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Professional Malpractice

Paying for the Sins of Others

Learning when to say 'no' to a client is now a crucial aspect of malpractice prevention

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In our litigious society, lawyers know (or should know) that our own bad lawyering can lead to malpractice liability. Missing a statute of limitation, drafting an inaccurate description of property to be sold, missing a patent filing deadline, or failing to perfect a client's security interest will typically result in a malpractice claim. These days, however, it is more and more common for lawyers to be sued not for bad lawyering, but for representing bad clients. Courts are ever more likely to impose a duty on a lawyer to prevent his client's fraud or illegal conduct, and even to warn the other side about it. This runs contrary to our deeply ingrained training to be loyal to our clients and to preserve our clients' confidences. As a result, learning when to say "no" to a client has become a crucial aspect of malpractice prevention and avoidance.

New Jersey courts have allowed actions to proceed against lawyers for participating in, or not preventing, their clients' misconduct. For example, in the case of *Davin, L.L.C. v. Daham*, 329 N.J. Super. 54 (App. Div. 2000), the client owned a commercial building that was in foreclosure. The client entered into a lease agreement with a prospective tenant, without telling the tenant of the foreclosure proceeding. The lawyer prepared the lease, which included a covenant of quiet enjoyment. When the foreclosure resulted in the ejectment of the tenant, the tenant sued both the landlord and its lawyer. Although the trial court dismissed the claims against the lawyer, the Appellate Division reversed, holding that the lawyer owed a duty of candor to the prospective tenant. It further held that the lawyer had a duty to advise his clients to disclose the foreclosure and not to include a covenant of quiet enjoyment in the lease when his clients could not perform that covenant. If his clients refused to make the required disclosure, he was required to withdraw from the representation. Thus, in this case, the lawyer's duty to the other side actually trumped his duties of loyalty and confidentiality to his own clients. While recognizing that the lawyer "was in a difficult position," the court concluded that "[a]ttorneys are frequently faced with difficult decisions. They must make the right decision."

Similarly, in *Banco Popular North America v. Gandi*, 184 N.J. 161 (2005), a creditor sued an attorney for allegedly assisting his debtor client in transferring assets. Specifically, the bank alleged that the lawyer counseled his client to violate the Uniform Fraudulent Transfer Act by transferring assets into the debtor's wife's name. It further alleged that the attorney engaged in negotiations and provided an opinion letter for a guaranty signed by the client, where the guaranty contained inaccurate representations as to the debtor's net worth. Although the trial court initially dismissed the claims, the Supreme Court reversed in part. Without reaching the truth or the merits of the creditor's allegations, the Court held that it stated a claim for conspiracy to violate the Uniform Fraudulent Transfer Act.

The Court further held that the plaintiff stated a claim against the lawyer for negligent misrepresentation based on the allegedly inaccurate opinion letter, as well as the fact that the attorney allegedly knew that the guaranty was worthless when signed. In so ruling, the Court noted that if the lawyer knew that the guaranty was worthless, he had a duty to counsel his client to tell the bank the truth and, if the client failed to do so, to withdraw. What he could not do, however, was assist the client in fraudulently securing further loans. Thus, these claims were remanded to the trial court.

Even if the lawyers ultimately prevail on the merits, the time and expense involved in defending the claims is significant. Accordingly, lawyers can no longer blindly follow a client's instructions, but must balance those instructions against the lawyer's duty to adversaries and the courts.

The difficult question for practicing lawyers is: when does a lawyer's duty to her adversary trump her duties to her

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clients? In both *Davin* and *Gandi*, the lawyers were alleged to have known about the fraud. But what are a lawyer's duties when she merely suspects something is up?

The Rules of Professional Conduct (RPC) provide somewhat conflicting guidance in this area. It is important to note, however, that although the RPCs inform the scope of an attorney's duties, they do not, in themselves, create a duty. A violation of those rules, standing alone, does not form the basis for a cause of action. *Baxt v. Liloia*, 155 N.J. 190, 201-02 (1998).

