The Lawyer's Duty to Disclose Material Facts in Contract or Settlement Negotiations

BY NATHAN M. CRYSTAL*

INTRODUCTION

Thomas Mistler, protagonist of Louis Begley's novel *Mistler's Exit*,[1] learns that he has terminal cancer shortly after agreeing to an all-cash sale of his advertising agency to a larger concern known as Omnium. The news of his impending death leads Mistler to focus on a number of problems, one of which is that it would be far better from a tax perspective if the transaction were restructured as a stock exchange rather than a cash purchase.[2] Mistler tells his lawyer, Mike Voorhis, that he wants to renegotiate the deal into a stock exchange. At first, he does not inform Voorhis why he wants to make this change.[3] Mistler privately reasons that he has not lied to Omnium about his health either personally or in the contract. Additionally, key man insurance on his life protects Omnium against loss. Voorhis becomes suspicious, however, and asks Mistler if anything is wrong with the company.[4] Mistler tells him that the company is fine but then reveals his illness. Voorhis is shocked, but Mistler dismisses his concerns and demands that they concentrate on business. Mistler asks about the legal risk he runs if he does not reveal his condition to Omnium. Voorhis advises Mistler that the legal risk is probably minimal so long as Omnium does not learn about Mistler's disease before the deal

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* Roy Webster Professor of Law, University of South Carolina. J.D. 1971, Emory University; LL.M. 1976, Harvard University. My wife, Nancy McCormick, provided invaluable assistance in the research, writing, and revision of this Article. My thanks also to Jim White for reading the manuscript and offering valuable comments.

[1] LOUIS BEGLEY, MISTLER'S EXIT (1998).

[2] *See id.* at 29.

[3] *See id.* at 36.

[4] *See id.* at 39-40.

closes. Before completion of the sale, Omnium could simply call off the transaction. After the sale, Voorhis believes, Omnium would not want to take the position that Mistler was crucial to the success of the acquisition yet the company had failed to ask any questions about his health. Voorhis also concludes that Omnium would face great difficulty in proving damages. Voorhis does not stop, however, with an explanation of the legal ramifications of nondisclosure. He points out that Mistler's demise so soon after restructuring the transaction would not go unnoticed. He would be viewed as "sharp and selfish," and his reputation would be tarnished.[5] Voorhis admits that they have not refused to answer any of Omnium's questions but says, "I think it would be right to disclose even if they weren't smart enough to ask."[6] Mistler disagrees, however, and proceeds to renegotiate the sale.

Did Voorhis act ethically? In particular, did he have a duty to disclose the state of Mistler's health to Omnium or to withdraw from the transaction?

Spaulding v. Zimmerman[7] is one of the best known cases in professional responsibility.[8] David Spaulding suffered severe head and chest injuries in an automobile accident. Three doctors who treated Spaulding failed to discover that he also suffered from a life-threatening aneurysm of the aorta that may have been caused by the accident.[9] The physician retained by the lawyers for the defense, however, discovered the aneurysm and reported it to defense counsel about a week before the case was scheduled to go to trial.[10] Neither Spaulding nor his father, who was the plaintiff in the case since Spaulding was a minor, knew about the aneurysm. On the day after the case was called for trial, the parties reached a settlement calling for a payment to Spaulding of $6500.[11] Counsel for Spaulding then filed a petition with the court seeking approval of the

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[5] *Id.* at 40.

[6] *Id.*

[7] Spaulding v. Zimmerman, 116 N.W.2d 704 (Minn. 1962).

[8] A recent and extensive critical examination of the case can be found in Roger C. Cramton & Lori P. Knowles, *Professional Secrecy and Its Exceptions:* Spaulding v. Zimmerman *Revisited*, 83 MINN. L. REV. 63 (1998). Cramton and Knowles engaged in extensive research into the case to provide a wealth of information not found in the reported opinion.

[9] *See Spaulding*, 116 N.W.2d at 707. Spaulding was examined by his family physician, Dr. James Cain, and by two other specialists (an orthopedist and a neurologist), who examined him at Dr. Cain's request. *See id.*

[10] *See id.*

[11] *See id.* at 708.

settlement. The petition described Spaulding's injuries but made no reference to the aneurysm since plaintiff and his counsel were unaware of its existence.[12] The court approved the settlement.

Early in 1959, about eighteen months after the settlement was approved, Spaulding was required to take a physical examination by the Army Reserve. He went to Dr. Cain, his family physician, who had originally treated him after the accident. In the course of this examination, Dr. Cain discovered the aneurysm. Dr. Cain recommended surgery, which was performed, to remove the aneurysm.[13] Spaulding then filed a petition to have the settlement vacated and the judgment reopened.[14] The trial court granted the motion, and the Minnesota Supreme Court affirmed. The court found that the trial court did not abuse its discretion in reopening the settlement, but this decision was based on principles applicable to settlements involving minors rather than on any impropriety by defense counsel:

> The court may vacate such a settlement for mistake even though the mistake was not mutual in the sense that both parties were similarly mistaken as to the nature and extent of the minor's injuries, but where it is shown that one of the parties had additional knowledge with respect thereto and was aware that neither the court nor the adversary party possessed such knowledge when the settlement was approved.[15]

As to the conduct of defense counsel, the court had this to say:

> *While no canon of ethics or legal obligation may have required them to inform plaintiff or his counsel with respect thereto, or to advise the court therein*, it did become obvious to them at the time, that the settlement then made did not contemplate or take into consideration the disability described. This fact opened the way for the court to later exercise its discretion in vacating the settlement and under the circumstances described we cannot say that there was any abuse of discretion on the part of the court in so doing . . . .[16]

Was the Minnesota Supreme Court correct in its dictum that defense counsel had not violated any rule of ethics or legal obligation in failing to disclose information regarding Spaulding's aneurysm?

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[12] *See id.*

[13] *See id.*

[14] *See id.*

[15] *Id.* at 710.

[16] *Id.* (emphasis added). The trial court had also noted that there was "no doubt of the good faith of both defendants' counsel." *Id.* at 709.

This Article addresses the question of when lawyers have an obligation to disclose information to the opposing side in contract or settlement negotiations.[17] *Mistler's Exit* and *Spaulding v. Zimmerman* are two examples of such situations. Part I of the Article reviews the major court decisions dealing with a lawyer's obligation to disclose information in contract or settlement negotiations.[18] As will be shown, lawyers have been subject to disciplinary action and legal liability, and contracts that they have negotiated have been rescinded, because of their failure to disclose information in certain circumstances.

The existence of the authorities discussed in Part I raises a significant question: can this case law be reconciled with the attorney's ethical duties of loyalty and confidentiality? I address this question in Part II of the Article.[19] I argue that the case law is consistent with the duty of loyalty because the cases impose a limited rather than a general duty of disclosure. The duty to disclose applies either when the lawyer's nondisclosure is the equivalent of a misrepresentation by the lawyer or when disclosure is required by law. Loyalty does not require or allow lawyers to engage in misrepresentation or to violate the law on behalf of their clients.[20] Similarly, the case law is consistent with the duty of confidentiality because the duty of confidentiality is subordinate to the principle that a lawyer cannot engage in misrepresentation or violate the law.[21]

The Article goes on to identify courses of action available to lawyers confronted with contract or settlement negotiations in which their continued participation without disclosure would be the equivalent of misrepresentation or would violate the law. I argue that lawyers can

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[17] On the scope of this disclosure obligation, see *infra* Part II. Disclosure obligations in connection with contract or settlement negotiations constitute only one form of disclosure obligation that lawyers may face. Both ethics rules and legal requirements may impose disclosure obligations in other contexts. For example, lawyers who learn that a client has committed perjury have a duty to take "reasonable remedial measures," including disclosure of the client's perjury to the court. MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3(a)(4) (1998); *see also id.*, Rule 3.3 cmt. Lawyers have an obligation to disclose adverse legal authority in the controlling jurisdiction that is not disclosed by opposing counsel. *See id.* Rule 3.3(a)(3). In ex parte proceedings, lawyers have an obligation to disclose all material evidence. *See id.* Rule 3.3(d). Prosecutors have an obligation to disclose mitigating information to the defense. *See id.* Rule 3.8(d).

[18] *See infra* notes 23-108 and accompanying text.

[19] *See infra* notes 109-225 and accompanying text.

[20] *See infra* Part II.A.

[21] *See infra* Part II.B.

ethically choose in most cases among three courses of action: disclose without client consultation or consent, disclose after consultation with their clients, or withdraw after consultation with their clients but without disclosure. A number of factors bear on the choice among these courses of action: the seriousness of the harm to the other party that will result from nondisclosure, the extent to which court approval of the agreement will be required, the client's interest in nondisclosure (particularly whether the information that the lawyer would be disclosing is sensitive), the feasibility and consequences of withdrawal given the status of the case, and the lawyer's philosophy of lawyering and tolerance for personal risk.[22]

I. CASE LAW IMPOSING DISCLOSURE OBLIGATIONS ON LAWYERS

Any analysis of lawyers' disclosure obligations must begin with the fact that many court decisions have held that under some circumstances lawyers have an ethical duty to disclose information in connection with contract or settlement negotiations. This Part reviews important decisions imposing disclosure obligations on lawyers. These cases are based on a general principle: lawyers have a duty to disclose material information if the failure to disclose would be the equivalent of misrepresentation by the lawyer or when the law requires disclosure. Contract and tort law provide useful standards for determining when the failure to disclose amounts to misrepresentation. Discovery rules are also an important source of standards defining when the law requires disclosure.

The cases imposing disclosure obligations have arisen in a variety of ways. In some cases, lawyers have been subject to professional discipline or to civil liability. In other cases, agreements negotiated by lawyers without disclosure have been subject to rescission. While cases in which courts have invalidated agreements have been decided on substantive grounds, the courts in these cases have typically relied on or discussed ethical principles as a basis for their decisions.

A. Cases in Which Lawyers Have Been Subject to Discipline or Civil Liability for Nondisclosure of Material Information

Perhaps the most extreme example of nondisclosure occurs when a lawyer fails to reveal the death of a client. *Kentucky Bar Ass'n v. Geisler*[23]

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[22] For a discussion of these factors, see *infra* notes 193-95 and accompanying text.

[23] Kentucky Bar Ass'n v. Geisler, 938 S.W.2d 578 (Ky. 1997).

was a disciplinary action resulting from litigation arising out of an accident in which the plaintiff was struck by an automobile while he was walking on the street. The plaintiff died as a result of these injuries. Shortly after the plaintiff's death, his attorney contacted opposing counsel and negotiated a settlement. Defense counsel learned of the plaintiff's death when respondent returned the settlement documents signed by the plaintiff's son, who had been appointed as the administrator of his estate.[24] Defense counsel did not attempt to rescind the settlement but instead sent the agreed order of dismissal to the court.[25] However, defense counsel then filed a bar complaint against respondent.[26] The Kentucky Supreme Court found respondent guilty of misconduct. The court reasoned that when the plaintiff died, any further communications by the lawyer without disclosure of the plaintiff's death were the equivalent of a misrepresentation of material fact in violation of Model Rule 4.1(a).[27] Although the court recognized the principle that a lawyer is generally not required to disclose adverse facts or evidence,[28] it noted that under some circumstances the failure to disclose can amount to misrepresentation. The court referred to the comment to Rule 4.1, which states: "A misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentations can also occur by failure to act."[29] The court administered a public reprimand.[30]

Mississippi Bar v. Mathis[31] illustrates when a lawyer's nondisclosure is both the equivalent of a misrepresentation and a violation of disclosure obligations under discovery rules. *Mathis* involved a claim by a beneficiary under accidental death insurance policies. The defendant insurance companies moved to have an autopsy performed to determine whether the insured's death was accidental.[32] The attorney resisted the motion on various grounds. In connection with the motion by the insurance compa-

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[24] *See id.* at 578-79.

