Malpractice Claim for Failure to Record a Right of First Refusal

By Jeffrey P. Lewis

Jeffrey P. Lewis is a member in the West Chester office of the Pittsburgh-based law firm of Eckert Seamans Cherin & Mellott L.L.C. He is co-vice chair of the PBA Professional Liability Committee and a member of the PBA House of Delegates.

Is it a breach of the duty of care owed by a lawyer to his or her client if the lawyer fails to record the client's right of first refusal to purchase a parcel of real estate? Recording provides any potential buyer of that parcel constructive notice of the existence of the contractual right. But is recording a necessary precaution that counsel should take notwithstanding that the owner, who is a party to the agreement, would presumably have actual knowledge of its existence and would honor it when he or she is ready to sell? A recent New Jersey case, *Shu v. Butensky*, 2009 WL 417265 (N.J. Super. A.D.), an "unpublished" opinion, suggests that failure to record a right of first refusal states at least a prima facie claim that the lawyer did breach the duty of care.

In *Shu*, a buyer had entered into an agreement of sale in 1986 to purchase a parcel of real estate (Lot One). That agreement contained language that granted the buyer a right of first refusal with respect to the future sale of an adjacent parcel (Lot Two), also owned by the seller, a husband and wife, which right "shall survive the passage of time." The lawyer representing the buyer did not record the agreement, although it is not clear from the opinion whether the agreement contained language prohibiting its recording, which provision is commonly found in agreements of sale for real estate. In the absence of recording, there would be no constructive notice of the right of first refusal to any prospective purchaser of Lot Two.

The seller husband dies, leaving his widow as the sole owner of Lot Two. Instead of offering that lot to the owner of Lot One, she conveys Lot Two to her two children, apparently without informing them of the existence of the right of first refusal. They then retain the very same lawyer who had represented the buyer of Lot One to handle the sale of Lot Two to a third party. Because this transaction was happening almost 20 years after the lawyer had represented the buyer of Lot One, he does not remember the existence of the right of first refusal.

As counsel for the owners of Lot Two, the children of the previous owners of both Lots One and Two, he writes the owner of Lot One, his former client, to inform him of the pending sale and to complain about an encroachment upon Lot Two. For reasons unexplained in the opinion, the owner of Lot One did not raise at that time the existence of the right of first refusal, nor did he complain that his former lawyer should not handle the pending sale due to his previous representation of the owner of Lot One. Accordingly, the owner of Lot One raised no objection to the sale of Lot Two to a third party, and so Lot Two was conveyed to the third party.

The owner of Lot One refused to remove the encroachment. The new owner of Lot Two filed suit against the owner of Lot One, seeking both an injunction for the removal of the encroachment and damages. Again unexplained in the opinion, the owner of Lot One filed an answer to the complaint, but it does not mention the right of first refusal or "implicate" his former attorney in any way. Only later, in a letter written by the Lot One owner's current counsel, did he indicate his client's intention to enforce his right of first refusal. The new owner of Lot Two refused to recognize the viability of the right of first refusal because of the failure of the owner of Lot One to have exercised that right when he was placed on notice of the pending sale to the new owner of Lot Two. The owners of Lot One and Lot Two then settle the encroachment dispute and the owner of Lot One sues his former lawyer.

The owner of Lot One contended that his former lawyer had committed malpractice "by failing to record the contractual provision establishing his right of first refusal." He also contended that his former lawyer should not have taken on the representation of the sale of Lot Two to a third party because of a conflict of interest. Instead of filing preliminary objections, the lawyer filed a summary judgment motion in which he argues that he owes no duty to his former client under these circumstances. The lower court embraced this argument and granted summary judgment in the lawyer's favor.

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The appellate court, however, reversed and remanded. Although it recognizes the procedural irregularity in filing a summary judgment motion instead of preliminary objections, which implicate different standards of review, the motion should have been denied, in its view, regardless of which standard applies. The appellate court concentrates its attention on the lawyer's conduct in the first and not the second representation. In its view, it could be argued that the lawyer breached the duty of care "by failing to draft and record an appropriate instrument echoing the contractual language, thereby giving constructive notice of the encumbrance to any prospective purchaser" of Lot Two. Based upon this premise, the court found that a jury could rationally find a causal link between this breach and damages for "1) lost opportunity to acquire the adjacent lot; 2) monetary damages paid ... to settle the encroachment action; and 3) counsel fees incurred in defense of that action."

In addition to the lesson learned from the failure to record a right of first refusal, this case also illustrates another point, which is the importance of purchasing an extended reporting period, also known as a tail, under one's professional liability policy under the appropriate circumstances. It can never be for too long a period because claims can surface many years after the actionable conduct occurred. In this instance, the alleged malpractice occurred more than 20 years before the claim was made and yet was not time-barred because of the discovery rule exception to the statute of limitations.

It remains to be seen whether, on remand, the owner of Lot One will be estopped by his failure to have raised the existence of his right of first refusal on either of the two previous opportunities he had to do so.