On the one hand, RPC 1.2(d) expressly provides that a lawyer may not "counsel or assist a client in conduct that the lawyer knows is illegal, criminal, or fraudulent … ." Likewise, RPC 4.1(a) provides that in "representing a client a lawyer shall not knowingly: (1) make a false statement of material fact or law to a third person; or (2) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client." RPC 3.3(a)(4) similarly precludes a lawyer from offering evidence the lawyer "knows" to be false, and requires the lawyer to undertake reasonable remedial measures if he comes to "know" of its falsity. RPC 1.0(f) defines "knowingly," "known," or "knows" to denote "actual knowledge of the fact in question," although a person's knowledge "may be inferred from circumstances." Thus, from these rules, it would appear that the attorney's duty to third persons only arises upon actual knowledge that the client is committing a fraud or misrepresentation.

On the other hand, RPC 1.6(b) provides:

> A lawyer shall reveal such information to the proper authorities, as soon as, and to the extent the lawyer reasonably believes necessary, to prevent the client or another person:
> (1) from committing a criminal, illegal, or fraudulent act that the lawyer reasonably believes is likely to result in death or substantial bodily harm or substantial injury to the financial interest or property of another;
> (2) from committing a criminal, illegal, or fraudulent act that the lawyer reasonably believes is likely to perpetrate a fraud upon the tribunal.

Significantly, the duty to disclose in these circumstances is mandatory under New Jersey law, not permissive as in most states. Therefore, it trumps the general rule of confidentiality set forth in RPC 1.6(a).

Similarly, RPC 1.6(c) authorizes release of information to affected persons to the extent the lawyer "reasonably believes necessary" to prevent death, substantial bodily harm, substantial financial injury, or substantial financial loss. RPC 1.6(d) likewise permits the lawyer to make disclosures "to the extent the lawyer reasonably believes necessary" to rectify the consequences of a client's criminal, illegal or fraudulent act in which the lawyer's services were used. RPC 1.6(e) defines reasonable belief as "the belief or conclusion of a reasonable lawyer that is based upon information that has some foundation in fact and constitutes prima facie evidence of the matters referred to … ." Therefore, unlike the rules requiring actual knowledge, RPC 1.6 seems to require only actual evidence of a prima facie case to permit, or even require, disclosure.

The Advisory Committee on Professional Ethics (ACPE) has on several occasions admitted that the conflict among the rules is a "thorny" problem, which it has struggled to resolve. ACPE Op. 673 & 677. It has further held that the interpretation and application of these rules involves a "fact-sensitive, and indeed, a soul-searching examination of the unique facts of a particular case." ACPE Op. 677. Another opinion refers to these issues as "fraught with complexity and conflict." ACPE Op. 642.

For example, in Opinion 677, the client was a business under investigation by the state. The client, through the lawyer, informed the state that certain charges were made on a flat fee basis, instead of on a prohibited percentage basis. The lawyer believed this to be true at the time the representation was made. Based on this representation, the investigation was resolved by consent order. The lawyer learned in a subsequent matter that the representation was false. The ACPE ruled that this constituted an ongoing fraud on the tribunal, and the lawyer was obligated to reveal it to the state, over the client's objection.

In contrast, in Opinion 673, the client retained the lawyer to defend a DUI charge. The client told the lawyer he had had seven drinks, although he told the police he had had three. A witness was also going to testify that the client had three drinks, although the witness admitted he was not present the entire evening. The client told the lawyer he would testify to three drinks. The lawyer properly withdrew, but learned from media coverage of the trial that the client might have testified to three drinks, and that the witness had said he was present the entire evening. Because the facts were unclear and equivocal, and to protect the privilege against self-incrimination, the ACPE held that the lawyer did not have a duty to disclose.

Similarly, in Opinion 642, the client was an insured, suing an insurer for coverage. On the insurance application, the insured had misrepresented his address and where the car was garaged, but the denial of coverage was unrelated to the (as yet undiscovered) misrepresentation. Balancing the duties of loyalty, confidentiality and candor, the ACPE held that because the misrepresentation was not (yet) material to the dispute, the lawyer had no duty to reveal it. Going forward, however, the lawyer could not participate in any continued misrepresentations of the client's address, although he could omit it from discovery responses and pleadings. Moreover, he had to remonstrate with his client to testify truthfully when asked, and he would have to withdraw if his client testified falsely.

Finally, in Opinion 643, the lawyer represented a client in a custody dispute. The client was involuntarily hospitalized

in a psychiatric ward, and asked the lawyer to keep that fact confidential. The ACPE held that, if the information was material, it had to be disclosed. The ACPE cautioned, however, that a determination of materiality should be made very carefully, and only after balancing the importance of the information against the clients' right to confidentiality.

