Formal Opinion 2018-4: Duties When an Attorney Is Asked to Assist in a Suspicious Transaction

TOPICS: Client Due Diligence, Confidentiality, Duty of Candor, Duty to Refrain from Counseling Fraudulent or Illegal Conduct**.**

DIGEST: The New York Rules of Professional Conduct (the "Rules") prohibit a lawyer from knowingly assisting a client's crime or fraud but do not explicitly address a lawyer's duty when the lawyer merely has doubts about the lawfulness of the client's conduct; nor do the Rules explicitly require a lawyer to investigate in such circumstances in order to ascertain whether the legal services would in fact assist a crime or fraud before assisting the client. Nevertheless, when a lawyer is asked to assist in a transaction that the lawyer suspects may involve a crime or fraud, a duty of inquiry in some circumstances is implicit in the Rules. First, in order to render competent representation as required by Rule 1.1, a lawyer has a duty to the client in some circumstances to undertake an inquiry into suspicious transactions to render reasonable and candid advice to the client about whether to undertake the proposed conduct and the consequences of doing so. Second, notwithstanding the absence of an explicit requirement, a duty to inquire into suspicious transactions under some circumstances is implicit in the duty to avoid knowingly assisting wrongful conduct. The lawyer's inquiry must be consistent with the confidentiality duty of Rule 1.6, which governs disclosures the lawyer may make to third parties during the inquiry, as well as with the duty to keep the client informed during the representation. If the lawyer concludes that the client will engage or is engaging in a crime or fraud, the lawyer must not assist, or further assist, the wrongdoing. The lawyer may undertake remedial measures to the extent permitted by the exceptions to the confidentiality rule.

RULES: 1.1, 1.2, 1.6, 1.16, 2.1, 8.4

QUESTION: When an individual client asks a lawyer to provide legal assistance in a transaction, and the lawyer suspects that the legal services may assist the client's crime or fraud, to what extent must the lawyer investigate to allay or confirm the suspicions, and what other conduct must the lawyer undertake under the Rules?[1]

[1] This opinion addresses the straightforward situation in which a lawyer for an individual in a transactional representation suspects that the client's conduct may be criminal or fraudulent. It does not address a lawyer's duties with regard to a client's potentially illegal conduct in the context of litigation. Rule 3.3 (Conduct Before a Tribunal) may establish additional, or different, obligations in that context. This opinion is relevant to the representation of an entity as well as an individual but it does not address additional or different obligations that in-house counsel or outside counsel may have when representing an entity, including under Rule 1.13 (Organization as Client). Finally, this opinion does not address obligations that may be established by law other than the Rules, such as obligations that may have to be undertaken to satisfy a legal standard of care under professional negligence law.

OPINION:

I. Introduction

In the context of the following scenario, this opinion addresses lawyers' obligations under the Rules when the lawyer is retained to assist an individual client in a transaction that appears to the lawyer to be suspicious.

> A lawyer represents a client in the sale of a business in New York. The client advises the lawyer that the proceeds of the transaction will be used to purchase a different business. The client directs that after the first transaction closes, all payments be sent to a bank in a well-known secrecy jurisdiction. The client then asks the lawyer to proceed with the purchase. In preparing the documents and doing general due diligence, the lawyer realizes that the proposed purchase price is much more than the business is worth. The lawyer also learns inadvertently that the client has two passports, each from a secrecy jurisdiction different than the one in which the bank is located. The lawyer suspects, but does not know, that the transaction will involve a fraud or crime, such as money laundering or tax evasion, on the part of the client.[2]

As set forth below, a number of Rules and considerations bear on whether a transactional lawyer has a duty to investigate the client's conduct in this scenario and whether there are other steps that must be taken. These include the lawyer's duties of competence [Rule 1.1], of confidentiality [Rule 1.6], and to refrain from assisting a client in conduct that the lawyer knows is illegal or fraudulent [Rule 1.2(d)].

