

CHAPTER 17/B

**ETHICAL & RISK MANAGEMENT CONSIDERATIONS:
CONFLICTS OF INTEREST**

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Note: Since the first two columns were published, the Washington Supreme Court adopted significant amendments to the Washington Rules of Professional Conduct effective September 1, 2006. The new rules were under review by the WSBA and the Supreme Court at the time the first two columns were written and they are discussed in those pieces. The third was written after the new rules were adopted and discusses them specifically. The RPCs as amended in 2006, the accompanying official comments and the report of the WSBA special committee that recommended the rule changes are all available on the WSBA's web site at www.wsba.org.

I. WHY CONFLICTS MATTER

Reprinted from the August 2004 WSBA Bar News Ethics & the Law column

Note: Since this column was published originally, the Washington Supreme Court adopted significant amendments to the Washington Rules of Professional Conduct effective September 1, 2006. The new rules were under review by the WSBA and the Supreme Court at the time it was written and they are discussed in this column. The RPCs as amended in 2006, the accompanying official comments and the report of the WSBA special committee that recommended the new rules are all available on the WSBA's web site at www.wsba.org.

Both the current Washington Rules of Professional Conduct and the proposed amended version are prefaced with views on their role in the practice of law. The current set notes that the RPCs “point the way to the aspiring and provide standards” to judge lawyers’ conduct in a disciplinary sense. The proposed amendments now under consideration echo that intent: “The Rules simply provide a framework for the ethical practice of law.” Without diminishing either that aspiration or their role as a disciplinary code, the professional rules—particularly those relating to conflicts—also increasingly form the substantive law of legal malpractice, lawyer breach of fiduciary duty, disqualification, fee forfeiture and lawyer-related Consumer Protection Act claims. In short, conflicts matter today in a very practical way.

In this inaugural edition of the quarterly Ethics Page, we’ll look at several Washington cases that underscore the practical importance of the conflict rules beyond the disciplinary setting. When the Ethics Page returns in the Fall, we’ll then consider ways of managing conflicts to reduce risk.

Legal Malpractice. The Washington Supreme Court in *Hizey v. Carpenter*, 119 Wn.2d 251, 257-66, 830 P.2d 646 (1992), ruled that the RPCs themselves cannot be cited directly in establishing the standard of care for legal malpractice. At the same time, the Supreme Court in *Hizey* found that an expert could incorporate the concepts underlying the rules into an opinion on

the standard of care. Because the conflict rules are grounded in a lawyer's fiduciary duty of loyalty to a client, the practical import of *Hizey*'s distinction for conflict-based malpractice claims is not as significant as it might first appear—a violation of the conflict rules will simply be recast as a corresponding violation of the legal duty of an agent (the lawyer) to the principal (the client).

Breach of Fiduciary Duty. In a parallel decision issued within months of *Hizey*, the Washington Supreme Court made explicit the link between the conflict rules and a lawyer's fiduciary duty of loyalty. The Supreme Court in *Eriks v. Denver*, 118 Wn.2d 451, 457-61, 824 P.2d 1207 (1992), held that a lawyer with an unwaived multiple client conflict had violated both the conflict rules and the fiduciary duty of loyalty. In doing so, *Eriks* allows the RPCs to be considered directly in assessing whether a lawyer has breached a fiduciary duty to a client.

Disqualification. Although court decisions provide the procedural law of disqualification in terms of standing and the like, the RPCs effectively supply the substantive law. A recent case from the federal district court in Seattle, *Oxford Systems, Inc. v. CellPro, Inc.*, 45 F. Supp. 2d 1055 (W.D. Wash. 1999), is an excellent example of this trend. *Oxford* turned on whether the law firm involved had a current or former client conflict. The court looked directly to the corresponding RPCs—1.7 for current client conflicts and 1.9 for former client conflicts—in resolving those questions.

