Ethical Dilemmas in Representing an Undisclosed Principal

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The Issue: Two Hypotheticals. Representing undisclosed clients in real estate or loan transactions can pose ethical dilemmas for lawyers where nondisclosure of the principal would amount to fraud.[2] In many instances, however, a lawyer's representation of an undisclosed principal in negotiations is an accepted and acceptable convention. A look at two contrasting hypotheticals illustrates the issues.

In the first hypothetical, a lawyer is called upon to assist a developer client with a real estate assemblage. The developer seeks to buy a number of separately owned contiguous parcels for assembly into one large tract, either for resale, or for development or redevelopment, as one project. The developer fears that if the owners of the desired parcels become aware of its plan, they may hold out for a higher sales price for each parcel to be included in the assemblage. To avoid precipitating an increase in the asking prices as the developer client collects the separately owned parcels, the developer client wishes its identity, or in some cases, even its very existence as the buyer, to remain undisclosed. The developer asks the lawyer to represent it as an undisclosed principal and to advise the seller that the client buyer does not wish its identity to be disclosed. The terms of the representation seem straightforward and legitimate: the client is quietly attempting to buy pieces of real estate for a business purpose. The lawyer's representation of an undisclosed principal in such a situation is consistent with generally accepted conventions in negotiation.

In the second hypothetical, the client is an original borrower that has defaulted on its loan. The lender is looking to sell the loan at a discounted price. The original borrower wishes to buy its loan, through an affiliate or a third party, at the discounted price and asks the lawyer to represent it as an undisclosed principal. It is likely that the second situation would cause more discomfort than the first. From one perspective, why should the identity of the buyer matter if the bank is looking to sell the loan? It inevitably comes to mind, however, that the lender might not be willing, or perhaps even permitted under internal rules or governmental regulations, to sell the loan to a defaulting borrower or such borrower's affiliate or other stand-in. In addition, the lender may make statements indicating that the lender would not enter into a proposed loan purchase and sale transaction if it were aware of any connection between the proposed purchaser and the defaulting borrower. At least where the lender has made such an indication, the existence and identity of the principal would be material to the negotiations.

The Model Rules. In what circumstances does representing an undisclosed principal raise potential ethical issues for consideration by counsel? The Model Rules of Professional Conduct provide a good starting point for the analysis.[3] Rule 4.1 provides, in pertinent part: "In the course of representing a client a lawyer shall not knowingly: (a) make a false statement of

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[2] The distinction between an *undisclosed* principal and an *unknown* client is considered below.

[3] Every state except California, which has its own Rules of Professional Conduct, has adopted some version of the Model Rules of Professional Conduct including an iteration of Rule 4.1.

material fact or law to a third person; or (b) fail to disclose a **material fact** when disclosure is necessary to avoid assisting a criminal or **fraudulent act** by a client, unless disclosure is prohibited by Rule 1.6,"[4] which deals with confidentiality of information.

Comment [3] to Rule 4.1 advises that Rule 4.1(b) expresses a "specific application" of Rule 1.2(d), which prohibits a lawyer from counseling or assisting a client in conduct that the lawyer knows is criminal or fraudulent. According to Comment [3], Rule 4.1(b) addresses the situation where a client's crime or fraud takes the form of a lie or misrepresentation. Comment [3] further explains that the disclosure called for by Rule 4.1(b) is required only in "extreme" cases, to the extent permitted by Rule 1.6, since, ordinarily, a lawyer can avoid assisting a client's crime or fraud by withdrawing from the representation, and, where necessary, giving notice of the fact of the withdrawal and disaffirming an opinion, document, affirmation or the like.[5]

Comment [1] to Rule 4.1, which addresses the issue of misrepresentation, recognizes that, while a lawyer is required to be truthful when dealing with others on a client's behalf, the lawyer generally has "no affirmative duty to inform an opposing party of relevant facts." Comment [2] to Rule 4.1 actually uses a lawyer's representation of an undisclosed principal as an example of permissible behavior, "except where nondisclosure of the principal would constitute fraud." By way of explanation, Comment [2] notes that Rule 4.1 "refers to **statements of fact**" and adds that "[w]hether a particular statement should be regarded as one of fact can depend on the circumstances." The drafters of Rule 4.1 elaborate, in Comment [2], that "[u]nder generally accepted conventions in negotiation, certain types of statements ordinarily are **not** taken as statements of fact," for example, "[e]stimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim." (Emphasis added). Comment [2] goes on to provide that "the existence of an undisclosed principal" also is in the category of statements not taken as statements of material fact within the scope of Rule 4.1(b) under generally accepted conventions in negotiation, "except [as just mentioned] where

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[4] ABA Model Rules of Prof'l Conduct Rule 4.1 (2007) (emphasis added). Rule 1.6 reads as follows:

(a) **[Disclosure of information generally.]** 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).

(b) [**Disclosure of information; specific circumstances.]** A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or 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;

(3) 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;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) to comply with other law or a court order.

[5] See id. Model Rule 1.16(b) (2007) (withdrawal when the lawyer's services have been used, or will be used in the client's fraud or crime) and Model Rule 3.3(a)(2) (mandating disclosure to a tribunal to avoid assisting in a client's crime or fraud).

nondisclosure of the principal would constitute fraud." Comment [2] concludes with the admonition that "[l]awyers should be mindful of their obligations under applicable law to avoid criminal and tortious misrepresentation."

