**Conflicts of Interest – The Three Dimensional Duty of Loyalty**

**Submission of the Corporate Counsel Section**
**Canadian Bar Association – BC Branch**
**to**
**the Law Society of British Columbia**
**on the Proposed Amendment to**
**the *Professional Conduct Handbook***

*A widespread belief appears to have evolved in the United States financial community that time honored rules such as those that discourage conflicts of interest are quaint and easily circumvented. Too frequently, in recent years, sharp practitioners in business, investment banking, accounting or law appear to have challenged the fundamental tenets of "full disclosure of material information" or "fair presentation of accounting results." A deterioration in the integrity of our corporate governance and mandatory disclosure systems may well have advanced, not because of a novel strain of human cupidity, but because we had so much success, for so long, that we began to forget why fundamental principles of full disclosure and corporate accountability long were considered essential. … After thoughtful and diligent investigation, I anticipate at least one inevitable result. Our traditional commitment to avoiding or fully disclosing conflicts of interest will be systematically reinvigorated.*

Joel Seligman
Dean and Ethan A.H. Shepley University Professor
Washington University School of Law in St. Louis
before the U.S. Senate Committee on Banking, Housing and Urban Affairs
March 5, 2002

*… the landscape of client relationships, particularly for national law firms, must change.*

*Lawyers and their firms … owe a full three-dimensional duty of loyalty—not just confidentiality—to their clients. The dimensions: the duty of avoiding conflicting interests, the duty of committing to the client's cause and the duty of being candid with the client on matters relevant to the retainer, or in other words, conflicts of interest.*

The Bright Line: The Decision of *R. v. Neil* and its Impact on the Business of Law in Canada by Kimberly J. Jakeman and Shanti M. Davies, Harper Grey Easton, 2003

Issue

After receiving a submission by representatives of certain Vancouver law firms, the Benchers of the Law Society of British Columbia recently approved in principle an amendment to the rules that would allow a lawyer to act against a current client without that client's consent in certain circumstances.

The Ethics Committee of the Law Society has advised that the policy decision was as follows:

> Lawyers may act against current clients who are sophisticated without their consent where:
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> a) the matters are substantially unrelated,
> b) the lawyer has no confidential information arising from the representation of one client that might reasonably affect the other representation, and
> c) the clients have been informed by their lawyers that their lawyers may act against them in the circumstances set out in a) and b) above.

The Corporate Counsel Section has concerns about the proposed amendment and asks the Law Society to accept the enclosed submission and recommendations.

Submission

The Professional Conduct Handbook currently provides, with respect to conflicts of interest, among other provisions, as follows:

**Acting against a current client**
6.3 A lawyer must not represent a client for the purpose of acting against the interests of another client of the lawyer unless:

> (a) *both clients are informed* that the lawyer proposes to act for both clients and *both consent*, and
> (b) the matters are substantially unrelated and the *lawyer* does not possess confidential information arising from the representation of one client that might reasonably affect the other representation. (Emphasis added.)

6.4 For the purposes of Rule 6.3, the consent of a client to the lawyer acting for another client adverse in interest may be inferred in the absence of contrary instructions if, in the reasonable belief of the lawyer, the client would consent in the matter in question because the client has

> (a) previously consented to the lawyer, or another lawyer, acting for another client adverse in interest,
> (b) commonly permitted a lawyer to act against the client while retaining the same lawyer in other matters to act on the client's behalf, or
> (c) consented, generally, to the lawyer acting for another client adverse in interest.

In the view of the Section, the proposed rule change would jettison two important safeguards in the current rules:

1. The requirement that both clients be informed of the proposal by the conflicted lawyer to act for both current clients; and
2. The requirement that both clients consent.

The proposed rule change violates the principles laid down by the Supreme Court of Canada in *Neil*, discussed below, and lacks the kinds of safeguards that other jurisdictions and bodies have deemed critical to a diluted conflicts standard.

It is the view of the Section that the proposed Rule change would seriously erode the absolute loyalty and unqualified zealousness that clients should be able to expect from their lawyers. It is further the view of the Section that, over time, such an eroded conflicts rule could present grave risks to clients, law firms, the profession at large, and the Law Society as the governing body for this province's lawyers and law firms.

*The right to be informed*

One reason the proposal alarms the Section is that it appears to assume perfect knowledge on the part of the conflicted lawyer. How, if the simple step of informing the client of his or her proposal to act is dispensed with, will the lawyer be in a position to know, understand and weigh the client's concerns? Dispensing with the process of obtaining consent means that clients will lose their opportunity to raise and discuss legitimate concerns and objections. The proposal undermines one of the foundations of the conflicts duty: the duty of being candid with the client on matters relevant to the retainer.

