

Articles

RECTIFICATION OF CLIENT FRAUD: DEATH AND REVIVAL OF A PROFESSIONAL NORM

by
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I. INTRODUCTION

As now is generally known, the American Bar Association has adopted a new set of recommended Rules of Professional Conduct (Rules), to supplant the present Code of Professional Responsibility (Code).¹ As is also generally known, one of the most intensely debated issues in the new Rules was the problem of client fraud—that is, the problem of what a lawyer properly should do when he discovers that a transaction he is handling for a client is tainted with fraud.² In adopting the new Rules, the ABA rejected the proposal of the Kutak Commission³ and replaced it with an amendment formulated by a group led by the American College of Trial Lawyers and the ABA Section of General Practice.⁴ The debate and the adoption of the amendment excited a great deal of public attention, much of it criticism that the amendment sanctions cover up of client fraud.

This Article explains the problem at issue, the resolution of the

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¹ MODEL RULES OF PROFESSIONAL CONDUCT, 52 U.S.L.W. 1 (August 16, 1983). The correct text of the MODEL RULES and Comment was published as an insert in the November, 1983 issue of the *American Bar Ass'n Journal*. 69 A.B.A. J. 1671 (1983).

² See N.Y. Times, Feb. 8, 1983, § 1, at 1, col. 2; *id.*, Feb. 9, 1983, at A24, col. 1; Taylor, *Lawyer Confidentiality v. Disclosing Crimes-to-Be*, *id.*, Feb. 14, 1983, at A9, col. 1.

³ The "Kutak Commission" is the informal name for the American Bar Association Special Commission on the Evaluation of Professional Standards. The Commission was created in 1977, published a Discussion Draft in 1980, and its Proposed Final Draft in May, 1981. MODEL RULES OF PROFESSIONAL CONDUCT (Discussion Draft 1980); *id.* (Final Draft 1981), 67 A.B.A. J. Supp. (1982). Its proposal is set forth *infra* at text accompanying note 42.

⁴ See 1 Materials on Model Rules of Professional Conduct, ABA Annual Meeting, item 503, at 19; item 519, at 2. (August 10-12 1982).

problem by the ABA's action, and the implications of that resolution.⁵ I conclude that the ABA's resolution embodied an important point that the Kutak proposal overlooked, that the ABA's resolution is reasonably workable so far as lawyers are concerned, but that the ABA's resolution is inadequate according to moral and legal principles. I therefore tender an amendment that might be considered by the states as they consider the new Rules and that might even be considered by the ABA in due course.

II. THE CLIENT FRAUD PROBLEM

To begin with, the client fraud problem should be clearly stated, so that there is common ground as to the matter to be addressed. The problem arises when a lawyer undertakes representation in a transaction that he assumes is nonfraudulent but then, having done substantial professional work to carry out the transaction, discovers that the transaction involves fraud against the other party to the transaction or against some other party. What is the lawyer required or permitted to do at that point? To give more concrete illustrations, suppose that:

1. The transaction is the issuance of stock and the lawyer for the issuer, having prepared all the legal papers for the issue, discovers that the statements purporting to show the issuer's financial condition are materially misleading. The transaction has progressed to one of the following stages:

(a) the closing with the underwriters is about to take place;

(b) the closing has taken place, the required offering statement has been filed with the SEC, and the marketing of the issue is about to take place;

(c) the issue has been sold to the public.⁶

⁵ See also Rotunda, *The Notice of Withdrawal and the New Model Rules of Professional Conduct: Blowing the Whistle and Waving the Flag*, 63 OR. L. REV. 455 (1984).

⁶ See, e.g., *In re O.P.M. Leasing Services, Inc.*, Report of the Trustee Concerning Fraud and Other Misconduct in the Management of the Affairs of the Debtor 422 (Bankr. April 25, 1983). See also Redlich, *Disclosure Provisions of the Model Rules of Professional Conduct*, 4 A.B.F. J. 981 (1980).

2. The transaction is the procurement of a performance bond by a building contractor, to secure his completion of a construction contract. The lawyer for the contractor, having prepared certain documents for the contractor in connection with the application to the bonding company, discovers that the contractor's financial condition is materially weaker than had been represented to the bonding company. The transaction has progressed to one of the following stages:

- (a) the delivery of the performance bond is about to take place;
- (b) the bond has been written and the contractor has begun performance but is experiencing financial distress.⁷

3. The transaction is the sale of a house to be financed in substantial part by a second mortgage and the lawyer for the buyer, having prepared the various legal documents for the transaction, discovers that the buyer does not have the income sources that had been represented to the seller. The transaction has progressed to one of the following stages:

- (a) the closing with the buyer is about to take place;
- (b) the closing has taken place and the seller is about to transfer possession;
- (c) the transaction is complete and the financially shaky buyer has taken possession.⁸

4. The transaction is a tax shelter venture involving purchase and development of natural resources. The lawyer has prepared a tax shelter opinion for the promoter, knowing that the opinion will be used in promoting the venture and will be known to the investors when they make deduction claims in their tax returns. After the lawyer has transmitted the opinion to the promoter, he discovers information indicating that the natural resources involved are so insubstantial that the venture is virtually certain to collapse, with the further likely consequence that the tax deductions may be disallowed. At the point of this discovery by the lawyer, the trans-

⁷ This hypothetical is based on a case in which I was involved in private practice.

⁸ *Cf. SEC v. National Student Mktg. Corp.*, 457 F. Supp. 682 (D.D.C. 1978).

action has progressed to one of the following stages:

- (a) the promoter is about to begin the public offering;
- (b) the public offering has been completed;
- (c) the tax year has arrived when the first tax deductions will be claimed.⁹

Posing the client fraud problem in these variations brings out several important variables while keeping the central problem in focus. The first variation—the securities issue based on material misrepresentation in the offer—is a three-party transaction rather than two-party. There is an immediate opposite number, that is, the underwriter of the issue, and also an eventual third party, that is, the members of the investing public who will purchase the issue. Furthermore, this situation involves a scheme of administrative regulation, which entails both filing requirements and an enforcement agency. These circumstances mean that (1) there are at least two participants in the transaction who presently or eventually can legally complain about the transaction—the underwriter and the eventual purchasers; (2) the details of the transaction will be made a matter of public record; (3) fraud in the transaction can be a predicate not only of civil liability for those involved but also criminal liability (securities fraud); (4) there is a definite possibility of public agency enforcement against the lawyer as well as the issuer.

All these aspects of the first alternative mean a higher risk that the fraud will be discovered by someone besides the lawyer for the issuer. They also mean that if the fraud is discovered, there is considerable risk that fraud sanctions, civil or criminal, will be invoked against the lawyer as well as the client. Apart from the high degree of risk, the transaction in its essentials is a defrauding of an innocent third party in which the unknowing lawyer and his work product were an instrument of the fraud.

The second variation—the contractors' performance bond ob-

⁹ See *Sharp v. Coopers & Lybrand*, 457 F. Supp. 879 (E.D. Pa. 1978). Cf. ABA Standing Committee on Ethics and Professional Responsibility, Formal Op. 346 (1981); Ass'n of the Bar of the City of New York, Special Committee on the Lawyer's Role in Tax Practice, Report (March, 1983).

tained on the basis of false financial statements—involves some other variables. First, the transaction is not a sale in the usual sense but an undertaking of indemnity or “guaranty.” Second, the victim of the fraud faces not an accomplished loss but a risk of loss that depends on an unresolved contingency—the possibility that the contractor will not be able to complete the construction project. Third, the victim of the fraud, the bonding company, is in a business in which the risk of being defrauded is more or less commonplace. Fourth, and partly for the foregoing reasons, the risk that the lawyer will be charged with complicity is relatively remote, whether we contemplate a civil suit by the bonding company, or a criminal prosecution (for example, under the mail fraud laws), or a professional disciplinary proceeding. Again, however, apart from the low degree of risk, the transaction is essentially a defrauding of an innocent third party in which the unknowing lawyer and his work product were an instrument of the fraud.

The third variation—the sale of a house under second mortgage—involves still other variables. It involves fraud on the part of a buyer rather than a seller, which is probably an atypical structure of a fraudulent transaction. It involves a transaction of relatively routine character, small dimension, and low visibility, one that could go through the office of any solo practitioner or small firm. It is also a transaction in which the defrauded party is unlikely to seek redress other than getting his money back from the seller. It is unlikely that the lawyer will be sued civilly, most unlikely that he will be subject to a disciplinary inquiry, and unlikely in the extreme that any public authority will even consider a criminal proceeding against either the lawyer or his client. Once more, however, the transaction involves a fraud in which the lawyer was an instrument.