[25] *See id.*

[26] *See id.*

[27] "In the course of representing a client a lawyer shall not knowingly: a. make a false statement of material fact or law to a third person . . . ." MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1(a) (1998).

[28] *See Geisler*, 938 S.W.2d at 580.

[29] MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1(a) cmt. (1998).

[30] *See Geisler*, 938 S.W.2d at 581; *see also* Toledo Bar Ass'n v. Fell, 364 N.E.2d 872 (Ohio 1977); ABA Comm. on Ethics and Professional Responsibility, Formal Op. 95-397 (1995).

[31] Mississippi Bar v. Mathis, 620 So. 2d 1213 (Miss. 1993).

[32] *See id.* at 1216.

nies, the attorney never revealed that he and his client's son had secretly had an autopsy performed.[33] In finding the attorney guilty of misconduct, the court stated:

> The conduct of Mathis which is at issue can be summed up simply: he failed to disclose the autopsy of June 1986, which was performed on the body of J.R. Laughlin by Dr. Jerry Francisco, to the court and opposing counsel in the civil action for bad faith denial of insurance coverage pending in the U.S. District Court for the Northern District of Mississippi and created, in pleadings and discovery responses, the impression that no autopsy had been performed.[34]

By failing to comply with discovery rules, Mathis violated DR 7-102(A)(3),[35] which prohibits a lawyer, in his representation of a client, from concealing or knowingly failing to disclose that which he is required by law to reveal.[36] The court also emphasized that Mathis's "failure to disclose is the equivalent of an affirmative misrepresentation."[37] Mathis attempted to justify his conduct by claiming that the attorney-client privilege and the work product doctrine prevented him from disclosing the existence of the autopsy. The court rejected this argument, stating that matters of privilege were not for the attorney to determine on his own.

> Even if such privileges were believed applicable by Mathis, it was not for him to determine that the privilege applied. The proper procedure would have been for him to object to the interrogatories and deposition questions and affirmatively assert the privilege, leaving the matter to be decided by the court.[38]

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[33] *See id.* at 1217.

[34] *Id.* at 1219.

[35] MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(3) (1983). The *Mathis* court gives no indication that Mississippi's DR 7-102(A)(3) differed from that given in the Model Code.

[36] *See Mathis*, 620 So. 2d at 1220. The court found that Mathis also made misrepresentations to the court and to opposing counsel that no autopsy had been performed. *See id.*

[37] *Id.* at 1221.

[38] *Id.* The Mississippi Supreme Court reaffirmed the principles established in *Mathis* in *Mississippi Bar v. Land*, 653 So. 2d 899, 909 (Miss. 1994), which held that a lawyer violated discovery rules and ethical standards by failing to disclose and concealing that the cause of the plaintiff's injury was not a rock thrown by a lawn mower, as alleged in the complaint, but a shot from a BB gun. *See also* Crowe v. Smith, 151 F.3d 217, 239 (5th Cir. 1998) (affirming decision that a lawyer who answered "none"

Lawyers have been subject to civil liability as well as professional discipline for failing to disclose information required by discovery rules.[39] *Cresswell v. Sullivan & Cromwell*[40] was an action for fraud and negligent misrepresentation. Plaintiffs claimed that defendants failed to disclose certain crucial documents that were covered by a request for production of documents in a securities fraud action that had been settled and dismissed with prejudice. Plaintiffs sought to recover the difference between the amount of the settlement and the amount for which they would have settled had defendants complied with their duty to disclose.[41] In holding that plaintiffs' complaint stated a claim for relief, the court rejected defendants' argument that the sole remedy available to the plaintiffs was to seek relief from the judgment by way of rescission under Federal Rule of Civil Procedure 60(b).[42] The court ruled that under New York law a party could either seek to rescind a settlement because of fraud or affirm the settlement and sue for damages.[43]

When a lawyer changes the terms of a settlement agreement or contract, the lawyer has an ethical obligation to disclose the changes to opposing counsel. In *In re Rothwell*,[44] attorney Rothwell represented a client in negotiations with his former employer. The employer had discharged Rothwell's client after he had moved from Ohio to South Carolina. To facilitate the move, the employer had loaned the employee funds to purchase a house. The company offered to buy back the house and to apply the proceeds to the employee's debt to the company.[45] The company sent Rothwell a deed along with a letter asking Rothwell to have his client sign the deed. The letter stated, "We will expect your call if there are any questions."[46] Rothwell modified the deed by inserting a paragraph

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in response to interrogatory request for insurance coverage should be suspended for one year when lawyer knew of potential coverage under D&O policy).

[39] For a discussion of lawyers' obligations under discovery rules, see WILLIAM H. FORTUNE ET AL., MODERN LITIGATION AND PROFESSIONAL RESPONSIBILITY HANDBOOK ch. 6 (1996).

[40] Cresswell v. Sullivan & Cromwell, 668 F. Supp. 166 (S.D.N.Y. 1987).

[41] *See id.* at 168.

[42] *See id.* at 170. Federal Rule of Civil Procedure 60(b)(3) provides for relief from an order or judgment because of "fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party." FED. R. CIV. P. 60(b)(3).

[43] *See Cresswell*, 668 F. Supp. at 170.

[44] *In re* Rothwell, 296 S.E.2d 870 (S.C. 1982).

[45] *See id.* at 870.

[46] *Id.*

discharging his client from all liability to the company. After his client signed the modified deed, Rothwell returned it with a letter to the company stating, "We are returning herewith your package to you duly executed. Once you have filed the deed of record, please forward on a clocked copy of same for our files. Thank you."[47] Rothwell did not inform the company that the deed had been changed. In the disciplinary proceeding, Rothwell argued that he did not have a duty to disclose the change in the deed to the company and that his change was merely a counteroffer. The South Carolina Supreme Court rejected this argument, finding Rothwell in violation of several disciplinary rules including DR 7-102(A)(3), which prohibits a lawyer from concealing or knowingly failing to disclose that information which the lawyer is required by law to reveal.[48] Rothwell received a public reprimand.[49]

Rothwell was a disciplinary action, but lawyers have also been held subject to civil liability for failing to disclose changes in contract documents. *Wright v. Pennamped*[50] was a civil action brought by a borrower in a loan transaction against the lender's attorney. The borrower alleged that the attorney had changed the prepayment provisions of the note and mortgage from the provisions in an earlier draft without disclosing the change to the borrower or his counsel.[51] The Indiana Court of Appeals held that these allegations stated a claim against the attorney for both actual and constructive fraud through nondisclosure. "By undertaking the tasks of a drafting attorney, including the distribution of draft loan documents and the solicitation of review and approval of the documents, Pennamped assumed a duty to disclose any changes in the documents prior to execution to the other parties or their respective counsel."[52] The court went on to hold that the attorney's conduct also violated the Indiana Rules of Professional Conduct:

> Furthermore, Appellees' argument is in contradiction with Rule 4.1(b) of the Rules of Professional Conduct which states, "[i]n the course of representing a client a lawyer shall not knowingly . . . (b) fail to disclose that which is required by law to be revealed." Ind. Professional

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[47] *Id.*

[48] *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(3) (1983).

[49] *See Rothwell*, 296 S.E.2d at 871; *see also* Illinois State Bar Op. 95-10, [12 Current Reports] Laws. Man. on Prof. Conduct (ABA/BNA) 56 (1996).

[50] Wright v. Pennamped, 657 N.E.2d 1223, *as modified on reh'g*, 664 N.E.2d 394 (Ind. Ct. App. 1996).

[51] *See id.* at 1228.

[52] *Id.* at 1231.

> Conduct Rule 4.1(b). As previously stated, the drafting attorney assumes a duty to disclose any changes in the documents prior to execution to the other parties.[53]

If a lawyer makes a representation that is true when made but later learns that the representation is now false, the lawyer has an ethical duty to inform the opposing party of this change. In *In re Williams*,[54] respondent represented a tenant in connection with a dispute with a landlord regarding the maintenance of his house. Williams wrote to the landlord to demand repairs and to inform the landlord that he would hold the rent in escrow until the repairs were made.[55] In a subsequent letter, Williams informed the landlord that the tenant would contract for the repairs and would pay the cost from the rent held in escrow. A few days later, however, the tenant moved out of the house. The lawyer returned a rent check to the tenant, but he did not inform the landlord that he had returned the check. The bar conceded that Williams had not engaged in misrepresentation because at the time he wrote to the landlord he intended to hold the rent in escrow.[56] The court accepted this concession and treated the case as one involving nondisclosure rather than affirmative misrepresentation.[57] Nonetheless, the court found Williams guilty of misrepresentation by failing to disclose that he was returning the rent check to the tenant.

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[53] *Id.* at 1235. Indiana's version of Rule 4.1(b) differs from the Model Rules promulgated by the American Bar Association. ABA Model Rule 4.1(b) provides as follows:

> In the course of representing a client a lawyer shall not knowingly . . .
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> (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1(b) (1998). As developed more fully in this Article, the basis of a lawyer's duty to disclose material information in contract negotiations is not Model Rule 4.1(b) but rather Model Rules 4.1(a) and Rule 8.4(c). Rule 4.1(a) states: "In the course of representing a client a lawyer shall not knowingly . . . (a) make a false statement of material fact or law to a third person." *Id.* Rule 4.1(a). Rule 8.4(c) states that it is professional misconduct for a lawyer to "engage in conduct involving dishonesty, fraud, deceit or misrepresentation." *Id.* Rule 8.4(c). The duties set forth in Rules 4.1(a) and 8.4(c) are not qualified by the duty of confidentiality. *See infra* Part II.B.

[54] *In re* Williams, 840 P.2d 1280 (Or. 1992).

[55] *See id.* at 1282.

[56] *See id.* at 1283.

[57] *See id.* at 1283-85.

> A misrepresentation can be made by making an assertion that is not in accordance with the truth when made . . . *or by failing to correct a representation that, although true when made, is no longer true in the light of information later acquired.*
>
> We find that the accused made a material misrepresentation in failing to correct the representations contained in his letter of December 10, when he knew that others believed that he held the rent in his trust account. Thus, the accused violated DR 1-102(A)(3).[58]

Discovery rules also require corrective disclosure. Federal Rule of Civil Procedure 26 provides that a "party who has made a disclosure . . . is under a duty to supplement or correct the disclosure or response to include information thereafter acquired . . . if the party learns that in some material respect the information disclosed is incomplete or incorrect."[59]

Cases involving the death of a client, surreptitious changes in contracts, or failure to correct representations that are now known to be false are rather extreme situations. Courts, however, have disciplined lawyers for nondisclosure in much less egregious situations. *State ex rel. Nebraska State Bar Ass'n v. Addison*[60] dealt with nondisclosure of insurance coverage. The defendant attorney represented a pedestrian injured in a collision between two automobiles. As a result of his injuries, the client incurred hospital expenses of more than $100,000.[61] The attorney engaged in negotiations with the business manager of the hospital, seeking a release of the hospital's lien in exchange for reduced payment of the client's bills. One driver had a liability policy with $100,000 coverage and a separate umbrella policy of $1 million; the other driver's coverage was limited to $50,000. During these negotiations, the attorney learned that the hospital's

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[58] *Id.* at 1284 (emphasis added).

