

# 80

## LAWYER'S DUTY TO DISCLOSE MISTAKES IN COMMERCIAL CLOSING

Adopted February 18, 1989.  
Addendum issued 1995.  
Revised July 8, 2019.

### *Syllabus*

In representing a client in the closing of a commercial transaction, a lawyer has both a duty of loyalty to the client and a duty of honesty to the other party and the other party's lawyer. If, in preparation for or at the time of the closing, one party or its lawyer has made an undeniable mistake in the closing settlement statement regarding a basic assumption or element upon which the contract between the parties is based, and silence by the other party would amount to a knowing misrepresentation under the facts and circumstances, a lawyer must advise his client to disclose the mistake rather than remain silent about the mistake and accept its benefits. If the client refuses disclosure, the lawyer may not continue representing the client in the closing. To do so would violate Colorado Rules of Professional Conduct (Colo. RPC or the Rules) 4.1 and 8.4(c) and, depending on the facts, might also violate Colo. RPC 1.2(d). Whether the lawyer also is either permitted or required to disclose the mistake to the other party depends on whether, under the facts and circumstances, the lawyer's previous silence and other conduct, despite discontinuing participation in the closing, would (i) involve dishonesty, fraud, deceit, or misrepresentation, (ii) result in concealing or knowingly failing to disclose that which the lawyer is required by law to reveal, or (iii) constitute a knowingly false statement of fact or law. If the lawyer participates in the closing without making disclosure and later determines that disclosure should have been made, the lawyer should call upon the client to rectify the error. If the client refuses, the lawyer may similarly be permitted or required to disclose the mistake to the other party, depending on the facts and circumstances.

### *Introduction and Scope*

The Colorado Bar Association Ethics Committee (Committee) received a request in 1988 for its opinion regarding a lawyer's duties in representing a client in the closing of a commercial transaction when the lawyer realizes the other party, in preparing the settlement statement, has made an undeniable mistake regarding a basic assumption or element on which the contract between the parties is based. The mistake, if not discovered, would benefit the client financially. The client asks the lawyer to not disclose the mistake. The Committee adopted the initial version of Opinion 80 on February 18, 1989 and issued an Addendum in 1995. This revision updates Opinion 80 to take into account changes in the Colo. RPC and the practice of law. This opinion considers the following situation:

Seller's Lawyer represents a corporation (Seller) in the purchase and sale of Seller's assets to another corporation (Buyer) represented by Buyer's Lawyer. Z is Seller's president and sole shareholder. The parties had entered into a written contract (Contract) for the purchase and sale of Seller's assets. Among other typical provisions, the Contract provided for the purchase price, including Buyer's assumption of certain liabilities, and the allocation of the purchase price among the assets and assumed liabilities. It appears, but is not certain, that Buyer's Lawyer prepared the Contract. At the closing, Buyer and Buyer's Lawyer presented the contemplated closing documents

and the closing settlement statement, also apparently prepared by Buyer's Lawyer. When Z and Seller's Lawyer reviewed the closing settlement statement, they realized that it clearly contained a conceptual and formatting error relating to the allocation of the purchase price. The effect of the error was that Seller would receive a net payment substantially in excess of that undeniably contemplated by and due under the Contract. When Z and Seller's Lawyer conferred about the closing documents and the error in the closing settlement statement, they speculated that Buyer or Buyer's Lawyer may have corrected or adjusted for the error in the disbursement checks to be delivered at the end of the closing. In any event, Z requested of Seller's Lawyer that, if at all possible, he did not wish to point out the mistake. Seller's Lawyer did not disclose the error. The parties proceeded with the closing. The final disbursements mirrored the closing settlement statement and the mistaken, excess payment was delivered to Seller.

All these events occurred within a short period of time during which Seller's Lawyer realized the conflict between his competing duties of loyalty to his client and to act honestly in dealing with Buyer and Buyer's Lawyer. Seller's Lawyer did not know how to resolve the conflict and still permit the closing to occur.

The Committee offers no opinion regarding any party's duty and possible liability under applicable substantive law, for example, under principles of contract or agency law. This opinion limits its analysis to the application of the Colo. RPC.

### ***Questions Presented***

1. In representing a client in the closing of a commercial transaction, what are a lawyer's duties to the client and to the other party when confronted by the other party's undeniable mistake regarding a basic assumption or element on which the contract between the parties is based, when the lawyer's client benefits financially from non-disclosure and the client requests disclosure not be made?
2. If the parties closed without disclosure having been made, and in doing so the lawyer had not been able to resolve the lawyer's conflicting duties in the situation, what duty, if any, does the lawyer have to rectify the situation if the lawyer later determines that disclosure was required at the closing?

