



1 of 15 DOCUMENTS

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Eli Wald on Oster v. Kirschner

2010 Emerging Issues 5230

Eli Wald on the meaning of "actual knowledge" in an aiding-and-abetting fraud claim against lawyers, *Oster v. Kirschner*, 2010 NY Slip Op. 5981; 2010 N.Y. App. Div. LEXIS 5848 (July 6, 2010).

By Eli Wald

July 30, 2010

SUMMARY: In *Oster v. Kirschner*, the court broadly construed the "actual knowledge" element of an aiding-and-abetting cause of action against lawyers, holding that plaintiffs may be able to sufficiently allege "actual knowledge" by inferring it from the surrounding circumstances, such as the nature of objectionable client conduct known to the lawyer at the time legal services are rendered and the nature of the legal services rendered.

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ARTICLE: Overview

In *Oster v. Kirschner* (hereinafter *Oster*), the court broadly construed the "actual knowledge" element of an aiding-and-abetting cause of action against lawyers, holding that plaintiffs may be able to sufficiently allege "actual knowledge" by inferring it from the surrounding circumstances, such as the nature of objectionable client conduct known to the lawyer at the time legal services are rendered and the nature of the legal services rendered. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the court.

Background

Cobalt Multifamily entities ("Cobalt"), purportedly a real estate investment firm specializing in the acquisition and development of multifamily properties, was in fact a Ponzi scheme, which defrauded its investors of over twenty-two million dollars. Plaintiffs-investors alleged that defendants-law firm and one of its partners aided-and-abetted the fraud perpetrated by Cobalt by drafting the private placement memoranda ("PPM") used to solicit plaintiffs' investment in Cobalt. The trial court granted defendants' motion to dismiss and plaintiffs appealed, arguing that they have adequately alleged the claim of aiding-and-abetting fraud by the defendants.

Pertinent Question: What must plaintiffs allege in order to satisfy the "actual knowledge" element of an aiding-and-abetting fraud claim against lawyers?

The Holding

A plaintiff alleging an aiding-and-abetting claim must allege (1) the existence of the underlying fraud, (2) actual knowledge, and (3) substantial assistance. *Oster*, at *4. The plaintiffs therefore had to show that defendants had actual knowledge of the Ponzi scheme and that defendants offered substantial assistance to it. Because preparation of PPM constitutes "substantial assistance" under NY law, *Oster*, at *4 (internal citations omitted), the court was called upon to construe the "actual knowledge" requirement, explaining the nature of the factual allegations plaintiffs must allege to survive a motion to dismiss.

The following facts alleged by plaintiffs were undisputed: while the PPM drafted by defendants represented that only "accredited investors" meeting certain wealth and income specifications would be allowed to invest in Cobalt, units in Cobalt were in fact sold to investors who did not meet these criteria; the PPM misrepresented the composition of the management team of Cobalt; and, in particular, the PPM failed to disclose that members of the management team had criminal histories. *Oster*, at *2-3. The parties, however, interpreted these facts differently. Whereas plaintiffs argued that these facts adequately demonstrated that defendants had actual knowledge of the Ponzi scheme, *id.*, at *4, defendants asserted that any misrepresentations contained in the PPM were irrelevant to the question of whether they had actual knowledge that Cobalt was being operated as a Ponzi scheme. *Id.*

The court held that "intent to commit fraud is to be divined ... [or] discerned from the surrounding circumstances." *Id.* Plaintiffs, reasoned the court, should be allowed to infer defendants' actual knowledge from the circumstances because "[p]articipants in a fraud do not affirmatively declare to the world that they are engaged in the perpetration of fraud," *id.*, rendering it difficult for plaintiffs to otherwise demonstrate defendants' actual knowledge.

The court went on to explore the kind of circumstances which give rise to an inference of actual knowledge. First, knowledge of objectionable client conduct at the time defendants offered their services supports an inference of actual knowledge of the fraud. The court drew a distinction between, on the one hand, client conduct which appears "completely unobjectionable" at the time lawyers learn of it and only subsequently is found to be objectionable, and, on the other hand, client conduct which from its inception appears objectionable. In *Oster*, explained the court, defendants knew of objectionable client conduct: units of Cobalt were offered to investors who did not meet the "accredited investor" criteria, and Cobalt was being run by convicted felons. *Id.*, at *4-5. Because defendants knew of objectionable client conduct when they drafted the PPM, plaintiffs may draw the inference that defendants had actual knowledge of the fraud.

Second, the nature of the services offered to clients would be relevant in ascertaining the lawyers' knowledge. In *Oster*, explained the court, "[t]he PPMs authored by defendant attorneys were the means by which [Cobalt was] able to solicit funds for [its] Ponzi scheme. The PPM is the very mechanism by which investments such as Cobalt are placed in the marketplace, and the admitted 'but for' cause of plaintiff's investment losses." *Id.*, at *5 (emphasis added). In other words, legal services which end up being the means by which fraud is perpetrated by clients will tend to show the lawyers' actual knowledge of it.

Applying the "surrounding circumstances" test to the facts alleged in *Oster*, the court concluded that "[i]f the facts and circumstances herein do not support an inference of actual knowledge, then it is doubtful that any action for aiding-and-abetting fraud could be sustained against an attorney, who, like defendant attorneys, consciously chose to look the other way when their clients asked them to prepare the PPM for their next 'investment' vehicle." *Id.* Defendants' position, that they simply helped clients solicit investments and did not have actual knowledge of the fraud they helped perpetrate, "is drawing distinctions based on gradations of knowledge that are simply not tenable." *Id.* The court reversed the trial court order dismissing the aiding-and-abetting claim, rejecting defendants' approach to construing actual knowledge as unacceptable "see no evil, hear no evil." *Id.*

Legal Analysis

The *Oster* holding - that lawyers' "actual knowledge" of clients' fraud may be inferred from the surrounding circumstances, and, specifically, that the relevant circumstances for drawing such an inference include the nature of the clients' conduct at the time legal services were rendered as well as the nature of the legal services provided to the clients - while a broad reading of "actual knowledge," is reasonable enough. It is supported by two policy arguments outlined by the court. First, especially at the pre-discovery stage where plaintiffs lack access to the very discovery materials which would illuminate defendants' state of mind, it is both logical and practical to allow plaintiffs to draw inferences from the surrounding circumstances regarding the lawyers' degree of knowledge. *Id.*, at *4, 6. Second, in an era in which "our society is experiencing a proliferation of frauds perpetrated by officers of large corporations," *id.*, at *5-6, it is desirable to allow plaintiffs to draw inferences regarding lawyers' degree of knowledge, in order to expose lawyers to a greater risk of liability which will in turn provide lawyers with better incentives to scrutinize "objectionable" client conduct and refuse to offer legal services which constitute the "but for" and "means by which" clients' might perpetrate fraud.

While adopting the "surrounding circumstances" test for construing lawyers' "actual knowledge" in aiding-and-abetting cases is sensible enough, the court's application of this standard in *Oster* is questionable. As explained by the court in *Hightower v. Cohen*, CV 08-3229 (RJD)(RM) (E.D.N.Y., September 30, 2009), a putative class action arising out of the same facts as *Oster* and brought against the same and additional defendants, the fraud that caused plaintiffs' harm was a devastating Ponzi scheme, not merely the PPM drafted by defendants. While the misleading PPM formed part of the Cobalt's scheme, "it was just that, only one step of a 'complex scheme to defraud' investors." *Hightower*, at *9-10. In other words, *Hightower* suggests that while defendants may have had actual knowledge regarding one step of the Ponzi scheme perpetrated by Cobalt, namely the PPM, they may have lacked actual knowledge of other steps, and therefore of the Ponzi scheme as a whole.

Moreover, the disposition of *Hightower* casts a cloud over the court's application of the "surrounding circumstances" test in *Oster*. The *Hightower* court dismissed the class action on the ground that plaintiffs have failed to sufficiently allege that defendants had actual knowledge of the Ponzi scheme. Indeed, the *Hightower* court explained that plaintiffs seemingly conceded that they do not allege that defendants had actual knowledge of the Ponzi scheme, arguing instead that "their failure to do so is not fatal to their claims because the fraud that caused plaintiffs' harm was not the Ponzi scheme but rather that '[t]he primary violation in this case is Cobalt's successful solicitation of investments using false and misleading offering document." *Hightower*, at *9. Responding to the court's holding in *Hightower*, the plaintiffs in *Oster* appear to have revised their position and argued instead that defendants did have actual knowledge of the Ponzi scheme. To be clear, whether defendants had actual knowledge of the Ponzi scheme is a question of fact. Perhaps the *Oster* defendants did have actual knowledge of their clients' Ponzi scheme, but *Hightower* suggests that plaintiffs conceded that defendants did not have actual knowledge of the entire Ponzi scheme; rather, they only had actual knowledge of one stop of the scheme, the PPM.

In sum, while the *Oster* holding that lawyers' "actual knowledge" of clients' fraud may be inferred from the surrounding circumstances for purposes of sufficiently alleging aiding-and-abetting is reasonable, it does seem that the court's application of its "surrounding circumstances" test for "actual knowledge" in *Oster* was driven by its outrage with the defendants and its desire to hold them accountable for what the court candidly called their "see no evil, hear no evil" approach. *Oster*, at *5. At the end of the day, *Oster's* articulated rule of law and its application illustrate the difficult task of striking an appropriate balance between the desirable goal of holding lawyers accountable for their own conduct and rejecting a "see no evil, hear no evil" approach to the practice of law, and on the other hand, protecting lawyers from lawsuits by (often sympathetic) plaintiffs who, seeking deep pockets to recover against, would be prone to assert lawyers' "actual knowledge" even when they cannot establish it.

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2 of 15 DOCUMENTS

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Lauer on client agreements and definition of value

2010 Emerging Issues 4961

The need to secure agreement with the client about the definition of value

By Mr. Steven A. Lauer Esq.

April 13, 2010

SUMMARY: Client perspective is the primary concern for legal work valuation. Quite simply such work must serve the client's interests or it does not possess any value. The degree to which it does serve those interests will determine how valuable it is. Therefore, corporate law departments should ensure that their own opinions regarding value provided to a company coincides with the views of internal clients.

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ARTICLE: The need to secure agreement with the client about the definition of value

The valuation of legal work must begin and, to a degree, end with the client's perspective. Inasmuch as the law constitutes a service profession and counsel serves to further the client's goals, it follows that the legal service must serve the client's interests or it does not possess any value. The degree to which it does serve those interests will determine how valuable it is.

For this reason, a corporate law department should ensure that its own view of the value that it provides to the company coincides with the view of its internal clients. Do the in-house lawyers place priority on the same types of service as do the "C" level executives? If the latter expect counseling and advice immediately on request but the attorneys focus on responding to contract-related inquiries in order to keep the corporate machine "humming," that disconnect will prove problematic for the law department. The opposite expectations by the executives, if not matched by similar perceptions by the lawyers, will prove just as deleterious to the law department's standing.

Similarly, different companies place more or less emphasis on the cost of legal service. While every company hopes to keep its expenses to a minimum, budget guidelines may constitute more a goal at some firms while others consider such guidelines to serve as absolute limits on the lawyers' prerogatives to the extent the lawyers want to take steps that would entail substantial outlays.

Accordingly, a law department should engage senior management of the company and its internal clients in discussions about the value proposition in respect of the legal service that it provides and manages. How does the law department's work better enable the company to achieve its business goals? Can the department and the legal team do more in that regard?

How much risk would the business tolerate in the context of its legal work? In-house lawyers understand that "leaving no stone unturned" in terms of legal issues researched for a transaction or issues analyzed in respect of a dispute will result in significant expense. Will that additional effort lead to a "better result" and a more-certain legal package? If it will not, that additional work will have added little value to the underlying legal work while increasing the cost of the transaction or the litigation. In order to avoid pursuing the "ultimate" piece of legal work at the expense of the cost effectiveness of the effort, though, a law department must develop guidelines on the level of legal "risk" that the organization will accept. It should develop those guidelines in conjunction with its clients to ensure that they share its views in that regard. Only if the lawyers and their clients apply the same priorities will they be able to work together effectively, particularly in the heat of a large transaction or the emotions of a challenging dispute or litigation.

Too often, in-house lawyers and their internal clients fail to recognize the existence of a gap between their respective expectations and views regarding some basic issues that typically arise during the former's representation of the latter. When a client sees things differently than his/her counsel, that counsel's performance likely will not meet the goals or expectations held by that client. This will lead the client to hold a less-than-favorable opinion of the lawyer's work which, in turn, will lead the client to recognize that work as holding less value than does the lawyer.

This can prove very deleterious to their relationship by poisoning the client's mind and his or her future receptivity to the lawyer's advice. This happens when law departments acquire the reputation of always preventing deals from closing or delaying their conclusions too much (becoming known as "the department of No").

Law departments should engage their clients in discussions around the part that the legal work plays in achieving the business goals and how much that work contributes to achieving those goals. Such discussions will enable those departments to realize several benefits. First, they will develop collaboratively with those clients a common understanding of how the clients want the lawyers to work toward the business's objectives. Second, those clients will become more educated consumers of that legal service because they will gain a much more complete appreciation for the legal risks inherent in the business and the costs of addressing those risks. Third, the clients will acquire a more sophisticated understanding of how the legal issues inherent in a situation can impede the achievement of those objectives or lead to post-transaction problems and disputes or, if addressed properly, can help the company to achieve those objectives more rapidly.

How should law departments begin those discussions? As an element of reporting to management, of course, a corporate law department should provide data that demonstrate the implications of the legal matters that it manages on behalf of the company. The department might include in those reports information that details the sources of those potential effects on the company's risk. Applying some descriptors that explain the relative risks of various plans, the in-house lawyers can begin to educate corporate leaders about the law-related implications of their business plans and to engage those leaders in discussions about means to reduce those risks if desired. If those discussions lead to an understanding between the in-house lawyers and their clients that the risks are understood by the latter and within acceptable limits, the law department will have done its job and should have much more supportive clients with respect to its role in managing those risks.

The first step, of course, consists of achieving consensus within the law department on means by which to categorize its matters by risk level. For litigation-related or dispute-related matters, this likely will involve discussions of what characteristics of a dispute or litigated matter relate to higher risk and which characteristics identify (or likely identify) those matters that present lower risk profiles. These characteristics probably have been identified for purposes of the department's process to evaluate those disputed matters. In the context of a personal injury lawsuit, for example, the more severe the injury in question, the higher the likelihood of an unfavorable or more expensive outcome (assuming liability for the moment). Venue in a plaintiff-favorable state court might suggest a higher risk if the matter is likely to go to a jury or a local judge for decision.

Transactions present a different set of criteria or characteristics. A high-profile sale of defense-related products (e.g., military equipment or computers designed for weapons application) to a foreign government probably creates a

not-insignificant risk of bribery or other unlawful activity under the Foreign Corrupt Practices Act and its counterparts in other countries. Highly regulated transactions have different risk profiles, as a rule, than do unregulated ones.

By developing its own lexicon of risk-related concerns and determining how to apply that lexicon to the work that it manages on behalf of the company, a law department will set the foundation for very productive and helpful discussions with its internal clients about their business plans and the risks associated with those plans. Tying that lexicon into a more easily understood set of graphics or metrics will assist in those discussions and, in turn, provide a format for reporting and discussion in the future that serves the interests of the law department and its clients well.

The law department must also take steps to assure that the outside legal service providers with which it works share (or at least understand) its understanding of how to value the legal work that they provide to the clients together. Such a common understanding will assist the in-house and outside lawyers in their discussions of the work, billing, alternative fee arrangements (if they tackle that subject) and other issues relevant to the relationship between the corporate client and the outside providers.

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3 of 15 DOCUMENTS

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Lauer on Without effective evaluation

2010 Emerging Issues 4866

Without effective evaluation, all may be for naught

By Mr. Steven A. Lauer Esq.

February 12, 2010

SUMMARY: Absent good communication, in-house and outside counsel's ability to work together effectively to represent their mutual client will suffer. Establishing good channels between the in-house and outside attorneys is necessary at the start of their relationship. Mr. Lauer provides an easy to follow and effective plan for ensuring good lines of communication between counsel and client.

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ARTICLE: Absent good communication, in-house and outside counsel's ability to work together effectively to represent their mutual client will suffer. Establishing good channels between the in-house and outside attorneys is necessary at the start of their relationship. Assuring that they understand each other, by developing or confirming that they share common understandings of the words that they use, must occur at the start as well. Shared expectations regarding the work that the latter performs at the direction of the former will serve as a useful calibration for the work going forward.

In order to assure that the client realizes the most value from the legal service, though, whether in the context of a single, one-off assignment or as an element of an ongoing relationship that covers multiple (even many) matters, in-house counsel must establish an effective means of evaluating outside counsel and the latter's work and communicating the results of those evaluations to outside counsel in a manner that will conduce toward improvement in the relationship and the work.

In fact, the evaluation of outside counsel might be as important as the initial selection. A failure to properly evaluate outside counsel and to communicate the results might irreparably damage the relationship and the work. On the other hand, the benefits of effective evaluation will serve counsel well immediately in respect of the current assignment and they will manifest themselves fully more and more over time. n1

Proper evaluation requires that a law department follow these steps:

Determine what criteria regarding outside counsel and outside counsel's work on behalf of the company match up with the law department's needs;

Develop measurements by which the department will be able to determine how well counsel fulfills those criteria;

Assure that the in-house attorneys apply those criteria consistently across the department and over time;

Establish a mechanism by which to convey to outside counsel the results of the evaluations.

The criteria used, of course, should be the same as, or at least not inconsistent with, the criteria by which the department selected the outside counsel to be evaluated. To the degree that they are, they will reinforce the department's ability to assess the wisdom of its selection and its ability to communicate to others within the company (and, perhaps, even audiences outside the company) why it selected the particular outside attorneys. In these days of heightened oversight and second guessing of many corporate decisions, that facility will serve the department well.

The measurements by which the department evaluates its outside counterparts should match up with and feed into any reporting that the department must prepare for internal audiences. Assuring corporate management that it identifies the legal support team methodically and with some objectivity will enable it to speak to that audience in language that the audience understands and uses on a day-to-day basis. Moreover, by demonstrating its willingness and ability to measure the performance of the company's outside counsel (and, indirectly, its own performance), the law department likely will impress its corporate management in ways that will redound to its benefit significantly.

Those criteria should also reflect the department's and the company's definition of "high quality legal service." If that definition is highly dependent on cost efficiency, for example, adherence of outside counsel to cost-control guidelines, budgets, and similar directions should be measured in some fashion. If a company has adopted a very aggressive mode of dispute management and resolution, look for ways to measure how well outside counsel serve that goal.

A law department should secure the views of its internal clients regarding the outside attorneys with which it works. This will provide several benefits to the in-house lawyers. First, they are the clients of the law department and of the outside attorneys, so their views of the service must command attention. Second, since the clients' views of the law department's service to and for them likely will affect the department's standing within the company, negatively or positively, enabling those clients to express their views about that service invests them in that service delivery. If, after having had an opportunity to express satisfaction or dissatisfaction, they later criticize the outside attorneys or those attorneys' work, their criticism will be less directed toward the law department. Third, since their perspective likely will differ from that of the in-house attorneys, their evaluations of whether and how the legal work product adds value to the business process should "round out" the overall assessment of that product in a way that benefits the company.

One law department that established a formal, consistent evaluation process for its outside law firms reports several benefits. The company general counsel believes that the process has led to healthier, more constructive relationships with the firms. That law department's initiatives around topics such as alternative fee arrangements and electronic billing have proceeded with little of the controversy that some other law departments have encountered because the firms have clearer understandings of the department's needs and perspectives and how those initiatives can benefit both in-house and outside counsel for that company. The department also recognizes the law firm that has earned the highest evaluation score at its annual meeting with the outside firms. The general counsel reports that the firms actively compete for that award, to the benefit of the company as well as themselves. A second law department that initiated such an evaluation process uses the results of its evaluations to inform its discussions with those firms that receive the bottom quartile of evaluations about ways in which those firms can improve their performance for that company. Without such a specific, well-thought-out process consistently implemented, that department would have less "ammunition" for such discussions.

By following these guideposts, a law department should be in a position to assure itself that it arranges for and manages the delivery of legal service that contributes value to the corporation's business efforts. By doing so, it also assures management that it contributes value to the enterprise. And that can only be a good thing these days.

[Return to Text](#)

ⁿ¹ See Lauer, "What Business Can Teach Law," *Legal Times* (September 22, 1997), p. 25.

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4 of 15 DOCUMENTS

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Lauer on effective attorney-client communications

2010 Emerging Issues 4844

If you don't speak the same language, how can you work together?

By Mr. Steven A. Lauer Esq.

January 22, 2010

SUMMARY: The law creates a form of "combat" in the form of the clash of ideas waged with words. In the context of the relationship between clients and their counsel, though, lawyers seem to forget or fail often to apply those lessons. However, with care and attention on both sides, however, miscommunication can be reduced, if not eliminated. Success in that endeavor should rebound to the benefit of both in-house and outside counsel.

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ARTICLE: Lawyers live and die (at least, professionally) with language. The law creates a form of "combat" in the form of the clash of ideas waged with words, to replace earlier forms of conflict resolution. Those earlier forms included jousting, person-to-person fighting and trial by combat. The criminal law no longer leads to a defendant being lowered into a body of water to determine, by whether he or she sinks or floats, guilt or innocence.

Law school training inculcates its students into this practice. They spend their time studying prior practitioners and the decisions of courts in order to understand how the use of words and intangible concepts can create, change and otherwise affect individuals' rights in many contexts.

In the context of the relationship between clients and their counsel, though, lawyers seem to forget or fail often to apply those lessons. This failure is particularly surprising and ironic when the client is represented by an in-house law department staffed by lawyers often as capable as those in the law firms that represent those businesses.

For example, a series of annual surveys several years ago probed the type of relationship that businesses had with their outside counsel. The responses of the in-house participants and the outside participants varied quite significantly. The outside attorneys routinely believed that they received considerably greater autonomy in the relationship than did their in-house counterparts at the client business organizations. In 2000 lawyers in law firms described their relationships with clients using the label "outsource" 63.5% of the time for acquisitions work, whereas in-house lawyers chose that descriptor only 7.8% of the time. (The survey defined an "outsource" relationship as one in which "[o]utside counsel is responsible for entire practice or block of work with little in-house management.") For that same area of law, the in-house respondents described the relationship with law firms as "co-counsel" ("in-house and outside counsel share substantive work responsibilities") 43.1% of the time, whereas outside counsel thought that term applied only 6.0% of the time. Such disparities existed in many, if not all, substantive areas of law covered in the survey. Outside counsel

consistently viewed their autonomy as much greater than did the in-house respondents, by wide margins.