*Controls and audit*

There is no evidence with respect to how firms would propose to assure clients that the double representation will not place the lawyer and firm in fact (even accidentally) in a position to use clients' confidences, secrets, tendencies and methods in a manner adverse to their interests, or that the confidences or secrets of others will not be improperly used on their behalf.

Would the Law Society undertake to audit law firms for compliance, and punish transgressions, or require lawyers and law firms to self-audit or self-report? If not, then the conflict system runs completely and exclusively on trust. If the past two years of turmoil in the financial and stock markets have taught us anything, it is this: even highly trained professionals are subject to human temptations and lapses, deliberate, reckless and inadvertent.

It is clear that the view of firms on when a conflict should not bar a firm from acting is not, to say the least, infallible. The national law firm Blake, Cassels & Graydon LLP recently garnered harsh criticism from the Ontario Superior Court in the case *Chiefs of Ontario* v. *Ontario* [2003] O.J. No. 580 for having crossed the "bright line" in seeking to act against a former client. As Mr. Justice A. Campbell, of the Ontario Superior Court, bluntly stated: "There are some things that a law firm simply cannot do."

The section submits that the duty of avoiding conflicting interests includes a duty on the part of a self-governing profession to monitor compliance, e.g. by a system of audit or self-reporting, and, where appropriate, sanction those who act in the face of a conflict.

Further, both the proposed and current standard are not whether *the firm* has confidential information arising from the representation of one client that might reasonably affect the other representation but whether *the lawyer* has confidential information arising from the representation of one client that might reasonably affect the other representation. What controls are in place internally at firms to ensure that the representations will be kept completely separate? See, for example, the lengthy discussion of how to treat affiliated vs. merged firms for conflicts purposes in *Manville Canada Inc. v. Ladner Downs* (1992) 63 BCLR (2d) 102 (BCSC), affirmed (1993) 76 BCLR (2d) 273 (BCCA). Neither the existing rule nor the proposed rule deal adequately with the situation of a lawyer who works next door to another lawyer in the same firm who has relevant but confidential information, or whose loyalties lie in a very different direction.

*The right to consent*
The proposal to act in the face of a real or apparent conflict without either clients' consent goes to the very root of the client-lawyer relationship, which requires that lawyers act with due care and "give undivided loyalty to every client" and commit themselves to the client's cause. As a fiduciary, lawyers and firms must put the client's interests above their own.

Recent world events in the areas of finance, accounting, law and corporate governance underscore how critical it is for the guardians of these systems to ensure that conflicts are avoided in fact and in appearance. It is, simply stated, inappropriate for a lawyer or law firm to act for a client if the lawyer's (or law firm's) interests diverge or appear to diverge from the client's interests. To permit this to take place without the consent of the client will undermine confidence of clients and the public generally in the legal profession.

Firms that act in the face of such conflicts will lose (whether this is apparent or not) at least some of their previous or expected 'zealousness' in representing the causes of one, the other, or both clients. This is inevitable where loyalties are by definition divided.

*Other concerns*
Another concern is that it is not clear how the term 'sophisticated' will be defined or applied in practice. At what point in time, and under what criteria would classification occur? Could a client avoid the application of such an amended rule simply by declaring itself to be unsophisticated? Is there to be a presumption of sophistication? What if two unsophisticated clients were to marry or merge?

Further, the proposed rule is based on a test of whether the lawyer has "confidential information arising from the representation of one client that might reasonably affect the other representation". This test does not adequately capture the kinds and nature of information that might properly restrict a lawyer from acting against a client. In the course of acting for a client a lawyer obtains insight into how that client makes decisions, and what philosophies or exigencies drive its selection among various options. Is the client risk adverse? Does it have a ready pool of money to settle claims? What are its ethical, moral, or principal-based decision making criteria? Who among the client's staff or management makes decisions about processes, goals, expenditures, risk allocation? This kind of detailed, intangible information will be at the ready disposal of a lawyer who proposes to act in the face of a conflict and there can be few if any meaningful controls on the use of such information other than to prohibit such a lawyer from acting.

Finally, the proposal does not consider the fact that clients will be put to additional expense as a result of the rule, for example, in obtaining independent counsel when they are notified that a firm will act as proposed, or in obtaining new counsel if a breach at the firm so acting requires the firm to refer both clients out to another firm.

