, a partner in the firm, is a trial lawyer who focuses on Complex Litigation, Professional Liability, Construction Litigation and Products Liability Defense.

The answer to this varies from state to state, but most states do allow such claims, generally under the tort of negligent misrepresentation. Many states, however, also allow a professional to protect him or herself by giving proper notice, disclaiming reliance by non-clients.

B. WHY SHOULD I WORRY ABOUT NON-CLIENTS, ANYWAY?

Originally, courts held that professionals, such as accountants, attorneys, surveyors, appraisers, etc. owed no duty at all to third parties, since there was not privity; in other words, if you were not directly dealing with the professional (i.e. hired them), you had no right to rely on their work at all. The leading case for this proposition is *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931), which held that accountants who prepared a negligent audit could not be negligent as to third parties, even parties that the accountants could foresee would justifiably rely on the audit, since in the absence of privity, no duty was owed to those parties. This basic "privity" rule has been drastically eroded, and is only applied in very few states today. *See, e.g. Stephens Industries, Inc. v. Haskins & Sells*, 438 F.2d 357 (10th Cir. 1971) (privity required under Colorado law).

In most states today, claims for negligent misrepresentation against a professional generally arise under the aegis of Section 552 of the Restatement (Second) of Torts:

Information Negligently Supplied for the Guidance of Others

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(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.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

RESTATEMENT (SECOND) OF TORTS § 552 (1977). Clearly, under Section 552, privity is not an automatic bar to liability – as long as a party can meet the requirements of subsection (2).

C. BUT I NEVER INTENDED FOR ANYONE ELSE TO RELY ON MY OPINION. THAT MAKES IT OKAY . . . RIGHT?

The language of subsection (2), above seems fairly straightforward, requiring intent on the part of the professional:

> This means that foreseeability of harm is not the test. The plaintiff must have been a person for whose use the representation was intended, and it is not enough that the defendant ought reasonably to have foreseen reliance by someone such as the plaintiff. Also, if the plaintiff is not an identifiable person for whose benefit the statement was intended, he must at least have been a member of some very small group of persons for whose guidance the representation was made.

PROSSER AND KEATON ON THE LAW OF TORTS § 107, at 747 (1984). Simple, right? Well, maybe, and maybe not.

As noted above, most states have adopted Section 552 and apply it to determine the parameters of a negligent misrepresentation claim against a professional. However, not all states apply Section 552 the same way.

The majority of states appear to interpret Section 552 to require the professional to either specifically intend the claimant (or the class of persons in which the claimant falls) to rely on the representations, or to actually know and expect that the claimant (or the class) will so rely. This is a fairly high standard, and significantly restricts the abilities of third parties to make negligent misrepresentation claims against a professional.

Under this test, a professional (such as an appraiser or accountant) will be liable to third parties where two criteria are satisfied: First, the loss must be suffered "by the person or one of a limited group of persons for whose benefit and guidance [the professional] intends to supply the information or knows that the recipient intends to supply it"; and second, the loss must be suffered "through reliance upon it in a transaction that [the professional] intends the information to influence or knows that the recipient so intends or in a substantially similar transaction." Under this test, the professional and the client agree between themselves as to who will be permitted to rely on the statements of the professional (audit, appraisal, survey, etc.).

Texas follows this approach. As the Texas Supreme Court held:

> "[A] section 552 cause of action is available only when information is transferred by [a professional] to a *known* party for a *known* purpose." [*McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787, 794 (Tex. 1990) (emphasis added)]. Under section 552, a "known party" is one who falls in a limited class of potential claimants '"for whose benefit and guidance one intends to supply the information or knows that the recipient intends to supply it."' *Id.* (*quoting* RESTATEMENT (SECOND) OF TORTS § 552(2)(a)). This formulation limits liability to situations in which the professional who provides the information is "aware of the nonclient and intends that the nonclient rely on the information." *Id.*

Grant Thornton LLP v. Prospect High Income Fund ML CBO IV (Cayman), Ltd., 314 S.W.3d 913, 920 (Tex. 2010).