Another example of a "failure to communicate" is the situation where in-house and outside attorneys use the same words but with different meanings in mind without realizing and adjusting for that discrepancy. Several years ago, during a panel discussion of relationships between in-house and outside attorneys, the managing partner of a national law firm referred to the "productivity" of the associates of that firm. While an in-house attorney (or, probably, almost any employee of a for-profit corporation) in the audience would think of productivity as a trait that would lead to lower cost or more efficient processes, that managing partner meant that more productive associates bill more hours than their less-productive colleagues, leading to more revenue for the firm. In the mind of an in-house attorney charged with serving his or her employer's legal interests in the most cost-effective manner, higher billings for a law firm do not represent a desired outcome. The audience may have taken away (at least, those audience members from corporate law departments) a far different message than that managing partner intended.

While researching the subject of communication between in-house and outside counsel, an in-house lawyer told me that a basic problem, in his view, was that in-house lawyers think strategically by training and due to the expectations of their internal clients. Outside lawyers, on the other hand, tend to approach challenges, and their clients' assignments, from a tactical perspective, focusing on what steps to take to accomplish the task identified. If they do not really understand the task that the client wants done, though (due to a communication failure like those described here), they may take unnecessary steps. Or they might pursue counterproductive tactics, such as by pursuing "scorched earth" tactics relative to a business dispute and spoiling a business relationship that the client wanted to salvage by simply delaying a judicial determination.

To what can you attribute such communication failures? Since the attorneys on both sides are educated and have taken similar (if not identical) training in law school, I suspect that the "failure to communicate" stems from inattention on both sides rather than an inability to do so. If inattention lies at the base of the problem, that constitutes both good and bad news. Good because it is easily remediable. Bad because, in light of attorneys' capabilities vis-à-vis communication, it shouldn't have happened in the first place.

The remedy would consist of more attention to expressing and sharing expectations and devoting effort to uncovering communication lapses or gaps that can undermine the parties' ability to reach a common understanding. Make sure that when you use words, your listener receives the message through those words that you intend. When an in-house attorney calls outside counsel and expresses the need to "win" a dispute, that outside attorney easily could interpret that to mean "beat the opponent into submission" when the company wants only to avoid an adverse result in court long enough to enable the parties to explore possible business solutions (as opposed to judicial solutions) to their conflict. A litigator who leaves a meeting with his or her client's in-house attorney with (perceived) instructions to "win" likely will begin immediately to prepare to take tactics that could prevent a non-judicial resolution so litigation becomes self-fulfilling and self-perpetuating. Avoiding such an outcome requires that the in-house attorney express the client's goals very clearly and secure the outside attorney's confirmation of that understanding.

Miscommunication or lack of communication can lead to failure in the representation and failure to reach the client's goals. The value of the legal service will decline, perhaps entirely, if the lawyers inside and outside the company do not see eye to eye and they do not have a common understanding of what they want to achieve for the company and how they expect to do so.

When lawyers for a common client cannot understand each other because they use the same words with different meanings in mind and never resolve that discrepancy, all of their subsequent dealings will be adversely affected. Suffice it to say that their ability to work together will be compromised and achievement of the client's goals will depend on happenstance rather than planning.

With care and attention on both sides, however, miscommunication can be reduced, if not eliminated. Success in that endeavor should rebound to the benefit of both in-house and outside counsel.

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5 of 15 DOCUMENTS

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Eli Wald on Assignability of Unpaid Legal Fees Lawsuits

2009 Emerging Issues 4676

Eli Wald on Assignability of Unpaid Legal Fees Lawsuits, *Burnison v. Johnston*, 277 Neb. 622 (Neb. 2009).

By Prof. Eli Wald

December 4, 2009

SUMMARY: In *Burnison v. Johnston*, the Supreme Court of Nebraska held that a law firm may assign its right to collect unpaid legal services. This Emerging Issues Analysis, written by Professor Eli Wald, a legal ethics expert, summarizes the pertinent legal issues decided by the Court and provides important insights for practitioners.

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ARTICLE: Overview

In *Burnison v. Johnston*, 277 Neb. 622 (Neb. 2009) (hereinafter *Burnison*), the Supreme Court of Nebraska held that a law firm may assign its right to collect unpaid legal services. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the Court and provides important insights for practitioners.

Factual Background

The law firm of Martin & Martin, P.C. provided legal services to defendant Johnston between 1994 and 1998. In 2001 the law firm assigned its right to collect defendant's unpaid legal fees from May 1, 1996 through February 25, 1998 to plaintiff Burnison. Plaintiff filed a complaint seeking recovery of unpaid legal fees for services provided by the law firm assignor. Defendant claimed, *inter alia*, that plaintiff was not the real party in interest; and that public policy considerations bar assignability of the right to collect unpaid legal fees. *Burnison*, at 623-24.

Procedural Background

The district court dismissed plaintiff's claim concluding that Burnison lacked standing to bring the action. Specifically, the court held that the law firm had impermissibly assigned personal legal services to plaintiff. *Id.*

Pertinent Legal Question

Does Nebraska law permit the assignability of unpaid legal fees lawsuits?

The Opinion

The Court began its analysis by clarifying the district court's holding, explaining that when the district court stated that law firm had impermissibly "assigned personal legal services," *Burnison*, at 623, 624, it meant that the law firm had inappropriately attempted to delegate performance of its duty to provide legal services. *Id.* at 626. The Court properly identified that *Burnison* does not involve an attempt to delegate the performance of a duty under a contract for legal services; the law firm had performed the legal services for defendant and only assigned the right to receive defendant's payment for services already rendered. *Id.* In fact, the record suggests that the attorney-client relationship between the law firm and defendant ended in 1998, three years prior to the assignment of the right to collect the unpaid legal fees to plaintiff. *Id.* at 623, 626.

Turning its attention to the assignability dispute, the Court held that contractual rights are generally assignable unless the terms of the contract validly preclude assignment or the assignment is contrary to statute or public policy. *Id.* at 626 (internal citations omitted). Additionally, a contractual right to the benefit of a promise cannot be assigned if the obligor "reasonably intended for the right to be exercised only by the party with whom it contracted." *Id.*

Because the contract between law firm and defendant did not preclude the assignment, and because defendant did not intend to limit law firm's ability to collect legal fees, the Court next considered defendant's claim that assignability of unpaid legal fees claims violated public policy. In particular, defendant argued that because she had malpractice defenses to the law firm's claim for unpaid fees, public policy concerns, similar to those prohibiting the assignment of attorney malpractice claims, apply. *Id.* at 627.

The Court rejected defendant's public policy claim. It noted that assignment of malpractice claims against attorneys is prohibited "to avoid undermining the duty of confidentiality and other professional duties that arise from the client-attorney relationship." *Id.* at 628 (internal citations omitted). Then, without any further explanation, the Court summarily concluded: "Those public policy concerns are not present here." *Id.* With regard to defendant's claim that her malpractice defense should preclude assignment, the Court reasoned that since an assignee's rights are no greater than the assignor's, plaintiff will have to prove the value of the legal services provided by the law firm, *id.* at 627, and, in particular, overcome defendant's malpractice defense, but that "public policy does not prohibit an attorney's assignment of a claim for unpaid legal fees simply because a client might raise malpractice defenses." *Id.* at 628.

Concluding that public policy considerations do not prohibit an attorney's assignment of a claim for unpaid legal fees when the former client defends with allegations of malpractice, the Court found for plaintiff and reversed.

Analysis

Burnison was a case of first impression in Nebraska. Its holding, however, is consistent with general principles of contract law: contract rights are generally assignable, except where the assignment is: (1) prohibited by statute; (2) prohibited by contract; (3) the contract involves a matter of personal trust or confidence, or (4) in violation of public policy considerations. In particular, generally, the right to receive money due or to become due under an existing contract may be assigned, even though the contract itself may not be assignable, unless there is something in the terms of the contract manifesting the intention of the parties that it shall not be assigned. *See, e.g., Travertine Corp. v. Lexington-Silverwood*, 683 N.W.2d 267 (Minn. 2004); *Webb v. Gittlen*, 174 P.3d 275 (Ariz. 2008).

Accordingly, lawyers should be allowed to assign the right to collect unpaid legal fees for services already rendered. Indeed, the few other courts that have dealt with the issue reached the same outcome as the *Burnison* court. For example, in *Levine v. Bayne, Snell & Krause, Ltd.*, 92 S.W.3d 1, 5 (Tex. App. Ct. 1999) the Texas Court of Appeals held that attorneys can assign their accounts receivable which includes current, future earned or unearned attorney's fees (internal citations omitted) (reversed for other grounds); *Baker v. Rapport*, 453 F.2d 1141, 1142 (1st Cir. 1972) (accepting, without analysis, lawyer's assignment of the right to collect unpaid legal fees to a third party)

Yet, the Court's quick dismissal of defendant's public policy argument is somewhat surprising. Courts routinely

hold that clients may not assign malpractice lawsuits against attorneys on the ground that such an assignment would undermine the sanctity of the attorney-client relationship, the interest of confidentiality and other professional duties that arise from the client-attorney relationship. *Burnison*, at 628; *see also*, Eli Wald on Assignability of Malpractice Lawsuits, *Taylor v. Babin*, 2009 La. App. LEXIS 724 (2009), 2009 *Emerging Issues* 4141. Prohibiting the assignability of malpractice lawsuits on the ground that it compromises the attorney-client relationship is suspect: after all the rationale of affording the attorney-client relationship special protection is to benefit the client, not the attorney. In particular, the interest of confidentiality belongs to, and may be waived by, the client, not the attorney. A client should be allowed to waive protections designed to protect her if she so wishes. *Id.*

Nonetheless, courts routinely invoke public policy to prohibit the assignability of malpractice lawsuits on the ground that it would compromise the sanctity of the attorney-client relationship, *see, e.g., Taylor v. Babin*, 2009 La. App. LEXIS 724 (2009), and as this rationale applies to malpractice lawsuits, it seems to apply with equal force to claims to collect unpaid legal fees. For example, in order to collect the unpaid legal fees from the client, the assignor law firm would have to disclose confidential information about the representation to the assignee, and while the rules of professional conduct usually allow *lawyers* to reveal confidential information in order to collect their fees, *see, e.g., American Bar Association Model Rules of Professional Conduct, R. 1.6(b)(5)*, public policy considerations could reasonably deny lawyers the right to reveal confidential information to third-party assignees, especially if protection of confidentiality is the rationale for disallowing assignment of malpractice lawsuits against lawyers.

Furthermore, allowing lawyers to assign the right to collect unpaid legal fees seems to contradict, on its face, one of the core values and ideals inherent in the attorney-client relationship that of an attorney's loyalty to clients. *See* Charles W. Wolfarm, *Modern Legal Ethics* 146 (1986) ("Whatever may be the models that obtain in other legal cultures, the client-lawyer relationship in the United States is founded on the lawyer's virtually total loyalty to the client and the client's interests."); Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 *Geo. J. Legal Ethics* 15, 21 (1987) ("In the relationship with a client, the lawyer is required above all to demonstrate loyalty."). Surely, lawyers have the right to be paid for their work on behalf of clients, and lawyers are allowed to sue to collect unpaid legal fees from clients. Yet assigning the right to collect unpaid legal fees to a third-party goes further than that, arguably undermining clients' trust in lawyers a cornerstone of the attorney-client relationship.

To be clear, the Court's rejection of defendant's public policy claims in *Burnison* may be justified. Notably, the relationship between defendant and law firm has concluded and defendant was a former client. Because the relationship ended three years prior to the assignment, *Burnison* did not involve any significant issues relating to the attorney-client relationship between law firm and defendant.

Yet one must wonder: what if law firm was still representing defendant? Would it be allowed to assign its right to collect unpaid legal fees against a current client? Would public policy considerations not be triggered, akin to the ones routinely invoked by courts to prohibit the assignability of malpractice lawsuits? As long as courts continue to disallow assignment of malpractice lawsuits it seems that the same justification the sanctity of the attorney-client relationship used to disallow the assignment of malpractice lawsuits by clients, should also prevent the assignment of the right to collect unpaid legal fees by lawyers, at least when the suit is brought against a current client. Consequently, while the Court's holding in *Burnison* may be ultimately justified (because defendant was a former client, not a current client), it can be argued that the speedy dismissal of defendant's public policy argument was unjustified.

Conclusion

In *Burnison* the Nebraska Supreme Court held that as a matter of public policy assignment of the right to collect unpaid legal fees should be allowed when the legal services in question have been rendered. While the outcome is not implausible, the Court's summary dismissal of defendant's public policy argument against assignability is surprising given that courts routinely disallow assignability of malpractice lawsuits. To the extent that the sanctity of the attorney-client relationship and the interest of confidentiality are invoked to preclude assignability of malpractice lawsuits, they ought to similarly preclude, at least in some circumstances, assignability of the right to collect unpaid

legal fees.

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Prof. Wald, a Continuing Legal Education instructor and expert witness, is a member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and a member of the Colorado Bar Association's Ethics Committee.

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6 of 15 DOCUMENTS

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Vermont Rules of Professional Conduct

2009 Emerging Issues 4536

Wroth on the Vermont Rules of Professional Conduct

By Professor L. Kinvin Wroth

November 11, 2009

SUMMARY: New Vermont Rules of Professional Conduct: Analysis.

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ARTICLE: I. Introduction: Vermont Supreme Court Adopts "Ethics 2000" Amendments to Vermont Rules of Professional Conduct

The "Ethics 2000" amendments to the ABA Model Rules of Professional Conduct are now in effect in Vermont. The Vermont Supreme Court has adopted a massive package of amendments to the Vermont Rules of Professional Conduct, effective September 1, 2009, that incorporate most of the amended Model Rules. In the works for six years, the Vermont amendments are intended to clarify provisions of the Vermont Rules and respond to developments in the practice of law and the law of lawyering produced by the impact of technology and the changing dynamic of the legal profession.

Vermont joins 41 other states and the District of Columbia that have adopted the Ethics 2000 amendments in their Rules of Professional Conduct. n1 The "Ethics 2000" amendments in fact consist of comprehensive and significant changes to the Model Rules that were adopted by the ABA House of Delegates in 2001-2003 after the first comprehensive review of the Model Rules since their initial adoption in 1983.

The Vermont Supreme Court originally adopted the Vermont Rules of Professional Conduct in 1999. The 2009 amendments to the Vermont Rules were developed by the Court's Advisory Committee on Civil Rules, which was asked in 2003 to undertake a full review of the Ethics 2000 amendments. Drafts of proposed Vermont amendments were discussed at Vermont Bar Association meetings in October 2004 and March 2005. A draft of revisions reflecting comments received was circulated in February 2007. In January 2008, the Committee recommended that the Court adopt a revision of the draft based on further comments. The Court promulgated the Rules as recommended, with a few additional revisions resulting from the Court's substantial review of the recommended revised draft.

II. Purpose and Overview of the 2009 Vermont Amendments

The 1999 adoption of the Model Rules was intended to assure that Vermont's standards for lawyer conduct would

reflect current national trends in the field and offer substantial uniformity with most other states as well as ready access to their decisions on key issues. Thus, the 1999 Vermont Rules in large measure incorporated the language and form of the ABA Model Rules and amendments to them. In a few areas, however, the 1999 Rules departed from the Model Rules, either to preserve an existing Vermont rule or practice or because the ABA rule had proven unsatisfactory in other jurisdictions. Because uniformity with the national model remains an important goal, the 2009 Vermont amendments include virtually all of the Ethics 2000 amendments. Nevertheless, most of the distinctive Vermont variations adopted in 1999 have been retained in the 2009 amendments, and those amendments also differ in specific respects from the amended Model Rules where Vermont practice calls for a different approach.

The Rules establish standards, violation of which may lead to discipline. Each rule is accompanied by a "Comment"-also adopted from the Model Rules-intended to explain and illustrate the meaning of the rule and to guide interpretation. The Rules continue to be organized in preliminary sections covering the Preamble and Scope (now combined in a single section) and Terminology (now Rule 1.0) and eight substantive sections relating to a lawyer's various professional roles and responsibilities and the structure and functioning of the practice and the profession: Client-Lawyer Relationship (Rules 1.1-1.18), Counselor (Rules 2.1-2.4), Advocate (Rules 3.1-3.9), Transactions with Persons Other Than Clients (Rules 4.1-4.5), Law Firms and Associations (Rules 5.1-5.7), Public Service (Rules 6.1-6.5), Information about Legal Services (Rules 7.1-7.6), and Maintaining the Integrity of the Profession (Rules 8.1-8.5).

Reporter's Notes, incorporating as appropriate the Ethics 2000 Reporters' "Explanation of Changes," explain the reasons for the amendments, as well as the basis for Vermont variations. The current Reporter's Notes should be read in conjunction with the 1999 Reporter's Notes and with the many Supreme Court cases decided since 1999 that are cited in the current Notes. As always, the Reporter's Notes are advisory. n2

This pamphlet highlights significant changes made by the 2009 amendments, such as clarification of confidentiality and conflicts of interest rules, the extension of mandatory disclosure rules to prevent or rectify significant financial harm, important clarifications of the rules governing IOLTA and other trust accounts, a new rule for dealing with conflicts and confidentiality issues for prospective clients, new rules for lawyers serving as neutrals in ADR proceedings, and new provisions covering multi-jurisdictional practice. Details and the full effect and rationale of these and all other changes will be found in the Reporter's Notes to each rule.

III. Significant Changes

Preamble and Scope

The Preamble and Scope sections, originally adopted as two preliminary sections, have been combined in a single section with some additions and amendments. New paragraph [3] makes clear that service as third-party neutral is an appropriate professional function that is particularly subject to Rules 1.12 and 2.4. Paragraph [3] also calls attention to the applicability of certain rules, such as those covering fraud and dishonesty, to the conduct of lawyers even when they are not acting in a professional capacity. In paragraph [9], language has been added reasserting the principle of Canon 7 of the former Model Code of Professional Responsibility that the lawyer should represent a client zealously within the bounds of the law. That principle had disappeared in the initial adoption of the Model Rules. It now reappears with the important further qualification that zealousness should be accompanied by "a professional, courteous and civil attitude toward all persons involved in the legal system." Paragraph [20] carries forward prior Vermont language intended to reflect more accurately the role that the Rules may play as standards to be applied in substantive or procedural settings outside the disciplinary context.

Rule 1.0. Terminology

The definitions contained in the prior "Terminology" section have been placed in a separate rule to give them greater visibility. They are now elaborated upon in a Comment section.

Important new definitions have been added to support changes intended to strengthen provisions of the many substantive rules that require client consent. See Rules 1.2(c), 1.4(a)(1), 1.6(a), 1.7(b)(4), 1.8(a)(3), 1.8(b), 1.8(f)(1), 1.8(g), 1.9(a), 1.9(b)(2), 1.11(a)(2), 1.12(a), 1.18(d)(1), 2.3(b). The basic provision is new Rule 1.0(e), which provides a definition of "informed consent" that replaces the phrase "consent after consultation." The new definition uses language, amplified in Comment [6], that is intended to make clear the nature of the information and explanation required to assure that a decision is truly informed. New Rule 1.0(b) defines "confirmed in writing" for purposes of those substantive rules that add that requirement to the giving of informed consent or other types of decisions. See Rules 1.5(c), 1.5(e)(2), 1.7(b)(4), 1.8(a)(3), 1.8(g), 1.9(a), 1.9(b)(2), 1.11(a)(2), 1.12(a), 1.18(d)(1). The writing must be given at the time of the consent or in a writing promptly transmitted by the lawyer after oral consent, or "within a reasonable time thereafter." "Writing" is defined in Rule 1.0(n) to include expression through a range of paper and electronic media. Rule 1.0(n) also defines "signed" to include electronic manifestations executed or adopted by the signer. A signed writing is required by Rules 1.5(c), 1.8(a)(3), and Rule 1.8(g).

New Rule 1.0(k) defines "screened" for purposes of those rules allowing a law firm to undertake representation in a matter in which a member of the firm has a conflict arising from a prior connection with the matter if that lawyer is "timely screened." See Rules 1.11(b)(1), 1.12(c), 1.18(d)(2).

Client-Lawyer Relationship

Rule 1.2. Scope of Representation and Allocation of Responsibility between Client and Lawyer

Amended Rule 1.2(c) allows the lawyer to limit the "scope" (rather than, as formerly, the "objectives") of the representation, "if the representation is reasonable under the circumstances and the client gives informed consent." The amendment applies to agreements to limit representation in any setting. In particular, it makes clear that the "unbundling" of legal services in litigation, as now expressly authorized by a recent amendment of Vermont Rule of Civil Procedure 79 and a pending amendment to Rule 15 of the Vermont Rules for Family Proceedings, does not violate the Rules of Professional Conduct. The procedural rules, which are intended to make limited representation available for litigants who might otherwise appear pro se and to encourage lawyers to undertake such representation pro bono, require written representation agreements that should establish compliance with Rule 1.2(c).

Rule 1.5. Fees

Rules 1.5(a), (b), and (c) have been amended to expressly prohibit agreements for unreasonable expenses, to require the basis or rate of expenses for which the client will be responsible to be communicated to the client, and to require a signed contingent fee agreement that notifies the client of expenses for which the client will be responsible.

Amended Rule 1.5(e)(2) expressly requires a fee-splitting arrangement to be stated in a written agreement.

Rule 1.6. Confidentiality of Information

Amended Rule 1.6 continues the unique features of the Vermont rule as adopted in 1999, adapting them to the language and format of the changes to Model Rule 1.6. The original Vermont rule, in contrast to the permissive disclosures allowed by Model Rule 1.6, *required* disclosure of client information when required by other rules, when necessary to prevent a crime that involved the risk of death or substantial bodily harm, and when necessary to avoid assisting a criminal or fraudulent act by a client. The mandatory nature of these disclosures reflected both a policy choice in favor of the public interest in preventing such harms and a concern that conduct standards for the imposition of professional discipline should be consistent with those for which civil or criminal liability might be imposed. The 1999 Vermont rule *permitted* disclosure of threats of lesser harm to leave the lawyer free to take the risk of civil or criminal liability in the client's interest without also being subject to professional discipline.

The amendments to Vermont Rule 1.6 retain and clarify the mandatory disclosure requirements of the prior Vermont rule. Amended Vermont Rule 1.6(b) adapts in modified form the language of amended Model Rule

1.6(b)(1)-(3) to describe the three key situations in which disclosure permitted by the Model Rule is required by the Vermont rule. These are situation in which the lawyer reasonably believes disclosure is necessary:

(1) to prevent the client or another person from committing a criminal act that the lawyer reasonably believes is likely to result in the death of, or substantial bodily harm to, a person other than the person committing the act; or

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services; or

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.

