

Conflicts of Interest—The Basics

By John W. Allen

John W. Allen, chairperson of the State Bar of Michigan's Standing Committee on Professional and Judicial Ethics, has prepared a four-part series on the important topic of conflicts of interest. This month, Parts One and Two will be presented. Parts Three and Four will be presented in a future edition.

Part One—Present Client; Direct Conflict

Loyalty is an essential element in the lawyer's relationship to a client; the rules prohibiting conflicts of interest are intended to assure that loyalty, and reinforce it in the minds of the public in general, and clients in particular. The conflicts rules also assure that protected information¹ obtained from the client will remain confidential, and that the lawyer's professional judgment will be independent of other influences.

The most common ethics issues concern conflicts of interest. Malpractice insurers report that up to 25 percent of all malpractice claims relate to a conflict of interest.²

"Focus on Professional Responsibility" is presented as a monthly feature to address ethics, professionalism, and other regulatory issues affecting Michigan lawyers.

Professor Nancy Moore of Rutgers University, observes that lawyers and law students do not display a thorough understanding of the conflicts rules.³

In addition, the conflicts rules are being used increasingly to disqualify opposing counsel in both transactional and litigation matters. Therefore, lawyers must understand and apply the rules, both in order to assess the opponent's conflict claim, and also to preserve the client's choice of counsel where no conflict exists.

The Rules Have Changed

Effective October 1, 1988, Michigan adopted the Michigan Rules of Professional Conduct (MRPC), patterned closely after the American Bar Association's Model Rules of Professional Conduct, which themselves were adopted in 1983 after a five-year study of the ABA's Kutak Commission.⁴ Especially regarding conflicts of interest, the MRPC marked a material departure from the former Code of Professional Responsibility (CPR), which admonished the lawyer to "resolve all doubts against the propriety of the representation."⁵ This is no longer the law under MRPC, which now favors a more objective assessment, placing some weight on preserving every client's choice of counsel.

Under the former code, conflicts analysis was less strictly defined, and frequently wound up at the former Canon 9 and its appearance of impropriety rubric. The Kutak

Commission found that the "appearance of impropriety" standard was no "standard" at all, but rather had developed into an undefined and subjective, question-begging approach, which all too often allowed a client's choice of lawyer to be nullified simply upon the general and subjective notions of the objecting party.⁶ The ABA's Model Rules, as well as the MRPC, reject the "appearance of impropriety" approach, and instead substitute strict, fact-based tests in MRPC 1.7 and 1.9 for determining the existence of a conflict of interest based upon a present or former client relationship.⁷ Thus, ethics opinions and court decisions under the former CPR (e.g., using the "appearance of impropriety" rubric) are of little use, and frequently lead to an incorrect conclusion under the MRPC.

These newer, fact-based MRPC tests are not always simple, nor easy to apply. This series of articles is not intended to provide an exhaustive treatise; rather, it provides a practical and basic approach to conflicts analysis, accompanied by visual "Decision Trees" to be used as a part of that analysis.

Who is the Client?

The threshold issue is to *identify the "client."* If the objecting party does not identify a *present* or *former* client relationship, there can be no conflict of interest. Thus, the analysis ends before it needs to begin.

Sometimes, identifying the client is not as easy as it sounds. Lawyers represent

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free of charge. This service has been added to assist Michigan lawyers in researching ethics inquiries.

clients, not property, issues, positions, or work product.⁸ The client is usually a person or an organization; however, representation of an organization (such as a partnership or corporation) does not mean that the lawyer also represents the organization's constituents (e.g., directors, offices, employees, members, shareholders, partners).⁹

The identity of the client is a fact issue.¹⁰ Probative evidence usually includes:

- Objectively viewed, reasonable beliefs of the client and the lawyer;
- Documentary evidence (such as the engagement letter, statements and other communications); and
- Who pays for the lawyer's services.

When more than one client is involved, the question of conflict must be resolved regarding each client.¹¹

Client—Present or Former? Adversity—Direct or Indirect?

If a client relationship is identified, different rules are used for a *present* client, as

distinguished from a *former* client. If the conflict issue involved a *former* client, then the analysis is controlled by MRPC 1.9 (which will be covered by Part Two of this series). If the conflict issue involved a *present* client, then it is controlled by MRPC 1.7(a) or (b), depending upon whether the alleged adversity is *direct* or *indirect*.

