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Imputed Conflicts Under The New DR 1-107

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My article in last month's NYPRR covered imputed conflicts of interest under DR 1-106, which governs a law firm's direct or indirect provision of legal services to its clients and to the general public. This month I will cover imputed conflicts under DR 1-107, which (in conjunction with the new 22 NYCRR Part 1205) governs a law firm's reciprocal referral arrangements, strategic alliances, and other cooperative or contractual business relationships with nonlegal professionals.

I will begin by imagining a law firm, Lex & Nonlex that wants to squeeze every possible advantage out of DR 1-107, establishing every type of legitimate relationship with nonlawyers that the rule allows. Lex & Nonlex handles a lot of real estate deals for major downtown developers, so it wants to coordinate its legal work with others in the real estate and construction fields, including architects, engineers, real estate brokers, and bankers. To accomplish this objective, Lex & Nonlex enters into the two major kinds of arrangements envisioned by DR 1-107. The two kinds of arrangements are summed up in EC 1-14, which begins by saying:

> **EC 1-14:** The contractual relationship permitted by DR 1-107 may provide for the reciprocal referral of clients by and between the lawyer or law firm and the nonlegal professional or nonlegal professional service firm. It may also provide for the sharing of premises, general overhead, or administrative costs and services on an arm's length basis...

First, pursuant to DR 1-107(A), the law firm enters into a "contractual relationship" with a major architectural firm, Skidmore, Jahn & Johnson, "for the purpose of offering to the public, on a systematic and continuing basis," legal services to be performed by Lex & Nonlex, plus architectural services to be performed by the architectural firm. Under this arrangement, the law firm will refer developers to the architectural firm, and the architectural firm will refer its clients to the law firm. In addition, the law firm and the architectural firm agree to move their offices into the same building, and to jointly advertise their new "strategic alliance," promising the public tightly coordinated professional services for serious real estate developers.

Second, pursuant to DR 1-107(D), the law firm and the architectural firm agree to allocate rent, general overhead, and administrative expenses in a manner that "reasonably reflects the costs and expenses incurred or expected to be incurred by each."

Third, pursuant to DR 1-107(C), the law firm enters into a non-exclusive reciprocal referral agreement with a professional engineering firm. The agreement provides that whenever the law firm's clients need professional engineering services (*e.g.*, construction advice, expert testimony, or soil testing), the law firm will recommend the engineering firm, unless there is some reason not to do so - and whenever the engineering firm's clients need legal services, it will recommend the law firm. (This is like the relationship with the architectural firm, except that the law firm and the engineering firm do not plan to share the same office, engage in joint advertising or share costs and expenses.)

The law firm may also want to coordinate its work with real estate brokers and bankers, but DR 1-107 authorizes reciprocal referral agreements and other types of contractual relationships only between lawyers and nonlegal *professionals*. In my view, real estate brokers and bankers do not qualify as "professionals" within the meaning of DR 1-107. Neither DR 1-107 nor the Definitions section of the Code defines the term "professional," but DR 1-107(B) gives some important clues. By way of background, both DR 1-107(A) and new 22 NYCRR Part 1205 refer to a "list" of approved professions to be jointly established and maintained by the Appellate Divisions. (The Appellate Divisions had not yet created this list as this article was written, but they were expected to do so shortly.)

To be eligible for inclusion on the list of "professions" under DR 1-107(B), a profession must be "composed of individuals who" satisfy three criteria: (1) they have a Bachelor 's Degree or its equivalent from an accredited college or university; (2) they are licensed by an agency of the State of New York or by a federal government agency; and (3) they are "required under penalty of suspension or revocation of license to adhere to a code of ethical conduct that is reasonably comparable to that of the legal profession." In my judgment, neither real estate brokers nor bankers are likely to meet all three criteria.

Accordingly, under DR 1-107, the law firm of Lex & Nonlex is limited to relationships with professionals such as architects and professional engineers. Relationships with nonprofessionals such as bankers and real estate brokers will have to be accomplished informally or through DR 1-106, which governs relationships with all nonlawyers, not just professionals.

The problem of imputed conflicts

The problems addressed in this article arise out of EC 1-18, which provides as follows:

Depending on the extent and nature of the relationship between the lawyer or law firm, on the one hand, and the nonlegal professional or nonlegal professional service firm, on the other hand, it may be appropriate to treat the parties to a contractual relationship permitted by DR 1-107 as a single law firm for purposes of these Disciplinary Rules, as would be the case if the nonlegal professional or nonlegal professional service firm were in an "of counsel" relationship with the lawyer or law firm. If the parties to the relationship are treated as a single law firm, the principal effects will be that the *conflicts of interest are imputed as between them pursuant to* DR 5-105(D), and that the law firm would be required to maintain systems for determining whether such conflicts exist pursuant to DR 5-105(E). ... [Emphasis added.]