In Rule 1.6(b)(1), because disclosure is mandatory, the requirement is confined to a criminal act and there is an exception for disclosure of the intention of a client or another person to commit suicide or otherwise engage in physically self-destructive behavior in circumstances where such conduct would be criminal. The latter provision is unique to Vermont and reflects a concern that the lawyer not be compelled to act in a situation that may require a kind of judgment not grounded in legal skills and experience. The exception applies whether the information comes from a client who is the person contemplating the attempt or from another client such as a treating psychologist or guardian. The lawyer is permitted to disclose such an intention pursuant to Rule 1.6(c)(1), however, when in the lawyer's professional judgment the best interests of the person involved require it.

Rule 1.6(b)(2) replaces more general language in the 1999 Vermont rule with the tighter language of the amended Model Rule focusing on use of the lawyer's services. The provision more clearly tracks the general law of liability and treats misuse of the lawyer's services as an abuse of the client-lawyer relationship. Rule 1.6(b)(3) is new to the Vermont rule and is also taken from the amended Model Rule. Its rationale is the same as that of paragraph (2), but it applies in a situation where the lawyer can no longer prevent the harm, or the abuse of services, by preventing the client from acting or by withdrawing.

Amended Rule 1.6(c), like the original Vermont rule, continues to list permissive disclosures, making clear that the provision applies to information other than that for which disclosure is required under Rule 1.6(b). Amended Rule 1.6(c)(1), like Rule 1.6(b)(1), permits disclosure only of an intended crime or self-destructive act. Disclosure of other threatened conduct that is merely tortious is not permitted.

Rule 1.7. Conflict of Interest: Current Clients

Amended Rule 1.7 adopts the amended Model Rule and completely replaces the former rule for clarity and without substantive change.

The new rule makes clear that it governs conflicts between current clients by defining "concurrent conflict of interest." Former Rule 1.7 treated "directly adverse" representations separately from representations that "may be materially limited" by the lawyer's other responsibilities or interests. The conditions under which representation could go forward in each category were similar but not identical. Amended Rule 1.7(a) defines concurrent conflict to embrace both forms of representation and makes clear that in situations other than direct adverseness, a concurrent conflict involves "a significant risk" that representation of one client will be materially limited by responsibilities to another client, including a former client, or by the lawyer's personal interest.

Under amended Rule 1.7(b), a lawyer may represent a client in a concurrent representation situation if all of the following conditions are met:

(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.

Clause (1) substitutes for the vague "adversely affected" test of the former rule a test reflecting qualitative standards of representation that invoke the competence and diligence requirements of Rules 1.1 and 1.3. Clauses (2) and (3) in effect rule out representation in two nonconsentable conflict situations regardless of the lawyer's belief concerning the quality of representation. Clause (4) substitutes a requirement of informed written consent as those terms are defined in Rule 1.0 for the less rigorous "consents after consultation" of the former rule.

Rule 1.8. Conflict of Interest: Current Clients: Specific Rules

Amended Rule 1.8 incorporates most of the amendments to the Model Rules and retains some existing Vermont variations.

Amended Rules 1.8(a)(3) concerning client-lawyer business transactions and 1.8(g) concerning aggregate settlements both now require signed, written, client consent because of the risks of overreaching and conflicts of interest.

In amended Rule 1.8(e)(2), consistent with the Model Rule, language permitting a lawyer to pay expenses of a party to a class action has been deleted, though lawyer advances or payment of litigation expenses in a class action might be permissible for indigent parties under the amended rule.

The amended rule does not expressly identify conflicts in family or other intimate personal relations. Former Rule 1.8(i) barring representation directly adverse to a person represented by a family member has been deleted from both the Vermont and Model rules. New Model Rule 1.8(j) prohibiting lawyer-client sexual relations is not included in the amended Vermont rule. Both omissions involve situations that are addressed more specifically in other rules requiring loyal, competent, conflict-free, and honest representation. The omission of Model Rule 1.8(j) is also based in part on the ground that an absolute prohibition of lawyer-client sexual relations is an invasion of privacy.

Rule 1.10. Imputation of Conflicts of Interest: General Rule

Amended Rule 1.10(a) incorporates Model Rule 1.10(a) as it stood prior to amendments adopted by the ABA in February and August 2009 to allow screening of a disqualified lawyer whose conflict would otherwise be imputed to the firm. The Civil Rules Advisory Committee is currently considering whether to recommend adoption of these amendments in the Vermont rule.

Rule 1.12. Former Judge, Arbitrator, Mediator, or Other Third-party Neutral

Rule 1.12 has been amended, consistent with the adoption of new Rule 2.4, to adopt the Model Rule amendments adding mediators and other third-party neutrals to those subject to the rule barring representation in connection with a matter in which the lawyer was active as a judge or dispute resolution professional. Rule 1.12(c) extends the provisions of the former rule for screening of the disqualified lawyer to the new category of neutrals.

Rule 1.13. Organization as Client

Amended Rule 1.13 conforms to changes in Model Rule 1.13 adopted in 2003 to clarify a lawyer's responsibilities to an organizational client in light of the Sarbanes-Oxley Act of 2002 and related regulations. Like the original Vermont rule, amended Rules 1.13(b)-(d) differ from the Model Rule where necessary to reflect the fact that certain disclosures of information relating to the representation may be required or permitted by Vermont Rule 1.6 and not by Model Rule 1.6.

Rules 1.15, 1.15A, 1.15B. Safekeeping Property; Trust Accounting System; Pooled Interest-Bearing Trust Accounts

Rules 1.15, 1.15A, and 1.15B governing a lawyer's responsibilities with client funds or property should be considered together.

Rule 1.15 is amended to conform to changes in Model Rule 1.15, with modifications to adapt the rule to Vermont practice. New Rule 1.15(a)(2), unique to the Vermont rule, is added to clarify the applicability of the rules to funds held by a lawyer other than in a professional capacity. "Property held in connection with a representation," to which these rules apply, is limited to property held in connection with a lawyer-client relationship, a fiduciary relationship that arises out of a lawyer-client relationship, or a court appointment. Thus, the rules govern both "trust" accounts, in which funds arising from representation of a client are held, and "fiduciary" accounts, in which funds arising from a fiduciary relationship are held.

New Rule 1.15(c) modifies the Model Rule by making clear that it applies only to fees or expense payments arising from a lawyer-client relationship. Such fees or expenses, if paid in advance, must be deposited in a trust account, no matter how the payments are designated, if the funds are to be applied as compensation for services subsequently rendered or reimbursement for expenses subsequently incurred. The rule does not require deposit in the trust account of a "pure" retainer or engagement fee, a flat fee paid to assure the lawyer's availability and not for performing services. However, any advance payment under an additional agreement for any specific services to be performed must go into a trust account. Fees under either form of agreement are subject to the overriding reasonableness requirement of Rule 1.5(a).

Rules 1.15A-1.15C are unique Vermont Rules originally adopted to address specific trust account matters not covered in the Model Rules, such as mandatory IOLTA, random auditing, and overdraft reporting. There are no Comments to these rules because they have no Model Rule equivalents. The amendments are intended to clarify these rules in light of current practice and the terminology and format of the Rules.

Rule 1.15A as amended applies only to funds held "in connection with a representation" as defined in new Rule 1.15(a)(2). The amended rule incorporates the requirement of former Rule 1.15C(a) that funds be held in a "financial institution" as defined in new Rule 1.15A(d), but Rule 1.15B(a) makes clear that the institution must be approved by the Professional Responsibility Board only if it holds a pooled interest-bearing account as defined in that rule. Amended Rule 1.15A(a) further makes clear that an account in which funds directly arising from a representation are held is a "trust account" and that an account in which funds held pursuant to a fiduciary relationship are held is a "fiduciary account."

Rule 1.15A(b) is amended to require a confidential compliance review of trust and fiduciary accounts by Disciplinary Counsel instead of review by an outside accountant. The results of this review are to remain confidential unless they become subject to disclosure as part of the record in a disciplinary proceeding.

The language of Rule 1.15A(d), applicable to both Rules 1.15A and B, is broadened to make clear that "financial institution" includes entities in which funds may be held for investment pursuant to client instructions or fiduciary obligations as well as banks and other traditional depositories.

Rule 1.15B(a) is amended to make clear that every lawyer or law firm holding client funds in a trust account pursuant to Rule 1.15A(a) must also maintain a pooled interest-bearing account for IOLTA funds, now more narrowly

defined in Rule 1.15B(a)(2) as client or third-party funds that would not earn interest or dividends net of administrative costs if separately accounted for because they are of a small amount or are held for a period of short duration. As under the prior rule, the interest or dividends on the pooled account, which may be significant, are to be paid to the Vermont Bar Foundation to support legal services for the poor or for public education on the legal system—a practice upheld in *Brown v. Legal Foundation of Washington*, 538 U.S. 216 (2003), against a Takings Clause challenge.

Rule 1.15B(d) carries forward only for IOLTA accounts the general requirement of former Rule 1.15C that trust accounts may be maintained only in Vermont institutions that have been approved by the Professional Responsibility Board because the institutions have agreed to notify the Board of an overdraft on any such account held by it. The amended rule continues to apply this requirement to IOLTA accounts both because an overdraft necessarily affects the funds of numerous clients and because no single client is in a position to police the account. By contrast, a non-pooled trust or fiduciary account may be readily monitored by the client or others with an interest in the funds. Required compliance review and audit of such accounts under Rule 1.15A(b) and (c) provide further safeguards. The amended rule gives the lawyer wide discretion to deposit or invest significant funds at the best possible terms regardless of the location and nature of the institution.

Former Rule 1.15C is eliminated by the present amendments. Its provisions are incorporated as appropriate in Rules 1.15A and 1.15B.

Rule 1.18. Duties to Prospective Client

Rule 1.18, spelling out a lawyer's duties to "a prospective client," is new to the Vermont Rules. The rule adopts Model Rule 1.18, also a new provision, with one important variation.

Rule 1.18 (a) defines "a prospective client" as one who discusses a possible lawyer-client relationship "in good faith"—a Vermont addition designed to prevent an individual whose intent is to disqualify the lawyer from representing others in a matter from taking advantage of the rule. Rule 1.18(b) follows the law of attorney-client privilege in imposing a duty of confidentiality on all communications with a prospective client as confidential—correcting an omission in Rule 1.9. Rule 1.18(c) prohibits representation adverse to the prospective client in the same or a substantially related matter, but, unlike Rule 1.9, only if the lawyer received information that could be "significantly harmful" to the prospective client in the later representation. Rule 1.18(d) allows waiver in terms similar to those Rules 1.7 and 1.9, and allows representation by a firm with screening of the lawyer who received the information.

Counselor

Rule 2.4. Lawyer Serving as Third-Party Neutral

New Rule 2.4, providing standards governing lawyers who serve as third-party neutrals, adopts Model Rule 2.4, which is also new. Former Rule 2.2, which governed the lawyer serving as "intermediary," has been entirely deleted in view of the potential confusion between "intermediation" and mediation that it created. The new rule is designed to promote the parties' understanding of the lawyer-neutral's role. Thus, Rule 2.4(b) requires the lawyer serving as a third-party neutral to inform unrepresented parties in all cases that the lawyer does not represent them and to explain the differences in a lawyer's role as a neutral and the role of a lawyer representing a party when an unrepresented party does not understand the difference.

Advocate

Rule 3.1. Meritorious Claims and Contentions

A new comment [3] to Rule 3.1 is intended to make clear that responsibilities imposed on a criminal defense lawyer by Constitutional requirements may trump the provisions of this rule that would otherwise forbid a lawyer from asserting a claim that might appear frivolous.

Rule 3.3. Candor toward the Tribunal

Rule 3.3 is amended to conform to the changes in Model Rule 3.3. The amended rule and Comments recognize four specific responsibilities that a lawyer has to a court or other tribunal: (1) A lawyer must not make a false statement of law or fact or leave such a statement uncorrected. (2) A lawyer may not offer or allow the introduction of evidence that he or she knows to be false and must take remedial steps, including disclosure of information otherwise protected by Rule 1.6, if she or he subsequently learns that material evidence is false. This rule applies to the testimony of a criminal defendant unless the court requires it to be offered. (3) A lawyer may refuse to offer evidence that he or she reasonably believes to be false, except for the testimony of a criminal defendant. (4) A lawyer must take remedial measures, including disclosure of confidential information, if the lawyer learns that any client, witness, or other person is engaging or has engaged in criminal or fraudulent conduct that undermines the integrity of the judicial process. New Comment [15] clarifies the relationship between duties under this rule and the provisions of Rule 1.16 governing withdrawal.

Rule 3.4. Fairness to Opposing Party and Counsel

Rule 3.4 has been amended consistent with the former and amended Model Rule to eliminate a Vermont exception to the provision of Rule 3.4(f) that limited to civil cases the ability of a lawyer to advise a nonclient to refrain from giving information to a party if the nonclient is a relative or employee of the client and the lawyer reasonably believes that the person's interests will not be adversely affected.

Rule 3.5. Impartiality and Decorum of the Tribunal

Amended Rule 3.5 incorporates some of the changes in the Model Rule but retains and updates the unique provisions of original Vermont Rule 3.5(b) concerning ex parte communication with judges and jurors. Rules 3.5(b) and (c) both extend the period of juror immunity until the clerk "has certified that the juror's term of service is complete." Rule 3.5(d) continues to retain language from DR 7-106(C)(6) of the Vermont Code of Professional Responsibility, adding the word "disrupting" to track the Model Rule.

Rule 3.8. Special Responsibilities of a Prosecutor

Rule 3.8 concerning special responsibilities of a prosecutor has been amended to adopt most of the 2002-2003 Model Rule amendments with certain Vermont variations. Model Rules amendments adopted by the ABA in 2008 that added subdivisions (g) and (h) concerning the duties of a prosecutor who knows of evidence creating a reasonable likelihood that a defendant did not commit an offense of which she or he was convicted or that a defendant was wrongly convicted were not adopted in the Vermont amendments. The Civil Rules Advisory Committee is currently considering whether to recommend adoption of these amendments.

Transactions with Persons Other Than Clients

Rule 4.4. Respect for Rights of Third Persons

Rule 4.4(b), requiring a lawyer who receives an inadvertently sent document to notify the sender, has been adopted from the amended Model Rule. The rule leaves the sender the choice of whether to request return of the document, though the receiving lawyer is free to return it without consultation. Note that Vermont Rule of Civil Procedure 26(b)(5)(B), effective July 6, 2009, adopts the provisions of Federal Rule 26(b)(5), as adopted in 2006, that govern requests for return of privileged material produced in the course of discovery.

Law Firms and Associations

Rules 5.1 and 5.3. Responsibilities of Partners, Managers, and Supervisory Lawyers; Responsibilities Regarding Nonlawyer Assistants

Rules 5.1 and 5.3 are amended to adopt Model Rules changes regarding the responsibilities of lawyers for law firm management and the conduct of nonlawyer assistants. The amendments make clear that those provisions apply not only to partners but to lawyers having "comparable managerial authority." The purpose is to make clear

that these rules apply to managing lawyers in corporate and government legal departments and legal services organizations.

5.4(a)(4)

A new Rule 5.4(a)(4), adopting the comparable Model Rule amendment, provides that a lawyer may share court-awarded legal fees with a non-profit organization that employed or otherwise involved the lawyer. The purpose is to allow fee-sharing in such situations, because the threat to independent professional judgment that underlies the general prohibition of Rule 5.4(a) against fee sharing is minimized.

Rule 5.5. Unauthorized Practice of Law; Multijurisdictional Practice of Law

Amended Rule 5.5 incorporates changes in amended Model Rule 5.5 to allow temporary practice in Vermont by lawyers from other U.S. jurisdictions in the limited circumstances recommended in the report of the ABA's Multijurisdictional Practice Commission, adopted by the ABA in August 2002. The amendments are intended to facilitate multi-state practice in situations where the provision of temporary legal services by out-of-state lawyers does not present risks to clients, the courts, or the public that are unreasonable in light of the benefits of such services.

New Rule 5.5(b) makes explicit that a lawyer not admitted in Vermont may practice in the state only as authorized by the Rules of Professional Conduct or other provisions of law and may not publicly represent that he is admitted to practice in the state.

New Rule 5.5(c) spells out four limited exceptions to the prohibition against practice in Vermont that allow temporary practice by an out-of-state lawyer:

- (1) An out-of-state lawyer who is associated in the matter with a lawyer who is admitted to practice in the jurisdiction and who actively participates in the representation.
- (2) An out-of-state lawyer who provides services ancillary to pending or prospective litigation in a state where the lawyer is admitted or expects to be admitted pro hac vice or to pending litigation in which the lawyer lawfully appears or reasonably expects to appear, because the lawyer is either licensed or otherwise authorized to appear in the jurisdiction or has been or reasonably expects to be admitted pro hac vice.
- (3) An out-of-state lawyer who provides services in connection with the representation of clients in pending or anticipated arbitrations, mediations, or other ADR proceedings, where the work arises out of or is reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted.
- (4) An out-of-state lawyer who engages in transactional representation, counseling, and other non-litigation work that arises out of or is reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

New Rule 5.5(d) describes two situations in which an out-of-state lawyer not admitted in Vermont may engage in regular practice in the state:

- (1) An out-of-state lawyer employed by an organizational entity (e.g. an in-house corporate lawyer or a government lawyer) providing legal services, other than representations for which pro hac vice admission is required, on behalf of the employer, an affiliated entity (i.e., an entity controlling, controlled by, or under common control with, the lawyer's organizational employer).

(2) An out-of-state lawyer authorized by federal law or other law to provide legal services in Vermont.

Public Service

Rule 6.1. Voluntary Pro Bono Public Service

Amended Rule 6.1 adopts a Model Rule change and makes clear that the expectation for a Vermont lawyer's pro bono service is a minimum of 50 hours per year service goal.

Rule 6.5. Nonprofit and Court-Annexed Limited Legal Services Programs

New Rule 6.5 adopts new Model Rule 6.5, providing special conflict of interest rules for situations in which lawyers provide short-term limited legal services under the auspices of a program sponsored by a nonprofit organization or court. The purpose is to remove possible deterrents to pro bono service in situations where the nature of the service provider and the services indicate a reduced risk of conflicts of interest. The rule is consistent with the policy behind recently adopted Vermont Rule of Civil Procedure 79.1(h), providing for limited representation in litigation ("unbundling").

Rule 6.5 (a)(1) provides that the lawyer is subject to the requirements of Rules 1.7 and 1.9(a) only if the lawyer knows that the representation involves a conflict of interest. Thus a lawyer need not do a comprehensive conflicts check in a situation where it may not be feasible. Under Rule 6.5 (a)(2) a lawyer participating in a short-term legal services program must comply with the vicarious disqualification provisions of Rule 1.10 only if the lawyer knows that a lawyer with whom the lawyer is associated would be disqualified from handling the matter. Rule 6.5(b) expressly exempts the lawyer and firm from any other application of Rule 1.10.

Information about Legal Services

Rule 7.1. Communications Concerning a Lawyer's Services

Rule 7.1 is amended to conform to the changes in the Model Rule. The purpose is to limit the rule to a prohibition against false or misleading communications. The categorical prohibitions in former paragraphs (b) and (c) are now found in the Comments as examples of statements that are likely to be misleading.

Rule 7.2. Advertising

Rule 7.2 is amended to conform to the changes in the Model Rule. New Rule 7.2(b)(4) is intended to provide guidance for reciprocal referral agreements with other lawyers or nonlawyer professionals.

Rule 7.6. Political Contributions to Obtain Government Legal Engagements or Appointments by Judges

Rule 7.6, prohibiting campaign contributions by a lawyer intending to obtain or be considered for government legal engagements or appointments by a judge, was adopted by the ABA in 2000. The rule is new to Vermont. In light of the fact that Canon 5B(4)(d) of the Vermont Code of Judicial Conduct prohibits candidates for judicial appointment or retention, or appointment to other public office, from soliciting or accepting funds "personally or through a committee or otherwise," the rule will have little or no applicability to those individuals. It will apply, however, to candidates for election as judge of probate or assistant judge who, by virtue of Canon 5C(3) of the Code of Judicial Conduct, may establish campaign committees to solicit or accept campaign contributions.

Maintaining the Integrity of the Profession

Rule 8.4. Misconduct

Rule 8.4 is amended to conform to the Model Rule as amended, but retains significant variations in the original

Vermont rule that carried forward provisions of the former Vermont Code of Professional Responsibility. The present amendment follows the original Model Rules in deleting subdivision (h) and related language in Comment [5] as overly broad. As Comment [2] points out, other provisions of Rule 8.4 effectively address specific conduct that "adversely reflects on the lawyer's ability to practice law." Lawyers need to be aware that, as Vermont cases cited in the Reporter's Notes to the amendments of Rule 8.4 show, this conduct can occur in specific activities in which they may engage while not acting as a lawyer.

Rule 8.5. Disciplinary Authority; Choice of Law

Rule 8.5 is amended to conform to changes in the Model Rule, which incorporate recommendations in the Report of the ABA's Multijurisdictional Practice Commission, adopted by the ABA in 2002. Amended Rule 8.5(a) provides that a lawyer not admitted in Vermont may nevertheless be disciplined if she or he provides or offers to provide legal services in the state.

Amended Rule 8.5(b)(1) adopts choice of law rules for adjudicative proceedings taken from the amended Model Rule that substitutes "matter" and "tribunal" for "proceeding" and "court" to make clear the broad scope of the rule. For conduct in nonadjudicative situations, amended Rule 8.5(b)(2), consistent with the amendment of Rule 8.5(a), abandons a strict choice of law rule looking to the law of the admitting jurisdiction in favor of a flexible rule that looks to the rules of either the jurisdiction where the conduct occurred or the jurisdiction where the predominant effect of the conduct was felt if that was a different jurisdiction. If the lawyer has followed the rules of a jurisdiction that he or she reasonably believes will be the situs of the prominent effect of the conduct, the lawyer will not be subject to discipline.

For the text of the Rules, Comments, and Reporter's Notes, see Vermont Rules of Professional Conduct. For the text with amendments shown by underlining and strikeouts, see <http://www.vermontjudiciary.org/LC/Statutes%20and%20Rules/PROMULGATED-JUN1709-VRPC.pdf>.

