Negotiation Ethics

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We will limit this discussion to the American Bar Association ("ABA") Model Rules of Professional Conduct. In most cases the states have rules identical to, or very similar to, the Model Rules. Where there is disparity, we will point it out.

Lawyer Conduct. The most important rule on truthfulness is Model Rule 4.1(a). It says a lawyer may not lie to a third person. The rule contains no exception for negotiations. Model Rule 8.4(c) overlaps with Rule 4.1(a) in providing that a lawyer may not engage in "dishonesty, fraud, deceit or misrepresentation." *See, too*, The Restatement (Third) of the Law Governing Lawyers § 98, cmt. C (2000), and Geoffrey C. Hazard, Jr. & W. William Hodes, The Law of Lawyering § 65.5 (3d ed. 2001).

In April 2006 the ABA Ethics Committee issued its Formal Opinion 06-439, entitled, "Lawyer's Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation." It repeats the obvious that a lawyer may not lie. The opinion does recognize that lawyers may be expected to "puff" as to certain issues. For example, the lawyer for the seller of real estate can probably say that seller expects a number of offers for the property in a certain price range. What the lawyer cannot say is that they have a firm offer from and undisclosed buyer for X dollars, when in fact there have been no offers.

Client Conduct. The situation gets trickier when, during negotiations, it is the client who is lying. Model Rule 1.2(d) provides that a lawyer may not assist the client in committing a crime or fraud. All states have such a rule. Moreover, Model Rule 1.16(a)(1) provides that the lawyer must withdraw from the representation where to continue would cause a violation of a rule.

Suppose a lawyer is aware that her client is lying to the other side in a negotiation. We have just seen that the lawyer cannot continue if the client persists. Under what circumstances may or must the lawyer warn others of the client's intentions? Model Rule 1.6, the confidentiality rule, plays a role. Rule 1.6(b)(2)&(3) now allows a lawyer to "blow the whistle" to prevent the client from committing a fraud on another or to rectify a fraud that has already occurred. Most states have comparable exceptions to their confidentiality rules. A few states provide that a lawyer *must* report client fraud.

Now return to Rule 4.1. Recall that Rule 4.1(a) says that a lawyer may not lie. Rule 4.1(b), however, says a lawyer must disclose a client's lie when it is "necessary to avoid assisting a criminal or fraudulent act by a client." That sentence ends with "unless disclosure is prohibited by Rule 1.6." Recall, though, that most states have provisions in their versions of Rule 1.6 that permit disclosure. Thus, in many states, the lawyer may have the obligation to blow the whistle on a client.

Caution: the interplay of these rules is extraordinarily complex, and the consequences of acting under them can be enormous. The average good lawyer needs to consult with an ethics expert before deciding on a strategy to deal with suspected client fraud.

Conduct within an Organization. Where the client is an organization, Model Rule 1.13 ("Organization as Client") is implicated. Assume that the lawyer and an officer of the client are negotiating a transaction with another party. Assume further that the officer is making claims that the lawyer knows (or strongly suspects) are not true. The lawyer should first attempt to straighten out the officer. Failing that, Rule 1.13(b) provides that the lawyer must go over the officer's head ("climb the ladder") even to the board of directors, if necessary. Prior to 2003 Model Rule 1.13 did not make climbing the ladder mandatory, nor did the rules of most states. Subsequent to the ABA changes in 2003 many states have amended their versions of Rule 1.13 to make climbing the ladder mandatory.

As to public companies, the SEC has adopted 17 C.F.R Part 205, which, among other things, requires, under some circumstances, the lawyer to climb the organizational ladder. To illustrate the complexity of the SEC requirements, many well-run law firms have committees of lawyers devoted to seeing that the regulation is followed and providing training to securities lawyers on the regulation.

A recent Ninth Circuit decision provides a vivid illustration of how negotiation principles apply under federal securities law, *Thompson v. Paul*, 2008 U.S. App. LEXIS 22307 (9th Cir. Oct. 27, 2008). *First, a warning*: the Ninth Circuit's opinion and the district court's decision were in the context of a motion to dismiss a complaint under Rule 12(b)(6) of FRCP. That means both courts took the allegations of the complaint to be true. The "facts" that follow were taken from Ninth Circuit's opinion, which, in turn, came from the complaint. Thus, while the complaint is harsh, plaintiff has, as yet, proven nothing.

