

ETHICAL ISSUES IN CONSTRUCTION CASES

**DALLAS BAR ASSOCIATION
CONSTRUCTION SECTION**

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ETHICAL ISSUES IN CONSTRUCTION CASES

I. TRUTH IN NEGOTIATING

A. Applicable Rules¹

Preamble Paragraph 2

As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealing with others.

Rule 4.01 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.

Rule 8.04 Misconduct

(a) A lawyer shall not: ... (3) engage in conduct involving dishonesty, fraud, deceit or misrepresentation.

B. Requirements of Honesty

Although one may be tempted to generalize the Texas Disciplinary Rules of Professional Conduct (the “Rules”) as requiring that “a lawyer must be honest,” the Rules actually interpose several conditions before a lawyer’s false statement violates the Rules.

First, a violation of Rule 4.01 requires that the false statement must be made in the course of representing a client. A lawyer’s dishonesty in his personal business matters and affairs does not violate Rule 4.01(a).²

Second, a violation of Rule 4.01 requires that the lawyer’s false statement must be knowing, i.e., undertaken with knowledge. Innocent misstatements of fact or law are not violations. The Rules define “knowingly” as actual knowledge of the fact in question, stating that a person’s knowledge may be inferred from circumstances.³ The Rules do not define

¹ The Texas ethics rules are found in the State Bar Rules, Art. X., § 9, Texas Disciplinary Rules of Professional Conduct (effective 1/1/90 as amended.). See also, <http://www.lawlib.uh.edu/ethics/> (University of Houston Texas Ethics Reporter website), http://www.txethics.org/reference_rules.asp?view=conduct and http://www.txethics.org/reference_opinions.asp (Texas Center for Legal Ethics and Professionalism website.)

² Statements made outside the scope of client representation may violate Rule 8.04, quoted above. See also the Preamble to the Rules (“A Lawyer’s Responsibilities,” Paragraph 4):

A lawyer’s conduct should conform to the requirements of the law, both in professional service to clients and in the lawyer’s business and personal affairs.

³ Preamble to the Rules, Terminology.

knowledge as, for example, negligent misrepresentation. As such, a statement made with a disregard for whether or not the statement is false is not equal to a false statement knowingly made. For example, a lawyer who “shoots from the hip” (e.g., opining as to matters of law on behalf of a client under circumstances that would give the lawyer no reasonable assurances about the accuracy of his legal opinions, but with no actual knowledge that his legal opinions are incorrect) does not violate Rule 4.01(a).

Third, Rule 4.01(a) refers to statements of material fact or law, and not to statements of opinion. The implication is that false statements of immaterial fact or law, and false statements of opinion, even if made knowingly and with an intent to deceive, do not violate Rule 4.01(a).

Comment 1 to Rule 4.01 goes even further, attempting to merge into the material-immaterial distinction set forth in the Rule the concept that certain statements, made in negotiations, are understood by the parties to be immaterial or matters of opinion. An excerpt from Comment 1 to Rule 4.01 states:

[Rule 4.01(a)] refers to statements of *material* fact. Whether a particular statement should be regarded as one of *material* fact can depend on the circumstances. For example, certain types of statements ordinarily are not taken as statements of material fact because they are viewed as matters of opinion or conjecture. Estimates of price or value placed on the subject of a transaction are in this category. Similarly, under generally accepted conventions in negotiations, a party’s supposed intentions as to an acceptable settlement of a claim may be viewed merely as negotiating positions rather than as accurate representations of material fact. [Emphasis added.]

Comment 1 suggests that Rule 4.01(a) does not apply in negotiations where “accepted conventions” would reasonably lead one to not rely on a lawyer’s statements made in those negotiations. The standard, of course, is vague: “accepted conventions” are not uniformly accepted and are, at best, poorly defined.

While Comment 1 is vague as to what constitutes “generally accepted conventions in negotiations”, the ABA ethics committee has advised that “a party’s actual bottom line or the settlement authority given to a lawyer is a material fact.”⁴

Rule 8.04(a)(3) prohibits lawyers from engaging in conduct involving dishonesty, fraud, deceit or misrepresentation. Rule 8.04(a)(3), however, has none of the conditions associated with Rule 4.01(a): the dishonesty, etc. need not occur in the course of representation of a client, it need not be “knowing” (although the concept of “knowledge” seems inherent in dishonesty) and it need not pertain to a material matter.

⁴ ABA Formal Ethics Opinion 93-370 (1993.)

The Rules define “fraud” as requiring an intent to deceive, but do not define dishonesty, deceit or misrepresentation.⁵

C. The Rules in Context of Negotiations

Much of the work done in handling construction cases requires a lawyer’s active use of and participation in negotiations. And while most lawyers believe themselves to be honest people, our profession seems to expect and arguably require dishonesty during the course of a negotiation.