The fourth variation—the tax shelter opinion—involves fraud by the client against the investors in the venture. In this respect it is like the fraudulent securities transaction. However, in the tax shelter situation the lawyer’s work product is also a link in a chain of events by which the government will be cheated of revenues to

which it is entitled under the tax laws.¹⁰

There are infinite other variations of the client fraud problem. However, the foregoing ones will serve for purposes of analysis.

III. WHAT THE PROBLEM IS NOT

My experience in discussions of the client fraud problems resigns me to realization of how easily the problem becomes confused, sometimes perhaps deliberately. The tangents go in several directions. They will be briefly explored in the interest of focusing attention on the specific problem under consideration.

A. *The Problem is Not One of Initial Lawyer Complicity*

The statement of the client fraud problem often evokes from lawyers a protest that the lawyer did not know about the client's fraud. That is true only if the transaction is considered at the initial stage, at which the lawyer was by hypothesis ignorant of the fraudulent element. After that, he did know.

The distinction becomes clear if we suppose that the lawyer *did* know about the fraudulent element at the outset of the transaction, before having taken any steps that affect another party to the proposed transaction. If the lawyer knows of the fraudulent element at this stage, the law is clear that he may not proceed to implement the transaction. By the same token, the legal consequences to the lawyer if he does implement the transaction are also clear. Such acts as preparing documents or engaging in their transmission constitute substantial assistance to a fraudulent scheme. The legal consequences of giving such assistance are: first, that the lawyer is a joint tortfeasor in the tort of fraud;¹¹ second, if the conduct is criminally proscribed as well as being a tort (as generally will be the case, given the operation of the mail fraud laws), that

¹⁰ See *supra* note 9.

¹¹ See, e.g., *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 57 Cal. App. 3d 104, 128 Cal. Rptr. 901 (1976); see Hazard, *How Far May a Lawyer Go in Assisting a Client in Legally Wrongful Conduct?*, 35 U. MIAMI L. REV. 669 (1981).

the lawyer is guilty as an accessory to the crime of fraud;¹² and, third, that the lawyer is guilty of professional misconduct that can be the basis of censure, suspension, or disbarment.¹³

It may be added that the fraud-doing client is also subject to civil and criminal liability as a principal, and that, if the lawyer is fortunate, the injured party and the public authorities may decide to pursue only the client. Nevertheless, the fact remains that, inasmuch as the lawyer knew of the fraud when undertaking to implement the transaction, he is civilly and criminally liable, and liable also for professional misconduct.

On another occasion I made reference to these tort and criminal consequences to the lawyer.¹⁴ Reference to them is repeated only in an effort to overcome a misapprehension that seems to persist among many lawyers. The misapprehension is the belief that if the client is liable civilly and criminally in a transaction, then the lawyer is not. A lawyer enjoys no such immunity. Moreover, in today's legal world, there is a real possibility that the lawyer's criminal liability will be enforced. If the lawyer has substantial assets or insurance coverage, it is also a virtual certainty these days that he will be a target for civil redress. Furthermore, it is now and has always been the rule that the lawyer's knowing participation in client fraud is professional misconduct.

For the record, therefore, the rule is that a lawyer may not be an accessory to fraud. Rule 1.2(d) of the ABA's Model Rules of Professional Conduct provides that: "A lawyer shall not counsel to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . ." This language was taken directly from, and is substantially identical to, the cognate provision of the present Code of Professional Responsibility. That provision, appearing in DR 7-102(A)(7), is that: "A lawyer shall not . . . counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent." The purport of the old ABA Canons of 1908 was the

¹² *E.g.*, *United States v. Benjamin*, 328 F.2d 854 (2d Cir. 1964); *see also* Hazard, *supra* note 11; *cf.* Beckler & Epner, *Principal White Collar Crimes*, BUSINESS CRIMES: A GUIDE FOR CORPORATE AND DEFENSE COUNSEL (1982) (J. Glekel ed.).

¹³ *E.g.*, *In re Blatt*, 65 N.J. 539, 324 A.2d 15 (1974).

¹⁴ *See* Hazard, *supra* note 11.

same, although its expression was indirect. The indirectness of expression undoubtedly resulted because the late Victorians who drafted the Canons simply assumed that assisting client fraud was unprofessional. Canon 41 thus provided as follows:

When a lawyer discovers that some fraud or deception has been practiced, which has unjustly imposed upon . . . a party, he should endeavor to rectify it . . . if his client refuses to forego the advantage thus unjustly gained, he should promptly inform the injured person or his counsel, so that they may take appropriate steps.

There were similar expressions in earlier authority.¹⁵

Indeed, the legal validity of the general proposition that a lawyer may not assist a client in a fraudulent scheme is not disputed. It is simply the premise for consideration of the problem at hand.

B. The Problem Is Not One of A Lawyer's Being Innocently Exploited by a Fraud-Doing Client

The statement of the client fraud problem often evokes another response, this time the protest that a lawyer who was unaware of fraud in a transaction is not guilty of professional misconduct, or of a civil or criminal wrong. That proposition is quite true. A lawyer is not legally guilty of assisting a fraudulent project unless he knows that the project is fraudulent. But that proposition also does not address the problem at hand.

In the first place, the lawyer's ignorance of the client's fraudulent purpose precludes his being charged with complicity only so long as the ignorance continues. When the lawyer's ignorance ceases—that is, when he acquires knowledge of the fraud—he then has the mental state of an accessory. Having that mental state is not alone sufficient to constitute being an accessory, for being an accessory requires the additional element of giving assistance to the project. But once the requisite mental state has been acquired, an act in furtherance of the project entails the combination of assistance and guilty knowledge, and that combination constitutes

¹⁵ *E.g.*, *Queen v. Cox and Railton*, 14 Q.B.D. 153 (1884).

the offense of assisting fraud.¹⁶ Thus, the fact that the lawyer may have innocently begun the representation does not obviate the fact that the representation ceases to be innocent once the lawyer becomes aware of the fraudulent basis of the transaction.

It is also true that if, upon discovering the fraud, the lawyer wholly terminates further assistance to the project, he is not guilty of being an accessory. In principle, this is the same situation as if the lawyer had never learned of the fraud at all—he has simply been the ignorant instrument of the client's fraudulent purpose. But the lawyer must have ceased his assistance in the transaction immediately upon learning of its fraudulent character. If, for example, the lawyer became aware of the fraud before the closing of the transaction, the participation in the closing would surely constitute "assisting" accomplishment of the client's fraudulent purpose.¹⁷

We will presently come back to the question of terminating assistance. The point here is simply that the lawyer will be legally innocent only if it is found that his awareness of the fraud did not precede any act on his part that substantially furthered the transaction. This situation may be described as "midstream discovery." As a matter of formal legal analysis, it raises little conceptual difficulty and little or no substantive controversy. However, the problem of "midpoint discovery" raises the question of what it means for a lawyer to discover or "know" what his client is up to. This question requires exploration because it runs through all variations of the client fraud problem.

C. The Problem Is Not that the Lawyer Cannot "Know" of a Client's Fraud

There are several intricacies in the question of a lawyer's knowledge of a client's fraud. The first intricacy is that of determining when a lawyer has come to "know" about the fraud being committed by his client. The criteria for determining whether a lawyer "knows" of a client's fraudulent purposes are more exacting than

¹⁶ Cf., e.g., *United States v. Alvarez*, 625 F.2d 1196 (5th Cir. 1980).

¹⁷ E.g., *SEC v. National Student Mktg. Corp.*, 457 F. Supp. 682 (D.D.C. 1978).

many lawyers seem to suppose.

Some lawyers, for example, at least profess that they cannot "know" anything—that facts exist only when a jury has found them in a verdict. This incapacity to "know" is a form of cognitive dissonance useful and legitimate for trial advocates, particularly those who represent criminal defendants. A lawyer's representation of a criminal defendant is easier if the lawyer does not "know" the accused is guilty.¹⁸ A criminal defense lawyer therefore wants to believe that he does not "know" anything about his client, at least until a jury "knows" it for him, as it were. The same cognitive incapacity can help sustain the civil advocate. Such ignorance is not only a professional convenience to the advocate but also a moral and legal tenet of the adversary system. If an advocate were considered to "know" the truth of the matter being controverted in litigation, it would be morally outrageous that he should pretend and contend otherwise. Legally, if the information in the advocate's mind were as accessible to the judicial fact-finder as such information in the mind of anyone else, the advocate would be a prime witness against his client. That consequence is of course interdicted, as it should be, by the attorney-client privilege.¹⁹

The special encapsulation of knowledge that is permitted in the advocate's mind, however, is not ordinarily sanctioned where the lawyer's representation of the client entails a function *other* than that of trial advocate. This point can be demonstrated by considering the situation of a lawyer who is consulted by a client concerning a proposed transaction that the lawyer realizes will be fraudulent if carried out.