### ***Analysis***

#### **I. Applicable Rules**

This opinion applies the following rules: Colo. RPC 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 . . ."); Colo. RPC 1.6(a) ("A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation, or the disclosure is permitted by paragraph (b)."); Colo. RPC 1.6(b)(3) ("A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary . . . to prevent the client from committing a fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;"); Colo. RPC 1.6(b)(4) ("A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary . . . to prevent, mitigate, or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;"); Colo. RPC 4.1 ("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.”); Colo. RPC 8.4(c) (“It is professional misconduct for a lawyer to . . . (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation[.]”).

## **II. Legal Framework**

The inquiry presents the persistent problem of resolving a lawyer’s sometimes conflicting duties of loyalty to the lawyer’s client and of candor and fairness when dealing with third parties. This opinion first describes the nature and scope of the applicable duties of Seller’s Lawyer and then presents the analytical bases for resolving any apparent conflicts among those duties and for choosing a proper course of conduct in the situation presented.

### **A. Description of Seller’s Lawyer’s Roles as Advisor and Representative and the Responsibilities Inherent in These Functions**

Lawyers perform different functions. Depending upon the circumstances and the functions being performed, a lawyer’s generally paramount duty of loyalty to the client may be affected by the client’s and the lawyer’s coexisting duties to third parties or the courts. As legal advisors or counselors at law, lawyers listen to, consult with, and give advice to their clients. With rare exception, those communications are confidential. Colo. RPC 1.6. As negotiators and representatives outside the litigation context, lawyers assist clients in solving problems or gaining opportunities. When these services involve dealing with third parties, a lawyer’s duties may include duties to those third parties. *See, e.g.*, Colo. RPC 4.1 & 8.4(c). As advocates, lawyers resolve disputes within the context of the adversary system of justice, for the most part dealing with a client’s past conduct and taking the facts as they happened. However, as an advocate, a lawyer’s loyalty in representing the client is subject to rules of conduct that prohibit presenting non-meritorious claims and require the lawyer’s candor to the court. *See, e.g.*, C.R.C.P. 11 and Colo. RPC 3.1 & 3.3. In performing each of these different functions, the lawyer-client relationship is complicated by varying relationships with, and resulting duties to, third parties or the courts.

As a legal advisor, Seller’s Lawyer’s responsibility is to assist Seller in evaluating present circumstances and determining the course of future conduct and relationships. Colo. RPC 2.1. In this capacity, a lawyer furthers the client’s interests by giving the lawyer’s professional opinion regarding the applicable principles or rules of law and the client’s legal responsibilities, duties, and potential liabilities under the law; by expressing what the lawyer believes would likely be the ultimate decision of the courts on the matter at hand; and by informing the client of the legal and practical effect of various courses of action. *See* Colo. RPC 1.2(d) (although a lawyer may not counsel or assist a client to engage in conduct that the lawyer knows is criminal or fraudulent, “a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist the client to make a good faith effort to determine the validity, scope, meaning or application of the law.”).

Seller’s Lawyer also was the client’s representative at the closing. In this role, Seller’s Lawyer was both a fiduciary and an agent, actively participating in the transaction on behalf of the client, the principal. As such, Seller’s Lawyer’s conduct is subject both to the provisions of the Rules as an officer of the court and to applicable principles of agency law, which already form the foundation for a lawyer’s duties. *See* Rest. (3d) Law Governing Lawyers, Ch. 2, Introductory Note & Ch. 5, §§ 59-67 (2000) (lawyers’ duties to clients, including duty of confidentiality, are derived from the law of agency); Annotated Model Rules of Professional Conduct 107 (8th ed. 2015) (lawyer’s duties under Rule 1.6 are derived from the laws of agency and evidence); *see generally* Colo. RPC 8.4 (various subsections depending on requirements of substantive law). If Seller’s Lawyer submits closing documents on Seller’s behalf, the Lawyer’s role is undiminished even if the closing is conducted electronically, as frequently occurs, without a physical meeting of the parties.

