COMMENTS

The Proposed Model Rules of Professional Responsibility: Disclosure of Clients' Fraud in Negotiation

This Comment compares the disclosure provisions of the ABA Code of Professional Responsibility with the proposed Model Rules of Professional Conduct. The Comment illustrates the differences between the two and analyzes what effect the Model Rules would have on an attorney whose client makes a material misrepresentation during negotiation. The Comment concludes that the Model Rules' disclosure provisions are preferable to those of the ABA Code.

INTRODUCTION

Lawyers confront numerous ethical problems during negotiation.[1] A particularly difficult dilemma arises if a lawyer learns that his client has fraudulently misrepresented a material fact to the adversary. When this occurs the lawyer faces conflicting ethical duties. On one hand, the lawyer has a duty to be honest[2] and to avoid participation in a fraud.[3] However, the lawyer must also maintain the client's confidences.[4] Dis-

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[1] *See* H. EDWARDS & J. WHITE, THE LAWYER AS A NEGOTIATOR 417-20 (1977). Edwards and White provide several hypotheticals illustrating many of the conflicts that the negotiator faces.

[2] MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102(A)(4) (1980) [hereafter ABA Code]. Most states have adopted the ABA Code. *See* Kramer, *Clients' Frauds and Their Lawyers' Obligations: A Study in Professional Irresponsibility*, 67 GEO. L.J. 991, 994 (1979).

[3] ABA Code, note 2 *supra*, DR 1-102(A)(4).

[4] ABA Code, note 2 *supra*, Canon 4. In addition, the attorney-client privilege of evidence law requires a lawyer to protect a client's confidential communications. *See* 8 J. WIGMORE, EVIDENCE § 2292 (McNaughton rev. 1961).

This Comment primarily concerns the ethical obligation of preserving a client's confidences. It discusses the attorney-client privilege only when the two principles overlap.

closure of the client's misrepresentation satisfies the lawyer's duty not to commit a fraud, but violates the duty to protect the client's confidences.[5]

The ABA Model Code of Professional Responsibility (ABA Code)[6] establishes ethical guidelines for the negotiating attorney whose client makes a material misrepresentation during the attorney-client relationship. In 1981 the ABA Commission on Evaluation of Professional Ethics proposed the Model Rules of Professional Conduct (Model Rules)[7] which provide attorneys with a very different set of ethical guidelines to follow.[8] The Model Rules would have mandated disclosure of a client's

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[5] An attorney may not reveal a client's fraud if he learns of the fraud through a protected confidence. *See* ABA Code, note 2 *supra*, DR 7-102(B)(1). See also notes 39-48 and accompanying text *infra* for an explanation of client communications which the ABA Code protects from disclosure.

Many commentators have examined the ethical conflict posed by attorney-client confidentiality. *See, e.g.*, M. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM (1975); Frankel, *The Search For Truth: An Umpireal View*, 123 U. PA. L. REV. 1031 (1975); Hoffman, *On Learning of a Corporate Client's Crime or Fraud - The Lawyer's Dilemma*, 33 BUS. LAW. 1389 (1978); Landesman, *Confidentiality and the Lawyer-Client Relationship*, 1980 UTAH L. REV. 765; Morgan, *The Evolving Concept of Professional Responsibility*, 90 HARV. L. REV. 702 (1977); Patterson, *The Limits of the Lawyer's Discretion and the Law of Legal Ethics*: National Student Marketing *Revisited*, 1979 DUKE L.J. 1251.

[6] ABA Code, note 2 *supra*.

[7] MODEL RULES OF PROFESSIONAL CONDUCT (Final Draft 1981) [hereafter Model Rules]. On May 30, 1981, the American Bar Association Commission on Evaluation of Professional Ethics proposed this draft, intending to supersede the ABA Code. The authors of the Model Rules found the ABA Code inadequate in two respects. First, discrepancies exist between the ABA Code and other regulations governing lawyers' ethical conduct. Second, recent judicial decisions changing the standards that govern minimum fee regulations, advertising, solicitation, and pretrial publicity dated the ABA Code. *See* Kutak, *Model Rules of Professional Conduct: Ethical Standards for the '80s and Beyond*, 67 A.B.A. J. 1116 (1981).

[8] *See* notes 49-75 and accompanying text *infra*. The disclosure provisions of the Model Rules are the most reviewed and criticized sections of the proposed rules. *See* Landesman, note 5 *supra*, at 765; Patterson, *An Analysis of the Proposed Model Rules of Professional Conduct*, 31 MERCER L. REV. 645 (1980); Pizzi, Figa & Barnhill, *The Adversary Model Is Bent*, 9 COLO. LAW. 2576 (1980); Redlich, *Disclosure Provisions of the Model Rules*, 1980 AM. B. FOUND. RES. J. 981; Schwartz, *The Death and Regeneration of Ethics*, 1980 AM. B. FOUND. RES. J. 953; Stark, *Review Essay, The Model Rules of Professional Conduct*, 12 CONN. L. REV. 948 (1981).