Walter Steele writes, “In my opinion, it is a cultural norm to lie during a negotiation. This ‘cultural’ norm appears to hold true in societies across the globe. In fact, lies might be the essence of negotiation.”⁶

“As practiced by many attorneys, deception is the spirit of negotiation. Negotiating lawyers misstate facts, willfully mislead by manipulating known facts, or fail to correct an opponent’s ignorance or misconception about matters central to the negotiation. These tactics vary in sophistication from merely putting on a false face to expressly lying about the extent of settlement authority. In a broad sense, justifications exist for this less than honest standard for negotiating. A lawyer’s devotion to the client’s interest is so compelling that some lawyers feel justified, if not compelled, to employ some deception when negotiating.”⁷

Jeffrey Krivis, a California mediator, writes, “Although few will admit to it, there is no doubt that deception plays an active role in mediation between both sides and their communications with the mediator.”⁸

The very nature of negotiating sends contradictory signals to the negotiator. “On the one hand the negotiator must be fair and truthful; on the other he must mislead his opponent. Like the poker player, a negotiator hopes that his opponent will overestimate the value of his hand. Like the poker player, in a variety of ways he must facilitate his opponent’s inaccurate assessment. The critical difference between those who are successful negotiators and those who are not lies in this capacity both to mislead and not to be misled.”⁹

⁵ “‘Fraud’ or ‘fraudulent’ denotes conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information.” Preamble to the Rules, Terminology.

⁶ Walter Steele, Ethics for Transaction Lawyers, Ethics Chat, Issue 1, Spring 2001.

⁷ Steele, Deceptive Negotiating and High-Toned Morality, 39 Vand. L. Rev. 1387 at 1399 (1986.)

⁸ Jeffrey Krivis, “To Tell the Truth in Deception, First Be Aware That It’s There,” Los Angeles Daily Journal, April 24, 2006, p. 9.

⁹ White, Machiavelli and the Bar: Ethical Limitations on Lying in Negotiation, 1980 Am. B. Found. Res. J. 926, at 927 (No. 4 Review Symposium: Model Rules of Professional Conduct) (1980).

“Most lawyers say it would be improper to prepare a false document to deceive an adversary or to make a factual statement known to be untrue with the intention of deceiving him. But almost every lawyer can recount repeated instances where an adversary of reasonable repute dealt with facts in such an imaginative or hyperbolic way as to make them appear to be different from what he knew they were.” [Emphasis added.]¹⁰

“[S]ome form of deceit, at least in the broadest sense of the word, is inherent in all negotiations and ... a lawyer with an obligation to obtain the best result for a client cannot be expected, realistically, to negotiate outside the context of everyday convention.”¹¹

Some argue that deception is a vital part of a competitive market. “One of the central reasons why the occasional white lie is tolerated is that competition in our society promotes an atmosphere of freedom of choice and enables buyers and sellers to define the limits of acceptability...In trying to get the best deal for a client, some forms of deception are tolerated within the marketplace of ideas, as long as individuals are not being fraudulent. There is no law against stretching the spectrum of deception in order to get a good deal.”¹²

Deception is particularly tolerated and even expected in the mediation context. “Within the typical negotiation process there are various forms of deception that attorneys have come to rely on. Some examples include: concealing the willingness to settle and/or the bottom line, making inflated demands, exaggerating strengths and weaknesses, concealing client intentions, claiming a lack of authority and failing to volunteer relevant facts.”¹³

So, do the Rules require honesty during negotiations or not? Should the Rules require lawyers to be truthful in all instances? What are the costs of tolerating dishonest behavior?

This issue is particularly important for lawyers handling complex matters like construction cases. In a simple case, with few facts and documents, it is reasonable to assume that all the lawyers will be familiar with all of the facts. In a construction case, or other complex and paper intensive matter, there is no way that each lawyer will have each “fact” in the case committed to memory. The Rules, then, begin to be more relevant as lawyers are forced to evaluate the truthfulness of what opposing counsel says.

Ken Starr argues that lawyers’ attitude toward the truth is one reason for the profession’s unpopularity. “We have lost, or at least mislaid, some measure of our profession’s traditional

¹⁰ Rubin, A Causerie On Lawyers’ Ethics in Negotiation, 35 La. L. Rev. 577, at 585 (1975).

¹¹ Steele, supra at 1399.

¹² Jeffrey Krivis, The Truth about Deception in Mediation, www.firstmediation.com (2002.)

¹³ Id.

respect for the truth. The behavior of too many lawyers today brings to mind Mark Twain's remark: "Truth is the most valuable thing we have. Let us economize it."¹⁴

Another potential cost of dishonesty in negotiations: "[d]amage to one's reputation is first in line, making it difficult to conduct business in the future. A negotiator who has been identified in the marketplace as dishonest has every claim closely scrutinized by his opponents and often wastes valuable time proving each fact and contention...Indeed parties can save time, money and profits by negotiating with an attorney who puts truth before deception....The truth is that while deception can provide a bargaining advantage, it often comes at a cost."¹⁵

At present, it is left to each one of us to decide how the Rules apply to our statements during negotiations.

