AVOIDING CONFLICTS IN BUSINESS LAW PRACTICE:
SEVEN DEADLY SINS

2005 Spring Meeting of the
ABA Section of Business Law
Nashville, Tennessee

Saturday, April 2, 2005

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# AVOIDING CONFLICTS IN BUSINESS LAW PRACTICE:
# SEVEN DEADLY SINS

## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Hypothetical. Doug Richmond</th>
<th>.................................................................</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Commentary: Records and Procedures to Identify Conflicts of Interest; Comment [3] under Rule 1.7</td>
<td>.................................................................................................</td>
<td>3</td>
</tr>
<tr>
<td>&gt; Conflict of Interest Checklist. Susan P. Shapiro</td>
<td>.................................................................</td>
<td>5</td>
</tr>
<tr>
<td>II. Commentary: Joint and Multiple Representation; Comments [4], [5], [8], and [28] to [31] under Rule 1.7</td>
<td>.................................................................................................</td>
<td>8</td>
</tr>
<tr>
<td>III. Commentary: Corporate Family Conflicts; Comment [34] under Rule 1.7</td>
<td>.................................................................</td>
<td>10</td>
</tr>
<tr>
<td>IV. Commentary: Consents to Future Conflicts; Comments [22] and [20], [21] under Rule 1.7; and Sample Forms</td>
<td>.................................................................................................</td>
<td>11</td>
</tr>
<tr>
<td>V. Commentary: Lawyers Changing Firms and Screening; Rules 1.0(e) “Informed Consent” and 1.0(k) “Screened”; and related Comments</td>
<td>.................................................................................................</td>
<td>14</td>
</tr>
<tr>
<td>&gt; Selected pages from Susan P. Shapiro, TANGLED LOYALTIES: CONFLICT OF INTEREST IN LEGAL PRACTICE</td>
<td>.................................................................................................</td>
<td>16</td>
</tr>
<tr>
<td>VI. Commentary: Investing in Clients</td>
<td>.................................................................................................</td>
<td>27</td>
</tr>
<tr>
<td>&gt; ABA Formal Opinion 00-418</td>
<td>.................................................................................................</td>
<td>28</td>
</tr>
<tr>
<td>VII. Commentary: Attorneys Defending Their Own Work: The “Underlying Work” Problem</td>
<td>.................................................................................................</td>
<td>68</td>
</tr>
<tr>
<td>Pertinent Rules of Professional Conduct (ABA 2004)</td>
<td>.................................................................................................</td>
<td>69</td>
</tr>
<tr>
<td>&gt; 1.7 (Conflict of Interest)</td>
<td>.................................................................................................</td>
<td>69</td>
</tr>
<tr>
<td>&gt; 1.9 (Duties to Former Clients)</td>
<td>.................................................................................................</td>
<td>69</td>
</tr>
<tr>
<td>&gt; 1.10 (Imputation of Conflicts of Interest), including Maryland Screening provision, Rule 1.10(c) and related Comments</td>
<td>.................................................................................................</td>
<td>70</td>
</tr>
<tr>
<td>&gt; 1.18 (Duties to Prospective Client)</td>
<td>.................................................................................................</td>
<td>71</td>
</tr>
<tr>
<td>Speakers’ Biographical Information</td>
<td>.................................................................................................</td>
<td>72</td>
</tr>
</tbody>
</table>
The “Underlying Work” Problem

Ron Realty, a partner in the firm of Realty & Suit, represented Larry Lessor in negotiating and drafting the lease of shopping center space to Tom Tenant, who opened his store in the shopping center about a year ago. Last week, Tenant wrote a somewhat brusque letter to Lessor, claiming that Larry owed him $1 million under the terms of the lease. Lessor was shocked, because he was just on the point of claiming that Tom instead owed him $5 million under the lease.

Larry Lessor rushed over to the offices of Realty & Suit, and asked Sam Suit, the head of litigation, to bring an action against Tom Tenant to recover the $5 million and to defend against any action that Tom might bring. While researching the matter, Sam read the lease and concluded that the outcome of the proposed or threatened litigation will depend upon the construction of—drum roll, “The Paragraph”—a single paragraph in the 45 page lease.

Ron Realty has retired, so Sam shows the lease to others in the real estate section of Realty & Suit. They all say that in their experience it is preferable to use a slightly modified version of The Paragraph, which makes plainer a lessor’s rights in such situations. In short, The Paragraph that Ron Realty actually used is somewhat ambiguous, and may be insufficiently protective of the lessor in this kind of transaction.

Sam Suit is getting nervous about his involvement—and the law firm’s involvement—in the upcoming litigation. Should he be?

Uh Oh

Same cast of characters, same transaction and same two versions of The Paragraph; only the timing is different. The lease was signed last week, and Tom Tenant is about to open his store in the shopping center. Ron Realty is tidying up the mess on his credenza, and preparing to send the Lessor-Tenant transaction file to the file room. Glancing at the lease, his eyes fall on The Paragraph, and he realizes that during word processing someone allowed the obsolete version of The Paragraph to replace the clearer version that both he and his partners have been using for several years.

What, if anything, should he do? After all, no dispute between Larry and Tom may ever arise, and no one may ever know or care about which version of The Paragraph was included in the final executed copies of the lease.
But, She Wasn’t My Client!

Ivan Invest calls his long-time lawyer, Lester Lawyer, and makes an appointment to discuss a new business venture. Ivan brings to the meeting Martha Manage and announces that she will run the business day-to-day. After further discussion, Lester drafts the proper documents to form a new corporation, Big Cat, Inc. As planned, Ivan becomes the majority shareholder, Martha becomes the sole minority shareholder, and she is also designated as President.

Lester begins to represent Big Cat in both litigated and transaction matters, and speaks on the telephone with Martha about Big Cat business nearly every day. After about a year, Ivan comes to Lester’s office and states that he wants to force Martha out of the business and to become sole owner of all of the stock. He wants Lester to ensure that all the legal bases are covered, to avoid any litigation that would interfere with Big Cat’s smooth operation.

Does Lester Lawyer face any problems complying with these directions?
I. RECORDS AND PROCEDURES TO IDENTIFY CONFLICTS OF INTEREST.

Avoiding conflicts is dependent upon maintaining adequate data to identify not only each current and former Firm client, but also (1) the nature of each representation, (2) all persons and entities affiliated or related to each named client, and (3) all engagement letters, consents, waivers and other documents related to each representation. Comment [3] under Rule 1.7 provides:

[3] A conflict of interest may exist before representation is undertaken, in which event the representation must be declined, unless the lawyer obtains the informed consent of each client under the conditions of paragraph (b). To determine whether a conflict of interest exists, a lawyer should adopt reasonable procedures, appropriate for the size and type of firm and practice, to determine in both litigation and non-litigation matters the persons and issues involved. See also Comment to Rule 5.1. Ignorance caused by a failure to institute such procedures will not excuse a lawyer's violation of this Rule. As to whether a client-lawyer relationship exists or, having once been established, is continuing, see Comment to Rule 1.3 and Scope.

Before undertaking a representation, a lawyer must obtain sufficient information from a prospective client, or a current client concerning a new matter, to identify any conflict with an existing client or a former client (that is substantially related to the new matter). The lawyer obtaining the information should, however, limit the initial interview to only such information as reasonably appears necessary “to detect a conflict and determine that the matter is one the lawyer would undertake.” See Rule 1.18, Comments [3] and [4]; Freivogel, “Initial Interview-Hearing Too Much,” at http://www.freivogelonconflicts.com/new_page_26.htm, one of many conflicts subject areas with commentary and citations maintained on his conflicts website by William Freivogel, Esquire, Senior Vice President, Loss Prevention at AON Risk Services. Because potentially disqualifying information often is necessary to make these determinations, a lawyer should seek a prospective client’s informed consent that no information revealed during the initial interview will prohibit the lawyer from representing a different client in the matter. See Comment [5].

Firms increasingly are ascertaining creditworthiness and other qualifications before accepting a partner’s new client and are requiring the intake to record information such as

- any restrictions the client places on other representations
- prohibitions against matters adverse to the client’s affiliates
- nature of client as a government or foreign entity and whether subject to Foreign Agent Reporting Act
- any financial interest a Firm lawyer has in the client.
Regarding new matters, specific intake information is being required, including

- listing of all parties related to the matter
- statements whether matter is adverse to certain types of parties such as attorneys, banks, insurers, accountants, health care institutions, etc., whom the Firm regularly represents
- statement whether matter is related to any earlier services the Firm provided this or another client.

Even though not mandatory under some states’ ethics rules, many firms today require that new clients, and existing clients as to certain new matters, accept and return written engagement letters satisfying the requirements of Rule 1.5(b) and including: the scope of the representation, especially any limitations agreed upon; the basis for fees and expenses; the nature of all conflicts and potential conflicts of interest apparent at the commencement of the matter; and waivers of existing and future conflicts. See Rule 1.5(b) and Comments [2] and [4]; Rules 1.2(c), 1.4 and 1.7(b).
CONFLICT OF INTEREST CHECKLIST

Susan Shapiro
American Bar Foundation

NEW BUSINESS

- The firm has procedures for managing or limiting information disclosed by prospective clients to lawyers, secretaries, or receptionists when they first contact the firm.
- The firm has special procedures for participating in beauty contests.
- New matter forms are completed for all potential cases.
- New matter forms include information on [check if more than 12]: principal business of the client; the legal services currently or previously performed by the firm; prior names used by the prospective client or commonly used abbreviations; parents, subsidiaries, divisions, affiliates, and joint venturers; principals, directors, officers, and principal shareholders; general or limited partners; members of an association client; spouse and employer or business affiliation of an individual client; related parties; adverse parties; other parties that might have an interest in the matter (e.g., officers, employees, major customers, suppliers, competitors); relationship between proposed client and any existing client of the firm; possible positional conflicts; why the prospective client sought this law firm and who referred it; whether a third party is paying for the representation; whether lawyers have a relationship with the prospective client other than that of attorney/client; whether a family member of a firm attorney has an ownership interest in or is an officer, director, or employee of the prospective client; etc.
- All new matter forms (or summarized versions) are routinely circulated to all lawyers and paralegals in the firm, across all firm offices - either through e-mail, voice mail, memoranda, firm newsletters, or partnership meetings.
- All lawyers and paralegals must sign off or affirm that they have reviewed the prospective matter and see no potential for actual or future conflicts.
- All new matter forms are entered into a computer conflicts database.
- The conflicts database also includes information on [check if more than 3]: corporate families and affiliates (for example, a Standard and Poors database), accounting and billing records, non-matters and non-parties that the firm declined or that the prospective client ultimately took to another firm; former clients and adverse parties of lawyers hired laterally.
- The conflicts database has been backdated, including matters opened long before conflicts screening was computerized.
- All prospective new matters as well as pro bono cases are manually or electronically screened for conflicts of interest.
- Conflicts screening and oversight is performed centrally in the headquarters of the firm for new matters opened in all branch offices.
- Conflicts screening is also routinely undertaken before marketing the firm to a new client.
- Conflicts screening is performed electronically by computer.
- The firm has specialized computer software developed solely for conflicts checking (not simply part of billing or docketing programs). The software allows for aliases, acronyms, varied spellings or misspellings, abbreviations, similar roots of words, and complex searching algorithms.
- A billing number is not assigned and no work can be performed on the new case until conflicts clearance and approval is complete.

ONGOING MATTERS

- Lawyers are required to submit new forms and undertake new conflicts screening when changes develop in the course of an ongoing case (the client merges, new parties join the lawsuit or transaction, new co-defendants are charged, new evidence is uncovered, parties file cross-claims, etc.).
**STAFF**

- The firm employs full-time specialized non-lawyer staff to develop and update databases, input data, design and conduct searches, and administer the conflicts screening and analysis process.

- A Conflicts-like Committee has mandatory oversight of all new matters, determines whether they pose conflicts of interest, and exercises discretion about whether to accept or decline the new business or to seek waivers.

- Associates or paralegals are assigned to the Conflicts Committee to help review new matters, analyze the output from conflicts searches, and perform legal research.

- A New Business Committee, Managing Partner, or Executive Committee evaluates all prospective matters for business considerations.

- A disinterested third party (e.g., the Conflicts or New Business Committee, the Managing Partner, a member of the Executive Committee) signs off on all new matters.

- One or more partners in the firm have special expertise in conflicts of interest or the firm uses outside ethics consultants for difficult conflict-of-interest questions.

**HIRING**

- In the early stages of evaluating a lateral hire, the firm will generate and evaluate a list of all matters it has against the firm or entity currently employing the candidate.

- In the early stages of evaluating a lateral hire, all lawyers in the firm will be consulted about any matters adverse to the candidate's current employer.

- Before making an offer of employment, candidates will be asked to supply a list of:
  - clients, cases, or occasionally products that (1) they intend to bring with them; (2) they worked on in the prior firm and will be leaving behind; (3) adverse parties involved in any of these matters; and (4) substantial client contacts or clients that they know so much about that the clients might object to the new firm taking a position adverse to them.

- These lists are checked against the firm’s conflicts database and circulated to all members of the firm for examination and approval.

- Candidates are also asked to examine a list of our own clients for potential conflicts of interest.

- The same procedures are undertaken for law clerks, entry-level associates, paralegals, and secretaries before hiring, as well as for potential merger or acquisition candidates.

- Once hired, laterals complete new matter forms for all business they brought with them to the firm, which are subject to routine conflicts clearance and circulated for the approval of all members of the firm.

- Newly-hired lawyers are placed behind ethical screens (i.e., Chinese walls) until it can be determined that they have not imported any conflicts of interest into the firm.

- Mergers or lateral hires have been abandoned by our firm because the conflicts of interest were too problematic.

- The firm has lost attorneys who left because they were repeatedly conflicted out of new business by conflicts of interest elsewhere in the firm.

**LAWYERS’ OUTSIDE INTERESTS**

- Lawyers in the firm are barred from investing with clients or serving on their boards of directors.

- Lawyers must get permission from the firm to serve on any other (non-client) corporate or non-profit boards, to make other investments, or to trade in the securities of non-clients.

- Lawyers must submit an annual list of all directorships, board memberships, personal or familial investments, holdings, or other business interests. (Lists are entered into the conflicts database.)