The Roscoe Pound-American Lawyers Foundation has proposed the American Lawyer's Code of Conduct (1980) [hereafter A.L.C.C.] to replace the ABA Code and to provide an alternative to the Model Rules. The disclosure provisions of the A.L.C.C. are much narrower than those of the Model Rules. *Compare* A.L.C.C. Rule 1 (disclosure never mandatory) *with* Model Rules, note 7 *supra*, Rules 1.6 and 4.1 (disclosure

confidences in circumstances in which the ABA Code requires nondisclosure.[9] However, in February, 1983, the ABA House of Delegates rejected the provision of the Model Rules which would have allowed a lawyer to disclose certain confidential information acquired during representation of a client.[10]

This Comment analyzes the Model Rules' disclosure provisions which the ABA House of Delegates rejected, and compares them with the existing confidentiality requirements of the ABA Code. First, the Comment discusses the lawyer's role in the negotiation process. It next examines the guidance that the ABA Code and the Model Rules offer to the negotiator whose client's fraud materially affects the negotiation. The Comment then presents three hypotheticals to illustrate the differences between the ABA Code and the Model Rules' confidentiality requirements which the ABA Delegates rejected. Finally, the Comment concludes that the Model Rules provide a more effective standard for disclosure by the negotiator. Therefore, the author urges the members of the House of Delegates to reconsider their rejection of the Model Rules' disclosure guidelines and adopt them when the final vote on the Model Rules takes place at the ABA annual meeting in August, 1983. The author also recommends that state legislatures and courts adopt the disclosure provisions originally included in the Model Rules.

I. THE LAWYER AS NEGOTIATOR

Before determining which set of ethical rules concerning disclosure

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mandatory in certain situations).

[9] *See* Redlich, note 8 *supra*, at 982. For specific illustrations of the differences between the ABA Code and the Model Rules, see text accompanying notes 77-104 *infra*. One purpose of this Comment is to illustrate the differences between the Model Rules and ABA Code in the hope that doing so will be useful to attorneys and judges, whether or not the Model Rules are adopted.

[10] *See* Nat'l L.J., Feb. 24, 1983, at 3, col. 2; N.Y. Times, Feb. 8, 1983, at A1, col. 2; The Recorder, Feb. 8, 1983, at 1, col. 5; Wall. St. J., Feb. 8, 1983, at 6, col. 1. The Model Rules would have allowed a lawyer to disclose information necessary "to prevent the client from committing a . . . fraudulent act that the lawyer reasonably believes is likely to result in . . . substantial injury to the financial interest or property of another." Model Rules, note 7 *supra*, Rule 1.6(b)(1). The Model Rules would have also allowed a lawyer to disclose information necessary "to rectify the consequences of a client's criminal or fraudulent act in the furtherance of which the lawyer's services had been used." Model Rules, note 7 *supra*, Rule 1.6(b)(2). The ABA House of Delegates rejected these rules and adopted only one exception to the rule that an attorney may not disclose a client's confidences. Disclosure is only permissible in situations in which "imminent death or substantial bodily harm" is likely to result. Nat'l L.J., Feb. 24, 1983, at 3, col. 2.

provides the most useful guide for the negotiator, it is necessary to understand the purpose of negotiation and the attorney's role therein. Negotiation is a "process by which consensual legal relationships are established."[11] Negotiation serves two purposes.[12] The first is to settle a dispute that may otherwise result in litigation,[13] as in settlement of a personal injury suit.[14] The second objective is to establish an agreement that will govern the future conduct of the participants,[15] as in the negotiation of a business contract.[16]

Litigation and negotiation involve different means and ends.[17] The litigator's goal is to defeat the opponent; the negotiator's goal is to act with the opposing side to resolve a mutual problem.[18] If the bargaining parties are not honest[19] in negotiation, the resulting settlement may later give rise to litigation.[20] However, the negotiator faces a conflict

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[11] L. BROWN & E. DAUER, PLANNING BY LAWYERS: MATERIALS ON A NONADVERSARIAL LEGAL PROCESS 359 (1978).

[12] V. COUNTRYMAN, T. FINMAN & T. SCHNEYER, THE LAWYER IN MODERN SOCIETY 330 (2d ed. 1976); Eisenberg, *Private Ordering Through Negotiation: Dispute-Settlement and Rulemaking*, 89 HARV. L. REV. 637, 665 (1976).

[13] Society has a great interest in encouraging negotiation because it reduces litigation in an overburdened judicial system. *See* S. THURMAN, E. PHILIPS JR. & E. CHEATHAM, THE LEGAL PROFESSION 250 (1970); Geller, *Unreasonable Refusal to Settle and Calendar Congestion - Suggested Remedy*, 34 N.Y. ST. B.J. 477 (1962); Title, *The Lawyer's Role in Settlement Conferences*, 67 A.B.A. J. 592, 592 (1981).

[14] V. COUNTRYMAN, T. FINMAN & T. SCHNEYER, note 12 *supra*, at 330.

[15] A successful settlement also allows the negotiating parties to resolve their disagreements by themselves rather than by judicial determination. *See* L. PATTERSON & E. CHEATHAM, THE PROFESSION OF LAW 115 (1971).

[16] V. COUNTRYMAN, T. FINMAN & T. SCHNEYER, note 12 *supra*, at 330.

[17] L. PATTERSON & E. CHEATHAM, note 15 *supra*, at 122.