## **B. Seller's Lawyer's Duty of Loyalty and Confidentiality of Information**

The fiduciary relationship between client and lawyer and the proper functioning of our legal system require a lawyer to preserve the confidentiality of information relating to the representation of a client. Colo. RPC 1.6(a). A lawyer's duty to protect client information is "a fundamental principle in the client-lawyer relationship." Colo. RPC 1.6 cmt. [2]. The principle requiring lawyer-client confidentiality is revered because it serves important societal purposes. Attempts to circumvent or undermine the privilege, when properly invoked, are carefully scrutinized and exceptions are narrowly construed. *See, e.g., Upjohn Co. v. United States*, 449 U.S. 383 (1981) (defining the scope of a corporate lawyer's attorney-client privilege in light of important purposes served by the privilege).

The prohibition against disclosure of information relating to the representation of a client extends to information that is protected by the attorney-client privilege. The attorney-client privilege is established in Colorado in C.R.S. § 13-90-107(1)(b). In a frequently quoted passage, *United States v. United Shoe Machine Corp.*, 89 F.Supp. 357 (D. Mass. 1950), explains that the privilege applies

only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the Bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client. *See also* 8 Wigmore, *Evidence* § 2292 (1961).

*Id.* at 358.

Despite the broad scope of confidentiality established by Rule 1.6(a), that duty may not be used to further a fraudulent or illegal purpose or to engage in other conduct that would violate the Rules. *See* Colo. RPC 1.6(b) & cmts. [6]–[12], Colo. RPC 3.3, 3.4(b), 4.1, & 8.4(c). The confidentiality rule thus may be superseded by the policy of preventing conduct that is fraudulent, illegal, or violates other Rules.

The facts giving rise to the instant inquiry — the discovery that Buyer or Buyer's Lawyer has made an error in the closing settlement statement benefitting Seller — involve "information relating to the representation" under Colo. RPC 1.6(a). Seller's Lawyer obtained the information about the error while performing work on behalf of a client. Moreover, it appears that the client does not wish the lawyer to disclose the information. Accordingly, Seller's Lawyer is not required to disclose the information absent an exception to the general rule of confidentiality.

## **C. Lawyer's Duties in a Commercial Closing**

A lawyer's duties in any situation depend to some extent on the facts, circumstances, and reasonable expectations of the parties. The setting here is the closing of the sale and purchase of a business. An important reality in any closing is that the parties already have struck a contract and the closing consummates that previous agreement. Under these circumstances, the parties reasonably expect that each will act fairly and in good faith to fulfill the ends of the agreement. *See, e.g., Rest. (2d) Contracts* § 205 (1981); C.R.S. § 4-1-304. In this context, certain actions have generally accepted meanings. For example, transfer documents are intended to transfer property under the terms and conditions required by the agreement. Similarly, closing settlement statements are intended in part to assist the parties in assuring each other that the agreement has been fulfilled to each party's satisfaction as to monetary matters. In such

a setting, approval or disapproval, acceptance or rejection, and affirmation or negation are the corroborative proof by which the parties measure performance. The lawyer is a key participant, whose actions, reactions, or inaction may have material meaning. And, silence may be meaningful conduct, a form of communication indicating approval or acceptance regarding the accuracy and conformity of documents and deliverables in the transaction.

Under these circumstances, rules requiring honesty have a plain meaning. C.R.C.P. 251.1(a) requires lawyers to act in accord with “the highest standards of professional conduct.” Colo. RPC 1.2(d), 4.1, and 8.4(c) prohibit conduct involving dishonesty, fraud, deceit, or misrepresentation. A simple hypothetical illustrates the point. Two parties agree that in exchange for a painting, \$10 will be given. The Committee concludes it would be dishonest for the artist’s lawyer to knowingly accept, without disclosure, a \$100 bill mistakenly delivered by the buyer.

In the scenario considered in this opinion, the calculation and allocation of the purchase price are basic and undisputed elements of the Contract. The closing’s purpose was to implement the parties’ agreement. Given those facts, the Committee concludes it would be dishonest for Z and Seller’s Lawyer to execute the closing documents and to the overpayment without pointing out the error in the closing settlement statement. *See* Colo. RPC 4.1(b) & cmt. [1].

Depending on the facts and circumstances in this or a similar situation, other provisions of the Rules may apply as well. For example, Colo. RPC 1.2(d) prohibits a lawyer from counseling or assisting a client in conduct that the lawyer knows to be criminal or fraudulent. Here, the Committee assumes that Seller’s conduct in not rectifying the Buyer’s mistake is not criminal. Whether the conduct is fraudulent requires resolution of issues of fact and substantive law. Colo. RPC 1.2(d) gives no guidance in applying the rule. In any event, the Committee does not opine on substantive law. The Committee makes no decision whether the facts in the hypothetical involve fraud by Seller or Seller’s Lawyer. However, the Committee’s research indicates almost a total absence of analytical examples of interpreting and applying provisions of the Rules that by their terms depend on determinations of substantive law. Therefore, the Committee believes that a general summary of some of the possibly applicable principles of substantive law would by illustration assist the bar in interpreting and applying such provisions.