Return to Text

n1 The web site of the ABA's Center for Professional Responsibility maintains a current listing of the states that have adopted the Ethics 2000 amendments and summaries of variations and key provisions in each state's rules. See http://www.abanet.org/cpr/jclr/ethics_2000_status_chart.pdf; <http://www.abanet.org/cpr/jclr/charts.html>; http://www.abanet.org/cpr/jclr/rule_charts.html.

n2 For additional interpretive guidance, see ABA Center for Professional Responsibility, *Annotated Model Rules of Professional Conduct* (6th ed. 2007 and subsequent editions); ABA/BNA, *Lawyers' Manual on Professional Conduct* (1984-date); American Law Institute, *Restatement of the Law: The Law Governing Lawyers* (2000, and annual supps. to date).

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7 of 15 DOCUMENTS

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Wald on Dropping "Hot Potatoes," Metropolitan Life v. The Guardian Life Ins. Co

2009 Emerging Issues 4142

Eli Wald on Dropping "Hot Potatoes," Metropolitan Life Insurance Co. v. The Guardian Life Insurance Co. of America, 2009 U.S. Dist. LEXIS 42475 (2009)

By Eli Wald

August 19, 2009

SUMMARY: In *Metropolitan Life v. The Guardian Life Ins. Co.*, the district court for the northern district of Illinois rejected a broad interpretation of the "hot potato doctrine" relating to motions to disqualify opposing counsel. This Emerging Issues Analysis, written by Prof. Eli Wald, a legal ethics expert, summarizes the pertinent legal issues decided by the court and provides important insights for practitioners.

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ARTICLE: Overview

In *Metropolitan Life Insurance Co. v. The Guardian Life Insurance Co. of America* (hereinafter "*MetLife*"), the district court for the northern district of Illinois rejected a broad interpretation of the "hot potato doctrine" relating to motions to disqualify opposing counsel. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the court and provides important insights for practitioners.

Factual Background

In February 2009 defendant sought to retain the law firm of Winston & Strawn, LLP (hereinafter "law firm") to represent it in a lawsuit against plaintiff. Law firm conducted a conflicts check and determined that its representation of plaintiff, although not formally terminated, had been completed. The law firm further concluded that it could formally terminate its relationship with plaintiff and thereupon commence representation of defendant without a conflict of interest. It nonetheless sought a waiver from plaintiff to represent defendant and plaintiff refused the request. The law firm then sent an e-mail to plaintiff confirming that it was not working on any active matters for it and shortly thereafter terminated the relationship with plaintiff. Plaintiff promptly moved to disqualify law firm from representing defendant against it. *MetLife*, at *1-5.

Pertinent Legal Question

(1) Under what circumstances, if any, may an attorney represent a more lucrative client in a case against a less lucrative client, which the attorney dropped like a "hot potato" when the more lucrative client came along?

(2) How does the "hot potato doctrine" relate to the elements of a motion to disqualify opposing counsel?

The Opinion

Preliminarily, the court found that as a matter of fact the law firm did have an ongoing attorney-client relationship with plaintiff when it was approached by defendant. The court reasoned that while "[t]hose projects may have been isolated and discrete they were never formally terminated, until [defendant] entered the picture." *Id.* at *9. Because the relationship was never formally terminated, plaintiff could have reasonably considered itself a current client of law firm. *Id.* at *10.

(1) Holding that the "hot potato doctrine" generally bars an attorney from representing a more lucrative client in a case against a less lucrative client, which the attorney dropped like a "hot potato" when the more lucrative client came along, the court, nonetheless, refused to apply the doctrine automatically. *Id.* at *8 (citations omitted). Noting that "courts should not be overly eager to substitute a clever phrase for thorough legal analysis," *id.* at *14, the court held that the "hot potato doctrine" does not apply in those instances in which a lawyer's representation of the less lucrative client is "sporadic, non-litigious and unrelated to the issues involved in the newer case." *Id.* at *13-4.

(2) A motion to disqualify counsel must meet a two-step test. First, the plaintiff must show that an ethical violation has occurred; and second, the plaintiff must demonstrate that disqualification is the appropriate remedy. *Id.* at *6. While the "bars an attorney from representing" language of the "hot potato doctrine" seems to collapse the two steps by mandating disqualification where a conflict of interest takes place, the court explained clearly that the doctrine may only be used to establish an ethical violation (the first step), *id.* at *8, and that following the "hot potato" analysis a plaintiff must still show the appropriateness of disqualification as a remedy (the second step). *Id.* at *14.

Applying these principles the court determined that plaintiff successfully established that law firm committed an ethical violation but failed to show that it would suffer any harm if law firm represented defendant, let alone that disqualification was warranted, and therefore denied plaintiff's motion to disqualify law firm. Specifically, the court found that because law firm never formally terminated its relationship with plaintiff, it violated conflict of interest rule *Local Rule 83.51.7*, which states that "a lawyer shall not represent a client [here, defendant] if the representation of that client will be directly adverse to another client [here, plaintiff]." *Id.* at *6, 10, 14. Turning to the issue of the appropriate remedy, the court noted that the law firm's past representation of plaintiff was wholly unrelated to plaintiff's case against defendant, that law firm did not have access to any confidential information that it could use to the detriment of plaintiff in this case, and that law firm did not forge relationships with any potential witnesses to plaintiff's disadvantage. The court refused to disqualify law firm.

Analysis

The court reached the correct conclusion in the case by refusing to disqualify law firm. It accurately stated that the "hot potato doctrine" should not automatically lead to disqualification, and properly clarified that the doctrine may only be used to show an ethical violation but cannot be used to show the appropriateness of disqualification. Unfortunately, however, the court needlessly confused the doctrine by articulating the "sporadic, non-litigious and unrelated to the issues" exception to the "hot potato doctrine" and by holding that law firm did not drop plaintiff like a hot potato.

A motion to disqualify counsel must meet a two-prong test. Plaintiff must show that: (i) counsel committed an ethical violation, for example, representing a new client notwithstanding a conflict of interest; and (ii) disqualification is the appropriate remedy. *Id.* at *6. The language of the "hot potato doctrine," however, is confusing. Stating that an attorney is "barred" from representing a new client against a dropped client mistakenly suggests that if plaintiff can merely show that it was dropped by an attorney in favor of a more lucrative client, its disqualification motion would be automatically granted. In other words, the "hot potato doctrine" seems to collapse the two-prong test by mandating

disqualification in the event of an ethical violation.

Clarifying the potential confusion, the court correctly held that the "hot potato doctrine" may only be used to prove step (i) the commission of an ethical violation, *id.* at *8 and that in order to prevail a plaintiff must still show step (ii) that disqualification would be the appropriate remedy. *Id.* at *14.

Turning its attention to step one, the court found that the law firm committed an ethical violation by violating Local Rule 83.51.7. Because it never formally terminated its attorney-client relationship with plaintiff, the law firm had a conflict of interest when it began to represent defendant against plaintiff. So far so good, and the court could have moved on to examine step two.

Instead, the court lingered on step one, exploring the "hot potato doctrine" (which was, by-the-way, unnecessary because it already found that law firm committed an ethical violation by violating Local Rule 83.51.7). And while the facts clearly indicate that law firm dropped plaintiff so it could represent defendant in a lawsuit against plaintiff, the court surprisingly held that "it is not clear that the hot potato doctrine' applies". *Id.* at *13. The doctrine did not apply, explained the court, because it does not attach to instances "in which a lawyer's representation [of the dropped client] is sporadic, non-litigious and unrelated to the issues involved in the newer case." *Id.* at *13-4.

Why would the court articulate this "sporadic, non-litigious and unrelated to the issues" exception to the "hot potato doctrine"? The court was likely concerned with crafting a too-broad disqualification standard and wanted to ensure that a dropped client who only had a sporadic, non-litigious relationship with an attorney, unrelated to the issues involved in a newer case, would not be able to disqualify the attorney delaying resolution of the case and imposing costs on its adversary. *Id.* at *15-6 Yet the court's concern was unwarranted. Its own analysis established that even if the "hot potato doctrine" applied, plaintiff would still have to demonstrate the appropriateness of disqualification.

To be clear, the court should have held that the "hot potato doctrine" applies in all instances in which an attorney drops a less lucrative client in favor of a more lucrative client, including instances in which the relationship with the less lucrative client was sporadic, non-litigious and unrelated to the issues involved in the newer case. Applying this straightforward doctrine, the court should have found that the law firm in *MetLife* dropped plaintiff like a hot potato and thus committed an ethical violation. The sporadic, non-litigious and unrelated nature of the relationship, however, would be relevant for analysis of step two. In *MetLife* it should have lent additional support for the court's conclusion that law firm should not be disqualified because plaintiff did not suffer any harm from being dropped.

Conclusion

In *MetLife* the court helpfully clarified the confusing relationship between the two elements of a motion to disqualify counsel and the "hot potato doctrine" by holding that the latter may be used to show the first element (ethical violation) but not the second (disqualification is the appropriate remedy). Unfortunately, the court added to the confusion clouding the "hot potato doctrine" by unnecessarily holding that the doctrine does not apply to "sporadic, non-litigious and unrelated to the issues" attorney-client relationships.

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8 of 15 DOCUMENTS

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Eli Wald on the Use of Credit Cards to Pay for Legal Services

2009 Emerging Issues 4143

Eli Wald on the Use of Credit Cards to Pay for Legal Services, Virginia State Bar Standing Comm. on Legal Ethics, Op. 1848, 2009 Va. Legal Ethics Ops. LEXIS 1 (April 14, 2009)

By Eli Wald

August 19, 2009

SUMMARY: Clients use of credit cards to pay for legal services has become commonplace. This opinion explores whether lawyers may pass along transactional fees charged by credit card companies to clients who are using credit cards to pay legal fees. This Emerging Issues Analysis, written by Professor Eli Wald, a legal ethics expert, summarizes the pertinent legal issues decided by the Committee and provides important insights for practitioners.

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ARTICLE: Overview

Clients' use of credit cards to pay for legal services has become commonplace. In *Legal Ethics Opinion 1848*, the Virginia State Bar Standing Committee on Legal Ethics explored an important aspect of clients' use of credit cards, whether lawyers may pass along transactional fees charged by credit card companies to clients who are using credit cards to pay legal fees. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the Committee and provides important insights for practitioners.

Background

Given the growing prevalence of credit cards as a convenient method of payment, ethics opinions by bar associations across the country generally authorize the use of credit cards for payment of earned legal fees. *See, e.g.*, ABA Formal Ethics Op. 00-419 (2000); Mass. Bar Association Ethics Ops. 78-11 (1978); Colorado Bar Association Formal Ethics Op. 99 (1997); North Carolina State Bar Formal Ethics Op. 97-9 (1998); New Mexico State Bar Association Advisory Op. 2000-1 (2000); California State Bar's Committee on Professionalism and Conduct Formal Op. 2007-172.

The opinions differ, however, with regard to the details of accepting credit card payments. Some consider whether advance fees (retainers) may be paid by credit cards in addition to earned fees. Charging advance fees to a credit card raises two issues. First, some credit card companies require that services be rendered before the charge is submitted,

making it almost impossible to use credit cards for advance fees. *See*, Colorado Bar Association Formal Ethics Op. 99 (1997).

Second, assuming the lawyer's credit card agreement allows for charging advance fees, such a practice triggers a complicated safekeeping property problem per ABA Model Rules of Professional Conduct, R. 1.15. Rule 1.15(a) states, in relevant part, that "A lawyer shall hold property of clients .. in connection with a representation separate from the lawyer's own property." Therefore, unearned retainers must be maintained in a trust account or its equivalent for the benefit of the client generally until the client has been billed and does not dispute the charges. On the other hand, fees paid for services already rendered cannot be left in such a trust account because that constitutes unauthorized commingling of lawyer and client funds. Most opinions resolve the tension by holding that credit card charges for both retainers and earned fees may be initially deposited to a trust account as long as the fees already earned are then immediately withdrawn and transferred to the attorney's operating account. *See*, North Carolina State Bar Formal Ethics Op. 97-9 (1998); Missouri Bar Ethics Op. 20000202 (2000). *See also*, Virginia State Bar Standing Comm. on Legal Ethics, Op. 999 (1987).

Pertinent Legal Question

May a lawyer pass along the transactional or service fees to the client who is using a credit card to pay legal fees?

The Opinion

The Committee held that a lawyer may pass along merchant fees associated with credit card use to the client with disclosure and consent. Specifically, the Committee stated that the lawyer must disclose to the client the amount of the finance charge and that the disclosure must take place prior to the time of honoring the client's credit card and before the client becomes obligated for the lawyer's services. The Committee explained that such disclosure is required because the credit card transaction fees fall within the definition of a "finance charge" under the Truth in Lending Act and the Consumer Credit Protection Act, *15 U.S.C. §1601*, which require disclosure of the terms of the charge.

Analysis

The Committee's holding is reasonable, practical and consistent with the ABA Rules of Professional Conduct. ABA Model Rules of Professional Conduct, R. 1.5(a) mandates that client charges be reasonable, and R. 1.5(b) requires that the basis of a fee "for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation." Most credit card companies charge a finance fee of up to 3%, reasonable per Rule 1.5 which notes in subsection 1.5(a)(3) that reasonableness may be a function of "the fee customarily charged in the locality for similar legal services." By analogy, because the credit card finance charge is set almost uniformly at 3% in all American jurisdictions, it is reasonable and the disclosure requirement specified by the Committee clearly meets the standard specified by R. 1.5(b).

Next, the Committee's disclosure standard is consistent with ABA Model Rules of Professional Conduct, R. 1.0(e), which defines a client's informed consent. Comment 6 to Rule 1.0 notes that "[t]he 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..". Here, disclosure of the amount of the finance charge prior to charging the client ensures that clients will decide whether to use credit cards on an informed basis.

Finally, the Committee's opinion is consistent with the holding of other ethics opinions on the subject, ensuring uniformity and consistency of application across jurisdictions. *See*, Missouri Bar Ethics Op. 20000202 (2000) (authorizing passing along finance charges to clients as long as clients understand the charges in advance and consent to

the extra charges).

Practicing lawyers should note, however, that while the emerging majority opinion among ethics committees is that lawyers may pass along merchant fees associated with credit card use to clients, some lawyers, as a matter of good client relations, may choose not to do so. Moreover, at least one state requires attorneys to absorb finance charges and disallows passing the charges along to clients (although the opinion is somewhat dated and the use of credit cards has significantly increased since it was issued). *See*, State Bar of Michigan Ethics Op. RI-168 (1993).

Moreover, regardless of whether an attorney decides to pass along a credit card charge to a client, lawyers who accept credit cards must take care to preserve their clients' confidentiality, per ABA Model Rules of Professional Conduct, R. 1.6(a). Specifically, an attorney must explain to the client that the use of a credit card entails some disclosure of confidential information. For example, some credit card companies require a description on the charge slip of the reason for the charge. Even if the lawyer merely states "fees and expenses," the fact of the client's representation by the attorney will be disclosed.

Conclusion

Virginia State Bar Standing Comm. on Legal Ethics, Op. 1848 allows lawyers to pass along merchant fees associated with credit card use to clients, as long as the transaction fee was disclosed in advance and the client gave his or her consent. Of course, some attorneys may decide to absorb the charges as a matter of good client relations.

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9 of 15 DOCUMENTS

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Wald on Aiding and Abetting Liability under the Federal Securities Law

2009 Emerging Issues 4146

Eli Wald on Outside Counsels Aiding and Abetting Liability under the Federal Securities Statutes, *In re Refco, Inc.*, Sec. Lit., 609 F. Supp.2d 304 (S.D.N.Y. 2009).

By Eli Wald

August 19, 2009

SUMMARY: In *In re Refco, Inc.* the district court for the Southern District of New York held that secondary actors are not liable for aiding and abetting violations of the federal securities statutes. This Emerging Issues Analysis, written by Professor Eli Wald, a legal ethics expert, summarizes the pertinent legal issues decided by the court and provides important insights for practitioners.

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ARTICLE: Overview

In *In re Refco, Inc., Sec. Lit.* (hereinafter *In re Refco*), the district court for the Southern District of New York followed the U.S. Supreme Court precedents in *Central Bank* and *Stoneridge* and held that secondary actors are not liable for aiding and abetting violations of the federal securities statutes. While following the law, the court suggested that Congress revisit its policy decision to excuse all secondary actors from aiding and abetting liability. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the court and provides important insights for practitioners.

Factual Background

Refco Inc. was one of the world's largest providers of credit in the international derivatives, currency and futures markets. Rather than writing off a significant number of bad loans, Refco allegedly devised a scheme to conceal its losses from the public: Refco created a shell holding company called Refco Group Holdings, Inc. (RGHI) to which it transferred the bad loans thus hiding its losses as loans to RGHI. Next, to avoid the disclosure of these large related-party transactions (with RGHI), it orchestrated a set of fictitious transactions to make RGHI's debt disappear just before reporting deadlines. This was accomplished by having a Refco subsidiary, Refco Markets Ltd. (RCM), loan hundreds of millions of dollars to third-party customers who then, through their accounts at Refco, simultaneously loaned the same amount to RGHI. The customers profited from their participation in the loans through interest earned on their loans to RGHI, which, by design, exceeded the interest they were charged by RCM. The net effect of these round-trip loans was that at the close of each reporting period instead of revealing its losses, Refco's books showed

loans to third-party customers while in essence the transactions enabled Refco to lend money to itself. *In re Refco*, at 306-307.

While successfully concealing its losses, Refco issued **600 million in bonds (LBO) and 670 million in shares (IPO)** to the public, in conjunction with which it filed with the Securities and Exchange Commission (SEC) materially false and misleading documents. *Id.* at 307-309. The LBO and IPO yielded tens of millions of dollars in cash payouts to certain Refco insiders. Shortly after the LBO and IPO were concluded Refco announced it had discovered the RGHI debt. A week later it filed for bankruptcy protection and collapsed, causing LBO and IPO investors to lose millions of dollars. *Id.*

From 1994 throughout the period of the round-trip loans and until its collapse, Mayer Brown (Law Firm) was Refco's outside counsel. The Law Firm provided Refco with a broad range of legal services and was familiar with Refco's operations and finances. In particular, Law Firm allegedly participated and facilitated the round-trip loans, *id.* at 307-308, and drafted portions of the LBO and IPO documents filed with the SEC. *Id.* at 308-309.

Pertinent Legal Question

Can plaintiff-investors hold Refco's outside counsel liable for their injury pursuant to the federal securities statutes?

The Opinion

Plaintiffs alleged that Law Firm should be primarily liable for Refco's statements in conjunction with its LBO and IPO because Law Firm knew, or was reckless in not discovering, that Refco's statements were false and materially misleading under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b). *In re Refco*, at 309.

Stating the relevant legal principles, the court began its analysis with *Central Bank of Denver v. First Interstate Bank of Denver*, 114 Sup. Ct. 1439 (1994), which held that Section 10(b) imposes liability only on a person who makes a material misrepresentation or omission, and, importantly, that there is no liability for aiding and abetting under the federal securities statutes. *Id.* at 311. Quoting *Shapiro v. Cantor*, 123 F.3d 717 (2nd Cir. 1997), the court explained that [i]f *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting *no matter how substantial that aid may be...* *In re Refco*, at 311-312 (internal citation omitted). Finally, Following *Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147, 153 (2nd Cir. 2007), the court noted that to rise to the required level of a primary violation, a secondary actor must not only make a material misstatement or omission, but rather the misrepresentation must be attributed to the specific actor at the time of public dissemination.

Based on these governing principles of law, the court framed the pertinent issue as follows: the decisive question is whether the allegations against [Law Firm] are sufficient to show that [it] made' the alleged material misstatements and omissions such that plaintiffs relied on the [Law Firm's] misrepresentation, as opposed to relying only on Refco's misstatements. *In re Refco*, at 312. The court found that plaintiffs could not make such a showing. It explained that in the LBO and IPO statements Law Firm was mentioned only once, identified as Refco's outside counsel. *Id.* Applying *Lattanzio*, the court reasoned that at no point did the documents attribute any of their contents to Law Firm. To the contrary, the documents attributed their content to Refco's management. *Id.*

The court further rejected plaintiffs' assertion that the scope and extent of Law Firm's involvement in the drafting process of the LBO and IPO documents provided a sufficient basis for attributing the false statements therein to Law Firm. *Id.* at 313. Even if [Law Firm] played a substantial role in drafting the statements at issue, explained the court, plaintiffs have offered no reason why the [Law Firm] status as counsel for Refco would be understood by investors as an endorsement of the accuracy of Refco's assertions about its financial condition. *Id.* at 313-314. Pursuant to *Central Bank* and *Lattanzio*, a secondary actor, concluded the court, cannot incur primary liability for a statement not attributed to it. Accordingly, Law Firm was not liable for the allegedly misleading statements contained in Refco's LBO and IPO

documents.

Finally, the court also rejected plaintiffs' claim that Law Firm designed and implemented Refco's sham transactions pursuant to subsection (a) and (c) of Rule 10b-5. 17 C.F.R. §240.10b-5(a), (c). Citing *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 Sup. Ct. 761, 769 (2008), which held that [t]he conduct of the secondary actor must satisfy each of the elements [of §10(b)] for liability, the court found that [h]ere, there is no dispute that plaintiffs had no knowledge of [Law Firm's] conduct that facilitated [Refco's] fraudulent transactions. *In re Refco*, at 315. Consequently, plaintiffs' could not have relied on Law Firm's conduct. The court concluded that Plaintiffs' allegations if proven true, are adequate to establish liability for aiding and abetting securities fraud, but are not enough to establish civil liability as a *primary* actor, as required by *Central Bank* and *Stoneridge*. *Id.* at 316 (emphasis in the original).

The court granted Law Firm's motion to dismiss.

Analysis

The critical holding of *Central Bank* and *Stoneridge* is that the federal securities statutes do not give rise to an aiding and abetting private cause of action. In other words, liability to investors pursuant to Rule 10b-5 does not extend to those who merely aid and abet violations by primary actors.

In re Refco tested the court's resolve in applying *Central Bank* and *Stoneridge*. The facts of *In re Refco* seemed quite extreme: for years Law Firm earned approximately 5 million per annum in legal fees representing Refco, *id.* at 307, represented Refco throughout its execution of the fraudulent round-trip loans, as well as its LBO and IPO transactions, and, in particular, according to plaintiffs, negotiated and facilitated the loans and drafted portions of the LBO and IPO documents. Plaintiffs may have hoped that given the extreme nature of the facts, the court will find an exception to *Central Bank* and *Stoneridge*, and extend them a remedy in order to punish Law Firm. *See, Eli Wald on Judicial Disqualification under the Due Process Clause of the Fourteenth Amendment, Caperton v. A. T. Massey Coal Co., Inc., et al* (explaining that the Court justified its finding for plaintiffs in part given the extreme nature of the facts alleged). 2009 *Emerging Issues* 3984.