[2] Many U.S. lawyers and law firms conduct due diligence before accepting a new client, and they are well-advised to do so. *See* ABA Formal Op. 463 (2013) ("It would be prudent for lawyers to undertake Client Due Diligence ('CDD') in appropriate circumstances to avoid facilitating illegal activity or being drawn unwittingly into a criminal activity."). However, there is no uniform legal requirement that US lawyers undertake due diligence. This contrasts with the law in a number of non-US jurisdictions that have well-developed anti-money laundering and other due diligence requirements. *See generally* John A. Terrill, II & Michael A. Breslow, *The Role of Lawyers in Combating Money Laundering and Terrorist Financing: Lessons from the English Approach*, 59 N.Y.L. Sch. L. Rev. 433, 440 (2014-2015) (discussing UK anti-money-laundering law requiring lawyers, among others, to undertake client due diligence, including identifying a beneficial owner who is not the customer and obtaining information on the purpose of the representation).

II. A Transactional Lawyer May Have a Duty to Inquire When Serious Questions are Raised Regarding Whether the Lawyer is Assisting the Client in a Crime or Fraud

a. The duty of competence may require the lawyer to conduct due diligence into the client's potentially fraudulent conduct

Rule 1.1(a) requires a lawyer to provide "competent representation to a client." In many contexts, the very purpose of the representation is to provide advice about the lawfulness of a client's proposed course of conduct or to assist the client in structuring a proposed transaction in a manner that conforms to the law. Rule 1.2(d) authorizes a lawyer to "discuss the legal consequences of any proposed course of conduct with a client," and in such cases, Rule 1.1 presupposes that the lawyer will provide competent advice about whether the proposed conduct would be unlawful or about how to achieve the client's objectives within the law.

Regardless of the client's objectives, competent representation presupposes that the lawyer is rendering assistance in carrying out a client's *lawful* objectives. Committing a crime or engaging in other illegal or fraudulent conduct is not a lawful objective. Rule 1.2(d) forbids a lawyer from assisting the client in conduct that the lawyer *knows* to be illegal or fraudulent. But even if the lawyer does not have the requisite knowledge under Rule 1.2(d), furthering a client's illegal or fraudulent transaction – thereby subjecting a client to criminal or civil liability – may run afoul of the Rules if the lawyer did not act competently under Rule 1.1(a). In general, assisting in a suspicious transaction is not competent where a reasonable lawyer prompted by serious doubts would have refrained from providing assistance or would have investigated to allay suspicions before rendering or continuing to render legal assistance.

Further, Rules 1.4 and 2.1 require lawyers to render reasonable, candid advice. Unless the lawyer inquires in response to serious suspicions, the lawyer will not be in a position to advise the client about the attendant risks of civil or criminal liability. Thus, the duty of competence not only protects the client, but also in some situations requires the lawyer to take the steps necessary, including additional inquiry, to ensure that she is providing competent advice.

What constitutes a suspicion sufficient to trigger inquiry will depend on the circumstances. In many representations, there is no reason for the lawyer to doubt the lawfulness of the client's proposed actions. On the other hand, there may be representations where the circumstances raise suspicions or questions. For example, in the hypothetical above, the lawyer may have a duty to inquire of the client as to the reasons for a purchase of a business at a higher-than-market price and for running the funds through a bank in a secrecy jurisdiction to determine whether the transaction is being used to launder money, to avoid legitimate taxes, or for some other criminal or fraudulent purpose. Depending upon the answer, the lawyer may conclude that the transaction is legitimate, that she needs to make further inquiry, or that she must not provide further assistance in the transaction.