Fee Forfeiture. The Supreme Court in *Eriks* also held that a lawyer's breach of fiduciary duty may result in full or partial fee forfeiture: "Disgorgement of fees is a reasonable way to 'discipline specific breaches of professional responsibility, and to deter future misconduct of a similar type.'" 118 Wn.2d at 463 (citation omitted). The Court of Appeals recently reiterated that view in *Cotton v. Kronenberg*, 111 Wn. App. 258, 275, 44 P.3d 878 (2002), in affirming the

complete forfeiture of a lawyer's fee in the face of a conflict and an accompanying breach of fiduciary duty.

Consumer Protection Act. Under *Short v. Demopolis*, 103 Wn.2d 52, 61, 691 P.2d 163 (1984), the Washington Consumer Protection Act (CPA) applies to the "entrepreneurial aspects" of practicing law including "the way a law firm obtains, retains, and dismisses clients." In *Eriks*, the Supreme Court found that a lawyer's conflicts might constitute a violation of the CPA if they were triggered by "entrepreneurial purposes." 118 Wn.2d at 465. The Court of Appeals in *Cotton* took that same approach. 111 Wn. App. at 273-75. The practical dimension of the CPA is that it adds an attorney fee remedy for a successful claimant.

Although there are important professional reasons as reflected in the preamble to the RPCs to follow the rules on conflicts, there are also important practical reasons. Conflicts are no longer the exclusive province of bar discipline. As illustrated by the cases we've just examined, the professional rules on conflicts form the essential substantive law on a spectrum from legal malpractice to disqualification. Or, put simply, conflicts matter in a very practical way.

II. MANAGING CONFLICTS

Reprinted from the October 2004 WSBA Bar News Ethics & the Law column

Note: Since this column was published originally, the Washington Supreme Court adopted significant amendments to the Washington Rules of Professional Conduct effective September 1, 2006. The new rules were under review by the WSBA and the Supreme Court at the time it was written and they are discussed in this column. The RPCs as amended in 2006, the accompanying official comments and the report of the WSBA special committee that recommended the new rules are all available on the WSBA's web site at www.wsba.org.

In the summer installment of Ethics & the Law, we looked at why conflicts matter. In this quarter's column, we'll examine two ways of managing conflicts to reduce civil and regulatory risk: (1) using conflict waivers effectively; and (2) structuring representations to eliminate conflicts in the first place.

Using Conflict Waivers Effectively

The recipe for an effective conflict waiver in Washington is drawn largely from the Rules of Professional Conduct. The WSBA and the Washington Supreme Court are considering proposed amendments to the RPCs—including those regulating conflict waivers. Although some terminology will change if the proposed amendments are adopted, the key practical ingredients for an effective conflict waiver will remain the same.

► *Confirm client consent in writing.* Both the present and the proposed versions of the current and former client conflict rules—respectively, RPCs 1.7 and 1.9—require that conflict waivers be confirmed in writing. With both, it is the client's consent that is being confirmed in writing. When documenting the client's consent, however, it is also wise to confirm *the disclosures* that led to consent. For the client, it sets out in one place the nature of the conflict to which the client consented. For the lawyer, it is an important record if there are ever any questions later about what the client was told before granting the waiver. Although

neither the current nor the proposed rules require that the client actually countersign the waiver to affirm consent, having the client do that is a good way to document consent. Oral disclosure and client consent are sufficient to start work on a matter. A written confirmation of the waiver, however, should follow shortly after that—both to meet the requirement of the rule and to document consent at the time it is granted.

► *Explain the nature of the conflict.* The current versions of RPCs 1.7 and 1.9 require that waivers be predicated on “consultation and a full disclosure of the material facts” and, in turn, define “consultation” as “communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question.” The proposed amended versions (which are available on the WSBA’s web site at www.wsba.org/lawyers/groups/ethics2003/default.htm) recast the predicate in terms of the client’s “informed consent” and define that as “the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.” Whether framed as “full disclosure” or “informed consent,” the goal remains the same: you need to tell the client in a way the client will understand what the risks of granting the waiver will be.

