Legal Ethics

Question of the Week—Negotiation Ethics

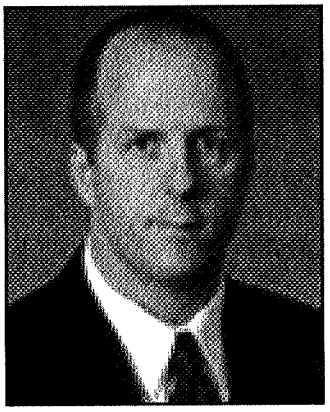
Robert Jensen, the general counsel of Ace Travel Corporation, has been negotiating a contract with a hotel chain concerning lodging for tour groups that the corporation schedules in certain cities. After extensive negotiations, the parties have finally agreed on a formula that will determine the amount of payments that the corporation makes to the hotel chain. Jensen recently received from counsel for the hotel chain the contract for the appropriate officer in the company to sign. During his review of the contract, before forwarding it to the corporate officer for signature, Jensen notices that it misstates the formula for computing the payments. The misstatement would result in the hotel chain receiving approximately 5 percent less in payments than the parties had agreed would be paid.

If Jensen obtains the corporate officer's signature on the contract and then sends it back to counsel for the hotel chain without mentioning the mistake in the formula, has he violated any of the Model Rules of Professional Conduct? If, instead, he brings the mistake to the attention of counsel for the hotel chain and it is fixed, with the result that the corporation pays more than it would have otherwise paid, has Jensen violated any of the Model Rules of Professional Conduct concerning his duty to his client?

Answer

John Steele:[1] Robert Jensen's duty to disclose the opponent's error arises from two critical facts: (1) the parties had "finally agreed on a formula" and (2) the opponent erroneously misstated the agreed upon formula.

[1] Now a solo practitioner emphasizing legal ethics, risk management, and professional liability, for over fifteen years Mr. Steele served as the top internal ethics lawyer at an AmLaw 100 and an AmLaw 200 law firm. He has taught legal ethics as an adjunct lecturer for twenty-five semesters, including at UC-Berkeley, Stanford, Indiana-Bloomington, and Santa Clara.



John Steele

First, let's avoid the common but faulty assumption that lawyer-negotiators are governed by the litigator/advocate rules (Rules 3.1–3.9). Lawyer-negotiators are regulated principally by Rule 4.1, but also by Rules 1.2(d), 1.6, and 8.4.

Second, let's get a handle on the negotiator role. Lawyer-negotiators seek advantageous results for their clients (Preamble [2]), but they may not engage in or assist frauds (Rules 8.4(c); 1.2(d)). Although lawyer-negotiators have no general duty to inform the opponent of relevant facts (Rule 4.1, cmt. [1]), they must disclose material facts when necessary to avoid assisting a client's fraud (Rule 4.1(b)), unless prohibited by Rule 1.6.

A negotiator's duty to speak can arise: (i) under statutes; (ii) if the lawyer or client has a legal duty running to the opponent; (iii) if the parties contract for disclosure; (iv) if the lawyer or client speaks falsely or such that their words would mislead for want of materially clarifying facts; and (v) if the other party has made certain mistakes about agreed upon terms or is ignorant of certain facts fundamental to the transaction. The Restatements cover this issue at length.[2]

The last category—fraud through silence when the opponent is mistaken or ignorant—can be tricky. It often runs counter to a practicing lawyer's intuitions about confidentiality, loyalty, and zeal. Case law and ethics opinions hold that a lawyer-negotiator must inform a litigation opponent if the lawyer's client has died [3] and must alert opposing negotiators if they have inadvertently omitted an agreed upon term from the latest iteration of the contract.[4] On the other hand, a lawyer-negotiator need not alert the opponent that it has poorly formulated a contract term still under negotiation,[5] and may not alert the defendant that the lawyer is pressing a claim barred by the statute of limitations.[6] These can be subtle, fine distinctions.[7] If we

[2] Restatement (Second) Torts §§ 526-530, 551; Restatement (Second) Contracts §§ 159, 161; Restatement (Third) Law Governing Lawyers § 98(3). *See also*, ABA Ethical Guidelines for Settlement Negotiations (2002), §§ 4.1.2 (Silence, Omission, and the Duty to Disclose Material Facts), 4.3.5 (Exploiting Opponent's Mistake).

[3] Virzi v. Grand Truck Warehouse & Cold Storage Co., 571 F. Supp. 507 (E.D. Mich. 1983); ABA Formal Op. 95-397 (duty to inform litigation opponent about death of client).