*Decisions*
In *MacDonald Estate* v. *Martin*, a 1990 decision of the Supreme Court of Canada, the majority of the Court set out the following two-step test for determining whether a lawyer should be restrained from representing a client on the ground of conflict of interest:

1. Whether the lawyer received confidential information attributable to a solicitor and client relationship relevant to the matter at hand. If so, and if the solicitor-client relationship is sufficiently related to the present matter, the court should infer that confidential information was passed on unless the lawyer can show that no relevant information was imparted to him/her.
2. Whether there is a risk that the information will be used to prejudice the client.

The Court stated: "A lawyer who has relevant confidential information cannot act against his client or former client. In such a case the disqualification is automatic. No assurances or undertakings not to use the information will avail."

The minority of the Court took an even stricter view, holding that there should be an irrefutable presumption that members of a law firm will share client confidences with one another.

The Court specifically referred to firm mergers and the growth of the mega-firm, saying that they should not be permitted to undermine the integrity of the legal profession.

In the 2002 decision *R. v. Neil*, the Supreme Court of Canada issued another significant decision in this area. The Court said in *Neil* that the duty of loyalty to a current client includes the much broader principle of avoidance of conflicts of interest, in which confidential information may or may not play a role. The aspects of the duty of loyalty in the case included issues of confidentiality as well as three other dimensions: the duty to avoid conflicting interests, a duty of commitment to the client's cause, and a duty of candour with the client on matters relevant to the retainer. The Court stated the general rule to be that a lawyer may not represent one client whose interests are directly adverse to the immediate interests of another current client – even if the two mandates are unrelated – unless both clients consent after receiving full disclosure (and preferably independent legal advice), and the lawyer reasonably believes that he or she is able to represent each client without adversely affecting the other.

The Court found that the law firm in question in the case owed a duty of loyalty to its former client and that this duty had been breached when a member of the firm used confidential information, obtained through attendance at a solicitor-client meeting, in the defence of a current client adverse in interest to the former client. The Court did not grant the former client a stay of proceedings because, among other reasons, the firm was no longer representing him when the charges against him were brought were brought; the damaging information would have been disclosed anyway even without the involvement of the law firm; and a stay was a disproportionate remedy in light of the seriousness of the charges. The Court did however suggest that the former client had grounds to complain to the Law Society of Alberta.

The Court affirmed in very strong language the ruling in *MacDonald Estate* that the duty of loyalty to one's client is essential to the integrity of the administration of justice and that this duty cannot be eroded though lawyers' desire for mobility or as a result of the trend to larger firms. Further, the Court highlighted that the duty of loyalty is not restricted to the use of confidential information, but includes a duty to avoid conflicting situations, a duty of commitment to the client's cause, i.e. zealous representation, and a duty of candor. It is further the duty of a lawyer to put the client's interests ahead of his or her own. Binnie J. defined conflicts as the "substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person." He referred to a limited number of exceptions:

> "In exceptional cases, consent of the client may be inferred. For example, governments generally accept that private practitioners who do their civil or criminal work will act against them in unrelated matters. … Chartered banks and entities that could be described as professional litigants may have a similarly broad-minded attitude where the matters are sufficiently unrelated that there is no danger of confidential information being abused. These exceptional cases are explained by the notion of informed consent, express or implied."

However, incomplete or inefficient conflicts searches or administrative difficulties associated with obtaining express consent to act are no excuse for allowing a firm to act in the face of a conflict.

Kimberly J. Jakeman and Shanti M. Davies, of the firm Harper Grey Easton, write in *The Bright Line: The Decision of R. v. Neil and its Impact on the Business of Law in Canada* (http://www.hgelaw.com/lawupdate/index.htm) as follows:

> The duty of commitment necessarily prohibits representing two or more clients, to whom the lawyer cannot give complete dedication. Human nature being what it is, Neil shows that solicitors cannot give their exclusive, undivided attention to the interests of their clients if they are torn

> between the interests of one client and those of another to whom he also owes the same duty of loyalty, dedication and good faith.

Further:

> The duty of candour requires the client be among the first to hear about a conflict, as soon as practicable after one emerges.

The B.C. Court of Appeal considered similar issues in *Ribeiro v. City of Vancouver et al*. (2002 BCCA 678). The City of Vancouver sought to prohibit a Vancouver law firm from acting against it in an assault case on the basis that the firm was acting for the City in two other cases, defending police officers in connection with high-speed car chases. The firm ceased acting for the city in the car chase cases and took the view that it ought to be able to continue acting for Ribeiro. The Court of Appeal considered that it must apply the Professional Conduct Handbook of the B.C. Law Society, which provided that a lawyer must not represent a client against the interests of another client of the lawyer unless both are informed that the lawyer proposes to act for both clients, both clients consent, the matters are substantially unrelated and the lawyer does not possess confidential information of one client that might reasonably affect the other.