► *Remember that some conflicts can’t be waived.* Not all conflicts can be waived—even if the clients involved want to. The classic example is that you can’t be on both sides of the same litigation. Under the current version of RPC 1.7, multiple client conflicts are waivable only when “[t]he lawyer reasonably believes that the representation will not adversely affect the relationship with the other client[.]” Proposed amended RPC 1.7 retains this general limit and adds a specific prohibition against representing both sides in the same litigation.

The new WSBA Legal Ethics Deskbook contains sample conflict waivers covering a variety of situations. It's a great place to start when you are trying to blend the right ingredients into an effective waiver.

Eliminating Conflicts in the First Place

For there to be a conflict, there has to be *adversity* in the legal positions of the clients involved. If the adversity (or the potential for adversity) is eliminated, then the potential conflicts will likely be eliminated, too. Adversity can be eliminated by structuring a representation at the outset to handle only aspects of a matter where the positions of multiple clients are in concert.

Although this technique can be used in some instances to eliminate multiple client conflicts in different matters, it is most commonly employed in situations where the same lawyer is handling a matter jointly for multiple clients. For example, in products liability cases, it is common for dealers to tender the defense of a case to the manufacturer and for both to want to use the same lawyer to defend them. If the manufacturer and the dealer agree (without the defense lawyer acting as a broker between them) to reserve any claims and other liability-shifting issues between them to a later forum with other counsel, then the lawyer has no conflict in defending them in the primary action against the plaintiff because their interests in that case are fully aligned.

Structuring or limiting representations won't eliminate all conflicts and can have practical constraints if the resulting scope is too narrow to represent the clients effectively. In many situations, however, it can be a very useful tool for managing conflicts.

III. THE “WHO IS THE CLIENT?” QUESTION REVISITED

Reprinted from the August 2007 WSBA Bar News Ethics & the Law column

In March 2006, I did a column called the “‘Who Is the Client?’ Question” that looked at two related questions in the context of representing organizational clients. *First*, who is your client when you represent an entity such as a corporation, a partnership or a governmental unit? *Second*, how does the “no contact” rule work in the organizational setting? I noted at the time that a potentially significant clarification was in the offing in this area because the then-proposed amendments to the Washington Rules of Professional Conduct included a specific rule on entity representation. The Supreme Court approved the amendments last year, including the new entity representation rule—RPC 1.13—and they became effective in September 2006. Given that change, it seemed appropriate to revisit the two questions I posed in my earlier column to see how the new rule impacts the answers.

Entity Representation under RPC 1.13

When Washington moved from the Code of Professional Responsibility to the Rules of Professional Conduct in 1985, the drafters rejected an earlier proposed version of ABA Model Rule 1.13 which specifically addressed entity practice. The legislative history from the time reflects that the drafters felt that this was an area better left for development through case law rather than a professional rule.¹ The case law, however, didn’t develop as anticipated and Washington lawyers and judges alike more often looked to the ABA Model Rule and a series of ABA formal ethics opinions interpreting that rule in analyzing entity representation issues.²

When the ABA revised its Model Rules in 2002 and 2003, it expanded Model Rule 1.13 to address confidentiality issues in the entity context in light of the Enron scandal and the Sarbanes-Oxley Act (and the accompanying regulations). But, the ABA kept the core idea

behind Model Rule 1.13: a lawyer representing an entity represents the organization alone and not its constituents such as officers and employees. When we revised our own RPCs, the “Ethics 2003 Committee” recommended that Washington adopt a specific entity practice rule patterned on ABA Model Rule 1.13. With a few Washington-specific modifications, the Supreme Court did so last year and we now have our own Washington profession rule on entity representation: RPC 1.13.