It is worth noting that several states have declined to adopt paragraph (b) of Rule 4.1, which requires an attorney to disclose material facts when the client is acting fraudulently or criminally, unless disclosure is prohibited by Rule 1.6. Among those states are Michigan, New York, North Carolina, North Dakota and Vermont.[6] Even where a jurisdiction has not adopted paragraph (b) of Rule 4.1, its code of ethics includes Rule 1.2(d) or its substantive equivalent, prohibiting a lawyer from counseling or assisting a client in conduct that the lawyer knows is criminal or fraudulent. Paragraph (b) of Rule 4.1 is simply a specific application of the principle articulated in Rule 1.2(d), as noted in Comment [3] to Rule 4.1, discussed above.

Rule 4.1 (b) appears to include conflicting commands. On the one hand, disclosure is required where necessary to avoid assisting a criminal or fraudulent act by a client. On the other hand, disclosure is prohibited under Rule 4.1(b) even when other rules appear to require it,[7] if necessary to protect confidential information under Rule 1.6. Leading commentators Geoffrey C. Hazard, Jr., and W. William Hodes have pointed out, however, that, notwithstanding the apparently conflicting commands of Rule 4.1 (b), the client confidentiality provisions of Rule 1.6 have always been subject to the lawyer's duty under Rule 1.2(d) to avoid participation in client or other crime and fraud and to withdraw from client representation under Rule 1.16(a)(1) where to maintain silence would assist client fraud and thus "result in violation of the rules of professional conduct," specifically, Rule 1.2(d).[8] Moreover, Professors Hazard and Hodes have noted that their conclusions are bolstered by the 2002 and 2003 amendments to Rule 1.6. Those amendments qualify lawyer duties of client confidentiality, with exceptions in paragraphs (b)(2), (b)(3), and (b)(6) permitting disclosure of client information in order to prevent client fraud in furtherance of which lawyer services have been used, or to rectify harm caused by such fraud, or where required by law, respectively.[9]

Analysis of the Hypotheticals. A discussion of the distinctions between the two hypothetical situations posed earlier, against the backdrop of Rule 4.1(b) and the related provisions treated above, helps to illustrate when a lawyer's representation of an undisclosed principal can pose ethical issues and how those ethical issues might be addressed. Recall that in the first hypothetical, the lawyer is called upon to negotiate with various separate sellers on behalf of an undisclosed principal seeking to create a real estate assemblage. In the second hypothetical, the lawyer is asked to represent a defaulting borrower seeking to buy, directly or indirectly, its own loan from the lender at a discount. In both situations, the lawyer is withholding information at the request of the client and protecting client confidences, but in the second case, it is more likely that the identity of the client will be material to the seller and that the nondisclosure of the client's identity could cross ethical boundaries.

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[6] Compare language of the Model Rules of Prof'l Conduct with the language in Model Rule 4.1; New York Rules of Prof'l Conduct Rule 4.1; North Carolina Rules of Prof'l Conduct Rule 4.1; North Dakota Rule of Prof'l Conduct 4.1; Vermont Rules of Prof'l Conduct Rule 4.1.

[7] See ABA Comm. On Ethics & Prof'l Responsibility, Formal Op. 93-375 (holding that attorney, while prohibited from lying or misleading agency officials in a bank examination, was not obligated under Model Rule 1.6 to disclose the client's lie or even to make a noisy withdrawal).

[8] 2 G. Hazard, Jr. & W. Hodes, The Law of Lawyering § 40.02 & n.2 (4th ed. 2015).

[9] Id.

In addition, the nondisclosure of a client's identity easily can run afoul of lender or loan program rules, such as those of Fannie Mae or Freddie Mac, and put the lawyer, as counsel to an undisclosed principal, at risk of assisting in a fraudulent or otherwise unlawful act.[10] Moreover, in **either case**, as this paper will discuss below, where a lawyer acts on behalf of an undisclosed principal, even where the lawyer's role as agent for its client **is** disclosed, the attorney can incur the liability of a principal under the law of agency.

How, then, can lawyers, without crossing any lines or exposing themselves to risk of personal liability, represent clients that wish their identities to be undisclosed? The underlying questions may be: when does the identity of the client become material and when does nondisclosure of the client's identity amount to assisting in a fraud by the client? In other words, when does representing an unidentified principal violate Rule 4.1? In considering these questions, it is useful to recall several points covered above: (i) that Rule 4.1, in both paragraphs (a) and (b), addresses misrepresentation and operates only with respect to statements of fact.; (ii) that, according to Comment [1] on Rule 4.1, which probes the parameters of misrepresentation, although lawyers are required to be truthful when dealing with others on a client's behalf, lawyers generally have no duty to inform an opposing party of relevant facts; and (iii) that, as Comment [2] makes clear, Rule 4.1 operates only on statements of fact, and, under generally accepted conventions in negotiation, the existence of an undisclosed principal is not considered a material fact requiring disclosure, except where nondisclosure of the principal would constitute fraud.

