ATTORNEY PROFESSIONALISM FORUM

To the Forum:

I'm a commercial litigator in New York. I recently was asked to mediate a commercial contract case, which is pending in the Commercial Division in the Supreme Court of New York, for one of my clients who is the defendant in the action. The morning right before commencement of the mediation, my client informed me that his business has been doing "lousy" and that even if the parties were to reach a settlement, he nevertheless intends to file for bankruptcy before the settlement payment becomes due. During that conversation, he emphasized that this information is confidential and cannot be disclosed to anyone. During the mediation, plaintiff's counsel communicated a final demand to my client, which my client indicated he was willing to accept. I did not disclose the information that my client shared with me either to the mediator or plaintiff's counsel.

My question to the Forum: Did I have an obligation to disclose my client's confidences under the circumstances? What should I have done? Is there anything I should do at this time?

Sincerely,

Concerned Counsel

Dear Concerned Counsel:

Your letter raises a very important and often difficult question. When and under what circumstances, if any, does a lawyer have an obligation to disclose confidential information learned from the client during the course of the lawyer's representation of the client?

It is a fundamental principle of ethics that a lawyer is generally prohibited, with some exceptions, from revealing a client's confidential information. *See* Rule 1.6 of the New York Rules of Professional Conduct (NYRPC). But, that is not the end of the road. The NYRPC also prohibit lawyers from making false statements to a third person, assisting a client in conduct that the lawyer knows is illegal or fraudulent, or from simply engaging in conduct involving dishonesty, fraud, deceit or misrepresentation. *See* NYRPC Rules 4.1(a), 1.2(d), and 8.4(c). Indeed, while the public interest is generally best served by strict compliance with the rule requiring lawyers to preserve the confidentiality of information relating to their representation of clients, the confidentiality rule is subject to limited exceptions that, *inter alia*, are intended to deter wrongdoing by clients, prevent violations of the law, and maintain the impartiality and integrity of the judicial process. *See* Rule 1.6 [Comment 6].

Does your predicament place you in one of the limited exceptions to the confidentiality rule? Based on what you have described, we believe it does even though the mediation is by its very nature a confidential process.

Let us take a look at which Rules of Professional Conduct are implicated in negotiations and specifically the mediation context. As an initial matter, we note that the negotiation process creates an inherent tension for lawyers since "[a]s negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealings with others." ABA Model Rules of Professional Conduct, Preamble (1995). Indeed, the mediation process often presents ethical dilemmas since the art of negotiation frequently involves some level of misrepresentations, "posturing" and "puffery," particularly concerning each side's minimum settlement points as well as the exaggeration or emphasis of the strengths of one's position, and the minimization or deemphasis of the weaknesses of one's position. *See* ABA Committee on Ethics and Professional Responsibility, Formal Op. 439 (Apr. 12, 2006) (ABA, Formal Op.). Certain types of statements during negotiations, such as estimates of price or value placed on the subject of a transaction, or a party's intentions as to an acceptable settlement of a claim, are generally accepted conventions in negotiation and are ordinarily not deemed to be false statements of material fact, and therefore are not considered to run afoul of the ethical rules. *See* Rule 4.1 [Comment 2]. Additionally, it is recognized that the duty of zealous representation generally prohibits a lawyer in negotiations from voluntarily disclosing weaknesses in his or her client's case. *See* ABA, Formal Op. 375 (1993).

The flip side to those general principles is that the ethical rules governing lawyer truthfulness and the ethical prohibitions against lawyer misrepresentations apply in all environments, including the mediation context. *See* ABA, Formal Op. 439, at 8.

Specifically, Rule 4.1 of the NYRPC, Truthfulness in Statements to Others, has been found to govern a lawyer's conduct when negotiating either inside or outside of the mediation context. It provides "[i]n the course of representing a client, a lawyer shall not knowingly make a false statement of fact or law to a third person." Pursuant to this rule, a lawyer is required to be truthful when dealing with others on a client's behalf and is not permitted to make misrepresentations to another – mean-

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ing the lawyer cannot incorporate or affirm a statement of another that the lawyer knows is false. NYRPC Rule 4.1 [Comment 1]. Although lawyers generally do not have an affirmative duty to inform opposing parties of relevant facts, it is recognized that misleading statements or omissions of facts may be "the equivalent of affirmative false statements." NYRPC Rule 4.1 [Comment 1].

