

Responding To A Client's Fraud; The Controlling Rules

BY LINDA GALLER

That should you do if a client has used your legal services to commit fraud or engage in a criminal act? That question was recently addressed by the Nassau County Bar Association Committee on Professional Ethics in Opinion 01-8. (See, NYPRR, April 2002, p. 7.) The Nassau Opinion related to a matrimonial matter, but the issue can and does arise in many areas of practice. This article discusses generally a lawyer's duties when her professional services or work product could be implicated in client fraud.

Consider two hypothetical scenarios. The first, based on the Nassau Opinion, involves a matrimonial attorney whose client presents him with a Statement of Net Worth prepared by the client's previous counsel and signed by the client. The attorney relies on the Net Worth Statement and on the client's income tax returns in responding, successfully, to allegations made by the client's wife that the client was hiding assets. The attorney certifies that he had no knowledge of any false facts contained in court papers which he filed in the action. Sometime after the matter has been settled and the representation has ended, the attorney and his former client enter into a business relationship. During the course of that venture, the former client reveals to the lawyer that the Net Worth Statement had indeed omitted assets, that his income tax returns were false, and that he had secreted substantial cash assets from his ex-wife.

The second hypothetical omits a court or tribunal. Suppose that a tax attorney and her client together attend an IRS appeals conference during which the client makes several important factual representations to the Appeals Officer. On the basis of those representations, which the lawyer believes to be true, the Appeals Officer agrees to resolve the tax dispute in the client's favor and promises to send settlement documents to the attorney for signature. As the two celebrate in the lawyer's office immediately after the conference, the client admits that the representations he made to the Appeals Officer were false.

Similar scenarios with different impact

While the two scenarios are similar, they are notably different in three regards, each or all of which could affect the lawyer's ethical obligations and choices. First, the lawyer's services in the first hypothetical were utilized in perpetrating a fraud during the course of a judicial proceeding, thereby implicating ethical duties owed to a court, while, in the second, the false representations were not made to or before a tribunal. See ABA Formal Opinion 314 (1965). (Because the

IRS is not a tribunal, lawyers do not owe it the same duty of disclosure as they owe the courts).

Second, in the first hypothetical, the lawyer learned of the fraud after the representation ended, while in the second hypothetical, the client admitted the fraud during the course of the representation. Third, the client's admission in the first hypothetical was made in the context of an extraneous and independent business relationship, while the disclosure in the second hypothetical occurred during the course of the legal representation itself.

Three separate questions are raised by our hypotheticals. 1) May/must the lawyer reveal the fraud to the affected parties, or is she obligated to remain silent? 2) Is the lawyer able to continue representing the client in the matter? 3) If the lawyer is required to withdraw or chooses to do so, can she withdraw in a manner that could or would implicitly reveal the fraud?

Revealing the Fraud

When a lawyer receives information that clearly establishes that a client has perpetrated a fraud during the course of the lawyer's representation, she is required promptly to call upon the client to rectify the fraud. If the client refuses to correct the fraud or is unable to do so, the lawyer must reveal the fraud to the affected person or tribunal unless the information is protected as a confidence or secret. In both hypotheticals, therefore, the lawyer must counsel her client to correct the fraud. If the client refuses, the lawyer's next step depends upon whether the client's admission is a confidence or secret and the degree of confidentiality which is required.

In the first hypothetical, it is doubtful that the client's admission is protected as either a confidence or a secret because it was not made during the attorney-client relationship. The Code of Professional Responsibility defines "confidence" as information protected by the attorney-client privilege. As a general matter, this covers only communications made for the purpose of seeking legal advice or services. The client's admission was made after the legal representation had ended, in the context of a business relationship that evolved after the attorney-client relationship was terminated. The Nassau Opinion expressly declined to determine whether a communication made after the conclusion of representation was protected by the privilege (because the question is a matter of law outside of the competence of the Ethics Committee), but strongly implied that the admission was not entitled to privilege protection.

A "secret" is defined, *inter alia*, as information gained by the lawyer in the professional relationship. Because the client made the admission after the attorney-client relationship had ended, the lawyer has no obligation to preserve its secrecy. If the admission is neither a confidence nor a secret, it may be revealed.

