

## Don't Get Burned By The Hot Potato Client

BY MARY C. DALY

With the downturn in the economy, the pressure on law firms to generate profits has reached a new level of intensity. Some law firms are merging with other firms, hoping that a larger staff and wider geographic presence in the United States and abroad will not only enable the combined firm to offer existing clients more services, but will also attract new clients. Other firms are aiming to achieve the same goal by increased cross-selling of services to existing clients and a more focused solicitation of potential clients. Still other firms are "raiding" smaller or weaker firms and building new departments or expanding existing specialties.

In their eagerness to attract new business, law firms will occasionally decide to drop one current client "like a hot potato" in order to represent an existing or potential client in a matter adverse to that current client. Often, they regard the decision to withdraw from a representation as simply a business call, ignoring its ethical implications. This article examines the lawyer's ethical duty of client loyalty and the relevant conflict of interest provision of the New York State Bar Association's Lawyer's Code of Professional Responsibility (Code), DR 5-105, and offers some practical compliance hints that do not necessarily require the sacrifice of new business opportunities.

Generally speaking, the duty of client loyalty prevents lawyers from concurrently representing two clients with adverse interests - even in unrelated matters.

It's not difficult to understand how a law firm can find itself in a predicament that prompts a decision to terminate a representation prematurely. A newly merged law firm is likely to base its decision to withdraw from Client A and retain Client B for solid business reasons, such as the strategic importance of the preferred client to the new firm and the size of the fees that its representation will generate. In circumstances not involving a merger, the initial decision to accept a conflicting engagement is often heavily influenced by the perception that the two engagements are not truly related. For example, a law firm may represent Client A in a labor matter and subsequently agree to represent Client B in an action against Client A for breach of contract. *E.g., Stratagem Development Corp. v. Heron Int'l N.V.*, 756 F. Supp. 789 (S.D.N.Y. 1991).

Sometimes a decision to withdraw is additionally complicated by the fact that one or both of the matters involves a subsidiary of Client A or B. In that instance, a law firm must also resolve difficult conflict issues related to the representation of the members of a corporate family. *Compare, Stratagem Development Corp, supra* (treating the representation of a subsidiary as the representation of the parent company) *with* N.Y. Co. Lawyers' Ass'n Op. 684 (1991); ABA Formal Op. 95-390 (1995) (concluding that a subsidiary is not a client of the lawyer for the parent company unless certain conditions are met.)

## **Rule Can Be Deceptive**

Dubbed "the hot potato gambit" by the courts, a law firm's decision to withdraw from a preexisting representation to pursue a new one rarely wins judicial approval. The courts' disapproval springs directly from the Code's insistence on the fundamental importance of the duty of loyalty that a lawyer owes a client. *See, Cinema 5, Ltd. v. Cinerama, Inc.*, 528 F.2d 1384 (2d Cir. 1976). DR 5-105 generally prohibits a lawyer from simultaneously representing two clients with interests adverse to one another without the clients' consent. But the language the rule employs can be deceptive in two ways. First, the language can easily mislead a lawyer into believing that the particular adverse representation is permitted. Second, it can be misinterpreted to suggest a preengagement solution to prevent the conflicts problem from arising at all.

Subsection A of DR 5-105 provides in relevant part: " A lawyer shall decline proffered employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve the lawyer in representing differing interests ... ." Subsection B contains almost identical language with respect to the continuance of employment on behalf of multiple clients.

Lawyers who are overly eager to accept a new representation tend to seize on DR 5-105's language "will be or is likely to be adversely affected" and hastily conclude that the representation will present no danger to the exercise of independent judgment. Their soul searching in conducting this inquiry is frequently both short and superficial. Furthermore, they are likely to ignore the definition of "differing interests." "Differing interests" are defined in the Definitions section of the Code as "every interest that will adversely affect either the judgment or the loyalty of a client, whether it be a conflicting, inconsistent, diverse, or other interest." It is difficult to conceive of a more encompassing definition.