Pamela Thompson was CFO of YP.Net until May 2002, when she resigned over the failure of top management to make certain disclosures to the SEC. Upon her resignation she reported her misgivings to the SEC. YP.Net then sued Thompson, and Thompson counterclaimed. That case settled with YP.Net agreeing to give Thompson a considerable amount of YP.Net stock. Three days after the settlement was signed, the CEO of YP.Net was "indicted on 29 counts of fraud, conspiracy, money laundering, and orchestrating a Ponzi scheme." The indictment had a negative effect on the value of the YP.Net stock Thompson received in the settlement.

Because of her loss in the stock's value, Thompson brought this case against the lawyers ("Lawyers") who had negotiated the settlement on behalf of YP.Net. Thompson claimed that Lawyers had represented to her that the CEO of YP.Net was not under criminal investigation when Lawyers knew that the CEO was, in fact, under investigation. Thompson further claimed that she did not know about the investigation. One of the counts in Thompson's complaint was that the lawyers' misrepresentation about the CEO's troubles violated Section 10(b) of the Securities Exchange Act. Lawyers moved to dismiss the complaint. The trial court granted the motion, holding, among other things, that under Arizona law, Thompson had no right to rely on the representations of YP.Net's

lawyers. In this opinion the Ninth Circuit reversed, holding that state law standards do not apply to claims under Section 10(b). The Ninth Circuit acknowledged that at the summary judgment or trial stage it may well develop that Thompson knew much more about the CEO's problems than she claimed in the complaint.

Other Cases. Sheppard v. River Valley Fitness One, L.P., 428 F.3d 1 (1st Cir. 2005) (lawyer sanctioned for making misrepresentations during settlement negotiations.); *Ausherman v. Bank of America Corp.*, 212 F. Supp. 2d 435 (D. Md. 2002) (lawyer referred to court's disciplinary committee for telling lie during settlement negotiations); *Makins v. District of Columbia*, 861 A.2d 590 (D.C. 2004) (settlement not enforceable where plaintiff's lawyer failed to obtain plaintiff's concurrence); *Hansen v. Anderson, Wilmarth & Van Der Maaten*, 630 N.W.2d 818 (Iowa 2001) (lawyer who prepared bogus transaction documents liable to non-client); *Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone*, 131 Cal. Rpter. 2d 777 (Cal. App. 2003) (lawyer who lied about insurance coverage opinion could be liable to non-client for fraud); *Jeska v. Mulhall*, 693 P.2d 1335 (Ore. App. 1985) (buyer of real estate could sue seller's lawyer for fraud during negotiations); *Slotkin v. Citizens Cas. Co. of N.Y.*, 614 F.2d 301 (2d Cir. 1979), *cert denied*, 449 U.S. 981 (1980) (allowed suit for fraud where lawyer misrepresented the amount of available insurance coverage); *Kentucky Bar Ass'n v. Geisler*, 938 S.W.2d 578 (Ky. 1997) (lawyer disciplined for failing to reveal death of client during settlement negotiations); *In re Warner*, 851 So. 2d 1029 (La. 2003) (same); *Toledo Bar Ass'n v. Fell*, 364 N.E.2d 872 (Ohio 1977) (same); *Virzi v. Grand Trunk Warehouse & Cold Storage Co.*, 571 F. Supp. 507 (E.D. Mich. 1983) (failure to reveal death of client grounds for setting aside settlement agreement); *Spaulding v. Zimmerman*, 116 N.W.2d 825 (Minn. 1962) (failure to disclose client's medical condition grounds for setting aside settlement agreement).

Law Reviews. Reed Elizabeth Loder, "Moral Truthseeking and the Virtuous Negotiator," 8 Geo. J. Legal Ethics 45 (1994); Alvin B. Rubin, "A Causerie on Lawyers' Ethics in Negotiation," 35 La. L. Rev. 577 (1975); Michael H. Rubin, "The Ethics of Negotiation: Are There Any?," 56 La. L. Rev. 447 (1995); Barry R. Temkin, "Misrepresentation by Omission in Settlement Negotiations: Should There Be a Silent Safe Harbor?," 18 Geo. J. Legal Ethics 179 (2004); James J. White, "Machiavelli and the Bar: Ethical Limitations on Lying in Negotiation," 1980 Am. B. Found. Res. J. 921 (1980); Charles B. Craver, "Negotiation Ethics: How to Be Deceptive Without Being Dishonest/How to Be Assertive Without Being Offensive," 38 S. Tex. L. Rev. 713 (1997); Van M. Pounds, "Promoting Truthfulness in Negotiation: A Mindful Approach," 40 Willamette L. Rev. 181 (2004); James J. Alfini, "Settlement Ethics and Lawyering in ADR Proceedings: A Proposal to Revise Rule 4.1," 19 N. Ill. U. L. Rev. 255 (1999).