- The firm has policies regarding spouses or significant family members who are lawyers, judges, regulatory officials, and the like (e.g., spouses cannot practice within 100 miles of the firm) or who work for clients or client adversaries.
PROPHYLACTIC MEASURES

- Before taking a new matter, partners will evaluate potential future business from which the firm may be conflicted out by the prospective matter. The firm has procedures to insure that a bird in hand will sometimes be declined in favor of potential future business.
- The firm has procedures so that colleagues do not take cases against prospective clients or marketing targets for which business has not yet been secured.
- The firm has policies about positional conflicts and joint representation.
- At the outset, the firm will disclose to a prospective client any conflicts of interest that are likely to emerge later in the case, explain how the firm will respond to them, and secure a waiver - rather than remain silent when taking the engagement and deal with the conflict if it detonates down the road.
- The firm often seeks so-called "advance consents," in which clients agree that they will not move to disqualify the firm for taking advantage of future opportunities that are adverse to their interests, but unrelated to the matter for which they engaged the firm or any of the confidences they shared with their lawyers. There are matters that we will decline without an advance consent.
- All waivers of conflicts are formal written documents signed by clients; they are never obtained orally or take the form of written memoranda placed in the file which summarize such conversations with clients. Unsophisticated clients are advised to consult with other lawyers before signing a conflicts waiver.
- The firm frequently erects ethical screens or Chinese walls in response to potential conflicts (whether from lateral hiring or adversities of interest among clients).
- Ethical screens in the firm require that:
  - all co-workers be notified of the screen, cautioned not to talk to their quarantined colleague about the case, and admonished that all conversations take place in private; access to files be restricted; files be segregated, labeled, and locked; passwords be placed on affected computer files; confidential procedures for inter-office mail be specified; screened lawyers sign a pledge to abide by the screen; a party responsible for supervising the screen be named; and all personnel be periodically reminded of the existence of the screen.
- The firm has implemented procedures to expedite the transformation of "current" into "former" clients (e.g., sending clients a "close-out" letter or "final bill;" archiving case records; removing clients from the firm mailing list; or sending an engagement letter which specifies the conditions under which the engagement will be considered completed) and a mechanism to periodically review open cases.
- The firm has spun off practice areas that continually create conflicts with other departments, eschewed mergers or rapid growth, or opened branch offices rather than growing internally at least in part to lessen its vulnerability to conflicts of interest.
- The firm gives compensation credit to lawyers for new business that had to be turned away because of conflicts of interest elsewhere in the firm.
- The firm holds seminars (or sends lawyers to seminars) on conflict of interest for newly-hired attorneys and periodic updates for all staff.
- The firm works closely with its malpractice insurer to devise loss-prevention strategies.

How does your firm compare? Few firms check off every item or none at all.

- A typical large general practice firm of more than 150 or 250 lawyers, perhaps with more than one office, would check more than 80% of the items.
- A typical general practice firm of 75-100 lawyers or a specialized firm which is a bit larger would check about half of the items.
- A typical firm of about 50 lawyers in a large city or of more than 15 in a small town would check about 20% of the items.
- A typical firm of less than 10 lawyers in a large city or less than 5 lawyers in a small town would check about 5% of the items.
II. JOINT AND MULTIPLE REPRESENTATION.

Comments [4], [5], [8], and [28] to [31] under Rule 1.7 explain the conflicts considerations in multiple representation and in representing organizations:

[4] If a conflict arises after representation has been undertaken, the lawyer ordinarily must withdraw from the representation, unless the lawyer has obtained the informed consent of the client under the conditions of paragraph (b). See Rule 1.16. Where more than one client is involved, whether the lawyer may continue to represent any of the clients is determined both by the lawyer's ability to comply with duties owed to the former client and by the lawyer's ability to represent adequately the remaining client or clients, given the lawyer's duties to the former client. See Rule 1.9. See also Comments [5] and [29].

[5] Unforeseeable developments, such as changes in corporate and other organizational affiliations or the addition or realignment of parties in litigation, might create conflicts in the midst of a representation, as when a company sued by the lawyer on behalf of one client is bought by another client represented by the lawyer in an unrelated matter. Depending on the circumstances, the lawyer may have the option to withdraw from one of the representations in order to avoid the conflict. The lawyer must seek court approval where necessary and take steps to minimize harm to the clients. See Rule 1.16. The lawyer must continue to protect the confidences of the client from whose representation the lawyer has withdrawn. See Rule 1.9(c)….

[8] Identifying Conflicts of Interest: Material Limitation. Even where there is no direct adverseness, a conflict of interest exists if there is a significant risk that a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer's other responsibilities or interests. For example, a lawyer asked to represent several individuals seeking to form a joint venture is likely to be materially limited in the lawyer's ability to recommend or advocate all possible positions that each might take because of the lawyer's duty of loyalty to the others. The conflict in effect forecloses alternatives that would otherwise be available to the client. The mere possibility of subsequent harm does not itself require disclosure and consent. The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.

[28] Whether a conflict is consentable depends on the circumstances. For example, a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interest even though there is some difference in interest among them. Thus, a lawyer may seek to establish or adjust a relationship between clients on an amicable and mutually advantageous basis; for example, in helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest or arranging a property distribution in settlement of an estate. The lawyer seeks to resolve potentially adverse interests by developing the parties' mutual interests. Otherwise, each party might have to obtain separate representation, with the possibility of
incurring additional cost, complication or even litigation. Given these and other relevant factors, the clients may prefer that the lawyer act for all of them.

[29] Special Considerations in Common Representation. In considering whether to represent multiple clients in the same matter, a lawyer should be mindful that if the common representation fails because the potentially adverse interests cannot be reconciled, the result can be additional cost, embarrassment and recrimination. Ordinarily, the lawyer will be forced to withdraw from representing all of the clients if the common representation fails. In some situations, the risk of failure is so great that multiple representation is plainly impossible. For example, a lawyer cannot undertake common representation of clients where contentious litigation or negotiations between them are imminent or contemplated. Moreover, because the lawyer is required to be impartial between commonly represented clients, representation of multiple clients is improper when it is unlikely that impartiality can be maintained. Generally, if the relationship between the parties has already assumed antagonism, the possibility that the clients' interests can be adequately served by common representation is not very good. Other relevant factors are whether the lawyer subsequently will represent both parties on a continuing basis and whether the situation involves creating or terminating a relationship between the parties.

[30] A particularly important factor in determining the appropriateness of common representation is the effect on client-lawyer confidentiality and the attorney-client privilege. With regard to the attorney-client privilege, the prevailing rule is that, as between commonly represented clients, the privilege does not attach. Hence, it must be assumed that if litigation eventuates between the clients, the privilege will not protect any such communications, and the clients should be so advised.

[31] As to the duty of confidentiality, continued common representation will almost certainly be inadequate if one client asks the lawyer not to disclose to the other client information relevant to the common representation. This is so because the lawyer has an equal duty of loyalty to each client, and each client has the right to be informed of anything bearing on the representation that might affect that client's interests and the right to expect that the lawyer will use that information to that client's benefit. See Rule 1.4. The lawyer should, at the outset of the common representation and as part of the process of obtaining each client's informed consent, advise each client that information will be shared and that the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other. In limited circumstances, it may be appropriate for the lawyer to proceed with the representation when the clients have agreed, after being properly informed, that the lawyer will keep certain information confidential. For example, the lawyer may reasonably conclude that failure to disclose one client's trade secrets to another client will not adversely affect representation involving a joint venture between the clients and agree to keep that information confidential with the informed consent of both clients.

See also 2 Restatement (Third) THE LAW GOVERNING LAWYERS (ALI 2000) §130 at 357 (representing multiple clients in a nonlitigated matter); Freivogel, “Joint/Multiple Representation,” at http://www.freivogelonconflicts.com/new_page_8htm.
III. CORPORATE FAMILY CONFLICTS.

Comment [34] under Rule 1.7 discusses representing affiliates of corporate clients:

[34]  *Organizational Clients.* A lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary. See Rule 1.13(a). Thus, the lawyer for an organization is not barred from accepting representation adverse to an affiliate in an unrelated matter, unless the circumstances are such that the affiliate should also be considered a client of the lawyer, there is an understanding between the lawyer and the organizational client that the lawyer will avoid representation adverse to the client's affiliates, or the lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client.

Whether to sue on behalf of one client the remote subsidiary of a corporation the lawyer also represents, even though permitted under the Rules, is a serious client relations issue. When undertaking representation of an organization with many affiliates, the lawyer should establish in the initial engagement letter whether, and the extent to which matters adverse to affiliates may be undertaken by the Firm. For additional authorities, see Freivogel, “Corporate Families” at [http://freivogelonconflicts.com/new_page_6.htm](http://freivogelonconflicts.com/new_page_6.htm).
IV. CONSENTS TO FUTURE CONFLICTS.

Comment [22] under Rule 1.7 recognizes that under some circumstances advance consent to future conflicts of interest are effective:

[22] Consent to Future Conflict. Whether a lawyer may properly request a client to waive conflicts that might arise in the future is subject to the test of paragraph (b). The effectiveness of such waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. The more comprehensive the explanation of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the requisite understanding. Thus, if the client agrees to consent to a particular type of conflict with which the client is already familiar, then the consent ordinarily will be effective with regard to that type of conflict. If the consent is general and open-ended, then the consent ordinarily will be ineffective, because it is not reasonably likely that the client will have understood the material risks involved. On the other hand, if the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, such consent is more likely to be effective, particularly if, e.g., the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation. In any case, advance consent cannot be effective if the circumstances that materialize in the future are such as would make the conflict nonconsentable under paragraph (b).

Comments [20] and [21] provide:

[20] Consent Confirmed in Writing. Paragraph (b) requires the lawyer to obtain the informed consent of the client, confirmed in writing. Such a writing may consist of a document executed by the client or one that the lawyer promptly records and transmits to the client following an oral consent. See Rule 1.0(b). See also Rule 1.0(n) (writing includes electronic transmission). If it is not feasible to obtain or transmit the writing at the time the client gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter. See Rule 1.0(b). The requirement of a writing does not supplant the need in most cases for the lawyer to talk with the client, to explain the risks and advantages, if any, of representation burdened with a conflict of interest, as well as reasonably available alternatives, and to afford the client a reasonable opportunity to consider the risks and alternatives and to raise questions and concerns. Rather, the writing is required in order to impress upon clients the seriousness of the decision the client is being asked to make and to avoid disputes or ambiguities that might later occur in the absence of a writing.

[21] Revoking Consent. A client who has given consent to a conflict may revoke the consent and, like any other client, may terminate the lawyer's representation at any time. Whether revoking consent to the client's own representation precludes the lawyer from continuing to represent other clients depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of a material change in circumstances, the reasonable expectations of the other client and whether material detriment to the other clients or the lawyer would result.
Similar standards are described in 2 Restatement (Third), The Law Governing Lawyers (ALI 2000), §122 Comment d Consent to future conflicts at page 268. See also authorities cited in Reporter’s Note at 279; ABA Formal Opinion 93-372, Prospective Waivers, at pages 171-174 (standards for prospective waivers of conflicts); and New York County Lawyers Assn. Op. No. 724 (1998) (describing requirements for informed consent to future conflicts under DR’s).


Form of general current and advance waiver:

Our Firm may currently or in the future represent one or more other clients in matters, including litigation or transactions, or having other contacts with [CLIENT NAME] and/or its affiliates or subsidiaries. For example, we may represent other clients in corporate matters (including takeovers and other change-in-control issues and transactions); in commercial transactions (including preparation and negotiation of agreements, licenses, leases, loans, securities offerings or underwritings); in litigation involving [CLIENT NAME] on behalf of these or other clients; or in legislative or policy matters, or administrative proceedings that may involve or affect [CLIENT NAME] and/or its affiliates or subsidiaries. We understand that [CLIENT NAME] consents to the firm’s current and future representation of any such other clients in any of such matters without the need for any further consents from [CLIENT NAME]. We understand that no such direct conflict would exist where the representation of another client is not substantially and adversely related to the matters the firm is handling for [CLIENT NAME], or where the firm’s representation of either [CLIENT NAME] or another client would involve legislative issues, policy issues, or administrative proceedings unrelated to the representation of the other. This advance consent does not permit unauthorized disclosure or use of any client confidences.

Form of more specific current and advance waiver encompassing specific type of litigation:

In our conversations with [IN HOUSE COUNSEL], I have advised you that we have represented individuals and others in litigation in which [CLIENT] sought recovery of certain loss claims. We also have represented other companies in matters that, given the competitive nature of the industry, could adversely affect [CLIENT]. Our undertaking the [CLIENT] representation is conditioned upon [CLIENT], represented by you and other corporate counsel, agreeing in advance that [CLIENT] waives any conflicts of interest that might arise from (1) our defending or prosecuting any litigation adverse to [CLIENT], and (2) representing other
companies in matters, including lawsuits, in which [CLIENT] is an adverse party or otherwise interested, so long as the matter is not directly and substantially related to the subject of our current [CLIENT] representation.

My search of the Firm's conflict records reveals only one currently active matter adverse to [CLIENT]. The firm is defending [Other Client] in a claim by [CLIENT] for subrogation regarding its insured, X. I am told that [CLIENT] paid X his property damage allegedly caused by ________________________________. We understand that you waive this conflict, and that we have your consent to seek a waiver from [Other Client] to permit our representation of you.

See also Freivogel, supra, at page 20 (Form of Advance Waiver).

For discussion, citations and forms for other consents and waivers, see generally Freivogel, supra.
V. LAWYERS CHANGING FIRMS AND SCREENING.

Although most attention is focused on the use of screening to avoid entire firms from disqualification based upon a lateral attorney’s—or her former firm’s—client representations, screening is more often used with the informed consent of all affected clients. Rule 1.0(e) and Comments [6] and [7] describe the requirements for an “informed” consent:

**Rule 1.0(e):**

“**Informed consent**” denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

[6] **Informed Consent.** ...The communication necessary to obtain such consent will vary according to the Rule involved and the circumstances giving rise to the need to obtain informed consent. The lawyer must make reasonable efforts to ensure that the client or other person possesses information reasonably adequate to make an informed decision. Ordinarily, this will require communication that includes a disclosure of the facts and circumstances giving rise to the situation, any explanation reasonably necessary to inform the client or other person of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client’s or other person’s options and alternatives. In some circumstances it may be appropriate for a lawyer to advise a client or other person to seek the advice of other counsel. A lawyer need not inform a client or other person of facts or implications already known to the client or other person; nevertheless, a lawyer who does not personally inform the client or other person assumes the risk that the client or other person is inadequately informed and the consent is invalid. In determining whether the information and explanation provided are reasonably adequate, relevant factors include whether the client or other person is experienced in legal matters generally and in making decisions of the type involved, and whether the client or other person is independently represented by other counsel in giving the consent. Normally, such persons need less information and explanation than others, and generally a client or other person who is independently represented by other counsel in giving the consent should be assumed to have given informed consent.

