

**THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 11-0002**

ISSUE: Has an attorney engaged in deceitful conduct by not alerting opposing counsel of: (A) an apparent material error made by opposing counsel in contract language; or (B) a material change made by the attorney in contract language?

DIGEST: Where an attorney has engaged in no conduct or activity that induced an apparent material error by opposing counsel, the attorney has no obligation to alert the opposing counsel of the apparent error. However, where the attorney has made a material change in contract language in such a manner that his conduct constitutes deceit, active concealment or fraud, the failure of the attorney to alert opposing counsel of the change would be a violation of his ethical obligations.

**AUTHORITIES
INTERPRETED:**

Rule 3-700(B)(2) of the Rules of Professional Conduct of the State Bar of California^{1/}
Business and Professions Code section 6106
Business and Professions Code section 6128(a)

STATEMENT OF FACTS

Buyer and Seller have been in discussions regarding the sale of the Company from Seller to Buyer, and have agreed in concept to some of the materials terms, including total consideration of \$5 million to be paid by Buyer and Buyer's requirement that Seller enter into a covenant not to compete with the Company following the sale. Buyer's Attorney and Seller's Attorney are tasked with preparing a Purchase and Sale Agreement to reflect the agreement of the parties.

Buyer's Attorney prepares an initial draft of the Purchase and Sale Agreement. One section towards the back of the 50-page draft agreement contains the terms of an enforceable covenant not to compete, and includes a provision that Buyer's sole and exclusive remedy for a breach by Seller of its covenant not to compete is the return of that portion of the total consideration which has been allocated in the Purchase and Sale Agreement for the covenant not to compete. Another section in the front of the draft agreement provides that, of the \$5 million to be paid by Buyer, \$3 million is to be allocated to the purchase price for the Company and \$2 million is to be allocated as consideration for the covenant not to compete.

Alternative A

After soliciting input on the initial draft from Seller and Seller's tax advisor, Seller's Attorney provides Buyer's Attorney with comments on the initial draft, including the observation from Seller's tax advisor that payments received by Seller with respect to the covenant not to compete are not as favorable, from a tax perspective, as payments with respect to the purchase price for the Company.

Buyer's Attorney then prepares a revised version of the Purchase and Sale Agreement which, apparently in response to the comments of Seller's Attorney, provides for an allocation of only \$1 as consideration for the covenant not to compete with the balance of the \$5 million allocated to the purchase price for the Company. In reviewing the changes made in the revised version, Seller's Attorney recognizes that the

^{1/} Unless otherwise indicated, all future references to rules in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

allocation of only \$1 as consideration for the covenant not to compete essentially renders the covenant meaningless, because Buyer's sole and exclusive remedy for breach by Seller of the covenant would be the return by Seller of \$1 of the total consideration. Seller's Attorney notifies Seller about the apparent error. Seller instructs Seller's Attorney to not inform Buyer's Attorney of the apparent error. Seller's Attorney says nothing to Buyer's Attorney and allows the Purchase and Sale Agreement to be entered into by the parties in that form.

Alternative B

After receiving the initial draft from Buyer's Attorney, Seller's Attorney prepares a revised version of the Purchase and Sale Agreement which provides for an allocation of only \$1 as consideration for the covenant not to compete, with the intent of essentially rendering the covenant not to compete meaningless. Seller's Attorney intentionally generates a defective "redline" of the draft that failed to highlight the change, and tenders the revised version to Buyer's Attorney. Seller's Attorney notifies Seller about the change, including the failure to highlight the change, in the revised version. Seller instructs Seller's Attorney to not inform Buyer's Attorney of the change. Seller's Attorney says nothing to Buyer's Attorney and allows the Purchase and Sale Agreement to be entered into by the parties in that form.

Under either Alternative, has Seller's Attorney violated any ethical duties?^{2/}

DISCUSSION

Following Client's Instruction to Not Disclose

Attorneys generally must follow the instructions of their clients. See ABA Model Rule 1.2(a) ("a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation ...").^{3/} However, if the client insists on certain unethical conduct, the attorney may have an obligation to withdraw from the representation. Rule 3-700(B)(2) ("[A] member representing a client . . . shall withdraw from employment, if: . . . [t]he member knows or should know that continued employment will result in violation of these rules or of the State Bar Act"). Such an obligation, for example, may arise if the unethical conduct in question involves a fraudulent failure to make a disclosure. As the Los Angeles County Bar Association has opined, upon discovering that an adverse party made an overpayment under a settlement agreement, "[c]ounsel is obligated to inform his/her client of the overpayment under [rule] 3-500. Under [Bus. & Prof. Code,] § 6068(e) . . . , where the client has requested the information be held in confidence, the attorney is obligated to preserve the secret. The attorney should counsel the client to disclose and return the overpayment. If the client refuses, however, the attorney must consider whether the failure to disclose constitutes fraud. The attorney must then determine whether he/she may or must withdraw from the representation pursuant to [rule] 3-700." Los Angeles County Bar Assn. Formal Opn. No. 520.