The court, however, strictly and narrowly applied *Central Bank* and *Stoneridge* holding that a secondary actor such as Law Firm is not liable for aiding and abetting under the federal securities statutes. The court noted that while Law Firm or its partner in charge of the Refco account may be liable criminally, *id.* at 316, and may be subject to discipline for violating the relevant rules of professional conduct, *id.* at 317, it is nonetheless not civilly liable under the federal securities statutes because the statutes do not give rise to aiding and abetting liability and the Law Firm's conduct did not trigger primary liability because the statements in question could not be attributed to it.

In a footnote the court did offer the following *dicta*, worth quoting in full:

It is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud. However, as the Court noted in *Stoneridge*, the fact that the plaintiffs-investors have no claim is the result of a policy choice by Congress. In 1995, in reaction to the Supreme Court's decision in *Central Bank*, Congress authorized the SEC but not private parties to bring enforcement actions against those who knowingly provide [] substantial assistance to another person in violation of the federal securities laws. *This choice may be ripe for legislative re-examination.* While the impulse to protect professionals and other marginal actors who may too easily be drawn into securities litigation may well be sound, a bright line between principals and accomplices may not be appropriate. There are accomplices and there are accomplices (emphasis added, internal citations omitted).

In re Refco, at 318, fn. 15.

The court's holding is correct and its *dicta* compelling. *Central Bank* and *Stoneridge* clearly stand for the proposition that the federal securities statutes do not give rise to an aiding and abetting private cause of action against

secondary actors. The court was therefore justified in dismissing plaintiffs' lawsuit against Law Firm.

However, *In re Refco* suggests that the bright-line rule adopted by *Central Bank* and *Stoneridge* excuses secondary actors such as Law Firm to an undesirable extent. Congress should consider revising the securities statutes and hold secondary actors liable for aiding and abetting at least in narrow circumstances such as *In re Refco* where Law Firm allegedly had knowledge of the fraudulent conduct of its client and it nonetheless facilitated its fraud by both helping the client hide its losses from the public in a series of fraudulent round-trip loans and subsequently by assisting it to file materially misleading LBO and IPO statement with the SEC. In addition, the practitioner would be wise to heed the important qualification that while civil liability may not attach to aiding and abetting violations of the federal securities statutes, the ramifications for accomplice liability under criminal statutes and codes of professional conduct likely will apply. The ruling does not therefore give a law firm *carte blanche* to aid and abet misrepresentations and fraud in the course of securities representation.

Conclusion

In *In re Refco* the court applied *Central Bank* and *Stoneridge* correctly and dismissed a lawsuit against a law firm for aiding and abetting violations of the federal securities statutes on the ground that the statutes do not give rise to a private cause of action against secondary actors, law firms included, for aiding and abetting. The circumstances of the case suggest that Congress ought to reexamine revising the statutes and consider holding secondary actors liable for aiding and abetting at least in extreme and narrow circumstances.

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10 of 15 DOCUMENTS

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Wald on Assignability of Malpractice Lawsuits, Taylor v. Babin

2009 Emerging Issues 4141

Eli Wald on Assignability of Malpractice Lawsuits, Taylor v. Babin, 2009 La. App. LEXIS 724 (2009)

By Eli Wald

August 19, 2009

SUMMARY: In *Taylor v. Babin*, the Louisiana Court of Appeals held that assignability of malpractice lawsuits contradicted public policy considerations. This Emerging Issues Analysis, written by Professor Eli Wald, a legal ethics expert, summarizes the pertinent legal issues decided by the court and provides important insights for practitioners.

PDF LINK: [Click here for enhanced PDF of this Emerging Issues Analysis at no additional charge](#)

ARTICLE: Overview

In *Taylor v. Babin* (hereinafter *Taylor*), the Louisiana Court of Appeals held that assignability of malpractice lawsuits contradicted public policy considerations. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the court and provides important insights for practitioners.

Factual Background

Plaintiffs Taylor and Ledet were seriously injured in an accident as passengers in a motorboat operated by Foret. Foret did not have liability insurance and following civil lawsuits by plaintiffs, Foret filed for bankruptcy. After the bankruptcy court entered a consent order declaring Foret's alleged debt to plaintiffs non-dischargeable, Foret discovered that his lawyers committed malpractice. Apparently, because the trial court ruled that Feret was negligent but did not operate the motorboat in a wanton or reckless manner, plaintiffs' claims were dischargeable pursuant to the relevant bankruptcy law provisions. Feret assigned his legal malpractice claims to plaintiffs, and plaintiffs commenced a malpractice action against defendants. *Taylor*, at *2-4.

The trial court dismissed the malpractice claim with prejudice, accepting defendants' argument that assignability of malpractice lawsuits contradicts public policy considerations and therefore plaintiffs had no right of action against the lawyer-defendants. Plaintiffs appealed.

Does Louisiana law permit the assignability of malpractice lawsuits?

The Opinion

Noting that the issue of the assignability of legal malpractice claims was *res nova* in Louisiana, *Taylor*, at *5, the court looked to sister states for persuasive authority and found that "most courts have determined that it is a simpler task -- or a better approach -- to simply resolve this issue from a public policy perspective." *Id.* at *8-9.

Nonetheless, the court first turned its attention to Louisiana's state law and held that the obligation of an attorney to his client is personal, and since personal obligations in general may not be assigned pursuant to Louisiana law, *La. C.C. art. 2642*, a legal malpractice action is not subject to assignment. *Id.* at *9 (citations omitted).

The court then turned to analyzing public policy considerations, raising seven inter-related arguments in support of its conclusion that assignment of malpractice lawsuits contradicts public policy. First, the court determined that the attorney-client relationship is a "fiduciary relationship of the very highest character," *id.*, and that this unique character requires that the relationship be "jealously guarded and restricted to only the parties involved." *Id.* at *10. Consequently, because the special relationship between attorney and client deserves unusual and exclusive protections which apply only to the parties -- the lawyer and the client -- these protections, and arguably the right to sue in malpractice for the breach of these protections, cannot be assigned by the client to another party. The court cited at length from *Goodley v. Wank & Wank, Inc.*, 62 Cal. App. 3d 389, 397-98 (Cal. App. 2 Dist. 1976):

It is the unique quality of legal services, the personal nature of the attorney's duty to the client and the confidentiality of the attorney-client relationship that invoke public policy considerations in our conclusion that malpractice claims should not be subject to assignment. The assignment of such claims could relegate the legal malpractice action to the market place and convert it to a commodity to be exploited .. The commercial aspect of assignability .. is rife with probabilities that could only debase the legal profession ..

Second, not only would assignability of malpractice lawsuits compromise the special attorney-client relationship, it would also both overburden the judiciary because of increased litigation and restrict the availability of competent lawyers, who presumably would be inhibited from representing clients for fear of increased exposure to malpractice actions. *Taylor*, at *9-10. Once again, the court cited *Goodley* approvingly:

The almost certain end result of merchandizing such causes of action is .. [to] encourage unjustified lawsuits against members of the legal profession, generate an increase in legal malpractice litigation, promote champerty and force attorneys to defend themselves against strangers .. [Assignability] would place an undue burden on not only the legal profession but the already overburdened judicial system, restrict the availability of competent legal services, embarrass the attorney-client relationship and imperil the sanctity of the highly confidential and fiduciary relationship existing between attorney and client.

Third, the court found that assignment of malpractice lawsuits amounts to a "transparent device to replace a judgment-proof, uninsured defendant with a solvent defendant," *Taylor*, at *11 (citing *Zuniga v. Groce, Locke & Hebdon*, 878 S.W.2d 313, 317-318 (Tex. App. 1994)), by allowing the defendant-client (here Feret) to escape liability at the expense of his lawyer. Such a device, reasoned the court, would exact high costs. It would drive a wedge between defense-attorneys and clients, and it would become increasingly risky for lawyers to represent the underinsured, judgment-proof clients. *Id.* Fourth, the court argued that as the result of such heightened risk, assignment of malpractice lawsuits would make lawyers reluctant to represent defendants with inadequate insurance and assets, because such representations might ultimately make lawyers the most attractive target in the lawsuit. *Id.* at *11.

Fifth, the court cited the risk of collusion between client-assignor and plaintiff-assignee as reason to disallow assignment of malpractice claims. The court reasoned that a client might confess liability and agree to pay excessive damages only to then turn around and assign a malpractice cause of action to the plaintiff against his attorney who "advised" him to confess and concede liability. *Id.* Next, the court acknowledged the self-interest of the legal profession in disallowing assignment of malpractice claims holding that such an assignment "would cause a reversal of the positions taken by each set of lawyers and clients, which would embarrass and demean the legal profession." *Id.* at *11 (citation omitted).

Finally, the court dismissed without an explanation two opinions allowing assignability of malpractice actions, *Thurston v. Continental Casualty Company*, 567 A.2d 922, 923 (Me. 1989), in which the court allowed assignment because the assignee had an intimate connection with the underlying lawsuit, and *Hedlund Manufacturing Company, Inc. v. Weiser, Stapler & Spivak*, 539 A.2d 357, 359 (Pa. 1988), which held that "[w]e will not allow the concept of the attorney-client relationship to be used as a shield by an attorney to protect him or her from the consequences of legal malpractice."

Concluding that assignment of malpractice lawsuits contradicts public policy the court affirmed the dismissal. n1

Analysis

The court's reasoning for finding assignability of malpractice actions contrary to public policy is unconvincing. To begin with, as suggested by the *Hedlund Manufacturing Company, Inc. v. Weiser, Stapler & Spivak* court, to allow lawyers to use the sanctity of the attorney-client relationship as a shield against clients is to misunderstand the nature of the relationship. The attorney-client relationship is indeed a special fiduciary relationship in which the agent-lawyer serves the interests of a principal-client. The special protections afforded to it, such as confidentiality, belong, importantly, to the principal-client, not the agent-lawyer. The client is therefore free to waive these special protections if she wishes to do so. Disallowing assignability, however, protects the lawyer, not the client, and therefore the special nature of the attorney-client relationship with its inherent protections to the client cannot be a reason to prohibit assignments. Furthermore, the client is not assigning a special protection of any sort, merely the right to institute a lawsuit.

Worse, in its zeal to protect lawyers' interests and disguise the effort by purporting to protect clients' interests, the court missed an opportunity to meaningfully explore the actual impact of assignability on clients, some of which may be harmful. For example, the court could have examined the chilling effect assignability might have on trust in the relationship, which in turn could render it less effective, *see, e.g.*, American Bar Association Model Rules of Professional Conduct, Rule 1.6 Comment 2 ("trust .. is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively"); or study the duties of clients to lawyers as a justification for disallowing assignability. *See, e.g.*, David B. Wilkins, *Do Clients Have Ethical Obligations to Lawyers? Some Lessons from the Diversity Wars*, 11 *Geo. J. Legal Ethics* 855 (1998) (exploring the extent and the circumstances under which clients owe lawyers ethical duties).

Next, the court over-stated possible justifications. For example, the court asserted that "The almost certain end result of merchandizing such causes of action is .. [to] encourage unjustified lawsuits against members of the legal profession .." *Taylor*, at *10 (citing *Goodley*). While it is possible that assignability of malpractice claims will lead to some unjustified lawsuits against lawyers, it is certainly not an "almost certain" result, not to mention that assignability might also encourage justified malpractice lawsuits against lawyers which would not be filed without it. Similarly, it is indeed possible that assignability would "generate an increase in legal malpractice litigation," *id.* but such an increase might be desirable to the extent that it results in more meritorious claims being filed. And while collusion between assignor and assignee is clearly undesirable, it would seem that an appropriate remedy might be to punish collusion when it transpires, rather than banning assignability altogether.

Other arguments were left under-explored. What did the court mean by suggesting that assignability "would drive a wedge between defense-attorneys and clients"? *Id.* at *10. If the court meant that assignability would drive a wedge *ex post*, that is, at a time when the client has filed or is contemplating filing a malpractice suit, one could simply assume the attorney-client relationship is already compromised. If, however, the court meant to suggest that assignability would operate *ex ante*, damaging an otherwise solid relationship, because the looming threat of assignment would lead attorneys to act cautiously and tentatively then the argument warrants a discussion, which the court never gets to.

To be sure, the court did address some plausible justifications for prohibiting assignability of malpractice suits. It

does stand to reason, for example, that assignability could make lawyers reluctant to represent defendants with inadequate insurance and assets, fearing that such representations might ultimately make the lawyers the most attractive target in the lawsuit. *Id.* at *11. Decreased access to legal services might result because while without assignability a client with little assets and resources was unlikely to file a malpractice claim, assignability would make the prospect of a malpractice suit more likely. At the end of the day, however, such potentially compelling reasoning is rendered less persuasive by the court's apparent determination to side with the legal profession against assignability in lieu of an objective and comprehensive analysis of the merits of assignability.

Conclusion

In *Taylor* the Louisiana court of appeals held that as a matter of public policy assignment of malpractice lawsuits should be disallowed. While the outcome is not implausible and is, in fact, consistent with the approach taken by a majority of courts deciding the issue, the court's reasoning is less than compelling. In a day and age in which courts increasingly permit assignability of causes of action generally, *see, e.g.*, Michael Abramowicz, *On The Alienability of Legal Claims*, 114 *Yale L.J.* 697 (2005), the court's wholehearted rejection of assignability of malpractice actions disturbingly appears to be motivated by promoting the legal profession's self-interest.

[Return to Text](#)

n1 The court also rejected plaintiffs' alternative arguments: that as obligees they could have initiated this action on their own behalf because the obligor (Feret) increased his insolvency by failing to file the malpractice action, *Taylor*, at *6-7; and that the client later joined the malpractice suit as a plaintiff negating the assignment. *Id.* at *13-16. The court held respectively that Feret did not increase his insolvency by failing to file a legal malpractice claim because he could have lost the suit, *id.* at *7-8, and that since the original plaintiffs (Taylor and Ledet) did not have a viable cause of action against Feret's lawyers, they could not amend the complaint to add a new party -- Feret. *Id.* at *15-16.

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11 of 15 DOCUMENTS

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Eli Wald on Caperton v. A. T. Massey Coal Co., Inc., et al (2009)

2009 Emerging Issues 3984

Eli Wald on Judicial Disqualification under the Due Process Clause of the Fourteenth Amendment, *Caperton v. A. T. Massey Coal Co., Inc., et al*, 2009 U.S. LEXIS 4157, 129 S. Ct. 2252 (2009).

By Eli Wald

July 7, 2009

SUMMARY: In *Caperton v. A. T. Massey Coal Co., Inc.*, the U.S. Supreme Court explored whether a justice who received extraordinary campaign contributions from the board chairman and principal officer of appellant corporation violated the Due Process Clause of the Fourteenth Amendment when he denied a recusal motion. This Emerging Issues Analysis, written by Professor Eli Wald, summarizes the pertinent legal issues decided by the Court.

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ARTICLE: *Eli Wald on Judicial Disqualification under the Due Process Clause of the Fourteenth Amendment, Caperton v. A. T. Massey Coal Co., Inc., et al, 2009 U.S. LEXIS 4157, 129 S. Ct. 2252 (2009).*

Overview

In *Caperton v. A. T. Massey Coal Co., Inc., et al* (hereinafter *Caperton*), the U.S. Supreme Court explored whether a justice who received extraordinary campaign contributions from the board chairman and principal officer of appellant corporation violated the Due Process Clause of the Fourteenth Amendment when he denied a recusal motion. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the Court.

Factual Background

A West Virginia trial jury awarded petitioner a \$50 million judgment. After the verdict but before the appeal, West Virginia held its judicial elections. Knowing the court of appeals will consider the appeal, Don Blankenship, respondent's chairman, chief executive officer and president, supported attorney Benjamin in his quest to replace a sitting justice seeking reelection. Blankenship donated almost \$2.5 million to a political organization which supported Benjamin and spent another \$500,000 in direct support of Benjamin's candidacy, who won the election. *Caperton*, at *6.

The court of appeals reversed the \$50 million verdict against respondent, granted petitioner's rehearing motion and reversed the jury verdict a second time. On three different occasions Justice Benjamin denied petitioner's motion to

disqualify him based on the conflict caused by Blankenship's campaign involvement. The U.S. Supreme Court granted certiorari. *Id.* at *7-8.

Pertinent Legal Question

Whether and under what circumstances the Due Process Clause of the Fourteenth Amendment warrants judicial disqualification.

The Majority Opinion

The Due Process Disqualification Standard

The Court began its analysis by noting that while a fair trial is a basic requirement of due process, "most matters relating to judicial disqualifications [do] not rise to a constitutional level." *Id.* at *8 (internal citation omitted). In *Tumey v. Ohio*, 273 U.S. 510 (1927), the leading case on judicial disqualification pursuant to the Fourteenth Amendment, the Court adopted a narrow disqualification approach. There, the Court stated that "matters of kinship, personal bias, state policy, remoteness of interest, would seem generally to be matters merely of legislative discretion," *id.* at 523, rather than of constitutional interpretation. For example, disqualification for personal bias and prejudice was not warranted under the Constitution and was left to statutes and judicial codes. *See, Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813, 830 (1986). Consistent with this narrow approach, in *Tumey* the Court incorporated the common-law rule that a judge must recuse himself only when he has "a direct, personal, substantial, pecuniary interest" in a case. *Id.* at 523. Yet, as new problems not discussed at common law arose, the Court recognized circumstances "in which experience teaches that the probability of actual bias on the part of the judge .. is too high to be considered constitutionally tolerable." *Withrow v. Larkin*, 421 U.S. 35, 47 (1975).

The Court reviewed two instances of such intolerable probability of actual bias where it previously held that recusal was required.

First, in *Tumey*, a case involving a judge who had a direct pecuniary interest in the outcome of a case, the Court articulated the following controlling principle:

Every procedure which would offer a possible temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which might lead him not to hold the balance nice, clear and true between the State and the accused, denies the latter due process of law. *Id.* at 532.

While *Tumey* itself could have been construed narrowly to merely follow the common-law rule of disqualification because the judge had a direct financial interest in case, subsequent decisions further explored the notions of "probability of bias" and a "possible temptation." In *Gibson v. Berryhill*, 411 U.S. 564, 579 (1973) the Court reasoned that "the [judge's] financial stake need not be as direct or positive as it appeared in *Tumey*," and in *Ward v. Monroeville*, 409 U.S. 57, 60 (1972) the Court reasoned that "[t]he fact that the [judge in *Tumey*] shared directly in the fees and costs did not define the limits of the principle," rather the principle turned on "possible temptation" the judge may face. Finally, in *Lavoie* the Court quoted *Monroeville* and explained that "what degree or kind of interest is sufficient to disqualify a judge from sitting 'cannot be defined with precision.'" *Lavoie, supra*, at 822.

The *Caperton* Court summarized *Tumey* and its progeny as follows: In the context of financial interest the constitutional standard for disqualification is an objective standard of intolerable probability of actual bias, meaning "possible temptation to the average .. judge to .. lead him not to hold the balance nice, clear and true." *Caperton*, at *8-9.

Second, *In re Murchison*, 349 U.S. 133 (1955) dealt with a judge who participated in an earlier proceeding involving the defendant. The Court reiterated that the disqualification criteria "cannot be defined with precision. Circumstances and relationships must be considered," *id.* at 136, and that the inquiry is an objective one. Citing the

judge's prior relationship with the defendant and concerned with information acquired from the prior proceeding, the Court found that there was an unconstitutional "potential for bias" and disqualified the judge.

The Court then turned to the facts of *Caperton* to explore the meaning of the intolerable probability of actual bias standard in the context of judicial elections. It held that while "[n]ot every campaign contribution by a litigant or attorney creates a probability of bias that requires a judge's recusal .. a serious risk of actual bias .. [exists] when a person with a personal stake in a particular case had a significant and disproportionate influence in placing the judge on the case by raising funds .. when the case was pending or imminent." *Caperton*, at *11. The Court added that "[t]he inquiry centers on the contribution's relative size in comparison to the total amount of money contributed to the campaign, the total amount spent in the election, and the apparent effect such contribution had on the outcome of the election." *Id.*

Mindful of having just enumerated a new instance of the "intolerable probability of actual bias" standard, the Court attempted to narrow the scope of its decision. "Our decision today addresses an extraordinary situation where the Constitution requires recusal," *id.* at *12 the Majority explained. Quoting *Lavoie*, the Court concluded: "The Due Process Clause demands only the outer boundaries of judicial disqualifications. Congress and the states, of course, remain free to impose more rigorous standards for judicial disqualification .. Application of the constitutional standard implicated in this case will thus be confined to rare instances." *Id.* at *14.

Application

Notwithstanding its proclamation that the newly construed standard will pertain to only rare circumstance, applying its principle, the Court found that Blankenship's campaign efforts had a significant and disproportionate influence in placing Justice Benjamin on the case. The Court noted that Blankenship contributed some \$3 million in support of Benjamin, a sum which exceeded the total amount spent by all other Benjamin supporters. Furthermore, the Court stressed the temporal relationship between the campaign contribution, the justice's election, and the pendency of the case -- when the contribution was made it was reasonably foreseeable that the pending case would be before the newly elected justice. *Id.* at *11-12. The Court ordered Benjamin be recused.

The Minority Opinion

The minority wholeheartedly rejected the majority's interpretation of the Court's Due Process disqualification precedents. The Court, argued Chief Justice Roberts, has never acknowledged a "probability of bias" open-ended standard. In particular, in *Tumey* and *In re Murchison* the Court did not specify two examples of this broad standard. Rather, it merely recognized two situations in which the Due Process Clause required disqualification: when the judge has a pecuniary interest in the outcome of the case, and when the judge is trying a defendant for certain criminal contempt. *Id.* at * 14. Subject to these two well-established and narrow exceptions, concluded the minority, "questions of judicial recusal are regulated by 'common law, statute, or the professional standards of the bench and the bar.'" *Id.* at *15. Even if a prudent judge would have recused himself, concluded the minority, the Due Process Clause affords petitioner no remedy in this instance.

Justice Scalia, joining in the dissent, added eloquently in a filed dissenting opinion: "[t]he Court today continues its quixotic quest to right all wrongs and repair all imperfection through the Constitution." *Id.* at *20.

Analysis

Caperton entails more than a simple dispute over whether and under what circumstances the Due Process Clause warrants disqualification of an elected judge receiving campaign contributions. In fact, the majority and minority disagreed with regard to the following three principled issues.