Suppose, first, that the lawyer's service to the client consists solely of listening to the proposal, then advising the client that the project would be fraudulent if carried out, and thereupon refusing to provide any further service with regard to the matter. It is clear

¹⁸ Cf. Lord Brougham's famous dictum: "An advocate, in the discharge of his duty, knows but one person in all the world, and that is his client." 2 Trial of Queen Caroline 8 (1821). Compare the clear-eyed analysis in Freedman, *Professional Responsibility of the Criminal Defense Lawyer: The Three Hardest Questions*, 64 MICH. L. REV. 1469, 1472 (1966).

¹⁹ *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

that this activity does not make the lawyer an accessory if the client thereafter carries out the project.²⁰ Under general principles of accessorial liability, mere knowledge of another's fraudulent purposes does not make the auditor an accomplice.²¹ However, the lawyer's innocence of complicity flows not from his lack of "knowledge" of the client's purpose, but from his failure to lend aid to that purpose.

Some lawyers go on to suggest that a lawyer who has only listened and honestly advised concerning a fraudulent proposal could not be regarded as an accessory *because* such consultations are privileged. The argument is that the lawyer's participation in the consultation will lead to his disapprobation of the fraudulent proposal, and thus possibly to the client's abandonment of it. Such consultations are therefore to be encouraged in the name of providing counsel against proposed frauds.

This elaboration is accurate to a limited and precise extent. It is legally accurate to say that the lawyer has what is essentially a privilege to *hear* the client's proposal.²² That is, the lawyer's professional role legitimately includes consulting about transactions that are at the margin of legality. Performing that role necessarily includes listening to proposals that if carried out would be illegal. The client cannot always know in advance of his recitation that a proposal constitutes fraud, and the lawyer cannot know in advance of the recitation what the proposal is.

To protect performance of the lawyer's counselling role, the law will not permit inferences that would jeopardize it. Thus, the fact that a fraud-doing client first consulted a lawyer and then committed fraud evidencing considerable legal sophistication ought not to support the inference that the sophistication was acquired from

²⁰ It does not follow that the *client* has a fully protected right to *ask* a lawyer about a transaction that the client evidently realizes is a fraud. The attorney-client privilege as generally formulated does not apply to such a consultation. *See, e.g.,* C. McCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 95 (1972) (E. Cleary ed.).

²¹ *See generally* W. LAFAVE & A. SCOTT, HANDBOOK ON CRIMINAL LAW § 64 (1972).

²² In this respect, a lawyer stands in a very different situation from a policeman or other law enforcement officer, who has an affirmative duty to act upon knowledge of a crime. Those opponents of the Kutak proposals who argued that a lawyer should not have to "become a policeman" had a powerfully effective rhetorical device but an inaccurate predicate.

the lawyer. However, if the office lawyer goes beyond listening and advising that fraud is fraud, his state of knowledge is not given special legal protection. The rule that governs beyond the point of honest advice is that a lawyer may not "counsel or assist" the client in a crime or fraud.²³ "Counsel," according to the definition applicable in this context, means "instruction or recommendation" and "interchange of opinion especially on possible procedure."²⁴ The comment to Rule 1.2 of the Model Rules expresses the same point:

The fact that a client uses advice in a course of action that is criminal or fraudulent does not, of itself, make a lawyer a party to the course of action. However . . . [t]here is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity.²⁵

The offense of "counselling" a crime or fraud, like the offense of "assisting," involves a combination of elements. One of the elements is the act of "encouraging" the client in the fraudulent project, that is, saying things and giving signs that tend to resolve the client's ambivalence or to allay his anxiety concerning a wrongful course of action. The second element is the lawyer's knowledge that the clients' projected course is a "crime or fraud." The rule against "counselling" a client in a crime or fraud thus incorporates the proposition that a lawyer can "know" what his client is up to. The office lawyer, unlike the advocate, has no legal immunity in giving assistance on the basis that he does not "know" what he knows.

Indeed, when it comes to determining what an office lawyer can be found to "know" about his client's purposes, the cases go further. The decisions say that a lawyer cannot "close his eyes" to facts that are readily apparent.²⁶ The lawyer will be taken as hav-

²³ MODEL RULES OF PROFESSIONAL CONDUCT 1.2(d) (1983); MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR-7-102(A)(7) (1981); cf. MODEL PENAL CODE § 2.04 (proposed official draft 1962).

²⁴ WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 518 (1971).

²⁵ MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 comment (1983).

²⁶ *E.g.*, *In re Blatt*, 65 N.J. 539, 324 A.2d 15 (1974).

ing seen such facts. They also say that a lawyer must apprehend the significance, considered as a whole, of facts that may be innocuous when considered in isolation.²⁷ The cases also say that a lawyer must gauge the significance of a fact, or set of facts, with the comprehension of one familiar with the type of transaction involved.²⁸ Thus, far from having the advocate's license to pretend ignorance of the truth about his client, the legal counsellor, for the purposes of the crime/fraud rule, may be taken as knowing what an alert lawyer would know upon looking with a professional eye at the totality of circumstances there to be seen.

D. The Problem Is Not that an Innocent Lawyer Can "Take Care of Himself"

Another response to the client fraud problem is one that might be called "white-collar macho." It is expressed in the retort that a lawyer who cannot take care of himself regarding client fraud is "not worth his salt." Implicit in this retort is the proposition that the concern over the crime/fraud rule is academic nattering beneath the notice of tough-minded professionals. Hence, the argument implicitly continues, we should have a blanket confidentiality rule, and stop worrying about it.²⁹

The fact is, however, that some clients are at least as tough and clever as their lawyers. As a result, an innocent lawyer—however competent and however watchful—is inevitably at risk in any transaction where the client could commit fraud.

That the innocent lawyer is at risk becomes obvious if we take account of certain additional facts in the transactions we are talking about. These facts are: (1) the client is engaged in fraud and does not want the lawyer to know about it; (2) the client generally has as good or better access to the material facts as the lawyer; (3) the client often can take initiatives to exploit these facts that the

²⁷ *E.g.*, *United States v. Benjamin*, 328 F.2d 854 (2d Cir. 1964).

²⁸ *E.g.*, *SEC v. National Student Mktg. Corp.*, 457 F. Supp. 682 (D.D.C. 1978).

²⁹ The lawyers holding this view generally are advocates, who don't handle transactions in which they can be implicated in client fraud, rather than securities lawyers, who do handle such transactions.

lawyer will have difficulty in discovering; (4) the client may be able to destroy evidence that would exonerate the lawyer; (5) the question of the lawyer's complicity will be determined by circumstantial evidence and not solely on the lawyer's protestation that he is innocent; (6) by the time the lawyer's complicity is an issue, the client may be out of the picture, for example in jail or in the Bahamas; (7) if the client is still in the picture, he may contend that he was the innocent in the transaction; (8) the lawyer's complicity under civil or criminal law, as distinct from the law of professional discipline, may be determined by lay jurors, who may not have much sympathy for lawyers.

Moreover, the client may know a good deal of law, some of it possibly acquired in earlier fraud litigation. The client's knowledge of law may extend to the law of client-lawyer confidentiality. If the client had that legal knowledge, and if the rule of confidentiality fully protected proposed fraud, then the client, having gotten all the service he could out of the lawyer, could lawfully demand that the lawyer keep his mouth shut, at least until the lawyer is interrogated by a grand jury or named as a defendant in a disciplinary or civil fraud proceeding.

I do not see how in such circumstances a lawyer, no matter how tough and how clever, could avoid being the subject of a criminal investigation or a defendant in a civil fraud suit. The lawyer of course might succeed in establishing his innocence to the satisfaction of the district attorney or criminal jury, or the civil plaintiff's attorney or a civil jury, or the disciplinary committee. Everyone is entitled to a fair trial, even lawyers. But lawyers especially know that fair trials do not always result in just verdicts, and that the event of a trial is expensive, distracting, infuriating, depressing, injurious to friendships and family, and often irreparably damaging to reputation. Surviving that experience is a way of "taking care" of one's self, but it is not very tender care.