Definitions of Fraud; Corrective Action. Situations do arise, however, where the identity of a lawyer's client is material and where a lawyer therefore must be vigilant not to make any misstatements or misrepresentations as to the client's identity in order to avoid assisting a client in an act that is a fraud or a crime. Whether a client's nondisclosure directive will put its counsel in an unacceptable situation will depend, largely, on the facts and circumstances surrounding the directive and the representation, but a consideration of the definition of "fraud" or "fraudulent" is a cornerstone of the analysis. According to Rule 1.0 (d), the term "'[f]raud' or 'fraudulent' denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive." Although each jurisdiction has its own definition of fraud, most will have the same basic elements as the Black's Law Dictionary definition, which is "a knowing misrepresentation of the truth or **concealment of a material fact** to induce another to act to his or her detriment."[11]

In some instances, a lawyer may have a duty to speak or take some other corrective action, even where no clear false statement has been made. Professors Hazard and Hodes have pointed out that a lawyer cannot remain silent where a client's, or perhaps even a lawyer's, conduct has created a false impression.[12] In such a case, they point out, "[t]he obligation to speak arises precisely because the third party has been misled, rather than merely left in

[10] See 18 U.S.C. § 1014 (2010), which criminalizes making knowingly false statements or reports "upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, loan, or insurance agreement or application for insurance or a guarantee, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution of security therefor," with the purpose of influencing in any way the action of a number of specified federally regulated lenders.

[11] Black's Law Dictionary 775 (10th ed. 2014) (emphasis added).

[12] 2 Hazard § 40.06.

ignorance."[13] Professors Hazard and Hodes also note that some jurisdictions have broadened the definitions of misrepresentation and fraud, making actionable a failure to disclose material facts, even absent "prior creation of the misapprehension," if the failure to provide full information was accompanied by an intent to deceive.[14]

The lawyer must tread cautiously where a client seeks to purchase its loan, directly or indirectly from its lender, and instructs that its identity not be disclosed, suspecting that the lender might not sell the loan if the lender were aware of the client's identity. The client's proposed plan may well amount to fraud, so that, in an "extreme case," according to Comment [3] to Rule 4.1, the lawyer may need to disclose the client's identity, if permitted by Rule 1.6, in order to avoid assisting in a fraud or a crime. It is important to note that, according to the provisions of Comment [3] to Rule 4.1, such disclosure would be required only in an "extreme case" and that, ordinarily, a lawyer could avoid assisting in a client's fraud or crime by withdrawing from the representation and, where necessary, giving notice of the fact of the lawyer's withdrawal and, if appropriate, for example, if the lawyer's work product is being used in furtherance of a fraud, disaffirming any opinion, document, or affirmation made. If a lawyer realizes a client is planning to commit fraud in concealing its identity, the lawyer must refuse to represent the client, or if the representation has begun, the lawyer must take corrective action. The corrective action required will depend on the circumstances and, as noted above, may require disclosure in extreme cases, for the reason, among others, that under Rule 1.6(b)(2), a lawyer's duties to refrain from assisting in, or to rectify unwitting assistance in, client crime or fraud and otherwise to comply with the law are paramount to a lawyer's duties of confidentiality to the client. Every lawyer should also be aware that any violation of Rule 4.1 would also amount to a violation of Rule 8.4, broadly defining lawyer misconduct to include all dishonest, deceitful and illegal conduct and violations or attempted violations of the Model Rules of Professional Conduct.[15]

Regulated Entities. An affirmative duty of disclosure also might be imposed by regulation, so that a lawyer negotiating with a regulated entity may have heightened duties. It is noted in the treatise of Professors Hazard and Hodes that because the Rules of Practice of the Patent office require "candor" and "good faith" in cases of patent applications and reexaminations, lawyers have an affirmative duty to disclose material facts and to correct prior misstatements.[16] A lawyer's duty of disclosure is even more clear-cut in the case of certain HUD-regulated loans discussed below. Thus, the localized definition of "fraud" in Rule 1.0(d) means that a lawyer representing an undisclosed principal must be mindful of the applicable law governing duties of disclosure to the opposing party, including both the law of the pertinent jurisdiction and any special regulations which may be applicable in the case of negotiations with a particular opposing party.

Clients attempting to conceal their identities to avoid agency rules, for example, those of the Department of Housing and Urban Development (HUD), could face actual criminal penalties

[13] Id.
[14] Id.
[15] See ABA Model Rules of Prof'l Conduct Rule 8.4 (2007).
[16] Id. & n. 4.

for submitting false information to HUD or otherwise violating Department rules.[17] HUD regulations provide that a defaulting mortgagor, or any principal, successor, affiliate, or assignee of a defaulting mortgagor, is ineligible to bid on or otherwise acquire property subject to a multifamily mortgage upon which HUD is foreclosing.[18] This regulation is consistent with case law to the effect that a defaulting mortgagor cannot skirt the duty of payment by buying the security property at a foreclosure sale free from the liens of the mortgagor's mortgage and other mortgages.[19] Similarly, under HUD regulations, a defaulting mortgagor or its principal, successor, affiliate or assignee, is ineligible to purchase property acquired by HUD as a result of the mortgagor's default.[20] An individual or entity that has been debarred or suspended from doing business with HUD is ineligible to bid at the sale of any HUD-held single family pool of loans**.**[21] Moreover, in the case of a sale of HUD-held single family loans, HUD regulations require that "[a]ny bid by a broker or agent for a principal must be signed by the broker/agent as the attorney-in-fact for the principal."[22] A lawyer representing a client in negotiating with a government agency with respect to a mortgage loan or the property subject to the mortgage should become familiar with that agency's regulations. A lawyer cannot knowingly be a part of any efforts on the part of a client to circumvent HUD or any other agency regulations. If a lawyer discovers any fraudulent scheme on the part of a client to circumvent HUD or similar agency regulations, under Rule 4.1, the lawyer must withdraw, and, if the lawyer discovers false information has been submitted, the lawyer also must take corrective action, including, in the extreme case, disclosure of a client's true identity.