## **Imagine Yourself As The Client**

The easiest way for a lawyer to avoid misapplying Subsections A and B is simply to imagine himself as the client in the first representation and to honestly answer the question, "Would I feel that my lawyer was disloyal to me if she accepted this representation adverse to me?" Most people will answer that question affirmatively if the proposed representation might cause the lawyer to accuse the existing client of deliberate misrepresentation, fraud, or criminal conduct in litigation, or lead the lawyer to engage in raw-knuckled negotiations. They will find it harder to answer the question affirmatively if the two matters are wholly unrelated, especially if the lawyers handling them work in different departments or offices in different locations. The courts, however, usually give little weight to the size and scope of the first engagement and to the relationship between the two matters, emphasizing, instead, the paramount duty of loyalty. When the conflict arises because of a merger of two firms, the lawyers may have strong ties of loyalty to both clients and genuinely believe that the vigor of their representation in behalf of both will not diminish by virtue of their new affiliation. In the view of most courts, the absence of client consent robs this argument of any force it may otherwise have.

As a general proposition, therefore, a law firm cannot unilaterally transform an existing client into a former client. The benefit of the transformation is, of course, obvious from the firm's perspective - the substantial relationship test used to measure when a law firm may represent a new client in a matter adverse to a former client is far less rigorous than the per se rule that most courts apply to simultaneous adverse representations. *See* DR 5-109.

On rare occasions, a court has permitted a law firm to withdraw from the representation of one existing client and continue an adverse engagement on behalf of another client. The departure from the generally applicable per se rule of disqualification frequently involves a conflict created by the corporate merger of one of the clients, an independent event over which the law firm obviously has no control. Because the conflict was not lawyer-generated (as in the instance of a law firm merger), the law firm may continue to represent the client of its choice. For example, in *University of Rochester v. G.D. Searle & Co., Inc.*, 2000 WL 1922271 (W.D.N.Y., Dec. 11, 2000), the plaintiff filed an action for patent infringement against four defendants. When the law firm representing the plaintiff initially accepted the representation, the merger that formed the defendant Pharmacia Corp. had not yet occurred. The court denied Pharmacia's motion for disqualification, noting that the timing of the merger "tips the balance further against disqualification."

### **Exception: "Client in the Traditional Sense"**

The *University of Rochester* decision is also noteworthy for the court's discussion of another rare exception to the hot potato doctrine. Known as the doctrine of "clients in the traditional sense," this exception examines the nature of the relationship between the law firm and the client the firm is trying to drop. A client may not be a client "in the traditional sense" in two sets of circumstances: first, if the law firm accepted a representation as an accommodation to another existing client; or second, if the law firm, with the client's consent, was playing a very inactive role in the representation because another law firm had assumed the responsibility of lead counsel. Withdrawal from the representation of the client in either of these two circumstances is more likely to be granted than withdrawal from a client "in a traditional sense." *Id.* at \*6-7.

In a few instances, a court has permitted a law firm to continue an otherwise prohibited representation, on the theory that the lawyer's conduct did not "taint" a pending trial or prejudice the other client. *Universal City Studios, Inc. v. Reimerdes*, 98 F. Supp.2d 449 (S.D.N.Y. 2000); cf., *Chemical Bank v. Affiliated FM Insurance Co.*, 1994 WL 141951 at \*19 (S.D.N.Y. 1994). The decision to deny a motion to disqualify for these reasons does not validate the conduct of the lawyer or the law firm, and they remain subject to discipline.

The hot potato doctrine has clearly made it more difficult for a law firm to withdraw from the representation of an existing client in order to undertake a representation adverse to that client. In the absence of client consent, there are two possible solutions to the dilemma the doctrine poses. One is for the law firm to include a waiver provision in its engagement letter. The other is for the bar to amend DR 5-105.

Subsection C of DR 5-105 expressly recognizes that a law firm may undertake an otherwise prohibited representation "if a disinterested lawyer would believe that the lawyer can competently represent the interests of each [client] and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved." Assuming that the representation can satisfy the disinterested lawyer standard, the remaining issue of disclosure to the "hot potato" client is nettlesome.