[59] FED. R. CIV. P. 26(e)(1). From the text of Rule 26(e), it is unclear whether the Rule requires supplementation of deposition testimony. Rule 26(e)(1) refers to supplementation of depositions of experts, but it does not mention other depositions. Rule 26(e)(2) requires supplementation of interrogatories, requests for production, and requests to admit, without mentioning depositions. *See id.* 26(e)(2). Despite this language, however, it appears that the duty to supplement applies to depositions as well as to the other forms of discovery. *See, e.g.*, Bunch v. United States, 680 F.2d 1271, 1280 (9th Cir. 1982); Gaytan v. Kapus, 181 F.R.D. 573, 580 (N.D. Ill. 1998). *But see* 6 Moore's Federal Practice (MB) § 26.131[1], at 26-299 n.7 (3d ed. 1997).

[60] State *ex rel.* Nebraska State Bar Ass'n v. Addison, 412 N.W.2d 855 (Neb. 1987).

[61] *See id.* at 856.

business manager was under the mistaken impression that there were only two insurance policies available to pay claims; the manager was unaware of the $1 million umbrella policy. Nonetheless, the attorney negotiated a release of the lien without disclosing the third policy.[62] The Nebraska Supreme Court found that the attorney had violated DR 1-102(A)(4),[63] which prohibits a lawyer from engaging "'in conduct involving dishonesty, fraud, deceit, or misrepresentation.'"[64]

Lawyers have also been disciplined for failure to disclose secret settlement agreements. In *In re Fee*,[65] respondents represented the plaintiffs in a medical malpractice action pursuant to a forty percent contingency fee agreement. The parties engaged in contentious negotiations before a settlement judge, who functioned as a mediator. Defendants made an offer of a structured settlement coupled with a separate offer of attorneys' fees, which was less than the amount under the contingency fee agreement. In order to keep the substance of the settlement available, plaintiff and her attorneys made a side agreement in which she agreed to pay an amount out of her cash settlement for attorneys' fees in addition to the amount offered by the defendant.[66]

Respondents did not reveal this agreement to the settlement judge because, they later argued, the settlement judge had no authority over fees.[67] They testified at their disciplinary hearing that they had planned to reveal the fee agreement to the trial judge in connection with the approval of fees in medical malpractice actions as required by Arizona rules.[68] Respondents never got that opportunity, however, because the plaintiff called the settlement judge and asked if she was required to pay the fees

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[62] *See id.*

[63] MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102(A)(4) (1983).

[64] *Addison*, 412 N.W.2d at 856 (quoting MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102(A)(4)). The referee also found the defendant guilty of violating DR 7-102(A)(5), which provides that a lawyer shall not "[k]nowingly make a false statement of law or fact." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(5). On the general civil liability of attorneys for nondisclosure, see *Midwest Commerce Banking Co. v. Elkhart City Centre*, 4 F.3d 521, 524 (7th Cir.1993) ("Omissions are actionable as implied representations when the circumstances are such that a failure to communicate a fact induces a belief in its opposite.").

[65] *In re* Fee, 898 P.2d 975 (Ariz. 1995).

[66] *See id.* at 977.

[67] *See id.*

[68] *See id.*

under the side agreement. The settlement judge then filed a complaint with the disciplinary authorities.[69]

The Arizona Supreme Court held that the attorneys violated Rule 3.3(a)(1), which provides that: "A lawyer shall not knowingly . . . make a false statement of material fact or law to a tribunal."[70] The court went on to point out that the comments to Rule 3.3 state that "[t]here are circumstances where failure to make a disclosure is the equivalent of an affirmative misrepresentation."[71] The court expressly rejected the views of some commentators that the nature of negotiations required only a minimal level of truthfulness. "Although this court is by no means naive to the realities of the marketplace, we are unwilling to accept or endorse such a flimsy ethical standard. It is not unreasonable to expect more from members of the bar, and we do."[72] The court ordered a public censure.[73] While *Fee* involved nondisclosure to the tribunal under Rule 3.3(a)(1), the duty would appear to be equally applicable to disclosure to opposing counsel because the language of Rule 4.1(a), which applies to third persons rather than to courts, is identical in its effect to Rule 3.3(a)(1).[74]

B. Cases in Which Agreements Have Been Held Invalid Because of the Lawyer's Nondisclosure of Material Information

Not only have lawyers been subject to disciplinary action or civil liability for nondisclosure or for violation of discovery rules, courts have also rescinded contracts on the ground of nondisclosure by lawyers. As an initial point, it could be argued that cases in which courts have rescinded contracts because of nondisclosure do not support the proposition that lawyers have an obligation to disclose information. Such cases could instead stand for the proposition that a contract entered into without appropriate disclosure exposes the client to the risk of rescission or civil liability but that the lawyer has done nothing unethical or illegal by failing

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[69] *See id.*

[70] *Id.* at 978 (quoting ARIZ. R. SUP. CT. Rule 42, ER 3.3(a)(1)). Arizona's rule mirrors Model Rule 3.3(a)(1).

[71] *Id.*

[72] *Id.*

[73] *See id.* at 980. A dissenting judge saw the respondents' conduct as more serious and would have ordered suspension. *See id.* at 980-81 (Corocoran, J., dissenting).

[74] *Compare* MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1(a) (1998), *with id.* Rule 3.3(a)(1).

to disclose information to the opposing party. Lawyers would have an obligation to counsel their clients about all aspects of nondisclosure, including the risk of rescission or civil liability for nondisclosure.[75] If the client decided to accept this risk, however, the lawyer could ethically and legally proceed to participate in the contract or settlement without disclosure. Indeed, this appears to be the holding of *Spaulding v. Zimmerman*, where the Minnesota Supreme Court decided that the settlement agreement was subject to rescission but also indicated that the defense lawyers had not violated any rule of ethics or law by failing to disclose their knowledge of Spaulding's aneurysm.[76]

This analysis should be rejected. First, in contract rescission cases, courts have not simply rescinded the contract but have instead often stated or indicated that the lawyers acted unethically by failing to disclose information under the facts of the particular case. Second, under this analysis, lawyers would be allowed to conclude a contract or settlement agreement even though they knew the agreement would be subject to rescission for nondisclosure. This analysis seems inconsistent with the lawyer's obligation not to counsel or assist a client in fraud.[77] As Judge Alvin Rubin stated in his seminal article on the ethics of negotiation, lawyers' obligations in negotiation should be at least as great as their clients'. Under Rubin's analysis, if the client has an obligation to disclose information in connection with contract or settlement negotiations, lawyers have a parallel duty.

> If he is a professional and not merely a hired . . . hand, the lawyer is not free to do anything his client might do in the same circumstances. The corollary of that proposition does set a minimum standard: the lawyer must be at least as candid and honest as his client would be required to be.

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[75] *See id.* Rule 2.1.

[76] *See supra* notes 15-16 and accompanying text. Later decisions have indicated that *Spaulding* could be read somewhat more broadly. *See* Virzi v. Grand Trunk Warehouse & Cold Storage Co., 571 F. Supp. 507, 510 (E.D. Mich. 1983) (finding a duty to disclose to the court in connection with approval of settlement); Kernan v. One Washington Park Urban Renewal Assocs., 713 A.2d 411, 465 (N.J. 1998) (Pollack, J., concurring) (finding a duty to disclose defendant's bankruptcy to opposing party). *But see* Crowe v. Smith, 151 F.3d 217, 237 n.30 (5th Cir. 1998) (finding it difficult to accept nondiscovery-related duty to reveal insurance coverage based on *Spaulding*). On the counseling obligations of defense attorneys in *Spaulding v. Zimmerman,* see Cramton & Knowles, *supra* note 8, at 84-96.

[77] *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(d).

> The agent of the client, that is, his attorney-at-law, must not perpetrate the kind of fraud or deception that would vitiate a bargain if practiced by his principal.[78]

Thus, the rescission cases should be seen as supporting and extending the principle that in some situations lawyers have a duty to disclose information to the opposing side.

Some of the rescission cases involve fact patterns similar to the disciplinary cases discussed above. For example, *Virzi v. Grand Trunk Warehouse & Cold Storage Co.*[79] involved rescission because plaintiff's counsel failed to reveal the death of his client. *Virzi* was a personal injury action that was subject to mediation under local district court rules. At the time of the mediation, plaintiff's counsel was unaware that his client had died a few days earlier. After the mediation, counsel learned of his client's death but nonetheless proceeded to conclude a settlement based on the mediation panel's evaluation without informing opposing counsel or the court. Counsel for plaintiff informed the attorney for the defendant of his client's death as they were leaving the court after the settlement had been placed on the record.[80] The court cited DR 7-102(A)(3) and (5) of the Model Code and Model Rules 3.3 and 4.1.[81] The court also referred with approval to several decisions that indicated that disclosure was required, including *Spaulding v. Zimmerman* and *Toledo Bar Ass'n v. Fell.*[82] Based on these authorities the court concluded that plaintiff's counsel had an ethical duty to both the court and to opposing counsel to reveal his client's death.

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[78] Alvin B. Rubin, *A Causerie on Lawyer's Ethics in Negotiations*, 35 LA. L. REV. 577, 589 (1975). Similarly, Professor James White in his influential article on negotiations expressed his support (with some cautionary statements) for a proposed model rule of professional conduct that would have required lawyers to disclose information necessary to correct a manifest misapprehension of fact or law resulting from a previous representation made by the lawyer or known by the lawyer to have been made by the client. *See* James J. White, *Machiavelli and the Bar: Ethical Limitations on Lying in Negotiation*, 1980 AM. BAR. FOUND. RES. J. 926, 935.

[79] Virzi v. Grand Trunk Warehouse & Cold Storage Co., 571 F. Supp. 507 (E.D. Mich. 1983).

[80] *See id.* at 508.

[81] *See id.* at 509.

[82] *See id.* at 510-11; *see also supra* notes 7-16, 30 and accompanying text.

> There is no question that plaintiff's attorney owed a duty of candor to this Court, and such duty required a disclosure of the fact of the death of a client. Although it presents a more difficult judgment call, this Court is of the opinion that the same duty of candor and fairness required a disclosure to opposing counsel, even though counsel did not ask whether the client was still alive. Although each lawyer has a duty to contend, with zeal, for the rights of his client, he also owes an affirmative duty of candor and frankness to the Court and to opposing counsel when such a major event as the death of the plaintiff has taken place.
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> . . . .
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> This Court feels that candor and honesty necessarily require disclosure of such a significant fact as the death of one's client. Opposing counsel does not have to deal with his adversary as he would deal in the marketplace. Standards of ethics require greater honesty, greater candor, and greater disclosure, even though it might not be in the interest of the client or his estate.[83]

In other rescission cases, the courts have also emphasized the lawyer's ethical obligation to disclose basic facts when the lawyer knows that the other side is entering into an agreement based on a mistake about those facts. *Hamilton v. Harper*[84] arose out of an automobile accident in which one plaintiff was killed and the other seriously injured. Nationwide Insurance Company was the insurer for the passenger in the vehicle driven by the defendant.[85] Plaintiffs claimed that the passenger was liable for their injuries because he had substantially encouraged or assisted the defendant driver's alcohol or drug impairment.[86]

Nationwide brought a declaratory judgment action against the passenger in federal court seeking a determination of whether its policy provided coverage for the passenger's conduct. At the same time, Nationwide entered into settlement negotiations with the plaintiffs. Nationwide first made an offer that it would pay the plaintiffs $200,000, the amount of its policy limits, if the declaratory judgment action resulted in a finding of coverage. Plaintiffs rejected this offer.[87] Nationwide then made an offer to pay the plaintiffs $100,000 in exchange for dismissal of

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[83] *Virzi*, 571 F. Supp. at 512.

[84] Hamilton v. Harper, 404 S.E.2d 540 (W. Va. 1991).

[85] *See id.* at 541.

[86] *See id.* at 541 n.1.

