

Ethics: Conflicts of Interests for Transactional Attorneys

As an attorney who advises law firms and lawyers on ethics, I frequently hear complaints from transactional lawyers that the ethics rules appear to have been written by litigators and are ill-suited to the realities of transactional practice. For many, the ethics rules concerning conflicts of interest seem particularly geared towards litigation. But with some basic background and a few practice tips, transactional attorneys can avoid the pitfalls of the conflicts rules.

I. Background: The Basic Conflicts Rules

The conflict of interest rules revolve around four basic concepts. First, a lawyer cannot be adverse to a current client, even on an unrelated matter. Second, a lawyer may be adverse to a former client but not if the new matter is “substantially related” to the matter that the lawyer handled for the former client. Third, a conflict that precludes any lawyer in a firm from taking a matter applies to all other lawyers within that firm. Fourth, clients can waive conflicts with adequate disclosure and consent. *See generally* ABA Model Rules of Professional Conduct (“Model Rules”) 1.7, 1.9 and 1.10.

Each of these four concepts has exceptions, which may differ by jurisdiction. For example, some conflicts cannot be waived, and a lawyer cannot negotiate business terms on behalf of a buyer and also represent the seller. There also are specific do’s and don’ts involving business transactions with clients, testamentary gifts, media rights and the like. For example, a business transaction with a client is subject to an objective test for fairness and the lawyer is required to advise the client to seek independent representation. *See generally* Model Rules 1.8, 1.11, 1.12 and 8.5. It is also helpful to keep in mind that conflicts can be waived “in advance.” The validity of such “advance waivers” depends upon the specificity and degree of the disclosure by the lawyer of the types of conflicts being waived, and the sophistication of the party agreeing to the waiver.

II. Practice Tips

A. Identifying the Client and Avoiding “De Facto” or “Accidental” Clients

Transactional lawyers frequently confront situations where they are representing entities – corporations, trade associations, institutions that are part of syndicates – that are related to other entities. In addition, transactional lawyers dealing with closed corporations often encounter situations where one individual controls the entity and directs the representation, but the transaction is for the benefit of the entity. One of the first steps to avoid conflicts in these situations is to identify those individuals or entities that are clients of the lawyer and similarly to identify those individuals or entities that are not clients. If there is no attorney-client relationship, then the conflict rules simply do not apply.

The formation of an attorney-client relationship is frequently judged from the reasonable perspective of the putative client, not from the subjective or even reasonable belief of the lawyer. Further, courts frequently brush aside the lack of an engagement letter or the fact that a putative client is not paying the lawyer’s fees. The courts have found that an attorney-client relationship can be created in the absence of an engagement letter or fee paying arrangement when the lawyer provides legal advice, receives confidential information or otherwise treats the entity or

individual as a client. Sending a copy of a letter marked “attorney-client privilege” may result in the lawyer slipping unawares into an attorney-client relationship. In the corporate family context, such “de facto” clients can be acquired when the lawyer’s de jure client has overlapping boards, officers or, particularly, in-house counsel, with subsidiaries, parents or affiliates. The situations in which “de facto” clients can arise in the corporate family context have been outlined recently by the New York City Bar Association. Formal Op. 2007-03, Corporate Family Conflicts; duty of loyalty; duty to preserve confidences and secrets (September 2007).

The best way to ensure that there is no misunderstanding about the identity of the client is to specify in the engagement letter who the client is and also to identify any related individuals or entities that the lawyer is not representing. A statement in an engagement letter that the lawyer represents a particular entity and not its affiliates, parents, subsidiaries or the like can save much anguish if, later on, the lawyer or a colleague becomes adverse to one of the related entities. This approach is not fool-proof, however, as statements in an engagement letter that certain individuals or entities are not clients can be of limited utility if the individuals or entities referenced in the engagement letter do not receive it. For example, a statement in an engagement letter to a trade association that the lawyer represents only the association or the lead bank in a lending syndicate and not its members or other participants is unlikely to have much force as to those members who do not receive the letter. In such situations, the lawyer should consider whether affirmative statements concerning the lack of attorney-client relationship should be made to those members with whom the lawyer has contact.

Clear statements by the lawyer concerning who the lawyer does and does not represent can largely but not entirely avoid the frequently troublesome issue of “de facto” clients. During the course of the engagement, the lawyer must respect the limitations set forth in the engagement letter concerning those individuals or entities with whom the lawyer has disclaimed an attorney-client relationship. All of this can become complicated in engagements with frequent conference calls and rapid e-mail communication among large groups of parties whose interests are generally aligned. The lawyer must be mindful, however, of the clients he actually represents.

B. Joint Representations

A joint representation is when a lawyer represents multiple clients in the same matter. For example, when one lawyer represents two partners who want to purchase a business, or multiple banks forming a single loan syndicate. Whenever a lawyer represents two or more clients in the same matter, the opportunity for a conflict exists. The lawyer owes a duty of loyalty and zealous representation to each client. A lawyer can fulfill that duty only if there is basic agreement among the jointly represented clients concerning the goals and general approach to the representation. Material disagreements among jointly represented clients may require the lawyer to decline or terminate the representation. A lawyer cannot represent clients whose interests are “fundamentally antagonistic.” Model Rule 1.7, Comment [28]. This does not mean that the lawyer must withdraw in the event of any disagreement among jointly represented clients, or that the client group cannot have frank discussions about the course of the representation in which they express and consider different opinions. It does mean, however, that the lawyer cannot continue with the representation if there are irreconcilable material differences.