The Supreme Court also noted that this rule was in contrast to earlier Texas appellate decisions that had applied a broader standard – the "should have known" standard. *Id.* at 920 & n. 12 (*disapproving Blue Bell, Inc. v. Peat, Marwick, Mitchell & Co.*, 715 S.W.2d 408, 413 (Tex. App.—Dallas 1986, writ ref'd n.r.e.). Hence, Texas law requires that the professional actually know of the non-client and actually intend the non-client to rely on the information. *Id.*

Another example from Iowa, *Pahre v. Auditor of State*, 422 N.W.2d 178 (Iowa 1988), involved a claim against an accountant that prepared a lender's financial statements. The court emphasized that Restatement Section 552 imposes liability only when the maker of the information knows that the recipient will pass it on to another, not when it is merely foreseeable that it will do so. *Id*. at 180 ("foreseeability of harm is not the test").[2] This appears to be the approach followed by the majority of states that use the Section 552 standard.

In *Badische Corp. v. Caylor*, 356 S.E.2d 198, 200 (Ga. 1987), the Georgia Supreme Court, in following the Section 552 standard, limited any duty to those whom the maker of a statement "is actually aware will rely upon" it; rejecting argument that duty is owed to "foreseeable" users of the information. Similarly, the North Carolina Supreme Court held that in an accountant case the Restatement provision requires that the auditor know that his client intends to supply information to another person or limited group of persons, rejecting the foreseeability and privity rules in favor of the "middle ground" offered by Section 552. *See Marcus Bros. Textiles, Inc. v. Price Waterhouse, L.L.P.*, 513 S.E.2d 320 (N.C. 1999). A number of other states, including, for example, West Virginia, Alaska, Louisiana, Hawai'i, Minnesota, Ohio and Florida follow similar standards.[3]

---

[2]However, in an earlier case, the Iowa court, while citing the Restatement, did not address whether the appraiser intended the third party to rely on the appraisal – essentially assuming that was the case. *See Larsen v. United Federal Savings & Loan Ass'n*, 300 N.W.2d 281 (Iowa 1981).

[3]*See, e.g. First Nat'l Bank of Bluefield v. Crawford*, 182 W. Va. 107, 386 S.E.2d 310, 313 (W.Va. 1989) (under Restatement § 552, accountant owed duty "only to known users" of financial statements); *Selden v. Burnett*, 754 P.2d 256 (Alaska 1988) (adopting § 552 and indicating intent/actual knowledge standard); *Barrie v. V.P. Exterminators*, 625 So. 2d 1007 (La. 1993) (same); *Chun v. Park*, 462 P.2d 905 (Haw. 1969) (same); *Bonhiver v. Graff*, 248 N.W.2d 291 (Minn. 1976) (same); *Demetracopoulos v. Wilson*, 640 A.2d 279 (N.H. 1994) (same); *Corporex Dev. & Constr. Mgmt. v. Shook, Inc.*, 835 N.E.2d 701 (Ohio 2005); *Schaaf v. Highfield*, 896 P.2d 665 (Wash. 1995) (same, emphasizing reliance); *First Florida Bank, N.A. v. Max Mitchell & Co.*, 558 So. 2d 9 (Fla. 1990) (rejecting "should have known" standard). Note also that there are some states that have explicitly adopted Section 552, but have not stated whether it requires actual intent/knowledge or some lower standard, such as mere foreseeability. *See, e.g. John Martin Co. v. Morse/Diesel, Inc.*, 819 S.W.2d 428 (Tenn. 1991); *Presnell Constr. Managers, Inc. v. EH Constr., LLC*, 134 S.W.3d 575 (Ky. 2004) (same).

A few states (such as Rhode Island, Nebraska and Vermont), while adopting the Section 552 analysis, have raised the standard even higher, often requiring actual intent by the professional for the third party to rely on the information provided.[4]

Some states, have adopted a more liberal view of the Section 552 standard, holding a professional liable to all persons who might reasonably be foreseen as relying upon his work product. These states include New Jersey, Wisconsin, Mississippi, Alabama, New Hampshire and Utah.[5]

A good example of this more liberal interpretation is found in *Schaaf v. Highfield*, 896 P.2d 665 (Wash. 1995). At issue in that case was a real estate appraisal prepared at the request of the Veteran's Administration in connection with a home purchase. The court emphasized that rather than expose a professional to liability for "an indeterminate amount for an indeterminate time to an indeterminate class," Restatement § 552 limits the scope of the duty owed to a "limited class" of recipients of the information. *Id*. at 669-70. Without considering whether the record contained evidence the appraiser knew the buyer would receive his report, the court concluded that the buyer's interest in the overall purchase transaction placed him within "that limited class" to whom the appraiser owed a duty of due care. *Id*. at