Direct Adversity to Present Client Prohibited

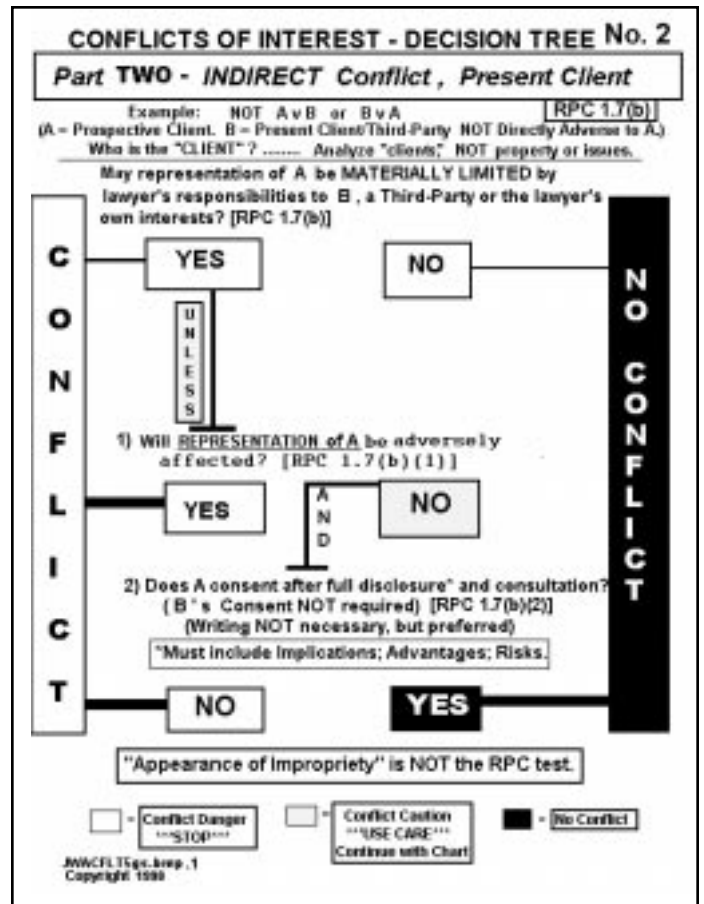
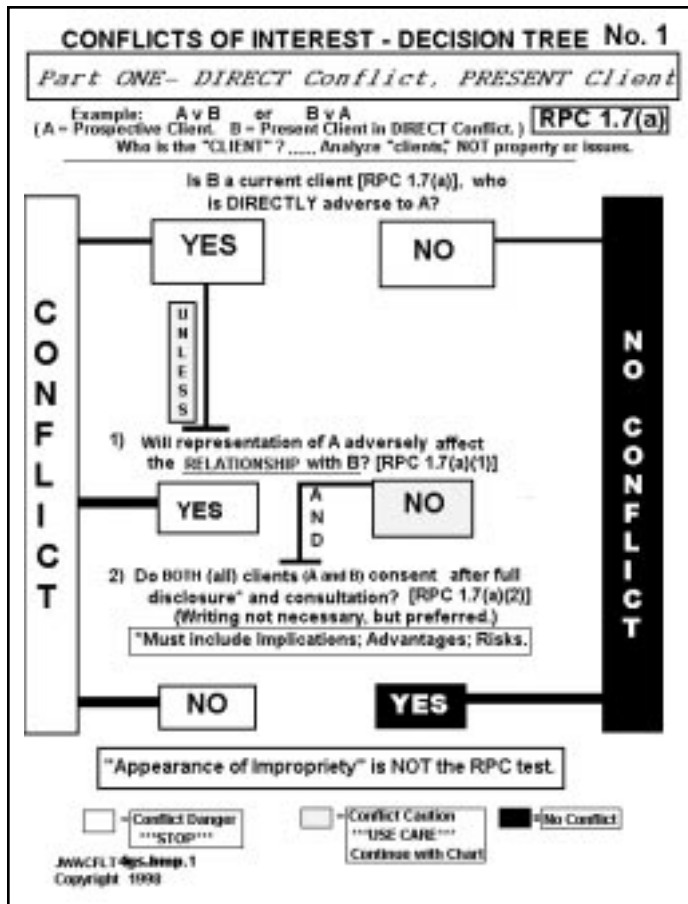
When the prospective client (Client A on Decision Tree No. 1) is *directly* adverse to the present client (Client B on the Decision Tree), MRPC 1.7(a) prohibits representation of the prospective client (Client A). As a general proposition, loyalty to a present client prohibits undertaking a representation directly adverse to that client without that client's consent, even if the matters are wholly unrelated. In relation to a *present* client, "substantial relationship" has nothing to do with it.¹²

Exception Upon Two Conditions

Adverse Effect Upon Relationship with Present Client?

Direct adversity with a present client is permitted only upon two successive conditions. First, the lawyer must form a good-faith belief that the representation of the prospective client (A) *will not adversely affect the relationship with the present client* (B). This determination is to be made initially by the lawyer. It focuses upon a broader inquiry regarding the *relationship* with the present client (B), not the *representation* of the prospective client (A).