[7] Obtaining informed consent will usually require an affirmative response by the client or other person. In general, a lawyer may not assume consent from a client’s or other person’s silence. Consent may be inferred, however, from the conduct of a client or other person who has reasonably adequate information about the matter.

Rule 1.0(k) and Comments [6] and [7] describe the requirements for a screen to be effective:

**Rule 1.0(k):**

“**Screened**” denotes the isolation of a lawyer from any participation in a matter through the timely imposition of procedures within a firm that are reasonably adequate under the circumstances to protect information that the isolated lawyer is obligated to protect under these
VI. INVESTING IN CLIENTS.

With the explosion of start-up companies mostly engaged in aspects of electronic recording and messaging, lawyers are more frequently accepting equity interests in clients as fees for their services. Comment [4] under Rule 1.5 recognizes that accepting property in payment for a lawyer’s services is permissible providing it isn’t a proprietary interest in the cause of action or subject matter of litigation prohibited by Rule 1.8(i). Comment [4] also warns that accepting a fee in property may be subject to the requirements of Rule 1.8(a) as a business transaction with the client.

The ABA Standing Committee on Ethics and Professional Responsibility in Formal Opinion 00-418 (reproduced below with permission) set forth ethical guidelines for lawyers who accept such equity interests. THE ATTORNEY HANDBOOK FOR INVESTING IN CLIENTS, prepared by the San Francisco Firm of Rogers Joseph O’Donnell & Quinn, is one of several excellent compilations of practical considerations attorneys must consider. See also, Freivogel, “Investing in Clients/Stock for Fees” at http://www.freivogelonconflicts.com/new_page_21.htm.
Ethical Screens

As I elaborated in chapter 7, lawyer mobility exacerbates conflict of interest. As attorneys travel through the job market, they accumulate the confidences of and duties owed to each collection of current and former clients they encounter along the way. Career mobility multiplies not only the conflicts of interest faced by these migratory lawyers but also, because of imputed disqualification rules, those of everyone they affiliate with as they move from job to job. They become so-called Typhoid Marys, conflicting out thousands of their colleagues and forcing their new firms to turn away substantial amounts of prospective business tainted by their prior affiliations. As a result, many tainted lawyers become immobile, unattractive to other employers because of the business that their presence in the new firm would preclude.

About two decades ago, the American Bar Association recognized that the imputed disqualification rules deterred from government service able lawyers who feared becoming Typhoid Marys, unable to move from government into lucrative partnerships in private law firms. Law reformers borrowed the concept of the Chinese wall, an institutional mechanism long used in banks, securities, and investment banking firms to segregate departments and ensure that confidential information in one did not find its way into another. The Model Rules of Professional Conduct officially greased the revolving door by stipulating that if former government lawyers, judges, or public officials are screened and receive no share of the fees generated by an otherwise tainted matter, conflicts of interest they carry with them into the private sector would not be imputed to their entire firm (American Bar Association 1983, Rules 1.12 and 1.13).

Because, in most firms, the revolving door connects lateral positions in other private law firms more frequently than it does those in the public sector, these pro-
visions for screening former public officials are of only limited value. In only a handful of jurisdictions--Illinois being one--does the prophylactic role of these screening devices, available when attorneys are hired from government positions, also apply when they are recruited from private law firms.\footnote{Rule 1.10 of the Illinois Rules of Professional Conduct makes an exception to the imputed disqualification rule when "the newly associated lawyer has no information ... that is material to the matter; or the newly associated lawyer is screened from any participation in the matter" (Illinois Supreme Court Rules 1990). Though controversial (Pizzimenti 1997, 306), the pro-posed Restatement of the Law: The Law Governing Lawyers is compatible with the Illinois regulations, stating that "restrictions imputed from a personally-prohibited lawyer to an affiliated lawyer or firm" can be removed with adequate screening measures (American Law Institute 1995, §204). The ABA Ethics 2000 Commission also recommended a screening provision similar to that in Illinois (American Bar Association 2001, Rule 1.10c). However; after a very contentious debate late in the day, the ABA House of Delegates voted 58 percent to 42 percent to strike the provision (personal observation). Most likely, screening will be revisited again before the Ethics 2000 process is concluded, though whether the vote will change and screening will spread to other jurisdictions is anybody's guess. The rationale for allowing law firms to establish screens to remove imputation occasioned by the mobility of private practitioners is that it gives clients a wider choice of counsel, makes it easier for lawyers to change jobs, and limits the number of costly and disruptive disqualification motions that have become commonplace in the arsenal of hardball litigators.}

Lawyers go into government "training programs," then leave to practice on the opposite side. It is only fair that if the courts allow this for government lawyers that they do so for those in private practice as well. \[14Ch100+j\]

Though law firms in all jurisdictions are free to erect what are variously called screening devices, Chinese walls, insulation walls, ethical walls or screens, zones or cones of silence, confidentiality screens, or fire walls, these devices cure conflicts of interest only when the adversities are indirect and the affected clients have given their consent.\footnote{Some commentators decry the use of the label, "Chinese wall," as ethnically insensitive or politically incorrect (Wolfram 1986, 401; Peat, Marwick, Mitchell & Co. v. Superior Court, 200 Cal. App. 3d 272 (Cal. Ct. App. 1988) (Low, J., concurring).} They serve as barriers for reassuring clients, not for neutralizing conflicts. Illinois lawyers and those in the few other states that extend the provisions for screening government lawyers to migratory private practitioners do not need to secure client consent for conflicts they import into the firm. If the firms build a proper and timely screen, the conflicts of lawyers traveling from other positions are not imputed to their new colleagues.

Firms in the sample varied considerably in the extent to which they made use of screens. Were screening devices as visible as the Great Wall of China, after which some are modeled, I would have seen dozens in place in a few of the firms that I visited and none at all in most of the others. Not surprisingly, none of the firms in the sample with fewer than ten attorneys had ever used a screening device; this was true of a quarter of those with ten to nineteen attorneys, more than four-fifths of those with twenty to forty-nine and virtually all those employing fifty or more lawyers. Although about a fifth of the firms with ten to nineteen attorneys have constructed screens on a number of occasions, this was true of almost half the
firms with twenty to forty-nine lawyers and roughly three-quarters of those with fifty or more. Indeed, almost half the respondents in firms of one hundred lawyers or more indicated that Chinese walls were common in their firm, with many, sometimes dozens, in place at any one time.

As described in chapter 7, I conducted pilot interviews in the largest law firms (all with more than one hundred attorneys), where Chinese walls would be most common, in another Midwestern state that—like most of the rest of the country—does not permit screens without client consent to resolve the conflicts of interest that arise from lateral hiring. This sample is far too small from which to generalize, but the contrast is telling. The chair of the Professional Standards Committee of the largest firm (which had a branch office in a state that allows screening) told me that most of the firm's lateral hiring occurs in the branch office that allows screening but that the firm as a whole probably uses Chinese walls in a third of the matters in which it seeks client consent to a conflict. The managing partner of a second firm indicated that screening devices are not common but "there are probably Chinese wall situations around here at all times." At the opposite extreme, the chair of the New Client Committee at a nearby firm was barely familiar with the notion of a Chinese wall. What little he knew, he conceded that he learned only hours before our interview when he questioned a colleague who had formerly worked in a Chicago law firm. Moreover, he said, the physical layout of the firm and the ease of access to files would render a wall "farcical." The remaining respondents explained that they erected screens on "a few occasions" or "no more than five times in the history of the firm," and some expressed distaste for the practice. So screening devices appear to be less institutionalized in states that do not allow this prophylactic device to cure conflicts detonated by mergers and lateral hiring.

What does an ethical screen look like? The respondents provided disparate descriptions, usually corresponding to the size of the firm.

S: What does a screen look like in the firm?

L: It's about this big [L gestures]. [Laughter] We have a set of forms in which .. the screened lawyer is notified by the Conflicts Department and our administrative manager that they have been screened from the particular matter or client. ... And the notice goes to the screened lawyer or lawyers. And the

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13 Of course, these "large" firms are half the size, on average, of their counterparts in Chicago. So some of the disinclination to erect screens probably reflects firm size.

14 Rule 1.10 of the Illinois Rules of Professional Conduct stipulates that:

(e) ... a lawyer will be deemed to have been screened from any participation in a matter if, (1) the lawyer has been isolated from confidences, secrets, and material knowledge concerning the matter; (2) the lawyer has been isolated from all contact with the client or any agent, officer, or employee of the client and any witness for or against the client; (3) the lawyer and the firm have been precluded from discussing the matter with each other; and (4) the firm has taken affirmative steps to accomplish the forgoing. (Illinois Supreme Court Rules 1990).

See also Pizzimenti 1997.
screened lawyer must sign an acknowledgment and a pledge to abide by the screen. Then the Conflicts Department sends out a screening memo to all parties and it's put into a database and then there are periodic reminders that go out. At this point, because of various technical problems, we do not lock files. We do not mark screened files. We're looking at that. [36Ch100+

We send out a memo to everyone in the office saying, "Do not discuss whatever case it is with whoever it is." We memo everyone. We indicate that the files for the particular case will be stored in a specific cabinet which is to be locked and that no file is to stay in anyone's office overnight. It must be locked in the cabinet, which is located in a specific spot. But usually the secretary for the lawyers who are working on the matter and the lawyers have the keys to the cabinet. Any interoffice mail regarding those items is to be in a sealed envelope marked "confidential," as opposed to our standard envelope which has a pull-tab on it. [10Ch100+] Many firms also communicate to attorneys and staff the seriousness with which they regard a breach of these barriers.

We circulate a memo: "So-and-So has come to us. At their prior firm, they did some work for B. We want to avoid even the appearance of conflicts. This partner is responsible for supervising the files. Don't leave files or records around. Don't ever talk to this individual about the case. We want lawyers to know that this is as serious as talking about a bomb in an airport. [43Ch20-49]"

Let me put it to you this way. ... if we discovered that this person was violating our Chinese wall principles, we'd probably take him out in the street and beat him up and leave him for dead. [51Ch20-49]

The most opaque and seemingly more impenetrable screens, generally found in larger firms, have a mechanism for

- alerting the screened lawyers to their new status, informing them of their obligations, and requiring them to sign a pledge to abide by the screen.
- notifying all their colleagues, file room personnel, and coworkers (even secretaries, messengers, and food service workers) of the screen and cautioning them not to talk to their quarantined colleague about the case.

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15Some lawyers do take the admonition seriously:

I had an associate come in. I thought the poor guy was going to be in tears. I really thought he was going to cry. 'I messed up, I messed up.' And what happened, it turned out this guy was an M.D. and he wants to do medical-type work and he got involved in taking a deposition for a partner in a breast implant case and he has been working regularly for another partner in some other kind of medical device case for different clients. But this client is also a codefendant in this one and so we had set up a screen and he was flipping through the file and, all of a sudden, he saw the screening memo and he thought that ... it was the end of the world. [pilot interview #2]
• explaining that all conversations must take place in private locations (and never in hallways, elevators, lunchrooms, etc.).
• restricting access to files.
• segregating, labeling, and locking files.
• reminding colleagues that records and documents must not be left out on their desks, but stored in secure locations.
• placing passwords on affected computer files.
• specifying confidential procedures for interoffice mail.
• naming a party responsible for supervising the screen.
• periodically reminding all personnel of the existence of the screen.¹⁶

Although screens in some firms are marked by barriers, locks, signs, and passwords and are enforced by assorted border guards, in many others--especially smaller firms--they are more "ephemeral," to quote one respondent, constructed from much simpler blueprints. A few firms simply admonish lawyers not to talk to one another.

A Chinese wall is "a state of mind." We don't give the screened lawyer access to information and, similarly, he doesn't give you material information. [14Ch100+]

We just say "Hey, stay away. Stay the hell away from this client. [Case] was at your old office. You worked on it. So forget it." ... We put something on the file saying, "So-and-So is not going to be involved in this. But people know it. If guys are working on a case, he knows who's working on the case and he shouldn't be talking to anybody about it and he shouldn't read the file. So he doesn't. [20Ch50-99]

Others tell the infected lawyer not to work on the case or assign separate teams of lawyers to work on the conflicting matters.

What we've done in the past--and what I still do--is that, if an attorney came from a certain firm, they just never work on the files from that firm.... But, generally, what we would do if there is a conflict, is just that attorney would not handle--ever handle--any of those files. That would be it. [102Ch10-19]

We have simply screened off lawyers from cases. And the way we do that is--we work in litigation teams, generally. And if we had such an issue, we would take the case outside of the entire "team sphere" and put it into another team sphere. Because there's very little crossover on the teams. That pretty much would guarantee that that lawyer would be screened off that case. [27Ch50-99]

¹⁶Few of the respondents, even those with heavily fortified ethical walls, spoke about provisions to exclude screened lawyers from their share of the fees accrued from the conflicted matter. Some of the larger and more sophisticated firms construct screens even for support personnel--especially paralegals and secretaries--hired laterally from other law firms. In contrast, some of the independent solo practitioners who share office space, secretaries, computers, phone lines, and file cabinets with other attorneys--who often represent coparties--have no screens in place to protect the confidentiality of their cases.
Virtually all the respondents offered immediate disclaimers that their security could be easily breached by an unscrupulous lawyer.

... we built this enormous edifice and there are times when you wonder what really is going on here. Because you built screens and go through all this. You're really, at the bottom, if the person you hired doesn't have integrity and wants to tell you the secrets that he learned at the other firm, he'll do it anyway. [5Ch100+]

But do you look up your files at night? No. Is there a possibility the information could be exchanged through the networks on computers? I think most of the things I do, you got to be a real dull person to raid my computer to find out what the hell I'm doing. I mean, you've got to have a dull life to track what [L names self] is doing. But if in a conflict, that's possible, that's possible to key into our network. And our [...] if someone in our [East Coast] office wanted to know what I'm doing--if we have a conflicts situation--Chinese wall won't help. So I think that the computer world is another reason why I'm dubious about them. [I6Ch100+]

Still, the risk of inadvertent leaks appears considerably greater in the firms with few border controls or bureaucratic hurdles to enforce secrecy and silence.