Walter Steele notes that no rules effectively limit negotiation behavior. "There are no effective rules of discipline, no rules of procedure; no rules of evidence; no presence of an overseeing judge; not even a shared ethos. At present, practically the only restraint on a lawyer negotiator is the tort of fraud. For now the only ethical guidelines for negotiating lawyers are their own moral compasses."¹⁶

D. Extreme of Fraudulent Misrepresentation

While the practicalities of mediation and negotiations make it difficult and/or impossible for the Rules to be enforced, if a lawyer crosses into "fraudulent representation," liability becomes more likely. For example, in *Hansen v. Anderson*,¹⁷ the Iowa Supreme Court held that an attorney who made a fraudulent misrepresentation during the sale of the assets of business could be required to indemnify the other parties for the damages caused by his misrepresentation. The court mentioned the ethics violation under the Iowa Code of Professional Conduct, but relied on the Restatement (Third) of the Law Governing Lawyers, Section 98, which provides in part that "[a] lawyer communicating on behalf of a client with a nonclient may not...[k]nowingly make a false statement of material fact or law to a nonclient..."^{18 19}

¹⁴ Starr, Truth and Truth Telling, 30 Tex. Tech. L. Rev. 901, 1999, quoting from Mark Twain, Pudd'nhead Wilson and Pudd'nhead Wilson's Calendar 167 (Heritage Press 1974).

¹⁵ Krivis, supra.

¹⁶ Steele, Ethics for Transaction Lawyers at p. 3.

¹⁷ 630 N.W. 2d 818 (Iowa 2001.)

¹⁸ Untruthful statements during negotiations have led to discipline in isolated instances. *In re McGrath*, 468 N.Y.S. 2d 349 (N.Y. App. Div. 1983) a lawyer was disciplined for stating that insurance coverage was \$200,000 when lawyers in his file indicated coverage of \$1 million.

¹⁹ See also *McCamish, Martin vs. Appling*, 991 S.W. 2d 787 (Tex. 1999.)

E. Another perspective

Wyoming Supreme Court Justice Kite, in a concurring opinion, comments on the “cost” of a lack of candor. In *Lavatal vs. Wyoming*²⁰, the State’s lawyers knew that the claimant had not personally certified his claim, as he was required to do. One day after the statute of limitations ran, the State filed a motion of summary judgment. Justice Kite wrote, quoting from *Virzi vs. Grand Trunk Warehouse and Cold Storage*²¹, “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....Another lawyer who deals with a lawyer should not need to exercise the same degree of caution that he would if trading for reputedly antique copper jugs in an oriental bazaar....The distinction between honesty and good faith need not be finely drawn here; all lawyers know that good faith requires conduct beyond simple honesty.”²²

II. JOINT REPRESENTATION

Lawyers are occasionally asked to represent two parties in the same transaction. The request is frequently made when the potential clients see no reason to hire two lawyers and want to “just get the deal done.” The potential clients are rarely adverse when the request is made and the lawyer is often encouraged to think that nothing could ever drive the potential clients apart.

The problem for the lawyer and the clients arises when the deal “goes bad” or some other dispute arises between the parties. The lawyer often ends up in the middle of a mess – one that could have been avoided or minimized by actions taken at the beginning of the representation.

This section of the paper will first discuss the ethical standards that apply when a lawyer decides whether he or she should undertake a joint representation. It will then comment on the issues that must be considered by the lawyer before he can make a well-informed decision. Finally, it will illustrate the issues that arise by analyzing a hypothetical request to represent both a principal and a surety in a payment bond dispute.

A. Applicable Rules

The Texas Disciplinary Rules of Professional Conduct govern whether a lawyer can accept any dual representation. The Rules that bear on this issue are Rules 1.01, 1.03, 1.05 and 1.06.

Rule 1.01 Competent and Diligent Representation:

(a) *A lawyer shall not accept or continue employment in a legal matter which the lawyer knows or should know is beyond the lawyer's competence, unless:*

(1) *another lawyer who is competent to handle the matter is, with the prior informed consent of the client, associated in the matter; or*

²⁰ 121 P.3d 121 (Wyo. 2005.)

²¹ 571 F. Supp. 507, 512 (E.D. Mich. 1983.)

²² *Lavatal*, p. 126.

- (2) *the advice or assistance of the lawyer is reasonably required in an emergency and the lawyer limits the advice and assistance to that which is reasonably necessary in the circumstances.*

Rule 1.03 Communication:

- (a) *A lawyer shall keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information.*
- (b) *A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.*

Rule 1.05 Confidentiality of Information:

...

(b) *Except as permitted by paragraphs (c) and (d), or as required by paragraphs (e) and (f), a lawyer shall not knowingly:*

- (1) *Reveal confidential information of a client or a former client to:*
 - (i) *a person that the client has instructed is not to receive the information; or*
 - (ii) *anyone else, other than the client, the client's representatives, or the members, associates, or employees of the lawyer's law firm.*
- (2) *Use confidential information of a client to the disadvantage of the client unless the client consents after consultation.*

...