^{2/} This opinion addresses a situation arising out of a transaction setting only, and because the matter is not pending before a tribunal, a lawyer's duty of candor to the court found in rule 5-200 and Business and Professions Code section 6068(d) are not being addressed in this opinion.

^{3/} The ABA Model Rules are not binding in California but may be used for guidance by lawyers where there is no direct California authority and the ABA Model Rules do not conflict with California policy. *City & County of San Francisco v. Cobra Solutions, Inc.* (2006) 38 Cal.4th 839, 852 [43 Cal.Rptr.3d 771]. Thus, in the absence of related California authority, we may look to the ABA Model Rules, and the ABA Opinions interpreting them, as well as the ethics opinions of other jurisdictions or bar associations for guidance. (Rule 1-100(A) (ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered); *State Comp. Ins. Fund v. WPS, Inc.* (1999) 70 Cal.App.4th 644, 656 [82 Cal.Rptr.2d 799].)

Under either Alternative A or Alternative B of our Statement of Facts, once Seller's Attorney has informed Seller of the development,^{4/} Seller's Attorney must abide by the instruction of Seller to not disclose.^{5/} If, however, failure to make such disclosure constitutes an ethical violation by Seller's Attorney, then Seller's Attorney may have an obligation to withdraw from the representation under such circumstances. See Cal. State Bar Formal Opn. No. 1996-146.

Failure to Alert Opposing Counsel

Attorneys are held to a high standard, and may be subject to general obligations of professionalism. For example, attorneys have been held to have a duty to respect the legitimate interests of opposing counsel. "An attorney has an obligation not only to protect his client's interests but also to respect the legitimate interests of fellow members of the bar, the judiciary, and the administration of justice." *Kirsch v. Duryea* (1978) 21 Cal.3d 303, 309 [146 Cal.Rptr. 218] (overturning a malpractice judgment against an attorney for withdrawing from a case he believed lacked merit). Further, this Committee has previously concluded that attorneys should treat opposing counsel with candor and fairness. Cal. State Bar Formal Opn. No. 1967-11 ("It is true that, under [former] canon 15 of the Canons of Ethics of the American Bar Association, an attorney must zealously advance the interests of his client, but not by using 'any manner of fraud or chicanery. He must obey his own conscience and not that of his client.' One of the obligations of conscience to which the lawyer must conform is stated in [former] canon 22: his conduct with other lawyers 'should be characterized by candor and fairness.' [Former] canon 29 states that a lawyer 'should strive at all times to uphold the honor and to maintain the dignity of the profession . . .' All of the canons are commended to the members of the State Bar by rule 1 of the Rules of Professional Conduct of the State Bar."). See also ABA Model Rule 3.4.^{6/}

Any duty of professionalism, however, must be balanced with the duties owed by attorneys to their own clients. There is no general duty to protect the interests of nonclients. *Fox v. Pollack* (1986) 181 Cal.App.3d 954, 961 [226 Cal.Rptr. 532] ("an attorney has no duty to protect the interests of an adverse party . . . for the obvious reasons that the adverse party is not the intended beneficiary of the attorney's services, and that the attorney's undivided loyalty belongs to the client."). See also *Skarbrevik v. Cohen, England & Whitfield* (1991) 231 Cal.App.3d 692, 702 [282 Cal.Rptr. 627] ("no [attorney] duty has been found when the third party is someone with whom the client is dealing at arm's length, rather than someone

^{4/} Attorneys have an obligation to keep their clients reasonably informed about significant developments relating to the matter for which they have been employed. Rule 3-500; Bus. & Prof. Code, § 6068(m); see also rule 3-510. Both the apparent error made by Buyer's Attorney in Alternative A and the intentional change made by Seller's Attorney in Alternative B would constitute a "significant development," which would require that Seller be informed of the potential for added costs and burdens of enforcement, including litigation and the likelihood that Buyer may seek reformation of the Purchase and Sale Agreement. See Civ. Code, §§ 3399, 1689; see also *Dyke v. Zaiser* (1947), 80 Cal.App.2d 639 [182 P.2d 344]; *Stare v. Tate* (1971) 21 Cal.App.3d 432 [98 Cal.Rptr. 264]. On the other hand, if Seller's Attorney intends to inform Buyer's Attorney of the apparent error, Seller's Attorney need not inform Seller of the apparent error. Where a client has already agreed to a contract provision which is inadequately reflected in the draft contract prepared by opposing counsel, the inadvertent error by opposing counsel by itself (i.e., unless left uncorrected in the final executed version) does not constitute a significant development, and the client's attorney may correct the drafting error and need not inform the client. See ABA Informal Opn. No. 86-1518 (attorney has no obligation to inform his client of the error because "the decision on the contract ha[d] already been made by the client.").