In addition, Rule 1.2(d) provides that "[a] lawyer shall not counsel a client to engage, or *assist a client*, *in conduct that the lawyer knows is illegal or fraudulent*, except that the lawyer may discuss the legal consequences of any proposed course of conduct with a client" (emphasis added). Rule 1.2(d) only applies when the lawyer "knows" that the client's conduct is illegal or fraudulent. It does not apply when it is merely "obvious" to others that the conduct is illegal or fraudulent, or when the lawyer simply believes or suspects but does not know that the client's proposed scheme is fraudulent or illegal. Roy Simon, *Simon's New York Rules of Professional Conduct Annotated*, Simon's Annotations on Rule 1.2(d), at 108 (2015 ed.).

Moreover, Rule 8.4(c) of the NYRPC overlaps with Rule 4.1 providing that a lawyer may not engage in "dishonesty, fraud, deceit or misrepresentation."

Based on the facts provided, it appears that your client does not have the wherewithal or the intention to fund the settlement that was entered into during the mediation. In our opinion, this creates a real possibility that later on someone may cry foul and accuse your client of fraud. Your risk is that you could be charged with actual knowledge of your client's wrongdoing because you were told prior to the mediation that the client's business is doing "lousy" and that he intends to file for bankruptcy before any settlement payment becomes due. Consequently, you are likely to be found to be in violation of the aforementioned Rules for assisting the client in perpetuating that fraud even if all you did was remain silent as to your client's situation. The Rules recognize that "omissions [of material facts] are the equivalent of affirmative false statements." Rule 4.1 [Comment 1].

So, what should you have done under the circumstances? The NYRPC expressly tell us that when a lawyer's representation will result in violation of the Rules or other law, the lawyer must advise the client of any limitation on the lawyer's conduct and remonstrate with the client confidentially. *See* Simon's Annotations on Rule 1.2(d), at 110–11 (citing NYRPC Rules 1.4(a)(5)) (a lawyer shall consult with the client about any relevant limitation on his or her conduct when the lawyer knows that the client expects assistance not permitted by the Rules or other law) and 1.16(b)(1) (a lawyer shall withdraw from the representation of a client when the lawyer knows or reasonably should know that the representation will result in a violation of these Rules or of law). A lawyer "cannot simply remain silent in the face of a request or expectation by the client for assistance the lawyer is forbidden to provide. The lawyer has to explain that the lawyer cannot give that assistance." Simon's Annotations on Rule 1.4(a)(5), at 139.

If the client is uncooperative and still wants to proceed after you have warned him that you cannot assist in his fraud, you are required to take reasonable remedial measures, including perhaps going so far as to tell the mediator that you no longer will participate in the mediation, and may be constrained to withdraw as counsel. We note that paragraph (b) to NYRPC Rule 1.6 simply permits, but does not require, a lawyer to disclose confidential information relating to the representation to, *inter alia*, prevent the client from committing a crime (Rule 1.6(b)(2)). However, Rule 1.16(b)(1) provides that a lawyer *shall* withdraw from the representation of a client when the lawyer knows or reasonably should know that the representation will result in a violation of these Rules or of law.

It is unclear from the facts you provided whether your client did all the talking during the mediation or whether you assisted him in giving the other side the misimpression the client was in a position to fund the settlement. This is important because as your role on behalf of the client expands, so too does your responsibility for making sure that third parties are not misled. In other words, if you made representations during the mediation concerning your client's ability to fund the settlement, then your ethical obligations are substantially greater than if you were merely present when the client himself was speaking. But even if you simply remained silent during the negotiations, your silence under the circumstances may nevertheless have severe consequences.