[18] *Id.*

[19] A lawyer may not knowingly make false statements of facts in negotiation. *See* Scofield v. State Bar, 62 Cal. 2d 624, 401 P.2d 217, 43 Cal. Rptr. 825 (1967); ABA Code, note 2 *supra*, DR 1-102(A)(4) and DR 7-102(A)(5). The Model Rules require honesty in negotiation, *see* Model Rules, note 7 *supra*, Rule 4.1(a), but recognize that within the negotiation context certain statements are not treated as statements of fact. Examples include a party's representation of what constitutes an acceptable settlement of a claim, and estimates of price or value. *See* Model Rules, note 7 *supra*, Rule 4.1 (comment).

[20] There are few reported cases in which the negotiating lawyer either made material misrepresentations or failed to disclose material facts. Many cases, however, discuss the duty of disclosure in arms-length negotiations between nonlawyers. A barterer may be liable for deceit, and the court may overturn the agreement, if the barterer misrepresents a material fact. Smith v. Pope, 103 N.H. 555, 558, 176 A.2d 321, 324 (1961) (seller of residential property was liable for deceit for inaccurately representing the quality of the property's well water). A barterer may also be liable for deceit for omitting material facts during the negotiation. If he has a duty to disclose, his suppression

when he must decide whether to be honest or to respect his ethical obligation not to disclose a client's confidence. Thus, to be effective, rules of professional ethics must recognize the importance of negotiation and address directly the ethical conflicts that occur during negotiation.

II. THE LEGAL AND ETHICAL DIMENSIONS OF DISCLOSING A CLIENT'S MISCONDUCT

The laws of evidence,[21] agency,[22] and legal ethics[23] provide that a client's communication with an attorney concerning a legal matter is confidential. In most instances, these laws prohibit lawyers from disclosing their client's confidences. However, the attorney may disclose certain unprotected communications.[24] The issue of when an attorney may disclose a client's confidential communication is vigorously disputed.

A. The Freedman-Frankel Controversy

Professor Monroe Freedman and Judge Marvin Frankel present opposing viewpoints on an attorney's disclosure of client fraud. Professor Freedman asserts that the duty to protect a client's confidences is an essential ingredient of the adversary system. Therefore, only a few situations warrant disclosure.[25] Conversely, Judge Frankel believes that the

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of a material fact is tantamount to an affirmative misrepresentation. Obde v. Schlemeyer, 56 Wash. 2d 449, 452, 353 P.2d 672, 674-75 (1960) (landlord has a duty to disclose concealed defects in premises that were known to the landlord, but not the tenant; failure to disclose constituted fraud); Kaas v. Privette, 12 Wash. App. 142, 148, 529 P.2d 23, 29 (1974) (seller of securities held liable for failing to disclose the company's financial difficulties and the absence of a dealership agreement).

[21] *See* 8 J. WIGMORE, note 4 *supra*, §§ 2290-2329. "Where legal advice of any kind is sought from a professional legal advisor in his capacity as such, the communications relevant to that purpose, made in confidence by the client, are at his instance permanently protected from disclosure by himself or by the legal adviser." *Id.* § 2292. *See also* CAL. EVID. CODE § 954 (West Supp. 1983): "the client . . . has a privilege to . . . prevent another from disclosing, a confidential communication between client and lawyer . . . ."

[22] *See* RESTATEMENT (SECOND) OF AGENCY § 395 (1957): "[A]n agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course . . . of his agency . . . ."

[23] ABA Code, note 2 *supra*, Canon 4, states, "[A] lawyer should preserve the confidences and secrets of a client."

[24] For example, a lawyer may reveal a client's intention to commit a future crime or fraud. *See* ABA Code, note 2 *supra*, DR 4-101(C)(3); CAL. EVID. CODE § 956 (West 1981).

[25] M. FREEDMAN, note 5 *supra*. Professor Freedman was the Reporter of the

adversarial ideal needs modification, stressing that truthfinding must be the judicial system's paramount objective.[26]

Professor Freedman begins with the premise that the adversary system is the most effective method for ascertaining the truth in legal controversies.[27] He emphasizes that proper representation requires that the attorney receive all pertinent information from the client, and points out that if the attorney must disclose these communications, the client will not divulge necessary information.[28] Thus, Professor Freedman contends that an effective advocate must protect the client's confidences.[29]

Judge Frankel also recognizes the attorney's fiduciary duty to preserve the client's confidential communications.[30] He asserts, however, that the attorney's primary obligation lies not with the client, but with the judicial system. Accordingly, in certain circumstances the attorney's duty of confidentiality should yield to public policy.[31] Judge Frankel has suggested that the ABA Code be amended to read:

> In representing a client, unless prevented from doing so by a privilege . . . a lawyer shall . . . report to the court and opposing counsel the making of any untrue statement by a client or . . . any omission to state a material fact necessary in order to make the statements made . . . not misleading.[32]

A.L.C.C., note 8 *supra*, which reflects his views on disclosure. See note 29 *infra*, for examples of when the A.L.C.C. would condone disclosure.

[26] Frankel, note 5 *supra*, at 1052.

[27] M. FREEDMAN, note 5 *supra*, at 4.

[28] *Id.* at 5.

