NEW YORK STATE BAR ASSOCIATION
One Elk Street, Albany, New York 12207 ◎ PH 518.463.3200 ◎ www.nysba.org

New York State Bar Association
Committee on Professional Ethics

Opinion 990 (11/12/13)

Topic: Representation of Conflicting Interests.

Digest: A lawyer who regularly represents both Client A and Client B may represent Client B in negotiating a loan agreement in which Client B would lend money to Client A in accordance with Rule 1.7. Whether the lawyer may properly request the clients to waive conflicts that might arise in the future if Client A defaults on the loan and Client B wishes the lawyer to sue Client A on its behalf, is subject to the conditions set forth in Rule 1.7(b) and on the sophistication and experience of the clients. If the consent complies with Rule 1.7(b) and both clients consented to such adverse representation, the lawyer would not have to withdraw from representing Client A in unrelated matters. If Client B is willing to make the loan to Client A only if the lawyer uses knowledge from the representation of Client A to help Client B determine the nature and value of Client A's collateral for the loan, the lawyer may disclose such information only if Client A gives informed consent to the disclosure. The lawyer may accept stock in Client B as all or part of the fee in the lending matter as long as the lawyer determines that the fee is not excessive for the work performed by the lawyer, the terms of the transaction are fair and reasonable to Client B, Client B is advised in writing of the desirability of seeking the advice of independent legal counsel and is given a reasonable chance to do so, and Client B signs a writing that describes the transaction and the lawyer's role in the deal, including whether the lawyer is acting for the client in the acquisition of the stock. It is unlikely that acceptance of stock in Client B would require the lawyer to withdraw from representing Client A in matters unrelated to the loan.

Rules: 1.0(f), 1.0(j), 1.5(a), 1.6, 1.6(b), 1.7, 1.7(b), 1.8(a), 1.8(b), 1.8(c)

FACTS

1. A lawyer represents a sophisticated business client who is an individual. The existing representations are both transactional and litigation, and the lawyer represents both the client individually and entities wholly-owned by the client. (The client individually and the client's wholly-owned entities are hereafter called Client A.) Client A wishes to borrow money, and the lawyer has one or more other clients (hereinafter Client B) who may be willing to extend the loans.

QUESTION

2. A. If Client B determines to lend money to Client A, may the lawyer represent Client B in the transaction and continue to represent Client A in other matters?

B. May the lawyer ask Client A to sign a waiver of future conflicts, so that if the loan transaction results in litigation between Client B and Client A, the lawyer may represent Client B?

C. If so, would the lawyer be required to withdraw from unrelated representation of Client A?

D. If Client B is only willing to make the loan to Client A in reliance upon the lawyer's personal familiarity with the nature and value of the underlying collateral, may the lawyer participate in the transaction and disclose such information?

E. If so, may the Lawyer receive, as all or part of the lawyer's fee, an equity interest in Client B?

F. Does such an ownership interest in the lender affect the lawyer's ability to continue to represent Client A in unrelated matters?

OPINION

Representation of Differing Interests

3. The first question involves whether the Lawyer, who regularly represents both Client A and Client B, may represent Client B in negotiating a loan agreement in which Client B would lend money to Client A. We assume Client A would be represented by separate counsel. Rule 1.7 of the New York Rules of Professional Conduct (the "Rules") prohibits a lawyer from representing a client if a reasonable lawyer would conclude that the representation will involve the lawyer in representing differing interests, unless the clients give informed consent, where consent is permitted by Rule 1.7(b). The term "differing interests" is defined in Rule 1.0(f) and including "every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be conflicting, inconsistent, diverse, or other interest."

4. In order to be "differing," the interests need not arise in the same matter, and they need not arise in litigation. For example, Comment [7] to Rule 1.7 provides:

> "Differing interests can also arise in transactional matters. For example, if a lawyer is asked to represent the seller of a business in negotiations with a buyer represented by the lawyer, not in the same transaction but in another, unrelated matter, the lawyer could not undertake the representation without the informed consent of each client."

In this case, representing Client B in lending money to Client A clearly would involve the lawyer in representing differing interests, since the interests of Client A and Client B in the negotiation of the loan agreement would be adverse. What is in the best interests of the lender are not necessarily in the best interests of the borrower. See Rule 1.7, Cmt [6] (absent consent, a lawyer may not advocate in one matter against another client that the lawyer represents in some other matter, even when the matters are wholly unrelated"); N.Y. State 952 (2012) ("The lawyer who

represents a residential buyer and lender is representing differing interests if only because the buyer is executing a note and a mortgage in favor of the bank.")

5. Rule 1.7(b) provides that, notwithstanding the existence of a concurrent conflict of interest, the lawyer may represent Client B in lending money to Client A if:

> "(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
> (2) the representation is not prohibited by law;
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
> (4) each affected client gives informed consent, confirmed in writing."