Indeed, this peril to the innocent lawyer is so obvious as to impugn the seriousness of the notion that competent lawyers can take care of themselves under a confidentiality rule that does not have an exception concerning client fraud. In pondering the rhetoric in favor of such a rule, I indeed conclude that it is not intended to be

taken seriously. Instead, the idea is that the confidentiality rule should *state* no qualifications concerning client fraud, but should be *understood* as having an exception "in practice." We will return to this "solution" later. For now, it suffices to say that recognizing an exception "in practice" is to recognize that an innocent lawyer cannot take care of himself in a client fraud situation unless he has some kind of out.

III. SOME COROLLARIES

It may further clarify the central question if we also resolve some preliminary issues that do not seem seriously in dispute.

A. *The Lawyer Must Have a Reasonable Basis for Supposing that Fraud Is Involved*

The information suggesting that a client's project is fraudulent should be substantial before it can be given significance so far as the lawyer's course of action is concerned. A lawyer should not intercept a client on mere suspicion or rumor. There seems no great need to worry that lawyers will be trigger-happy about apparent client fraud, although there have been cases in which such predisposition might have been manifested.³⁰ A lawyer has very strong incentives not to interpret a client's project as fraudulent or to intercept the project if he does make that interpretation. If he acts on a mistaken premise that fraud is involved, the certain results will be acrimony and possible litigation with the client, damage to the lawyer's reputation for being trustworthy with client confidences, risk of disciplinary proceedings for having unjustifiably betrayed a client confidence, and peer disapproval. This array of deterrents is so formidable that rule-makers should be careful not to add legal deterrents that would reduce the lawyer's ambit of action to the vanishing point. It is therefore enough to say that the lawyer should have a reasonable basis for concluding that fraud is involved before acting. Obviously, a more stringent requirement, such as that there should be a provable case against the client,

³⁰ Cf. *Meyerhofer v. Empire Fire & Marine Ins. Co.*, 497 F.2d 1190 (2d Cir.), *cert. denied*, 419 U.S. 998 (1974).

would virtually preclude the possibility of the lawyer's action except in most egregious situations.

B. As Little Damage as Possible Should Be Done to the Client

If the lawyer decides to act, he should proceed in such a way as to damage the client as little as reasonably possible. This is a general principle regarding action that may harm others. The principle is especially applicable to action affecting a person to whom the actor has some sort of protective responsibility, as a lawyer has to a client.

In the client fraud situation, this principle has several implications. The lawyer should if possible try to prevent the fraud, rather than rectifying it after the scheme is under way. Prevention if successful will leave the fraud unconsummated, and probably undiscovered and hence unpunished; the intended fraud will simply be an ugly secret between client and lawyer. Interception after the fraud is under way, on the other hand, is more likely not only to result in the client's suffering sanctions but also in the lawyer's having to give evidence in the imposition of such sanctions.

It must be noted, however, that there is unavoidable tension between the proposition that the lawyer should act early, to prevent the fraud, and the requirement that he should act only on the basis of solid information. The longer the wait, the more solid the information, but also the greater the likelihood of the client's deeper inculcation.

A corollary of the principle of doing the least possible damage to the client is that, in addressing the client upon discovering the fraud, the lawyer should warn the client about the lawyer's responsibilities if the fraudulent project materializes. Giving such a warning to a client is of course a most difficult, delicate task. But unless the client is given such a warning, the client may persist when otherwise he might have been deflected in his purpose. The client should also be made to realize that if the project goes forward, the lawyer will not only have to withdraw but also may wind up being an adverse witness.

The confrontation in giving such a warning is so odious that

many lawyers evidently wish there were some escape from having to do so. The only escape within the boundaries of the lawyer's own obligations to the law, however, is by the route of silent withdrawal. In some situations, that may be sufficient warning to deflect the client from his purpose, but in others it may not. If it is not, and the project goes forward, the lawyer may find himself being diversely involved, possibly as a witness, in a client fraud that he and the client both know might have been prevented by a warning from the lawyer.

The principle of least damage to the client obviously cannot have much practical scope in situations where the project is so far advanced that third parties have acted in reliance. Anything the lawyer does at that stage is almost certainly bound to hurt the client. This is the excruciating difficulty of the "midpoint discovery" situation, where the fraud has gone so far forward that its injurious consequences have begun to unfold. But again the lawyer's only alternative to withdrawing after a warning, aside from now becoming an accomplice in the fraud, would be to withdraw silently.

As a practical matter, it may be doubted how "silent" a withdrawal can be at this stage. What are the other parties to make of the fact that the lawyer fails to show up for the closing? It is also doubtful that such a withdrawal will adequately protect the lawyer against being drawn into litigation over the fraud. In any case, the lawyer has no lawful course of action that guarantees no serious consequences to the client. This fact simply has to be accepted.

C. The Lawyer Must Be Allowed a "Self Defense" Exception to the Confidentiality Rule

Another proposition undisputed in the bar's debate over the client fraud problem is that the lawyer should be allowed to defend himself against charges of complicity in the client's fraud. Needless to say, the bar itself has accepted the "self defense" provision without much debate. That is, although vehemently opposed to "whistle blowing" on clients as a general proposition, lawyers accept the necessity for doing so as a matter of self defense. This attitude is readily intelligible as a matter of crude self interest on the part of lawyers. This does not mean, however, that such a pro-

vision is inappropriate. The point of difficulty is not that a self defense provision illegitimately protects lawyers, but that it protects *only* lawyers.

Unless there is a self defense exception, the result of the confidentiality rule would be that a lawyer could be held liable for assisting client fraud on the basis of evidence that he would be legally prohibited from rebutting. Neither the law of confidentiality nor the attorney-client privilege has ever been construed to have that effect.³¹ The "self defense" proviso is nevertheless troubling not because as such it protects lawyers, but because, if it stands alone, in its usual operation it gives lawyers preferred treatment among victims of the client's fraud.

The preferred treatment accorded lawyers results from the fact that in its ordinary application, the self defense proviso is operative only when a third party is actually victimized. The self defense exception by its terms applies only when the lawyer is accused of complicity. But such an accusation requires an accuser, which presupposes a victim. The lawyer's being unjustly accused is simply a secondary consequence of the original fraud.³² Thus, if the "self defense" provision stands alone, in the ordinary course of events it gives protection to innocent victims who are lawyers but not to other victims.

On general legal principles such a preference for lawyers, as compared with third party victims, seems very difficult to justify, to put it mildly. As compared with other victims, the lawyer is likely to be in a superior position to prevent the wrong. As compared with other victims, he probably runs a lesser risk of suffering actual injury if the fraud is consummated. Moreover, the client-lawyer relationship between the lawyer and the fraud-doer justifies no

³¹ DR 4-101(C)(4) provides that:

A lawyer may reveal . . . [c]onfidences or secrets necessary to establish or collect his fee or to defend himself or his employees or associates against an accusation of wrongful conduct.

³² See *supra* note 31. The Code does not indicate what is meant by an "accusation." Specifically, it does not say whether an "accusation" includes not only a formal charge, such as a criminal prosecution or civil action complaint, but also an assertion made before such a charge has been filed, for example, an accusing inquiry by a fraud victim. These different possibilities of meaning have great practical importance for the lawyer.

special protection for the *lawyer*. Both the lawyer and the third party are simply "arms length" contractors with the client. Indeed, situations can be imagined where the relationship between the fraud-doer and the third party gives rise to a higher measure of legal protection to the third party than to the lawyer.³³ Thus, aside from purely invidious self protection in the legal profession's composing its own rules of the game, there seems to be no explanation for allowing lawyers to breach client confidences to protect themselves but not to protect others.

At least three aspects of the "self defense" exception to the confidentiality rule merit attention, however, in considering the interests of third-party victims. The first is that the self defense exception comes into play, except under extraordinary circumstances, only after the client-lawyer relationship has terminated. Conceivably, of course, a dispute over a lawyer's complicity in client fraud could proceed while the client-lawyer relationship endured. But such a situation is hardly a practical possibility; the parties will surely have dissolved their "relationship of trust and confidence." Thus, the "self defense" exception to the confidentiality rule, for practical purposes, allows disclosure of confidences only as against a *former* client. There is an intelligible distinction between disclosure as regards a present client and disclosure as regards a former client. Assuming such a distinction is intelligible, the "self defense" exception is consistent with that distinction.

A second aspect of the "self defense" exception is that it is likely to come into play only where the lawyer's services in some way facilitated the fraud on the third party. If the lawyer's services were unrelated to the fraud, and his learning of the fraud was only incidental to the representation, the lawyer probably would not face a charge of complicity, which is the trigger for the self defense exception.