[29] The A.L.C.C., note 8 *supra*, provides two alternative sections which describe when the lawyer may disclose a client's confidential communication. Disclosure is never mandatory. Alternative "A" permits the lawyer to reveal the client's confidences to the extent that the law or a court order requires, *id.* Rule 1.3; to prevent imminent danger to human life, *id.* Rule 1.4; to defend against charges of criminal conduct or malpractice, *id.* Rule 1.5; and to reveal bribery of a judge or juror, *id.* Rule 1.6. Alternative "B" allows disclosure only to defend against formal charges that the client initiates, *id.* Rule 1.4, and to the extent the law or a court order requires, *id.* Rule 1.3.

[30] Frankel, note 5 *supra*, at 1056.

[31] *Id.* at 1055; *cf.* Tarasoff v. Regents of Univ. of Cal., 17 Cal. 3d 425, 551 P.2d 334, 131 Cal. Rptr. 14 (1976). The Supreme Court of California held that a therapist who determines that a patient poses a serious danger of violence to others has a duty to warn the foreseeable victim of that danger. *Id.* at 431, 551 P.2d at 345, 131 Cal. Rptr. at 25. *Tarasoff* could be extended to require a lawyer, who learns of a client's intention to violate the law, to disclose the information to foreseeable victims. *See* Hoffman, note 5 *supra*, at 1398.

[32] Frankel, note 5 *supra*, at 1057-58. *But see* ABA Code, note 2 *supra*, DR 7-102(B) (requiring the attorney to disclose his client's positive fraudulent acts in limited situations). *See* notes 42-46 and accompanying text *infra*. The current rule, however, neither compels disclosure of material facts nor forbids material omissions.

B. The Common Law

Courts recognize the lawyer's ethical obligation to protect a client's communications and thus do not compel the lawyer to disclose a client's past fraud.[33] The lawyer, however, has a duty to advise the client to rectify the fraud. If the client refuses, a court may require the lawyer to withdraw from representation.[34]

A recent far reaching case concerning an attorney's duty to disclose a client's misrepresentation is *SEC v. National Student Marketing Corp.*[35] The Securities and Exchange Commission (SEC) sued for injunctive sanctions against the defendant corporation and its lawyers. The SEC accused the lawyers of aiding and abetting a fraud by their failure to prevent a merger when they knew that the corporation had withheld material information from its shareholders.[36] The SEC contended that when the corporation refused to correct the misleading financial statement, the lawyers had a duty to cease representing the corporation and to disclose the information to the shareholders and the SEC.[37] The court did not resolve the disclosure issue, holding only that the lawyers' inaction constituted aiding and abetting a fraud.[38] Thus, under the common law, the lawyer cannot remain a silent observer of his client's frauds, but must persuade the client to disclose material misstatements, or withdraw from the case.

C. The ABA Code Of Professional Responsibility

ABA Code Disciplinary Rule 4-101 provides that a lawyer should preserve his client's confidences and secrets.[39] The ABA Code allows a

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[33] *See In re* Malloy, 248 N.W.2d 43, 45-46 (N.D. 1976). The court held that when a client commits perjury during negotiation the attorney has no duty to disclose the perjury, but is required to withdraw. *Id.*

Courts impose an affirmative duty on nonlegal negotiators to disclose material facts in transactions such as the sale of property. *See* cases cited in note 20 *supra*. Moreover, the misrepresentation or omission of a material fact in these transactions may give rise to an action for deceit or fraud. *Id.*

[34] *Id.*; *see also In re* A, 554 P.2d 479, 487 (Or. 1976). The defendant, a lawyer, continued to represent his client after the client materially misled the court in a civil proceeding. The court held that withdrawal was mandatory if the client refused to rectify his fraud. *Id.*

[35] 457 F. Supp. 682 (D.D.C. 1978).

[36] *Id.* at 712.

[37] *Id.*

[38] *Id.* at 715.

[39] ABA Code, note 2 *supra*, Canon 4 and DR 4-101. "Confidence" is information that the attorney-client privilege protects. DR 4-101(A). "Secret" refers to information

lawyer to reveal "[t]he intention of his client to commit a crime and the information necessary to prevent the crime."[40] Disclosure is mandatory when a lawyer receives information clearly establishing that the client perpetrated a fraud,[41] except when the information is privileged.[42]

The ABA Ethics Committee has interpreted "privilege" to include the same confidences and secrets that Disciplinary Rule 4-101 protects.[43] This definition of privilege encompasses all information that the attorney-client evidence privilege protects, as well as information that the lawyer gains in the professional relationship which, if disclosed, would harm the client.[44] The Committee's interpretation substantially eliminates the mandatory disclosure rule concerning clients' frauds,[45] because "almost all client frauds are necessarily discovered as a result of information gained in the professional relationship."[46] The ABA Code requires disclosure only if the lawyer learns of the client's fraud outside the context of the representation.[47] Therefore, under the ABA Code, a lawyer may disclose a client's confidences without the client's

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gained in the professional relationship that would be detrimental to the client if disclosed. *Id.*

[40] ABA Code, note 2 *supra*, DR 4-101(C)(3). The ABA Code also allows disclosure of a client's confidences: with the client's consent, DR 4-101(C)(1); when permitted under a Disciplinary Rule or when required by law or court order, DR 4-101(C)(2); to collect a fee, DR 4-101(C)(4); or when an attorney must defend himself from an accusation of wrongful conduct, DR 4-101(C)(4).