We have now reached our main question: When does a contractual relationship between a law firm and a nonlegal professional service firm create circumstances in which conflicts of interest are imputed from the law firm to the non- legal professional service firm, and vice versa?

According to EC 1-18, if the contractual relationship under DR 1-107 between the law firm and the architectural firm is sufficiently close, then the lawyers and the architects may be treated as if they were "a single firm." If this occurs, then if any lawyer in the law firm of Lex & Nonlex is personally disqualified under DR 5-101, 5-105, 5-108, or 9-101(B), then every lawyer in the law firm will be disqualified under DR 5-105(D) - and since we are assuming that the law firm and the architectural firm are close enough to be treated as a "single firm," the same conflicts will also be imputed to the architectural firm and to every architect. Moreover, the architectural firm's conflicts will be imputed to the law firm. To meet the duty imposed by DR 5-105(E) to check for imputed conflicts of interest, the law firm therefore must combine its client database with the architectural firm's client database and check every proposed new engagement against *both* databases for conflicts. That is a gargantuan task, and the law firm and the architectural firm surely want to avoid it. The next question, then, is how to avoid circumstances requiring that the law firm and the nonlegal professional service firm be treated as "a single firm."

Imputed conflicts under
DR 1-107(A) and (D) and EC 1-18

As mentioned earlier, DR 1-107(A) refers to a "contractual relationship with a ... nonlegal professional service firm for the purpose of offering to the public, on a systematic and continuing basis, legal services performed by the lawyer or law firm, as well as other nonlegal professional services ...." And DR 1-107(D) makes it clear that the parties to such a contractual relationship "may allocate common costs and expenses ... provided the allocation reasonably reflects the costs and expenses incurred or expected to be incurred by each."

EC 1-18 gives no guidance for determining when the "extent and nature of the relationship" between the lawyers and the nonlegal professionals will make it "appropriate" to treat them as a single law firm, but a useful approach is to examine situations in which two separate law firms share offices and are treated as if they were a single law firm for purposes of conflicts of interest.

A very helpful opinion on this issue, New York County Lawyers' 680 (1990), stated:

Even though lawyers who share office space are not partners, they may be treated as if they were partners for some purposes under the Code (particularly the provisions for vicarious disqualification in the event of a conflict of interest) *if their office sharing arrangements give them access to each other's files* and, thus, to the confidences and secrets of each other's clients. [Emphasis added.]

Another helpful opinion, N.Y. City 80-63 (1980), concerned two different law firms that shared a suite of offices and had a close working relationship. The firms acted as co-counsel on some cases, referred matters to each other, and shared a telephone system. Moreover, because the firms shared offices, the secretaries of both law firms covered for one another at lunch or when a secretary was out sick. When lawyers from one law firm walked through the office suite, they could see papers relating to clients of the other law firm. The two firms asked the Committee whether they could represent opposing parties in a

litigation. The Committee said "no," because it saw a "strong likelihood" that the separate law firms could not maintain the confidences and secrets of their respective clients.

The Comment to Rule 1.10 of the ABA Model Rules of Professional Conduct expresses similar principles. Comment 1 says, in part:

Whether two or more lawyers constitute a firm ... can depend on the specific facts. For example, two practitioners who share office space and occasionally consult or assist each other ordinarily would not be regarded as constituting a firm. However, *if they present themselves to the public in a way suggesting that they are a firm or conduct themselves as a firm, they should be regarded as a firm for purposes of the Rules*. The terms of any formal agreement between associated lawyers are relevant in determining whether they are a firm, as is the fact that they have mutual access to confidential information concerning the clients they serve. *[Emphasis added.]*

Of course, New York has not adopted the ABA Model Rules, but in N.Y. State 609 (1990) the Committee stated that the Comment quoted here "correctly summarizes the general principle under the Code."

The key to avoiding imputed conflicts
These opinions about office-sharing arrangements between two law firms provide the key to avoiding "single firm" treatment for law firms and nonlegal professionals who have entered into contractual relationships pursuant to DR 1-107. The key to avoiding "single firm" treatment is to keep the *operations* of the law firm and the nonlegal professional service firm sufficiently separate to avoid compromising confidential client information, and to keep the *identities* of the law firm and the nonlegal professional service firm separate in terms of public perception.

In terms of operations, the law firm and the nonlegal professional service firm must each carefully guard the confidential information of its clients to make sure the information is neither visible nor accessible to the other firm. (The nonlegal professionals may not have the same duty of confidentiality as the lawyers, but it would be unfair and unseemly for a law firm to oppose the nonlegal professional service firm's clients if the law firm possessed or had ready access to confidential client information about those clients. It would be equally unfair to clients of the law firm to be opposed by nonlegal professionals who had access to the confidential information relating to the law firm's clients.)