Similarly, Federal law provides criminal penalties for knowingly making a false statement to a number of federally regulated lending entities, including FDIC-insured lenders, with the purpose of influencing such entities' actions.[23] Further, both Freddie Mac, through its Financial Fraud Investigation Unit, and Fannie Mae, have promulgated materials to aid their respective industry partners, for example, servicers and lenders, in identifying and combatting mortgage fraud, including purchases through straw buyers and fictitious purchase offers by straw buyers for the benefit of defaulting borrowers.[24] Thus, if an attorney were to act as an undisclosed agent of a defaulting borrower seeking to buy back, through a straw party or

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[17] 18 U.S.C. § 1010 states that: Whoever, for the purpose of obtaining any loan or advance of credit from any person, partnership, association, or corporation with the intent that such loan or advance of credit shall be offered to or accepted by the Department of Housing and Urban Development for insurance, or for the purpose of obtaining any extension or renewal of any loan, advance of credit, or mortgage insured by such Department, or the acceptance, release, or substitution of any security on such a loan, advance of credit, or for the purpose of influencing in any way the action of such Department, makes, passes, utters, or publishes any statement, knowing the same to be false, or alters, forges, or counterfeits any instrument, paper, or document, or utters, publishes, or passes as true any instrument, paper, or document, knowing it to have been altered, forged, or counterfeited, or willfully overvalues any security, asset, or income, shall be fined under this title or imprisoned not more than two years, or both.

[18] 24 C.F.R. § 27.20(f).

[19] 1 G. Nelson & D. Whitman, Real Estate Finance Law § 4.44 & nn. 1-7 (5th ed. 2007).

[20] 24 C.F.R. § 290.18.

[21] 24 C.F.R. § 291.303.

[22] 24 C.F.R. § 291.304(h).

[23] 18 U.S.C. § 1014 (2010), supra note 10.

[24] *See* FANNIE MAE: MORTGAGE FRAUD PROGRAM, Fraud Schemes and their Characteristics: Resources to Help You Combat Mortgage Fraud, 1 (Aug. 11, 2011) https://www.fanniemae.com/content/fact_sheet/mortgage-fraud-schemes-and-characteristics.pdf; FREDDIE MAC, Fraud Mitigation Best Practices Single-Family (January 2015), http://www.freddiemac.com/singlefamily/pdf/fraudprevention_practices.pdf.

otherwise, the borrower's defaulted loan held by Fannie Mae or Freddie Mac, the attorney would run afoul of the published anti-fraud programs of those entities and, necessarily, applicable rules of ethics.

The Danger of Partial Disclosure. If a lawyer decides he or she can comfortably represent a client that wishes to remain unidentified, how can the lawyer handle the concerns that predictably may arise? One major pitfall to avoid is partial disclosure. Comment [1] to Rule 4.1 expressly provides that, while "[a] misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false, misrepresentations can also occur by partially true but misleading statements or omissions that are the equivalent of affirmative false statements." Thus, where a lawyer accepts the representation of an undisclosed principal and is asked to disclose the identity of the client, the lawyer must be prepared to state that he or she cannot divulge the requested information as to the client's identity. The situation immediately becomes complicated if a lender selling a loan states something to the effect of, "I don't care who the buyer is, as long as it isn't X." In order to maintain client confidentiality consistent with the provisions of Rule 1.6, but to avoid crossing any ethical lines under Rule 4.1, the lawyer should be prepared to respond: "I cannot say whether the client and proposed buyer I represent is or is not X." Implying that the buyer is not X, when the lawyer knows differently, creates a false impression and is a misrepresentation and violation of Rule 4.1, as touched on above in examining the advice of Professors Hazard and Hodes on the duty to disclose or take corrective action where client or lawyer conduct or statements have given rise to a misapprehension.

The prospective client in the second hypothetical often seeks to purchase its delinquent loan from its lender indirectly, through an affiliated entity or family member or other third party. Counsel to the loan purchaser, then, could say that, technically, the buyer is not X, but to do so could amount to a deception if counsel were aware that the lender would not sell to the client or to an affiliate or third party under the client's control or influence. Ethical dilemmas may arise in the gaps between the technical language of the Model Rules and common sense. As noted above, Comment [1] to Rule 4.1 specifies that misrepresentations include "partially true but misleading statements or omissions that are the equivalent of affirmative false statements." The reference to half-truths and omissions in Comment [1] to Rule 4.1, in combination with common sense, makes it clear that no lawyer can rely on a technicality like the absence of exact identity between the defaulting borrower and the prospective loan purchaser to escape his or her professional and ethical duties to refrain from making any false statement of material fact or law to a lender or other third party in the course of representing a client.