[87] *See id.* at 541-42.

plaintiffs' claims against the passenger and dismissal of the declaratory judgment action. On December 22, 1988, counsel for plaintiffs informed Nationwide's counsel that plaintiffs accepted this offer.[88] Plaintiffs' counsel had just learned that the federal court had granted summary judgment for Nationwide in its federal court declaratory judgment action. Plaintiffs' counsel also knew that counsel for Nationwide had not yet learned of the federal court's decision. When Nationwide learned of the federal court's decision, it refused to go forward with the settlement. Counsel for the plaintiffs moved to enforce the settlement. The trial court granted the plaintiffs' motion, but the West Virginia Supreme Court of Appeals reversed. The court found that the settlement agreement was unenforceable due to failure of consideration.[89] The court recognized that the settlement agreement was not technically conditioned on the outcome of the federal action,[90] but it ruled that the plaintiffs' counsel knew that "Nationwide's primary incentive for offering the $100,000 cash settlement was the unknown outcome of the declaratory judgment action."[91] While the court decided the case on contract principles, it chastised plaintiffs' counsel for nondisclosure of the federal court judgment. The attorney argued that he was not required to disclose the federal court judgment because Rule 4.1 of the West Virginia Rules of Professional Conduct[92] did not require disclosure.[93] The court rejected this argument:

> As justification for not informing Nationwide regarding the issuance of the summary judgment ruling in its favor by the district court, the Hamiltons cite the comment to Rule 4.1 of the West Virginia Rules of Professional Conduct. Rule 4.1 is entitled "Truthfulness in Statements to Others" and provides that:
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> > In the course of representing a client a lawyer shall not knowingly:
> > (a) make a false statement of material fact or law to a third person; or
> > (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.
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> While the commentary section to Rule 4.1 does indeed state that "[a] lawyer . . . generally has no affirmative duty to inform an opposing party

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[88] *See id.* at 542.
[89] *See id.* at 544.
[90] *See id.* at 544 n.6.
[91] *Id.* at 544.
[92] WEST VIRGINIA RULES OF PROFESSIONAL CONDUCT Rule 4.1 (1997).
[93] *See Hamilton*, 404 S.E.2d at 542.

> of relevant facts," the same commentary also notes that "[m]isrepresentations can . . . occur by failure to act," and that "[m]aking a false statement includes the failure to make a statement in circumstances in which nondisclosure is equivalent to making such a statement." While we do not dispose of this case on the grounds of misrepresentation or fraud, we take a particularly dim view of the Hamiltons' attorney's failure to disclose his knowledge regarding the action taken by the federal court. The preferred course of action for the Hamiltons' counsel, in our opinion, would have required him to voluntarily disclose that information to Nationwide in the spirit of encouraging truthfulness among counsel and avoiding the consequences of his failure to disclose, e.g. this appeal.[94]

Similarly, *Kath v. Western Media, Inc.*[95] was a suit in Wyoming between former codefendants in business-related litigation in Montana. One lawyer had represented all of the defendants in the Montana litigation. The Montana lawyer's deposition was taken in connection with the Wyoming litigation; he testified that he had represented all the codefendants in Montana equally. Shortly after the Montana attorney's deposition, the lawyer for the Wyoming defendants found a letter from the Montana lawyer to the Wyoming lawyer's clients showing that the Montana lawyer was protecting their interests over the interests of the other defendants in the Montana litigation.[96] When he learned about the letter, the attorney for the Wyoming defendants contacted plaintiffs' counsel to learn whether a prior settlement offer was still open. After several telephone conversations, the parties reached an oral settlement agreement. The attorney for the Wyoming defendants did not disclose the letter from the Montana lawyer in connection with these settlement negotiations. On the same day the settlement was reached, the Montana lawyer sent a copy of his letter to the *Kath* plaintiffs. They immediately sought to revoke the settlement on the ground that they would not have settled if they had known of the conflict of interest of their Montana lawyer.[97]

The trial court confirmed the settlement, but the Wyoming Supreme Court reversed, holding that the lawyer for the Wyoming defendants had an ethical duty to disclose the letter from the Montana lawyer.[98] The court

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[94] *Id.* at 542 n.3.

[95] Kath v. Western Media, Inc., 684 P.2d 98 (Wyo. 1984).

[96] *See id.* at 99.

[97] *See id.* at 100.

[98] *See id.*

relied on DR 7-102(A)(3).[99] The *Kath* court stated that the duty to disclose ran equally to the court and to opposing counsel: "We hold that appellees' counsel owed a duty of candor and fairness to disclose to opposing counsel and the court [the] letter of June 23, 1980."[100]

Virzi, *Hamilton*, and *Kath* all involve nondisclosure of basic facts when the lawyer knows that the other party is entering into a settlement based on a mistake about those facts. Nondisclosure of significant mathematical errors has also been the basis for rescission of settlement agreements. For example, *Stare v. Tate*[101] was an action by an ex-wife to reform a property settlement agreement entered into by parties prior to their divorce and to enforce the agreement as reformed. The agreement was the result of extensive negotiations between parties who were both represented by counsel. The parties agreed that community property would be divided equally, but they disagreed about the value of a piece of real estate referred to as the "Holt property." The wife contended that the Holt property was worth $550,000, while the husband argued that the property had a value of no more than $450,000. The property was subject to a mortgage of approximately $300,000.[102] The wife's attorney submitted a settlement offer based on a $550,000 valuation of the Holt property, but the attorney made a mathematical mistake of $100,000 in computing the equity in the property.[103] The husband's lawyer and his accountant spotted the error but did not reveal the mistake to the wife's attorney. They reasoned that the mistake was the equivalent of acceptance of the husband's valuation of the property.[104] Acting on the husband's behalf, they presented a counteroffer that used the mistake by the wife's attorney. After some further negotiation, the parties reached agreement based largely on the terms of the husband's counteroffer.[105] The mistake would probably never have come to light except that after the settlement agreement was signed, the husband sent a note to his wife gloating over the fact that she and her attorney had made a mistake.[106] The California Court of Appeals held that the agreement should be reformed to reflect the wife's intent. The husband argued that

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[99] *See id.* at 101 (citing MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(3) (1980)).

[100] *Id.* at 102.

[101] Stare v. Tate, 98 Cal. Rptr. 264 (Ct. App. 1971).

[102] *See id.* at 265.

[103] *See id.*

[104] *See id.* at 266.

[105] *See id.*

[106] *See id.*

reformation was inappropriate because this remedy would force the husband to enter into a contract that he did not intend to make. The court rejected this argument, reasoning that the husband was estopped to claim that his intention varied from the wife's.[107] While the court did not specifically address the propriety of the conduct by the husband's lawyer, it did say this:

> The mistake was known to Tim's former attorney who swept it under the rug in the counter-offer by setting forth just the equity, instead of the value minus encumbrances, as he did with respect to other properties. True, he apparently justified this to himself morally by the fact that the value which Tim had been claiming all along resulted in a $70,000 equity, but he never drew the other side's attention to the fact that the counter-offer was based on Tim's previous position on the value of the Holt property.[108]

II. RECONCILING THE CASE LAW WITH THE DUTIES OF LOYALTY AND CONFIDENTIALITY

Many lawyers will resist the idea that they have an obligation to disclose information to the opposing party in contract or settlement negotiations. They will claim that such disclosure violates the lawyer's duty of loyalty, undermines the adversarial system, and infringes on the duty of confidentiality. In this section, I argue that these objections are unsound when the scope of the duty of disclosure is properly defined.

A. The Duty of Loyalty and the Lawyer's Obligation to Disclose

The lawyer's duty of loyalty to the client is not unlimited. It is well established that it is improper for lawyers to engage in illegal or fraudulent conduct in representation of their clients.[109] The duty to disclose material

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[107] *See id.* at 268.

[108] *Id.* at 267; *see also* Building Serv. Employees Pension Trust v. American Bldg. Maint. Co., 828 F.2d 576, 578 (9th Cir. 1987) (determining that questions of fact exist as to whether settlement of dispute about amount of interest payments on delinquent employer contributions to employee pension and health and welfare trusts can be subject to rescission on ground that employer's counsel took advantage of mathematical mistake by attorney for trusts).

[109] *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(d) (1998); *id.* Rule 3.3(a)(1), (2); *id.* Rule 4.1; *id.* Rule 8.4(b), (c). *See generally* NATHAN M.

information is fully consistent with the duty of loyalty when it is recognized that the duty to disclose applies *when the failure to disclose would be the equivalent of misrepresentation or when nondisclosure would violate other law.* In other words, the lawyer's duty of disclosure is not an independent obligation but rather a further application of the basic principle that lawyers cannot engage in fraud or illegality.

In many of the cases discussed in Part I, the courts found that the lawyer's nondisclosure was the equivalent of misrepresentation, a violation of a legal obligation, or both. In *Kentucky Bar Ass'n v. Geisler*,[110] the court stated that Geisler's continued communications and negotiations without disclosure of his client's death amounted to misrepresentation in violation of Model Rule 4.1(a).[111] The court cited with approval the comment to Rule 4.1, which states that "'[m]isrepresentations can also occur by failure to act.'"[112] Similarly, the court in *State ex rel. Nebraska State Bar Ass'n v. Addison*[113] affirmed that the lawyer violated DR 1-102,[114] which prohibits in part "conduct involving dishonesty, fraud, deceit, or misrepresentation"[115] by failing to disclose the existence of additional insurance coverage in negotiations with a hospital for release of its lien. In *Hamilton v. Harper*,[116] the court set aside the settlement because the plaintiff's counsel had failed to reveal that summary judgment had been granted for the insurance company in its federal court declaratory judgment action. As in *Geisler*, the *Hamilton* court cited with approval the comment to Rule 4.1, which provides not only that "[m]isrepresentations can . . . occur by failure to act," but also that "[m]aking a false statement includes the failure to make a statement in circumstances in which nondisclosure is equivalent to

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CRYSTAL, AN INTRODUCTION TO PROFESSIONAL RESPONSIBILITY 66 (1998).

[110] Kentucky Bar Ass'n v. Geisler, 938 S.W.2d 578 (Ky. 1997).

[111] *See id.* at 580.

[112] *Id.* (quoting MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 cmt.).

[113] State *ex rel.* Nebraska State Bar Ass'n v. Addison, 412 N.W.2d 855 (Neb. 1987).

[114] *See id.* at 856.

[115] MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102(A)(4) (1983). The court also affirmed the finding that the defendant was guilty of violating DR 7-102(A)(5), *see Addison*, 412 N.W.2d at 856, which provides that a lawyer shall not "[k]nowingly make a false statement of law or fact." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(5) (1983).

[116] Hamilton v. Harper, 404 S.E.2d 540 (W. Va. 1991).

making such a statement."[117] In *Mississippi Bar v. Mathis*,[118] the lawyer was disciplined for failing to reveal information that he was required to reveal under discovery rules and for nondisclosure when the failure to disclose was the equivalent of misrepresentation.[119]

The case law is also consistent with the ALI's recently adopted *Restatement (Third) of the Law Governing Lawyers*.[120] Section 157 of the *Restatement* provides:

> A lawyer communicating on behalf of a client with a non-client may not:
> (1) knowingly make a false statement of material fact or law to the non-client;
> (2) make other statements prohibited by law; or
> (3) fail to make a disclosure of information required by law.[121]

Comment e recognizes that generally lawyers do not have a duty to make affirmative disclosure, but the comment notes that "[a]pplicable statutes, regulations, or common-law rules may require affirmative disclosure in some circumstances."[122]

The most difficult aspect of the duty to disclose deals with determining when a lawyer's nondisclosure is the equivalent of misrepresentation. While the case law discussed in Part I seems to lack any unifying principles, it is possible to find clarity by comparing this case law with substantive law which defines when nondisclosure is the equivalent of misrepresentation. Section 161 of the *Restatement (Second) of Contracts* provides:

> A person's non-disclosure of a fact known to him is equivalent to an assertion that the fact does not exist in the following cases only:

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[117] *Id.* at 542 n.3 (quoting MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 cmt.).