6. Whether the lawyer reasonably believes the lawyer can provide competent and diligent representation to each affected client is a factual determination that we cannot make. But in the facts presented here, we see nothing that would prevent the lawyer from reasonably reaching that conclusion. Similarly, the representation is not prohibited by any law. *Cf.,* Rule 1.7, Cmt. [16] (non-consentable conflicts). Moreover, the inquirer has presented no facts that would provide grounds for believing, at this stage of the relationship between Clients A and B, that the lending relationship will result in litigation or another proceeding before a tribunal. Consequently, if the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to both Clients A and B, the lawyer may ask for consent to the conflict.

7. In N.Y. State 952 (2012) we found yet another possible conflict of interest. Because the lawyer regularly represented the lender and might well be eager to maintain that relationship and income stream, we found that the lawyer would have a personal business interest in advancing the lender's cause, which would create a significant risk that the lawyer's professional judgment on behalf of the borrower would be adversely affected by the personal business interest. *See* N.Y. State 867 at n. 2 (2011). Rule 1.7(a)(2) provides that a lawyer may not represent a client if a reasonable lawyer would conclude that there is a significant risk that the lawyer's professional judgment on behalf of the client will be adversely affected by the lawyer's own financial, business, property or the personal interest, except as provided in paragraph 1.7(b) (quoted above). The lawyer must therefore decide whether a reasonable lawyer would conclude that such a personal conflict of interest exists, and, if so, whether the requirements for requesting client consent are met. If so, the lawyer may request such consent, after disclosing the nature of the relationship with Client A.

Future Conflict Waivers

8. The second question assumes that the clients will grant a waiver for the lawyer to represent Client B in negotiating the loan agreement and asks if the conflict waiver may also include a consent to represent Client B against Client A if the loan agreement should result in litigation.

9. As noted above, Rule 1.7(b) allows a lawyer to represent a client despite the existence of differing interests, as long as, among other things, the lawyer reasonably believes he or she will

be able to provide competent and diligent representation to each affected client and each affected client gives informed consent, confirmed in writing. Whether each affected client can give informed consent to a future conflict depends on the extent to which the lawyer is able to explain adequately the material risks of the proposed course of conduct and reasonably available alternatives, and on the sophistication of the client. *See* Rule 1.0(j) (definition of informed consent) and Rule 1.7, Cmt [22].

10. Rule 1.7, Comment 22 states:

> "The more comprehensive the explanation and disclosure of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the understanding necessary to make the consent "informed" and the waiver effective. . . . The lawyer should also disclose the measures that will be taken to protect the client should a conflict arise, including procedures such as screening that would be put in place."

Since Client A would be asked to consent to his lawyer's (or law firm's) suing him, it would be particularly important to make clear whether the lawyer who regularly represents Client A would be actively involved in any potential litigation.

11. Comment 22 warns that the effectiveness of advance conflict waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. The more comprehensive the explanation and disclosures of the types of future represents that might arise, the greater the likelihood that the client will have the understanding necessary to make the consent "informed." *See also* Comment [22A], which discusses how to determine whether an advance waiver remains valid after the passage of time, when the circumstances may have greatly changed from those anticipated in the waiver. Whether Client A understands the material risks that the waiver entails depends on the sophistication of Client A. See, e.g. Rule 1.7, Cmt [22]:

> "[I]f the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, an advance waiver is more likely to be effective, particularly if, for example, the client is independently represented or advised by in-house or other counsel in giving consent."

See generally Simon's New York Rules of Professional Conduct Annotated (2012 ed), Annotations of Rule 1.7(b)(3) (hereinafter, *Simon*) ("The depth and content of the disclosure will depend largely on the sophistication of the client") .

12. In the fact situation posited here, the requested conflict waiver would not be open-ended. The circumstances anticipated -- that the lawyer would represent Client B in suing Client A for a default under the loan agreement (and in executing on the collateral for the loan) -- is quite specific. *Compare* N.Y. City 2006-1 (authorizing a law firm to request that the client waive future conflicts of interest, and discussing requests for open-ended waivers, where the lawyer may not be able to give appropriate disclosure of the implications, advantages and risks involved,

so that the client can make an informed decision whether to consent). The inquirer characterizes Client A as a sophisticated business client who is an individual. It is not clear whether Client A will be independently advised in connection with the waiver. Such independent advice would clearly make any waiver less subject to challenge.