These conclusions are consistent with Comment [5] to Rule 1.1 which notes that "[c]ompetent handling of a particular matter includes inquiry into an analysis of the factual and legal elements of the problem," and with other authorities. *See, e.g.*, N.Y. City 2015-3 (2015) (a lawyer who believes he is the victim of a scam by a purported prospective client has a duty of competence to

investigate further before proceeding with the matter); ABA Informal Op. 1470 (1981) ("Opinion 1470") ("[A] lawyer should not undertake representation in disregard of facts suggesting that the representation might aid the client in perpetrating a fraud or otherwise committing a crime."); *cf.* N.Y. City 2018-2 (2018) ("The duty of competence under Rule 1.1 establishes additional duties in the post-conviction context, including, in some cases, a duty to investigate new potentially exculpatory evidence regardless of whether Rule 3.8(c) is triggered.").

b. A lawyer who fails to investigate potentially fraudulent conduct may also violate Rule 1.2(d), depending on the circumstances

Rule 1.2(d) prohibits a lawyer from assisting a client in conduct that the lawyer *knows* to be criminal or fraudulent. "Knowledge" under the Rules is defined as "actual knowledge of the fact in question . . . [which] may be inferred from the circumstances." Rule 1.0(k). However, consistent with the criminal law standard of "conscious avoidance," a lawyer may be deemed to have knowledge that the client is engaged in a criminal or fraudulent transaction if the lawyer is aware of serious questions about the legality of the transaction and renders assistance without considering readily available facts that would have confirmed the wrongfulness of the transaction. *See* N.Y. City 2018-2 (2018) ("Conscious avoidance of the fact in question may also constitute knowledge under the Rules, as under criminal law") (citing N.Y. City 99-02 (1999) ("Lawyers have an obligation not to shut their eyes to what was plainly to be seen … A lawyer cannot escape responsibility by avoiding inquiry.")).[3]

Opinion 1470 similarly recognized that when lawyers are aware that the client's proposed course of conduct is likely to be illegal, they "cannot escape responsibility by avoiding inquiry" but "must be satisfied, on the facts before [them] and readily available to [them], that [they] can perform the requested services without abetting fraudulent or criminal conduct and without relying on past client crime or fraud to achieve results the client now wants"; if lawyers are not satisfied that the client's conduct is lawful, they have "a duty of further inquiry" before rendering assistance. Thus, while Rule 1.2(d) does not require lawyers to inquire when there is no ground for suspicion, they cannot ignore "red flags." *Cf.* Rebecca Roiphe, *The Ethics of Willful Ignorance*, 24 Geo. J. Legal Ethics 187 (2011), citing *In re Blatt*, 63 324 A.2d 15, 17-19 (N.J. 1974) (holding that "a lawyer committed misconduct by helping a client effect a purchase after failing to investigate its suspicious nature"); *In re Dobson*, 427 S.E.2d 166, 166-68 (S.C. 1993) (sanctioning "an attorney for helping his client while remaining deliberately ignorant of his client's criminal conduct" and holding that the court would " not countenance the conscious

[3] The knowledge standard differs from the "should know" or "should have known" standard of several other Rules. *See* Rules 4.4(b), 5.1(d)(2)(ii), 5.3(b)(2)(ii). Under the knowledge standard of Rule 1.2(d), a lawyer is not deemed to "know" facts, or the significance of facts, that become evident only with the benefit of hindsight. As Justice Stevens observed in a different context, after a representation ends, "a particular fact may be as clear and certain as a piece of crystal or a small diamond," but lawyers "often deal with mixtures of sand and clay. Even a pebble that seems clear enough at first glance may take on a different hue in a handful of gravel." *Nix v. Whiteside*, 475 U.S. 157, 189, 106 S. Ct. 988, 1005 (1986) (Stevens J, concurring).

avoidance of one's ethical duties as an attorney").[4]

III. Limits on the Lawyer's Duty to Inquire

Ordinarily, a lawyer will begin an inquiry by seeking information from the client before turning to other sources. After concluding a reasonable inquiry, the lawyer may ordinarily credit the client when there are doubts. Whether a particular inquiry is adequate will vary with the circumstances.