[118] Mississippi Bar v. Mathis, 620 So. 2d 1213 (Miss. 1993).

[119] *See id.* at 1220-21.

[120] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 157 (Tentative Draft No. 8, 1997).

[121] *Id.*

[122] *Id.* § 157 cmt. e. Similarly, the *Restatement (Second) of Agency* provides that an agent is liable for tortious conduct even when it is committed on behalf of the principal unless the principal would not be subject to liability. *See* RESTATEMENT (SECOND) OF AGENCY § 343 (1958); *see also id.* § 348 (stating that an agent is liable for fraud or duress even though conduct occurs in transaction on behalf of principal).

> (a) where he knows that disclosure of the fact is necessary to prevent some previous assertion from being a misrepresentation or from being fraudulent or material.
>
> (b) where he knows that disclosure of the fact would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing.
>
> (c) where he knows that disclosure of the fact would correct a mistake of the other party as to the contents or effect of a writing, evidencing or embodying an agreement in whole or in part.
>
> (d) where the other person is entitled to know the fact because of a relation of trust and confidence between them.[123]

For convenience, I have given the following labels to these four categories of disclosure:

1. corrective disclosure;
2. disclosure of known mistakes in a writing;
3. fiduciary disclosure; and
4. disclosure of mistakes about basic facts when required by good faith.[124]

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[123] RESTATEMENT (SECOND) OF CONTRACTS § 161 (1981); *see* FORTUNE ET AL., *supra* note 39, § 17.5 (relying on this section as the standard for when non-disclosure is the equivalent of misrepresentation).

[124] Section 551 of the *Restatement (Second) of Torts* provides for civil liability for nondisclosure by a fiduciary as follows:

> (1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.
>
> (2) One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated,
>
> (a) matters known to him that the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them; and
>
> (b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading; and

The cases discussed in Part I and other authorities fit quite well into these four categories.

1. *Corrective Disclosure*

In *In re Williams*,[125] the respondent was disciplined for failing to make a corrective disclosure about his handling of his client's rent payments. Both the *Restatement of the Law Governing Lawyers* and the *Restatement of Agency* recognize a duty of corrective disclosure.[126] Similarly, lawyers have a duty to make corrective disclosure under discovery rules.[127]

2. *Disclosure of Known Mistakes in a Writing*

Application of the obligation to disclose known mistakes in a writing is reasonably straightforward. *In re Rothwell*[128] and *Stare v. Tate*[129] both

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> (c) subsequently acquired information that he knows will make untrue or misleading a previous representation that when made was true or believed to be so; and
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> (d) the falsity of a representation not made with the expectation that it would be acted upon, if he subsequently learns that the other is about to act in reliance upon it in a transaction with him; and
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> (e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.

RESTATEMENT (SECOND) OF TORTS § 551 (1977).

While the text of section 551 of the *Restatement (Second) of Torts* differs from the provisions of section 161 of the *Restatement (Second) of Contracts*, substantively there is little difference. Section 551(2)(a) deals with fiduciary disclosure; subsections (2)(b), (c), and (d) involve corrective disclosure; subsection (2)(e) deals with disclosure of mistakes about basic facts when required by good faith. The *Restatement of Torts* does not have a section which specifically imposes a duty to disclose scrivener's errors, but that duty is probably encompassed by section 551(2)(e), requiring disclosure of basic facts. *See id.*

[125] *In re* Williams, 840 P.2d 1280 (Or. 1992); *see supra* notes 54-58 and accompanying text.

[126] *See* RESTATEMENT (THIRD) THE LAW GOVERNING LAWYERS § 157 cmt. d (Tentative Draft No. 8, 1997); RESTATEMENT (SECOND) OF AGENCY § 348 cmt. c (1958).

[127] *See, e.g.*, FED. R. CIV. P. 26(e).

[128] *In re* Rothwell, 296 S.E.2d 870 (S.C. 1982); *see supra* notes 44-49 and accompanying text.

[129] Stare v. Tate, 98 Cal. Rptr. 264 (Ct. App. 1971); *see supra* notes 101-08 and accompanying text.

dealt with disclosure of known mistakes in a writing. In cases like *Rothwell*, the lawyer causes the mistake by changing the writing,[130] while in *Stare*, the opposing party makes the mistake.[131] In either case, it is improper for the lawyer to take advantage of the mistake, although cases like *Rothwell* may warrant greater sanction.

3. *Fiduciary Disclosure*

Situations in which lawyers will have a fiduciary duty to the opposing party to disclose material information in negotiation will rarely occur. When the opposing party is represented by counsel, a lawyer does not have a fiduciary duty to the opposing party. If the lawyer is dealing with an unrepresented opposing party, the lawyer has an obligation to correct any misunderstanding that the other party may have about the lawyer's role in the negotiations. Under Model Rule 4.3, if the lawyer reasonably believes that the unrepresented party believes that the lawyer is representing her, the lawyer has a duty to correct the unrepresented person's misunderstanding.[132] If the lawyer knows about and yet fails to correct a misunderstanding by the unrepresented party about the lawyer's role, the lawyer may be subject to liability for breach of fiduciary duty.[133] In some limited circumstances, a lawyer may properly act as an intermediary between parties engaged in contract negotiations.[134] Because lawyers who act as intermediaries represent both parties, they have a fiduciary duty to disclose material information to both of them.[135]

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[130] *See Rothwell*, 296 S.E.2d at 870.

[131] *See Stare*, 98 Cal. Rptr. at 266.

[132] Model Rule 4.3 states:

> In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.3 (1998).

[133] *See* Hotz v. Minyard, 403 S.E.2d 634, 637-38 (S.C. 1991) (reversing summary judgment for lawyer because material issues of fact existed as to whether lawyer had fiduciary duty of disclosure to daughter regarding terms of her father's will, which the lawyer had drafted, when the daughter consulted the lawyer about the terms of the will, the lawyer had an on-going professional relationship with the daughter, and the lawyer failed to disclose that he was representing the father and not the daughter with regard to the will).

[134] *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 2.2.

[135] *See id.* Rule 2.2(b), Rule 2.2(b) cmt.

4. *Disclosure of Mistakes About Basic Facts When Required by Good Faith*

Section 161(b) of the *Restatement (Second) of Contracts* states that non-disclosure is the equivalent of misrepresentation:

> (b) where he knows that disclosure of the fact would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing.[136]

Section 551(2)(e) of the *Restatement (Second) of Torts* provides that a party has a duty to exercise reasonable care to disclose:

> (e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.[137]

While the language of these two sections is different, they largely agree on three key elements that trigger a duty of disclosure: (1) knowledge by one party that the other party is about to enter the transaction based on a mistake; (2) the mistake relates to basic facts; and (3) failure to disclose violates a general standard of good faith and fair dealing.

A duty to disclose only exists if the lawyer knows that the other party is about to enter into the transaction based on a mistake. In most nondisclosure cases, the lawyer's knowledge of the other party's mistake is clear. Typically the lawyer receives a communication either from the client, as in *Mistler's Exit*,[138] or from a third person, as in *Spaulding v. Zimmerman*,[139] under circumstances where it is clear that the opposing party does not know of the fact. Indeed, what normally produces litigation in these cases is the lawyer's attempt to take advantage of the other party's ignorance.

The comments to the *Restatement (Second) of Torts* provide guidance on when facts are basic to the transaction:

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[136] RESTATEMENT (SECOND) OF CONTRACTS § 161(b) (1981).

[137] RESTATEMENT (SECOND) OF TORTS § 551(2)(e) (1977).

[138] *See supra* text accompanying notes 1-6.

[139] *See supra* text accompanying notes 7-16.

> A basic fact is a fact that is assumed by the parties as a basis for the transaction itself. It is a fact that goes to the basis, or essence, of the transaction, and is an important part of the substance of what is bargained for or dealt with. Other facts may serve as important and persuasive inducements to enter into the transaction, but not go to its essence. These facts may be material, but they are not basic.[140]

Thus, the concept of a basic fact is one that goes beyond importance or materiality and rises to the essence of the transaction.[141]

Finally, nondisclosure must violate a standard of good faith and fair dealing.[142] Some lawyers will argue that there is no professional agreement or consensus on the meaning of good faith and fair dealing in negotiations, and accordingly, this standard cannot be a basis for imposing disclosure obligations on lawyers. This argument should be rejected for several reasons. First, the fact that lawyers may disagree about the meaning of good faith and fair dealing in negotiations is not an argument against the existence of such an obligation. The law is filled with general legal principles. Controversy often exists about the meaning and application of these principles, but the presence of such controversy is not an argument against having the principle. Just because lawyers and citizens disagree strongly about the meaning and application of concepts like due process or reasonable care is not an argument for discarding these obligations. Second, lawyers are subject to the law, and as discussed previously, general contract and tort law recognize a duty to disclose information when required by good faith and fair dealing. Finally, lawyers should consider the consequences of the absence of a duty of good faith and fair dealing in connection with contract and settlement negotiations. Do lawyers want to have a profession in which they do not have a right to expect good faith and fair dealing from their fellow professionals? Are lawyers willing to state publicly that the profession's values do not include good faith and fair dealing when ordinary business people must live by such an obligation?

Admittedly, giving content to the duty of good faith and fair dealing is difficult, but the *Restatement (Second) of Torts* provides some general

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[140] RESTATEMENT (SECOND) OF TORTS § 551 cmt. j (1977).

[141] Comment d to *Restatement (Second) of Contracts* § 161 provides that disclosure is required as to a "basic assumption" but does not elaborate on the meaning of that term. RESTATEMENT (SECOND) OF CONTRACTS § 161 cmt. d (1981).

[142] The *Restatement (Second) of Torts* does not use the terminology "good faith and fair dealing," but the concepts it uses are very similar.

guidance. The *Restatement* recognizes that the "traditional ethics of bargaining between adversaries" do not normally require disclosure of relevant information,[143] even when one party is taking advantage of the other party's ignorance. Superior information and better business acumen are not the basis of a duty of disclosure.[144] At the other extreme are cases in which a duty of disclosure clearly exists. In such cases, the contract is "so shocking to the ethical sense of the community, and is so extreme and unfair, as to amount to a form of swindling, in which the plaintiff is led by appearances into a bargain that is a trap, of whose essence and substance he is unaware."[145] Between these extremes is where the difficulty of determining good faith and fair dealing lies.

The cases in Part I fall into five broad groups: first, disclosure of mistakes regarding the physical condition of a party, exemplified by *Kentucky Bar Ass'n v. Geisler*,[146] *Mississippi Bar v. Mathis*,[147] and *Virzi v. Grand Trunk Warehouse & Cold Storage Co.*;[148] second, disclosure of significant procedural developments, exemplified by *Hamilton v. Harper*;[149] third, disclosure that witness testimony has been recanted, as in *Kath v. Western Media, Inc.*;[150] fourth, disclosure of mistakes regarding insurance coverage, as in *State ex rel. Nebraska State Bar Ass'n v. Addison*;[151] and finally, disclosure of fee agreements when the fees are part of the negotiation, exemplified by *In re Fee*.[152] These groups should provide some guidance to lawyers as to the types of cases in which courts have held that they have a duty to disclose basic information. These situations involve the duty of good faith. As discussed above, the duty to disclose also applies in cases of corrective disclosure, disclosure of known mistakes about the contents of a writing, and fiduciary disclosure.