---

[4]*See Anjoorian v. Arnold Kilberg & Co.*, 2006 R.I. Super. LEXIS 166 (2006) (same); *St. Paul Fire & Marine Ins. Co. v. Touche Ross & Co.*, 507 N.W.2d 275 (Neb. 1993) (same); *Webb v. Leclair*, 182 Vt. 559, 933 A.2d 177, 181, P 16 (Vt. 2007) (appraiser retained by lender to support extension of credit in connection with home purchase owed no duty to purchaser; appraiser must either intend the appraisal be provided to third party, or have actual knowledge that it would).

[5]*See H. Rosenblum, Inc. v. Adler*, 461 A.2d 138 (N.J. 1983); *Citizens State Bank v. Timm, Schmidt & Co.*, 335 N.W.2d 361 (Wis. 1983). *See also Touche Ross & Co. v. Commercial Union Ins. Co.*, 514 So.2d 315 (Miss. 1987) (statutory prohibition from requiring third parties to be "known", but noting that the professional can limit "reasonably foreseeable" parties by specific agreement); *Zanaty Realty, Inc. v. Williams*, 935 So.2d 1163, 1167 (Ala. 2006) ("the key factor in determining whether a real-estate appraiser owes a duty to a buyer of the appraised property is whether injury to the buyer was foreseeable by the appraiser"); *Bronstein v. GZA Geoenvironmental, Inc.*, 665 A.2d 369, 372 (N.H. 1995) (in buyer's case against environmental survey firm, test was whether it was "reasonably foreseeable" that the original recipient of the survey would furnish it to the plaintiff); *Price-Orem Inv. Co. v. Rollins, Brown & Gunnell, Inc.*, 713 P.2d 55 (Utah 1986) (duty under § 552 owed to third parties "likely" to rely on representation).

670. Because the V.A. had contracted for the appraisal "solely because" of the buyer's application for financing, the buyer was "the most proximal third party there will ever be" to the appraisal. *Id*. Consequently, the court explained, a real estate appraiser owes a duty "to those involved in the transaction that triggered the appraisal report, including, but not necessarily limited to, the buyer and the seller." *Id*.

Hence, even under the "majority approach" of Section 552, there is a fairly large discrepancy as to whether the professional must intend or expect a third party to rely on his work before liability can attach, or whether liability extends to situations where it is "foreseeable" that some third party might rely on it.

D. What About States That do not Follow Section 552?

A few states have adopted tests for negligent misrepresentation claims against professionals that are completely separate from the traditional "privity" and "Section 552" analyses. The main independent standard is that adopted by New York. In *Securities Investor Protection Corp. v. BDO Seidman, LLP*, 746 N.E.2d 1042 (N.Y. 2001), the court held:

> In deciding whether liability can be imposed by a non-privy third party, we ask whether the accountant was aware that the reports were to be used for a particular purpose, whether in furtherance of such purpose a known party was intended to rely and, finally, whether there was some linking conduct which evinced the accountant's understanding of that party's reliance

Id. at 1048. This standard is similar to the strict "intent" version of the Section 552 analysis, but adds the additional requirement of "linking conduct" demonstrating that the professional intended the third party to rely on the information provided. While not as restrictive as the pure "privity" rule set forth in the *Ultramares Corp.* case, it is very close to that standard, and is generally considered a "near-privity" standard. A few states, like Indiana, Idaho and California have adopted this standard.[6]

---

[6]*See Ackerman v. Schwartz*, 947 F.2d 841 (7th Cir. 1991) (Indiana law); *Idaho Bank & Trust Co. v. First Bancorp of Idaho*, 772 P.2d 720 (Idaho 1989); *Bily v. Arthur Young & Co.*, 834 P.2d 745 (Cal. 1992) (purporting to adopt Section 552, but actually adopting this more restrictive standard).

Finally, at least one state (Missouri) follows a "balancing test" (actually enunciated by a now overruled California case) which relies on the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff would suffer injury, the closeness of the connection between the defendant's conduct and the injury suffered, the policy of preventing future harm, and the burden on the profession. *See Donahue v. Shughart, Thomson & Kilroy, P.C.*, 900 S.W.2d 624, 629 (Mo. 1995).