In more concrete terms, keeping the operations sufficiently separate to protect confidential information means maintaining separate computer networks and file systems, and using common sense to keep confidential information secret. Preferably, the law firm and the nonlegal professionals should not share a common computer network. If they do, they must have highly secure passwords so that only the lawyers can access the law firm's confidential information and only the nonlegal professionals can access the nonlegal professional service firm's confidential information. At the same time, each entity should maintain a separate file room, and each should lock its file room or otherwise prohibit the personnel of the other from gaining access to its file room. If separate file rooms are not possible, then files should all be kept in locked file cabinets or otherwise kept beyond the reach of professionals and employees of the other firm. If the lawyers and nonlegal professionals share fax machines, photocopy equipment, telephones, conference rooms, or receptionists, both the lawyers and the nonlawyers must constantly be vigilant to prohibit anyone in the other firm from seeing confidential papers or overhearing confidential conversations.

In terms of public perception, both the law firm and the nonlegal professionals must make clear that the law firm and the nonlegal professional service firm remain separate entities. The separate status should be reflected on signs, in advertising, on stationery, in the way the receptionists answer the phones, and in all that other ways that each firm interacts with the public. The firms can mention each other orally and in print, but they should always make plain that the law firm and the nonlegal professional service firm are two separate and independent firms, not a single large firm.

Of course, only the law firm is required to follow the Code of Professional Responsibility. DR 4-101 of the Code requires a law firm to maintain the confidences and secrets of its clients. A law firm that has entered into a contractual relationship pursuant to DR 1-107 can fulfill this duty only by making sure that the nonlegal professional service firm respects and protects the confidential information entrusted to it by its own clients in its separate engagements and by the law firm's clients in joint engagements. If the nonlawyers fail to do this, then the lawyers are violating DR 4-101(D). Moreover, the law firm has a duty under DR 2-101 to avoid misleading the public. The law firm must therefore ensure that the nonlawyers do not confuse the public about the nature and extent of the DR 1-107 contractual relationship. The Comment to ABA Model Rule 1.10 bears repeating: if the two firms "present themselves to the public in a way suggesting that they are a firm or conduct themselves as a firm, they should be regarded as a firm for purposes of the Rules."

Imputed conflicts under DR 1-107(C)

DR 1-107(C) refers to "relationships consisting solely of reciprocal referral agreements or understandings between a lawyer or law firm and a nonlegal professional service firm." As far as I know, no authorities impute conflicts to the lawyers in a mere reciprocal referral relationship between lawyers and nonlegal professionals. Thus, a law firm may refer a client to a nonlegal professional for expert testimony or consultation regarding environmental concerns even if the same nonlegal professional is serving as a consultant or expert for an opponent of the law firm's client's in another pending lawsuit. Even though the law firm itself could not simultaneously represent the client while advising the client's opponent, the work done by the nonlegal professionals is not imputed to the law firm. Therefore, the law firm need not check for imputed conflicts with nonlegal professionals if the relationship is limited to reciprocal referrals. While the law firm might occasionally have a conflict under DR 5-101(A) arising from the law firm's own interests -personal, business, or financial - in maintaining good relations with the nonlegal professionals to keep the referral stream flowing, that is the law firm's own conflict, not a conflict imputed from the nonlegal professionals to the law firm. In other words, the law firm must always determine whether its lawyers have a conflict arising out of the relationship with the nonlegal professionals, but the law firm does not have to determine whether any of the nonlegal professionals has a conflict.

Conclusion

Mere reciprocal referral agreements between lawyers and nonlegal professionals do not pose any danger of imputed conflicts, but EC 1-18 makes clear that under some circumstances, the "nature and extent" of a contractual relationship under DR 1-107 will transform a law firm and a nonlegal professional service firm into a "single firm" for conflict of interest purposes. This "single firm" treatment will require the law firm and the nonlegal professionals to maintain a common database of present and past engagements to enable the law firm to satisfy its duty to check for conflicts as required by DR 5-105(E). Any conflicts discovered in either firm will then be imputed to the other firm pursuant to DR 5-105(D). That will have drastic consequences for both firms.

To avoid this harsh result, a law firm that enters into a contractual relationship with nonlegal professionals pursuant to DR 1-107 firm should zealously protect the confidential information relating to its clients, and insist that the nonlegal professionals zealously protect the confidential information relating to their nonlegal clients. Moreover, the law firm and the nonlegal professionals must make clear to the public that they remain separate and independent firms despite their strategic alliance.

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