The analysis is *objective*, from the perspective of the "reasonable" client and disinterested lawyer. It does not permit subjective views of "impropriety," as it might appear to an uninformed observer or even an interested party. The likelihood of adverse effect on the relationship must be *substantial*, meaning significant and plausible, even if not certain and probable. The standard requires more than a mere possibility.¹³



If the lawyer believes that the representation will adversely affect the relationship with the present client (B) then there is a conflict which is not waivable even with the present client's (B's) consent. In those circumstances, a waiver should not be sought.¹⁴ The engagement with the prospective client (A) should be declined. This is a conflict without cure. The analysis ends.

Even if the lawyer determines in good faith that the representation of a prospective client (A) will not adversely affect the relationship with the present client (B), the analysis continues to the second condition.

Do Both Clients (A and B) Consent?

Second, both the prospective client (A) and the present client (B) must waive the conflict.¹⁵ Their consent may be sought only after a full disclosure and consultation, which includes the implications, advantages and risks.¹⁶ A "consultation" requires communication of information reasonably sufficient to permit the client to appreciate the significance of the matter.¹⁷ A written and signed confirmation of the waiver is preferred, but not required.

If either prospective client (A) or present client (B) objects, the engagement must be declined. If both consent, the lawyer may accept the engagement with prospective client (A).

Part Two—Present Client; Indirect Conflict

In Michigan Rules of Professional Conduct (MRPC) 1.7, conflicts involving present clients come in two flavors: *direct*; and *indirect*. MRPC 1.7(a) applies only when the representation of one client would be *directly* adverse to another client.

Indirect conflicts under MRPC 1.7(b) can involve other clients, nonclient third parties, or even the lawyer. While *direct* conflicts concern simultaneous representation of two or more clients *adverse* to each other, *indirect* conflicts often concern a more subtle infringement which materially limits the quality of the representation. Examples could include:

- Representation of an organization and its constituents (business and its owner);
- Multiple plaintiffs or defendants;
- Being paid by someone else (e.g., employer, parent or insurance company);

- Serving in a separate fiduciary capacity (e.g., lawyer as director, personal representative, trustee, escrow agent, etc.);

- Multiple parties in any single transaction; or

- The lawyer's own personal interest.

Loyalty to a client is also impaired when a lawyer cannot consider, recommend, or carry out an appropriate course of action for the prospective client because of the lawyer's other responsibilities or interests. The lawyer might pull some punches. The conflict forecloses alternatives that would otherwise be available to the client. MRPC 1.7(b) addresses such situations.

A possible conflict does not itself preclude the representation. The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the prospective client. Since MRPC 1.7(b) focuses upon protection of the prospective client, consideration should be given to whether the prospective client wishes to accommodate the other interest involved.¹⁸

Indirect Adversity— May Representation Be Materially Limited?

The threshold question in matters of *indirect* adversity is whether the representation of the prospective client (Client A on Decision Tree No. 2) may be *materially limited* by the lawyer's representation responsibilities to B, a third party, or the lawyer's own interest?¹⁹ Even though there is no direct adversity, would the lawyer foreclose some alternative for prospective client A, or pursue it less aggressively, because of some concern for another client (B), or a third party, or the lawyer? There need not be any connection between the subjects of the representations; "substantial relationship" has nothing to do with it.

The limitation must be "material" and real, not remote or merely imagined. As with the determination of whether a "direct adversity" adversely affects a present client relationship, the analysis is *objective*, not subjective.²⁰ But an otherwise immaterial conflict could be considered "material," if a client had made it clear that the client

considered the possible conflict a serious and substantial one.²¹

Exception Upon Two Conditions

Will the Representation with Prospective Client (A) Be Adversely Affected?

As with *direct* adversity under MRPC 1.7(a), *indirect* adversity under MRPC 1.7(b) is permitted only if two successive conditions are met. But first is not the same as the "direct adversity" analysis,²² which focuses on the effect upon the relationship with present client B. The "indirect adversity" analysis focuses only on the effect upon the representation of prospective client A.

The comments to MRPC 1.7 say:

Relevant factors in determining whether there is potential for adverse effect include the duration and intimacy of the lawyer's relationship with the client or clients involved, the functions being performed by the lawyer, the likelihood that actual conflict would arise, and the likely prejudice to the client from the conflict if it does arise. The question is often one of proximity and degree.

... The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.

If the lawyer determines that these would likely be an adverse effect upon the representation, there is a conflict without cure. No waiver is permitted—and none should be sought. The analysis ends and the engagement with prospective client A must be declined.



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Mr. Allen wishes to acknowledge the special contributions to these articles by: Terry Bacon; Tom Byerley; Roger Clark; Jerry Goetz; Marcia Proctor; and the entire Ethics Committee.

Will Prospective Client (A) Consent?