In Colorado the well-recognized, elementary constituents of fraud in a contractual relationship include concealment of a material existing fact that in equity and good conscience should be disclosed. *Morrison v. Goodspeed*, 68 P.2d 458, 462 (Colo. 1937). Colorado recognizes that nondisclosure of a fact may result in fraudulent misrepresentation. *Cahill v. Readon*, 273 P. 653 (Colo. 1928); *Bohe v. Scott*, 265 P. 694 (Colo. 1928); CJI-Civ.2d 19:2, 19:5 (2018); Rest. (2d) Contracts §§ 159 & 161 (1981). The Colorado Supreme Court has stated:

[F]raud may be committed by the suppression of truth as well as the suggestion of falsehood. *The test of liability for failure to disclose facts material to the transaction is some duty, legal or equitable, arising from the relations of the parties, such as that of trust or confidence, or superior knowledge or means of knowledge.* When in the circumstances of the particular case such duty is present, failure to disclose a material fact with intention to mislead or defraud is equivalent to a fraudulent concealment of the fact, and stands no better than the affirmation of material misrepresentation.

*In re Cisneros*, 430 P.2d 86, 89 (Colo. 1967) (emphasis in original and (quotation marks and citation omitted).

Similarly, in a tort action for misrepresentation the plaintiff must prove (1) a false representation of material fact by the defendant, (2) the defendant’s knowledge that the representation was false, (3) the

plaintiff's ignorance as to the falsity of the representation, (4) that the defendant made the representation with the intent that the plaintiff should act on it, and (5) justified reliance that caused damage to the plaintiff. *Morrison*, 68 P.2d at 462; CJI-Civ.2d 19:1 (2018). Also, the tort of misrepresentation may arise from the failure to disclose a material existing fact that in equity and good conscience should have been disclosed. *Schnell v. Gustafson*, 638 P.2d 850 (Colo. App. 1981) (citing *McNeill v. Allen*, 534 P.2d 813, 818 (Colo. App. 1975)); see also *Morrison*, 68 P.2d at 462.

Determining the existence of fraud also may depend on other factors such as Buyer's or Buyer's Lawyer's possible negligence in committing the error in the first instance and possibly related issues of justifiable reliance.

Summarizing, the Seller's Lawyer must determine how to protect Seller's information while not engaging in prohibited conduct in advancing the client's interests in the third-party relationships with Buyer. Generally, prohibited conduct in this context would mean conduct that violates CRPC 1.2(d).

### **III. Application**

#### **A. Resolution Before Execution of the Closing Documents**

Based on the foregoing, how should Seller's Lawyer proceed? Realizing that allowing Seller to execute the closing documents without disclosure would involve dishonesty and assisting a client in possibly fraudulent conduct, Seller's Lawyer should explain to Z why disclosure is required and the possible practical and legal effects of failure to disclose. On this basis, Seller's Lawyer should advise Z to point out the error in the settlement statement. Based on the collective experience of its members, the Committee believes most instances of this sort would be resolved at this juncture based on the lawyer's professional stature and ability to influence a client to do at least what the law requires and what people reasonably expect as requirements of good faith and fair dealing.

If Z refuses and instructs Seller's Lawyer not to disclose the error, Seller's Lawyer must decline to do so. If Z persists, Seller's Lawyer must withdraw from the representation and decline to participate further in the closing or the execution of and delivery of closing documents. Withdrawal is mandatory under Colo. RPC 1.16(a)(1), because continuing a representation clearly involving dishonest conduct by the lawyer would violate Colo. RPC 4.1 and 8.4(c). Depending on the facts, withdrawal also could be permitted under Colo. RPC 1.16(b)(2), (3), or (4).

Whether, in addition to withdrawing from representation, Seller's Lawyer also is permitted or required to disclose the error depends on the facts, particularly Seller's Lawyer's own statements or other conduct prior to withdrawing. For example, if Seller's Lawyer's conduct was equivalent to a representation that the closing settlement statement was accurate, and Seller's Lawyer now knows that not to be the case, Colo. RPC 1.6(b)(3) permits and Colo. RPC 4.1 and 8.4(c) require disclosure . The rules requiring disclosure where the lawyer's own conduct is the critical question are recognized exceptions to the strict duty of confidentiality.