- (4) *Use privileged information of a client for the advantage of the lawyer or of a third person, unless the client consents after consultation.*

Rule 1.06 Conflict of Interest: General Rule

- (a) *A lawyer shall not represent opposing parties to the same litigation.*
- (b) *In other situations and except to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person:*
 - (1) *involves a substantially related matter in which that person's interests are materially and directly adverse to the interests of another client of the lawyer or the lawyer's firm; or*
 - (2) *reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests.*

(c) *A lawyer may represent a client in the circumstances described in (b) if:*

- (1) *the lawyer reasonably believes the representation of each client will not be materially affected; and*
- (2) *each affected or potentially affected client consents to such representation after full disclosure of the existence, nature, implications, and possible adverse consequences of the common representation and the advantages involved, if any.*

(d) *A lawyer who has represented multiple parties in a matter shall not thereafter represent any of such parties in a dispute among the parties arising out of the matter, unless prior consent is obtained from all such parties to the dispute.*

Comment 1 to Rule 1.06 provides that "[l]oyalty is an essential element in the lawyer's relationship to a client."

It is important to note that the Texas Rules are not the same as the ABA Model Rules. Rule 1.06 (c) of the Texas Rules is identical to Model Rule 1.7 (c), but sections (a), (b), (d), (e) and (f) of the Texas Rule 1.06 are more restrictive than Model Rule 1.7.²³ So, when consulting case law from other jurisdictions, one should review the wording of the applicable rule as well as the language of the opinion before judging its applicability to a particular situation.

B. Considerations Before Accepting Joint Representation

How then should a lawyer apply these rules when making a decision about accepting joint representation?

1. Competent and Diligent Counsel

The first consideration should be whether the lawyer can competently represent each of the parties who have requested representation. Rule 1.01 requires competent and diligent counsel. The lawyer must consider the position of each of potential clients – is there anything unique about any of them that would result in providing less than competent representation? Is the lawyer familiar enough with the law that applies to each party to be certain he can competently represent each one?

2. Loyalty

Comment 1 to Rule 1.06 states that "loyalty is an essential element in the lawyer's relationship to a client." If the lawyer will be unable to be loyal to both or all clients, Rule 1.06 precludes him from undertaking joint representation. The lawyer must consider whether his loyalty will be compromised by the hope (or the promise) of future work from one of the clients or by knowledge acquired about one or more of the clients during past representation.

²³ Zeev Eiger and Brandy Rutan, 14 Geo. J. Legal Ethics 945, 954 (Summer 2001).

3. Provide Reasonable Information

Rule 1.03 provides that "[A] lawyer shall keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information." A lawyer has this obligation to both clients in a dual representation situation, even if he only considers one of the two to be his "real" client.

In *Insurance Company of North America vs. Westergren*,²⁴ the lawyer argued that he had represented one of the two parties "on a merely pro forma basis. He did not consider [Client #2] his client because [Client #2] did not pay for his representation."²⁵ The Court stated, "We find nothing in the disciplinary rules which permits a pro forma representation of a client."²⁶

When considering undertaking dual representation, a lawyer must consider whether there is something that would prevent him from keeping all clients informed. Has one client asked to be the contact and asked the lawyer not to "muddy the water" by copying the other client on correspondence? Will one client require communications to be translated into another language? Is there anything that will make it more difficult to keep one client as informed as the other?

4. No Disclosure of Confidential Information

Rule 1.05 is designed to prevent the disclosure of a client's confidential information. This rule applies to all information relating to the representation regardless of the source if it is the client's desire for the information to remain confidential. When undertaking joint representation, the lawyer must consider whether there may be confidential information that one client will want to keep confidential from the other client. In that situation, the lawyer may be faced with the conflict between Rules 1.03 (keep each client fully informed) and 1.05 (keep each client's information confidential).

In Texas Ethics Opinion 482,²⁷ a law firm was representing an employer and two former employees. During a conversation with one of the former employees, the employee "indicated hostility toward his former employer and expressed dissatisfaction with the manner in which the former employer had treated him...The ex-employee also suggested that his recollection of facts might change in the absence of some type of 'financial reward' from his former employer."²⁸ Even though the tape of that conversation would obviously be interesting to the other clients the firm was representing, the firm was not permitted to disclose the contents of

²⁴ 794 S.W. 2d 812 (Tex. App. - Corpus Christi 1990, orig. proceeding).

²⁵ Id. at 814.

²⁶ Id. at 815.

²⁷ Texas Ethics Opinion, February 1994.

²⁸ Id. at 1.

the tape. “The firm gained this information as part of the attorney-client relationship and cannot disclose it without the client’s informed consent.”²⁹ The lawyer was also required to withdraw from the matter. “[The firm] is bound to protect any confidences the firm received. In order to adequately safeguard those confidences, the firm must withdraw from representing any of the parties.”³⁰

5. Avoid a Conflict of Interest

In addition to the loyalty requirement in Comment 1 to Rule 1.06, Rule 1.06 provides some guidance as to when a lawyer may represent two different clients.

Rule 1.06 requires a multi-level analysis. First, a lawyer can never represent opposing parties to the same litigation. This prohibition is non-waivable.³¹

If that hurdle is overcome, the lawyer needs to determine if the interests of the two clients are “materially and directly adverse” or if the representation would be limited by the lawyer's responsibilities to another client. If not, the lawyer then needs to determine if the representation of either one would be "materially affected" by the joint representation.