E. BUT I CAN FIX ALL THAT WITH A DISCLAIMER, CAN'T I? ISN'T THAT MY ACE IN THE HOLE?

Even where a duty may otherwise arise under Section 552 – where a third party falls within the "limited class" of persons that the professional knows the recipient is likely to supply the information, or in a state where "foreseeability" is the rule, it is possible for a professional to still be immunized from any potential liability from a third party. This often may be accomplished through the use of clear disclaimers. Typical language such as the following often appears in real estate appraisals:

INTENDED USE AND INTENDED USER

> It is the appraisers' understanding that the intended use of this appraisal is to provide a valuation basis to be utilized in the decision-making process and loan documentation purposes specifically for [______] Bank, the intended user. Any other use or users are not intended or authorized. The report has no other purpose and should not be relied upon by any other person or entity.

The clear and obvious intent of this type of disclaimer is to eliminate any intent by the appraiser for third parties to rely on the appraisal.

Similar language was used in an appraisal in *Zanaty Realty, Inc. v. Williams*, 935 So.2d 1163 (Ala. 2005). That court held that such a clear disclaimer eliminated any duty owed by the appraiser to any third party (including the borrower). The court went on to hold that even if any duty had arisen, the disclaimer would be nullified by the disclaimer. In addition, such a disclaimer strikes right to the heart of a foreseeability argument – how can it be foreseeable that a third party would rely on an appraisal that explicitly states that no third party is to rely on it? Although there are few Section 552 cases that specifically address this type of disclaimer, most cases that discuss disclaimers indicate that such could be a defense. *See Touche Ross & Co. v. Commercial Union Ins. Co.*, 514 So.2d 315 (Miss. 1987).

One case that is of interest in this regard is *Sage v. Blagg Appraisal Co.*, 209 P.3d 169, 173 (Ariz. App. 2009). In *Sage*, the Arizona court adopted Section 552, but appeared to take an extremely liberal construction of it – even to implying that disclaimers might not be effective. In so holding, the court noted that Fannie Mae and Freddie Mac had modified their requirements to require that appraisers certify that borrowers (among various other parties) may rely upon the appraisal. *Id.*, 209 P.3d at 175. Of course, this requirement only applies to residential mortgages that fall under those two programs, but the *Sage* court thought that it was strong evidence that the real intent of an appraisal is that the borrower was to rely on it.[7]

It is also important to make sure that disclaimers do not conflict. In *Desimone v. Quicken Loans, Inc.*, 2011 U.S. Dist. LEXIS 26772 , *9 (S.D. Ind., Mar. 15, 2011), the court refused to allow disclaimers in an appraisal to eliminate a claim for negligent misrepresentation because although the appraisal specifically stated that the "intended user" of the appraisal was the lender, and that "[n]o additional intended users are identified by the appraiser," the appraisal also provided that a borrower and others

[7]Interestingly, the *Sage* court noted that the Fannie Mae/Freddie Mac changes had not been implemented until several months after the appraisal at issue in that case had been provided.

"may rely on this appraisal report as part of any mortgage finance transaction that involves any one or more of these parties." Unclear disclaimers are never a good idea.

F. LET'S SUM UP: DISCLAIMERS ROCK! (MOST PLACES, BUT MAYBE NOT SO MUCH IN ARIZONA).

Most states follow some interpretation of Section 552 when negligent misrepresentation claims are asserted against a professional, such as an appraiser, auditor, or even an attorney. Although some states (including Texas) require a pretty strict showing of intent for a third party to rely on the professional's work, others have relaxed the standard to that of mere foreseeability. One good way to demonstrate a lack of intent (and to preserve defenses of lack or foreseeability and reliance) would be to provide explicit disclaimers that specifically limit the ability of third parties to rely on the work. Ultimately, many professionals do just that, including fairly specific disclaimers in their opinions. In most states, Texas included, this should be sufficient to limit potential liability for claims made by non-client third parties.

About The Authors:

Paul W. Bennett - A Partner in the firm, is a trial lawyer who focuses on Complex Litigation, Professional Liability, Construction Litigation, Products Liability Defense and General Defense. He has practiced in the state and federal courts for over 20 years.

Kenneth J. Lambert – A Senior Associate, he practices in the firm's Insurance Coverage and Appellate Section. He has more than 23 years of experience in trial and appellate litigation.