[41] The ABA Code, note 2 *supra*, does not define "fraud," but commentators have interpreted it to mean tortious fraud. Callan & David, *Professional Responsibility and the Duty of Confidentiality: Disclosure of Client Misconduct in an Adversary System*, 29 RUTGERS L. REV. 332, 359 (1976). The elements of the tort of fraud include: false representation, knowledge or belief that the representation is false, an intention to induce another person to act or refrain from acting in reliance on the representation, justifiable reliance by that person, and damage resulting from the reliance. *See* W. PROSSER, HANDBOOK ON THE LAW OF TORTS §105, at 685-86 (4th ed. 1971).

[42] ABA Code, note 2 *supra*, DR 7-102(B)(1).

[43] ABA Comm. on Ethics and Professional Responsibility, Formal Op. 341 (1975).

[44] *See* note 39 *supra*.

[45] *See* Kramer, note 2 *supra*, at 994, 999.

[46] *Id.* at 999.

[47] ABA CODE, note 2 *supra*, DR 7-102(B)(1); *see* Kramer, note 2 *supra*, at 994, 999; *cf.* ABA Comm. on Professional Ethics, Informal Op. 778 (1964); L.A. County Bar Ass'n Comm. on Legal Ethics, Op. 267 (1960). These opinions suggest the proper conduct for a lawyer who learns that his client has misappropriated funds from a ward's trust. First, the lawyer should use every effort to see that the client makes full restitution. Second, the lawyer should advise the client to disclose the misappropriation to the court. Third, if the client refuses, the lawyer may withdraw from representation, but may not disclose the misappropriation to the court or to a third party.

consent only when the client intends to commit a future crime.[48]

D. Model Rules of Professional Conduct

Like the common law and the ABA Code, the Model Rules would require an attorney to maintain the confidentiality of information obtained while representing a client.[49] In addition, the common law, the ABA Code, and the Model Rules all forbid an attorney to assist a client in the commission of a fraud.[50] Nevertheless, the disclosure provisions of the Model Rules differ meaningfully from those of the common law[51] and the ABA Code.

The Model Rules require an attorney to disclose a client's fraud when the attorney's services are so bound to the misconduct that nondisclosure would be equivalent to assisting the client's fraudulent act.[52] The Model Rules also would require disclosure when the attorney's own conduct would be fraudulent without disclosure.[53] Although neither the common law[54] nor the ABA Code[55] permit disclosure of the client's fraud when the information is privileged, the Model Rules would not recognize the attorney's ethical privilege of confidentiality in these circumstances.[56] The common law[57] and the ABA Code[58] require

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[48] *See* Model Rules, note 7 *supra*, Rule 1.6 (comment).

[49] Model Rules, note 7 *supra*. Rule 1.6 (comment) states that "[a] fundamental principle in [the] client-lawyer relationship is that the lawyer maintain the confidentiality of information relating to the representation."

[50] Model Rules, note 7 *supra*, Rules 1.2(d) and 8.4(b); ABA Code, note 2 *supra*, DR 1-102(A)(2),(3); DR 7-102(A)(7).

[51] See notes 33-38 and accompanying text *supra* for a discussion of the common-law requirements for a lawyer who discovers that his client has committed a fraud. Although the court in SEC v. National Student Mktg. Corp., 457 F. Supp. 682 (D.D.C. 1978) did not explicitly require a lawyer to disclose a client's fraud to avoid aiding and abetting a fraud, commentators have suggested that a lawyer's duty of candor is now as important as the lawyer's duty of loyalty to the client. *See* Hoffman, note 5 *supra*, at 1404; Patterson, note 5 *supra*, at 1254. However, no case has required a lawyer to disclose a client's fraud. The lawyer need only advise the client to disclose the fraud, and if the client refuses to disclose, then the lawyer must withdraw.

[52] *See* Model Rules, note 7 *supra*, Rule 4.1(b) (comment); *see also* Kutak, note 7 *supra*, at 1120.

[53] Model Rules, note 7 *supra*, Rules 1.2(d), 1.6(b)(5), 1.6 (comment), and 4.1(b)(1), (2). Rule 4.1(b)(1) provides: "[I]n the course of representing a client a lawyer shall not knowingly fail to disclose a fact to a third person when in the circumstances failure to make the disclosure is equivalent to making a material misrepresentation."

[54] *See* cases cited in notes 33-34 *supra*.

[55] *See* notes 41-48 and accompanying text *supra*.

[56] Model Rules, note 7 *supra*, Rule 1.6(b)(3) (notes).

[57] *See* cases cited in notes 33-34 and accompanying text *supra*.

[58] *See* note 83 *infra*.

the attorney to withdraw from representing the client upon discovering the client's fraud. However, mere withdrawal from representation would not satisfy the Model Rules' ethical requirements.[59]

The Model Rules' disclosure provisions fall between the competing views of Professor Freedman and Judge Frankel.[60] In contrast with Judge Frankel's approach,[61] the Model Rules would not require disclosure of all the client's unprivileged false statements or material omissions. Disclosure would be required only if necessary to prevent an attorney from assisting in the client's misconduct.[62] However, the Model Rules would require disclosure of a client's misrepresentation in circumstances in which Professor Freedman would recommend confidentiality.[63]

1. Mandatory Disclosure

The Model Rules provide three examples that illustrate circumstances in which disclosure would be mandatory during negotiation:[64] when disclosure would prevent a lawyer's statement from being so materially misleading as to constitute a misrepresentation;[65] when a lawyer makes a statement he believes to be true, but subsequently discovers to be false;[66] and when a lawyer knows that the client has made a materially false statement during a transaction in which the lawyer repre-

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[59] *See* Model Rules, note 7 *supra*, Rule 4.1(b) (notes); *see also* note 85 *infra*.