Washington RPC 1.13 generally follows the same structure as its ABA counterpart:

- Section “a” articulates the baseline principle that a lawyer representing an entity represents the organization alone.
- Sections “b” through “e” address several facets of the confidentiality rule in the entity context and counsel that a lawyer who learns of a violation of the law within the organization that could result in substantial injury to the organization should report that violation “up” the entity’s chain of command and, in some circumstances, may report the violation “out” of the entity to the appropriate authorities.
- Section “f” reinforces the principle of entity representation by suggesting that a lawyer for an entity explain that role to organizational constituents such as directors, officers and employees so the constituents will not inadvertently be led to think that the lawyer also represents them as individuals by virtue of the lawyer’s representation of the entity.
- Section “g” notes that a lawyer for an organization may also represent an entity constituent, but that representation would be subject to RPC 1.7’s multiple client conflict rules.

- Section “h” differs from the ABA Model Rule by incorporating former RPC 1.7(c)’s rule on governmental representation that generally limits the representation in that setting to the specific agency involved rather than the larger governmental unit of which the agency is a part.

RPC 1.13 is accompanied by 15 comments that elaborate on each of its subsections.

Both RPC 1.13 and its comments are available on the WSBA’s web site at www.wsba.org.

Because RPC 1.13 is patterned on the corresponding ABA Model Rule, the ABA formal ethics opinions exploring various facets of entity representation, such as ABA Formal Ethics Opinion 95-390 that addresses often difficult issues of corporate affiliate representation, should now also offer more direct guidance for Washington lawyers. The ABA’s ethics opinions are available on the ABA Center for Professional Responsibility’s web site at www.abanet.org/cpr. Some of the WSBA’s informal ethics opinions already cited to the ABA’s ethics opinions in this area and those, too, are available on the WSBA’s web site. Finally, the WSBA Legal Ethics Deskbook in Chapter 10 contains a discussion of entity representation and is being updated to reflect the new rule.

Although the new rule is a very useful clarification, it is neither the sole source for entity representation law nor will it provide all of the answers.

On the sources, the general rule for determining whether an attorney-client relationship exists in the first place remains governed by case law rather than the RPCs.³

The leading case on that point remains *Bohn v. Cody*, 119 Wn.2d 357, 832 P.2d 71 (1992). In *Bohn*, the Supreme Court articulated a two-part test for determining whether an attorney-client relationship exists. The first element is subjective: does the client believe that an attorney-client relationship has been formed? The second element is objective: Is the client’s subjective belief

objectively reasonable under the circumstances? Both elements of *Bohn*'s two-part test must be met for there to be an attorney-client relationship.

On the lingering questions, many applications of RPC 1.13 will remain very fact-specific. As noted earlier, one of the most difficult areas in the entity context is whether representation of a corporate affiliate will be construed as representation of a broader "corporate family" for conflict purposes. As also noted earlier, ABA Formal Ethics Opinion 95-390 provides a framework for analyzing this issue, but it remains very fact-specific. 95-390 generally looks to whether the client has told the lawyer that the broader corporate family should be considered a unified whole and, if not, whether the corporate affiliate shares majority ownership with the corporate parent and whether they share common general and legal affairs management. The answers to these questions can have great practical consequence when representing corporations. The past year, for example, saw several cases turn on these issues and resulted in disqualification of the law firms involved, including *Jones v. Rabanco*, 2006 WL 2237708 (W.D. Wash. Aug. 3, 2006), and *Ali v. American Seafoods Co.*, 2006 WL 1319449 (W.D. Wash. May 15, 2006).

The "No Contact" Rule in the Entity Context

Washington's "no contact" rule is found at RPC 4.2. A key question in applying the "no contact" rule in the corporate context is: who is the represented party? Or stated alternatively, if the corporation (or other entity) is represented, does that representation extend to its current and former officers and employees?