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[143] RESTATEMENT (SECOND) OF TORTS § 551 cmt. k (1977).

[144] *See id.*

[145] *Id.* cmt. *l.*

[146] Kentucky Bar Ass'n v. Geisler, 938 S.W.2d 578 (Ky. 1997).

[147] Mississippi Bar v. Mathis, 620 So. 2d 1213 (Miss. 1993).

[148] Virzi v. Grand Trunk Warehouse & Cold Storage Co., 571 F. Supp. 507 (E.D. Mich. 1983).

[149] Hamilton v. Harper, 404 S.E.2d 540 (W. Va. 1991).

[150] Kath v. Western Media, Inc., 684 P.2d 98 (Wyo. 1984).

[151] State *ex rel.* Nebraska State Bar Ass'n v. Addison, 412 N.W.2d 855 (Neb. 1987).

[152] *In re* Fee, 898 P.2d 975 (Ariz. 1995).

B. The Duty of Confidentiality and the Lawyer's Obligation to Disclose

The previous section addressed whether the imposition of a duty to disclose can be reconciled with the lawyer's duty of loyalty to the client. The answer given in that section was that the two obligations are compatible because the duty of loyalty stops at the point where the lawyer engages in misrepresentation or violates the law; this is the point at which the duty to disclose arises.

Can the duty to disclose be reconciled with the lawyer's duty of confidentiality? Central to this question is the application of Model Rule 4.1, which provides as follows:

> **Rule 4.1 Truthfulness in Statements to Others**
> In the course of representing a client a lawyer shall not knowingly:
>
> (a) make a false statement of material fact or law to a third person; or
>
> (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.[153]

On its face the rule appears to impose two obligations on lawyers: a broad, unqualified duty not to knowingly make false statements of material fact or law and a narrow duty to disclose material facts. Under this facial analysis, the duty to disclose is limited in two ways. First, the duty only applies if disclosure is necessary to avoid assisting a criminal or fraudulent act by the client. Second, even if the client is committing a criminal or fraudulent act, the duty to disclose only applies if the information is not protected by the duty of confidentiality set forth in Rule 1.6.[154] Under Rule 1.6 the duty of confidentiality is broad, and the exceptions to the duty are very narrow.[155] As a result, lawyers would rarely be allowed to disclose information under Rule 4.1(b).[156]

The legislative history of the Model Rules provides some support for this narrow view of lawyers' disclosure obligations. The Discussion Draft of the Model Rules, issued by the ABA Commission on Evaluation of Professional Standards on January 30, 1980, included a specific section on

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[153] MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 (1998).

[154] *See id.* Rule 1.6.

[155] *See id.*

[156] *See* CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 13.5.8, at 724 (1986).

the lawyer as a negotiator. This section included three rules: Rule 4.1, "Disclosures to a Client"; Rule 4.2, "Fairness to Other Participants"; and Rule 4.3, "Illegal, Fraudulent, or Unconscionable Transactions."[157] Proposed Rule 4.2(a) stated, "In conducting negotiations a lawyer shall be fair in dealing with other participants."[158] This broad obligation was quickly abandoned because it was unworkable.[159] Instead, the drafters focused on the lawyer's obligation of truthfulness.

The proposed final draft of the Model Rules, issued on May 30, 1981, imposed a fairly broad disclosure obligation on lawyers. Proposed Rule 4.1 stated:

> **Rule 4.1 Truthfulness in Statements to Others**
> In the course of representing a client a lawyer shall not:
> (a) knowingly make a false statement of fact or law to a third person; or
> *(b) knowingly fail to disclose a fact to a third person when:*
> *(1) in the circumstances failure to make the disclosure is equivalent to making a material misrepresentation;*
> *(2) disclosure is necessary to prevent assisting a criminal or fraudulent act, as required by Rule 1.2(d); or*
> *(3) disclosure is necessary to comply with other law.*[160]

Rule 4.1(b) did not discuss the relationship between the duty of confidentiality and the obligation to disclose, but the comment to the proposed rule made it clear that the duty of disclosure was superior to the duty of confidentiality. The comment on disclosure stated, "[a]s noted in the Comment to Rule 1.6, the duty imposed by Rule 4.1 may require a lawyer to disclose information that otherwise is confidential."[161]

Rule 4.1 as adopted by the ABA in 1983, however, substantially narrowed the disclosure obligation from the Commission's original proposal. As finally adopted, Rule 4.1 makes three significant changes

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[157] MODEL RULES OF PROFESSIONAL CONDUCT Rules 4.1, 4.2, 4.3 (Discussion Draft 1980).

[158] *Id.* Rule 4.2(a).

[159] *See* Geoffrey C. Hazard, Jr., *The Lawyer's Obligation to be Trustworthy When Dealing With Opposing Parties*, 33 S.C. L. REV. 181 (1981) (noting that regulation of trustworthiness cannot go further than to proscribe fraud because of substantial differences in technical sophistication among lawyers).

[160] MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 (Proposed Final Draft 1981) (emphasis added).

[161] *Id.* Rule 4.1 cmt.

from the Commission's original proposal. First, it deletes the obligation to disclose when nondisclosure is equivalent to a material misrepresentation. Second, it deletes the duty to disclose when necessary to comply with law. Finally, it makes the duty to disclose, when necessary to avoid assisting a criminal or fraudulent act by the client, subordinate to the duty of confidentiality.[162]

Nonetheless, too much can be read into these changes.[163] First, while the text of Rule 4.1 does not specifically require disclosure when nondisclosure is tantamount to a material misrepresentation, the comments indicate that this obligation remains in effect. A comment to the Rule states that nondisclosure can sometimes be the equivalent of misrepresentation: "Misrepresentation can also occur by failure to act."[164] Similarly, a comment to Rule 3.3 also provides that nondisclosure in some instances is the equivalent of a misrepresentation: "There are circumstances where failure to make a disclosure is the equivalent of an affirmative misrepresentation."[165] Moreover, Model Rule 8.4 broadly prohibits lawyers from engaging in conduct involving "dishonesty, fraud, deceit or misrepresentation."[166] Thus, it is reasonable to conclude that the Model Rules still prohibit nondisclosure when nondisclosure is the equivalent of a misrepresentation.

Second, while the Model Rules do not specifically require lawyers to disclose information when required by law, this exception must be read into the Model Rules.[167] No one, and surely not a lawyer, is above the law. Further, courts do not have the authority to create rules of ethics that would exempt lawyers from statutory or other general principles of law.

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[162] *See* 2 GEOFFREY C. HAZARD, JR. & WILLIAM R. HODES, THE LAW OF LAWYERING § 4.1:102, at 711-12 (2d ed. 1990). *Compare* MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 (1998), *with* MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 (Proposed Final Draft 1981).

[163] *See* 2 HAZARD & HODES, *supra* note 162, § 4.1:102, at 711-12 (arguing that the revisions to Rule 4.1 can have little substantive effect when the rule is considered in relation to other parts of the Model Rules and to case law).

[164] MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 cmt.

[165] *Id.* Rule 3.3 cmt. This comment to Rule 3.3 should also apply to Rule 4.1. The comment explains the meaning of Rule 3.3(a)(1), which prohibits lawyers from making a false statement of material fact or law to a tribunal. Rule 4.1 imposes an identical obligation on lawyers not to make false statements of material fact or law to third parties. *See id.* Rule 4.1.

[166] *Id.* Rule 8.4.

[167] *See* 2 HAZARD & HODES, *supra* note 162, § 4.1:303, at 721-23.

Finally, the legislative history of the Model Rules shows that the confidentiality qualification to Rule 4.1(b) was intended to have limited application. The ABA Commission originally proposed a confidentiality rule that was subject to a number of exceptions.[168] As finally adopted, however, the rule on confidentiality eliminated or restricted a number of these proposed exceptions. When the ABA considered Rule 4.1, the American College of Trial Lawyers proposed an amendment to Rule 4.1(b) to harmonize that rule with changes in the duty of confidentiality. The amendment was only intended to apply to situations in which the client had engaged in wrongful conduct. It was not intended to affect the lawyer's duty not to engage in misrepresentation under Rule 4.1(a).[169]

Based on this analysis, Rule 4.1(a) is properly interpreted to require lawyers to disclose material facts or law when the nondisclosure is the equivalent of a material misrepresentation. By implication, lawyers are also required to disclose information when required by law. Finally, the limitation on disclosure found in 4.1(b) does not apply when the lawyer's failure to disclose would be the equivalent of misrepresentation under 4.1(a).

This interpretation of Rule 4.1 makes the rule consistent with the case law. As shown in Part I, numerous cases have disciplined lawyers because of nondisclosure or rescinded agreements that result from nondisclosure by lawyers when the nondisclosure is the equivalent of a misrepresentation or

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[168] Proposed Rule 1.6(b) stated:

> A lawyer may reveal such 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 death or substantial bodily harm, or in substantial injury to the financial interests or property of another;
>
> (2) to rectify the consequences of a client's criminal or fraudulent act in the furtherance of which the lawyer's services had been used;
>
> (3) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, or to establish a defense to a criminal charge, civil claim or disciplinary complaint against the lawyer based upon conduct in which the client was involved: or
>
> (4) to comply with other law.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (Proposal Final Draft 1982); *see also* A.B.A. CENTER FOR PROFESSIONAL RESPONSIBILITY, THE LEGISLATIVE HISTORY OF THE MODEL RULES OF PROFESSIONAL CONDUCT 48 (1987).

[169] *See* A.B.A. CENTER FOR PROFESSIONAL RESPONSIBILITY, *supra* note 168, at 146.

when nondisclosure violates the law, without regard to the duty of confidentiality. In fact, a number of cases have specifically rejected claims of confidentiality as a defense in such actions. For example, in *Mississippi Bar v. Mathis*,[170] the attorney attempted to justify his failure to disclose the autopsy of the insured on the ground of attorney-client privilege and work product. The court rejected these arguments, stating that issues of privilege were for the court to determine, not the lawyer on his own.[171] Similarly, in *People v. Petsas*,[172] a lawyer was indicted for presenting fraudulent insurance claims. The fraud involved misrepresentation and concealment of the fact that his client's injuries resulted from multiple accidents rather than a single accident.[173] The lawyer attempted to justify his conduct by claiming that his ethical duty of confidentiality prevented revelation of information that was damaging to his client.[174] The appellate court rejected this argument, holding that the duty of confidentiality stops when the lawyer engages in fraud.

> [I]t is true an attorney has an ethical obligation not to disclose information adverse to his client which is obtained in confidence. . . . There is a distinct difference between restricting an attorney from divulging information learned in confidence from a client, and proscribing him from knowingly making affirmative false representations regarding a claim or claims of that client.[175]

Similarly, the *Restatement of the Law Governing Lawyers* recognizes that the duty of confidentiality is subordinate to the principle that lawyers must obey the law. The comment to section 157 states: "Disclosure, being required by law . . . , is not prohibited by the general rule of confidentiality."[176] Under this analysis, the duty of confidentiality does not constitute a valid objection to disciplining or holding lawyers civilly liable when nondisclosure by the lawyer is the equivalent to a misrepresentation or violates the law.

None of the cases discussed in Part I mentioned any lawyer/client consultation regarding disclosure. In these cases, the lawyers apparently

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[170] Mississippi Bar v. Mathis, 620 So. 2d 1213 (Miss. 1993).

[171] *See id.* at 1221.

[172] People v. Petsas, 262 Cal. Rptr. 467 (Ct. App. 1989).

[173] *See id.* at 468.

[174] *See id.* at 472.

