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Seventh Circuit Affirms Dismissal of $1.5 Billion Malpractice Claim Filed by Lenders Against Borrower's Law Firm Because it Owed No Duty to Lenders

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Oakland Police & Fire Ret. Sys. v. Mayer Brown, 2017 U.S. App. LEXIS 11522, ___ F.3d ___ (7th Cir. 2017)

Brief Summary

Plaintiffs filed a putative class action against the defendant, a law firm that represented a borrower, General Motors, arising out of a $1.5 billion (with a "b") mistake in documenting a commercial transaction. The central issue was who could be held legally responsible for that mistake. Plaintiffs alleged that defendant committed malpractice and negligent misrepresentation, and they sought to hold defendant liable for the damages resulting from the erroneous release of the wrong security interest. Plaintiffs alleged that defendant owed them a duty of care, breached that duty and caused them harm. The district court granted defendant's motion to dismiss for failure to state a plausible claim. The court held that under controlling Illinois law, defendant did not owe a duty of care to the plaintiffs, who were not defendant's clients, but parties adverse to defendant's client (General Motors) in the loan transaction. The Seventh Circuit affirmed the dismissal, holding that defendant owed no duty to non-clients.

Complete Summary

This case began with a $1.5 billion mistake in documenting a commercial transaction. General Motors, represented by the defendant law firm, entered into two separate secured transactions in which the JP Morgan bank acted as agent for two different groups of lenders. The first loan (structured as a secured lease) was made in 2001 and the second in 2006. In 2008, the 2001 secured lease was maturing and needed to be paid off. The closing for the 2001 payoff required the lenders to release their security interests in the collateral securing the transaction. The big mistake was that the closing papers for the 2001 deal accidentally also terminated the

lenders' security interests in the collateral securing the 2006 loan. No one noticed – not defendant and not JP Morgan's counsel.

After General Motors filed for bankruptcy protection several months later in 2009, however, General Motors and JP Morgan noticed the error. Although the security for the plaintiffs' 2006 loan had been terminated, the plaintiffs in this case (members of the consortium of lenders on the 2006 loan) were not informed until years later. These lenders filed this action asserting legal malpractice and negligent misrepresentation. But they sued not JP Morgan or its law firm, who would seem to be the most obvious defendants under the circumstances, but the borrower General Motors' law firm – defendant. The district court dismissed for failure to state a claim, holding that defendant did not owe a duty to plaintiffs, who were third-party non-clients.

Plaintiffs appealed and argued that defendant owed them a duty of due care. Plaintiffs offered three theories: (a) JP Morgan was a client of defendant in unrelated matters and thus not a third-party non-client; (b) even if JP Morgan was a third-party non-client, defendant assumed a duty to JP Morgan by drafting the closing documents; and (c) the primary purpose of the relationship between General Motors and defendant was to influence JP Morgan. The Seventh Circuit agreed with the district court (Judge Gettleman) that defendant did not owe a duty to plaintiffs under any of these theories and affirmed the dismissal.

The court held that defendant owed no duty to the lenders it did not represent. The court noted that in every complex transaction, one party or another must prepare the first draft of the document. The court stated: "By preparing a first draft, an attorney does not undertake a professional duty to all other parties in the deal." The lenders argued that defendant represented JP Morgan Chase Bank in different matters at the time of the 2001 loan transaction, and that meant the law firm owed a duty of care to JP Morgan Chase, as well as the lenders for whom the bank was acting as agent.

The 7th Circuit rejected this argument and stated: "That is an astonishing claim." The court further stated: "Consider the consequences of the rule plaintiffs advocate, that a law firm owes a duty of care to a party adverse to its client because the adverse party is a client in unrelated matters and has waived the conflict of interest." The court continued: "If plaintiffs' theory held water, the law firm would continue to owe a duty of care to look out for the adverse party's interests, in conflict with its duties to its client in the matter at hand. The law firm would then face an impossible and unwaivable conflict of interest. Plaintiffs' theory thus conflicts with the rules of professional conduct that allow such waivers (and that, as a practical matter, have allowed law firms to grow as large as they have in recent decades)."

In summary, the 7th Circuit rejected all plaintiffs' arguments. The court noted that plaintiffs "cannot avoid the mandates of *Pelham* by couching their grounds for recovery in principles that have not been accepted in delineating the duty of an attorney to his clients and non-clients." In *Pelham v. Griesheimer*, 92 Ill.2d 13 (1982), the Illinois Supreme Court held that under very limited circumstances, a non-client may maintain an action against an attorney. In *Pelham*, the court held that "to establish a duty owed by the defendant attorney to the non-client, the non-client must 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." *Pelham*, 92 Ill.2d at 20-21. The Illinois Supreme

Court in *Pelham* made it clear, however, that such a duty to third parties would not arise in favor of a party adverse to the attorney's current client.

Here, plaintiffs could not escape the application of *Pelham* by claiming to be in an attorney-client relationship with defendant or asserting that defendant voluntarily undertook a responsibility triggering a duty. Plaintiffs' relationship to defendant was like the attorney - third-party relationships in other Illinois cases cited by the court. Plaintiffs were represented by their own counsel, who were not prevented from reviewing the documents and had no valid justification for relying on defendant's drafts. Plaintiffs failed to plausibly allege that the primary purpose of General Motors' relationship with defendant was to benefit or influence JP Morgan. Because plaintiffs could not establish a duty between defendant and JP Morgan, the court's analysis stopped there.

Significance of Opinion

This decision is significant because despite the fact there was a $1.5 billion mistake (acknowledged by all involved), the court affirmed the dismissal of plaintiffs' malpractice claims against defendant because plaintiffs could not establish that the primary or direct purpose of the relationship between defendant and the borrower, General Motors, was to benefit the lenders, who had their own attorneys. This decision is also significant because it underscores the dangers of tiered case management, the dangers of delegating work to support staff and the need for quality control protocols in high stakes transactions.

For more information, please contact Terrence McAvoy.

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Terrence P. McAvoy

Of Counsel

312-704-3281