The leading case in Washington on this point is *Wright v. Group Health Hosp.*, 103 Wn.2d 192, 691 P.2d 564 (1984). *Wright* was decided under Washington's former DR 7-104(A)(1). Nonetheless, Comment 10 to RPC 4.2 adopted in 2006 notes that "[w]hether and how lawyers may communicate with employees of an adverse party is governed by *Wright*["]

In *Wright*, the Supreme Court drew a relatively narrow circle of employees who fall within the scope of corporate counsel’s representation—particularly as it relates to a line employee whose conduct is at issue:

“We hold the best interpretation of ‘party’ in litigation involving corporations is only those employees who have the legal authority to ‘bind’ the corporation in a legal evidentiary sense, *i.e.*, those employees who have ‘speaking authority’ for the corporation. This interpretation is consistent with the declared purpose of the rule to protect represented parties from the dangers of dealing with adverse counsel. . . . We find no reason to distinguish between employees who in fact witnessed an event and those whose act or omission caused the event leading to the action. . . .

“We hold *current* Group Health employees should be considered ‘parties’ for the purposes of the disciplinary rule if, under applicable Washington law, they have managing authority sufficient to give them the right to speak for, and bind, the corporation. Since former employees cannot possibly speak for the corporation, we hold that CPR DR 7-104(A)(1) does not apply to them.” 103 Wn.2d at 200-01 (emphasis in original).

Wright’s explicit reliance on substantive evidence law produces an interesting dichotomy depending on whether the underlying case is pending in state or federal court. Professor Robert Aronson of the University of Washington notes this difference in his treatise, *Law of Evidence in Washington*:

“ER 801(d)(2)(iv) provides that the statement of a party’s agent or servant is imputed to the party only if the agent or servant is ‘acting within the scope of the authority to make a statement for the party.’ This is a more stringent requirement than FRE 801(d)(2)(D), which exempts from hearsay treatment admissions by a party’s agent ‘concerning a matter *within the scope of his agency or employment*, made during the existence of the relationship.’

“ER 801(d)(2)(iv) requires that the declarant be a ‘*speaking agent*.’ See Comment 801(d); *Kadiak Fish Co. v. Murphy Diesel Co.*, 70 Wn.2d 153, 422 P.2d 946 (1967). Thus, the statement of a truck driver after an accident, ‘Sorry, I was speeding,’ would be admissible against the truck company in federal court (because it is within the scope of his authority to act), but not in Washington courts (because the truck company did not authorize him to *speak* on its behalf).” Robert H. Aronson, *The Law of Evidence in Washington*, § 801.04[3][b][v] at 801-32 through 33 (Rev. 4th ed. 2006) (emphasis in original).

In other words, senior officers and directors are “off limits” and line-level employees whose conduct is at issue may or may not be “off limits” depending on their status as “speaking agents” under applicable evidence law. By contrast, line-level employees who are simply occurrence witnesses (to borrow from Professor Aronson’s example: another company truck driver who simply observed the accident) and former employees of all stripes are “fair game.” In communicating with a former employee, however, RPC 4.4(a) and its accompanying Comment 1 suggest that the contact cannot be used to invade the former employer’s attorney-client privilege.

Summing Up

Even with the adoption of RPC 1.13, the “who is the client?” question will remain a very fact-specific exercise. As always, a lawyer can help answer that question by carefully defining the client in a written engagement letter and then handling the representation consistent with that engagement agreement.

¹ For a discussion of the legislative history of the earlier proposal to add an entity rule, *see* Robert H. Aronson, *An Overview of the Law of Professional Responsibility: The Rules of Professional Conduct Annotated and Analyzed*, 61 Wash. L. Rev. 823, 829-30 (1986).

² *See* ABA Formal Ethics Opinions 95-390 (corporate representation), 91-361 (partnerships), 92-365 (trade associations) and 97-405 (governmental units).

³ Paragraph 17 of the “Scope” section of the RPCs notes: “For purposes of determining the lawyer’s authority and responsibility, principles of substantive law external to these Rules determine whether a client-lawyer relationship exists.”