#### **B. Resolution Following the Closing**

Finally, the Committee turns to the question of Seller's Lawyer's duties in the event of a completed closing, including delivery of the overpayment without disclosure.

In this case, Seller's Lawyer arguably acted in good faith in proceeding with the closing without disclosure at Z's request, because Lawyer was uncertain how to balance the apparently conflicting duties. Seller, and Seller's Lawyer as Seller's agent, had a common law duty of honesty and fair dealing, which

may have been breached by Z's and Seller's Lawyer's failure to disclose the error. Also, Seller's Lawyer's conduct appears to have been inconsistent with the ethical obligation not to engage in conduct involving dishonesty or misrepresentation insofar as Seller's Lawyer knew the truth of the error and refrained from comment, albeit only at the client's request. Under these apparent circumstances, the Committee concludes the lawyer may rectify the error.

Since there may now exist differing interests between Seller and Z on the one hand and Seller's Lawyer on the other hand, Seller's Lawyer should so inform Z and Seller, but should do so in calling upon Seller and Z to rectify the overpayment. If Seller declines, Seller's Lawyer is permitted to rectify the injury by disclosing the overpayment to Buyer under Colo. RPC 1.6(b)(4).

If the facts surrounding nondisclosure were determined to be fraudulent conduct by Seller's Lawyer, disclosure would be permissible under Colo. RPC 1.6(b)(4) and required by Colo. RPC 4.1, which prohibits a lawyer from "knowingly . . . mak[ing] a false statement of material fact," and Colo. RPC 8.4(c), which prohibits "conduct involving dishonesty, fraud, deceit or misrepresentation." Since lawyers must not engage in deliberate deception, Rule 1.6(a) does not prevent a lawyer from correcting intentionally false or misleading statements made in violation of Rules 4.1 and 8.4(c).

#### *Afterword*

In view of this opinion's introductory remarks emphasizing how a change in the lawyer's role or function may alter the analysis and require different results, the Committee offers two additional illustrations.

The first example involves a defense lawyer's representation in a criminal case. In *People v. Schultheis*, 638 P.2d 8 (Colo. 1981), the defendant had insisted upon presenting perjured testimony through alibi witnesses. The trial court refused the defense lawyer's request to withdraw. Defense counsel proceeded with the defense but refused to call the alibi witnesses. After a conviction of murder in the first degree, the defendant appealed. He claimed that he was deprived of his constitutional right to effective assistance of counsel because defense counsel refused to present the alibi witnesses' testimony.

In affirming the conviction, the Colorado Supreme Court illuminated the course for a lawyer in resolving the difficult conflict between loyalty to the client and candor to the tribunal under these circumstances. As its beginning principle, in the interest of preserving the integrity of the American adversary system of criminal justice, the Court held that a lawyer may not offer testimony of a witness that the lawyer knows is false, fraudulent, or perjured. When serious disagreement occurs between defense counsel and the accused, and counsel is unable to dissuade the client from insisting that fabricated testimony be presented, counsel should request permission to withdraw from the case. In making the request, the lawyer should not reveal to the trial judge the specific reason for the motion to withdraw. Rather, counsel should state only that there exists an irreconcilable conflict with the client. If the motion is denied, counsel must continue to serve as defense counsel but must not present the perjured testimony. The lawyer's refusal to call particular witnesses, because obedience to ethical standards prohibits presentation of fabricated testimony, does not constitute ineffective assistance of counsel. This case illustrates how, in an adversarial situation, a lawyer should seek to maintain client confidences while not, by the lawyer's own conduct, presenting false evidence.

The second example involves a tax lawyer who, in reviewing a new client's past tax returns, discovers that the government had made a \$100,000 error, to the client's benefit, in calculating the client's tax liability. The Chicago Bar Association Professional Responsibility Committee has opined that a lawyer whose client benefitted in this situation is not ethically required to disclose the error to the government unless the lawyer's failure to disclose the error would perpetrate a fraud *by the lawyer* (and not the client)

on the government; the lawyer may, but is not required to, disclose the government's error if the client consents to the disclosure or if disclosure is required by law. Chicago Bar Ass'n Prof. Resp. Comm. Op. 86-4 (undated). The Committee approves of this analysis. While the lawyer should not reveal confidential information about the client's past affairs, the lawyer may not, through the lawyer's own conduct, engage in dishonest, fraudulent, or misleading behavior.

10317218\_v2