The distinction has been illuminated by Professor Bernard Wolfman, who gave me an example that could easily arise in the

³³ Specifically, when the client is a fiduciary in relation to the third party.

practice of a tax lawyer or other specialist.³⁴ Suppose that a tax lawyer is retained by the client to resist a deficiency claim asserted by the Internal Revenue Service. The tax lawyer becomes satisfied that the deductions, or whatever, are nonfraudulent but also discovers in the course of working on the case that the client's earnings, correctly reported, had been derived from fraud practiced on a third party—for example, embezzlement from his employer. Suppose, further, that the embezzlement evidently was continuing.

In such a situation the lawyer knows of past client fraud that the lawyer could help rectify, and also of intended fraud that the lawyer could prevent. On one hand, there is a moral basis for saying that the lawyer should be permitted to take action to either effect, and indeed a basis for saying that morally he is required to take such action. But, on the other hand, there is also a moral basis for saying that he should remain silent, that protecting the confidentiality of confidential advisers is a value more weighty than that of protecting innocent victims, at least where the offense does not involve physical injury of person. The latter moral proposition provides a basis for a legal distinction that would permit disclosure when the lawyer is the instrument of fraud, but could not permit disclosure when the lawyer discovers the fraud as an incident to representation in another subject matter.

The third aspect of the self defense exception concerns the distinction in protective action between preventing a fraud before it occurs and rectifying a fraud after it has occurred. The self defense exception operates only when the fraud has occurred, or at least is well on its way to occurring, and thus applies only to rectification.

Several moral differences between prevention and rectification could be considered significant, but they more or less offset one another. The lawyer is likely to have a unique opportunity of prevention, compared with other possible intervenors, by reason of access to the facts while the transaction is in the making. Prevention involves the lawyer's moral initiative, whereas after the fact rectification may simply be a byproduct of the lawyer's saving himself.

³⁴ See also B. WOLFMAN & J. HOLDEN, *ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE* (1981).

Preventive action by definition shapes the future, making it better, whereas rectification deals with the past and mitigates but does not undo the course of events. A consummated fraud has irreparable aspects—the pollution of society's moral climate, the destruction of a trust relationship. Prevention therefore is an opportunity for achieving a greater good than is rectification.

On the other hand, preventive action by definition involves prediction of events, and hence uncertainty as to whether the fraud will actually be consummated, whereas rectification is predicated on brute historical fact. Preventive action therefore involves the risk of betraying a client who, even absent the lawyer's intervention, would recede from the fraudulent purpose. Rectification is an opportunity for doing lesser good but at much less risk of unnecessary wrong.

All of this goes to the point that, while the "self defense" exception may be invidious standing alone, it has both independent justification and dimensions that are relevant in considering whether, when, or how far a lawyer might be allowed to protect a third party.

D. *The Problem Restated*

With the false and collateral issues put aside, the problem of client fraud can be restated in the following way: What should a lawyer be permitted or required to do when he learns that the client's project is fraudulent at a point when it is simply too late for innocuous withdrawal?

One solution available *a priori*, of course, is that the lawyer could help the client complete the project, and indeed help conceal the fraud. Jame Gould Couzzens reminds us in *By Love Possessed* that this option is not unthinkable, and indeed that it is morally intelligible.³⁵ Assisting the fraud or covering it up, however, is foreclosed as a matter of law as distinct from morals. A "lawyer" by definition exists and functions in a legal system. A legal system necessarily claims that its norms in general are supreme normative

³⁵ J. COZZENS, *BY LOVE POSSESSED* (1957).

commands as against other normative imperatives such as morals or personal conscience. The law cannot license some of its subjects, least of all "lawyers," to assist in the commission or concealment of transactions that it defines as serious wrongs, such as fraud. To do so would license lawyers to be instruments for subverting the structure of law itself.

Assuming that possibility is foreclosed, the legal lines have to be drawn somewhere around two nodal points. One is protection of the lawyer, the other protection of third party victims or prospective victims. We have already indicated that a self defense exception to the confidentiality rule is justified, at least if it does not give preferential treatment to lawyers. The focus thus is on protection of third party victims.

The problematic variables, in addition to whether there ought to be any exception for protection of third parties, are: (1) Whether the lawyer may act only when he has been an instrument of the fraud; (2) Whether the authority should cover prevention or rectification, or both; (3) Whether there must be a warning to the client where possible; and (4) Whether the authority to take action should be discretionary or mandatory.

IV. *Defining the Exception for Third-Party Victims*

A. *The Present Code and Its Antecedents*

With these analytic variables in mind, it is instructive to consider how the problem of client fraud was addressed in the old Canons of Professional Ethics and the present Code of Professional Responsibility.

Canon 41 provided that: "When a lawyer discovers that some fraud has been practiced . . . he should endeavor to rectify it; at first by advising his client, and if his client refuses. . . he should promptly inform the injured person" ³⁶ Thus, as regards third-party victims, Canon 41 was *not* limited to situations in which the lawyer was an instrument of the fraud; it contemplated

³⁶ ABA CANONS OF PROFESSIONAL ETHICS, reprinted in T. MORGAN & R. ROTUNDA, PROFESSIONAL RESPONSIBILITY (2d ed., Selected Standards Supp. 1983).

rectification rather than prevention; it required a warning to the client; and it provided a mandatory direction to act.

The present Code of Professional Responsibility is almost totally incoherent on the subject. Much of this confusion arises because most instances of client fraud also constitute a crime, and the Code has one provision addressing client crime and another addressing client fraud. The provision on client crime is DR 4-101(C)(3). This provision is explicitly an exception to the general rule of confidentiality and states that: "A lawyer may reveal . . . the intention of his client to commit a crime and the information necessary to prevent the crime."³⁷ In terms of the relevant variables, DR 4-101(C)(3) does not require that the lawyer must have been an instrument in the crime; it contemplates prevention, not rectification; it suggests nothing about a warning to the client; and it confers discretion on the lawyer rather than imposing an obligation.

The second Code provision speaking to the problem is DR 7-102(B)(1), which, as originally promulgated, provided:

A lawyer who receives information clearly establishing that:

(1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal

This provision is ambiguous as to whether the lawyer's services must have been employed in the fraud. The better interpretation is that it does entail such a requirement, since the phrase "in the course of the representation" modifies "perpetrated a fraud" rather than "receives information." On that interpretation, DR 7-102(B)(1) requires that the lawyer have been an instrument; contemplates rectification rather than prevention; requires a warning to the client; and specifies mandatory action on the part of the lawyer.

Oddly enough, DR 7-102(B)(1) as originally promulgated by the

³⁷ DR 4-101(B) provides: "Except when permitted under DR 4-101(C), a lawyer shall not knowingly . . . [r]eveal a confidence or secret of his client"

American Bar Association did not expressly indicate whether the duty to disclose fraud was an exception to the confidentiality rule. It must have been an exception, however. That is, it is difficult to see how a lawyer could "reveal fraud to the affected person," as required by DR 7-102(B)(1), while at the same time obeying the injunction of DR 4-101(B) that "a lawyer shall not reveal a confidence or secret of his client," where "secret" is defined in DR 4-101(A) as "information gained in the professional relationship . . . the disclosure of which would be embarrassing or would be likely to be detrimental to the client."

In most states today, DR 7-102(B)(1) stands in the form stated above. Putting aside a 1974 amendment to the Code, which explicitly deals with the confidentiality issue, but which apparently has been adopted in only fourteen states,³⁸ the Code provisions on cli-

³⁸ The 1974 ABA amendment altered DR 7-102(B)(1) to read as follows, the amendment being in emphasis:

A lawyer who receives information clearly establishing that:

(1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal, *except when the information is protected as a privileged communication.*

MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(B)(1) (1977); (amended 1974).

As of 1983, only fourteen states had adopted the amended version of Rule 7-102(b). One additional state, Iowa, has adopted a version of the rule that apparently ties the exception to the duty to disclose to the more limited evidentiary attorney-client privilege rather than the confidentiality privilege of the Code and Rules. IOWA CODE ANN. § 610 App. at DR 7-102(B)(1) (West Supp. 1983). See 4 National Reporter on Ethics and Professional Responsibility ABA 6 (1983) (R. Mersky ed.) Another analyst counts seventeen states as having adopted the 1974 amendment. See Nahstoll, *The Lawyer's Allegiance: Priorities Regarding Confidentiality*, 41 WASH. & LEE L. REV. 421, 433 (1984).