Warning the Client. In addition, before undertaking the representation of a client as an undisclosed principal, the lawyer should make known to the prospective client some foreseeable consequences of being an undisclosed principal. For example, the lawyer should explain to the prospective client in the second hypothetical outlined above that if the lender seeking to sell the loan inquires of the lawyer as to the client's identity, or states that that the prospective loan purchaser's identity is irrelevant unless it is X, the best the lawyer will be able to do is to decline to answer. Refusing to relieve the selling lender's concerns likely will cause the lender to assume the buyer is the undesired party, and the lawyer will not be able to do anything to address the lender's assumption one way or the other. The prospective client must be prepared for the possible scenario just described when the lawyer accepts the representation and must understand that although the lawyer will try to abide by the client's wishes to keep its identity confidential,

the lawyer cannot and will not misrepresent the client's identity in any way, including through partially true but misleading statements or through omissions that are equivalent to affirmative false statements.

Straw Parties. A 1997 Pennsylvania Ethics Opinion sheds further light on the duties of counsel when a straw party is utilized in a transaction.[25] The Pennsylvania Ethics Opinion responded to the inquiry of a lawyer who had been representing an undisclosed buyer in negotiating with a landowner toward a purchase agreement. The inquiring lawyer had advised the landowner that the lawyer was negotiating on behalf of a buyer who did not wish his identity disclosed, and the landowner proceeded with the negotiations, knowing he was dealing with an unknown purchaser. The negotiations were unsuccessful and failed to yield a purchase agreement.[26] Thereafter, the client retained the services of a non-lawyer straw party who approached the landowner with a purchase agreement on behalf of the undisclosed client. When the negotiations were close to fruition, the client asked the inquiring lawyer to prepare both the sales agreement and the "straw party" agreement, and to handle the title work and the loan financing for the client.[27] The lawyer asked the Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility whether there would be any problems with the lawyer's performing the work for the client without disclosing the identity of the client to the landowner and without discerning whether the landowner in fact knew that he was dealing with a straw party.[28] The Pennsylvania Bar Committee concluded in its Opinion that the lawyer could do the work directed by the client without violating Rule 4.1 because he was only preparing documentation for the client and not dealing directly with or negotiating with the landowner, but the opinion added that if, during the course of the lawyer's preparation of the relevant sales and financing documents, the lawyer were to contact or otherwise have dealings with the landowner, he would be under no duty to disclose the identity of the client but would be under a duty, as before, to advise the landowner that he was representing a client who preferred to keep his identity undisclosed.[29]

Straw Parties in Apple Trademark Acquisition. In 2012, Proview, a Taiwanese computer company, sued Apple alleging deceptive negotiating tactics amounting to fraud and unfair practices in the purchase of the iPad trademark through an undisclosed straw party.[30] The facts set out below are drawn from Proview's complaint.[31] In 2000, Proview designed a portable computer that it called the "iPad." It trademarked the name in China, the EU, Mexico, and various countries in Asia. Later, Apple began work on its tablet, which it wanted to call the "iPad." Proview had already trademarked the name, however. Apple did not use one of its lawyers as an "undisclosed agent" to buy the trademark from Proview, as in the first hypothetical. Instead, according to the Proview complaint, Apple and its counsel created a shill British corporation called "IP Application Development, Ltd.," with the coincidental initials of

[25] ABA/BNA Lawyers' Manual on Prof'l Conduct, Pa. Ethics Op. 97-44 (April 23, 1997).

[26] Id.

[27] Id.

[28] Id.

[29] Id.

[30] First Amended Compl. For Fraud, Intentional Misrepresentation, Fraudulent Inducement, Unfair Competition, Proview Electronics Co. Ltd., et al v. Apple, Inc., et al, No. 112CV219219 (Super. Ct. for the State of Cal., Cnty. of Santa Clara Feb. 27, 2012).

[31] Id.

"iPad," which Apple utilized as a straw party. The Proview complaint further alleges that Apple retained as its agent a man named Graham Robinson who pursued negotiations with Proview on behalf of the shill British corporation and, indirectly, Apple, under the alias of Jonathan Hargreaves. According to the Proview complaint, Graham/Hargreaves represented to Proview that the British shill company wanted the iPad name because it represented a form of that company's name and that the company would not be a competitor in Proview's market. The complaint goes on to allege that Graham/Hargreaves failed to disclose that the iPad trademark was to be acquired for Apple, which was a direct competitor of Proview. Ultimately, the shill British corporation purchased the iPad trademark from Proview for Apple for only $55,000.[32]

Apple's affirmative misrepresentations described in the Proview complaint may have been enough to send its alleged hawkish negotiation strategies into the realm of the unethical, had an Apple attorney practicing in the United States been involved in the alleged ruse, as legal blogger and attorney Michael D. Young speculates in his 2012 article, "Where Deception is Still King: Apple, iPad, And The Still Murky World of Negotiation Ethics."[33] Mr. Young posits that, rather than having its lawyers work on behalf of an undisclosed principal, Apple set up a dummy corporation in order to hide its very existence and assigned to the shill company a name with the initials Apple wanted to trademark. In his article, Mr. Young offers: "By deceiving the seller into thinking there is no hidden principal, the true principal is making an effort to avoid even the moderate increase in price that would likely be associated with a purchase by an agent of a known, but unidentified, principal."[34] Proview and Apple's disputes ultimately were disposed of without an adjudication, through a dismissal of the California action on jurisdictional grounds and a settlement of Proview's claims in China.[35]