[175] *Id.*

[176] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 157 cmt. d (Tentative Draft No. 8, 1997).

took it on themselves to proceed with the transaction without disclosure, often because it was in the lawyer's financial interest to conclude the agreement without disclosure. It would have been appropriate to discipline these lawyers not only for nondisclosure but also for a failure to advise their clients about the potential risks to the clients from nondisclosure.[177]

The issue of consultation with the client actually presents two questions. First, is consultation necessary, or may lawyers disclose on their own without client consent or consultation? Second, may lawyers avoid the obligation to disclose by counseling their clients regarding disclosure and by withdrawing from representation if the client refuses to authorize disclosure?

Suppose a lawyer decides that he or she cannot proceed with the transaction without disclosure. Are consultation with the client and client authorization necessary before the lawyer makes disclosure? In some cases, lawyers have the authority on their own, without client consent and without disclosure to the client, to disclose information when consummation of a contract or settlement agreement without disclosure of the information would amount to a misrepresentation or would violate the law.

Under Rule 1.6, all information a lawyer obtains "relating to representation of a client" is subject to the ethical duty of confidentiality.[178] When a client authorizes a lawyer to engage in settlement negotiations, the client has given the lawyer implied authority to reveal certain information about the case even though that information would otherwise be subject to the ethical duty of confidentiality. Rule 1.6(a) provides that a lawyer may ethically make "disclosures that are impliedly authorized in order to carry out the representation."[179] One of the comments to Rule 1.6 states:

> A lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out the representation, except to the extent that the client's instructions or special circumstances limit that authority. In litigation, for example, a lawyer may disclose information by admitting

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[177] *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 2.1 (1998) (imposing a duty on lawyers to render candid advice); *see also id.* Rule 1.4 (imposing a duty to communicate).

[178] *Id.* Rule 1.6(a). The ethical duty is broader than the attorney-client privilege in several ways. The ethical duty applies to information gained from third parties, not just from the client. In addition, the information need not be conveyed in confidence. *See id.* Rule 1.6 cmt.

[179] *Id.* Rule 1.6.

> a fact that cannot properly be disputed, or *in negotiation by making a disclosure that facilitates a satisfactory conclusion.*[180]

Support for this analysis of the lawyer's authority can be found in ABA Informal Opinion 86-1518.[181] The ABA Committee on Ethics and Professional Responsibility dealt with the issue of whether lawyers had a duty to disclose knowledge of inadvertent omissions of contract terms or other "scrivener error."[182] The committee ruled:

> Where the lawyer for A has received for signature from the Lawyer for B the final transcription of a contract from which an important provision previously agreed upon has been inadvertently omitted by the lawyer for B, the lawyer for A, unintentionally advantaged, should contact the lawyer for B to correct the error and need not consult A about the error.[183]

The committee advised that client consent was unnecessary because under Rule 1.4 a lawyer has an obligation to fulfill "reasonable client expectations,"[184] and an agreement based on a scrivener's error is not part of the client's reasonable expectations.[185] The committee also found that the duty of confidentiality under Rule 1.6 did not preclude disclosure because the lawyer was impliedly authorized to make disclosure of information that "facilitates a satisfactory conclusion."[186]

Some lawyers may feel uncomfortable about revealing information detrimental to their clients based simply on a claim of implied authority without disclosure to or consent of the client. Such lawyers may conclude that they prefer to discuss with their clients the risks of nondisclosure rather than to disclose on their own. If, after consultation, the client consents to

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[180] *Id.* Rule 1.6 cmt. (emphasis added).

[181] ABA Comm. on Ethics and Professional Responsibility, Informal Op. 86-1518 (1986).

[182] *Id.*

[183] *Id.*

[184] *Id.*

[185] *See id.*

[186] *Id.* n.1; *see also* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 92-368 (1992) (holding that a lawyer who receives confidential documents from the opposing side by mistake should not read the documents but should notify opposing counsel and abide by his instructions, and any duty to client is subordinate to obligations to opposing counsel). *See generally* 1 HAZARD & HODES, *supra* note 162, § 1.6:201-1, at 168.33-168.41 (discussing scope of implied authorization to reveal confidential information).

disclosure, the lawyer does not face a problem. Suppose, however, that the client refuses to authorize disclosure by the lawyer. At a minimum, the lawyer must withdraw from the transaction because the lawyer's continued participation without disclosure will amount to misrepresentation or violation of the law.

Is withdrawal sufficient? In many cases, withdrawal will not be sufficient to relieve the lawyer of responsibility for nondisclosure. For example, when the lawyer learns that a prior representation by the lawyer was or has become false, the lawyer's withdrawal will not cure the problem. The lawyer must make a corrective disclosure.[187] In other cases, it may be unclear whether the lawyer's withdrawal is sufficient. For example, suppose the lawyer receives a draft of a settlement agreement that includes a material mistake to the advantage of the lawyer's client. The lawyer counsels with the client who refuses to agree to disclosure. If the lawyer withdraws from the matter, the client may retain other counsel to conclude the transaction or may continue on pro se. In either event, the mistake may not be disclosed. On this set of facts, arguably the lawyer has no responsibility for nondisclosure because the agreement was not signed until after the lawyer withdrew. On the other hand, the agreement with the mistaken provision was received by the lawyer while the lawyer was representing the client. The event that was the basis of the duty to disclose occurred on the lawyer's watch. Under these circumstances, a court might well find that the lawyer's withdrawal was not sufficient to avoid responsibility for nondisclosure.

How then should a lawyer proceed? Lawyers have at least three courses of action available to them:[188]

- disclose without client consultation or notification (the "pure disclosure" solution);
- consult with the client prior to disclosure, but disclose rather than withdraw if the client refuses to authorize disclosure (the "consult/disclose" solution); or
- consult with client prior to disclosure, but withdraw rather than disclose if the client refuses to authorize disclosure (the "consult/withdraw" solution).[189]

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[187] *Cf.* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 98-412 (1998) (stating that a lawyer's duty of candor to the tribunal requires correction of past representations on which a court continues to rely, and withdrawal is not sufficient).

[188] Lawyers will no doubt think of a number of nuances and variations of these basic solutions.

[189] One way to make the withdrawal solution more effective is through a noisy notice of withdrawal, one which informs either the other party or the court that it

Each of these courses of action is ethically defensible. The lawyer can justify the pure disclosure approach on the ground that client consent and consultation is irrelevant because the lawyer has a duty to disclose to avoid engaging in misrepresentation by nondisclosure or to avoid violating the law. Further, under Rule 1.6, the lawyer has implied authority to disclose information to reach a satisfactory conclusion of a negotiation.[190] An agreement that is subject to rescission for nondisclosure is hardly a satisfactory conclusion. The consult/disclose solution is justified on the ground that a lawyer should consult with the client even about matters in which the lawyer has the right to make a decision.[191] Further, if the lawyer discloses information without even notifying the client of what the lawyer has done, the lawyer could be accused of deceit in violation of Model Rule 8.4(c).[192] The purpose of consultation is both to inform the client of the lawyer's planned disclosure and to provide the client with an opportunity to supply the lawyer with information that might affect the lawyer's evaluation of whether disclosure is required. Finally, the consult/withdraw solution is defensible in those cases where the lawyer concludes that nonparticipation rather than actual disclosure is sufficient to avoid misrepresentation or violation of the law. As noted previously, in some cases, the consult/withdraw solution is insufficient to remedy the problem. An example is when the lawyer has made a prior representation that the lawyer now knows is false.

How should lawyers choose among these courses of action? It is impossible to give a definite answer as to which course of action a lawyer should follow. The choice will depend on a variety of factors, including the following:

- Seriousness of the harm to the other party that will result from nondisclosure. For example, *Spaulding* presents a particularly compelling situation for disclosure.[193]
- Extent to which court approval of the agreement will be required. If court approval is required, the lawyer's nondisclosure involves a violation of the duty of candor to the tribunal as well as a

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should not continue to rely on any opinion, statement, document, or state of affairs. On the noisy notice of withdrawal, see ABA Comm. on Ethics and Professional Responsibility, Formal Op. 92-366 (1992).

[190] *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1998).

[191] *See id.* Rules 1.2(a), 1.4.

[192] *See id.* Rule 8.4(c) (prohibiting attorney conduct "involving dishonesty, fraud, deceit, or misrepresentation").

[193] *See supra* text accompanying notes 7-16.

violation of an obligation owed to the other party. The duty of confidentiality has less force when the issue involves the duty of candor to the tribunal rather than a duty to the opposing party.[194]

- The client's interest in nondisclosure. In some cases, disclosure would involve "sensitive information." By "sensitive information," I mean information about the client the disclosure of which would damage the client in ways that go beyond simply loss of the value of the settlement or contract.
- Feasibility and consequences of withdrawal given the status of the case. In some cases, it may be very difficult for the lawyer to withdraw. Even if withdrawal is feasible, the consequence of withdrawal may be the practical equivalent of nondisclosure. On the other hand, in some cases, withdrawal is reasonably feasible, and the fact of withdrawal would be sufficient to put the other party on notice that some reexamination of the transaction may be required.
- The lawyer's philosophy of lawyering[195] and tolerance for personal risk. Many, perhaps most, lawyers are client-centered in their approach to lawyering. In cases of doubt, these lawyers will resolve issues in a way that advances their clients' interests even if the decision may involve an arguable question of professional duty and even if it may expose the lawyer to some risk. Other lawyers follow an officer-of-the-court approach. In cases of doubt, these lawyers will attempt to determine what both the letter and the spirit of the rules require and will act accordingly, even if the result will not necessarily be advantageous to their clients. Still others adhere to the old adage, "if someone must go to jail, let it be the client," as a rule of thumb for deciding difficult questions. Under this approach, in case of doubt, the lawyer will adopt the approach that reduces the risk that the lawyer will be exposed to discipline, sanction, or civil liability.

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[194] *Compare* MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3, *with id.* Rule 4.1. Rule 3.3, which deals with disclosure to a court, is broader than Rule 4.1. Under Rule 3.3, the lawyer's duties of disclosure to the court are not qualified by the duty of confidentiality. *See* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 98-412 (1998) (dealing with the lawyer's obligation to disclose when a client has violated a court order).

[195] On the concept of a philosophy of lawyering, see NATHAN M. CRYSTAL, PROFESSIONAL RESPONSIBILITY: PROBLEMS OF PRACTICE AND THE PROFESSION ch. 1 (1996).

C. Hard Cases

As in any area of law, difficult cases will arise. *Brown v. County of Genesee*[196] is such a case. *Brown* dealt with an employment discrimination matter. During settlement negotiations, the plaintiff stated on several occasions that her objective in settlement was to receive, in terms of benefits and compensation, what she would have received had she been hired by the defendant county on June 16, 1982.[197] The parties entered into a settlement which provided that plaintiff would be advanced to the third of seven employment levels (the "C" level). Prior to concluding the settlement, defense counsel was advised by the county that the highest level that plaintiff could have had if she had been hired on June 16, 1982, was the "D" level.[198] "Counsel for defendant did not know, but he believed [that] it [was] probable"[199] that plaintiff was acting under the mistaken belief that the "C" level was the highest level to which the plaintiff would have been entitled.[200] Defense counsel did not ask plaintiff's counsel about this possible mistake. Subsequently, the plaintiff learned that she would have been eligible for the "D" level and moved to modify the settlement.[201] The district court ordered modification and sternly criticized defense counsel.