But how easy is it to practice law in a firm crisscrossed with barricades--constantly under construction, being moved or torn down--that segregate departments, practice groups, even neighbors? Though most respondents whose firms utilize Chinese walls find them relatively easy to erect and to live with, others note some difficulties. Those in smaller firms comment that screens are difficult to enforce:

We have a really small firm. This is [less than fifteen] lawyers. We have three thousand square feet here. So I've got--whatever my square footage is--this is a small office. Is a Chinese wall a fiction? I mean, look, if it's a big enough case, then--and you've got a Chinese wall issue--then I've got a problem in a small firm this small. And the problem is--assuming that all the clients think the Chinese wall is wonderful and so on and so forth--how the hell am I going to enforce it? There's no secrets here. Everybody knows what's going on in all the cases. So that would be a problem. [104Ch10-19]

Of course we could do that [build a screen]. I think I would feel awkward about it, especially if it's going to be a long drawn-out kind of thing. Because there's just too many chances--in a firm like ours--that something is going to be said. You know, the lawyers get together to have a beer--whatever. And you just don't want something said. [76Ch10-19]

I think that would be pretty unworkable for us. I mean, all of our support staff is centrally located. I simply would walk through the secretarial area and my eyes could see documents that they may be working on. And if that's a problem--and I assume it is--that would make it not feasible for us. [87DSS10-19]
I can't do that [set up a Chinese wall]. I can't, I can't enforce it. I can't enforce it. I can't be out there worrying about whether she's looking at documents she shouldn't be looking at. I won't place myself in that position. [118Ch<10]

Those in larger firms find that screening devices impede and complicate communication and make access to records and documents sometimes cumbersome and inefficient.

It would be easier if we were a smaller firm. But, we're a bigger firm and it's harder to wall somebody off from everything. I mean, for instance, we send these [New Business] Sheets out to everybody.... How do you say, "Well, don't give that to somebody." ... How do you limit somebody's access on the computer to documents about that? So it's much more difficult in the age of information, because of the accessibility of things, than it would, you know, the old days, where you'd just sort of block somebody off from everything. And you take as many steps as you can, but who's to say that you've taken all of the steps so that that person doesn't find out anything.... I think there are a lot of problems. [1Ch100+]

Sometimes that's not practical. It's hard to lock a room. It's hard when you've got 200 files for a client and someone's supposed to not have access to them. [2Ch 100+]

Other respondents, even those in big firms, found it difficult to adequately staff cases with the necessary expertise when departments are fractured by Chinese walls.17

Sometimes you say, "Well, I'd like to use [...] So-and-So's my environmental expert on this matter, but I can't because she's on the other side of the screen." [5Ch100+]

L: Our biggest problem on that was probably right at the beginning, being sure we had enough people [ ... ] You don't want to get all your tax lawyers on one side of the wall. Or your banking lawyers on one side of the wall. You want to leave enough people so you could adequately represent the RTC [Resolution Trust Corporation] and yet you could adequately represent a client.

17Though others disagree. Clearly it depends on the social organization of expertise in the firm.

It's not hard. I mean, again, because we're big enough.... A perfect example is a recent bankruptcy situation, where ... one of the attorneys that joined our office from another firm did not work on a particular matter there, but his old office represented the other side of this matter. He's a bankruptcy lawyer. Also, we have another lateral who joined our firm from that same firm who's a business practitioner, okay? We now had a transaction involving that firm and that client, okay? The transaction had started while those two individuals are still at their other firm. So, it's the perfect Chinese wall situation. It wasn't a problem for us, because we have a number of switch players. So we were able to have a different business lawyer and a different bankruptcy lawyer working on the matter. So it wasn't that hard. If we were a smaller operation and the only bankruptcy person we had was that person, then there would have been a significant problem.... if you have a conflict and you do a Chinese wall, you have an alternative source for the legal work within the firm. [10Ch100]
R: Your existing clients, yeah. Yeah, that was probably the hardest part on that one was getting the personnel shifted one way or the other.
L: ... It can get tricky. Yeah, I mean, we don't have that much turnover. But if you're setting up a wall there that you expect to continue for three or four years, I mean, realistically, you ought to look at scheduled retirements to be sure you don't run down a small area and have nobody left there. [3Chi00+]

Because of these difficulties, a minority of respondents indicated that they try to avoid creating screens or use them mostly to solve conflicts between branch offices of the firm where the impediments and disruptions are less problematic.

We try to discourage Chinese walls unless we would otherwise lose business. Do a Chinese wall if you have to, but do something else if you are able. They are hard to administer. [pilot interview #7]

They're very difficult to deal with when they're in the same office. And I'd be very hesitant to really do it in the same office. I mean, it's one thing if my [East Coast] has got a problem. I mean, we're not, it's probably never going to happen that you're going to exchange information. Inside the office--very difficult, very difficult.... People are going to lunch and they're talking and you know. I've been at lunch where people will start talking and somebody'll say, "Hey, wait a minute. You know, I'm, I can't hear this." And I'm glad people think about that stuff, but it's [... ] I'm not so sure it's something that you really should do very often. [18Chi00+]

Small-firm lawyers were particularly likely to disparage Chinese walls--certainly in firms their size and often in much larger firms as well.

By the way, I do not believe that Chinese walls exist--not in fact, not in fiction. Not even the tooth fairy believes in them. Do you believe? There isn't such a thing. It's all baloney. Once another firm tried to lay this (that they had a Chinese wall) on our office; we wouldn't buy it. Perhaps the notion of a Chinese wall might work under extraordinary circumstances. We're a small operation; you couldn't create an effective Chinese wall here. [90Ch20-49]

At best, they considered screening devices a kind of sophistry that allowed firms to represent adverse interests.

L: We're not like Winston & Strawn [large Chicago law firm] or anything. They probably have a computer program to come up with their conflicts.
S: A lot of the big firms tend to do that kind of thing.
L: Yeah. But they have those Chinese walls, so they can represent both sides. [laughter] [73CCI0-19]

At worst, they rejected them out of hand.
I don't believe, myself, in a China-wall concept. I think it's just a [ ... ] it's a big lie. [81Ch10-19]

S: You smiled at one point when I mentioned Chinese walls. Could you envision a Chinese wall in this firm?

L: No, absolutely not. I [sneers] think Chinese walls are bullshit.... I think the whole idea of Chinese wall, especially when you have lawyers talking, it just doesn't work. And the appearance of impropriety should be avoided. You know, I think Chinese walls give me a very strong sense of the appearance of impropriety. Clearly, not in a small firm like this. But, even in a big firm, I think there are pressures that are brought to bear, there are informal talks. It just shouldn't happen. If you're on one side, you should be on that side and not the other.... In a small firm, a Chinese wall, everybody would laugh about it. Three lawyers can't have a Chinese wall. You almost live together. Six lawyers: a Chinese wall is not going to happen.... I mean, out here, a Chinese wall would have been, "Yeah, I represented the husband. My partner's representing the wife. But don't worry, we won't talk about it." Who are you kidding? [84CC<10]

Other respondents questioned the impenetrability of screening devices as well as the temptations to breach the barrier:

I'm not a big advocate of that Chinese wall either. I think they have big ears. [105Ch<10]

You can certainly put your ear to 'em and listen [laughter]--sometimes peek over, right [snicker]? I'm sure that happens all the time. [63DSS<10]

I don't think it's easy in a large firm to function with a Chinese wall. You're basically asking a firm to be on its honor. There's a temptation there.... I kind of like the quote from the one guy that said, "I can resist anything but temptation." I don't want the temptation around. [107DSL<10]

... the judge said, "Set up the China wall, and he's not supposed to talk to anybody about it." ... And they said, "He's not going to work on the file." Come on! That's what you work with associates and partners with, is to discuss things and bounce things off of them. But I'm not saying that they didn't, but I mean, I think there was strong evidence a impropriety could have existed there.... We didn't have any ax to grind with this particular law firm, other than the fact that we felt that, human nature being what it is, there's going to be some communication back and forth. [95CC10-19]

Perhaps most telling, one respondent described his reaction when he learned that the confidences and secrets of his law firm were being protected by barriers equivalent to those of a Chinese wall. It raised his consciousness about the kind of trust in an artificial construct that lawyers routinely ask of their own clients.
You know, a while ago, I found out that our CPAs--two guys--had joined a large insurance defense firm--a competitor of ours. They moved their practice and all of our files and records right into that law firm. Our files were actually physically located there. These files conveyed virtually everything about our business, our financial condition. When I found out, I said, "No way!" I insisted that they had to move the records out of the firm. They argued that they were all locked up and no one could get to them. But this is a dog-eat-dog world. What if the major law firm client started asking questions about us? I couldn't sleep at night. This experience made me realize how clients must feel when their law firm is representing competitors or parties with adverse interests. [89Ch20-49]

As law reformers continue to debate the ethics and efficacy of extending screening devices to the revolving door between private law firms, Illinois provides an instructive case study. What does the evidence tell us? First, Illinois law firms are not teeming with Chinese walls. They are constructed most frequently where they are most appropriate—in large law firms where conflicts are more common and confidentiality easier to cloister, especially where conflicts span physical, social, or geographic distance within the firm. Screens have not overtaken Illinois law firms because they are administratively costly to maintain and, although they may satisfy ethical requirements, they do not necessarily satisfy clients' expectations of undivided loyalty. Though Illinois lawyers may not be required to secure their clients' consent before erecting a wall, they are unlikely to begin construction if they know that what lies behind the screen may drive away a valued and significant client. Moreover, although Chinese walls may allow Typhoid Marys to travel through the job market, they do not allow them to travel laden down with heavy baggage. They do not permit migratory lawyers to undertake adverse representations shielded by the screen. And that is why, as I described in chapter 7, many prospective lateral hires or mergers wither when lawyers realize that they will have to leave behind significant clients whose interests are adverse to those in the host firm. Ethical walls do not change that fact. They may help to unstick the revolving door; but they do not motorize it.

Do the screens meet the specifications found in the ethics codes and case law? Not always, especially in the smaller firms. Admonitions simply to "stay the hell away" do not live up to the spirit of the rules. Even walls constructed from more

18Unfortunately, because the efficacy of screening devices was not the central focus of my study, the research was not designed to provide the kind of systematic experimental data that might have informed the debate.

19For another perspective, see Pizzimenti (1997), who asked detailed questions about the use of screens in a mail survey of firms with more than fifty lawyers practicing in states that allow screens in lateral hiring between private firms. Though tainted by a very low response rate (20 percent) and a likely selection bias that overrepresents compliant firms mindful of their professional responsibilities, the findings are instructive. The survey concluded that most firms try "to do the right thing" (306), but it also found significant minorities that did not know when screens should be erected or what was required and that did an inadequate job of maintaining them. Indeed the author concluded that she had "real questions regarding the efficacy of screens" (329).
sophisticated blueprints have points of vulnerability, especially with respect to computer networks and firmwide communications. Even more problematic, firms often do not construct screening devices as quickly as necessary because of the lag between the time that the migratory lawyer joins the firm and the time that their tainted baggage is discovered. Some of the most notorious and costly disqualification cases involve firms with the most impenetrable screens, constructed too late.

Whatever the shortcomings of ethical screens, the glass is probably still half full. Because ethical screens in Illinois are routinized and subject to regulation, they are most likely more opaque, more secure, better protected, less vulnerable, and better supervised than those erected in states where screens alone do not solve the imputation problem. In most other states, screens are offered to clients as a way of inducing them to consent to the conflict. They are designed by the affected lawyers and built ad hoc to reassure the clients. Because there are no regulatory standards, each wall can meet different specifications, be constructed from different materials. Because they are devices negotiated by affected attorneys rather than offered by the firm, there is less need to tinker with firmwide information systems--computer networks; voice mail, e-mail, and interoffice mail; communications; and the like--to ensure that screens are not inadvertently breached. In these states, it would be unlikely to find self-regulatory systems as institutionalized and comprehensive as those I have described in this chapter, which are standard in many large Illinois law firms to ensure the integrity of their Chinese walls. Whether Illinois screens are really more impenetrable is, of course, an empirical question. But the economies of scale, the regulatory requirements, and the scrutiny of screening devices by Illinois courts all increase the likelihood that they are. One effect of liberalizing the law may well be that, ironically, clients are better protected and confidentiality even more inviolate.

Still, it is likely that the liberalization of the law will reinforce the double standard encountered many times before in this book. If clients have considerable clout, it may be unnecessary to require that lawyers secure their consent because their lawyers will anticipate their reaction before constructing a screening device. It's those one-shotters we have to worry about. Are their rights and interests being trampled in Illinois? Do they fare better in states in which lawyers must seek their consent? Or do the off-the-rack Illinois screening devices, devised to satisfy even powerful repeat-playing clients, better protect one-shotters than their lawyers do in other states after they have consented to the conflict? Unfortunately, we can only speculate.
VI. INVESTING IN CLIENTS.

With the explosion of start-up companies mostly engaged in aspects of electronic recording and messaging, lawyers are more frequently accepting equity interests in clients as fees for their services. Comment [4] under Rule 1.5 recognizes that accepting property in payment for a lawyer’s services is permissible providing it isn’t a proprietary interest in the cause of action or subject matter of litigation prohibited by Rule 1.8(i). Comment [4] also warns that accepting a fee in property may be subject to the requirements of Rule 1.8(a) as a business transaction with the client.

The ABA Standing Committee on Ethics and Professional Responsibility in Formal Opinion 00-418 (reproduced below with permission) set forth ethical guidelines for lawyers who accept such equity interests. THE ATTORNEY HANDBOOK FOR INVESTING IN CLIENTS, prepared by the San Francisco Firm of Rogers Joseph O’Donnell & Quinn, is one of several excellent compilations of practical considerations attorneys must consider. See also, Freivogel, “Investing in Clients/Stock for Fees” at http://www.freivogelonconflicts.com//new_page_21.htm.
Formal Opinion 00-418

Acquiring Ownership in a Client in Connection with Performing Legal Services

The Model Rules of Professional Conduct do not prohibit a lawyer from acquiring an ownership interest in a client, either in lieu of a cash fee for providing legal services or as an investment opportunity in connection with such services, as long as the lawyer complies with Rule 1.8(a) governing business transactions with clients, and, when applicable, with Rule 1.5 requiring that a fee for legal services be reasonable. To comply with Rule 1.8(a), the transaction by which the lawyer acquires the interest and its terms must be fair and reasonable to the client, and fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client. The client also must be given a reasonable opportunity to seek the advice of independent counsel in the transaction and must consent to the transaction in writing. In providing legal services to the client’s business while owning its stock, the lawyer must take care to avoid conflicts between the client’s interests and the lawyer’s personal economic interests as an owner, as required by Rule 1.7(b), and must exercise independent professional judgment in advising the client concerning legal matters as required by Rule 2.1.

Background

With growing frequency, lawyers who provide legal services to start-up businesses are investing in their clients, sometimes accepting an ownership interest as a part or all of the fee.¹ Some representatives of the organized bar have questioned

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1. See, e.g., Jason M. Klein, No Fool for a Client: The Finance and Incentives Behind Stock-Based Compensation for Corporate Lawyers, 1999 COLUM. BUS. L. REV. 329, 330-31; Debra Baker, Who Wants to be a Millionaire?, 86 A.B.A. JOURNAL, February 2000, at 36, 37. Although the interest the lawyer acquires usually is in the form of stock or warrants or options to buy stock of a corporation, this Opinion applies equally to ownership in any form of business entity, such as a limited liability company, limited partnership, or business trust that is the client of the lawyer. For convenience, this Opinion assumes the ownership interest is comprised of corporate stock.