If the lawyer decides neither party will be “materially affected” and that he can represent both clients, he needs to provide full disclosure of the potential problems to each client. A lawyer should not ask for the client's agreement to the joint representation "when a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances.”³²

Finally, both clients must consent after full disclosure. “The test by which counsel will be judged is whether he advised the ... [client] of all facts and circumstances which, in the judgment of an attorney of ordinary skill and knowledge, were necessary to enable the client to make a free and intelligent decision regarding the effect of the conflict.”³³

In Ethics Opinion 487, the lawyer sought to represent an employer and an employee who were both defendants in a suit by a former employee. The initial disclosure agreement read, in part, “The law firm may discover confidential information about either X or Y that may damage X’s relationship with Y, thereby causing a conflict of interest. In the event such information is discovered, such information is to be revealed to both X and Y as soon as the conflict is recognized.”³⁴ The Opinion continued representation of the employer was acceptable

²⁹ Id. at p. 1.

³⁰ Id. at p. 2.

³¹ Eiger and Rutan, p. 954

³² Texas Ethics Opinion 500, Texas Bar Journal April 1995; comment 7 to Rule 1.06

³³ David Beck, Legal Malpractice in Texas, 50 Baylor L. Rev. 671, 677 (Summer 1998).

³⁴ Texas Ethics Opinion 487, page 2, December 1992.

that so long as the law firm fully advised the employer and the employee of “*all* implications of the dual representation of the employer and the employee, including the potential consequences to the employee of the disclosure to the employer of confidential information about the employee.”³⁵ The Opinion did note, however, that “[i]t may be difficult to fully inform a client of *all* potential consequences of the disclosure of confidential information before knowing the substance of that information.”³⁶

Comment 8 to Rule 1.06 cautions “[d]isclosure and consent are not formalities. Disclosure sufficient for sophisticated clients may not be sufficient to permit less sophisticated clients to provide fully informed consent. While it is not required that the disclosure and consent be in writing, it would be prudent for the lawyer to provide potential dual clients with at least a written summary of the considerations disclosed.”³⁷

“This [disclosure] includes the attorney’s possible biases from previous experience or representation of any party, the potential for future claims between the parties in which the attorney could not participate, and that there will be no attorney-client privilege between the parties.”³⁸

As an example of this analysis, Texas Ethics Opinion 512 considers whether an in-house lawyer of a corporation may represent a joint venture in which the corporation is a venturer. The Opinion concludes that such representation is permissible if the lawyer “reasonably believe[s] that the representation of each client will not be materially affected and the corporation and the joint venture... consent to such representation after full disclosure.”³⁹

6. Continuing analysis

Once an initial decision about representation is made and the necessary disclosures discussed with the clients, the attorney representing two or more clients in a matter must remain cognizant throughout the course of the representation that the possibility for conflict exists. When and if a conflict arises, the attorney must follow the principles and mandates set out in the State Bar Rules of Professional Conduct.

While many situations may develop during the course of the representation, Comment 3 to Rule 1.06 suggests a couple of possible situations that would change a “potential

³⁵ Id.

³⁶ Id.

³⁷ Comment 8, Rule 1.06.

³⁸ Linda A. Klein, *Ethical and Other Pitfalls of Dual Representation in Surety Bond Litigation*, ABA TIPS Fidelity and Surety Law Committee, paper presented at the Annual Midwinter Meeting 1991, p. 11.

³⁹ Texas Ethics Opinion 512, June 1995, p. 2.

conflict” into an “impermissible conflict.” “An impermissible conflict may...develop by reason of substantial discrepancy in the parties’ testimony, incompatibility in positions in relation to an opposing party or the fact that there are substantially different possibilities of settlement of the claims or liabilities in question.”⁴⁰

Another possible arising conflict is raised in Texas Ethics Opinion 500, which finds that “it would be a violation of DR 1.06 to represent two or more persons injured in a single accident caused by a third person when it becomes clear that the third person has a limited amount of funds to pay a possible judgment or settlement.”⁴¹

In *In re Posadas*,⁴² the lawyer “received a communication from his clients which create[d] an ‘irreconcilable conflict’.” Even though this communication was received late in the case, the Court found that there was no consent from the client to reveal the substance of the communication pursuant to Rule 1.06(c) after the conflict arose and so the lawyer was allowed to withdraw.

7. Subsequent dispute

If a dispute does arise between joint clients either during the representation or subsequent to it, the lawyer must again turn to Rule 1.06. Rule 1.06(d) states that “[a] lawyer who has represented multiple parties in a matter shall not thereafter represent any of such parties in a dispute among the parties arising out of the matter, unless prior consent is obtained from all such parties to the dispute.” In the absence of an agreement, the proper course is for the lawyer to withdraw from the entire representation.

8. Checklist

So, what questions should a lawyer asked when faced with this request? The following is a good place to start, but may not include all the considerations, based on the facts of the individual matter:

- Do I know enough about this type of matter to represent the client competently and diligently:
 - (a) Client A?
 - (b) Client B?

