

CHAPTER 5-A

**ENTANGLED AND DIVIDED LOYALTIES:
AN AFTERNOON OF CONFLICTS OF INTEREST HYPOTHETICALS
WITH AUDIENCE PARTICIPATION**

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I. WHY CONFLICTS MATTER

Note: This section originally appeared in the August 2004 Ethics & the Law column in the Bar News. Although the RPCs have been amended since this article was originally published, the amendments did not affect the content of this section.

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 & the Law column, 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. THE “WHO IS THE CLIENT?” QUESTION REVISITED

Note: This section originally appeared in the August 2007 Ethics & the Law column in the Bar News.

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

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).

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

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

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).

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."

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.