The Court characterized the handbook restriction as barring any lawyer from acting for and against a client at the same time and was "troubled by the absolute character of this prohibition." [Section members do not agree that the handbook is as restrictive as the Court seemed to view it, since in our experience consent in such circumstances is often sought and obtained.]

In the *Ribeiro* case, having regard to the inadvertence of the conflict, the fact the two matters were not within the 'sufficiently related category', the fact that the firm had no confidential information that could be used against the City, and the weight the court put, on the unusual facts of this case, on Ribeiro's right to have counsel of his choice, the Court consented to the conflict.

*Other jurisdictions/Associations*
All provinces and territories in Canada except Nunavut have in place codes of professional conduct for lawyers that address conflicts of interest. Generally, these require that lawyers act at all times in accordance with their duty to give undivided loyalty to every client.

The Standing Committee on Ethics and Professional Issues of the Canadian Bar Association has recently considered a request by law firms to make the conflicts rules less restrictive. Their discussion of this issue is contained in a just-released draft review of the CBA's Code of Professional Conduct, *Modernizing the CBA Code of Professional Conduct*. The Committee has asked for comment on the draft and proposes to formulate resolutions for CBA Council's consideration and debate at the 2004 mid-winter meeting.

An excerpt from *Modernizing the CBA Code of Professional Conduct* is reproduced below.

> 6. Multiple Representation with Client Consent Without Sharing of Confidential Information
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> The Committee received a thorough and thoughtful submission on behalf of six law firms who have urged the CBA to amend Chapter V to permit law firms, with informed client consent, to represent two or more parties to a transaction on the basis that confidential information will not be shared among the lawyers who are representing different parties to the transaction. Such a regime would entail the use of screening mechanisms similar to those that are used where lawyers transfer from one firm to another. The proponents of such a proposed reform have submitted that conflict of interest rules should promote freedom of choice for knowledgeable and sophisticated clients, and that where all clients involved consider it to be in their best interests that the same law firm act for all of them on the basis that confidential information will not be shared between clients, and are prepared to consent to such an arrangement, codes of professional conduct should not prevent their preference from being respected.
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> The Committee is not prepared at present to recommend that Chapter V be amended to permit such arrangements, though it would welcome further input respecting the issue. The Committee is concerned that to allow a law firm to act for different parties to a transaction on such a basis would not be in the public interest in some cases. It is concerned that, notwithstanding the client's consent, a party who learns after the completion of a transaction of information that would have influenced the client's decision to enter into an agreement may justifiably object to the fact that information known to the firm representing the client (though not the lawyer in that firm representing the client) was withheld.
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> In summary, the Committee recommends that Chapter V be amended to read as follows:
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> Chapter V – Impartiality and Conflict of Interest Between Clients
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> Rule
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> The lawyer shall not advise or represent both sides of a dispute and, save after adequate disclosure to and with the consent of the clients or prospective clients concerned, shall not act or continue to act in a matter when there is or is likely to be a conflicting interest.

Commentary

Guiding Principles

1. A conflicting interest is one that would be likely to affect adversely the lawyer's judgment or advice on behalf of, or loyalty to a client or prospective client.

2. The reason for the Rule is self-evident. The client or the client's affairs may be seriously prejudiced unless the lawyer's judgment and freedom of action on the client's behalf are as free as possible from compromising influences.

3. Conflicting interests include, but are not limited to the duties and loyalties of the lawyer or a partner or professional associate of the lawyer to any other client, whether involved in the particular transaction or not, including the obligation to communicate information.

4. A lawyer may not represent one client whose interests are directly adverse to the immediate interests of another current client, even if the two matters are unrelated, unless both clients consent after receiving full disclosure and, preferably, independent legal advice.

Disclosure of Conflicting Interest

5. The Rule requires adequate disclosure to enable the client to make an informed decision about whether to have the lawyer act despite the existence or possibility of a conflicting interest. As important as it is to the client that the lawyer's judgment and freedom of action on the client's behalf should not be subject to other interests, duties or obligations, in practice this factor may not always be decisive. Instead it may be only one of several factors that the client will weigh when deciding whether to give the consent referred to in the Rule. Other factors might include, for example, the availability of another lawyer of comparable expertise and experience, the extra cost, delay and inconvenience involved in engaging another lawyer and the latter's unfamiliarity with the client and the client's affairs. In the result, the client's interests may sometimes be better served by not engaging another lawyer. An example of this sort of situation is when the client and another party to a commercial transaction are continuing clients of the same law firm but are regularly represented by different lawyers in that firm.