⁴⁰ Comment 3, Rule 1.06.

⁴¹ Texas Ethics Opinion 500, August 1994, p. 2.

⁴² 2001 Tex. App. LEXIS 5134 (Tex. App. San Antonio), p.2.

- If not, is another lawyer who is competent available to assist and be associated in the matter?
- If so, have I gotten the prior, informed consent of the client for this association?
- Is there any reason why I couldn't keep the client reasonably informed about the status:
 - Client A?
 - Client B?
- Will the two (or more) clients need things explained to them in different ways? If so, will that be a problem for me?
- Am I likely to come into possession of confidential information about one or more of the clients that he will not want me to share with the other client?
- Will I come into possession of confidential information about one client that would benefit the second client?
- If so, will the first client agree to the use of the information?
- Are the two clients opposing parties to the same litigation?
- Are the interests of the two potential clients "materially and directly adverse?"
- Will my representation of one client be adversely limited by my representation of the second client?
- If the answer to either 10 or 11 is "yes," do I believe that the representation of the client will not be materially affected:
 - Client A?
 - Client B?
- If the answer to 10, 11 or 12 is "yes," have I fully disclosed all the issues to all the potential clients?
- Has an agreement been discussed about what happens if a dispute develops?

C. Real Life Illustrations of the Issue

1. Consequences of a failure to assert surety defenses

*Morse/Diesel, Inc. v. Trinity Industries, Inc.*⁴³ graphically illustrates the problems caused if counsel fails to assert the appropriate surety defenses. In *Morse/Diesel*, the obligee obtained a verdict against the principal and the surety in an amount in excess of the bond's penal sum. After the trial, new attorneys, retained by the surety after the verdict, sought to assert the applicable surety defenses.

⁴³ 875 F. Supp. 165 (S.D.N.Y. 1994), rev'd on other grounds, 67 F.3d 435 (2d Cir. 1995).

The court held:

Aetna's motion for a new trial is denied on the basis of my finding that the trial errors alleged by Aetna were not properly preserved by Aetna's prior counsel (who was simultaneously counsel for Trinity Industries).⁴⁴

In the opinion, the court noted:

Aetna's new counsel now contends the [Court's jury] charge was incorrect in three respects. First, Aetna now maintains, my characterization of the performance bond as "a form of insurance" was a misstatement of the law and a conceptual error. Second, Aetna now asserts that I erred in neglecting to instruct the jury that its liability under the performance bond was contingent upon its receipt from Morse/Diesel of a formal declaration of default by Trinity [the principal].... Finally, Aetna now argues that I erred in instructing the jury that Aetna's liability to Morse/Diesel was co-extensive with Trinity's; on the contrary, Aetna now claims, its exposure was narrower. The relevant law and the terms of the performance bond, Aetna now says, rendered it liable for only the excess cost of completing Trinity's subcontract work in the event Trinity failed to do so; consequential damages stemming from Trinity's delay in performing its subcontract (i.e., the type of damages awarded Morse/Diesel by the jury) were not within the range of its exposure.⁴⁵

The court found:⁴⁶

With respect to the first two points of error, it is apparent that Aetna did not comply with the dictates of [Fed. R. Civ. P.] Rule 51 [objecting in a manner so as to alert the trial judge to alleged error and allow the court an opportunity to correct.] Prior to the filing of this motion, counsel for Aetna did not so much as mention, much less object to, the [jury] charge's reference to the performance bond as a "form of insurance" or the charge's failure to note that a declaration of default was a precursor to Aetna's liability. [Emphasis added]

In remarking on the joint representation, the court wrote:

⁴⁴ *Morse/Diesel*, 875 F. Supp. at 167.

⁴⁵ *Morse/Diesel, Inc.*, 875 F. Supp. at 168.

⁴⁶ *Morse/Diesel, Inc.*, 875 F. Supp. at 169.

Neither in its pleadings, nor in a summary judgment motion, nor in any of the many motions in limine, nor during the trial itself did their common counsel suggest that Aetna's liability might diverge from Trinity's based on the type of damages claimed by Morse/Diesel. Indeed, an examination of the trial transcript demonstrates that the parties tried the case as if it were a dispute solely between the principal parties, with Aetna merely an interested but uninvolved spectator. Common counsel for the defendants offered no evidence concerning Aetna or the performance bond, did not cross-examine any of the plaintiff's witnesses on any matter relating to Aetna or the performance bond, and did not so much as mention Aetna or the performance bond in either the opening or closing arguments before the jury. [Emphasis added]⁴⁷

2. Settlement discussions

In some cases, a conflict could exist if either the principal, or the surety, independently of the other, attempts to settle with the obligee in return for a release, leaving the other party to face the claims of the obligee alone. Whereas an obligee will generally not be able to settle with the principal without also releasing the surety, a surety will often resolve an obligee's claim when it determines that liability under the bond exists, or in an attempt to reduce exposure. If a decision to settle is made by the surety during the course of litigation in which both the surety and principal are represented by a single attorney (especially when the principal objects to the surety's settlement), the attorney's representation of both parties is difficult if not impossible.

