Minnesota Legal Malpractice Trends & Issues

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Eighth Circuit Finds No Third-Party Liability in Leonard v. Dorsey & Whitney

In substantial reliance upon the Minnesota Supreme Court's decision in a parallel case, McIntosh County Bank v. Dorsey & Whitney LLP, 745 N.W.2d 538 (2008), the Eighth Circuit Court of Appeals held that the firm did not owe a duty to a participant bank in a loan participation agreement where the firm represented the lead lender and that the firm did not owe a duty to the lead lender to disclose a possible malpractice claim.

Bremer Bank was one of 31 banks involved in a loan participation agreement originated by Miller & Schroeder Financial, Inc. ("M & S"), which had hired Dorsey to draft the loan documents for the transaction. Bremer filed an adversary complaint against Dorsey in M & S's bankruptcy proceedings, alleging that Dorsey was a client or third-party beneficiary of Dorsey's services. The bankruptcy trustee and M & S's successor in interest brought their own complaint against the firm, alleging that it failed to disclose a conflict of interest and that M & S had a third-party claim against the firm that it could assert in a lawsuit brought by a participant.

The bankruptcy court held after trial that Dorsey had a direct attorney-client relationship with Bremer or, alternatively, that Bremer had standing for such a claim as a third-party beneficiary. It also held that Dorsey failed to disclose that it may have committed malpractice and that its ongoing representation of M & S after the malpractice created further conflict of interest. On appeal, the district court held that Bremer did not become Dorsey's client until it began work on subsequent litigation and upheld the bankruptcy court's determination regarding the conflict of interest.

In order for a party to be a "direct and intended beneficiary," the transaction must have "as a central purpose an effect on the third party and the effect [must be] intended as a purpose of the transaction."

While the district court's decision was on appeal, the Minnesota Supreme Court handed down its decision in McIntosh, holding that a third-party must be a direct and intended beneficiary of an attorney's services to maintain a legal malpractice action on a third-party beneficiary theory. In order for a party to be a "direct and intended beneficiary," the transaction must have "as a central purpose an effect on the third party and the effect [must be] intended as a purpose of the transaction."

The Eighth Circuit applied McIntosh to virtually identical facts. It cited the participation agreement itself as key to its determination. Such agreements are arms length transactions. When Bremer bought a participation interest in the loan, it did so in reliance not on M & S but on its own independent evaluation of the loan.

The court also disagreed with the lower courts in holding that Dorsey had no conflict of interest in the subsequent litigation. "As a matter of law, none of the loan participants had standing to be a party in the President litigation; only M & S could sue President on the promissory note (since it was the lead bank in the participation agreement). It follows that only M & S was Dorsey's client in the President litigation."

Through its consistency with McIntosh, the Leonard decision clarifies the scope of third party malpractice claims that can be pursued against Minnesota attorneys in the federal courts.

Additional information:

- Review the case: Leonard v. Dorsey & Whitney LLP, __ F.3d __, 2009 WL 88855 (8th Cir. Jan. 15, 2009).
- Kay Hunt of Lommen Abdo represented the Minnesota State Bar Association and the Minnesota Defense Lawyers Association as Amicus Curiae before the Minnesota Supreme Court in the McIntosh County Bank case.
- This article was authored by Brett Clark, a member of Lommen Abdo's Professional Liability section.

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