[4] ABA Informal Op. 86-1518 (Notice to Opposing Counsel of Inadvertent Omission of Contract Provision); *see also*, Restatement (Second) Contracts, § 161(b)-(c) & illus. 8.

[5] Brown v. County of Genesee, 872 F.2d 169 (6th Cir. 1989) (no fraud upon the court occurred where defendant knew that plaintiff wanted to settle at highest possible level of back-pay but through counsel's error plaintiff offered to settle at a lower pay level than plaintiff was entitled to); *see also*, Restatement (Second) Contracts § 161, cmt. d (it is generally permitted to take advantage of the opponent's poor lawyering).

[6] ABA Formal Op. 94-387 (Disclosure to Opposing Party and Court that Statute of Limitations Has Run).

[7] *Compare*, Brown v. County of Genesee, *supra*, *with*, Stare v. Tate, 98 Cal. Rptr. 264 (Cal. Ct. App. 1971) (contract reformed where one party knew of other side's unilateral mistake in improperly

were to gently tweak our hypothetical, silence might be permitted.

Here, because the opponent has erred about a "finally agreed upon" term, remaining silent and executing the flawed contract would work a fraud causing financial harm on the opponent. Jensen may not commit fraud himself (Rule 8.4) or assist a client to do so (Rules 1.2(d); 4.1). In this situation, it is not clear if Jensen has his client-employer's authority to finalize the contract. If so, his silence and acceptance of the flawed draft could effect a fraud on behalf of his client. If not, his silence could lead to some officer within his client-employer accepting the flawed draft and consummating the fraud unawares, because Jensen's knowledge is attributed to his client-employer. Further, by reading Rules 1.2(d), 1.6(b)(2), and 4.1(b) together, we see that the lawyer must disclose even otherwise confidential information when disclosure appears necessary to prevent assistance in a fraud.

So, what should Jensen do? Two approaches have support in the ethics rules. Some lawyers would simply inform the opposing lawyer of the error without first consulting with and counseling their own client.[8] Other lawyers would explain the situation to the client under Rules 1.2(a), 1.4, and 2.1, and seek consensus that disclosure is warranted under the ethics rules—not to mention under the law of fraud. If, despite remonstration, the client insists upon silence/fraud, the lawyer would have to withdraw from the representation (Rule 1.16(a)(1)) and undertake the difficult analysis under Rule 4.1, cmt. [3] of whether he must nonetheless make disclosure and, if so, of what kind.[9]

Sadly, some lawyers would butcher the analysis, shun both those options, keep silent, finalize the contract, and leave their clients and themselves vulnerable to allegations of fraud and professional misconduct.[10]

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subtracting the undisputed mortgage amount from the disputed market value of the house). The secondary literature argues for different approaches. *See, e.g.*, Nathan M. Crystal, *The Lawyer's Duty to Disclose Material Facts in Contract or Settlement Negotiations*, 87 KY. L.J. 1055 (1998) (arguing for expansive duties to disclose); Barry R. Temkin, *Misrepresentation by Omission in Settlement Negotiations: Should There Be a Silent Safe Harbor?*, 18 GEO. J. LEGAL ETHICS 179 (2004) (arguing for narrower duties); Douglas R. Richmond, *Lawyers' Professional Responsibilities and Liabilities in Negotiations*, 22 GEO. J. LEGAL ETHICS 249 (2009) (a useful guide for the perplexed lawyer).

[8] Note that under ABA Informal Op. 86-1518, in the case of an inadvertently omitted, agreed-upon term, the lawyer may inform the opponent without first notifying the client. For an older opinion suggesting that the lawyer should first consult with the client, see N.Y. City Eth. Op. 477 (1939). *See also*, Restatement (Third) Agency, § 8.11; Rule 1.4. In my view, this decision about whether to inform the client of the opponent's error or to simply alert the opponent should be left to the lawyer's professional discretion. One can easily imagine scenarios where the client is best served by either approach.

[9] Rule 4.1, cmt. [3] provides that depending on the circumstances, the lawyer may satisfy her ethical duty by withdrawal, disaffirmance of prior statements, or outright disclosure of material facts.

[10] A fascinating (if frightening) recent article includes a survey of responses by practicing lawyers to a fact pattern where silence in negotiation would obviously work a fraud on the opponent. A whopping 19 percent of the responding lawyers indicated that they would accede to a client request that would work a fraud and another 19 percent did not know if they would accede. Hinshaw and Alberts, *Doing the Right Thing: An Empirical Study of Attorney Negotiation Ethics* (June 10, 2009), *available at* http://ssrn.com/abstract=1417666. Obviously, practicing lawyers need to better understand when silence can work a fraud.

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