Alternatively, what are the lawyer's obligations if the obligee is willing to settle with both the principal and the surety for an amount which the attorney knows will be acceptable to the surety? Can counsel keep this information from the surety in the face of insistence by the principal that it does not want to settle? What if the obligee is prepared to accept a very reasonable settlement but the principal informs the lawyer that he does not have enough cash to fund the settlement? And what if the principal tells the lawyer he doesn't want the surety to know his cash position because it will adversely affect his bonding line?

One commentator states the proposition in an uncompromising way:

[T]he General Indemnity Agreement gives the surety the right to compromise claims without the contractor's consent, even though the contractor is expected to reimburse the surety. Faced with this situation, the construction lawyer should not take part in any settlement activities without the consent of and/or authority from

⁴⁷ *Morse/Diesel, Inc.*, 875 F. Supp. at 171.

both clients. Without consent the lawyer may be required to withdraw from representing either client. [Emphasis added.]⁴⁸

If, in the context of handling the matter, the lawyer learns information for one client that is detrimental to the rights of the other, he cannot reveal it. His responsibility is to withdraw and recommend separate counsel be had for each client.

This issue was recently explored in a North Carolina Ethics opinion. A lawyer was representing both a general contractor and a surety against a subcontractor's payment bond claim. The surety had no valid defenses to the claim but the general contractor wanted to delay the proceeding to avoid paying the claim. The Opinion concludes that the lawyer has an obligation to assert only valid defenses and to avoid unnecessary delays. Therefore, if the general contractor persists in his strategy, the lawyer must withdraw and advise both parties to retain separate counsel.⁴⁹

3. Principal defended by insurer

Many construction claims brought by an obligee against a principal/contractor trigger possible coverage under the contractor's General Liability or Builder's Risk insurance policies. Often the principal will tender its defense of the construction claims to its insurer. The question then arises as to how this situation affects the surety's right to or need for separate counsel, and whether or not the situation justifies separate counsel to the extent of entitlement to reimbursement for the separate counsel fees.

When a surety tenders its defense to its principal, who in turn tenders the defense of the surety to the insurer, often the insurer will not agree to defend since the surety is not a named insured. However, assuming the insurer agrees to also defend the surety, can the surety reasonably accept such a defense? If the insurer is defending under a reservation of rights, does this further affect whether or not a conflict exists, and whether the attorney hired by the insurer can competently and ethically represent both the surety and the principal?

Many times it is necessary and appropriate for the surety to urge the existence of coverage, and the contribution by the insurer toward settlement. Certainly the joint attorney representing both the principal and surety cannot raise these issues with the insurer. Yet, that attorney is representing the surety, and is the one most familiar with the facts and issues in the underlying case. The surety would benefit by counsel having full knowledge of the litigation, in order to make demand upon the insurer, and the principal, to settle.

Furthermore, to the extent insurance coverage exists for a certain claim, the surety will more than likely not be liable for that particular covered item of damage. Because the principal has an obligation to reimburse its surety, but not its insurer, what type of conflict exists for the principal, the surety, the insurer, and especially the attorney hired to represent all?

⁴⁸ Klein, *supra* note 17, at p. 10.

⁴⁹ North Carolina State Bar, 2003 Formal Ethics Opinion 1.

Again, these conflicts must be considered at the outset of litigation, or at least as soon as facts arise which indicate the conflict may exist. The surety will have to balance the risk of not receiving reimbursement for separate counsel fees, with the benefit of more effective representation and a better likelihood of avoiding a judgment or other payment under its bond.

All parties concerned, the surety, the principal, and especially the attorneys facing potential joint representation, must carefully consider the terms of the bond and indemnity agreement, the claims being made against the principal and surety, and the specific facts in each underlying case, prior to any party agreeing to joint representation. The above scenarios are only a few examples of the ways in which conflicts can arise during the course of joint representation. For the surety, the risk of the denial of reimbursement for separate counsel fees must be balanced against the risk of possible ineffective representation, not to mention the potential for increased exposure for underlying contractual damages as well as punitive damages.

It is certainly possible and appropriate in certain cases for one attorney to represent both the principal and the surety. The Oregon State Bar Ethics Committee considered the joint representation of a principal and a surety in 1984.⁵⁰ The Committee concluded that the lawyer could represent both the surety and the contractor in an action against the owner but was not able to represent either one in a later indemnity action.

As demonstrated above, various problems and conflicts can arise when one attorney attempts to represent both the principal and surety, primarily in a litigation context, but also pre-litigation. The potential for conflict exists in the handling of both payment and performance bond claims. Theoretically, the existence of a conflict which prevents one attorney from representing both surety and principal would in most instances also serve to justify the hiring of separate counsel thus allowing a claim for reimbursement of the surety's attorney's fees under the Indemnity Agreement. However, in light of the various standards applied by the courts on this issue, reimbursement for separate counsel fees cannot be guaranteed.