^{5/} See ABA Model Rule 1.2.

^{6/} See also, the California State Bar's *California Attorney Guidelines of Civility and Professionalism*, which, among other things, encourages attorneys "to be professional with . . . other parties and counsel . . ." We note, however, that such guidelines are nonbinding: "[T]he Guidelines are . . . voluntary [and] not mandatory rules of professional conduct, nor rules of practice, nor standards of care, [and] are not to be used as an independent basis for disciplinary charges by the State Bar or claims of professional negligence."

intended to be benefited by the attorney-client transaction.”). Furthermore, a duty to nonclients would damage the attorney-client relationship. *Fox, supra*, 181 Cal.App.3d at p. 962 (“The effect of such a duty on respondent would be the eradication of confidentiality (Bus. & Prof. Code, § 6068, subd. (e); Evid. Code, § 950 et seq.), the creation of a conflict of interest ([former] rules 4-101, 5-101, and 5-102) and the consequent destruction of the attorney-client relationship between respondent and his clients.”).

Attorneys generally owe no duties to opposing counsel nor do they have any obligation to correct the mistakes of opposing counsel. There is no liability for conscious nondisclosure absent a duty of disclosure. *Goodman v. Kennedy* (1976) 18 Cal.3d 335, 342, 346 [134 Cal.Rptr. 375]. There is also no duty to correct erroneous assumptions of opposing counsel. See ABA Formal Opn. No. 94-387 (no duty to disclose to opposing party that statute of limitations has run). See also *Ethical Guidelines for Settlement Negotiations* (August 2002), ABA Section of Litigation (“there is no general ethics obligation, in the settlement context or elsewhere, to correct the erroneous assumptions of the opposing party or opposing counsel . . .”).^{7/}

On the other hand, it is unlawful (and a violation of an attorney’s ethical obligations) for an attorney to commit any act of moral turpitude, dishonesty, or corruption. Business and Professions Code section 6106 (“The commission of any act involving moral turpitude, dishonesty, or corruption, whether the act is committed in the course of his relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension.”). It is similarly inappropriate for an attorney to engage in deceit or active concealment, or make a false statement of a material fact to a nonclient. Business and Professions Code section 6128(a) (“Every attorney is guilty of a misdemeanor who . . . is guilty of any deceit or collusion, or consents to any deceit or collusion, with intent to deceive the court or any party.”). Also, an attorney may not knowingly assist his or her client in any criminal or fraudulent conduct. See rule 3-210 (“A member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule, or ruling is invalid.”); Business and Professions Code section 6068(a) (it is the duty of an attorney to “support the Constitution and laws of the United States and of this state.”); ABA Model Rule 1.2(d) (“A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent”).^{8/}

^{7/} This opinion does not address scrivener’s error. See ABA Informal Opn. No. 86-1518: interpreting Model Rule 1.2(d) to conclude that where a transcription of an agreement contains a scrivener’s error, an attorney cannot allow his or her client to benefit from the mistake and must notify the other party’s attorney (“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.”). See also *In re Conduct of Gallagher* (Or. 2001) 332 Or. 173 [26 P.3d 131] (attorney who was aware of opposing counsel’s mistake regarding settlement checks – settlement amount had been wrongly calculated – had a duty to correct such mistake). But see Md. State Bar Ass’n, Comm. on Ethics Opn. No. 89-44 (1989) (opining that there is no obligation to reveal the omission of a material term in a contract).

^{8/} See also ABA Model Rule 8.4(c) (“It is professional misconduct for a lawyer to . . . engage in conduct involving dishonesty, fraud, deceit, or misrepresentation”); ABA Model 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.”); *Ethical Guidelines for Settlement Negotiations* (August 2002), ABA Section of Litigation (“the duty to avoid misrepresentations and misleading conduct implies a professional responsibility to correct mistakes induced by the lawyer or the lawyer’s client and not to exploit such mistakes.”); and *In Re Martinez* (Bankr. D. Nev. 2008) 393 B.R. 27 (attorneys sanctioned for “advocating the propriety of [a] mistaken stipulation when they knew, or should have known, that the continued assertion of the validity of the stipulation, and the order entered on it, was not ‘warranted by existing law.’”).