If an attorney practicing in the United States had been involved in the Proview trademark acquisition, an analysis of applicable standards of professional conduct might include consideration of the absence of any ethical rule, in the abstract, requiring an attorney to disclose facts unknown to opposing counsel,[36] as well as consideration of the counterbalancing allegations that Apple took affirmative steps to conceal its identity and to misrepresent to Proview that the purchaser of the trademark would not compete with the seller. If there had been a lawyer involved on behalf of Apple, consideration should be given to whether, in light of the facts alleged in the Apple-Proview litigation and an assessment as to whether they created a false impression and were material to the negotiations, the attorney would have had a duty to speak and even identify the principal, Apple, to correct misstatements or false impressions.[37]

Fiduciary Relationships. Yet another concern arises when an undisclosed purchaser has a fiduciary relationship with the seller. The existence of a fiduciary relationship carries with it duties of full disclosure on the part of the fiduciary. In Chien v. Chen, a 1988 decision of the Texas Court of Appeals, Tomas Chien sued his real estate advisors and agents, Grace Chen and

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[32] For further discussion of the ethical implications of Apple's "iPad" trademark acquisition, see Michael D. Young, Deception is Still King: Apple, iPad, And The Still Murky World of Negotiation Ethics, J. OF CONSUMER ATT'Y ASS'N FOR S. CAL. (Aug. 2012).
[33] Id.
[34] Id.
[35] Id.
[36] See ABA Model Rules of Prof'l Conduct 4.1 (2007) ("A lawyer … generally has no affirmative duty to inform an opposing party of relevant facts.").
[37] See *Definitions of Fraud; Corrective Action*, supra.

C. Woodrow Deal, for, among other things, breach of fiduciary duty.[38] Chen and Deal had first represented Chien in 1981, in acquiring a particular piece of property. In 1984, they urged him to sell that same property, at what turned out to be a price below market, to one S. Wei Lee, Trustee. Chen and Deal represented Chien in that 1984 sale to Lee, who, in fact, purchased the property for Chen, her undisclosed principal. On taking the property from Lee, Chen immediately sold it to Chasewood Company, realizing a profit of in excess of $700,000. The court found that Chen and Deal were fiduciaries with respect to Chien, under the facts of the case, and that "neither disclosed to Chien that the sale to Lee was colorable only and that Chen was the actual purchaser."[39] The court noted that where two parties are in a fiduciary relationship, "the law imputes to the relationship **additional and higher** duties and their breach may constitute fraud as well."[40] The court elaborated: "Generally speaking, these additional duties are described as those of good faith and candor by the fiduciary toward his principal. This includes the general duty of full disclosure respecting matters affecting the principal's interests and a general prohibition against the fiduciary's using the relationship to benefit his personal interest, except with the full knowledge and consent of the principal."[41]

What the Chien decision means, practically, is that the identity of a prospective purchaser owing fiduciary duties to a seller must be disclosed. If a lawyer is approached to represent an undisclosed purchaser that turns out to be a fiduciary with respect to the seller, the lawyer should urge the purchaser to disclose the purchaser's identity to the seller, as well as all other information material to the purchase and the purchaser's interest in the purchase. If the purchaser declines to make the recommended disclosures, the lawyer should decline the representation. Because, as the Chien case reaffirms, secrecy in a fiduciary relationship amounts to fraud, any lawyer knowingly proceeding on behalf of an undisclosed purchaser with fiduciary duties to the seller would quickly run afoul of Rules 4.1(b), 1.2(d), and 8.4. As underscored in Chien, fraudulent concealment includes, even if it is not limited to, silence about material facts in a fiduciary relationship.

In general, borrowers do not owe fiduciary duties to lenders.[42] It should be noted, however, that if there were a situation in which a borrower did owe a fiduciary duty to a lender, a lawyer could almost never ethically do what the client in the second hypothetical is asking: that the lawyer keep the client's identity a secret in negotiating for the purchase of the client's loan at a discount from the lender.

Unknown Clients. Further difficulty arises where even the lawyer does not know the identity of its own buyer or borrower client. In some instances, a client wishing to assure that its identity is protected in purchase and sale negotiations, may ask its regular counsel to refer it to new counsel without disclosing the client's identity. The referring attorney advises the new attorney that the client, as borrower or buyer, wishes to remain unnamed and anonymous, even with respect to its counsel, so that its counsel cannot divulge anything about its identity in negotiations relating to the purchase of a discounted loan or relating to property. Although such

[38] 759 S.W.2d 484 (Tex. App. 1988).

[39] Id. at 496.

[40] Id. at 495 (emphasis added).

[41] Id. (internal quotation marks & citation omitted).

[42] See, e.g. Alpine Bank v. Hubbell, 555 F.3d 1097, 1111 (10th Cir. 2009) ("Under Colorado law, no per se fiduciary relationship exists by virtue of the borrower-lender relationship ...." (internal quotation marks & citation omitted)).

an arrangement could alleviate some of the pressure of partial disclosure, it introduces a host of problems to any proposed client relationship. For example, a lawyer cannot perform conflicts and due diligence checks on a client whose identity is unknown.