[60] *See* Kutak, note 7 *supra*, at 1119; *see also* notes 25-32 and accompanying text *supra*.

[61] *See* text accompanying notes 31-32 *supra*.

[62] *See* note 52 and accompanying text *supra*.

[63] *See* notes 25, 29 *supra*, for examples of situations in which Professor Freedman would allow disclosure. Notes 64-67 and accompanying text *infra* provide examples of situations in which the Model Rules would require disclosure.

[64] Model Rules, note 7 *supra*, Rule 4.1 (comment and legal background). Rule 4.1 provides:

> *Truthfulness in Statements to Others.*
> In the course of representing a client a lawyer shall not:
> (a) knowingly make a false statement of fact or law to a third person; or
> (b) knowingly fail to disclose a fact to a third person when:
> (1) in the circumstances failure to make disclosure is equivalent to making a material misrepresentation;
> (2) disclosure is necessary to prevent assisting a criminal or fraudulent act, as required by Rule 1.2(d); or
> (3) disclosure is necessary to comply with other law.

[65] Model Rules, note 7 *supra*, Rule 4.1(b)(1) and Rule 4.1 (comment and legal background).

[66] Model Rules, note 7 *supra*, Rule 4.1(b) and Rule 4.1 (comment and legal background).

sented the client.[67] In these cases, disclosure would be required even though the attorney-client confidence rules[68] otherwise protect the information.[69]

2. Discretionary Disclosure

The Model Rules would permit but not require disclosure of a client's confidences in two situations. The Model Rules would permit disclosure to "prevent the client from committing a criminal or fraudulent act that the lawyer believes is likely to result in death or substantial bodily harm, or substantial injury to the financial interest . . . of another."[70] Thus, while the ABA Code permits disclosure of any potential crime,[71] the Model Rules would permit disclosure only if the prospective crime or fraud would result in substantial harm.

The Model Rules would also permit disclosure of confidential information to "rectify the consequences of a client's . . . fraudulent act in the commission of which the lawyer's services had been used."[72] In this situation the lawyer unknowingly has assisted the client in a fraud. Disclosure is not mandatory in these circumstances because the lawyer has acted innocently.[73] The rule is similar to ABA Code Disciplinary Rule 7-102(B)(1).[74] However, the Model Rules would make disclosure of the fraud discretionary, and also would eliminate the ABA Code's exception for privileged information.[75]

III. THE EFFECT OF THE DISCLOSURE PROVISIONS OF THE MODEL RULES ON THE LAWYER AS A NEGOTIATOR

A series of hypotheticals will demonstrate the effect of the Model Rules on the negotiator, and will illustrate specific instances in which the Model Rules would mandate disclosure. The hypotheticals also show that the Model Rules are not as drastic a departure from the existing disclosure rules as some commentators suggest.[76]

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[67] *Id.*

[68] Model Rules, note 7 *supra*, Rule 1.6.

[69] *Id.* (comment).

[70] Model Rules, note 7 *supra*, Rule 1.6(b)(2).

[71] ABA Code, note 2 *supra*, DR 4-101(C)(3); *see* text accompanying note 40 *supra*.

[72] Model Rules, note 7 *supra*, Rule 1.6(b)(3).

[73] Kutak, note 7 *supra*, at 1120.

[74] ABA Code, note 2 *supra*, DR 7-102(B)(1), requires a lawyer to disclose a client's fraud committed during the course of representation unless the information is privileged. *See* text accompanying notes 41-47 *supra*.

[75] Model Rules, note 7 *supra*, Rule 1.6(b)(3) (notes).

[76] *See, e.g.*, Pizzi, Figa & Barnhill, note 8 *supra*, at 2580; Pike & Granelli, *Ethics*

A. Hypothetical One

A lawyer represents a client injured in a car accident. The client's problems include a debilitating back injury. However, the lawyer does not know that the client suffered the back injury in a prior accident in Canada. Opposing counsel is also unaware of the previous accident and fails to learn of it during discovery. The injured client's lawyer files a verified complaint alleging that the present accident is the proximate cause of the client's back injury. Still unaware of the origin of the client's back injury, the lawyer begins negotiation. Before a settlement is reached, the client informs the lawyer of the earlier accident. Must the lawyer inform opposing counsel of the prior accident?

1. Ethical Obligations Under the ABA Code

The ABA Code provides that if a client has perpetrated a fraud upon another person the lawyer must urge the client to rectify the fraud.[77] If the client refuses, the lawyer must disclose the fraud to the affected person unless the information is privileged.[78] In the hypothetical the client's disclosure to the lawyer of the prior accident is privileged because it was made during their attorney-client relationship.[79] Therefore, disclosure would be unethical.[80]

The ABA Code also provides that a lawyer may not engage in conduct involving dishonesty, fraud, or misrepresentation,[81] and also bars the lawyer from making a false statement of fact or law.[82] In the hypothetical, continued representation upon discovery of the client's fraud would require the lawyer to knowingly misrepresent a material fact. Therefore, if the client refuses to rectify the fraud, and pursues the claim, the lawyer should withdraw from the case.[83]

2. Ethical Obligations Under the Model Rules

The Model Rules would require a lawyer to disclose information to

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Code Keeps Inching Along: Will It Ever Get ABA Approval?, Nat'l L.J., Aug. 24, 1981, at 8, col. 2.