Frequently, jointly represented clients will tell the lawyer at the outset of a representation that they are in agreement about the goals and methods of the representation. Regardless, the lawyer has an independent obligation to validate the conclusion reached by his clients. Indeed, over the course of the representation the lawyer must periodically re-evaluate whether the jointly represented clients continue to be sufficiently of like mind and interests about the representation. A case where the lawyer's clients are in complete agreement at the outset may have a radically different posture later in the representation; one of the jointly represented clients may change their mind about the deal or the developments in the negotiations may reveal differing positions among the jointly represented clients.

There are special rules concerning confidentiality in representations of multiple clients. Normally, a client is entitled to have the lawyer preserve his confidences and secrets from disclosure to any third party. In multiple representations, there is no privilege or secrecy among jointly represented clients. One client cannot tell their lawyer to keep relevant information from another client. Model Rule 1.7, Comment [30]. A client can always decide that he wishes his lawyer not to disclose a secret or confidence, but the cost of that decision may be an end to the joint representation.

Before embarking on a joint representation, the lawyer should consider what will occur if the clients no longer wish to be jointly represented, or, for whatever reason, the lawyer can no longer represent multiple clients. If the lawyer has not discussed this scenario with the clients in advance, the lawyer may find himself forced to withdraw from the representation of all clients in the matter. The lawyer should at the outset of a matter alert each client to the possibility that the joint representation will not survive and chart a path for how to determine the lawyer's continued role in the case. Even when the lawyer has discussed this issue in advance, and secured the agreement of all clients for the lawyer to remain in the matter on behalf of some of the formerly jointly represented clients, the lawyer should understand that continuing to represent one client over the objection of a former client in the same matter can be problematic. A consent that a lawyer obtains from a client to continue to represent another client after the demise of the joint representation must be "informed." A consent which is "informed" at the beginning of a representation may no longer be valid when judged in the light of developments over the course of the matter.

C. Waivers

Most conflicts can be waived. A lawyer can, for example, represent a bank on a real estate matter and still negotiate with that bank on behalf of a borrower, provided that there is a waiver by the bank (and the borrower). Under the Model Rules, the only conflicts that can never be waived are litigation conflicts where one lawyer seeks to represent two adverse parties in the same proceeding. Model Rule 1.7(b)(3). In non-litigation matters, there is no bright line rule but a lawyer still may not represent clients whose interests are "fundamentally antagonistic," even with a waiver. Model Rule 1.7, Comment [28]. A waiver must be "informed," which means that a lawyer must "communicate adequate information and explanation about the material risks and reasonably available alternatives to the proposed course of conduct." Model Rule 1.0(e). It is worth pausing over this definition and understanding that one of the "reasonably available alternatives" that must almost always be

explained to the client by the lawyer is the option of declining the requested consent. Conflict waivers should be in writing. The Model Rules require that consent be confirmed in writing and most jurisdictions similarly require a writing or strongly encourage it.

Advance waivers or consents to future conflicts have received increasing acceptance by the ethics authorities. Unfortunately, many firms simply fold advance waiver boilerplate into the engagement letters without considering how to strengthen that waiver in a given matter. “[G]eneral and open-ended” advance waivers are “ordinarily . . . ineffective.” Model Rule 1.7, Comment [22]. On the other hand, advance waivers that result from a detailed explanation of the types of conflicts that may arise and reference specific foreseeable conflicts are more likely to withstand scrutiny. If there are specific circumstances that the lawyer is trying to guard against – for example, the inability to represent a long-time major client of the firm – those scenarios should be included in the waiver discussion. A lawyer might agree, for example, to represent a developer in a matter knowing that the developer is likely at some point to have loan negotiations with a bank for whom the lawyer’s firm regularly does lending work. This is a circumstance that should be specifically described in any advance waiver.

Waivers that are procured from parties represented by independent counsel are most likely to be upheld. Waivers procured from unsophisticated clients receive the greatest scrutiny, both in terms of the adequacy of the disclosure and the fairness to the client. One common pitfall is to assume that a waiver procured from a high-level corporate executive will be judged under the same standard as those procured from in-house counsel. No matter how successful or experienced the business executive, the lawyer takes a risk in getting a waiver from such an individual, when an in-house counsel or independent outside counsel is equally available. At a minimum, it is prudent to copy in-house counsel or other independent counsel on any waiver received from a non-lawyer.

Finally, while typically a wall or a screen does not cure a conflict, a wall or a screen is frequently part of the inducement offered by a lawyer to obtain a conflict waiver. In those circumstances, the components of the wall or screen can be established as a matter of agreement between the lawyer and the client. The lawyer should be aware that by promising a wall and screen they are referencing an entire body of jurisprudence about the components of an adequate screen or wall – locked file cabinets, electronic firewalls, timely implementation, written memoranda and the like. As a result, a lawyer should avoid promising a wall or a screen unless they are prepared to implement such a mechanism immediately and properly. Often clients are just as willing to provide a waiver based on a less elaborate commitment that certain lawyers will not work on a matter. In short, don’t use the terms “wall” or “screen” lightly, particularly when the client may well be satisfied with less formal procedures.

III. Conclusions

We have seen over the last few years how vulnerable lawyers are when a transaction that they worked on fails financially and investors lose money. In those situations, investors look to the lawyers, among others involved in structuring or negotiating the transaction, to be made whole. The lawyer who unwittingly violates the ethics rules, in general, or the conflicts rules in particular, hands the unhappy investor an advantage in pressing his claims, even though

the ethical misstep may have no connection with reasons for the financial collapse of the deal. Identifying and avoiding conflicts at the outset and over the course of a transaction protects the lawyer from being the insurer of last resort for a failed transaction.

Thomas B. Mason
Zuckerman Spaeder LLP
tmason@zuckerman.com