Even if a lawyer without knowledge as to the identity of a proposed client could somehow overcome the hurdles posed by conflicts and due diligence search requirements, agreeing to proceed would still be ill-advised. If a lawyer does not know the relationship between borrower and lender or buyer and seller, how can that lawyer ensure that he or she is not contributing to fraudulent or criminal conduct on the part of the client? Some might seek shelter in the express proscription in Rule 4.1 of only **knowing** acts or omissions: Rule 4.1 provides that "a lawyer shall not **knowingly** . . . make a false statement or . . . fail to disclose a material fact . . . necessary to avoid assisting a criminal or fraudulent act by a client." (Emphasis added). The lawyer might rationalize, "the less I know, the better my position." Such rationalization does not withstand scrutiny, however. Courts have held that intent to defraud can be found both in knowledge and in **willful ignorance**.[43] It follows that if counsel is to avoid running afoul of Rule 4.1 and to avoid aiding a client in criminal or fraudulent behavior, counsel must know the client's identity.

Civil Liability. Although this paper focuses on the ethical implications of representing an undisclosed principal, it should be noted that a lawyer's exposure to professional discipline for violating Rule 4.1(b) is largely coextensive with the lawyer's exposure to civil, and in some cases criminal, liability for failing to make a material disclosure.[44] The lawyer's civil liability for conduct prohibited under Rule 4.1(b) can extend to third parties, including the client's adversary, and even to the lawyer's client.[45] Where an alleged fraud is based on omission, a non-client generally must show a **duty to disclose** on the part of the lawyer charged.[46] Such a duty of disclosure has been found to arise in the case, among others, of a half-truth that is affirmatively misleading.[47] Where a lawyer incurs liability to a third party for assisting in the perpetration of a fraud committed in the name, and ostensibly under the auspices, of a client, the lawyer can, at the same time, incur liability to the client for failure to interdict wrongful conduct of the client's agents.[48] Several examples of a lawyer's liability to its own client for assisting in the client's wrongdoing can be found in actions brought by financial institutions that collapsed during the 1980s savings and loan crisis.[49] In those cases, there was a fraud against a third party that grew out of actions of corporate officials that were wrongful, including toward the corporate lender, and facilitated by outside counsel, who knew or should have known of the harmful nature of the offending transactions.[50]

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[43] See Century Pacific, Inc. v. Hilton Hotels Corp., 528 F. Supp. 2d 206, 222 (S.D.N.Y. 2007), aff'd, No. 09-545, 2009 WL 4072087 (2d Cir. Nov. 25, 2009).

[44] See 1 Hazard §§ 5.01, 5.17; See also Restatement (Third) of the Law Governing Lawyers § 56 cmt. f (2000).

[45] Id. § 5.16.

[46] 1 R. Mallen & J. Smith, Legal Malpractice § 6.15 & n. 5 (2011 ed.).

[47] Id. § 6.15 nn. 10, 11.

[48] 1 Hazard § 5.09.

[49] Id.

[50] Id. (discussing In re American Continental-Lincoln Savings & Loan Securities Litigation, 794 F. Supp. 1424 (D. Ariz. 1992); Federal Deposit Insurance Corp. v. O'Melveny & Myers, 969 F.2d 744(9th Cir. 1992), rev'd on other grounds, 512 U.S. 79 (1994)).

Agency Law. An additional concrete problem for a lawyer representing an undisclosed principal is that, under established principles of agency law, the lawyer for the undisclosed or unidentified principal can himself or herself incur the liability of a principal to a transaction, even where the fact of the lawyer's agency is disclosed. This point of agency law is illustrated by a decision of the New Mexico bankruptcy court. In that case, styled In re Texas Reds, Inc., the bankruptcy trustee filed a complaint against a lawyer representing the daughter of the debtor's principal in submitting an offer to purchase the debtor's restaurant assets for $50,000.[51] The trustee claimed that it had accepted the offer, but that the lawyer's client had failed to close. The trustee then sold the restaurant assets to a third party for $20,000 and sought to recover from the lawyer, among other things, the $30,000 difference between the actual $20,000 sale price of the assets and the $50,000 amount offered by the lawyer on behalf of his client. The trustee claimed, first, that the lawyer had failed to disclose that the party seeking to purchase the assets, in fact, was the debtor's principal and, second, that the lawyer was thus personally liable on the contract as agent for an unidentified principal.[52] The lawyer moved to dismiss, urging that the trustee's claims failed to state a cause of action. The court determined that the complaint did state a claim plausible on its face that the lawyer had acted as an agent for an unidentified principal and could be held liable as a party to the contract.

In disposing of the lawyer's motion to dismiss, the Texas Reds court focused its analysis on the plausibility of the trustee's claim that the lawyer could be held liable for breach of contract based on agency principles. The court first turned to Tenth Circuit precedent for the propositions that "an agent is liable as if it were the principal when the agent acts for an undisclosed principal" and that "this rule applies whether the agent holds itself out as a principal or only as agent but does not disclose the identity of the principal."[53] The court noted that, in articulating the foregoing principles, the Tenth Circuit had been applying Kansas law, which is based on agency principles expressed in the Restatement of Agency. The court determined that New Mexico law, which was determinative of the issues before it, was reliant on the Restatement of Agency and thus was the same as Kansas law.