[77] ABA Code, note 2 *supra*, DR 7-102(B)(1).

[78] *Id.*

[79] *See* text accompanying notes 43-45 *supra*.

[80] ABA Code, note 2 *supra*, DR 4-101(B)(1) provides that a lawyer shall not knowingly reveal a confidence or a secret of a client.

[81] ABA Code, note 2 *supra*, DR 1-102(A)(4).

[82] ABA Code, note 2 *supra*, DR 7-102(A)(5).

[83] ABA Code, note 2 *supra*, DR 2-110 describes the circumstances in which the lawyer may withdraw from representation. DR 2-110(C)(1)(b) permits a lawyer to withdraw if the client personally seeks to pursue an illegal course of conduct.

a third person to prevent the lawyer's statement from being so materially misleading that it would constitute a misrepresentation.[84] In the hypothetical, the lawyer stated facts in both the verified complaint and during negotiation which he believed to be true, but later discovered were false. Disclosure to the person relying on these statements is necessary if remaining silent would constitute a misrepresentation.[85]

The opposing counsel will have relied on a false material fact if he settles the case because it appeared that his client, the defendant, caused the back injury. Unlike the ABA Code, mere withdrawal from representing the client would not satisfy the lawyer's ethical duties under the Model Rules.[86] In this hypothetical the Model Rules would require the lawyer to disclose the client's previous accident to opposing counsel.

B. Hypothetical Two

Two parties, each represented by counsel, are negotiating the sale of real property. During the negotiation, the seller states that the property is unencumbered. However, the seller's attorney knows that the client's sister intends to place a lien on the property the next day.

1. Ethical Obligations Under the ABA Code

As in the previous hypothetical, the ABA Code requires the attorney to first advise the client to rectify the fraud, and then to disclose the fraud if the client refuses, unless the information is privileged.[87] In the hypothetical, if the client informed the attorney of his sister's intention to put the lien on the property, the attorney-client privilege applies.[88] In addition, the ABA Code requires nondisclosure if a third party in-

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The ABA Code requires withdrawal from representation if the lawyer's continued employment will result in the violation of a Disciplinary Rule, DR 2-110(B)(2). Thus, the lawyer must withdraw if continued representation would cause the lawyer to engage in a fraud or dishonesty, DR 1-102(A)(4), or would require the lawyer to assist the client in conduct that the lawyer knows is fraudulent, DR 7-102(A)(7).

[84] *See* Model Rules, note 7 *supra*, Rule 4.1(b)(1).

[85] Model Rules, note 7 *supra*, Rule 4.1(b) (notes), provides that:

> It may occur that the lawyer has made a statement believed to be true at the time, but which he subsequently discovers to be false. . . . In such cases, if remaining silent would be the equivalent of misrepresentation, a lawyer has an affirmative obligation to disclose the true facts . . . to persons who may act in reliance on the original statement.

[86] "Where third persons rely on the lawyer's earlier statements, withdrawal from representation may not itself terminate the lawyer's assistance in the fraud." *Id.*

[87] ABA Code, note 2 *supra*, DR 7-102(B)(1).

[88] *See* note 20 *supra*.

forms the attorney of the lien during the representation of the client, because disclosure of this secret would be detrimental to the client.[89] Therefore, disclosure is impermissible.[90] The attorney may withdraw from representation[91] if the client continues the fraudulent conduct.[92]

2. Ethical Obligations Under the Model Rules

The Model Rules would require the negotiator to make a disclosure when he knows that the client has made a materially false statement "in the course of a transaction where the lawyer's services . . . have been employed."[93] Disclosure would also be mandatory if it is necessary to prevent the attorney from assisting in a fraudulent act.[94]

In the hypothetical the client made a material[95] misrepresentation during the negotiation. The statement concerning the lien was material because knowledge of the lien would affect the buyer's decision concerning the sale. If the attorney were not to disclose the lien to the other side he would be assisting the client in a fraud.[96] Therefore, the Model Rules would require disclosure of the lien.[97]

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[89] ABA Code, note 2 *supra*, DR 4-101(A). Information gained in the professional relationship may not be disclosed if disclosure would be detrimental to the client. ABA Code, note 2 *supra*, DR 4-101(B)(2).

[90] ABA Code, note 2 *supra*, DR 7-102(B) allows disclosure of a client's fraud only if the information is not privileged. *See also* text accompanying note 42 *supra*.

[91] *See* note 83 *supra*.

[92] Kramer suggests that the ABA Code be amended to require withdrawal in all situations in which the client refuses to rectify a fraud committed during the course of representation. *See* Kramer, note 2 *supra*, at 1002.

[93] Model Rules, note 7 *supra*, Rules 4.1(b) and 4.1(b) (notes).

[94] *See* note 52 and accompanying text *supra*.

[95] Model Rules, note 7 *supra*, (terminology) defines "material" as "a matter of practical importance."