The amendment has the virtue of recognizing the interaction between the client fraud problem and the confidentiality rule. But it is simply incompetent in dealing with that interaction. The amendment was probably intended to cancel the duty to reveal fraud when doing so would require revealing information that would be prejudicial to the client. But this would be to cancel the duty in DR 7-102(B)(1) in virtually all circumstances in which the duty could arise: Can anyone imagine a situation in which the lawyer could reveal a client's fraud, the client having refused to do so, without prejudicial effect on the client? On this interpretation, the amendment operatively repeals the duty to disclose fraud, while nominally preserving it, which is surely disingenuous.

The foregoing interpretation of the effect of the 1974 amendment was affirmed by the ABA Standing Committee on Discipline and Professional Ethics, Formal Op. 341 (1975). Opinion 341 is scandalous as a matter of technical analysis because its result requires tor-

ent fraud therefore array themselves as follows:

Transaction construed as "crime"	Transaction construed as "fraud"
(1) lawyers not required to be instrument	(1) lawyer must be instrument
(2) prevention, not rectification	(2) rectification, not prevention
(3) warning not required	(3) warning required
(4) discretionary	(4) mandatory

The confusion in this structure is suggested by considering its application to one of our initial illustrations.³⁹ Thus, suppose the case of the fraudulent tax shelter, in which a lawyer who had written a tax shelter opinion discovers that the financial information about the venture apparently is false. The transaction can equally well be classified as a crime or a fraud, because it is both. Consid-

tered reading of the 1974 amendment. Specifically, it requires that the term "privileged communication" be read to refer *not* to the rule of evidentiary privilege, which applies only when the lawyer is under *compulsion to testify*, but to the rule of confidentiality, which applies to autonomous disclosures on the part of the lawyer. *Id.* at 4-5. Thus, it treats the amendment to DR 7-102(B) as though it read "except when the information is a 'confidence' or 'secret.'" But even that reading of the amendment ignores two serious problems.

First, as we have seen, the confidentiality that DR 4-101(A) accords a "confidence" or "secret" is qualified by the "permissive crime disclosure" provision of DR 4-101(C)(3). It would follow that, when the client fraud is also a crime, the cancellation of the duty to disclose under amended DR 7-102(B)(1) may itself be cancelled by the exception in DR 4-101(C)(3).

Second, Opinion 341 takes no account of the common law exception to *both* the attorney-client privilege and the rule of confidentiality that arises when the information in question concerns a prospective or ongoing fraud. According to the common law, such information is not entitled to the protection of confidentiality. *See Rotunda, supra* note 5, at 475 n.99.

Third, Opinion 341 is technically scandalous in its obliviousness to the self defense problem. *If* amended DR 7-102(B)(1) does indeed preclude disclosure of a client's criminal fraud when disclosure would prejudice the client, then the lawyer seemingly could not make disclosure in self defense. The self defense exception in the Code is in DR 4-101(C)(4), which is *in pari materia* with DR 4-101(C)(3). If "confidences" and "secrets" are incorporated into DR 7-102(B)(1) *without* the "permissive crime disclosure" exception in DR 4-101(C)(3), that incorporation also would not carry the self defense exception in DR 4-101(C)(4). On the other hand, if the self defense exception is carried over, so is the "permissive crime disclosure," and we are back to the cancellation of the 1974 amendment of DR 7-102(B)(1).

The legislative history of the 1974 amendment and Formal Opinion 341, taken together, is little short of sordid. *See Nahstoll, supra*, at 430-32.

³⁹ *See supra* text accompanying note 9.

ering it as a crime, under the Code the lawyer *may* act without warning the client even if the transaction has not gone forward (prevention). Considering the transaction as a fraud, on the other hand, the lawyer *must* act after giving warning but only if the fraud has been partially consummated (rectification).

A repeated objection to the Model Rules was that the present Code provisions have "worked well in practice." This is true in the sense that the Code's anomalies could be interpreted to reach whatever result one might prefer.⁴⁰ That may be good political accommodation but it is not very good law. And bad law can result in bad practice. Indeed, it can result in different kinds of bad practice. These are illustrated by the sharply contrasting courses of action undertaken by the lawyer in *Meyerhofer v. Empire Fire & Marine Ins. Co.*,⁴¹ and the *OPM* case.⁴² In *Meyerhofer*, the lawyer went to the SEC without first warning the client when the fraud—if it was a fraud—was still in prospect. In the *OPM* case, the lawyer continued to assist the client in transactions that were obviously fraudulent. Both courses of action could be justified under the literal terms of the Code as amended in 1974. That is a strange concept of what "works well."

B. *The Rejected Kutak Proposal*

It was the Code's incomprehensibility that induced the Kutak Commission to undertake a reformulation. The Kutak Commission proposal concerning client fraud, proposed Rule 1.6(b), was as follows:

A lawyer may reveal [confidential] information to the extent the lawyer reasonably believes necessary:

(1) to prevent the client from committing a criminal or fraudulent act that the lawyer reasonably believes is likely to result in . . . substantial injury to the financial interests or

⁴⁰ See *supra* note 38.

⁴¹ 497 F.2d 1190 (2d Cir.) *cert. denied*, 419 U.S. 998 (1974). The lawyer in that case interpreted the law of professional responsibility to require that he go to the law enforcement authorities.

⁴² See *supra* note 6. The lawyer in that case was advised that the law of professional responsibility prohibited him from going to the law enforcement authorities.

property of another; [or] (2) to rectify the consequences of a client's criminal or fraudulent act in the furtherance of which the lawyer's services had been used⁴³

This provision covered prevention of a fraud, whether or not the lawyer's services had been involved, and rectification of a fraud where the lawyer's services had been used, both courses of action being discretionary and neither requiring a warning to the client.

It will also be noticed that paragraph (b)(1) above substantially corresponded to DR 4-104(C), except that (b)(1) referred to prevention of fraud as well as crime⁴⁴ and that it was limited to instances involving "substantial" injury.⁴⁵ Paragraph (b)(2) of the Kutak proposal substantially corresponded to DR 7-102(B)(1), except that (b)(2) referred to rectification of crime as well as fraud.⁴⁶

These were the proposals that evoked the outcry that the Kutak Commission proposed "whistle blowing" and "making the lawyer into a policeman." The vehement rhetoric of this criticism diverted attention from the complexity of the issues at stake. In retrospect, however, some aspects of the criticism may have been warranted.

One criticism was the "reasonableness" threshold and "reasonableness" limitation on scope of disclosure. "Reasonableness" boundaries make sense for the reasons stated earlier. On the other hand, such threshold and scope limitations operate in two directions. They raise or lower the degree of the lawyer's discretion at the point of action where the lawyer must decide whether to make a disclosure. But these terms also raise or lower the level of justification at the point where the lawyer may have to defend a charge that he should have acted otherwise. Thus, a "reasonableness" standard gives the client the protection of an objective standard when the lawyer is deciding whether to act, but it also holds the lawyer to an objective standard if he is subsequently charged with a violation. Correlatively, a subjective standard (the lawyer "believes") gives the lawyer wider discretion, in both the rule of action

⁴³ MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(b) (Proposed Final Draft 1981).

⁴⁴ This is not a big difference, since most fraud is also a crime.

⁴⁵ DR 4-101(C) did not have a such a limitation.

⁴⁶ Again, not a big difference.

and the rule of liability.

The principal criticism concerned not these matters of dimension but the very idea of permitting disclosure of client fraud—whether for prevention or rectification, whether with warning or not, whether discretionary or mandatory. The argument was that permitting disclosure would constitute a “radical” change from the Code of Professional Responsibility. As we have seen, however, the Code gives the lawyer broad discretion to reveal client confidences and secrets to prevent any client behavior, including fraud, that would be a crime. And, as the Code stood in well over half the states, it *required* a lawyer to take action regarding client fraud, whether or not a crime. These legal facts were of little moment to the critics. They persuaded the bar that the Kutak proposal would have opened wide new exceptions to confidentiality, whereas in fact the Kutak proposal would have narrowed these exceptions.

This factual aspect of the argument against the Kutak proposal is now largely of historical and sociological interest. Suffice it to say that the Kutak proposal was essentially consistent with the law as it stood, soberly considered. The more significant aspect of the argument against the Kutak proposal was the flat proposition that disclosure of client confidences to protect third-party victims should not be permitted at all. This thesis is important because it is the key to understanding Model Rule 1.6 as adopted by the ABA.

C. *ABA Model Rule 1.6*

In adopting the Model Rules of Professional Responsibility, the ABA House of Delegates eliminated the Kutak Commission's proposals as to both preventing and rectifying client fraud. However, it enlarged the “self defense” exception in modest but significant ways. As adopted by the ABA, Rule 1.6 reads as follows:

- (a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in

paragraph (b).