Mandatory disclosure in court proceedings

The lawyer's duties to the court provide a rationale for mandatory disclosure in the first hypothetical. Lawyers are not permitted to engage in conduct prejudicial to the administration of justice. In construing the breadth of this proscription, the Ethical Considerations state that fraudulent, deceptive, or otherwise illegal conduct by a participant in a court proceeding is inconsistent with the fair administration of justice. According to the Nassau Opinion, attorneys are obligated to avail themselves of any disciplinary rule that is meant to prevent fraudulent, deceptive, or illegal conduct.

The ABA Model Rules prescribe the duty of candor to the courts: a lawyer shall not knowingly "fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client." Although there is no obvious analog in New York's Code of Professional Responsibility, the same duty may be implicit in DR 7-102(A)(3), which provides that a lawyer shall not knowingly fail to disclose that which he is required by law to reveal.

Unlike the admissions in the first hypothetical, the client's admission in the second hypothetical is protected. Because it was made during the course of legal representation, it is likely to be a confidence and, if not, it would certainly be protected as a secret. The lawyer, therefore, cannot reveal.

Continuing in the Representation

In the first hypothetical, the issue of withdrawal does not arise because the representation has ended. In the second, however, the lawyer's ability to continue representing the client depends on whether the fraud has ended or is continuing. If the fraud has ended, the lawyer may not reveal the fraud and may continue in the representation. As a practical matter, however, it may be difficult to know whether or when the fraud has ended. For example, because the client is likely to face further contact with the IRS on the matter involving the misrepresented facts, it may be difficult for the lawyer to avoid the fraud even if the client makes no further false statements. (Under the Disciplinary Rules, of course, lawyers may never counsel or assist their clients in conduct which they know to be fraudulent or illegal.) Under these circumstances, the lawyer should consider withdrawing.

Among the permissible bases on which withdrawal may be premised are the following: (1) the client persists in a course of action, involving the lawyer's services, that the lawyer reasonably believes is criminal or fraudulent; (2) the client insists that the lawyer pursue a course of conduct which is illegal or is prohibited under the Disciplinary Rules; and (3) the lawyer's continued employment is likely to result in a violation of a Disciplinary Rule. The lawyer is required to withdraw only if she knows or it is obvious that continued representation will result in violation of a Disciplinary Rule. Continued representation of our hypothetical tax client will not in and of itself result in an ethical violation unless actions remain to be taken which depend on the fraud and the lawyer will be asked to participate in those actions.

Making a "Noisy Withdrawal"

If a lawyer discovers that a written or oral opinion or representation previously given was based on materially inaccurate information or is being used to further a crime or fraud, she is permitted to reveal this information, even though it may consist of confidences or secrets, at least to the extent implicit in withdrawing the opinion or representation. This rule permits only implicit disclosures, which are referred to as "noisy withdrawals". The reason for disavowing the work product may not be given, but the act of disavowal itself can obviously send a red flag to persons affected by the client's fraud.

If it were somehow concluded in the first hypothetical that the admission was a protected confidence, then a noisy withdrawal would be the lawyer's best and only course of action. In the second hypothetical, a noisy withdrawal would be appropriate to the extent of any representations made by the lawyer herself.

The relationship between New York's noisy withdrawal rule and ABA Formal Opinion 314 (supra) is unclear. That opinion states that a lawyer who would believe the IRS "relies on him as corroborating statements of his client which he knows to be false" is under a duty to withdraw "unless it is obvious that the very act of disassociation would have the effect of violating" the lawyer's duty of confidentiality. Thus, if withdrawal would amount to disclosure, the option to withdraw may not be available. The more expansive New York noisy withdrawal rule, however, probably takes precedence over the contradictory language in Opinion 314, as the rule was adopted long after the opinion was issued. Moreover, the ABA

Model Rules do not themselves provide for noisy withdrawal; that option is provided for only in the Comments to the Model Rules and in two ABA Formal Opinions, 93-0375 and 92-366, which are controversial precisely because there may be no satisfactory foundation in the text of the Model Rules. New York's noisy withdrawal rule is set forth in a Disciplinary Rule and should be deemed controlling.

Linda Galler is Professor of Law at Hofstra University School of Law. She teaches courses in Federal Taxation, including Ethics in Tax Practice. She is former Chair of the ABA Tax Section Committee on Standards of Tax Practice.