[96] There would be no obligation to disclose the information unless the lawyer knows or reasonably should know that the client committed a fraud. Kutak, note 7 *supra*, at 1120.

[97] The Michigan Bar Association has confronted an analogous situation. A lawyer negotiated a settlement agreement between his client and his client's business associate. The settlement provided that the client would receive $150,000 and the other party would receive the corporation's plant and equipment. The settlement was based on the understanding that the plant was free of encumbrances. After the parties agreed to the settlement, the lawyer discovered that there was an unpaid mortgage on the property. The state bar permitted disclosure to the injured party, stating that "the duty imposed upon an attorney to preserve his client's confidence does not . . . relieve counsel from his duty . . . to rectify a fraud or deception . . . ." Mich. Comm. on Professional and Judicial Ethics, Op. 59 (1940), *reprinted in* 38 MICH. ST. B.J. 80, 81 (May 1959).

C. Hypothetical Three

An attorney represents an insurance company, which is the defendant in a personal injury suit arising from an automobile accident. The plaintiff suffered intestinal injuries in the accident. His physician did not diagnose the condition during treatment of the plaintiff's other injuries. However, the insurance company's physician discovered the condition and informed the company's attorney. The plaintiff's counsel failed to seek the insurance company's medical report through discovery.[98]

1. Ethical Obligations Under the ABA Code

The lawyer learned of the intestinal injuries in the course of his professional relationship with the insurance company. The ABA Code protects this information from disclosure unless the client consents.[99] Thus, the lawyer could not disclose the injury to the plaintiff without the insurance company's approval. The ABA Code does not permit a lawyer to withdraw from representation in this circumstance.[100]

2. Ethical Obligations Under the Model Rules

The Model Rules would require the lawyer to disclose information "in circumstances when failure to make the disclosure is equivalent to making a material misrepresentation."[101] The intestinal injury is clearly a material fact in the settlement of the accident victim's claims. The question is whether nondisclosure of the intestinal injuries would constitute a misrepresentation and thus require the lawyer to disclose the injury.

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[98] This hypothetical differs from the first two because neither the attorney nor the client have made an affirmative misrepresentation. However, the information would be detrimental to the insurance company if disclosed. If the attorney fails to disclose the information and the injured person later discovers the intestinal condition, the earlier negotiated settlement may become the subject of litigation. This fact pattern is suggested by Spaulding v. Zimmerman, 263 Minn. 346, 116 N.W.2d 704 (1962). In *Spaulding*, the court overturned the settlement of a personal injury accident because the insurance company's lawyer knew of internal injuries suffered by the plaintiff that were unknown to the plaintiff. The court held that, although the defendant's lawyer had no ethical obligation to disclose the undiscovered injury to the plaintiff, a settlement based on the mistake by one party and concealed by the other may be vacated. 116 N.W.2d at 709-10.

[99] ABA Code, note 2 *supra*, DR 4-101(A),(B) prevents disclosure by the lawyer of a client's confidences or secrets. DR 4-101(C)(1) allows a lawyer to reveal information with the client's consent.

[100] ABA Code, note 2 *supra*.

[101] Model Rules, note 7 *supra*, Rule 4.1(b)(1); *see also* notes 52-53 and accompanying text *supra*.

Although the injury is material to the negotiation, the Model Rules would not require disclosure. Disclosure would be mandatory when the lawyer participates with or aids a client in fraudulent conduct.[102] In the hypothetical, neither the client nor the lawyer has acted fraudulently. Of course, the lawyer could not directly deny knowledge of the injury during negotiation.[103] Also, if the lawyer made misleading statements in the negotiation that constituted a misrepresentation, the Model Rules would then require disclosure.[104]

CONCLUSION

The proposed Model Rules of Professional Responsibility directly address the lawyer's role as a negotiator.[105] In contrast, few provisions of the ABA Code specifically apply to negotiation.[106] The Model Rules recognize the lawyer's duty of loyalty to the client, but also stress the importance of candor and fairness in the negotiation process.[107] The lawyer's obligation to disclose a client's fraudulent conduct will result in fewer legal challenges to settlement agreements. For these reasons the Model Rules better serve the dual purposes of negotiation: to settle rather than litigate, and to establish agreements that govern the future conduct of the parties without judicial intervention.

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[102] *See* Kutak, note 7 *supra*, at 1119.

[103] Model Rules, note 7 *supra*, Rule 4.1(a) provides that an attorney may not knowingly make a false statement.

[104] Model Rules, note 7 *supra*, Rule 4.1(b) (notes).

[105] The Model Rules specifically discuss the lawyer as a negotiator in Rules 1.2(a), 1.4(a), (b), and 4.4, and in the comments to Rules 1.2 and 4.1. A discussion draft of the Model Rules included a section on the lawyer as a negotiator. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 4 (Discussion Draft 1980). The Final Draft incorporates most of Rule 4.

[106] *See* Rubin, *A Causerie on Lawyers' Ethics in Negotiation*, 35 LA. L. REV. 577, 578 (1975).

[107] *See* Model Rules, note 7 *supra*, (Preamble), which recommends that lawyers in negotiation should seek a result that is advantageous for the client but consistent with the requirements of fair dealings with others. *See also* Model Rules, note 7 *supra*, Rules 4.1(a)(b) and 4.4 (comment).