To the extent that the lawyer must seek information from others, the Rules may impose conditions or limits. In general, the duty under Rule 1.4 to keep the client reasonably informed will require the lawyer to explain why there are doubts about the legality of the transaction and what steps the lawyer proposes to take to allay or confirm suspicions. If suspicions are sufficiently serious to give rise to a duty of inquiry under Rule 1.2(d), then the lawyer would render further assistance at her peril. A lawyer's fear that a client may seek to cover up his actions does not eliminate the duty of communication. Rule 1.4(a)(5). If the lawyer does suspect a cover-up and cannot persuade the client to be forthcoming, she may choose to terminate the representation. Rule 1.16(c)(2). Similarly, if the client will not authorize such an inquiry, the lawyer may have no realistic choice other than to cease assisting in the particular transaction, because to continue the representation may put her in jeopardy of violating Rule 1.2(d). And, needless to say, a client's refusal to authorize and assist in an inquiry into the lawfulness of the client's proposed conduct will ordinarily constitute an additional, and very significant, "red flag."

If the client green-lights an inquiry but refuses to pay for the time required to conduct it, the lawyer must decide whether to conduct the inquiry at her own expense or terminate the representation. The lawyer may discontinue the representation based on concerns as to the legality of the transaction. *See* Rule 1.2(f) (permitting a lawyer to refuse to participate in conduct that the lawyer believes to be unlawful, even if there is support for an argument that the conduct is legal); Rule 1.2, Cmt. [15].[5]

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[4] This opinion focuses on situations where a lawyer recognizes that a transaction is suspicious at the outset or at some later time before the transaction is completed. It does not address a lawyer's duty of inquiry, if any, after assisting in a potentially fraudulent or criminal transaction that is completed. We note, however, that Rule 8.4(h), which prohibits a lawyer from "engag[ing] in any other conduct that adversely reflects on the lawyer's fitness as a lawyer," has been found to require inquiry after assisting a completed transaction if the lawyer then suspects that the transaction was fraudulent or criminal. *See Matter of Reno*, 147 A.D.3d 8, 12 (1st Dep't 2016) (sanctioning lawyer under Rule 8.4(h) for assisting and not then remedying a fraudulent transaction, because the lawyer had strong reasons to suspect that his client was defrauding a vulnerable seller and "at a minimum, had a duty to confirm that his client tendered the agreed consideration . . . to ensure that the transaction was 'legitimate.'"). The implication of the *Reno* opinion is that, if the lawyer concluded upon inquiry that the transaction he assisted was fraudulent, the lawyer would have had some remedial obligation.

[5] Whether a lawyer should continue to work on the potentially illegal or fraudulent matter while conducting the inquiry depends on the circumstances. Even if the transaction is never

Further, any inquiry must be undertaken consistently with the confidentiality duty under Rule 1.6. Ordinarily, without client consent, the lawyer cannot conduct the inquiry in a manner that discloses client confidences to third parties. *See* NYCBA Formal Op. 2015-3.

IV. Remedial Obligations

If a lawyer gains knowledge during the course of representation that a client is engaged in unlawful conduct (or plans to be), the lawyer has a range of options. The lawyer's remedial steps should be dictated by such factors as the lawyer's knowledge of the facts at hand, the seriousness of the client's misconduct, and the extent of the lawyer's involvement in the client's misconduct. When the lawyer has actual knowledge of prospective wrongdoing, the lawyer may not assist in the wrongdoing and, further, must counsel the client against the illegal course of conduct under Rule 1.4(a)(5). This counseling obligation derives from the duty of competence under Rule 1.1. Despite the challenges involved in "persuading a client to take necessary preventive or corrective action" under Rule 1.4, such communications are appropriate not only to assist the client but to mitigate any risks the attorney is assuming by continuing to represent the client. Rule 1.2(d), Cmt. [10].