As a result, an attorney may have an obligation to inform opposing counsel of his or her error if and to the extent that failure to do so would constitute fraud, a material misstatement, or engaging in misleading or deceitful conduct.^{9/} “While an attorney’s professional duty of care extends only to his own client and intended beneficiaries of his legal work, the limitations on liability for negligence do not apply to liability for fraud. Accordingly, a lawyer communicating on behalf of a client with a nonclient may not knowingly make a false statement of material fact to the nonclient . . .” *Vega v. Jones, Day, Reavis & Pogue* (“*Vega*”) (2004) 121 Cal.App.4th 282, 291 [17 Cal.Rptr.3d 26].^{10/} Even when no duty of disclosure would otherwise exist, “where one does speak he must speak the whole truth to the end that he does not conceal any facts which materially qualify those stated. One who is asked for or volunteers information must be truthful, and the telling of a half-truth calculated to deceive is fraud.” *Cicone v. URS Corp.*, *supra*, 183 Cal.App.3d 194, 201; see *Goodman v. Kennedy*, *supra*, 18 Cal.3d 335, 346-347; *Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2003) 107 Cal.App.4th 54, 72 [131 Cal.Rptr.2d 777].^{11/}

Alternative A

In Alternative A of our Statement of Facts, although the Purchase and Sale Agreement contains a covenant not to compete, the apparent error of Buyer’s Attorney limits the effectiveness of the covenant because the penalty for breach results in payment by Seller of only \$1. However, Seller’s Attorney has engaged in no conduct or activity that induced the apparent error. Further, under our Statement of Facts, there had been no agreement on the allocation of the purchase price to the covenant, and the Purchase and Sale Agreement does in fact contain a covenant not to compete the terms of which are consistent with the parties’ mutual understanding. Under these circumstances, where Seller’s Attorney has not engaged in deceit, active concealment or fraud, we conclude that Seller’s Attorney does not have an affirmative duty to disclose the apparent error to Buyer’s Attorney.^{12/}

Alternative B

In Alternative B of our Statement of Facts, Seller’s Attorney has surreptitiously concealed the change he made which essentially renders the covenant not to compete meaningless. Under these circumstances, where Seller’s Attorney has engaged in conduct that constitutes deceit, active concealment, and possibly fraud, we conclude that the failure of Seller’s Attorney to alert Buyer’s Attorney of the change would be a violation of his ethical obligations.

^{9/} “Active concealment or suppression of facts by a nonfiduciary is the equivalent of a false representation, i.e., actual fraud.” *Vega*, *supra*, 121 Cal.App.4th at p. 291 [citations omitted]. See *Fox*, *supra*, 181 Cal.App.3d at p. 962; 5 Witkin, Cal. Procedure (4th ed. 1997) Pleading, 678, p. 136.

^{10/} If a person commits actual fraud, the fact that such person does so in the capacity of attorney does not relieve the person of liability. *Goodman v. Kennedy* (1976) 18 Cal.3d 335, 346 [134 Cal.Rptr. 375]; *Vega*, *supra*, 121 Cal.App.4th at p. 291 (“A fraud claim against a lawyer is no different from a fraud claim against anyone else.”). Also, the fact that the other person is also an attorney makes no difference. *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, 202 [227 Cal.Rptr. 887] (“the case law is clear that a duty is owed by an attorney not to defraud another, even if that other is an attorney negotiating at arm’s length.”).

^{11/} See also *Vega*, *supra*, 121 Cal.App.4th at p. 294 (“it is established by statute that intentional concealment of a material fact is an alternative form of fraud and deceit equivalent to direct affirmative misrepresentation In some but not all circumstances, an independent duty to disclose is required; active concealment may exist where a party while under no duty to speak, nevertheless does so, but does not speak honestly or makes misleading statements or suppresses facts which materially qualify those stated [citations omitted].”); *Lovejoy v. AT&T Corp.* (2001) 92 Cal.App.4th 85, 97 [111 Cal.Rptr.2d 711]; *Stevens v. Superior Court* (1986) 180 Cal.App.3d 605, 608 [225 Cal.Rptr. 624].

^{12/} We do not address whether such conduct is offensive or unprofessional – only that such conduct does not violate Seller’s Attorney’s ethical obligations.

CONCLUSION

Where an attorney has engaged in no conduct or activity that induced an apparent material error by opposing counsel, the attorney has no obligation to alert the opposing counsel of the apparent error. However, where the attorney has made a material change in contract language in such a manner that his conduct constitutes deceit, active concealment, or fraud, the failure of the attorney to alert opposing counsel of the change would be a violation of his ethical obligations.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Governors, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.