The Texas Reds bankruptcy court, in adopting the Kansas and Restatement view, quoted Section 6.02 of the Restatement (Third) of Agency (2006), as follows: "'When an agent acting with actual or apparent authority makes a contract on behalf of an unidentified principal, (1) the principal and the third party are parties to the contract; and (2) the agent is a party to the contract unless the agent and the third party agree otherwise.'"[54] The court explained, citing Comment b to Section 6.02 of the Restatement (Third) of Agency (2006), that an underlying reason for holding an agent for an unidentified principal subject to liability under a contract negotiated and entered into by the agent, albeit as agent, is that without knowing the identity of the principal, the third party cannot assess the reliability of the principal as he or she otherwise would.[55] As a result, the third party is essentially relying on the credibility of the agent when it accepts the terms of an agreement.

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[51] 438 B.R. 699 (Bankr. D.N.M. 2010).

[52] Id. at 702.

[53] Id. at 702-03 (internal quotation marks & citations omitted) (alteration omitted).

[54] Id. at 703 (quoting Restatement (Third) of Agency § 6.02 2006)).

[55] Id. at 704 (citing Restatement (Third) of Agency § 6.02 cmt. B).

It is worth noting that the Restatement (Third) of Agency distinguishes between an **undisclosed** principal and an **unidentified** principal. "A principal is undisclosed if, when an agent and a third party interact, the third party has no notice that the agent is acting for a principal."[56] "A principal is unidentified if, when an agent and a third party interact, the third party has notice that the agent is acting for a principal but does not have notice of the principal's identity."[57] "When an agent acting with actual or apparent authority makes a contract on behalf of an **unidentified** principal, . . . the agent is a party to the contract unless the agent and the third party agree otherwise." The agent and third party can agree that the agent will not be liable, but, according to the Restatement, the default position is that the agent assumes liability.[58] "When an agent acting with actual authority makes a contract on behalf of an **undisclosed** principal, . . . the agent and the third party are parties to the contract," as is the principal, unless the principal is excluded by the contract.[59] The agent acting on behalf of an undisclosed principal is subject to greater risk than the agent acting on behalf of an unidentified principal. The Restatement does not provide a way for the agent representing an undisclosed principal to avoid liability.

Although the Restatement is not controlling law, several states, Kansas, Tennessee, Maine, and New Mexico among them, have adopted the positions of the Restatement (Third) on Agency with respect to the liability of an agent for an undisclosed principal and for an unidentified principal. In jurisdictions adopting such Restatement-based positions on agency liability, lawyers should be cautious to avoid personal liability and be especially careful not to put themselves in a position where liability cannot be waived. While this presentation focuses primarily on the ethical implications of representing an undisclosed or unidentified principal, liability under the laws of agency, in addition to civil liability for fraud related to omission, adds another layer of concern. Even in the best of ethical situations, counsel would do well to consider the liability aspects of representing an undisclosed principal before accepting such representation.

Conclusion. In conclusion, representing an undisclosed principal does not, in itself constitute a violation of the Model Rules of Professional Conduct. After all, Comment [2] to Rule 4.1 points out that, under generally accepted conventions in negotiation, the nondisclosure of the principal's identity even fails to rise to the level of a statement of fact, except where nondisclosure of the principal would constitute a fraud. Such representation can pose a minefield of ethical dilemmas, however. In deciding whether to represent an undisclosed or unidentified principal, a lawyer should heed the guidelines set out in Rule 4.1 and its Comments, and should address the question of whether nondisclosure of the existence of a principal or of the identity of the principal amounts to a statement of material fact under the pertinent circumstances. Rule 4.1 and its Comments, too, should be assessed in light of pertinent ethics opinions and the commentary of scholars and the weight such opinions and commentary accord factors such as the existence of a fiduciary relationship between the undisclosed principal and the third party with whom the lawyer is negotiating on behalf of that undisclosed principal.

Knowing the reasons why a prospective client wishes to avoid identification can help the lawyer decide whether or not to accept the representation. The lawyer should accept the

[56] Restatement (Third) of Agency §1.04(2)(b) (2006).
[57] Id. § 1.04(2)(c).
[58] Id. § 6.02(2) (emphasis added).
[59] Id. § 6.03(2).

representation of a client that wishes its identity to remain confidential only if comfortable that the client's reasons for concealing its identity or existence do not fall outside the bounds of the conventions of negotiation, as discussed above, and otherwise do not involve the perpetration of any fraudulent or criminal acts. In some cases, after weighing the guidelines and considerations discussed above, a lawyer will feel confident or at least comfortable that, in representing an undisclosed principal, he or she will not be crossing ethical boundaries or risking personal liability. In other cases, however, a lawyer should consider whether representing an undisclosed principal would run afoul of the prohibitions of Rule 4.1, for example, where a prospective client wishes to keep its identity or its very existence secret, based on a belief that the other party to the proposed transaction would be unwilling to negotiate or proceed if the principal's identity or existence were known. In such a situation, the likelihood of fraud is greater, and it is possible that the prospective client's objectives otherwise would violate applicable law, including, for example, if the third party were regulated and the prospective client were barred from entering into transactions with it or if the third party were owed a fiduciary duty by the prospective client. Finally, lawyers should be mindful of their exposure to personal liability in representing clients that are undisclosed or unidentified principals, particularly if problems occur with the sale, loan, or other transaction.