In our hypothetical situation, if the lawyer determines that the client may be engaged in tax fraud or tax evasion, the lawyer may choose to counsel the client to pay the appropriate taxes or take other corrective action. There may also be circumstances in which corrective action is not possible and the lawyer may have no alternative but to resign.[6] Rule 1.16(b)(1).

If it becomes clear during a lawyer's representation that the client has failed to take necessary corrective action, and the lawyer's continued representation would assist client conduct that is illegal or fraudulent, Rule 1.16(b)(1) mandates that the lawyer withdraw from representation. Comment [10] to Rule 1.2(d) states that the lawyer's obligations are "to avoid assisting the client" and to "remonstrate with the client" when the representation will result in violation of the Rules or other law. Withdrawal alone may be insufficient in some circumstances, for example, where the lawyer believes there is continued third-party reliance on an inaccurate opinion or representation. In that case, the lawyer may engage in "noisy withdrawal," which permits the attorney to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like. Rule 1.2(d), Cmt [10]; *see* Rule 1.6(b)(3); Rule 4.1, Cmt. [3]. The lawyer must also decide whether and how to prevent any serious harm that will result from the client's conduct, including whether to reveal the client's confidential information to accomplish that end. In general, the potentially applicable exceptions to the ordinary confidentiality duty

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completed, a lawyer is subject to discipline for knowingly *attempting* to assist a client's illegal or fraudulent conduct. *See* Rule 8.4(a) (providing that a lawyer or law firm may not attempt to violate the Rules). But certain tasks may be peripheral to the transaction and unrelated to any potential wrongdoing. And preliminary work on the transaction may not constitute a knowing "attempt" to assist a client's illegal or fraudulent conduct if the lawyer is concurrently investigating with an eye toward ending assistance if suspicions are confirmed.

[6] If, for example, the lawyer learns that the transaction is being used to launder the proceeds of a crime, it is unlikely that counseling the client not to act unlawfully will be successful.

provide that the lawyer may disclose confidences to prevent criminal conduct or for other specified purposes, but not that the lawyer must do so. *See* Rule 1.6(b)(1), (2) & (3).[7]

Throughout the process described above, the prudent lawyer would be well advised to keep a record of the decision making process and the basis for the steps she has (or has not) taken.

V. Conclusion

When asked to represent a client in a transaction that a lawyer believes to be suspicious, the lawyer has an implicit duty under some circumstances to inquire into the client's conduct. If the lawyer believes that her client is entering into a transaction that is illegal or fraudulent, the lawyer ordinarily must attempt to inquire in order to provide competent representation to the client under Rule 1.1. Further, under Rule 1.2(d), which forbids knowingly assisting a client's illegal or fraudulent conduct, a lawyer has the requisite knowledge if the lawyer is aware of serious questions about the legality of the transaction and renders assistance without considering readily available facts that would have confirmed the wrongfulness of the transaction. Implicit in the rule, therefore, is the obligation to take reasonably available measures to ascertain whether the client's transaction is illegal or fraudulent. The lawyer's inquiry must be consistent with the confidentiality duty of Rule 1.6, which governs disclosures the lawyer may make to third parties during the inquiry, as well as with the duty to keep the client informed during the representation. If the lawyer concludes that the client's conduct is illegal or fraudulent, the lawyer must not further assist the wrongdoing and may undertake remedial measures to the extent permitted by the exceptions to the confidentiality rule.

[7] This opinion does not address whether there are circumstances where a lawyer *must* undertake remedial measures to prevent or rectify wrongdoing in a transactional context and, if so, what measures must be undertaken. We assume that, in the transactional context, whether, and in what circumstances, such an obligation exists will largely be determined by substantive law rather than the Rules. *See* ABA Model Rules of Professional Conduct, Rule 4.1, Cmt. [3] (observing that: "In extreme cases, substantive law may require a lawyer to disclose information relating to the representation to avoid assisting a client's crime or fraud.").