First, the Justices considered whether the Court's precedents establish an open-ended standard with regard to judicial disqualification under the Due Process Clause, or merely recognized two narrow situations warranting

disqualification. Whereas the minority took the latter approach, the majority adopted the "intolerable probability of actual bias" and added a campaign contribution example to the existing pecuniary interest and criminal contempt precedents. To the minority's query, "[a]t the most basic level, it is unclear whether the new probability of bias standard is somehow limited to financial support in judicial elections, or applies to judicial recusal questions more generally," *id.* at *15, the majority would likely answer that its open-ended standard generally applies to all judicial recusal questions.

Second, the Justices considered whether open-ended standards in general are an appropriate and desirable approach to be utilized in judicial decision-making. While the majority did not shy away from adopting a broad "intolerable probability of actual bias" standard, the minority went to great lengths to demonstrate the open-endedness of the standard adopted by the Court. Chief Justice Roberts articulated no less than 40 questions that he felt were left open by the majority's adopted standard, *id.* at *16-18, and concluded that "[t]he Court's inability to formulate a 'judicially discernible and manageable standard' strongly counsels against the recognition of a novel constitutional right." *Id.* at *18 (citation omitted). For example, Chief Justice Roberts wondered:

8. What if the "disproportionately" large expenditure is made by an industry association, trade union, physician's group, or the plaintiffs' bar? Must the judge recuse in all cases that affect the association's interests? Must the judge recuse in all cases in which a party or a lawyer is a member of that group? Does it matter how much the litigant contributed to the association?

29. When do we impute a probability of bias from one party to another? Does a contribution from a corporation get imputed to its executives, and vice-versa? Does a contribution or expenditure by one family member get imputed to other family members?

Id. at *16-17.

The Chief Justice's probing questions do illustrate convincingly that standards, as opposed to bright-line rules, are open-ended. Yet the Court may choose to address such questions in future decisions or allow lower courts to apply the standard as needed. For instance, the Court may (borrowing from its corporate law jurisprudence) respect the separate legal entity of industry associations, trade unions, groups, corporations and family members making campaign contributions (just as the separate legal entity of a corporation is distinguished from that of its various constituencies) and therefore find recusal unwarranted (replying to questions 8 and 29 above), subject to the "alter ego" and domination exceptions (the usual reasons to "pierce the corporate veil" and refuse to acknowledge the separate legal identity of a corporation). The point, to be clear, is that the disagreement between the justices is not merely with regards to whether judicial disqualifications should be decided by a standard or a rule, but rather whether in general the Court ought to articulate open-ended standards or bright-line rules.

Third, the Court considered whether extreme cases make good law. All justices agreed that "[t]he facts now before us are extreme by any measure." *Id.* at *13. While the majority conceded that "[i]t is true that extreme cases often test the bounds of established legal principles, and sometimes no administrative standard may be available to address the perceived wrong," *id.* it nonetheless argued that "it is also true that extreme cases are more likely to cross constitutional limits, requiring the Court's intervention." *Id.* The minority retorted that "[t]here is a cost to yielding to the desire to correct the extreme case .. it is captured in a legal aphorism 'Hard cases make bad law.'" *Id.* at *18.

In addition, the justices strongly disagreed regarding whether the facts of *Caperton* warranted Benjamin's disqualification. While the majority found Blankenship's \$3 million contribution had a significant and disproportionate influence in placing Justice Benjamin on the case, the minority disagreed. Of course, since it rejected the adoption of the "intolerable probability of actual bias" standard, the minority did not need to reach this factual analysis. Nonetheless it found that because Justice Benjamin and his campaign committee had no control over how the money was spent, *id.* at *19, the \$500,000 in direct support did not appear "grossly disproportionate" compared to other such expenditures in the election. *Id.* Blankenship has made large expenditures in previous West Virginia elections, and because it was far from clear that the contributions affected the outcome of the election, *id.*, the minority believed the disqualification of Justice

Benjamin was unwarranted.

Conclusion

Understanding that the facts of this case are on the extreme end of the scale, attorneys appearing before elected judges should nonetheless be aware of the availability of a *Caperton* motion to disqualify a judge based on the "intolerable probability of actual bias" standard. While "[n]ot every campaign contribution by a litigant .. creates a probability of bias that requires a judge's recusal," *Id.* at *11, a disqualification motion will succeed where the following elements hold: (1) a person with a (2) personal stake (3) in a particular case (4) had a significant and disproportionate influence (5) in placing the judge on the case (6) by raising funds. *Id.*

The Due Process Clause does afford protection for litigants where there exists an intolerable probability of actual bias, even if under only the most extreme facts. Whether the decision in *Caperton* will result in more judicial recusals, or is limited solely to the facts, remains to be seen. Clearly, the majority's opinion opens the door to more judicial recusal motions both in the context of campaign contributions and more generally arguing new applications of the intolerable probability of actual bias standard.

RELATED LINKS: See Professor Eli Wald's Emerging Issues Analysis accompanying *Caperton v. A. T. Massey Coal Co., Inc., et al*, at
■ 2009 U.S. LEXIS 4157 (2009)

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12 of 15 DOCUMENTS

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Wechsler on The New York Rules of Professional Conduct

2009 Emerging Issues 3557

Wechsler on The New York Rules of Professional Conduct

By Prof. Steven Wechsler

April 27, 2009

SUMMARY: This Emerging Issues Analysis by Prof. Stephen Wechsler summarizes the most significant changes wrought by the new Rules of Professional Conduct, effective April 1, 2009, and alerts New York practitioners to significant potential practice pitfalls and ethical dilemmas.

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ARTICLE: I. Introduction: New York Court Adopts Part 1200: Rules of Professional Conduct, Effective April 1, 2009

On December 16, 2009, the Administrative Board of the Courts announced the adoption of Part 1200, Rules of Professional Conduct. Taking effect April 1, 2009, these supersede the existing Part 1200, Disciplinary Rules of the Code of Professional Responsibility. Without doubt, this is the biggest, most fundamental change in the entire history of regulation of lawyers in New York State. New York lawyers must quickly learn and adapt to the new Rules. This will be especially difficult for lawyers admitted to the Bar prior to 1982; those who came later have had to take the Multistate Professional Responsibility Exam and thus have learned at least the structure of the Rules.

The difficulty in adapting to the new Rules is compounded by the way in which the Appellate Division adopted them. The new Rules first appeared just two weeks before the end of 2008. In contrast to its earlier practice in connection with the adoption of new advertising rules in 2007, in this case the Appellate Division did not provide for any discussion or comment period. Thus, there was only a short time for study before the Rules went into effect on April 1, 2009.

In addition, the Appellate Division rejected large parts of the work that had been done by the New York State Bar Association in its efforts to change to the Rules. That project, which ran over five years, had produced a large body of commentary and explanation. The Appellate Division ignored much of this, but did not provide any comparable tools for the Bar to use in adapting to the new Rules. Obviously no one wants to make a disciplinary blunder. On the other hand, the new Rules (and their Comments) give lawyers guidance on handling practical situations and problems that routinely arise in practice. In many cases, the guidance is clearer and more helpful than that which was provided by the Disciplinary Rules.

This article is intended to assist New York lawyers in understanding and complying with the new Rules. After a very brief description of the history of lawyer regulation in New York, the article will point out the most important changes and those that are most likely to be of concern to practicing lawyers. No attempt has been made to capture every change, but the hope is that this will get lawyers started on looking at the new Rules on their own. To that end, before going further, please be sure to have downloaded a copy of the new Rules at:

http://www.nysba.org/Content/NavigationMenu/ForAttorneys/ProfessionalStandardsforAttorneys/Professional_Standar.htm

A useful cross reference table correlating the new Rules with the Code can be found at:

<http://www.nysba.org/Content/NavigationMenu/ForAttorneys/ProfessionalStandardsforAttorneys/CorrelationtableofnewNYrules.pdf>

II. A Brief History of Lawyer Regulation in New York

The American Bar Association and state bar associations have been the principal supporting players in the evolution of the rules governing lawyer conduct, with the state courts having the final say. The New York State Bar Association adopted the ABA's original Canons of Ethics in 1909; the Code of Professional Responsibility (which itself was based on the ABA Model Code) was adopted in 1970. In 1983, the ABA superseded the Code with the Model Rules. New York adhered to its version of the Code even as the Model Rules became widely accepted across the country.

In 2003 the New York State Bar Association created the Committee on Standards of Attorney Conduct (COSAC) in its second effort to get New York to join the national trend of adopting the Model Rules (an earlier attempt in 1985 failed to win approval in the House of Delegates). COSAC's five year work plan and product was approved piecemeal by the House of Delegates at a series of meetings, adopted by the Bar Association in 2007 (with Comments and Reporter's Notes), and sent to the Appellate Division for its consideration. In December 2008 the Appellate Division announced the adoption of the new Rules effective April 1, 2009.

With this long-awaited event, New York has finally joined the rest of the country in adopting the Model Rules format. By harmonizing the structure and format of the New York Rules with that used by virtually every other state our ethics jurisprudence (expressed in judicial and bar opinions) will have much more influence on the national stage. At the same time, other states' interpretations will be easier for New York lawyers to find and consider.

III. Introduction to the New York Rules of Professional Conduct

The new Rules are at once very similar to the Code and very different. First, the whole look and feel is different—there has been a complete reorganization and adoption of a different format that follows the ABA Model Rules. Second, although a large portion of the substance of the Code has been carried forward, albeit in a new format, there are some Code sections that have been substantially changed and others that are completely new. Some of the changes are subtle but others are sweeping and drastically alter long-held basic rules.

In adapting to the new Rules, it is helpful to remember that under the previous Code, the Appellate Division adopted only the black letter of the Disciplinary Rules; only the New York State Bar Association adopted the Ethical Considerations, which were described as "aspirational" but were often used in interpreting the Code. With the new Rules, the Appellate Division again adopted only the black letter of the Rules and the New York State Bar Association has adopted lengthy Comments. It is anticipated that the Appellate Division will again decline to adopt the Comments; however, the Comments should be very helpful to lawyers in understanding what the new Rules mean, including portions of the former Code that have been transferred whole into the Rules. The Comments are written in a clear explanatory style, often giving best practices, and are much more detailed, precise and practice-oriented than the EC's.

IV. Organization and Structure of the Rules of Professional Conduct

The new Rules consist of 58 black letter Rules. Unlike the Code, the Rules are arranged in a logical fashion, putting like with like. The roles lawyers play and the tasks they perform are the organizing principles used. The Rules thus fall into nine logical groups as follows: n1

- 1.0: Terminology
- 1.1-1.18: Client-Lawyer Relationship
- 2.1-2.4: Counselor
- 3.1-3.9: Advocate
- Transactions with Persons Other Than Clients
- 5.1-5.7: Law Firms and Associations
- 6.1-6.5: Public Service
- 7.1-7.6: Information About Legal Services
- 8.1-8.5: Maintaining the Integrity of the Profession

V. The New Rules of Professional Conduct-the Most Important Changes

A. Rule 1.0 Definitions

The new Rules have approximately twice as many definitions as the Code had. While they are all important, the following deserve particular attention:

1. 1.0(e) Confirmed in Writing

(e) "Confirmed in writing" denotes (i) a writing from the person to the lawyer confirming that the person has given consent, (ii) a writing that the lawyer promptly transmits to the person confirming the person's oral consent, or (iii) a statement by the person made on the record of any proceeding before a tribunal. If it is not feasible to obtain or transmit the writing at the time the person gives oral consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

This is an important definition because it comes up in two new places: consent to conflicts and consent to fee splitting. The writing needed does not require the client's signature, but should be done at the time of consent or "within a reasonable time thereafter."

2. 1.0(q) Reasonable

(q) "Reasonable" or "reasonably," when used in relation to conduct by a lawyer, denotes the conduct of a reasonably prudent and competent lawyer. When used in the context of conflict of interest determinations, "reasonable lawyer" denotes a lawyer acting from the perspective of a reasonably prudent and competent lawyer who is personally disinterested in commencing or continuing the representation.

In connection with conflicts of interest, a "reasonable lawyer" means "a lawyer acting from the perspective of a reasonably prudent and competent lawyer who is personally disinterested in commencing or continuing the representation." This standard replaces the Code's "disinterested lawyer" test for measuring whether the conflict is consentable; the difference is linguistic only and the test remains substantively the same.

3. 1.0(t) Screened

(t) "Screened" or "screening" 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 or the firm is obligated to protect under these Rules or other law.

This new definition gives substance to the concept of screening to attempt to avoid or mitigate conflicts of interest. It comes up in Rule 1.11 (government lawyers coming into private practice) and new Rule 1.18 (prospective clients) discussed below.

4. 1.0(x) Writing

(x) "Writing" or "written" denotes a tangible or electronic record of a communication or representation, including handwriting, typewriting, printing, photocopying, photography, audio or video recording and email. A "signed" writing includes an electronic sound, symbol or process attached to or logically associated with a writing and executed or adopted by a person with the intent to sign the writing.

This helpful new definition takes account of modern technology. A "writing" includes electronic records and email and may be signed electronically.

B. Rule 1.3 Diligence and Rule 1.4 Communication

These two Rules take obvious best practices and put them directly into the black letter. Lawyers should know that a great many disciplinary complaints stem from the failure to meet the requirements of these Rules. To comply, lawyers must be diligent, act reasonably promptly and must communicate with their clients about the representation.

1. 1.3 Diligence

- (a) A lawyer shall act with reasonable diligence and promptness in representing a client.
- (b) A lawyer shall not neglect a legal matter entrusted to the lawyer.
- (c) A lawyer shall not intentionally fail to carry out a contract of employment entered into with a client for professional services, but the lawyer may withdraw as permitted under these Rules.

2. 1.4 Communication

- (a) A lawyer shall:
 - (1) promptly inform the client of:
 - (i) any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(j), is required by these Rules;
 - (ii) any information required by court rule or other law to be communicated to a client; and
 - (iii) material developments in the matter including settlement or plea offers.
 - (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
 - (3) keep the client reasonably informed about the status of the matter;
 - (4) promptly comply with a client's reasonable requests for information; and
 - (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by these Rules or other law.
- (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

C. Rule 1.5 Fees and Division of Fees

Rule 1.5(b) is similar to the Mandatory Letter of Engagement Rule (22 NYCRR § 1215), but Rule 1.5(b) applies to every new engagement, not just those where the expected fees will be over \$3000. Putting the two together, lawyers must communicate fee arrangements to clients for every engagement, unless it is the "regular representation" of a client on the same basis as earlier representations. Best practices suggest using a writing even if it is not required.

(b) A lawyer shall communicate to a client the scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible. This information shall be communicated to the client before or within a reasonable time after commencement of the representation and shall be in writing where required by statute or court rule. This provision shall not apply when the lawyer will charge a regularly represented client on the same basis or rate and perform services that are of the same general kind as previously rendered to and paid for by the client. Any changes in the scope of the representation or the basis or rate of the fee or expenses shall also be communicated to the client.

Rule 1.5(c) makes a change in the writing required in contingent fee matters. Although lawyers may now advance expenses of litigation without making the client ultimately responsible for them, ⁿ² the Rule makes plain that the lawyer must now disclose in writing if indeed the client will be liable for any expenses if the litigation is not successful.

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. Promptly after a lawyer has been employed in a contingent fee matter, the lawyer shall provide the client with a writing stating the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or, if not prohibited by statute or court rule, after the contingent fee is calculated. The writing must clearly notify the client of any expenses for which the client will be liable regardless of whether the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a writing stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

Rule 1.5(d) takes the familiar prohibition on nonrefundable retainers ⁿ³ and puts it into the black letter of the Rule. Interestingly, while nonrefundable retainers are still prohibited, the Rule explicitly recognizes that a lawyer may charge a reasonable minimum fee. This would seem to permit at least some minimal fee just for opening the file, even if the client then goes elsewhere. To do this, the minimum fee must be explained clearly in plain language.

(d) A lawyer shall not enter into an arrangement for, charge or collect:

(4) a nonrefundable retainer fee; provided that a lawyer may enter into a retainer agreement with a client containing a reasonable minimum fee clause if it defines in plain language and sets forth the circumstances under which such fee may be incurred and how it will be calculated;

Rule 1.5(g)(2) deals with the familiar and important transaction in which one lawyer refers a case to another lawyer and expects to receive part of the fee. In such a case, the referring lawyer might prefer that the client did not know how much the lawyer would receive merely for referring the case. Now, although the rest of the underlying rules are the same, the required disclosure must include the share each lawyer will receive and the client's consent must be confirmed in writing. Since failure to comply with the requirements of the fee splitting rule may interfere with the referring lawyer's right to collect a fee ⁿ⁴ the importance of doing this correctly cannot be overemphasized.

(g) A lawyer shall not divide a fee for legal services with another lawyer who is not associated in the same law firm unless:

(1) the division is in proportion to the services performed by each lawyer or, by a writing given to the client, each lawyer assumes joint responsibility for the representation;

(2) the client agrees to employment of the other lawyer after a full disclosure that a division of fees will be made, including the share each lawyer will receive, and the client's agreement is confirmed in writing; and

(3) the total fee is not excessive.

D. Rule 1.6 Confidentiality of Information

Although Rule 1.6(a) abandons the "confidences and secrets" dichotomy which has so long defined what is within the duty of confidentiality in New York, the actual substance of the definition is substantially the same as it was under the Code. The Rule, however, makes clear that confidential information does not cover the lawyer's legal knowledge or research or information that is generally known.

(a) A lawyer shall not knowingly reveal confidential information, as defined in this Rule, or use such information to the disadvantage of a client or for the advantage of the lawyer or a third person, unless:

(1) the client gives informed consent, as defined in Rule 1.0(j);

(2) the disclosure is impliedly authorized to advance the best interests of the client and is either reasonable under the circumstances or customary in the professional community; or

(3) the disclosure is permitted by paragraph (b).

"Confidential information" consists of information gained during or relating to the representation of a client, whatever its source, that is (a) protected by the attorney-client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential. "Confidential information" does not ordinarily include (i) a lawyer's legal knowledge or legal research or (ii) information that is generally known in the local community or in the trade, field or profession to which the information relates.

Rule 1.6(b) Exceptions

Two changes in Rule 1.6 and a change in Rule 3.3(a)(3) (creating a new exception to Rule 1.6, discussed below) are arguably the biggest changes wrought by the new Rules. Rule 1.6(b)(1) allows disclosure of confidential information "to prevent reasonably certain death or substantial bodily harm." The related Code provision allowed disclosure of confidential information only to prevent a future crime. n5 In many cases, this exception allowed the lawyer to disclose in order to prevent death or bodily harm, but it did not extend to cases where the action or inaction of the client was not criminal, but would still have the described result. The classic example is the death penalty case where the client confesses to the lawyer a crime for which someone else has been convicted and the client refuses to allow disclosure. Such cases occur, but are unusual.

Lawyers should note that the new language could also apply where the lawyer represents a client who comes for advice about an act or omission that could cause harm, but no crime is involved. Possible examples include a client who explores a product safety issue with a lawyer or a client who consults a lawyer about a non-criminal environmental threat that they caused. Despite counseling, the client decides not to undertake the added expense of preventing or correcting the problem; the lawyer believes that death or substantial bodily harm will result.

Under the Code, if no future crime is involved, the lawyer's lips would be sealed; under the new Rule, the lawyer may disclose. Will the lawyer disclose? If the lawyer does disclose, the client may feel completely betrayed by their own lawyer. And if the lawyer does not give the client an advance warning about the limits of confidentiality, the lawyer may be sued for malpractice. On the other hand if the lawyer does not disclose, will the lawyer have liability along with the client for harms that could have been prevented by disclosing? The answer is not known, but see *Tarasoff v. Regents of University of California* n6 for one well known failure to warn liability case.

Rule 1.6(b)(4), which permits the disclosure of confidential information to secure legal ethics advice, is a welcome addition to these Rules. Although some practitioners have always maintained that this was implied, there is now solid authority that a lawyer can seek advice on ethical problems and that disclosure for that purpose is authorized.

(b) A lawyer may reveal or use confidential information to the extent that the lawyer reasonably believes necessary:

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

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

(3) to withdraw a written or oral opinion or representation previously given by the lawyer and reasonably believed by the lawyer still to be relied upon by a third person, where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud;

(4) to secure legal advice about compliance with these Rules or other law by the lawyer, another lawyer associated with the lawyer's firm or the law firm;

(5) (i) to defend the lawyer or the lawyer's employees and associates against an accusation of wrongful conduct; or

(ii) to establish or collect a fee; or

(6) when permitted or required under these Rules or to comply with other law or court order.

E. Rule 1.7 Current Client Conflicts

The core definition of a concurrent conflict is perhaps slightly narrowed by Rule 1.7(a)(1):

a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:

(1) the representation will involve the lawyer in representing differing interests;

The Code, DR 5-105(A) and (B), used the "differing interests" test, but also encompassed cases where "the independent professional judgment in behalf of a client will be or is likely to be affected..". This is not much of a change, but perhaps eliminates some situations that would have been conflicts under the Code.

Similarly, Rule 1.7(a)(2) arguably narrows the scope of conflicts between lawyer and client. The Rule uses a test of "significant risk" of an adverse effect on the independent professional judgment, where DR 5-101 used a "will be or reasonably may be affected" standard.

The former "disinterested lawyer" test of DR 5-105(C) has been changed in Rule 1.7(b)(1) to "the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client." As noted above, however, the definition of "reasonable" means that this is not a substantive difference. Rule 1.7(b)(3) makes explicit what surely was implied before, namely that lawyer cannot be on two sides of the same litigation.

Perhaps the most important change in this Rule is the requirement that consent to a conflict must satisfy the test of "informed consent," as defined in Rule 1.0(i) and must be "confirmed in writing," as discussed above. Thus, what was always good practice is now required by the Rules.

F. Rule 1.8a Business Transactions with Client

The rule regulating business transactions with clients has always been one of the strictest in the Code. The requirement that the transaction be fair and reasonable to the client will generally be tested at the worst possible time, that is, after the transaction has resulted in loss to the client. The rule has now been made even more stringent: the client must be advised in writing to seek independent legal advice and must give informed consent. In addition, note that this is one of the places in the new Rules where the client's consent must be confirmed in a writing signed by the client. That second writing must set out the details of the transaction and the lawyer's role in it.

The mere fact that the Rule imposes so many requirements should be a warning to lawyers that such transactions are extraordinarily dangerous. Wise lawyers will either steer clear or will go to great lengths to ensure compliance with the Rule. It is worth noting that the Rule does not apply to standard commercial transactions between the lawyer and the client on the same terms as the client deals with others in the marketplace, see Comment 4B.