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This opinion is based on the Model Rules of Professional Conduct and, to the extent indicated, the predecessor Model Code of Professional Responsibility of the American Bar Association. The laws, court rules, regulations, codes of professional responsibility, and opinions promulgated in the individual jurisdictions are controlling.

AMERICAN BAR ASSOCIATION STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY, 541 North Fairbanks Court, 14th Floor, Chicago, Illinois 60611-3314 Telephone (312)988-5300 CHAIR: Donald B. Hilliker, Chicago, IL Loretta C. Argett, Washington, DC Jackson M. Bruce Jr., Milwaukee, WI William B. Dunn, Detroit, MI James W. Durham, Philadelphia, PA Mark I. Harrison, Phoenix, AZ Daniel W. Hildebrand, Madison, WI William H. Jeffress, Jr., Washington, DC Bruce Alan Mann, San Francisco, CA M. Peter Moser, Baltimore, MD CENTER FOR PROFESSIONAL RESPONSIBILITY: George A. Kuhlman, Ethics Counsel, Eileen B. Libby, Associate Ethics Counsel

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this practice. Many lawyers nevertheless believe that acquiring ownership interests in start-up business clients is desirable in order to satisfy client needs and also, because of growing competition with higher paying venture capital and investment firms, to attract and retain partners and associates. From the client's perspective, the lawyer's willingness to invest with entrepreneurs in a start-up company frequently is viewed as a vote of confidence in the enterprise's prospects. Moreover, a lawyer's willingness to accept stock instead of a cash fee may be the only way for a cash-poor client to obtain competent legal advice. Frequently, this may be the determining factor in the client's selection of a lawyer.

The Committee in this Opinion examines the issues that must be addressed under the ABA Model Rules of Professional Conduct when a lawyer or law firm acquires an ownership interest in a client in connection with performing legal services. A typical situation might be one in which the client business is a corporation that the law firm is organizing at the request of the founding entrepreneurs. The latter already have a few friends and family members who are eager to invest funds to start up the corporation. The founders may allow the lawyer working with them to invest the firm's fee for legal services in stock of the corporation. The organizers expect the law firm to introduce them to the firm's venture capital

2. See, e.g., ABA Commission on Professionalism, In the Spirit of Public Service: A Blueprint for the Rekindling of Lawyer Professionalism (1986), in which the Commission identified lawyers investing in the activities of clients as one of several problem areas. The Commission expressed the view that lawyers investing in clients "may make the client's financing efforts easier, [but that] it creates a potential or actual conflict of interest, changing the lawyer-client relationship in a very fundamental way." Id. at 31 (footnotes omitted). See also ABA Section of Litigation Task Force on the Independent Lawyer, Taking an Interest in the Client's Business in Lieu of a Fee (Draft August 1999); Baker, supra note 1, at 39-40.

3. See, e.g., Sean Somerville, Lawyers Stocking Up on Payday, BALTIMORE SUN, November 7, 1999, at D-1. See also Shawn Neidof, Silicon Valley Lawyers Embrace VC-Like Role, VENTURE CAPITAL J., Oct. 1, 1999, at 1, 2 ("Most Silicon Valley attorneys defer billing, with many offering discounts for the opportunity to invest in a client's company through a law firm's fund.").

4. Klein, supra note 1, at 351, also argues that compensating lawyers with equity interests finds support in public policy. Similar to contingent fees, permitting clients to pay with stock or options creates a financing device that allows clients broader access to legal services by providing an alternative currency to pay for those services.

5. The Committee notes that a lawyer considering the acquisition of ownership in a client should address practical issues as well as legal issues that arise under law other than the Model Rules when a lawyer owns an interest in a client. Among these issues are: (1) extent of coverage under lawyer professional responsibility policies when the lawyer also is a stockholder; (2) possibility of civil liability claims, including stockholder derivative actions resulting from the lawyer representing the client in certain types of matters; (3) desirability of adopting clear policies on investing in clients in order to minimize liability risks and to avoid internal disharmony among lawyers in the firm regarding investment opportunities individual lawyers may be offered by clients; and (4) need for assuring compliance by all firm personnel with securities law and regulations.
contacts and to continue representing the corporation, eventually performing the
designs necessary to take it public.6

A. Compliance with Rules 1.8(a) and 1.5(a)

When Acquiring Ownership in a Client

In our opinion, a lawyer who acquires stock in her client corporation in lieu of
or in addition to a cash fee for her services enters into a business transaction with
a client, such that the requirements of Model Rule 1.8(a) must be satisfied.7 In
determining whether Rule 1.8(a)'s first requirement of fairness and reasonableness
to the client is satisfied, the general standard of Rule 1.5(a) that "a lawyer's fee
shall be reasonable" and the factors enumerated under that Rule are relevant.8

6. We see no substantial difference under the Model Rules between direct pay-
ment to the lawyer of her fee by way of an interest in the business entity in lieu of cash
and the opportunity to purchase an interest for cash, if the opportunity to acquire the
stock would not have been offered had the lawyer not also undertaken to perform legal
services. The same ethical issues also must be addressed whether the ownership inter-
est is acquired directly by the lawyer or by an investment partnership controlled by the
lawyer or members of her firm.

7. Rule 1.8(a) states in pertinent part:
(a) A lawyer shall not enter into a business transaction with a client . . . unless:
(1) the transaction and terms on which the lawyer acquires the interest are fair
and reasonable to the client and are fully disclosed and transmitted in writing to
the client in a manner which can be reasonably understood by the client;
(2) the client is given a reasonable opportunity to seek the advice of independ-
ent counsel in the transaction; and
(3) the client consents in writing thereto.

Authorities are in agreement that Rule 1.8(a) applies when a lawyer accepts an
interest in the client in connection with a fee for legal services. See RESTATEMENT
a (requirements of § 126 apply when lawyer takes interest in client's business as fee); see
also G. C. HAZARD AND W. W. HODES, THE LAW OF LAWYERING (2d ed. 1998) §
1.8:202 et seq.; C. WOLFRAM, MODERN LEGAL ETHICS (1986) § 8.11.2 (Model Rule
1.8(a) or former Model Code of Professional Responsibility DR 5-104(A) apply to the
transaction). Rule 1.8(a) does not, however, apply when the lawyer acquires the stock
in an open market purchase or in other circumstances not involving direct intervention
by the client.

8. Rule 1.5(a) states that:
The factors to be considered in determining the reasonableness of a fee include the
following:
(1) the time and labor required, the novelty and difficulty of the questions
involved, and the skill requisite to perform the legal service properly;
(2) the likelihood, if apparent to the client, that the acceptance of the particular
employment will preclude other employment by the lawyer;
(3) the fee customarily charged in the locality for similar legal services;
(4) the amount involved and the results obtained;
(5) the time limitations imposed by the client or by the circumstances;
(6) the nature and length of the professional relationship with the client;
For purposes of judging the fairness and reasonableness of the transaction and its terms, the Committee's opinion is that, as when assessing the reasonableness of a contingent fee, only the circumstances reasonably ascertainable at the time of the transaction should be considered. It seems clear that "[i]n a discipline case, once proof has been introduced that the lawyer entered into a business transaction with a client, the burden of persuasion is on the lawyer to show that the transaction was fair and reasonable and that the client was adequately informed." Accordingly, it is incumbent upon the lawyer to take account of all information reasonably ascertainable at the time when the agreement for stock acquisition is made.

Determining that the fee is reasonable in terms of the enumerated factors under Rule 1.5(a) does not resolve whether the requirement of Rule 1.8(a) that the transaction and terms be "fair and reasonable to the client" has been met. Determining "reasonableness" under both rules also involves making the often difficult determination of the market value of the stock at the time of the transaction. As

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.

Rule 1.5 would not apply if the opportunity to invest was not offered in connection with undertaking to provide legal services.

9. See Restatement, supra note 7, § 207 Comment e ("Fairness is determined based on facts that reasonably could be known at the time of the transaction, not as facts later develop."). See also ABA Formal Op. 94-389 (1994) (Contingent Fees), note 21 (finding various aspects of contingent fee arrangements to be ethical. The note cites Lester Brickman, Contingent Fees Without Contingencies, 37 U.C.L.A. L. Rev. 29, 87 (1989), to the effect that the legitimacy of a contingency fee is to be judged by the effort expected "prior to the commencement of representation," not by the actual effort expended.) (Emphasis supplied); Klein, supra note 1, at 336 ("[R]eview of the fee is only appropriate at the time the fee is granted, for the lawyer has undertaken 100% of the risk associated with the value of that fee in the future.").

10. Restatement, supra note 7, § 207 at 639; see also Comment e at 641-42. The transaction also remains voidable in a civil suit, and the lawyer investor, as a fiduciary, has the burden of proving its fairness. See Restatement § 207 cmt. a; see also Passanante v. McWilliams, 53 Cal. App. 4th 1240, 1248, 62 Cal. Rptr. 2d 298, 302 (Cal. Ct. App. 1997) (lawyer for corporation denied recovery of $32 million for stock of corporation that its board previously had authorized to be issued him in connection with his legal services because the lawyer failed to advise board to consult independent counsel about the transaction); Matthews v. Spears, 24 So.2d 195 (La. App. 1945) (court cancelled contract transferring to lawyer undivided one-fourth interest in mineral rights in land owned by clients on the grounds that the lawyer did not fully disclose the nature of the transaction and because consideration for the conveyance was lacking).

11. See also Comment [2] to Rule 1.5(a) stating that a fee paid in property (such as corporate stock) "may be subject to special scrutiny because it involves questions concerning both the value of the services and the lawyer's special knowledge of the value of the property." Though the Comment is applicable here, meeting the requirements of Rule 1.8(a) serves to satisfy the special scrutiny standard applicable to the receipt of property in exchange for services.
Professors Hazard and Hodes state, "[o]ne danger [to the lawyer who accepts stock as a fee] is that the business will so prosper that the fee will later appear unreasonably high."12 Of course, instead of increasing in value, the stock may become worthless, as occurs frequently with start-up enterprises.13 The risk of failure and the stock's nonmarketability are important factors that the lawyer must consider, along with all other information bearing on value that is reasonably ascertainable at the time when the agreement is made.14

One way for the lawyer to minimize the risk noted by Professors Hazard and Hodes is to establish a reasonable fee for her services based on the factors enumerated under Rule 1.5(a)15 and then accept stock that at the time of the transaction is worth the reasonable fee. Of course, the stock should, if feasible, be valued at the amount per share that cash investors, knowledgeable about its value, have agreed to pay for their stock about the same time.

A reasonable fee also may include an agreed percentage of the stock issued or to be issued when the value of the shares is not reasonably ascertainable. For example, if the lawyer is engaged by two founders who are contributing intellectual property for their stock, it may not be possible to establish with reasonable certainty the cash value of their contribution. If so, it would not be possible to establish with reasonable certainty the value of the shares to be issued to the lawyer retained to perform initial services for the corporation. In such cases, the percentage of stock agreed upon should reflect the value, as perceived by the client and the lawyer at the time of the transaction, that the legal services will contribute to the potential success of the enterprise. The value of the stock received by the lawyer will, like a contingent fee permitted under Rule 1.5(c), depend upon the success of the undertaking.16

12. Hazard & Hodes, supra note 7, §1.8:202 at 264.
13. In comparing cash to stock compensation, Klein points out that "[w]hen a lawyer is compensated with stock or options rather than with cash, the lawyer accepts the risk or uncertainty in the value of the stock or options . . . . The risk in the future value of the stock or options is significant, because there is no downside protection." Supra note 1, at 339-40.
14. See Utah Ethics Adv. Op. Comm Op. 98-13, 1998 WL 863904 * 1 (Dec. 4, 1998) (in addition to factors enumerated under Rule 1.5(a), the lawyer also should consider in determining reasonableness of a fee when accepting client stock: (i) the liquidity of the stock, (ii) whether and when it can be expected to be publicly traded, (iii) any restrictions on its transfer, and (iv) its presently anticipated value, including the risks that a proposed patent or trademark may not be granted or necessary government approvals may not be received).
15. Supra note 8 and accompanying text.
16. The Committee is aware that sometimes the lawyer will ask the corporation to issue her a percentage of the shares initially issued to the founders as a condition to the lawyer agreeing to become counsel to the new enterprise. We take no position on the ethical propriety of this practice. We caution, however, that in this circumstance, and especially if the cash value of the shares is not reasonably ascertainable, the lawyer should take special care to be in a position to justify the reasonableness of the total fee.
In addition to assuring that the stock transaction and its terms are fair and reasonable to the client, compliance with Rule 1.8(a) also requires that the transaction and its terms must be fully disclosed and transmitted in a manner that can be reasonably understood by the client.\textsuperscript{17} Thus, the lawyer must be careful not only to set forth the terms in writing, but also to explain the transaction and its potential effects on the client-lawyer relationship in a way that the client can understand it. For example, if the acquisition of stock by the lawyer will create rights under corporate by-laws or other agreements that will limit the client's control of the corporation, the lawyer should discuss with the client the possible consequences of such an arrangement.\textsuperscript{18}

At the outset, the lawyer also should inform the client that events following the stock acquisition could create a conflict between the lawyer's exercise of her independent professional judgment as a lawyer on behalf of the corporation and her desire to protect the value of her stock.\textsuperscript{19} She also should advise the client that as a consequence of such a conflict, she might feel constrained to withdraw as counsel for the corporation, or at least to recommend that another lawyer advise the client on the matter regarding which she has a personal conflict of interest.\textsuperscript{20}

\textsuperscript{17} As Professor Wolfram notes, "the fact that a transaction is arguably fair and reasonable does not mean that MR 1.8(a) has been complied with if the other requirements of the rule are not satisfied." WOLFRAM, \textit{supra} note 7, \S\ 8.11.4 at 480 (even though contract between client and lawyer was sufficiently fair and reasonable to decree specific performance, lawyer's failure to make full disclosure of the transaction to client referred to disciplinary authority) (citing Ruth v. Crane, 392 F. Supp. 724, 731 (E.D. Pa. 1975), \textit{aff'd}, 564 F.2d 90 (3d Cir. 1977)); Comm. on Prof. Ethics and Conduct of Iowa State Bar Ass'n v. Mershon, 316 N.W.2d 895, 900 (Iowa 1982) (violation of DR 5-104(A) established "even though respondent did not act dishonestly or make a profit on the transaction").