6. Before the lawyer accepts employment from more than one client in the same matter, the lawyer must advise the clients that the lawyer has been asked to act for both or all of them, that no information received in connection with the matter from one can be treated as confidential so far as any of the others is concerned and that, if a dispute develops that cannot be resolved, the lawyer cannot continue to act for both or all of them and may have to withdraw completely. If one of the clients is a person with whom the lawyer has a continuing relationship and for whom the lawyer acts regularly, this fact should be revealed to the other or others at the outset with a recommendation that they obtain independent representation. If, following such disclosure, all parties are content that the lawyer act for them, the lawyer should obtain their consent, preferably in writing, or record their consent in a separate letter to each. The lawyer should, however, guard against acting for more than one client where, despite the fact that all parties concerned consent, it is reasonably obvious that an issue contentious between them may arise or their interests, rights or obligations will diverge as the matter progresses.

7. Although commentary 6 does not require that, before accepting a joint retainer, a lawyer advise the client to obtain independent legal advice about the joint retainer, in some cases, especially those in which one of the clients is less sophisticated or more vulnerable than the other, the lawyer should recommend such advice to ensure that the client's consent to the joint retainer is informed, genuine, and uncoerced.

8. If, after clients involved have consented, an issue contentious between them or some of them arises, the lawyer, although not necessarily precluded from advising them on other non-contentious matters, would be in breach of the Rule if the lawyer attempted to advise them on the contentious issue. In such circumstances the lawyer should ordinarily refer the clients to other lawyers. However, if the issue is one that involves little or no legal advice, for example a business rather than a legal question in a proposed business transaction, and the clients are sophisticated, they may be permitted to settle the issue by direct negotiation in which the lawyer does not participate. Alternatively, the lawyer may refer one client to another lawyer and continue to advise the other client if it was agreed at the outset that this course would be followed in the event of a conflict arising.

The Section will be reviewing and commenting on the draft, but considers the caution and care taken by the drafters to be an appropriate and fair approach to the issue.

The District of Columbia Bar recently considered the issue of advance waivers of conflicts of interest, i.e. waivers that are granted before the conflict arises and generally before its precise parameters are known.

The reasons for the review included issues familiar to the bar in BC, and, indeed, throughout Canada:

1. The increasing concentration of lawyers in large firms scatted across the country and around the world;
2. A trend by clients to distribute their work among many firms; and
3. The risk that a strict conflicts rule will deny clients' choice of a lawyer and reduce their potential choice of lawyers generally.

It was noted that the DC rules allowed clients to waive conflicts on a case by case basis if they viewed such waivers as being in their interest, subject to the limitation that a lawyer may not advance adverse positions of two current clients in the same matter, being a conflict that is not waivable.

US courts had sustained advance waivers where the potential adverse party was known and identified, the client giving the waiver was sophisticated, and the waiver had been reviewed by the client's in-house counsel.

The DC bar concluded that advance waivers should be permissible provided that:

1. there was full disclosure of the existence and nature of the possible conflict and the possible adverse consequences of the representation;
2. the client had information reasonably sufficient to permit the client to appreciate the significance of the matter in question and to allow a fully informed decision with awareness of the possible extra expense, inconvenience, and other disadvantages that may arise if an actual conflict arises and the lawyer is required to terminate the representation; and
3. there had been detailed explanation of the risks and disadvantages to the client, which usually requires either (1) that the consent is specific to certain types of adverse representations, or (2) in-house counsel has reviewed and approved the waiver.

The DC recommendations have some features that should be considered should the Law Society ultimately make any changes to the current rules on conflicts.

<u>Recommendation</u>

The Corporate Counsel Section has serious concerns about the breadth, scope, content and apparent philosophy of the proposed amendment.

We ask that the Law Society:

1. Provide the Section with a copy of the submission by the law firms that led to the proposed rule change so that we can review and comment on it.
2. Request that the proponent law firms to meet and work with the Section toward a more carefully structured amendment (if one is necessary) that would set appropriate criteria on the circumstances (if any) in which firms should be permitted to act in the face of conflicts between clients.
3. Defer any amendment to the rules until (i) we have met with the law firms and worked toward a common position; (ii) the Canadian Bar Association completes its review and report after debate at the 2004 mid-winter meeting; and (iii) input from the B.C. bar has been solicited and carefully reviewed.
4. Conduct a review of the whether the current language in the rules is too permissive in light of *Neil, Chiefs of Ontario* v. *Ontario*, and the Canadian Bar Association report on modernizing the CBA Code of Professional Conduct.

It may be possible for the Law Society to amend the conflicts rules, but, in the view of the Corporate Counsel Section, such a move should be taken after due consideration of all interests, including most critically those of the affected clients we all serve, and not simply those of law firms.

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