(b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:

(1) To prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or

(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in a proceeding concerning the lawyer's representation of the client.⁴⁷

This formulation makes no provision at all for client fraud. It is a comprehensive and unqualified prohibition of disclosure, subject only to the homicide/bodily injury exception, the "self defense" exception, and the uncontroversial exception regarding disclosures "impliedly authorized" to carry out the representation. It leaves unanswered the question: What does a lawyer do to protect himself in a situation where he has unwittingly been made the instrument of client fraud, but has not yet been charged with complicity (which would activate the "self defense" exception)? And what can he do to protect a third-party victim in such circumstances?

Members and friends of the Kutak Commission put these questions to the proponents of the amendment. The first order answer, given in the debates in the ABA House of Delegates, was that the lawyer should withdraw from the representation. This looks like a nice solution. There are client fraud situations in which the lawyer's withdrawal from the representation will adequately protect him and the third-party victim. Thus, in our original hypotheticals,⁴⁸ withdrawal itself would signal the lawyer's innocence and also tip off the opposing party if: (1) the transaction had not yet been consummated, so that the fraud could be prevented rather than having to be rectified; and (2) the lawyer's act of withdrawing would be understood by the opposing party to mean that the transaction should be aborted rather than completed through sub-

⁴⁷ MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1983).

⁴⁸ See *supra* text accompanying notes 6-9.

stitute counsel. That is, the opposing party would have to smell something fishy.

This solution preserves intact the rule of confidentiality in broadly comprehensive form. It has great rhetorical appeal, and obviously did so for the House of Delegates. It also covers some variations of the fraud problem in a way that would be entirely satisfactory to a morally conscientious lawyer. But it has two serious limitations for the morally conscientious lawyer or for a lawyer merely interested in protecting his own skin. First, the remedy of withdrawal is too late if the transaction has already been closed—what if the third party discovers the fraud thereafter? Second, what if the third party does not comprehend the significance of the withdrawal?

The lawyer's withdrawal would signal that something was wrong to most lawyers, brokers, and legally sophisticated principals. The scenario would go something like this, all carefully avoiding a "disclosure":

Scene 1:

Oposing Party's Lawyer (OPL) to Withdrawing Lawyer (WL):
"Can you tell me the basis of your withdrawal?"

WL: "No. You must ask my client."

OPL to Fraud-Doing Client (FDC): "Why did your lawyer withdraw?"

FDC to OPL: "Because of a conflict of interest he suddenly discovered. Now I have to pay for a second lawyer. You guys always look out for number one."

Scene 2:

OPL, being very knowledgeable about the rules of confidentiality and very wary, to WL: "Your former client says you withdrew on account of conflict of interest. Is that true?"

WL, remembering that if he answers affirmatively he will in effect assist his client in committing the fraud, and that he may tell the truth in order to avoid doing that, to OPL: "That is not why I withdrew."

Scene 3:

OPL to FDC: "Your former lawyer says that his withdrawal was not on account of conflict of interest. I insist that you authorize him to tell me the circumstances, or the deal is off."

This scenario, if properly performed by the third party's counsel or by the third party himself, will do the job of protecting both the withdrawing lawyer and the third party. It is consistent with Rule 1.6 as adopted by the ABA, and with the debate upon which the vote was based. But, to return to the tough questions, what if the lawyer discovers the fraud after he has completed the representation, too late to "withdraw," and, in any event, what if the third party is a small country bank, or a rich "poor widow," who does not understand the signal?

D. *The Parliamentary Denouement*

At this point it is useful to describe the parliamentary sequence in which the Model Rules and the Comment were adopted by the ABA House of Delegates.

As presented by the Kutak Commission, the Model Rules "package" consisted of a Preamble (including a Scope note and Terminology); the black letter Model Rules; a Comment to each of the Rules; a comparison of each Rule with the cognate provisions of the present Code; and a note on Legal Background, citing decisional law, ethics opinions, law reviews, etc. Only the Preamble, Model Rules, and Comment were considered for adoption to replace the Code. These components were presented to the House of Delegates in August 1982 for general debate and deliberation. Moreover, it was decided to consider *only* the black letter in the first round of deliberations. The Comment would be considered after the black letter was adopted, in the interest of conserving time and attention. In the interest of rationing time, it was further decided to commence with the more important and controversial Rules.

Accordingly, discussion in the August 1982 session began with the black letter of Rule 1.5 (fees) and then went on to Rule 1.6. The debate on Rule 1.5 and the beginning of the debate on Rule 1.6 took the better part of a day, which was all the time that had

been allotted at that session of the House. Further deliberation and debate was therefore deferred until February 1983.

This delay gave the opposition time to organize, which it did very effectively. In February the House addressed the black letter of Rule 1.6, along with the black letter of the remaining proposed Rules. In its action on Rule 1.6, as noted above, the House rejected the Kutak proposal and adopted the formulation that eliminated the client fraud exception.⁴⁹ The House then proceeded with the rest of the black letter Rules, adopting them all with various amendments.

In accordance with the special parliamentary procedure, it still remained to consider the Comment to each Rule. Deliberations on the black letter had consumed all the time available at the February meeting. Hence, consideration of the Comment was deferred to the next meeting of the House, in August 1983.

Since many of the black letter provisions had been amended in the February deliberations, it was obvious that much of the Comment required corresponding amendment. Also, since the debate had been both exhaustive and indicative of House sentiment, it made sense to both the Kutak proponents and the interested opponents to work out an agreed revision of the Comment. Negotiations to this end were conducted.

In the course of the negotiations directed to Rule 1.6, it was pointed out that withdrawal would not serve to extricate the lawyer unless the other side understood that withdrawal could be a "signal." It was also pointed out that withdrawal as such would not work at all where the transaction had been consummated before the lawyer discovered the fraud, because there would be no extant representation from which to withdraw.

It was in this context that the opponents of the Kutak Commission fully explicated their solution to the conundrum. The basic proposition, which is now embedded in Rule 1.6, is this: *An act or statement of the lawyer that does not reveal the content of client confidential information does not constitute a disclosure of such*

⁴⁹ See *supra* text accompanying notes 46-48.

information.

From this it follows that the lawyer may give a sufficient signal that the transaction is smelly, so long as he does not reveal the information upon which he reached the conclusion that he should give such a signal. Applied to the postulated hypotheticals, the proposition permits the lawyer to do any of the following, depending on what is needed to get across the message:

1. Announce that he is withdrawing.
2. Withdraw any work product over which he still has control, such as closing documents.
3. Withdraw any work product that had been used in a completed transaction, by announcing: "The [closing statement] which I prepared is hereby withdrawn."
4. Withdraw any *implication* that might be drawn from his participation in the transaction, by announcing: "I withdraw my participation in the transaction, and any implication that might be drawn therefrom."
5. And, according to one exponent of the adopted version, advising a hopelessly naive opposite party, such as a rich "poor widow," as follows: "I must tell you that you should not buy the [property], for reasons I cannot disclose."

All of these measures, it will be observed, do not as such contain the information from which the lawyer deduced that the transaction was fraudulent. Therefore, so the argument goes, they are consistent with the duty prescribed in Rule 1.6 not to "reveal information relating to the representation."

The foregoing analysis is the premise of the revised Comment to Rule 1.6 adopted by the House of Delegates. The Comment implements the analysis and permits signals such as those described above. The Comment states:

Neither this Rule nor Rule 1.8(b) nor Rule 1.16(d) prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, docu-

ment, affirmation or the like.⁵⁰

V. THE REVIVAL OF DISCLOSURE

A. *The ABA's Formula*

To one of only ordinary sophistication, the ABA's resolution of the client problem in substance permits disclosure. Giving a signal—going through a ritual that is intended to be a signal and is understood as a signal—is surely to “reveal” the information that the signal denotes.⁵¹ If that were not the purpose, why give the signal? And if that is the purpose, why not frankly call it a disclosure? What the ABA has done is loudly to proclaim that a lawyer may not blow the whistle, but quietly to affirm that he may wave a flag.⁵²

There are several explanations for this peculiar resolution of the client fraud problem. One explanation, of course, is that the ABA's resolution is sheer sophistry. A second is that the formula entailed a peculiar transposition of the definition of the attorney-client privilege and the concept of confidential information. The attorney-client privilege is defined in terms of *communications from* the client to the attorney intended to be confidential.⁵³ Under the attorney-client privilege, it is those communications that are “confidential.” The black letter of Rule 1.6 and the “withdrawal” signal formula in the Comment continue to prohibit disclosure of such communications. In this sense, the Rule and the Comment absolutely protect an artificially defined “confidentiality” while permitting signals that do the job of extricating the lawyer from fraud.