\textsuperscript{18} If the lawyer is acquiring a percentage of the equity or a class of securities that entitles her to exercise rights not shared by stockholders generally, then specific disclosure might be required. See, e.g., Comm. on Prof. Ethics and Conduct of Iowa State Bar Ass'n v. Humphreys, 524 N.W.2d 396, 399 (Iowa 1994) (lawyer disbarred when, inter alia, without advising client-majority stockholder of the potential conflict of interest, he acquired stock and prepared corporate documents that prevented the lawyer's termination as a director and required the lawyer's approval to reduce his compensation as an officer or to take certain other corporate actions). As to the absolute right of a client to discharge the lawyer and the conflict created by differences over business decisions, see \textit{infra} notes 33 and 34 and accompanying text.

\textsuperscript{19} Rule 2.1 admonishes: "In representing a client, a lawyer shall exercise independent judgment and render candid advice." See also Comment [6] under Rule 1.7 ("lawyer's own interests should not be permitted to have an adverse effect on representation of a client"); \textit{Hazard & Hodes, supra} note 7, \S\ 1.8:202 at 264 ("Another danger is that the business will falter, and that [the lawyer], worried about recovering her fee [stock rather than cash] for work already performed, will not be able to advise the client dispassionately.").

\textsuperscript{20} See \textit{infra} note 31 and accompanying text regarding actions the lawyer must take should a conflict later arise.
Full disclosure also includes specifying in writing the scope of the services to be performed in return for receipt of the stock or the opportunity to invest. The scope of services should be covered in the written transmission to the client even though the stock is acquired by the firm's investment partnership as an opportunity rather than by the firm directly as a part of the fee in lieu of cash. If the client's understanding is that the lawyer keeps the stock interest regardless of the amount of legal services performed by the lawyer and solely to assure the lawyer's availability, it is important to set forth this aspect of the transaction in clear terms.21 Otherwise, a court might regard the stock acquisition as being in the nature of an advance fee for services and require part of the stock to be returned if all the work originally contemplated as part of the services for which the stock was given has not been performed.22

Although it is better practice to set forth all the salient features of the transaction in a written document, compliance with Rule 1.8(a) does not require reiteration of details that the client already knows from other sources. Indeed, too much detail may tend to distract attention from the material terms. Nonetheless, the lawyer bears the risk of omitting a term that seems unimportant at the time, but later becomes significant because she has the burden of showing reasonable compliance with Rule 1.8(a)(1). A good faith effort to explain in understandable language the important features of the particular arrangement and its material consequences as far as reasonably can be ascertained at the time of the stock acquisition should satisfy the full disclosure requirements of Rule 1.8(a).23

21. See Pennsylvania Bar Ass'n Comm. on Legal Ethics and Prof. Resp. Formal Op. 95-100, 1995 WL 902545 *3 (August 1, 1995) (non-refundable retainers permissible so long as confirmed by "clear and unambiguous language of a written statement provided to the client or a written agreement between the attorney and client").

22. Even though in such a case a court might not order disgorgement of the fee in a civil action if the client ends the relationship without cause, see, e.g., Ryan v. Butera et al., 193 F.3d 210, 218 (3rd Cir. 1999), the lawyer's ethics might be questioned for failure to return the "unearned" portion of the stock acquired by the lawyer. See also Oregon State Bar Ass'n Bd. of Gov. Formal Op. 1998-151, 1998 WL 717731 *2 (July 1998) (lawyer must return pro rata portion of fixed fee, even though specified as "earned on receipt," if representation ends before lawyer performs all the work); District of Columbia Bar Op. 264 (1996) ("special retainers or fee advances in this jurisdiction must be refundable," at least where "tied directly to provision of legal services, rather than designed solely to ensure availability"); In re Cooperman, 83 N.Y.2d 465, 475, 633 N.E.2d 1069, 1073, 611 N.Y.S.2d 465, 469 (N.Y. 1994) ("non-refundable retainer fee agreement clashes with public policy because it inappropriate compromises the right to sever the fiduciary services relationship with the lawyer").

23. Professor Wolfram describes the elements constituting full disclosure applicable generally to business dealings with clients as follows:

(1) the nature of the transaction and each of its terms; (2) the nature and extent of the lawyer's interest in the transaction; (3) the ways in which the lawyer's participation in the transaction might affect the lawyer's exercise of professional judgment in concurrent legal work for the client, if any; (4) the desirability of the client's seeking independent legal advice if the client is not already indepen-
The client also must have a reasonable opportunity to seek the advice of independent counsel in the transaction and must consent in writing to the transaction and its terms. In addition, although not required by the Model Rules, the written documentation of the transaction should include the lawyer's recommendation to obtain such advice. This serves to emphasize the importance to the client of obtaining independent advice. The client's failure to do so then is his own deliberate choice. The lawyer has complied with Rule 1.8(a) in this respect because actual consultation is not required.24

The best way to comply with the requirements of Rule 1.8(a) is to set forth the salient terms of the transaction in a document written in language that the client can understand and, after the client has had an opportunity to consult with independent counsel, to have the document signed by both client and lawyer.

B. Conflicts Between the Lawyer's Interests and Those of the Client

On rare occasions the acquisition of stock in a client corporation will amount to acquiring, in the language of Rule 1.8(j), "a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting."25 As Comment [7] under Rule 1.8 explains, the prohibition "has its basis in common law champerty and maintenance [and] is subject to specific exceptions developed in decisional law and continued in these Rules, such as the exception for reasonable contingent fees set forth in Rule 1.5 . . . ." The modern rationale for the rule is the concern that a lawyer acquiring less than all of a client's cause of action creates so severe a conflict between the lawyer's interest and the client's interest that it is nonconsentable.26

dently represented; and (5) the nature of the respective risks and advantages to each of the parties to the transaction.

WOLFRAM, supra note 7, $ 8.11.4 at 485 (footnotes omitted).
24. When a client declines to obtain the advice of independent counsel or chooses to seek financial advice instead, the lawyer also may wish to confirm this in writing.
25. Rule 1.8(j) states:
A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien granted by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

26. Professor Wolfram, in condemning Rule 1.8(j) as unnecessary, nevertheless notes: "[a] purchase of a partial interest, of course, does present the possibility that the lawyer will not seek and accept client guidance on major decisions in the lawsuit because of the lawyer's own economic interest in the outcome." WOLFRAM, supra note 7, § 8.13 at 492. The Committee believes that the failure to consult with the client and accept the client's decision as posited by Professor Wolfram would violate Rule 1.2(a) and Rule 1.7(b), discussed in the next part of this Opinion. As Professor Wolfram suggests, no flat prohibition against a lawyer's purchase of an interest in a client's cause of action is needed "so long as the client consents and the transaction is fair and reasonable." Id. Of course, because this constitutes a business transaction with a client, the lawyer also must fully comply with all the other requirements of Rule 1.8(a) as discussed earlier in this Opinion.
In our view, when the corporation has as its only substantial asset a claim or property right (such as a license), title to which is contested in a pending or impending lawsuit in which the lawyer represents the corporation, Rule 1.8(j) might be applicable to the acquisition of the corporation's stock in connection with the provision of legal services. If the acquisition of the stock constitutes a reasonable contingent fee, however, Rule 1.8(j) would not prohibit acquisition of the stock. 27

Rule 1.7(b) prohibits representation of a client if the representation “may be materially limited . . . by the lawyer's own interests,” unless two requirements are met. The lawyer must reasonably believe that “the representation will not be adversely affected,” and the client must consent to the representation after consultation. 28

A lawyer's representation of a corporation in which she owns stock creates no inherent conflict of interest under Rule 1.7. Indeed, management's role primarily is to enhance the business's value for the stockholders. Thus, the lawyer's legal services in assisting management usually will be consistent with the lawyer's stock ownership. In some circumstances, such as the merger of one corporation in which the lawyer owns stock into a larger entity, the lawyer's economic incentive to complete the transaction may even be enhanced. 29

27. See District of Columbia Bar Op. 179 (1987) (under DR 5-103(A), though acquiring stock in a corporation the lawyer represented in an FCC license application amounted to acquiring an interest in the client's license proceeding, no disciplinary rule is violated by the lawyer in "accepting a reasonable contingent fee that takes the form of a small and noncontrolling equity interest in the client"). The District of Columbia's Rules of Professional Conduct, later adopted, do not contain Rule 1.8(j) or any other specific prohibition against acquiring an interest in litigation. Of course, Rule 1.8(j) also would apply were the stock itself subject to a claim in which the lawyer represents the corporation or other stockholders. See Kansas Bar Assn. Op. 98-06 (Sept. 15, 1998) (contracts regarding corporate stock that is the subject of litigation are not per se unethical, depending on the circumstances in the case).

28. Rule 1.7(b) states:
   (b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:
   (1) the lawyer reasonably believes the representation will not be adversely affected: and
   (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

29. See Klein, supra note 1, at 355-56 suggesting stock ownership as an incentive that is in furtherance of the lawyer's fiduciary duties to her corporate client. Ownership of corporate client stock should not create a conflict with the corporate client's interests because the lawyer's duty of loyalty is to the corporation. Rule 1.13(a) states: "A lawyer employed or retained by an organization represents the organization acting through its duly authorized representatives."
There may, however, be other circumstances in which the lawyer's ownership of stock in her corporate client conflicts with her responsibilities as the corporation's lawyer. For example, the lawyer might have a duty when rendering an opinion on behalf of the corporation in a venture capital transaction to call upon corporate management to reveal material adverse financial information that is being withheld, even though the revelation might cause the venture capital investor to withdraw. In that circumstance, the lawyer must evaluate her ability to maintain the requisite professional independence as a lawyer in the corporate client's best interest by sub-ordinating any economic incentive arising from her stock ownership. The lawyer also must consider whether her stock ownership might create questions concerning the objectivity of her opinion. She must consult with her client and obtain consent if the representation may be materially limited by her stock ownership.

The conflict could be more severe. For example, the stock of the client might be the lawyer's major asset so that the failure of the venture capital opportunity could create a serious financial loss to her. The lawyer's self-interest in such a case probably justifies a reasonable belief that her representation of the corporation would be affected adversely. This would disqualify her under Rule 1.7(b) from providing the opinion even were the client to consent.31

30. Rule 2.3 applies to legal evaluations made for the use of others and states:
   (a) A lawyer may undertake an evaluation of a matter affecting a client for the use of someone other than the client if:
   (1) the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client; and
   (2) the client consents after consultation.
   (b) Except as disclosure is required in connection with a report of an evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.

As Comment [4] cautions: "The lawyer must be satisfied as a matter of professional judgment that making the evaluation is compatible with other functions undertaken in behalf of the client." When making an evaluation under Rule 2.3, the lawyer should establish with the client in the beginning the types of information that will be revealed and any information that must be withheld. See Comment [5] ("The quality of an evaluation depends on the freedom and extent of the investigation upon which it is based.").

31. See Rule 1.7, Comment [4] ("Loyalty to a client is . . . impaired when a lawyer cannot consider, recommend or carry out an appropriate course of action for the client because of the lawyer's other . . . interests. The conflict in effect forecloses alternatives that would otherwise be available to the client."). See also Utah Ethics Adv. Op. Comm Op. 98-13, supra note 14 (quoting Comment [4]). A lawyer who owns stock in a client corporation may, in circumstances where her disagreement with some transaction approved by the corporation's board limits her ability to provide independent professional advice to management, call upon another firm lawyer who is not so limited to advise the client respecting the transaction. In such a circumstance, the lawyer-stockholder must obtain consent of the client pursuant to Rule 1.7(b) to avoid imputed disqualification of other lawyers in the firm under Rule 1.10(a). When the probity of the lawyer's own conduct is questioned, however, better practice calls for independent counsel to advise the client. See Comment [6] under Rule 1.7 ("The lawyer's own interests should not be permitted to have an adverse effect on representation of a
In order to minimize conflicts with the interests of the clients such as those described, some law firms have adopted policies governing investments in clients. These policies may include limiting the investment to an insubstantial percentage of stock and the amount invested in any single client to a nonmaterial sum. The policies also may require that decisions regarding a firm lawyer's potential client conflict be made by someone other than the lawyer with the principal client contact (who also may have a larger stock interest in the corporate client) and may also transfer billing or supervisory responsibility to a partner with no stock ownership in the client.

Even though a lawyer owns stock in a corporation, she, of course, has no right to continue to represent it as a lawyer if the corporate client discharges her. Were the lawyer to challenge the decision duly made by the authorized corporate constituents to discharge her, she would violate Rule 1.7(b) because it is clear that her own interests adversely affect the representation of the corporation.

client."]. See also ABA Formal Op. 98-410 (1998) (Lawyer Serving as Director of Client Corporation) at 9-10; Peter Geraghty, ASK ETHICSsearch, in THE PROFESSIONAL LAWYER 21 (Fall 1999) (citing other examples of conflicts between a lawyer's interest as owner of client property and the interests of the client).

32. Other law firm policies regarding investments in clients also include some of the following: (1) No lawyer may invest in or with any firm client without prior executive committee approval, sometimes excepting purchases in de minimis amounts in a private placement or open market purchase; and (2) Investments in nonpublic clients offered firm lawyers are to be allotted among partners (or all firm lawyers) as investment opportunities, or may be placed in a pooled investment fund or allocated to a bonus plan. Reminders to avoid securities violations, including Section 10-b-5 (anti-fraud) and Section 16 (short swing profits), and mechanisms to avoid insider trading also are frequently included.

33. Rule 1.16(a)(3) states in pertinent part that "a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if . . . the lawyer is discharged." See also Comment [4]. The decision to discharge the lawyer is made by the corporation "acting through its duly authorized constituents," usually its chief executive or more likely the Board of Directors in this circumstance. See Rule 1.13(a), supra note 29. Sometimes authority to discharge counsel is vested in the stockholders giving rise to the question whether a lawyer who is a stockholder may ethically vote as a stockholder to retain her firm. Once the decision is duly made, however, the client's right to discharge a lawyer is absolute. Whether because of contract the lawyer may recover damages for her discharge is a matter of law beyond the scope of an ethics opinion.