## Dealing with Advance Waivers

There is no per se ethical prohibition against advance waivers of conflicts of interest. N.Y. Co. Lawyers' Ass'n. Op. 724 (1998). Many law firms ask their clients for an advance waiver that incorporates the substantial relationship test of DR 5-109, the provision used to measure former client conflicts. The problem here, of course, is that determining when one matter is substantially related to another is less a science than an art. Furthermore, describing to the client the advantages and risks of a simultaneous adverse representation that has not yet occurred is not an easy task. For these reasons, many clients are reluctant to give consent and prefer that the law firm renew its request for consent when the conflict actually arises.

A law firm must pay careful attention to the wording of any advance waiver. At least one court has warned that a waiver must specifically include a reference to possible litigation before a law firm will be permitted to sue an existing client on behalf of another. *See, University of Rochester, supra*. If a law firm chooses to adopt the related strategy of limiting the scope of an engagement in order to avoid a conflict with a present or former client, it should make that explicitly clear in its retention letter as well. N.Y.C. Op. 2001-3 (2001). *See, also, Sumitomo Corp. v. J.P. Morgan & Co.*, 2000 WL 145747 (S.D.N.Y., Feb. 8, 2000)

Many law firms, especially the larger ones, complain that a strict prohibition against simultaneous adverse representation makes little sense given the realities of modern practice. They accuse clients of unfairly withholding consent. In their view, the rule may have been justified when law firms had only one or two offices, and clients and law firms had long-standing relationships. They object that today's corporate clients employ the hot potato gambit at least as often as law firms, noting the ease and frequency with which some clients hire new law firms at the expense of existing relationships. These critics also suspect that clients deliberately spread their business among a large number of firms in order to benefit to the greatest degree possible from the ethical prohibition against simultaneous adverse representation.

The time may be ripe for the New York State Bar Association to consider amending the rule against simultaneous adverse representation. One possibility would be the substitution of the substantial relationship test of DR 5-109. The Texas Rules of Professional Conduct have a similar provision. *See Texas Disciplinary Rules of Professional Conduct R.1.06(b)(1)* (1990).

Another, more limited solution, would be to model a new disciplinary rule on Rule 1.7(d) of the Washington, D.C. Rules of Professional Conduct. Rule 1.7(d) permits a law firm to represent parties with adverse interests (1) if the conflict between them was not reasonably foreseeable at the outset of a representations; (2) the clients' interests are not adversely affected; and (3) the lawyer's professional judgment is not adversely affected. Using this Rule as "guidance and support," the D.C. Bar Legal Ethics Committee has opined that under some circumstances, a law firm may withdraw from the representation of a client in order to represent another client in an adverse matter. DC Bar Op. No. 272 (1997).

Still another limited solution would be to incorporate the language of the comment to the new ABA Model Rule 1.7. The comment allows a lawyer to "withdraw from one of the representations in order to avoid the conflict" provided that the conflict resulted from "[u]nforeseeable events, such as changes in corporate and other organizational affiliations or the addition or realignment of parties in litigation ... ."

In sum, it is a serious mistake for a law firm to treat as a business call the decision to withdraw from the representation of one client in order to accept or continue the representation of another client in an adverse matter. Failure to observe the ethical obligations that DR 5-105 creates and implies can subject both a lawyer and a law firm to sanction. (Remember: New York is one of only two jurisdictions in the United States that allow for law firm discipline. *See* DR 1-104 & DR 5-105(e)). The failure may also lead to disqualification in litigation. If the conflict is sufficiently egregious, the "hot potato" client may seek monetary damages in an action for malpractice or breach of fiduciary duty. The risk of injury to a law firm's reputation regardless of these other consequences can be quite high. A law firm that does not carefully consider how the Code's conflict provisions affect its client-base after a merger or its new business strategies is penny wise, but pound foolish.

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