The tension between these rules can be illustrated by a simple example. A client comes in seeking help with the sale of a small apartment building. A tentative deal was in place, and the buyer was conducting due diligence. The client provided fully executed leases for all the units in the building, which the lawyer dutifully sent to buyer's counsel. One night, however, the lawyer was in the neighborhood and decided to drive by the building. She noticed that it was dark and no cars were parked in the drive. She called the client the next day, who hemmed and hawed, and gave some excuse about a big event at the local school. He encouraged her to meet him at the building that night. When she did, the drive was full and the lights were on. He showed her an apartment with a family apparently living there. The lawyer thought nothing more of it, until she happened to drive by at dinner time a month later, and saw the building completely dark and no one parked in the drive. Upon reviewing the leases again, she noticed that they all seemed to be signed in the same handwriting. What are her obligations?

If the client fesses up and admits that all the leases are fake and the building is empty, the decision is easy. RPC 1.2(d) prevents her from assisting in the fraud. RPC 4.1(a) requires disclosure of the faked leases. RPC 1.6(b) also requires disclosure. The lawyer should instruct her client to make the disclosure. If he does not, she has to do it herself.

But what if the client insists that the leases are real? Does she have enough information to dispute this? Does she have to do further investigation? Moreover, the lawyer is in jeopardy regardless of what she does. If she discloses the possible fraud, she could be liable to her client for disclosing confidential information. If she does not, she could be liable to the buyer for participating in the possible fraud.

On our hypothetical facts, it does not appear that the lawyer has enough information to require her to disclose over her client's objections. Although the lack of leases would certainly be material to the transaction, she does not have the kind of knowledge and evidence to demonstrate that there are no leases. All she has is her supposition and some suspicious circumstances. She does appear to have enough information to pursue it further with her client, however, to prevent her from being further caught up in any scam. Moreover, it would certainly be prudent to push the client for further information to prove up the leases, and protect the lawyer from a subsequent claim. If she can still not satisfy herself, the wisest course is to withdraw from the representation.

Given the difficult problems created by bad clients, the best solution is not to represent them in the first place — much easier said than done — or to withdraw from the representation once the problem has surfaced. Despite our duty of loyalty, lawyers are not required to represent the bad client. To the contrary, RPC 1.16 expressly authorizes lawyers to decline a representation or withdraw from representing clients that are bad news, and even requires it in some circumstances. Specifically, RPC 1.16(a)(1) mandates withdrawal where "the representation will result in violation of the Rules of Professional Conduct." For example, in *Davin*, the Appellate Division held that not only was the attorney required to advise his clients to disclose the foreclosure, but that he was required to withdraw if they insisted on keeping it secret. Because he did not do so, the tenant's lawsuit against him was permitted to proceed.

In addition, RPC 1.16(b) permits the lawyer to withdraw where "the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent" (RPC 1.16(b)(2)), where "the client has used the lawyers' services to perpetuate a crime or fraud" (RPC 1.16(b)(3)), or where "the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement" (RPC 1.16(b)(4)). Here, the lawyer in our example above could withdraw on the grounds that she would not participate in a possible fraud.

As a practical matter, how can we identify difficult clients before we have a problem? To some extent, we simply have to use our judgment, but there are certain red flags that should put us on alert. A client that has gone through multiple lawyers is one such flag. A client who is vague, or fails to provide requested information is another. Likewise, clients who are not straight with others tend not to be straight with their lawyers. A client who repeatedly makes untrue statements, even about little things, like when they responded, or what they provided, is a client to be watched carefully. As lawyers, we have to evaluate credibility every day. We evaluate the credibility of witnesses, opposing counsel and adversaries. We should apply that same analysis to our clients. We cannot take everything our clients say as gospel, just as we cannot take everything our adversaries say as gospel. Trust your intuition. If your gut tells you something is wrong, check it out. We are far past the day where lawyers could "see no evil," and we ignore our clients' wrongdoing at our peril. Remember, if a deal your client is asking you to document appears too good to be true, it probably is.

Finally, attorneys should conduct some research and exercise due diligence when taking on new clients. Use the numerous sources available on the Internet and elsewhere to get some background information about the new client. Have they been sued previously? Are they creditworthy? Is there any criminal history? It is always better to find out the answers to these questions going into the relationship rather than after being named a co-defendant with your new client. ■