If the lawyer determines that there would be no adverse effect upon the representation of prospective client A, the lawyer must also obtain a waiver, but the *only necessary consent is from Prospective Client A*. There is no need to obtain consent from the present client B, unless the lawyer intends to represent both A and B in a single matter; in that event, because there is an indirect conflict involving both A and B, each must consent, following a full disclosure and consultation with both A and B.²³

Except in such a dual representation, so long as prospective client A is informed of and consents to the indirect conflict, MRPC does not require informing or obtaining consent from present client B. This is consistent with the focus of MRPC 1.7(b) upon the representation of prospective client A. There is no need to inform or obtain consent from an unrelated third party. The lawyer must be aware of *indirect* conflicts issues, but need not inform every indirectly related client or third party of the prospective engagement being considered. ■

Footnotes

1. "Protected information" may include both "confidences" (privileged information) and other nonprivileged "secrets." See MRPC 1.6.
2. St. Paul Fire and Marine Ins. Co., *Professional Liability Claims by Error Group* (1987 to 1991).
3. *ABA/BNA Lawyers Manual on Professional Conduct*; February, 1998, News and Background.
4. Reform is never over. The ABA and its Ethics 2000 Commission are now considering a rewrite of the Rules of Professional Conduct, including the conflict rules. Stay tuned.
5. ABA, *Model Code of Professional Responsibility*, Ethical Consideration 5-15 (1969).
6. *Annotated Model Rules of Professional Conduct* (3rd Edition), ABA Center for Professional Responsibility (1996), pp. 144 and 152. See also *Waters v Kemp*, 845 F2d 260, 265-266 (11th Cir 1988); *Bergeron v Mackler*, 623 A2d 489 (Conn 1993); *ABA/BNA Lawyers Manual on Professional Conduct*, p. 51:206-207; Hazard and Hodes, *The Law of Lawyering*, § 1.9:107. Even under the former code, some courts found the "appearance of impropriety test" problematic. *Bennett Silvershein Assocs v Furman*, 776 F Supp 800 (SDNY 1991); *Silver Chrysler Plymouth v Chrysler Motors Corp.* 518 F2d 751 (2d Cir 1975). Only New Jersey retains "appearance of impropriety" as part of a version of the

- ABA Model Rules. *Dewey v R J Reynolds Tobacco Co*, 109 NJ 201; 536 A2d 243 (1988). A further source of confusion (especially for judges) is that the "avoid all appearance of impropriety" standard is retained in the Michigan Code of Judicial Conduct, Canon 2-A.
7. Other forms of proscribed conduct involving specific transactions with a client are covered by MRPC 1.8, which also prohibits the disadvantageous use of protected information without client consent. See MRPC 1.8(b).
8. For instance, see *Telectronics Proprietary, Ltd v Medtronic, Inc.* 836 F2d 1332, 1338 (Fed Cir 1988), where the court held that the lawyers who participated in the original prosecution of a patent were not disqualified from representing a party seeking to invalidate the same patent, now owned by a company which was never a client of the challenged lawyers.
9. See MRPC 1.13; nevertheless, even a non-client could present an indirect conflict under MRPC 1.7(b). See Part Two of this series of articles. "Present Client; Indirect Conflict."
10. See MRPC 1.0, Preamble—"Scope."
11. MRPC 1.7, Comment—"Consultation and Consent."
12. MRPC 1.7, Comment—"Loyalty to Client." "Direct" adversity does not require that both clients be parties; a present client as an adverse witness may also present a conflict under MRPC 1.7. See ABA Formal Opinion 92-367 (October 16, 1992).
13. *Restatement of the Law (Third) Governing Lawyers*, Proposed Final Draft No. 1 (3/29/96) § 201(c) (iii-iv).
14. MRPC 1.7, Comment—"Consultation and Consent."
15. MRPC 1.7(a)(2). Depending upon the sophistication, experience and other legal resources of the client, circumstances could recommend the retention of independent counsel before acting on the waiver request. Waivers and Consents are discussed (with examples) in Part Four of this series of articles: "Waivers, Consents and Screening Devices."
16. MRPC 1.7(b)(2). There may be circumstances where it is impossible to make the "full disclosure" necessary for consent, as when it involves protected information the disclosure of which is refused by the relevant client; in those instances, the lawyer may not properly ask for a waiver, since "informed consent" cannot be obtained. See MRPC 1.7, Comment—"Consultation and Consent."
17. MRPC 1.0, Comment—"Terminology."
18. MRPC 1.7, Comment—"Loyalty to Client."
19. MRPC 1.7(b)
20. *Restatement of the Law (Third) Governing Lawyers*, Proposed Final Draft No. 1. See Footnote 11, *supra*.
21. *Restatement of the Law (Third) Governing Lawyers*, Proposed Final Draft No. 1. § 201(c)(ii).
22. See Footnotes 12 and 13, *supra*, and accompanying text.
23. MRPC 1.7(b)(2). See Footnotes 15-17, *supra*, and accompanying text.