Indeed, lawyers who make misrepresentations on behalf of clients or withhold material facts when negotiating a settlement in mediation or otherwise risk ethical discipline. *See generally Sheppard v. River Valley Fitness One, L.P.*, 428 F.3d 1 (1st Cir. 2005) (lawyers sanctioned for making misrepresentations during settlement negotiations). They also risk civil liability for fraud, deceit, and legal malpractice. *See*, *e.g.*, *Taft v. Shaffer Trucking, Inc.*, 52 A.D.2d 255, 259 (4th Dep't 1976) (contribution cause of action upheld based upon an attorney's breach of the obligation "to conduct settlement negotiations in a fair and equitable manner without recourse to fraud or misrepresentation"); *Corva v. United Servs. Auto. Ass'n*, 108 A.D.2d 631 (1st Dep't 1985) (action against automobile insurer and its attorneys for misrepresenting policy limits in settlement of personal injury lawsuit); *see also Slotkin v. Citizens Cas. Co. of N.Y.*, 614 F.2d 301 (2d Cir. 1979), *cert. denied*, 449 U.S. 981 (1980) (allowing fraud suit where lawyer misrepresented the amount of available insurance coverage); *Hansen v. Anderson, Wilmarth & Van Der Maaten*, 657 N.W.2d 711 (Iowa 2003) (lawyer who lied about client owning a business in negotiation to sell that business held liable for fraud). Not to mention that lawyers jeopardize their reputations and effectiveness in

future encounters with mediators and other lawyers. Once your reputation for honesty is compromised, you may find it exceedingly difficult to negotiate at all with other parties, having lost your credibility.

So, that leads us to your next question: What should you do now? We believe the best course for you to follow is to try to persuade your client to take any necessary preventive or corrective steps that will bring the client's conduct within the bounds of the law – meaning your client should come clean and disclose to the other side that he does not have the wherewithal to pay the settlement agreed to and see if the parties can negotiate a settlement that your client can honor. If the client refuses to take the necessary corrective action and your continued representation would further assist in the fraudulent conduct, including, *inter alia*, if it has not already occurred, the drafting and negotiation of the language of the settlement agreement, you must take the necessary steps to withdraw as counsel. *See* NYRPC Rule 1.16(b)(1).

In certain circumstances, withdrawal alone may be insufficient and the lawyer may be required to give notice of the fact of the withdrawal and to disaffirm any document, opinion or affirmation proffered to the other side. *See* Rules 1.6(b)(3) and Rule 4.1 [Comment 3]. Notably, the Court of Appeals, albeit not in the mediation context, has instructed that an attorney's duty to zealously represent a client is circumscribed by an "equally solemn duty to comply with the law and standards of professional conduct . . . *to prevent and disclose frauds*." *People v. DePallo*, 96 N.Y.2d 437 (2001) (emphasis added) (quoting *Nix v. Whiteside*, 475 U.S. 157, 173 (1985)).

Sincerely,

The Forum by
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QUESTION FOR THE NEXT ATTORNEY PROFESSIONALISM FORUM

I specialize in commodities and securities regulation, as well as the tax consequences of transactions in securities and commodities. Almost 10 years ago, a client of mine in the financial services industry had devised a new transaction that he asked me to implement. The transaction implicated numerous novel questions in commodities and securities regulation, and I was concerned about solicitation were I to represent both my client as the originator and the investors to whom the idea was to be pitched. *See* Forum (Mar./Apr. 2007) N.Y. St. B.J., p. 52.

As it turned out, for reasons related entirely to market conditions, that transaction did not go forward. In the interim I have stayed close with this client, and now he has come to me with a similar concept. The client would like me to represent only him in his individual capacity and the vehicle as issuer's counsel. He would also like me to connect him with some investors whom I know and whom I have represented on unrelated matters, but not to hold myself out as representing any of these investors. My role will be to structure the transaction and to provide an opinion stating that the transaction is legal and outlining the specific consequences (as well as any risks). My opinion will be included in the marketing materials, and it is expected that I will make myself available to speak with investors and their advisors. The investors will all be sophisticated persons. However, we will not be able to control whether they will each have their own counsel.

What advice do you have for me?

Sincerely,

U. N. Certain