34. See, e.g., Comm. on Prof. Ethics and Conduct of Iowa State Bar Ass'n v. Humphreys, 524 N.W.2d at 398, supra note 18. A lawyer who no longer represents a client whose stock she owns must remember that a conflict of interest under Rule 1.7(b) may arise if another client seeks representation on a matter adverse to the former client. The law firm in seeking the new client's consent may need to disclose not only the earlier client-lawyer relationship, but also the investment relationship if it is material. Of course, if the stock value is so high or subject to such risk from the second client's matter that it would not be reasonable to conclude that the representation would not be affected adversely, the lawyer must decline the representation.
Conclusion

When a lawyer accepts stock or options to acquire stock in a client corporation in connection with providing legal services to it, she must comply with the requirements of Rule 1.8(a) because the stock acquisition constitutes a business transaction with a client and, if applicable, with the requirement of Rule 1.5(a) that the lawyer's fee shall be reasonable. Under Rule 1.8(a), the stock transaction and its terms must be fair and reasonable to the client. This is satisfied if the fee, including receipt of the stock, is reasonable applying the enumerated factors under Rule 1.5(a), and if the transaction and its terms in other respects are fair and reasonable to the client under the circumstances that are reasonably ascertainable at the time the arrangement is made.

The terms of the transaction also must be fully disclosed in writing to the client in a manner that can be reasonably understood by the client. Full disclosure includes, for example, discussions of the consequences of any rights by virtue of the lawyer's stock ownership that may limit the client's control of the corporation under special corporate by-laws or other agreements and the possibility that the lawyer's economic interests as a stockholder could create a conflict with the client's interest that might necessitate the lawyer's withdrawal from representation in a matter. The client also must be afforded a reasonable opportunity to consult independent counsel concerning the transaction and its terms. Finally, the client's consent must be in writing.

Although a lawyer's representation of a corporation in which the lawyer owns stock creates no inherent conflict of interest, circumstances may arise that create a conflict between the corporation's interests and the lawyer's economic interest as a stockholder. In such event, the lawyer must consult with the client and obtain client consent if, as a result of her ownership interest, the representation of the corporation in a particular matter may be materially limited. The lawyer may in some circumstances be required under Rule 1.7(b) to withdraw from representing the client in a matter if her financial interest in the client is such that she cannot reasonably conclude that the representation would not be adversely affected.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>TAB</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Overview of the issues</td>
</tr>
<tr>
<td>2</td>
<td>ABA’s position on investing in clients</td>
</tr>
<tr>
<td>3</td>
<td>Consequences of failure to follow the applicable ethics rules</td>
</tr>
<tr>
<td>4</td>
<td>Checklist for investing in clients</td>
</tr>
<tr>
<td>5</td>
<td>Law firm risk management policies</td>
</tr>
<tr>
<td>6</td>
<td>What your conflict waiver letter should say</td>
</tr>
<tr>
<td>7</td>
<td>Parting words of wisdom</td>
</tr>
<tr>
<td>8</td>
<td>Author</td>
</tr>
</tbody>
</table>
OVERVIEW OF THE ISSUES

The legal profession’s interest in investing in clients waxes and wanes, depending on the market, but attorneys have been investing in clients for years, often at the client’s request or insistence. It is legal and ethical for lawyers to invest in their clients, as long as they do it in compliance with the applicable rules. ABA Formal Op. 00-418 (July 2000). This paper provides a brief survey of the ethical rules and practical advice on how to invest “correctly.”

Nomenclature. People often mean different things when they talk about an attorney investing in a client. The forms of investments can vary tremendously, from taking stock in lieu of fees to paying the client to receive stock. The type of “investment” typically done in Silicon Valley (California) is a rather routine, formulaic, cookie-cutter approach to investing X number of dollars in a particular round of financing. This shaves away a large number of conflicts issues.

Market forces. The practice of investing in clients accelerated and spread in the 1990’s because the market was driving it -- clients wanted it, partners wanted it, associates wanted it, and even staff started asking for the opportunity. If the opportunity is not available at “home,” but is available elsewhere, then firms can lose valuable personnel, which makes it harder to service clients the way clients need and want to be serviced.

Sophisticated clients. The law often fails to distinguish between sophisticated and unsophisticated clients. For their own protection, attorneys should think about drawing some distinctions between sophisticated clients and unsophisticated clients in terms of deciding whether to invest in a client. The more sophisticated the client, the less risk in choosing to invest.

Protective measures to minimize conflicts. There are certain mechanisms law firms can use to minimize ethical concerns. Some are: outside investment partnerships; committees (so that individual attorneys are not agonizing over investment decisions); limits on the amount of investments; and payouts done in a way that makes it hard for attorneys to know the origins.
Basic rules: Each state has its own peculiar twists on the rules of investing in clients, but most require the following:

1. The terms of the investment have to be fair and reasonable – to the client;
2. The terms have to be explained in writing in a way that is understandable to the client;
3. The client needs to be told that it has right to consult with independent counsel;
4. Client must be given a reasonable opportunity to consult with independent counsel; and
5. The client must consent in writing.\(^1\)

See, e.g., ABA Rule 1.8; Cal. Rules of Professional Conduct Rule 3-300 (doing business with client), Rule 3-310(B)(4) (financial interest in subject matter of transaction) and possibly Rule 3-310(B)(1) (financial relationship with a party); New York Disciplinary Rule 5-104(A) and Ethical Considerations 5-2, 5-3 and 5-4.

As discussed in more detail, infra, the ABA does not see any inherent conflict in an attorney investing in his or her client. However, under ABA Rules, the lawyer must determine whether he or she has some interest that could “materially limit” the lawyer’s representation of a client. If so, the lawyer cannot take the matter on unless the lawyer reasonably believes the representation will not be adversely affected and the client consents after consultation. ABA Model Rule 1.7(b).

California’s “doing business with a client” rule is similar to the ABA’s rule, but handles the attorney’s “interest” situation differently. In California, the rules governing investing in clients often have an oblique name, such as “Avoiding Interests Adverse To a Client” (California); “Conflict of Interests: Current Clients: Specific Rules” (ABA); or “Transactions Between Lawyer and Client” (New York).

\(^1\) The rules governing investing in clients often have an oblique name, such as “Avoiding Interests Adverse To a Client” (California); “Conflict of Interests: Current Clients: Specific Rules” (ABA); or “Transactions Between Lawyer and Client” (New York).
the attorney must disclose in writing any financial relationship the lawyer has with a party to a matter (presumably including the client) and whether the lawyer has a financial interest in the outcome of the subject of the representation. In those situations, the California rules require disclosure of the actual and reasonably foreseeable consequences that could flow to the client from the attorney’s investment, but no written consent from the client. Rule 3-310(A), (B)(4).
ABA’S POSITION ON INVESTING IN CLIENTS

A. ABA Opinion – Formal Op. 00-418 (July 2000): Acquiring Ownership in a Client in Connection with Performing Legal Services

1. There is “no inherent conflict” in owning stock in a company you represent. When an attorney invests in a corporate client, the attorney’s interests are, in fact, “aligned” with management’s interests. ABA Opinion, p. 9 and n. 29. However, ABA Model Rules 1.7(b) and 1.8(a) apply.

2. Attorney must comply with ethical rules:
   a. Whenever the opportunity to invest is offered in connection with an undertaking to provide legal services;
   b. Even if the stock is not acquired in lieu of cash for fees; and
   c. Whether the attorney makes an investment directly or the attorney forms an investment partnership to make the investment. ABA Opinion, n. 6
   d. See ABA Opinion, p. 3 and n. 8, p. 6.

3. Terms of investment must be fair to client. ABA says attorney needs to determine market value to judge fairness.
b. Can use what other investors are paying as a standard for fairness – ABA Opinion, p. 5.

c. Attorney’s interest can be a percentage of stock to be issued – consider lawyer’s anticipated contribution to company’s success – ABA Opinion, p. 5.

d. “Reasonable fee” standard: ABA suggests this standard also be used to judge the fairness of the transaction - ABA Opinion, p. 3 and n. 8.2

e. The reasonableness of the investment should be judged at the time of the investment, not with hindsight. ABA Opinion, pp. 4-5.

4. ABA took no position on attorneys demanding founder’s stock, but warned “reasonable fee” standard will apply – ABA Opinion, p.5, n.16., citing ABA Model Rule 1.5(a).

B. ABA defines full disclosure (ABA Opinion, pp. 6-7 and n. 23)

1. Attorney must explain the consequences the investment could have on the client.

2. Attorney must explain how post-investment events could create a conflict – e.g., interference with attorney’s dispassionate advice.

3. Attorney must explain that if a conflict arises, the attorney might need to withdraw from representation or

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2 This conclusion is a bit odd, because an attorney’s investment may have absolutely no relationship to the attorney’s fees. This conclusion might also be at odds with the rules of individual states. For example, California does not have a “reasonable fee” standard, but rather, an attorney cannot charge an “illegal or unconscionable” fee. See California Rules of Professional Conduct, Rule 4-200.
recommend independent counsel on issues where the attorney has a conflict.

4. Attorney must specify in writing the scope of services to be provided in return for the stock or the opportunity to invest. ABA Opinion, p. 7.3

C. ABA’s “suggestions” about investment policies

1. In its Opinion 00-418, the ABA noted in very neutral language that some law firms have adopted certain policies regarding investments in clients to help avoid risks associated with those investments. We can probably safely infer that the ABA thinks it is wiser to adopt policies than not to do so. See Opinion, n.5.

2. The ABA did not offer any analysis of how or why the particular policies it mentioned reduce the risks, which is unfortunate, as it would have been helpful to have the ABA’s views.

3. The policies the ABA acknowledged (without endorsement) were:

   a. Limiting investments to an insubstantial percentage of stock.

   b. Limiting the amount invested in any single client to a nonmaterial sum.

Again, this part of the ABA opinion is a bit mystifying. In many instances, there is no direct relationship between the services to be provided and the opportunity to invest. That is, attorneys providing general corporate services generally get the opportunity to invest, sometimes only after years of service, and the opportunity to invest is not tied to any specific services.
c. Having someone other than the attorney in principal contact with the client make decisions about conflicts arising out of the investment.

d. Transferring billing responsibility to a partner with no stock ownership in the clients.

e. Transferring supervisory responsibility to a partner with no stock ownership in the clients.

f. Forbidding attorneys from investing in clients without prior approval by firm management (sometimes with exceptions for purchases in de minimus amounts in a private placement or for open market purchases.)

g. Allotting investment opportunities among all partners (or all firm attorneys). The ABA does not comment on how this particular action would impair the firm’s ability to adopt the practices described in paragraphs 4 and 5, above.

h. Pooling investments in a fund or bonus plan. The ABA does not comment on how this helps minimize conflicts, but presumably the ABA agrees that it makes the attorney performing services less likely to allow a single investment to affect his or her advice.

i. Reminding attorneys to avoid securities law violations, including Section 10(b)(5) (anti-fraud) and Section 16 (short swing profits), and adopting mechanisms to avoid insider trading.

Opinion, p. 11 and n. 32
WHAT HAPPENS IF YOU DO NOT COMPLY WITH APPLICABLE ETHICAL STANDARDS?

A. You can be disciplined by your State Bar

B. The client can sue you for breach of fiduciary duty (improper handling of conflict of interest, divided loyalty)

C. The client can usually rescind the transaction, which means that you lose any upside in your investment

D. Even if the client does not seek to rescind, you cannot enforce your agreement. See, e.g., Passante v. McWilliams, 53 Cal. App. 4th 1240 (1997) (attorney lost $32 million in stock partly because he did not comply with California’s rule for doing business with a client)
CHECKLIST FOR INVESTING IN CLIENTS

☐ Check your state’s rules of professional conduct: determine what they say you must do.

*Generally, ethics rules allow attorneys to invest in their clients, but the rules usually specify steps you must follow to protect the client, yourself and your firm.*

☐ If you are a member of a law firm or other legal organization, make sure that the investment you are contemplating satisfies whatever rules the firm or organization has.

☐ Decide whether you trust the client.

*Doing business with clients is risky, because the law presumes that an attorney can easily take advantage of a client. In these modern days of high technology clients, clients often expect and want their lawyers to invest -- not only to receive the funds, but also as a sign of the lawyer’s faith, trust and confidence in the client. It shows that the lawyer is “part of the team” that is critical to success of the client.*

*Most lawyers do not take advantage of their clients, but clients often have great incentive to take advantage of their lawyers if it later suits their purpose. So be careful, don’t invest in just any client. Decide if this is a client you can trust.*

☐ Decide whether the terms of the investment are fair and reasonable to the client.

*You want to deal fairly with the client, of course, because you are a fiduciary. But you should also be aware that if the client later wants to rescind the transaction, the court will scrutinize the transaction to make sure that it was fair and reasonable, possibly using hindsight. If you have not followed the ethics*
rules prescribed by your state, the court will likely allow the client to rescind the transaction.

☐ Explain the terms of the transaction in writing to the client in easily understandable language.

The courts are concerned that the client “knew what it was getting into.” Explain the terms so that they are clear. Draft a description that you would be proud to have a court review, and one that you think a jury would understand.

Don’t hesitate to provide “context” for the transaction. For example, if you are taking stock in lieu of fees because the client is cash-strapped, include that explanation in the letter. If you have worked at below-market rates as a key member of the start-up team, and have made significant sacrifices to help the client succeed, say so. Don’t get carried away by your ego, however: don’t put anything in writing that you would later be embarrassed to have others see.

☐ Explain how the transaction could interfere with the attorney-client relationship, even if you do not believe that it will.

Does it give you a financial interest in the very matter on which you are giving the client advice? Could it impair your duty of objectivity and independence? Could it cause you to put your own financial interests ahead of the client’s? Probably not, but let the client know that these are at least theoretical possibilities, and say that if the client is concerned about any of this, it should not enter into the transaction.

☐ Explain to the client, in writing, that you cannot advise the client on whether to enter into the transaction with you, and tell the client, in writing, that it is free to seek independent counsel to advise it on the transaction.
Some states may require you to recommend that the client seek the advice of independent counsel.

See also ABA Formal Op. 00-418, p. 8.

New York: should not seek to persuade client to permit you to invest [EC 5-2, 5-3].

☐ Obtain the client’s informed written consent to the transaction.

*Provide the client with a signed copy of the disclosure and consent letter, and put your own copy in a safe place, where you can find it if you need it.*

☐ If you are going to have an active role in the business, stay attuned to potential conflicts.

*Check whether you (or your firm’s) investment affects your independent judgment or objectivity.*

_Is it a large investment for you?_

*If stock value is unstable, does that impact you?*

*Does your work directly affect the stock’s value?*

*As a shareholder, do you have any control over the company’s business?*

*Conflicts can also be created:*

_By owning stock in others with whom your clients do business or to whom your clients are adverse.*

_By litigators acquiring stock in clients or adversaries.*
LAW FIRM RISK MANAGEMENT
POLICIES ON INVESTING IN CLIENTS

1. **Threshold issue: Should you allow investments in clients?** Decide whether you want to allow lawyers and/or the firm to invest. It can be lucrative, but it can also be risky.