(a) A lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise professional judgment therein for the protection of the client, unless:

(1) the transaction is fair and reasonable to the client and the terms of the transaction are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking, and is given a reasonable opportunity to seek, the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

G. Rule 1.8c Gifts from Clients

The Code addressed the subject of gifts from clients in EC 5-5, which suggested caution in accepting gifts from clients. This general principle has now been elevated to a Rule, making clear that the lawyer may under no circumstances solicit a gift from a client and, except in limited family cases, must not prepare an instrument giving a gift to the lawyer or a close family member of the lawyer. If a client wishes to make such a gift, the best course is to send them to another law firm and thus avoid later suggestions of undue influence or improper behavior.

(c) A lawyer shall not:

(1) solicit any gift from a client, including a testamentary gift, for the benefit of the lawyer or a person related to the lawyer; or

(2) prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any gift, unless the lawyer or other recipient of the gift is related to the client and a reasonable lawyer would conclude that the transaction is fair and reasonable.

For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative, or an individual with whom the lawyer or the client maintains a close, familial relationship.

H. Rule 1.10 Conflict Checking Records and Procedures

Law firms have long been required to maintain records and have a policy that ensures that they are checked in order to avoid conflicts. Specific conflict checking procedures have previously been left to each firm's judgment. The Rule changes that. The Rule now requires that a conflict check must be made in four specified instances: (1) taking on a new client; (2) taking on a new matter for an existing client; (3) bringing in a new lawyer; and (4) the addition of a party to a pending matter. Law firms may have been doing this already in an effort to avoid conflicts. However, since these specific checks have now been embodied in the Rule, it is imperative to implement a system that ensures that such

checks are done and that makes a record that they have been done. Aside from the inherent practical value of doing a thorough conflicts check, lawyers should note that the new Rule brings forward the Code provision that failure to keep the required records is a per se violation for which a lawyer or law firm may be disciplined even if no other violation or harm occurs.

(e) A law firm shall make a written record of its engagements, at or near the time of each new engagement, and shall implement and maintain a system by which proposed engagements are checked against current and previous engagements when:

- (1) the firm agrees to represent a new client;
- (2) the firm agrees to represent an existing client in a new matter;
- (3) the firm hires or associates with another lawyer; or
- (4) an additional party is named or appears in a pending matter.

I. Rule 1.11(a) Former Government Employees

This new Rule enlarges on the requirements of DR 9-101(B)(1) relating to government lawyers moving into the private sector. The Rule recognizes that the government can consent to the lawyer's representation of a client in connection with a matter in which the lawyer previously represented the government and requires that such consent be confirmed in writing. In addition, the Rule elaborates on the actions required so that the lawyer's firm may avoid disqualification. An effective process for this purpose involves notification inside the firm, information control procedures, eliminating the lawyer from participation in any fee for the matter, and giving written notice to the government so that it may be sure of compliance with the Rule.

J. Rule 1.13(d) Representing Constituents of a Client Organization

Former EC 5-18 pointed to the dangers of representing a corporation and its employees or other constituents. That caution has now been elevated to a Rule, making clear that before undertaking such a dual representation, Rule 1.7 must be satisfied. Anticipating the possibility that the consent required under that Rule might be an empty promise if the constituent is also the spokesperson for the organization, the Rule makes plain that the consent must come from someone other than the individual who will be represented.

K. Rule 1.14 Client with Diminished Capacity

The Code addressed the issue of dealing with a client with diminished capacity only in the Ethical Considerations. n7 The subject is now in the Rule proper and the Rule provides better guidance and increases the ability to protect such a client's interest. First, the Rule makes clear that the lawyer should, as far as possible, maintain a "conventional" relationship with the client. Diminished capacity takes many forms and has many degrees; the lawyer's duty is to treat such a client like any other client to the fullest extent possible.

Rule 1.14 then goes on to protect the lawyer who has a client who is at serious risk of harm and does not have the ability to interact with the lawyer and protect the client's own interest. For example, suppose a lawyer represents an elderly person in a landlord-tenant dispute. At some point, the client becomes unable to make decisions and at the same time, eviction proceedings begin. Here, immediate action is necessary to protect the client and the Rule allows the lawyer to go forward, including consulting outsiders who may help (for example, family or social services agencies). Moreover, the lawyer is authorized to reveal such limited confidential information as is necessary to protect the interests of the client.

L. Rule 1.18 Prospective Clients

Rule 1.18 is a totally new Rule that begins by codifying the existing law that people who seek legal advice from a lawyer are entitled to confidentiality even though an ongoing client-lawyer relationship does not ensue and even though no fee is paid. What the Rule adds are three provisions that make it harder for the lawyer to be disqualified because of an initial consultation that did not flower into a full representation.

First, the lawyer who is consulted but not engaged is disqualified from being adverse in the same or a substantially related matter only if the lawyer received information that "could be significantly harmful" to that prospective client. This provision should mean that in some cases a lawyer who would be disqualified under the "substantially related" test will avoid disqualification because the information fails to meet the higher standard imposed by the Rule.

Second, even if the individual lawyer who met with the client is disqualified, there is a possibility that the rest of the firm will not be. The special vicarious disqualification rule set out in Rule 1.18(d) saves the firm from being disqualified if the involved lawyer was careful not to learn more than was necessary for a conflicts check and to determine whether the firm wanted the matter and the firm performs an extensive screening. Like the screening required under Rule 1.11(a), above, the process requires notification inside the firm, information control procedures, eliminating the disqualified lawyer from any participation in the fee for the matter, and giving written notice to the now adverse prospective client so that it may be sure of compliance with the Rule. Additionally, the representation of the current client must pass the reasonable lawyer standard.

Third, Rule 1.13(e) makes clear that not everyone who gives information to a lawyer automatically becomes a client. That is, lawyers are now protected from the "thrust upon" client as well as the "taint shopping" client. The test for "thrust upon" is that the person communicates with the lawyer unilaterally, without any reasonable expectation that the lawyer is willing to discuss the possibility of a relationship.

Taken in its entirety, the new Rule suggests some important practical considerations for lawyers in their contact with potential clients. Lawyers should be careful that advertisements do not invite people to contact the lawyer and provide a lot of facts. This caution is particularly apt with regard to the firm's website. If the website goes beyond just including contact information and instead provides a form for readers to fill out, which can then be automatically submitted, the contact may not be "thrust upon." In addition when meeting with prospective clients for the first time, lawyers should be careful to gather the least amount of information reasonably possible until it becomes clear that representation is going to ensue. The lawyer meeting with the prospective client should not share that minimal information with anyone and, of course, a contemporaneous record of the whole matter should be kept in the conflict checking file.

M. Rule 2.1 Advisor

The duty to exercise independent professional judgment on behalf of a client was formerly expressed in Canon 5 n8 and indirectly in various other places such as DR 5-105(A) and (B). The only guidance in the Code on the duty to render candid advice, including all possible alternative courses of action, was found in EC 7-8. Rule 2.1 now elevates both of these principles to mandatory duties. Although this change will probably not have much impact for most practitioners, it is a good reminder of basic duties regarding the client-lawyer relationship.

N. Rule 2.3 Evaluation for Use by Third Persons and Rule 2.4 Lawyer Serving as Third Party Neutral

These two new Rules have no counterpart in the Code. Rule 2.3 makes clear the boundaries that must be respected when the lawyer is providing an evaluation for the use of a third person and the matter being evaluated affects the client. In such a case, the lawyer may go forward only if doing so is compatible with the lawyer's relationship to the client and the client gives informed consent. The Rule also includes a reminder of the application of Rule 1.6 in this situation.

Rule 2.4 gives specific guidance to lawyers serving as arbitrators and mediators. The Rule states the obvious: that a lawyer cannot be a neutral in a matter involving his or her own client. It then goes on to require that the lawyer must take steps to make sure that unrepresented parties understand the lawyer's role in the process. The prohibition on later

representation of any of the parties, previously found in EC 5-20, is not in this new Rule; instead such conflicts and the imputation of them are dealt with in Rule 1.12.

O. Rule 3.3 Conduct Before A Tribunal

Rule 3.3(a)(1)

The duty not to make a false statement of law or fact in the representation of a client, formerly contained in DR 7-102(A)(5), is now found in two places: (1) Rule 3.3(a)(1) covers this when the lawyer is before a tribunal and (2) Rule 4.1 deals with statements to other persons. Rule 3.3(a)(1) adds something that was probably understood before: the duty to correct a false statement of material fact or law previously made to the tribunal by the lawyer. One may wonder why the word "material" is included in the second part of this duty, but not the first. The best advice would be to always correct any statement made by the lawyer to a tribunal which the lawyer later finds to be incorrect.

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

Rule 3.3(a)(3) and Rule 3.3(b) and (c)

These three short paragraphs represent one of the biggest changes in the whole Rules project. They deal with the age old perjury problem. Under the DR's, if a lawyer concluded that the client was going to commit perjury, the lawyer could tell the court before it happened because it fell within the future crime exception of DR 4-101(C)(3) and, of course, the lawyer could not use perjured testimony or false evidence under DR 7-102(A)(4).

However, if the perjury came as a surprise or was after-discovered, the duty to reveal was encompassed within the exception at the end of DR 7-102(B)(1).ⁿ⁹ Now, the Rule makes clear that if the lawyer knowsⁿ¹⁰ that the client or another person is going to defraud the tribunal, or if the lawyer, the client, or a witness called by the lawyer has defrauded the tribunal, the lawyer must take reasonable remedial measures, including, if necessary, disclosure to the tribunal. Moreover, this duty applies even if it requires disclosure of information protected by Rule 1.6.

(a) A lawyer shall not knowingly:

(3) offer or use evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client before a tribunal and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

Although some scholars have argued that this new Rule is consistent with prior New York case law, this writer contends that this is a huge change in New York ethics jurisprudence. Previously the situation in New York was, at best, somewhat muddled in this whole area.ⁿ¹¹ Criminal defense lawyers might elicit the defendant's testimony by narrative and not use that perjured testimony in final argument. They might wrestle with the question of what to do if they knew they had a perjury problem only after the testimony was in. Now the Rule is crystal clear: fix the problem, essentially by revealing it to the court; it is then up to the court to figure out what to do.

There are a couple of interesting side notes to this new Rule. First, it is worth noting that in the Model Rules, the disclosure duty continues only to the end of the proceeding. The New York Rule, however, places no time limit on that duty and would seem to call for a revelation even after an acquittal and even after the passage of many years. Second, the Code made it explicit that the first step to take if the client committed perjury was to call upon the client to rectify the fraud. This procedure, obviously good practice, is not in the Rule proper, but is found in Comment 10.

Additionally, it is interesting to note that DR 7-102(B)(1) included a duty that ran to a 'person' as well as a tribunal; of course, the exception for confidences or secrets negated the supposed duty to reveal. The successor provision, Rule 3.3, limits the duty to disclose to tribunals. The change in result is subtle: late discovered fraud on a person outside of litigation (for example, misrepresentations about financial statements) could not be revealed under the Code and cannot be revealed under the Rules. Previously, if the client refused to rectify the fraud, the lawyer presumably would have had to withdraw from the representation so as to avoid assisting the client in a crime or fraud. In addition, in some cases, DR 4-101(C)(5) would permit a limited revelation of confidential information:

(C) A lawyer may reveal:

(5) Confidences or secrets to the extent implicit in withdrawing a written or oral opinion or representation previously given by the lawyer and believed by the lawyer still to be relied upon by a third person where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud. n12

Under the Code, the New York State Bar Association's Committee on Professional Ethics interpreted these interrelated sections to conclude that if the lawyer had the option to withdraw such a prior representation, the lawyer was required to do so. n13 While Rule 1.6 still gives the lawyer the option to withdraw such an opinion or representation previously given by the lawyer, the omission of "person" in Rule 3.3(b) means that the reasoning of those bar opinions would no longer require withdrawal of that prior opinion or misrepresentation, but

would only permit it. That said, a wise lawyer whose client has involved him or her in a fraud will exercise the right to extricate himself or herself to the fullest extent possible, withdrawing such earlier opinions and withdrawing from the representation.

Rule 3.3 (d) and (f)(4)

While not earthshaking, it is worth noting that the Rule now includes a duty to disclose adverse facts if appearing ex parte which duty was not found in the DR's. There is also a somewhat strange new prohibition in conduct before a tribunal: a lawyer shall not engage in conduct intended to disrupt the tribunal. It is hard to see why this provision is needed in addition to the court's contempt powers, but there it is.

P. Rule 4.1 Truthfulness in Statements to Others

While there is no change in the Rule itself, it is worth noting that the Comment picks up the Model Rule comment 2:

This Rule refers to statements of fact. Whether a particular statement should be regarded as one of fact can depend on the circumstances. Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of material fact. Estimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim are ordinarily in this category;

This should make clear that it is not improper for a lawyer, negotiating on behalf of a client, to say (even if not true) "My client is in no hurry to settle this case" or "My client won't accept a penny less than \$100,000."

Q. Rule 4.3 Unrepresented Parties

The Rule expands on the core protections in the Code for unrepresented parties. In communications with unrepresented parties, the lawyer shall not state or imply that the lawyer is disinterested and must take reasonable steps to clear up any misunderstandings about the lawyer's role in the matter.

R. Rule 4.4b Misdirected Fax or Email

This new provision ends the long debate on the duty of a lawyer who receives a misdirected fax or email from the adverse party or adverse counsel. A bewildering array of bar opinions had previously counseled a range of responses from "stop reading and return" to "retain but notify." Now the Rule makes clear that the only duty of the recipient in such a case is to promptly notify the sender. The lawyer does not have to stop reading the document or return it unless ordered to do so by a court. Again, however, the lawyer should remember to make a contemporaneous record of the entire event.

S. Rule 5.5 Unauthorized Practice of Law

The Bar Association had recommended basing this Rule on the ABA's Model Rule 5.5-Multi Jurisdictional Practice of Law (MJP), which would allow out of state lawyers the right to practice law in New York under certain limited and controlled circumstances. The court did not adopt that recommendation. The bar's proposed MJP rule would not directly affect New York lawyers; instead, it was addressed to lawyers from other states, allowing them some freedom in New York. It is unfortunate that the court did not adopt this MJP provision. That choice leaves New York in a shrinking minority of jurisdictions that do not extend at least some rights to outside lawyers; moreover, other states, which now have open MJP rules, may decide to insert a reciprocity provision. If that happens, a New York lawyer who today may provide limited assistance to a client in another jurisdiction would lose the ability to do so.

T. Rule 6.1 Voluntary Pro Bono Service

Rule 6.1 on pro bono is not really a rule at all-it clearly states that it is not intended to be enforced through the disciplinary process. Nevertheless, by putting this moral obligation into at least the form of a Rule, the court has made the encouragement to provide pro bono services much more concrete.

VI. Conclusion

Plainly, New York lawyers have a lot to learn. This article is intended to address the most important changes wrought by the adoption of the Rules, but it is not all inclusive by any means. At this point the best advice for any New York lawyer is to go immediately to [nysba.org](http://www.nysba.org) and read the new Rules and Comments. They are already in effect and there is no time to waste.

For the text of the Rules, see New York Rules of Professional Conduct.

http://www.nysba.org/Content/NavigationMenu/ForAttorneys/ProfessionalStandardsforAttorneys/Professional_Standar.htm

For a table comparing the new Rules to the former Code, see Comparison Chart.

<http://www.nysba.org/Content/NavigationMenu/ForAttorneys/ProfessionalStandardsforAttorneys/CorrelationtableofnewNYrules.pdf>

Return to Text

n1 The headings shown here are taken from the ABA Model Rules; they are not included in Part 1200 as adopted by the Appellate Division.

n2 *See* Feb. 2007 amendment to DR 5-103(B)(1).

n3 *In re Cooperman*, 83 N.Y.2d 465, 633 N.E.2d 1069, 611 N.Y.S.2d 465 (1994).

n4 *See, e.g., Ford v. Albany Med. Ctr.*, 283 A.D.2d 843, 843-46, 724 N.Y.S.2d 795, 796-98 (3d Dep't 2001) construing former DR 2-107(a)(2).

n5 DR 4-101C(3).

n6 17 Cal.3d 425; 551 P.2d 334; 131 Cal. Rptr. 14 [1976].

n7 EC 7-11, 7-12.

n8 *See* "A Lawyer Should Exercise Independent Professional Judgment On Behalf Of A Client."

n9 The DR requires the lawyer to reveal, unless the information is protected as a confidence or a secret, which it always will be.

n10 *See* Rule 1.0(k) for the definition of knowing.

n11 For a full discussion, see S. Wechsler, 2000-2001 Survey on Professional Responsibility, 52 *Syr. L. Rev.* 619-623 (2002); S. Wechsler, 2004-200 Survey on Professional Responsibility, 56 *Syr. L. Rev.* 970-971 (2006).

n12 This was often referred to as a "noisy withdrawal." The noise actually came from the implication that would arise from such a withdrawal accompanied by silence instead of an explanation.

n13 N.Y. State 781 (2004); N.Y. State 797 (2006).

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13 of 15 DOCUMENTS

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Wald on Enforcement of Contracts Which Violate Rules of Professional Conduct

2009 Emerging Issues 3362

Eli Wald on Enforcement of Contracts Which Violate the Rules of Professional Conduct

By Eli Wald

February 9, 2009

SUMMARY: In *Patterson v. Law Office of Lauri J. Goldstein PA*, 980 So. 2d 1234 (Fla. Dist. Ct. App. 4th Dist., 2008), the Florida court of appeals explored whether a fee-sharing agreement between a lawyer and a paralegal which violated the Rules of Professional Conduct could be enforced against the attorney.

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ARTICLE:

Overview

In *Patterson v. Law Office of Lauri J. Goldstein PA* the Florida court of appeals explored whether a fee-sharing agreement between a lawyer and a paralegal which violated the Rules of Professional Conduct could be enforced against the attorney. This Commentary, written by Professor Eli Wald, a legal ethics expert and member of the Colorado Supreme Court Standing Committee on the Colorado Rules of Professional Conduct and the Colorado Bar Association Ethics Committee, summarizes the pertinent legal issues decided by the court.

Factual Background

Attorney Goldstein hired paralegal Patterson orally agreeing to pay Patterson an annual salary plus a bonus calculated as 10% of Goldsteins attorneys fees from cases on which Patterson worked. *Id. at 1235-1236*. At that time, Patterson did not know that the bonus provision violated the Florida Rules of Professional Conduct. Patterson demanded payment of the bonus and attorney Goldstein, after first paying a portion of the bonus and promising to pay the rest, refused to pay Patterson the reminder of the bonus. *Id.*

Procedural Background

Patterson filed an unpaid wages action. Attorney Goldstein moved for summary judgment, arguing as an affirmative defense that the bonus agreement was not enforceable against her office because the bonus provision was unethical and thus void as against public policy. *Id. at 1236*. The trial court granted Goldstein summary judgment. Patterson appealed. *Id.*

Pertinent Legal Question

(1) Are Contracts which Violate the Rules of Professional Conduct Void as against Public Policy?

The Decision

Noting that the standard of review of an order granting summary judgment is *de novo*, *Id. at 1236*, the court first turned to the Florida Rules of Professional Conduct to determine whether the bonus provision violated the Rules.

Florida Rule 4-5.4(a), entitled Professional Independence of a Lawyer, states in relevant part that:

(a) Sharing Fees with Nonlawyers.

A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

...

(4) bonuses may be paid to nonlawyer employees based on their extraordinary efforts on a particular case or over a specified time period, *provided that the payment* is not based on the generation of clients or business and *is not calculated as a percentage of legal fees received by the lawyer or law firm* (emphasis added).

Because the bonus provision clearly violated Rule 4-5.4(a), the court next explored the enforceability of the agreement. In *Chandris, S.A. v. Yanakakis*, 668 So.2d 180 (Fla. 1995), the Florida Supreme Court held that a contingent fee agreement that violates the Rules of Professional Conduct is void as against public policy and a lawyer cannot recover attorneys fees under such agreement. *Chandris*, 668 So.2d at 185186. Goldstein argued that *Chandris* stands for the general proposition that agreements that violate the Rules of Professional Conduct are void as against public policy and the trial court agreed.

The court of appeals refused to construe *Chandris* so broadly and distinguished the facts of *Patterson* on three separate grounds:

First, the court reasoned that whereas the contingency fees rule in *Chandris* was designed to govern agreements between attorneys and clients and thus directly protect the public from potentially unreasonable or abusive fee agreements, the rule prohibiting fee sharing with nonlawyers in *Patterson* was designed to govern agreements between lawyers and nonlawyers and thus only indirectly protect the public from the undue influence of nonlawyers on the independence and exercise of professional judgment of lawyers. Given the different impact on the public, while a contingency fee agreement that violates the Rules of Professional Conduct is antagonistic to the public interest and therefore void as against public policy, a bonus agreement that violates the Rules of Professional Conduct is not per se void as against public policy. *Id. at 1236-1237*.

Second, the court found that whereas in *Chandris* voiding a contingent fee agreement which violates the Rules encouraged compliance with the Rules (because an attorney would not be able to enforce such a fee agreement and thus have little reason to execute it to begin with), in the present case voiding the bonus agreement would reward non-compliance with the fee-sharing rule by permitting an unscrupulous attorney to repudiate a non-conforming agreement after reaping the benefit of the bargain. *Id. at 1237*.

Finally, the court noted that the doctrine that a contract offensive to public policy is void and unenforceable is subject to the exception that where the parties [to the contract] are not in *pari delicto*, the innocent party may recover. *Id.* (citations omitted). Because Patterson did not have knowledge that Goldstein was breaking the Rules by offering her a bonus, and because Patterson was not an attorney herself and thus not subject to the Rules, the court found that Patterson was an innocent party and thus entitled to collect the bonus.

The court concluded that the bonus agreement was enforceable by Patterson, notwithstanding the fact that it violated the Rules of Professional Conduct. *Id.* at 1237. It cautioned, however, that [w]e specifically limit our holding to the factual circumstances of this case involving an employment relationship between an attorney and a paralegal. This opinion is not to be construed to apply to a proscribed referral fee arrangement, which is distinguishable because it raises a separate set of policy considerations. *Id.* at 1238.

Analysis

Eager to prevent an unscrupulous attorney, *Id.* at 1237, from executing a bonus agreement in violation of the Rules of Professional Conduct with the intention of reaping the benefits of the agreement only to then repudiate it on the ground that it is against public policy, the court offered multiple justifications for distinguishing Chandris. While the courts heart may have been in the right place and the outcome it reached just given the facts of the case, the rationales offered by the court are unfortunately somewhat confusing.

The court could have reversed the summary judgment solely on the strength of its third rationale, that Ms. Patterson was not in *pari delicto* to the ill-advised bonus agreement. In other words, the court could have held that it need not decide whether a fee-sharing agreement with a nonlawyer violates public policy and is therefore void, because even if the bonus provision was against public policy, Patterson was an innocent party and may enforce it against attorney Goldstein.

