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The case for amending conflict-related outside counsel guidelines

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Today's legal market is in large part a buyer's market that provides clients with significant leverage to exercise control over outside counsel relationships.

One way clients exercise this control is through outside counsel guidelines, which generally provide valuable guidance for outside counsel on their clients' expectations.

Certain OCG provisions, however, can result in unintended consequences that significantly hamper outside counsel's ability to effectively represent the client. Chief among these are OCG provisions that seek to expand the definition of client conflicts.

Many clients include in their OCG requirements a definition of conflicts that expands the traditional universe of legal conflicts as defined by regulatory bodies and the courts. Presumably, they do this because they believe these requirements give them more control over the relationship and/or improve administrative efficiency.

However, in the legal market — as in so many other parts of our economy — for many actions, there are unintended consequences.

By expanding the definition of conflicts, these OCG provisions impose significant disadvantages on outside counsel and the client in three ways: they endanger a lawyer's ability to provide the most informed and knowledgeable service to the client; they threaten the unbiased advice that clients expect and desire from their lawyers; and they prevent rapid and efficient action by the firm to protect the clients' interests.

REDEFINING 'CONFLICT OF INTEREST'

Clients' OCGs often redefine what constitutes a conflict of interest in one or more of the following ways:

- They expand the definition of who is the client (far beyond the bounds of prevailing case law and regulation).
- They explicitly limit the universe of other clients from whom lawyers and their firms may accept work.
- They expand the definition of "interest" and "positional" conflicts to prevent lawyers and firms from undertaking or continuing to work for other clients that may take public positions on issues that the client unilaterally — and often only in hindsight — deems adverse to its own interests.

EXPANDING THE DEFINITION OF WHO IS THE 'CLIENT'

The most common OCG provisions inflate the definition of "client" for purposes of conflicts analysis, such as by defining the client to include not only the client company but also all of its subsidiaries.

Such provisions create a variety of problems for outside counsel. The most obvious of these are greatly increased difficulty in conflict screening and an increased likelihood of becoming conflicted out of a future representation even though no conflict exists under current law.

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However, such an agreement is contrary to American Bar Association Ethics Opinion 95-390, as well as ABA Model Rule 1.7, Comment 34, which provides that a "lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary." The courts have expanded on the reasoning behind the rule.

OCG guidelines that sweep all of a company's subsidiaries into the definition of client eviscerate the fact-specific inquiry courts usually conduct to determine conflicts. This inquiry generally focuses on two key factors: the degree of operational commonality between affiliated entities, and the extent to which one depends financially on the other.

These OCG provisions change what ought to be an objective inquiry based on the specific relationship between the client and its subsidiaries, replacing it with a generalized and wholesale expansion of the meaning of client.

Imposing this expansive definition of client narrows the universe of potential clients the lawyer otherwise could represent.

This narrowing of the pool of potential clients can cause real harm not only for the law firm but for clients as well by limiting counsel's experience within the client's industry and narrowing the firm's client base.

The expanded definition of the term client creates other serious problems.

For example, through unilateral corporate action, the identity of the OCG-defined client can and does change frequently — and with no notice to, or input from, the lawyer.

Although the identity of the client may change when the client company merges with, buys, sells, or creates a new subsidiary, the lawyer will have no idea when a new conflicts check is required and can fall into a disqualifying conflict despite the best of intentions and the most sophisticated conflict system.

Expanded conflicts provisions can also prevent rapid action by the firm. They also create expanded conflicts checking requirements, which can be time-consuming.

Consider how long it would take a U.S. law firm to obtain consent from local general counsel for subsidiaries located in dozens of different countries, most or all of whom have nothing to do with the matter at hand. In this situation (which has in fact occurred), the firm's ability to take prompt action on its client's behalf is compromised.

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LIMITING OTHER CLIENTS

For many years, clients understood that a lawyer who had gained advanced knowledge about its industry — based on its representation of multiple entities with similar businesses — could provide more complete and comprehensive service, often identifying and understanding issues because of its deep experience and years of practice.