2. **Establish policies.** If you are going to allow investments, establish policies specifying the ground rules: who can invest, when, how much, and how.

   Decide whether you will invest in all clients, no clients or only some.

   Decide whether to allow individual lawyers to invest or whether to limit investments to the firm as a whole.

   Decide whether the attorneys must first offer the investment opportunity to the firm and what rules should govern that process.

   Decide whether the firm should make any investments directly or whether the firm should set up a separate partnership to make the investments.

   Decide whether to establish an investment committee to make investment decisions (rather than individual attorneys) and what criteria the committee should follow.

   Decide whether to have any “disqualification” or “recusal” rules, which would take investment decisions out of the hands of the lawyers doing the work for the client.

   Decide whether to put any limits on the amount of the investments.
3. **Decide internal disclosure rules.**

   Decide whether and when lawyers must disclose to the firm their personal investments in clients.
   Decide whether to enter such information into the firm’s conflicts database and how it will be used.

4. **Announce and educate.** Announce the policies. Educate your lawyers about the risks of investing. Teach them how to follow the applicable ethics rules. Give them forms to use. Insist that they use the prescribed forms. Have periodic check-ups to see if lawyers are complying with the rules.

5. **Indemnification.** If the firm allows attorneys to invest in firm clients; consider whether to require lawyers to indemnify the firm for any liability the firm incurs as a result of their personal investments.

6. **Insurance.** Consider whether investments will impair or otherwise impact the firm’s professional liability insurance coverage. Explore whether there is any insurance that could protect the firm for suits arising out of the investments.

7. **Curing a conflict.** To cure a conflict that develops after the investment is made, the ABA opines that, with client consent, the firm can bring in another attorney from the same firm to handle the client’s work. Might want to work this out in advance. ABA Opinion, p. 4.

8. **Exit rules.** Client has absolute right to terminate attorney’s services. Right must remain unfettered. Have an exit plan. ABA Opinion, p. 11 and n. 33.
WHAT YOUR CONFLICT WAIVER LETTER SHOULD SAY

• **Fairness and reasonableness.** Make sure the terms of the investment are fair and reasonable to the client.

• **Explain the terms** of the investment in easily understandable language. Make full disclosure of all relevant facts and circumstances you are aware of that could affect the client’s decision to enter into the investment.

• **Provide context** for the investment. Courts should not use hindsight to judge the fairness or reasonableness of the transaction, but they might. Expressly stating the context for the investment is helpful. For example, if you are taking stock in lieu of fees because the client is cash-strapped, include that explanation in the letter. If you have worked at below-market rates as a key member of the start-up team, and have made significant sacrifices to help the client succeed, say so. If the client has asked you to invest, say so. Including the context for the investment helps you demonstrate its fairness and reasonableness. *See Passante v. McWilliams*, 53 Cal. App. 4th 1240 (1997) (attorney lost $32 million in stock partly because he did not comply with Rule 3-300).

• **Explain the potential consequences** that the investment could have on the attorney-client relationship, even if you do not think the investment will have any actual negative consequences for the client. For example, let the client know that at least theoretically, your investment could:
  
  ▶ impair your objectivity and independent judgment by giving you an interest in the subject matter of the representation;

  ▶ cause you to put your own financial interests ahead of the client’s, thus interfering with your duty of undivided loyalty;

  ▶ strain the attorney-client relationship; and/or

  ▶ means you might need to withdraw from the representation if the investment causes a conflict that cannot be resolved.
• **Explain that you cannot advise** the client on whether to enter into the transaction with you, and tell the client that it is free to seek independent counsel to advise it on the transaction. Some states may require you to recommend that the client seek independent legal advice.

• **Tell the client it must raise any concerns it has** about the potential consequences of the transaction with you, and with its separate counsel, now. Otherwise, you will rely on the client’s signature as confirming that the client understands and consents to the transaction despite the potential consequences.

• **Obtain the client’s informed written consent to the transaction.** (If you are in a jurisdiction that follows the ABA Rules, you also need to obtain the client’s informed written consent to your future representation of the client in light of the “interest” your investment may give.) Be sure to calendar follow-up reminders until you receive the client’s signature.
PARTING WORDS OF WISDOM

- Investing in a client is permissible if done correctly
- Check your state’s rules – they vary
- Put the deal in writing
- Do not be greedy
- Pay attention after you invest – be honest with yourself and with your client about conflicts
- Step out of the representation if your investment begins to interfere with your objectivity – but in withdrawing, follow applicable ethical rules regarding protecting the client’s interests
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Pamela Phillips is the Chair of the Professional Liability Practice Group at the law firm of Rogers, Joseph, O’Donnell & Phillips in San Francisco, California. In practice for more than 20 years, she specializes in representing lawyers and law firms in legal malpractice cases, and acts as general outside ethics counsel for many of the largest firms in California. She also testifies as an expert witness.

Professional Liability Practice Group

The Professional Liability Practice Group at Rogers, Joseph, O’Donnell & Phillips specializes in representing lawyers and law firms throughout California. Many of California’s most prestigious law firms regularly turn to us for counseling on ethical and law practice management issues, for analysis of potential claims, and for representation in lawsuits brought against them.

Litigation. We represent lawyers and law firms in a wide variety of lawsuits, but particularly those alleging legal malpractice, breach of fiduciary duty, unethical conduct and malicious prosecution. Our attorneys specialize in knowing the laws and rules governing lawyers, and excel at providing thorough, efficient and expert representation in all phases of litigation. We also have substantial experience in resolving claims through mediation and other alternatives to litigation.

Counseling services. We counsel lawyers and law firms on a range of issues, including conflict-of-interest problems, fee disputes, fee audits, risk management, partnership disputes, disqualification motions, privilege questions and other ethical issues. We also offer many educational seminars. These seminars qualify for MCLE credit and include valuable written materials.

Claims analysis. The Professional Liability Practice Group specializes in investigating and analyzing claims for malpractice and breach of fiduciary duty
before litigation has been filed. With our written claims analysis in hand, a law firm’s management (and its insurers) can make informed, intelligent decisions about how to deal with the risks involved in a potential claim before it ripens into litigation.

**Insurance issues.** RJOP also has attorneys who are experts in analyzing, advising on, and litigating coverage disputes under professional liability policies.

**Products.** PLPG licenses a conflicts manual and other similar products, such as engagement materials, policies, etc.

**Representative clients.** Fenwick & West, LLP; Heller Ehrman White & McAuliffe; Sheppard, Mullin, Richter & Hampton; and Wilson Sonsini Goodrich & Rosati.
VII. ATTORNEYS DEFENDING THEIR OWN WORK:
THE “UNDERLYING WORK” PROBLEM.

Sometimes it is tempting for lawyers to defend their earlier work. For example, the lawyer might be asked to investigate and provide an opinion as to the legality of a transaction in which the lawyer or another in her firm substantially participated. Or it could involve litigating over a partner’s unclear contract in a dispute with the other party as to its effect.

The lawyer wants to “make things right” rather than having another firm rectify any mistake, and gain the glory—and the client. The client wants the original lawyer or her firm to handle the matter because it’s generally less expense, and any mistake was hers in the first place.

The lawyer should, however, think twice before attempting to vindicate her earlier work product. Doing so may lead to a malpractice lawsuit. See discussion and cases cited in Freivogel, “Underlying Work Problem,” at http://www.freivogelonconflicts.com/new_page_21.htm.
Pertinent Model Rules of Professional Conduct (ABA 2004)

Rule 1.7 (Conflict of Interest: General Rule).

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

Rule 1.9 (Duties to Former Clients).

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

(1) whose interests are materially adverse to that person; and

(2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter;

unless the former client gives informed consent, confirmed in writing.
A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

Rule 1.10 (Imputation of Conflicts of Interest: General Rule). [ABA Rule 1.10 omits paragraph (c) (underscored below), which is the screening provision in the Maryland Rules as recently revised by the Court.]

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless the prohibition is based on a personal interest of the prohibited lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm.

(b) When a lawyer has terminated an association with a firm, the firm is not prohibited from thereafter representing a person with interests materially adverse to those of a client represented by the formerly associated lawyer and not currently represented by the firm, unless:

(1) the matter is the same or substantially related to that in which the formerly associated lawyer represented the client; and

(2) any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(c) that is material to the matter.

(c) When a lawyer becomes associated with a firm, no lawyer associated in the firm shall knowingly represent a person in a matter in which the newly associated lawyer is disqualified under Rule 1.9 unless the personally disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom.

(d) A disqualification prescribed by this rule may be waived by the affected client under the conditions stated in Rule 1.7.

(de) The disqualification of lawyers associated in a firm with former or current government lawyers is governed by Rule 1.11.

The Maryland Rules of Professional Conduct as recently revised by the Court also add the following Comments to explain screening under MD RPC 9.10(c):
Where the conditions of paragraph (c) are met, imputation is removed, and consent to the new representation is not required. Lawyers should be aware, however, that courts may impose more stringent obligations in ruling upon motions to disqualify a lawyer from pending litigation.

Requirements for screening procedures are stated in Rule [1.0(k)]. Paragraph (c) does not prohibit the screened lawyer from receiving a salary or partnership share established by prior independent agreement, but that lawyer may not receive compensation directly related to the matter in which the lawyer is disqualified.

Rule 1.18 (Duties to Prospective Client).

(a) A person who discusses with a lawyer the possibility of forming a client-lawyer relationship with respect to a matter is a prospective client.

(b) Even when no client-lawyer relationship ensues, a lawyer who has had discussions with a prospective client shall not use or reveal information learned in the consultation, except as Rule 1.9 would permit with respect to information of a former client.

(c) A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter, except as provided in paragraph (d). If a lawyer is disqualified from representation under this paragraph, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d).

(d) When the lawyer has received disqualifying information as defined in paragraph (c), representation is permissible if:

(1) both the affected client and the prospective client have given informed consent, confirmed in writing, or

(2) the lawyer who received the information took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the prospective client; and

(i) the disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom; and

(ii) written notice is promptly given to the prospective client.

Compare Rule 1.18(d) to the recently approved Maryland counterpart, which, like Rule 1.10(c), supra, provides in 1.18(d)(2): “or the disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom.”
BIOGRAPHIES

ROBINS H. LEDYARD

Rob Ledyard is a member of Bass, Berry & Sims PLC in Nashville, practicing Corporate and Insurance Law. He holds an undergraduate and a law degree from Vanderbilt where he was Assistant Editor of the Law Review and Order of the Coif. Rob is a member of the ABA Business Law Section and the Corporate Section of the Tennessee Bar Association. His law practice emphasizes corporate work for insurance companies and health care intermediaries. Rob has served as loss prevention counsel at Bass, Berry & Sims PLC for the past 20 years and has written extensively on that and other subjects.

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Thomas D. Morgan has been Oppenheim Professor of Antitrust and Trade Regulation Law at The George Washington University Law School since 1989. A 1965 graduate of the University of Chicago Law School, he has taught at the University of Illinois College of Law, served as Dean and then Professor at the Emory University School of Law, was the first Rex E. Lee Professor of Law at Brigham Young University, and in 1990, he served as President of the Association of American Law Schools. Professor Morgan has taught and written in the field of professional responsibility for over 30 years. In addition to articles in the field, he is co-author of the widely-used “Problems and Materials on Professional Responsibility” (8th Edition 2003), and an accompanying annual Standards Supplement. He served as one of two Associate Reporters for the American Law Institute's Restatement of the Law (Third): The Law Governing Lawyers, and as one of two Associate Reporters for the American Bar Association’s Ethics 2000 Commission.

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Doug Richmond is Senior Vice president in the Professional Services Group of Aon Risk Services, where he consults with Aon’s many large law firm clients on professional responsibility and liability issues. Before joining Aon in Chicago, Doug was a partner with Armstrong Teasdale LLP in Kansas City, Missouri (1989-2004), where he had a national trial and appellate practice. In 1998, he was named the nation’s top defense lawyer in an insurance industry poll as reported in the publications Inside Litigation and Of Counsel. He is a member of the American Law Institute (ALI), the American Board of Trial Advocates (ABOTA), the International Association of Defense Counsel (IADC), and the Federation of Defense and Corporate Counsel (FDCC). Doug has also been selected to The Best Lawyers in America in the areas of legal malpractice, personal injury litigation, and railroad law. In 2003, the Euromoney Legal Media Group named him as one of the nation’s top insurance and reinsurance lawyers. He has published over 40 articles in university law reviews, and many more articles in other scholarly and professional journals. Doug teaches Legal Ethics at the Northwestern University School of Law and he is a regular National Institute of Trial Advocacy (NITA) faculty member. He previously taught Trial Advocacy and Insurance Law at the University of Kansas School of Law, and Insurance Law and a seminar on Damages at the University of Missouri School of
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Susan Shapiro is a sociologist and Senior Research Fellow at the American Bar Foundation in Chicago. She is author of *Tangled Loyalties: Conflict of Interest in Legal Practice*, winner of the Distinguished Book Award of the Sociology of Law Section of the American Sociological Association. She has written numerous articles on the legal profession and ethics, fiduciary relationships and trust, and white-collar crime and is the author of *Wayward Capitalists: Target of the Securities and Exchange Commission*. She serves on the Executive Committee of the Law & Society Association and has been a professor at Northwestern and New York Universities. She received her A.B. from the University of Michigan and Ph.D. from Yale University.

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Ann Yvonne Walker is a partner in the law firm of Wilson, Sonsini, Goodrich & Rosati in Palo Alto, California. She primarily represents high technology companies located in the "Silicon Valley" and specializes in corporate and securities law, including public offerings, mergers and acquisitions and general corporate representation, with a particular emphasis on public company disclosure obligations and SEC compliance issues.

Ms. Walker is currently a member of the Council of the ABA Business Law Section (2001 – present) and is the immediate past Chair (1997 – 2001) of the ABA Business Law Section's Committee on Lawyer Business Ethics, having served on that committee since its founding in 1993. She also serves on the ABA Business Law Section's Committee on Professional Conduct. She was previously a member of the Section’s Ad Hoc Committee on Ethics 2000 and its Ad Hoc Committee on Multidisciplinary Practice. She also served as a member of the ABA Standing Committee on Professionalism (1996 - 1999), for which she now serves as liaison from the Business Law Section. From 1999 to 2001, she served as Chair of the ABA Section/Division Committee on Professionalism and Ethics.

Ms. Walker is an active member of the Federal Regulation of Securities Committee of the ABA Business Law Section and is also very active in the State Bar of California. She is a former Co-Chair of the Council of State Bar Sections (2001 – 2002) and Chair (1999 – 2000) of the State Bar’s Business Law Section.