In all instances, the surety, the principal, and the attorney must each review the facts of the particular case for the existence of a conflict, and when joint representation is undertaken, all three parties must be cognizant that the potential for a conflict exists.

Thus, it is critically important for an attorney considering joint representation to undertake this representation to ask the "tough questions up front." Hugh E. Reynolds, Jr., former Chair of the Torts and Insurance Practice Committee, and its Surety and Fidelity Committee, as well as former Chair of the ABA's Forum on Construction Industry, has nicely summarized tendering counsel's responsibility:

In contractor-surety dual representation, conflicts of interest and confidentiality appear to be the primary ethical concerns. A lawyer may not represent a party when such action could materially limit its ability to represent other clients, unless informed consent is gained from each client potentially affected. If a reasonable attorney would believe that one of the representations will definitely be adversely

⁵⁰ Oregon State Bar Legal Ethics Committee, Opinion 498 (September 4, 1984).

affected, consent is inadequate, and the lawyer must withdraw. This duty to anticipate and avoid conflicts is continuous through the representation.

Confidentiality must be maintained as to each client. If informed consent to a potential conflict is impossible in light of a client's refusal to waive confidentiality, withdrawal is mandatory. Upon withdrawal, the lawyer may not represent another client in a matter which is materially adverse to the former client's interest without consent of the former client. Regardless, a lawyer is prohibited from utilizing information gained while representing a client to that person's detriment subsequent to withdrawal.⁵¹

Before consenting to the representation of more than one client in a matter, a lawyer must carefully study of the applicable rules and give careful thought to the issues involved for all potential clients. After representation is accepted, a lawyer must continue to vigilantly consider the issues involved in dual representation to avoid running afoul of any of the applicable Disciplinary Rules.

III. CONCURRENT REPRESENTATION OF ADVERSE CLIENTS

A. Applicable rule

Rule 1.06 Conflict of Interest: General Rule

(b) In other situations and except to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person:

- (1) ...*
- (2) reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests.*

B. Concurrent representation

“While not encouraged, concurrent representation of adverse clients is permitted in Texas.”⁵² Comment 11 provides some guidance: “Ordinarily, it is not advisable for a lawyer to act as an advocate against a client the lawyer represents in some other matter, even if the other matter is wholly unrelated and even if paragraphs (a), (b), and (d) are not applicable. However, there are circumstances in which a lawyer may act as a advocate against a client...For example, a

⁵¹ Hugh E. Reynolds, Jr. *Ethical Issues Raised by Simultaneous Representation of a Surety and its Contractor/Principal*, p. 1, presented at 1995 Construction Superconference (San Francisco, 1995) as quoted by Daniel Toomey and Karen Lubovinsky, *Too Many Hats: Representing Sureties, Principals, Indemnitors and Insureds in Construction Contracts*, p. 26, presented at the ABA Forum on the Construction Industry Conference (Dallas 1996).

⁵² *In re Southwestern Bell Yellow Pages*, 141 S.W. 3d 229 (Tex. App. San Antonio 2004.)

lawyer representing an enterprise with diverse operations may accept employment as an advocate against the enterprise in a matter unrelated to any matter being handled for the enterprise if the representation of one client is not directly adverse to the representation of the other client.”⁵³

This issue was recently discussed in *In re Southwestern Bell Yellow Pages, Inc.*⁵⁴ A lawyer undertook the representation of Star Shuttle in a personal injury case. Some years later, a company related to Star Shuttle sued Southwestern Bell for breach of contract arising from the alleged omission of an advertisement from the phone book. The lawyer’s firm undertook the representation of Southwestern Bell. A motion to disqualify the law firm followed. The Court held that for disqualification to be ordered, the moving party had to show “actual prejudice” to the concurrent representation – showing a potential for prejudice is not enough.

IV. MAINTAINING CLIENT CONFIDENCES IN A TECHNOLOGICAL AGE

A. Applicable Rule

Rule 1.05 Confidentiality of Information

(a) ...

(b) *Except as permitted..., a lawyer shall not knowingly:*

(1) *Reveal confidential information of a client...*

B. Inadvertent revelation of client confidences

Rule 1.05 requires an attorney to maintain client confidences. A recent ethics opinion from New York State illustrates how a well-meaning lawyer could inadvertently reveal client confidences. In this opinion, the Committee considered the responsibilities of a lawyer when emailing word processing documents. Word processing documents can contain “meta data.” “Meta data” may “be loosely defined as data hidden in documents that is generated during the course of creating and editing such documents.... The hidden text may reflect editorial comments, strategy considerations, legal issues raised by the client or the lawyer, legal advice provided by the lawyer, and other information.”⁵⁵ The opinion concludes that “lawyers have a duty ... to use reasonable care when transmitting documents by e-mail to prevent the disclosure of metadata containing client confidences or secrets.”⁵⁶

⁵³ Comment 11 to Rule 1.06, Texas Rules of Professional Conduct.

⁵⁴ 141 S.W. 3d 229, supra.

⁵⁵ New York Ethics Opinion 782 (2004.)

⁵⁶ *Id.*