Clients now appear to reject that conclusion, as evidenced by OCG provisions that define the representation of a client's competitor as a conflict — notwithstanding the fact that the rules of professional conduct and the courts have considered and rejected this position.

One concern is that this type of provision conflicts with Model Rule 1.7, Comment 6, which states that "simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients."

More importantly, for purposes of explaining to a client why this kind of provision is a bad idea, enforcing such an expansive definition of conflict limits the ability of lawyers to understand industry-wide issues from multiple perspectives, and ultimately makes it more difficult to provide the best possible service.

These provisions also threaten the economic viability of law firms in at least two ways.

First, by preventing firms from representing competitors in an industry in which the firm has experience, they tend to make firms much more dependent upon a single client. This reduces the firm's utility to the client as an unbiased independent counselor.

Firms that rely primarily on a single client can be tempted to provide advice based not on what is best for the client, but on what is most likely to keep the relationship, and therefore the firm, alive.

Second, by significantly limiting the firm's ability to attract and serve other clients, the client deprives the firm of its ability to manage its own practice and financial future.

In the end, if the firm fails, the client will have to find itself a new captive firm. Clients are best served by firms that are economically stable and can provide independent advice.

REDEFINING 'INTEREST' AND 'POSITIONAL' CONFLICTS

OCG provisions that redefine "interest" and "positional" conflicts can create a limitless expansion of potential conflicts.

Most often, these clauses demand that the lawyer inform the client of positions taken on behalf of other clients that might or could become adverse to positions taken later by the client.

In so doing, these clauses require the outside lawyer to simultaneously read the client's mind and accurately predict what type of issue might (at some point in the future) be adverse to the client, or to forecast what position the client might (at some point in the future) consider to be a conflict.

In addition, when retained under these guidelines, lawyers must decide whether to breach the engagement agreement with the client imposing the guidelines, or to breach their ethical and fiduciary duties to other clients.

To comply with such a contractual provision, a law firm and its lawyers would have to breach the fundamental duties to preserve client confidences under Model Rule 1.6, as well as their fiduciary duties of loyalty to their other clients.

As a result, the firm and the lawyers risk professional discipline, loss of client relationships, fee disgorgement demands, and civil liability to the other clients, as well as potentially devastating reputational injury.

This type of provision is contrary to the rules of professional conduct that define conflicts of interest.

For example, Rule 1.7, Comment 24 makes it clear that issue or positional conflicts are not conflicts at all unless certain specific factors are present.

"The mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not create a conflict of interest," it says.

Absent a contract saying otherwise, this has always been the law. Lawyers are advocates. The positions they advance on one day, under a given set of circumstances, necessarily differ from positions that may be appropriate for them to take on behalf of other clients, at another time and under different circumstances.

In addition to requiring that lawyers and firms breach their Rule 1.6 duty of confidentiality, the contractual requirement here could create a Rule 1.7(a)(2) material limitation on representation of other clients.

Some provisions go so far as to require withdrawal from other current clients, which violates the limitations placed on a lawyer's ability to withdraw under Rule 1.16.

Other rules of professional conduct that are also implicated, depending upon the exact language of the OCG provision, are: 1.9 (former client conflicts), 1.10 (imputation) and 1.18 (duties to prospective clients).

For these reasons, agreeing to these requirements with a client puts lawyers and firms in an untenable position. They are forced to choose between breaching the engagement agreement with the client imposing the guidelines or breaching the rules of professional conduct and their fiduciary duties to other clients.

The potential domino effect of these provisions can be devastating.

DRAFTING BETTER CONFLICT PROVISIONS

Taken together, the unilateral expansion of the definition of what constitutes conflicts of interest undermines lawyers' abilities to provide unbiased, impartial, thorough and rapid advice to all of their clients.

Anecdotally, many firms have had success in negotiating these provisions by raising the points discussed above.

By amending or deleting such provisions in a cooperative process with outside counsel, a client can remove impediments to rapid, efficient, long-term and knowledgeable service.

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