But the rule of confidentiality that governs disclosures by a law-

⁵⁰ In Rotunda, *supra* note 5, it is said that this comment was proposed by John Elam, former President of the American College of Trial Lawyers and in the debates an opponent of the Kutak Commission. That is not correct. In the post-February negotiations, the Kutak Commission proposed the formulation and Mr. Elam accepted it on behalf of his team. The original author of the concept of “notice of withdrawal” is in fact James G. Hazard, a young Boston lawyer with whom the problem had been discussed.

⁵¹ See Rotunda, *supra* note 5, at 481.

⁵² See *id.* I think I originated this *mot.*

⁵³ *E.g.*, Suezaki v. Superior Ct., 58 Cal.2d 166, 23 Cal. Rptr. 368, 373 P.2d 432, 437 (1962).

yer out-of-court⁵⁴ is not limited to protection of *communications* from the client. It covers all "information" relating to the representation, including information obtained from third persons. The formula in Rule 1.6 and Comment makes technical sense if one treats the black letter as referring only to attorney-client privileged material. But that is not the intended scope of the black letter. Indeed, such an interpretation would constitute massive decomposition of the confidentiality principle.⁵⁵

A third explanation is that the ABA wanted a statutory rule of confidentiality "up front," but also some kind of common law or common lore exception for cases of fraud or other urgent necessity. At least one person supporting Rule 1.6 as adopted has stated that decisions to disclose might be considered matters of civil disobedience. This is truly extraordinary—a general legal rule whose manifest impracticality is to be saved by selective illegal but morally principled violation. That resolution may commend itself to those trial lawyers who are confident of the merciful dispensation of a jury, a prosecutor, or a disciplinary authority. It does not commend itself to the securities bar and others who are less sanguine about jury dispensation, prosecutorial discretion, administrative agency discretion, client vendettas, stockholder derivative suits, and other factors that come into play when the text of a law is squarely at variance with how it is supposed to operate in practice.

A more coherent variation of this approach is to suppose that the unqualified general rule of confidentiality in Rule 1.6 is implicitly subject to common law modifying corollaries based on Rule 1.2(d).⁵⁶ That is, the prohibition in Rule 1.2(d) against knowingly assisting fraud would be construed to include a requirement of

⁵⁴ *I.e.*, outside the contexts in which the attorney-client privilege applies. The privilege is a rule of evidence, and rules of evidence apply in court, not in out-of-court transactions.

⁵⁵ For the obvious reason, among others, that it would leave the lawyer free to disclose information except when under testimonial compulsion. For an elementary illustration of the difference in scope between the *privilege* as to *communications* and the *confidentiality* of *information* learned in the course of representation, see *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

⁵⁶ Rule 1.2(d), provides: "A lawyer shall not counsel his client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . ." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(d) (1983).

withdrawing assistance that had unknowingly been provided to a fraudulent project. Such a withdrawal could be effectuated even if it resulted in, and was intended to result in, a signal to the fraud victim. There is little doubt that the courts could devise some such construction, if forced to do so in order to avoid the literal text of Rule 1.6 as adopted by the House of Delegates. Thus, as so often occurs in legislation these days, the parliamentary body can take the high ground of general principle and leave it to the courts to do the dirty work of interpolating the necessary qualifications. That may be exemplary legislating by contemporary standards but it is not serious law-making.

The trouble with the solution in Rule 1.6 and the Comment as adopted is that some fools may not understand that Rule 1.6 does not mean what it seems to mean. There is reason to be concerned with this possibility. For example, I am told on good authority that, immediately after the House of Delegates' action on Rule 1.6, one of the lawyers in the *OPM* case received several congratulatory calls from fellow lawyers, celebrating the ABA's vindication of his decision not to blow the whistle on the scams his firm had been helping.

More fundamentally, the formula that "a signal is not a disclosure" formula seriously compromises the definition of confidentiality in cases where confidentiality obviously *should not* be compromised. Consider this hypothetical:

A married couple, Kim and Stacy, have known a lawyer socially for some time, but on a casual basis involving infrequent encounters. Without Stacy's knowledge, Kim consults the lawyer on the implications of getting a divorce, wanting simply to think about it for the time being. A few days later, the lawyer sees Stacy on the street and says, "It was good to see Kim the other day."

The lawyer's remark does not reveal the *content* of anything communicated by Kim. Hence, it is not a violation of the concept of confidentiality enacted in Rule 1.6. Needless to say, however, the remark is certainly a breach of confidence as that concept has always been understood in the profession.

Or consider this hypothetical, closer to the context of the client fraud problem:

A lawyer is closely acquainted with both members of a partnership business, A and B, but represents only A. A tells the lawyer of a very lucrative business opportunity, and asks the lawyer to set up a separate venture to pursue it. The lawyer advises A that the opportunity is clearly within the scope of the partnership business and that it would be fraud not to tell B and offer the opportunity to the partnership. A says he thinks he would prefer to go ahead alone. The lawyer withdraws without doing any further work for A.

May the lawyer advise B of his withdrawal from representing A? After A has proceeded with the other venture? I would think that the lawyer should not do so. The client had not manifested a firm intention to go forward, so no fraud was imminent while the lawyer was still involved. And when the fraud had become manifest, the lawyer no longer was involved. The information in question would be covered not only by the rule of confidentiality as it has been traditionally understood, but also by the more narrowly defined attorney-client privilege. Therefore, not only is the lawyer prohibited from voluntary disclosure of the conversation, he probably is prohibited from revealing it under compulsion as a witness.

Yet under the formula in Rule 1.6 and the Comment, the lawyer could tell partner B that he had withdrawn from representing partner A, for such a statement does not reveal the *content* of the information gained in the representation.

It will of course be protested that "this is not what was meant" by Rule 1.6 and the Comment, as adopted. What was *meant* in the adopted formula was that a lawyer may give a signal, by withdrawal, etc., only in circumstances where doing so is a justified exception to the general principle of confidentiality. However, this leaves open the essential question: What should be the definition of this justified exception? The lawyer's course of action in the justified exception can be described disparagingly or euphemistically: blowing the whistle, waving the flag, making noisy withdrawal, making a disclosure, call it what one will. The hard problem, unanswered in the ABA's resolution of Rule 1.6, is to define the circum-

stances in which the lawyer may or should act.

B. *An Articulate Resolution*

Sooner or later it will be necessary to face once again the task of defining these circumstances, because it is too dangerous for the practicing bar to let the question remain adrift. With the circumstances undefined, some lawyers will believe—some lawyers *do* believe—that the *OPM* lawyers did the right thing in staying with the scam. Others may believe that whenever withdrawal is permitted, withdrawal can be ostentatious. For example, Rule 1.16(b)(3) permits a lawyer to withdraw, even if doing so will adversely affect the client, where the client “insists upon pursuing an objective that the lawyer considers repugnant or imprudent.” It would technically follow, under the ABA formula in Rule 1.6, that whenever the client insists on doing something repugnant or imprudent, the lawyer can withdraw with flag flying. Again, of course, it will be said that this is not what was *meant*. But the only sure way to indicate what is meant is to say what is meant.

Given the opportunity once more to try to say what is meant, or what ought to be meant, it would be as follows:

A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:

. . . (2) to prevent or rectify the consequences of a client's criminal or fraudulent act in the commission of which the lawyer's services have been used, but the lawyer shall where practicable first make reasonable effort to persuade the client to take corrective action.

This formulation requires a connection between the lawyer's services and the fraud. It thus draws the line between not being an instrument of fraud, on the one hand, and not being a policeman on the other. On reflection, I believe that is the proper place to draw the line, rather than also allowing disclosure of fraud that the lawyer discovered incidental to the representation.⁵⁷ The formula includes both prevention and rectification, recognizing that in real

⁵⁷ See *supra* text accompanying note 34.

life there is often no clear distinction between the two and that prevention produces greater good even if it entails a greater risk of error.⁵⁸ The formula requires warning where practicable, so that the client is under no illusion as to the lawyer's position and so that the relationship between them thereby is transformed into one of "differing interest,"⁵⁹ which is, of course, what the relationship has become if the lawyer is a law-abiding person.

⁵⁸ See *supra* text accompanying notes 31-34.

⁵⁹ Cf. DR 5-105(B): "A lawyer shall not continue . . . if it would be likely to involve him in representing differing interests"