> What defendant's counsel seeks to do is not only not authorized by law, but is unethical.
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> . . . .
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> Frankly, I am shocked that defendant's counsel says he has no duty to advise plaintiff through her counsel that they are operating under a mistake of fact. Under the defendant's theory, if when paying for a meal in a restaurant, one by mistake is given back $10 more than entitled to receive, one is entitled to keep the $10 because of the unilateral mistake. The converse shows the ridiculousness of the argument: while paying your check the cashier knows that a $10 addition mistake against the patron was made and accepts the money in payment on the basis that the mistake is unilateral.[202]

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[196] Brown v. County of Genesee, 872 F.2d 169 (6th Cir. 1989).

[197] *See id.* at 172.

[198] *See id.*

[199] *Id.*

[200] *See id.*

[201] *See id.* at 173.

[202] Brown v. County of Genesee, 694 F. Supp. 250, 252-53 (E.D. Mich. 1987).

The Sixth Circuit vacated the district court's order.[203] The court gave a number of reasons for its decision. First, it noted that the district court erred in finding that the parties intended to enter into a settlement at the highest level. The settlement specified the "C" level but did not state that this was intended to be the highest level that the plaintiff was entitled to receive. Further, the plaintiff's settlement proposal containing the "C" level was in response to the defendant's settlement proposal offering the "B" level, so there was a manifestation of assent at the "C" level but not necessarily a meeting of the minds for settlement at the highest level.[204] In addition, information about levels of pay was readily available to plaintiff because the defendant was a public entity. Moreover, any misunderstanding about the settlement was the fault of the plaintiff's counsel for failing to include a provision in the settlement agreement stating that the plaintiff was to receive the highest level to which she was entitled.[205]

As the difference between the district court and the Sixth Circuit opinions shows, *Brown* is a close case, but one that I think was correctly decided although for the wrong reason. In its opinion, the Sixth Circuit stated that "nondisclosure to an adverse party and to the court of facts pertinent to a controversy before the court does not add up to 'fraud upon the court' for purposes of vacating a judgment under Rule 60(b)."[206] The court cited *Kerwit Medical Products v. N. & H. Instruments, Inc.*,[207] where the court refused to set aside a consent judgment.[208] The court in *Kerwit* ruled that the plaintiff's failure to reveal facts on which defendant could have based a defense in a patent infringement suit did not amount to fraud on the court within the meaning of Federal Rule of Civil Procedure 60(b).[209]

The Sixth Circuit's reliance on *Kerwit* is insufficient to justify the result in *Brown*. Lawyers clearly do not have a duty to disclose facts that will help establish a defense by the opposing party, as was the situation in *Kerwit*.[210] The issue of disclosure in *Brown* is much more complex,

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[203] *See Brown*, 872 F.2d at 169.

[204] *See id.* at 174.

[205] *See id.* at 175.

[206] *Id.* (referring to FED. R. CIV. P. 60(b)).

[207] Kerwit Med. Prods., Inc. v. N. & H. Instruments, Inc., 616 F.2d 833 (5th Cir. 1980).

[208] *See id.* at 834.

[209] *See id.* at 837.

[210] *Cf.* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 94-387 (1994) (finding no duty to disclose to opposing side or to court that statute of limitations has run on client's claim).

however, because the disclosure relates to a factual mistake by the opposing party about the basis of the settlement agreement.

Nonetheless, the result in *Brown* was probably correct because the facts of the case do not fall into any of the categories of cases in which a duty of disclosure exists. *Brown* certainly does not involve a case of corrective disclosure[211] because defense counsel never represented that the "C" level was the highest level that plaintiff would have been entitled to receive if she had been hired on June 16, 1982. The case also does not involve a fiduciary disclosure.[212] While an employment relationship existed between the parties, no fiduciary duties exist in connection with the settlement of the lawsuit in which each party was represented by counsel.

The plaintiff could have argued that the case involved a known mistake about the contents of a writing,[213] but it is difficult to characterize the writing as containing a mistake. The settlement agreement did not refer to level of pay and benefits to which the plaintiff would have been entitled had she been hired on June 16, 1982. The case is unlike *Stare v. Tate,*[214] where a mathematical error existed in the plaintiff's settlement offer,[215] or *In re Rothwell,*[216] where respondent attorney had changed the terms of the offer that he received.[217] In addition, for a duty of disclosure to attach, the attorney must have "knowledge" of the mistake by the other party as to the contents of the writing.[218] In *Brown*, defense counsel stated that he did not know but believed that it was "probable" that the plaintiff was operating under a mistake,[219] but "belief" and "probability" do not rise to the level of knowledge. If a lawyer engages in willful blindness, the lawyer will be treated as having knowledge of the facts to which the lawyer closed his eyes,[220] but it is difficult to characterize defense counsel's conduct in *Brown* as willful blindness.

Finally, the plaintiff could also have argued that defense counsel had a duty to disclose the mistake about level of pay and benefits because good

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[211] *See supra* notes 125-27 and accompanying text.

[212] *See supra* notes 133-35 and accompanying text.

[213] *See supra* notes 128-31 and accompanying text.

[214] Stare v. Tate, 98 Cal. Rptr. 264 (Ct. App. 1971).

[215] *See supra* notes 101-08 and accompanying text.

[216] *In re* Rothwell, 296 S.E.2d 870 (S.C. 1982).

[217] *See supra* notes 44-49 and accompanying text.

[218] *See supra* notes 128-31 and accompanying text.

[219] Brown v. County of Genesee, 872 F.2d 169, 172 (6th Cir. 1989).

[220] *See* John P. Freeman & Nathan M. Crystal, *Scienter in Professional Liability Cases*, 42 S.C. L. REV. 783, 833-38 (1991).

faith and fair dealing required disclosure.[221] Two objections can be made to this argument. First, the facts of the case do not fit clearly within any of the categories of cases in which courts have recognized that good faith requires disclosure.[222] On the other hand, the plaintiff's mistake about level of pay and benefits is similar in significance to the mistake about insurance coverage in *State ex rel. Nebraska State Bar Ass'n v. Addison.*[223] Second, for the same reasons discussed above, it is difficult to conclude that defense counsel had knowledge of the plaintiff's mistake such that good faith requires disclosure.

Although it is probably correct to conclude that the defense attorney in *Brown* did not have a duty to disclose the plaintiff's mistake about pay level, he should have advised his client about the mistake and counseled with the county about the desirability of disclosure.[224] Indeed, it is arguable that the county had already implicitly authorized disclosure. The county had informed defense counsel that the "D" level was the highest level to which the plaintiff was entitled, and it did not expressly direct defense counsel not to reveal this information to the plaintiff.[225]

CONCLUSION

This Article has been an argument for the following proposition: It is unethical for a lawyer to fail to disclose material information when the nondisclosure amounts to misrepresentation or when the failure to disclose violates discovery rules or other law. The *Restatements of Contracts* and *Torts* provide useful standards for determining when a nondisclosure is the equivalent of a misrepresentation. Under these authorities, nondisclosure is equivalent to a misrepresentation in four situations: (1) corrective disclosure; (2) disclosure of known mistakes in a writing; (3) fiduciary disclosure; and (4) disclosure of mistakes about basic facts when required by good faith.[226] The duty of confidentiality does not preclude disclosure because the duties not to engage in misrepresentation and not to violate the law are superior to the duty of confidentiality. Further, when clients authorize lawyers to enter into contract or settlement negotiations, they

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[221] *See supra* notes 136-52 and accompanying text.

[222] *See supra* notes 136-52 and accompanying text.

[223] State *ex rel.* Nebraska State Bar Ass'n v. Addison, 412 N.W.2d 855 (Neb. 1987); *see supra* notes 60-64 and accompanying text.

[224] MODEL RULES OF PROFESSIONAL CONDUCT Rules 1.4, 2.1 (1998).

[225] *See supra* notes 196-201 and accompanying text.

[226] *See supra* notes 123-52 and accompanying text.

impliedly authorize their lawyers to reveal information necessary to facilitate a satisfactory conclusion. This implied authority reasonably includes authorization to reveal information necessary to prevent the agreement from being unenforceable due to nondisclosure.[227]

Lawyers have three courses of action available to them when they confront situations in which their continued participation in contract or settlement negotiations without disclosure would constitute either a misrepresentation or would violate the law: the pure disclosure solution, the consult/disclose solution, or the consult/withdraw solution.[228] Choice among these courses of action depends on analysis of a variety of factors: the seriousness of the harm to the other party that will result from nondisclosure; the extent to which court approval of the agreement will be required; the client's interest in nondisclosure, particularly whether the information that the lawyer will be disclosing is sensitive; the feasibility and consequences of withdrawal given the status of the case; and the lawyer's philosophy of lawyering and tolerance for personal risk.[229]

This Article began with two cases posing problems of nondisclosure. How do the principles set forth in this Article apply to these cases? In *Spaulding v. Zimmerman*, the court held that the settlement agreement was subject to rescission, but the court also stated that the lawyers had not acted unethically in failing to reveal the information they had about the plaintiff's health.[230] Under the principles set forth in this Article, the court was wrong in its characterization of the lawyers' conduct. Under the facts of the case, defense counsel's failure to disclose was the equivalent of a misrepresentation. Defense counsel had a duty to disclose because plaintiff's physical condition was a basic fact about which plaintiff was mistaken, and the failure to disclose violated principles of good faith and fair dealing. Indeed, *Spaulding* is probably the clearest case for disclosure that can be imagined because of the threat to the plaintiff's life. Defense counsel should have immediately revealed this information to the plaintiff without the need for consultation with their clients. All of the factors bearing on the issue call for disclosure: the harm was serious, the case involved a duty of candor to the court because it involved a minor settlement, disclosure would not reveal any sensitive information of the defendant, defense counsel's withdrawal on the eve of trial was not feasible and would in any event have

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[227] *See supra* notes 178-86 and accompanying text.

[228] *See supra* text accompanying notes 188-89.

[229] For a discussion of these factors, see *supra* text accompanying notes 193-95.

[230] *See supra* text accompanying notes 7-16.

simply reaffirmed the problem of nondisclosure. Finally, any sensible philosophy of lawyering must give primacy to the value of human life.

In *Mistler's Exit*, it is somewhat less clear whether the information is subject to a duty of disclosure. Mistler claimed that his presence is not material to the purchase of his agency because the agency had key man insurance on his life, his value to the agency had been internalized into other employees, and he would not be staying with the agency for many more years in any event.[231] Nonetheless, given the history of the negotiations, it seemed likely that his health would be treated as a basic fact by Omnium. When Omnium's chairman, Jock Burns, broached the subject of a possible acquisition, he referred to the "Mistler factor" as a significant reason for the purchase.[232] Whether good faith requires disclosure is another possible issue. The purchaser failed to ask questions about Mistler's health. On the other hand, Mistler seemed to have a close personal relationship with Burns. The closeness of this relationship would probably mean that good faith requires disclosure. Based on this analysis, attorney Voorhis's continued participation in the transaction without disclosure of Mistler's health was improper.

The factors bearing on Voorhis's decision as to how to proceed, however, were different from those in *Spaulding*. The harm to the purchaser from nondisclosure was much less clear than in *Spaulding*. Disclosure of Mistler's health situation would reveal sensitive information because disclosure would harm Mistler in ways beyond simply the loss of his contract with Omnium. Mistler had not told his wife or other members of his family about his condition. Unlike *Spaulding*, *Mistler's Exit* did not involve a duty of candor to the court. Further, Voorhis's withdrawal was feasible and would have been likely to put the purchaser on notice to reexamine the transaction. Based on this analysis, after consulting with Mistler about disclosure of his health condition, Voorhis should have informed Mistler that he could not proceed with the transaction without disclosure. He then should have withdrawn if Mistler refused to authorize disclosure.

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[231] *See* BEGLEY, *supra* note 1, at 37, 40-41.

[232] *Id.* at 15.