Such a narrow holding would have allowed the court to avoid its confusing second rationale. While the court was correct that voiding a contingent fee agreement in violation of the Rules in Chandris encouraged compliance with the Rules, the court was mistaken in arguing that voiding the bonus provision in this case would discourage compliance with the fee-sharing rule, see, Patterson, at 1237. Voiding the bonus provision, would have, consistent with Chandris, encouraged compliance with the Rules, because fee-sharing with nonlawyers, and in this case with paralegals, would be disallowed. Attorneys would have no reason to violate the fee-sharing rule and attempt to share fees with nonlawyers because such agreements would be voided as against public policy.

Contrary to the courts reasoning, voiding the bonus agreement would therefore encourage compliance with the fee-sharing rule. However, as the court pointed out, voiding the agreement would nonetheless have a negative consequence: it would allow an unscrupulous attorney the opportunity to manipulate a nonlawyer by agreeing to pay a bonus in violation of the Rules only to later on move to repudiate the agreement. *Id.* at 1237. In essence, such an attorney attempts to comply with the fee-sharing rule at the expense of an innocent nonlawyer. And yet because of the not in *pari delicto* principle, a nonlawyer would be able to enforce the bonus agreement against the attorney. In conclusion, the courts second rationale is both mistaken and unnecessary to support its correct decision.

The courts first rationale for distinguishing Chandris is the most intriguing. The court essentially attempts to draw a distinction between rules of professional conduct that directly protect the public and rules of professional conduct that indirectly protect the public by regulating the interactions of attorneys not with clients but rather with others. According to the court, agreements that violate rules of professional conduct which directly protect the public would be void as against public policy (for example, Chandris), whereas agreements that violate rules of professional conduct which only indirectly protect the public interest would not be void (for example, Patterson).

A main goal of the Rules of Professional Conduct is to protect clients, the public and the public interest. And yet,

the Rules have other goals, such as protecting the interests of members of the bar and the interests of the legal system. See, Eli Wald, *Lawyer Mobility and Legal Ethics: Resolving the tension between Confidentiality and Contemporary Lawyers Career Paths*, 31 *J. Legal Prof.* 199, 201 (2007). The courts distinction between types of rules of professional conduct based on the impact on clients is thus thoughtfully reflective of the multiple goals served by the Rules, and its decision to deem only Rules that directly protect the public worthy of the protection of against public policy is original and plausible.

Ultimately, however, the courts reasoning is not persuasive. Even Rules of Professional Conduct that only indirectly protect the public interest are worthy of protection and agreements that violate any Rules of Professional Conduct should be voided on the ground that they are against public policy. In particular, in *Patterson* the rationale for prohibiting an attorney from sharing a percentage of attorneys fees with a paralegal is that such a bonus agreement may lead to improper interference in a case by the paralegal. See, *Patterson*, at 1237. Such interference would come at the expense of clients. The fee-sharing rule protects the interests of clients and of the public, its indirect impact notwithstanding, and thus agreements violating it should be deemed void as against public policy.

In conclusion, the court made the correct decision on questionable and confusing rationales. It should have found that:

(1) Consistent with *Chandris*, agreements by lawyers violating the Rules of Professional Conduct are generally void as against public policy;

(2) Voiding agreements that violate the Rules of Professional Conduct would encourage compliance with the Rules; and

(3) An innocent party (such as Ms. *Patterson*), not *in pari delicto* to a violating agreement, may enforce it against an attorney.

Note that such a coherent holding would have spared the court the need to try to limit its (confusing) holding as it did and caution against a broad reading of its opinion, *Id.* at 1238. Specifically, had the court decided the case consistent with this commentary, referral fee agreements which violate the Rules of Professional Conduct would be void as against public policy. See, e.g., *Scolinos v. Kolts*, 44 *Cal. Rptr.2d* 31, 34 (*CA Ct. App.* 1995); *Evans & Luptak, PLC v. Lizza*, 650 *N.W.2d* 364, 370 (*Mich. Ct. App.* 2002).

Practice Tip #1:

An attorney should not enter into agreements which violate the Rules of Professional Conduct. Such agreements should be found to be against public policy and should not be enforceable by an attorney who has violated the Rules. For example, a contingency fee agreement in violation of the Rules is void as against public policy and cannot be enforced by an attorney against client, see, *Chandris*. Moreover, while an attorney cannot enforce agreements which violate the Rules of Professional Conduct, an innocent part who is not *in pari delicto* to such an agreement, may enforce it against the attorney, see, *Patterson*.

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14 of 15 DOCUMENTS

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Bowman on Representing the Entity Client

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Bowman on Representing the Entity Client: A matter governed by Hawaii Rules of Professional Conduct 1.13

By Addison M. Bowman

April 30, 2008

SUMMARY: Hawaii Rule of Professional Conduct 1.13, Organization as client, guides lawyers whose rendition of professional legal services to organizational clients. In this commentary Addison M. Bowman addresses the identity of the client, the question of joint representation, the rule of client-lawyer privilege, and the obligation of confidentiality in the special circumstances presented when a lawyer represents an entity client.

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ARTICLE: Summary

Rule 1.13, entitled Organization as client, guides lawyers whose rendition of professional legal services to organizational clients is frequently affected by the duality of the client entity and its constituents, who act, speak, and otherwise personify it, thereby occasioning a set of challenges that justify a special rule of professional conduct. In this commentary we address the identity of the client, the question of joint representation, the rule of client-lawyer privilege, and the obligation of confidentiality in the special circumstances presented when a lawyer represents an entity client.

Analysis

Who is the client? Hawaii Rule of Professional Conduct 1.13(a) supplies the general rule: A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents. This rule applies whenever the client is a corporation, and subdivision (e), listing constituents, speaks of directors, officers, employees, members, shareholders or other constituents. But Comment [2] points out that rule 1.13 appl[ies] equally to unincorporated associations, and adds that the term other constituents . . . means the positions equivalent to officers, directors, employees, and shareholders held by persons acting for organizational clients that are not corporations. This rule applies, then, to corporations, partnerships, labor unions, trade associations, and other collective enterprises in which people associate to promote common purposes.

The client is the organization. The lawyer represents the organization but, as Comment [1] to this rule explains, the organization cannot act except through its . . . constituents. In practice, the entity lawyer takes direction from,

reports to, and advises organizational representatives, all of whom purport to personify the organization in such interactions with the lawyer. But the organization is the client, and the constituents are not. Questions that may arise in this context are (1) Is it permissible for the lawyer to represent a constituent at the same time she represents the entity? and (2) Could a lawyer-client relationship with a constituent develop without the lawyer's knowledge or intent?

Permissible concurrent representation. Rule 1.13(e) addresses this possibility: A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the representation entails different matters, such as general counsel to the company and drafting a will for the constituent, then rule 1.7 is not implicated and the concurrent undertakings are as separate, distinct, and permissible as those of any two other clients. If, on the other hand, joint representation of the entity and one or more of its constituents *in the same matter* were to be undertaken, then rule 1.7(b) would be triggered and the consent of both clients would be required. Rule 1.13(e) envisions such a situation and insists that organizational consent to such joint representation be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders. This is a prudent measure, for the consent required by rule 1.7(b) needs to be informed by the risks and disadvantages of the contemplated joint representation, and the constituent who is to be individually represented is not in a conflict-free position to evaluate organizational interests.

Implied representation. Representation of an organization necessarily entails communication and interaction with its officers and employees, as the lawyer's services are sought and delivered. But individual constituents are generally not clients of the organizational lawyer. As the Restatement puts it, [T]he lawyer does not enter into a client-lawyer relationship with a person associated with an organizational client solely because the person communicates with the lawyer on matters relevant to the organization that are also relevant to the personal situation of the person. American Law Institute, Restatement of the Law Third, The Law Governing Lawyers § 14, comment *f* (2000). To the same effect are two opinions of the ABA Standing Committee on Ethics and Professional Responsibility: Formal Opinion 95-390, entitled Conflicts of Interest in the Corporate Family Context ([Corporations] constituents, including its stockholders, are not also the lawyer's clients solely because of their relationship to the [corporate] client); and Formal Opinion 91-361, entitled Representation of a Partnership ([A] lawyer who represents a partnership represents the entity rather than the individual partners unless the specific circumstances show otherwise).

Recent cases approve the ABA/Restatement rule. *Innes v. Howell Corp.*, 76 F.3d 702, 712 (6th Cir. 1996) (corporate attorney's investigation of CEO was not malpractice nor a conflict of interest because an attorney for a corporation does not automatically represent the corporation's constituents in their individual capacities, even on the same matters, citing MRPC 1.13); *Hopper v. Frank*, 16 F.3d 92 (5th Cir. 1994) (quoting MRPC 1.13 and Formal Opinion 91-361 and holding that a dominant constituent who was majority stockholder and general partner was not individually represented by the partnership's lawyer). Both *Innes* and *Hopper* reject not only *automatic* joint representation of an entity and its dominant constituent but also *implied* attorney-client relationships of the sort approved in *Otaka, Inc. v. Klein*, 71 Haw. 376, 382-83, 791 P.2d 713, 717 (1990) (deciding factor is what the prospective client thought, and Otaka's principals reasonably believed that lawyer Jon Miho was acting as Otaka's lawyer). The *Innes* court was explicit: Simply the fact that Innes [the CEO] might have been subject to personal liability in the ongoing environmental litigation does not establish any legal [attorney-client] relationship--Cook [the lawyer] would have needed to take action on Innes's personal behalf, not just action for the general good of the corporation. 76 F.3d at 712 .

The rule that emerges from *Hopper* and *Innes* is that an organizational constituent who claims co-client status must show more than communication with organizational counsel about matters of organizational interest, even if those matters happen also to be of personal interest to that individual. The only way the organizational context can spawn implied individual representation, added the *Innes* court, is with proof that [the lawyer] contemporaneously performed services for [the constituent] personally. *Id.* Other cases of the *Hopper* and *Innes* variety are collected in the Reporters Note to § 14 of the Restatement. But *Hopper* and *Innes* notwithstanding, any organizational lawyer who recognizes a substantial adversity between the interests of her client and the interests of the constituent with whom she is dealing should clarify the identity of the client in accordance with rule 1.13(d): In dealing with an organization's . . .

constituents, a lawyer shall explain the identity of the client when it is apparent that the organizations interests are adverse to those of the constituents with whom the lawyer is dealing. Comment [8] explains that this express disclaimer clears the air and prompts such constituents to consider obtaining independent representation.

The organizational privilege and rule 503. Organizational clients are entitled to a client-lawyer privilege. Haw. R. Evid. 503(a)(1): A client is a person, public officer, or corporation, association, or other organization or entity, either public or private, who is rendered professional legal services by a lawyer, or who consults a lawyer with a view to obtaining professional legal services. The counterpart federal privilege was established in *Upjohn Co. v. United States*, 449 U.S. 383 (1981)(corporate client).

The scope of the organizational privilege is governed by HRE 503 (a)(2), defining representative of the client as a person having authority to obtain professional legal services, or to act on advice rendered pursuant thereto, on behalf of the client. Because the organizational privilege applies only when the lawyer communicates with a client representative, the effect of this definition is to limit the scope of the organizations privilege to communications between the lawyer and those upper level constituents who qualify as client representatives under this formulation. See A. Bowman, Hawaii Rules of Evidence Manual § 503-2 [2][B]; compare *Upjohn Co.*, 449 U.S. at 394, extending the federal attorney-client privilege to communications with any corporate employee who speaks to corporate counsel at the direction of corporate superiors in order to secure legal advice from counsel . . . [concerning] matters within the scope of the employee[s] corporate duties. The Hawaii limitation, although inimical to corporate secrecy, is consistent with the principle of strict containment [of privilege] and the development of the truth. Lower level [organizational] employees having knowledge of relevant events are thus viewed as witnesses rather than corporate embodiments. Bowman, id.

Organizational confidentiality and Hawaii Rule of Professional Conduct 1.6. The rule of professional confidentiality differs in many ways from the rule of attorney-client privilege. Whereas the privilege of HRE 503 is limited to confidential communications among lawyers and client representatives, the requirement that a lawyer maintain confidentiality under HRPC 1.6(a) extends to all information relating to representation of a client, which includes not merely . . . matters communicated in confidence by the client but also . . . all information relating to the representation, whatever its source. Comment [5] to HRPC 1.6. Thus, anything the lawyer learns about the client or its activities is covered by the rule 1.6 umbrella. The operative difference between the evidentiary privilege and the rule of professional confidentiality is that the former applies only in court proceedings to protect against compelled testimonial revelation, whereas the latter protects the clients information from divulgence by the lawyer anywhere anytime.

The obligation of confidentiality informs rule 1.13(b), instructing lawyers who learn that organizational constituents are engaged in activities that are likely to result in substantial injury to the organization. In any such case subdivision (b) presents a hierarchy of remedial measures designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such minimization, however, is always subject to the discretionary and mandatory revelation requirements of HRPC 1.6(b) and (c)(1) and (c)(2) in cases of client crime or fraud. See Bowman & Kidwell, *Revelation of Client Fraud*, Haw. B.J., May 1993, p. 9.

Government entity as client. Rule 1.13 applies to government lawyers, whose clients are organizations within the meaning of this rule. See Comment [7]: The duty defined in this rule applies to governmental organizations. Subdivision (f) parallels subdivision (b), mentioned above, and specifies a liberal set of remedial measures applicable to government lawyers who discover unlawful activity requiring rectification.

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15 of 15 DOCUMENTS

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Bowman on Lawyer-Client Sexual Relations

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Bowman on Lawyer-Client Sexual Relations

By Addison M. Bowman

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SUMMARY: In 2002 the American Bar Association added to its Model Rule of Professional Conduct 1.8 an express prohibition of sexual relations with clients. A growing number of states have followed suit. The Hawaii Rules of Professional Conduct, however, are silent on the matter. Does this mean that a Hawaii lawyer can commence such a relationship without risking disciplinary sanctions? Addison Bowman examines the issue and offers guidance to practitioners.

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ARTICLE: Summary

In 2002 the American Bar Association added to its Model Rule of Professional Conduct 1.8 an express prohibition of sexual relations with clients: (j) A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them when the client-lawyer relationship commenced.

A growing number of states have followed suit, e.g., Minnesota Rule of Professional Conduct 1.8(k); Oregon Rule of Professional Conduct 1.8(j). Commentary accompanying the ABA model rule explains these developments:

Because of the significant danger of harm to client interests and because the clients own emotional involvement renders it unlikely that the client could give adequate informed consent, this Rule prohibits the lawyer from having sexual relations with a client regardless of whether the relationship is consensual and regardless of the absence of prejudice to the client.

The Hawaii Rules of Professional Conduct are silent on the matter of lawyer-client sexual relations. Does this mean that a Hawaii lawyer can commence such a relationship without risking disciplinary sanctions? Decidedly not, this commentary concludes.

Analysis

Historical development of the ABA rule. In 1992 the American Bar Associations Standing Committee on Ethics and Professional Responsibility issued Formal Opinion 92-364, entitled Sexual relations with clients. The Standing Committees conclusion was:

It is apparent that a sexual relationship during the course of representation can seriously harm the clients interests. Therefore, the Committee concludes that because of the danger of impairment to the lawyers representation associated with a sexual relationship between lawyer and client, the lawyer would be well advised to refrain from such a relationship. If such a sexual relationship occurs and the impairment is not avoided, the lawyer will have violated ethical obligations to the client.

Formal opinion 92-364 described a triple threat to client interests presented by a lawyer-client sexual relationship that does not predate the professional relationship. First, it is likely that the lawyer has breached the basic fiduciary obligation not to exploit the clients trust and confidence for the lawyers personal advantage. The relationship of client and lawyer typically involves inequality and dependence, and fiduciary duty protects against manipulation of a clients inherent vulnerability in these circumstances. There is an analogy to the prohibition of client-lawyer business transactions. Protecting a clients emotional and physical well-being is surely as important as protecting the clients financial well-being, observed the opinion. Formal Opinion 92-364 was cited in *People v. Good*, 893 P.2d 101, 103, 105 (Colo. 1995) (approving discipline under predecessor code of professional responsibility and observing that client, charged with felonies, was vulnerable to sexual advances).

Second, the lawyers emotional investment in a love or sexual relationship may undermine the quality of the lawyering that is contracted for and furnished to the client. Hawai'i Rule of Professional Conduct 1.7(b), our foremost prohibition of conflicts of interest, supplies the rule: A lawyer shall not represent a client if the representation of that client may be materially limited by . . . the lawyers own interests, unless: (1) the lawyer reasonably believes the representation will not be adversely affected; and (2) the client consents after consultation. . . . The material limitation risked by sexual involvement with a client is impairment of the exercise of independent professional judgment that should characterize any competent professional endeavor. Independent professional judgment requires objectivity and detachment, and these desiderata are strained in any client relationship that includes a sexual encounter. The threat is that the lawyers personal interest in the love relationship will skew the judgment that the lawyer brings to bear on the clients problem and impair the advice that the lawyer furnishes to assist the client in making the critical decisions presented by the problem. In a nutshell, the roles of lawyer and lover are essentially incompatible.

A third difficulty is the potential of the love or sexual relationship to blur the contours of the attorney-client relationship and thereby undermine client confidentiality protection. The quote is from Formal Opinion 92-364, which adds: [T]here is no privilege for lovers. Thus, the shield of HRCPC 1.6, protecting information relating to representation of a client, and the shield of its evidentiary counterpart, the client-attorney privilege of HRE 503, safeguarding confidential communications between a lawyer and her client, are endangered by the ambiguity of the bedroom and the law office. Consider *Jones v. United States*, 828 A.2d 169, 175 (D.C. 2003), cert. denied, 540 U.S. 1166 (2004), where attorney-client privilege protection was refused because a telephone conversation was between boy friend and girl friend rather than client and lawyer, even though it touched upon the formers response to a police murder investigation.

Client consent would rarely eliminate these dangers, Formal Opinion 92-364 concluded.

The lawyer may, therefore, be called upon in a disciplinary . . . proceeding to show that the client consented, that the consent was freely given based on full and reasonable disclosure of the risks involved, and that any ensuing sexual relationship did not in any way disadvantage the client in the representation

Shift to a per se prohibition. Model Rule of Professional Conduct 1.8(j) codifies case law approving disciplinary sanctions imposed even in jurisdictions lacking an express prohibition of client-lawyer sexual relations. An illustrative case is *In the matter of Tsoutsouris*, 748 N.E.2d 856 (Ind. 2001), holding that client sexual relations constituted misconduct warranting a thirty day suspension under Indiana Professional Conduct Rule 1.7(b), which resembles HRPC 1.7(b). Tsoutsouris, who began dating [his client] and engaged in consensual sexual relations several times, argued that his conduct did not offend Indianas rule 1.7(b) because (1) there was no evidence that his ability to represent his client effectively was impaired, and (2) he was unaware of his obligation to avoid sexual conduct in view of the absence of an express prohibition in the governing rule. The Indiana Supreme Court rejected both arguments. Regarding Tsoutsouris

first point, the court concluded that the threat of adverse effect on the quality of representation in any such case is sufficiently great to justify, indeed compel, a per se prohibition. To buttress this conclusion, the Tsoutsouris court cited ABA Formal Opinion 92-364 and quoted its warnings about breach of fiduciary duty, impairment of independent professional judgment, and compromise of confidentiality. *748 N.E.2d at 859 n.3.*

Rejecting Tsoutsouris notice argument, the Indiana Court pointed to Formal Opinion 92-364, its own 1996, 1998, and 2000 precedents, and Model Rule 1.8(j), which resulted from a three-year comprehensive study by the ABA Ethics 2000 Commission. The ABA made it clear, the court observed, that attorneys should avoid sexual contact with their clients. *Id.* Moreover, Indiana's rule 1.7(b)'s exceptions based on absence of adverse effect and client consent are simply not available in cases of sexual involvement with clients. For other cases to the same effect, see *People v. Good*, 893 P.2d 101 (Colo. 1995) (predecessor Code of Professional Responsibility analysis); *In re Rinella*, 677 N.E.2d 909 (Ill. 1997) (predecessor Code of Professional Responsibility analysis); *Iowa Supreme Court Bd. of Professional Ethics & Conduct v. Furlong*, 625 N.W.2d 711, 714 (2001) (Professional responsibility involves many gray areas, but sexual relationships between attorney and client is not one of these).

These cases and materials stand for two propositions: (1) Rule 1.7(b) and its MCPR predecessor, DR 5-101(A), are offended by lawyer-client sexual relations; and (2) Showings of impaired lawyering and absence of consent are not required to support disciplinary measures under these rules.

The lawyer-client sexual prohibition is understood throughout the profession. Even in the absence of a specific rule on point, cautions the ABA/BNA Lawyers Manual on Professional Conduct 51:416, plenty of lawyers have been disciplined for having a sexual relationship with a client. Compare G. Hazard & W. Hodes, *The Law of Lawyering* § 12.22 (3d ed.): The substance of what is now Rule 1.8(j) has been accepted for a long time by broad segments of the legal profession.

Pre-existing sexual relationships. Model Rule of Professional Conduct 1.8(j) does not prohibit sexual relationships that existed . . . when the client-lawyer relationship commenced. Notice that Formal Opinion 92-364's first concern, that client vulnerability is subject to exploitation in violation of fiduciary duty, is not implicated in such a case. However, the possibility of adversely impaired lawyering triggering rule 1.7(b) is at issue, and the Model Rule 1.8(j) commentary cautions: [B]efore proceeding with the representation in these circumstances, the lawyer should consider whether the lawyer's ability to represent the client will be materially limited by the relationship. See Rule 1.7

Thus, although the Hawaii lawyer with a client and a pre-existing sexual relationship could point to the MRPC 1.8(j) exception and could distinguish all the cases cited above, she must consider the HRPC 1.7(b) paradigm and the possibility that personal interests may affect the quality of the representation. In addition, informed consent should be obtained in such a case.

Conclusion

The new ABA prohibition of lawyer-client sexual relationships, Model Rule of Professional Conduct 1.8(j), codifies abundant case law approving lawyer discipline under state rules of professional conduct that resemble Hawaii's Rule of Professional Conduct 1.7(b) (representation materially limited by lawyer's personal interests) or its Model Code of Professional Responsibility predecessor, DR 5-101(A), which was equally silent about this matter. The disciplinary sanction is not dependent upon showings of impaired representation or absence of consent. Accordingly, Hawaii lawyers should consider themselves on notice of these developments, and should structure their client agendas accordingly.

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