The Downsides of Requesting Current and Future Waivers

13. The conflict of interest rules are derived from the lawyer's traditional duty of loyalty to the client. *See, e.g.* Preamble, par. 2 ("The touchstone of the client-lawyer relationship is the lawyer's obligation . . . to act with loyalty during the period of the representation"); Rule 1.7, Cmt. [1] ("Loyalty and independent judgment are essential aspects of a lawyer's relationship with a client.") The lawyer who requests a conflict waiver from a client must consider the possibility that a client such as Client A may give consent to a conflict today but consider it to be the height of disloyalty tomorrow (or in several months) when the lawyer represents Client B in bringing suit against Client A. Such a client may challenge whether the conflict waiver was made with sufficient disclosure, and may seek fee forfeiture or professional discipline, or sue the lawyer for malpractice or breach of fiduciary duty. *See generally Simon*, supra.

14. As Comment 21 to Rule 1.7 points out, the client (in this case, Client A) can also revoke a valid consent at any time, at least with respect to continued representation of Client A. Whether such revocation would also prevent the lawyer from representing Client B depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of a material change in circumstances, the reasonable expectations of Client B, and whether material detriment to Client B would result. See N.Y. State 902 (whether the lawyer may continue to represent the non-revoking client depends upon the circumstances, unless an advance agreement specifies what happens upon revocation of consent.)

Suing a Current Client

15. The third question asks whether the lawyer may represent Client B in legal action against Client A if the lawyer still represents Client A. Rule 1.7(b)(3), in describing non-consentable conflicts, includes cases where the representation involves "the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal." However, in this case, the lawyer would not represent Clients A and B in the same litigation or other proceeding. Client A, we assume, would be represented by another law firm. Thus the conflict would not be non-consentable. The question would be the same as that discussed above with respect to Rule 1.7(b)(1) -- whether the lawyer believes he or she can adequately represent Client B, explains the situation to both clients and obtains the informed consent of both. *See generally, Simon*, Annotations of Rule 1.7(b)(3). In addition, the lawyer would have to determine that the lawyer's independent professional judgment on behalf of Client A in the unrelated matters would not be affected.

Use of Client Confidential Information

16. The fourth question posits that Client B might only be willing to make the loan to Client A in reliance upon the lawyer's personal familiarity with the nature and value of Client A's collateral for the loan.

17. Rule 1.6(a) prohibits a lawyer from knowingly revealing confidential information of a client, or using such information to the disadvantage of the client or for the advantage of the lawyer or a third person, unless the client gives informed consent (as defined in Rule 1.0(j)) or the disclosure is permitted by Rule 1.6(b) (which is not applicable to this situation). Confidential information is defined in Rule 1.6 to include information gained during or relating to the representation of a client that the client has requested to be kept confidential or the disclosure of which is likely to be embarrassing or detrimental to the client.

18. We believe that information gained by the lawyer during the representation of Client A about the value of the potential collateral for the loan by Client B constitutes confidential information within the meaning of Rule 1.6. Consequently, the Lawyer could not use the information for the benefit of Client B without the informed consent of Client A. In accordance with Rule 1.0(j), this would involve the lawyer explaining to Client A the material risks of the authorizing the lawyer to disclose information about the collateral to Client B, as well as the reasonably available alternatives, and obtaining the agreement of Client A. Although use of the information might be detrimental to the client (if the lawyer possesses information indicating that the value of the collateral is less than it otherwise appears), we believe that a sophisticated client might well consent to the disclosure, and see no reason why the conflict is inherently non-consentable.

19. The inquirer will want to clearly spell out to both Client A and Client B the extent to which confidential information of Client A will be shared, and the extent to which the lawyer has continuing obligations to inform Client B of changes in the value of the collateral. *See Spector v. Mermelstein*, 361 F. Supp. 30 (S.D.N.Y. 1972), *aff'd in part and remanded,* 485 F.2d 474 (2d Cir. 1973) (defendant attorney breached his fiduciary duties to plaintiff client by failing to inform client fully of facts known to attorney which raised serious questions regarding the advisability of client's loaning money to a corporation which owned a Nevada gambling casino). *Cf.,* Rule 2.3 (When the layer knows or should know that the evaluation is likely to affect the client's interests materially and adversely, the lawyer shall not provide the evaluation unless the client gives informed consent).

Ownership Interest in a Client/Lender

20. The fifth question assumes that Client B might wish to compensate the lawyer by giving the lawyer an interest in the legal entity that makes the loan and asks whether such an ownership interest would affect the ability of the lawyer to represent Client B in the loan transaction or to represent Client A in other matters. It is not clear whether the entity that makes the loan is a public or private company, whether its shares have a recognized value, and whether the value of its shares will depend principally on the success of the loan to Client A.

21. There are three questions implicit in this question. First, could the lawyer personally make the loan to the client (i.e. is the ownership interest in the lender allowing the lawyer to do something that would otherwise not be permitted by the Rules)? *See* Rule 8.4 (A lawyer shall not violate the Rules of Professional Conduct through the acts of another). Second, would the ownership interest in the lending entity pass muster under the rule governing the reasonableness of legal fees and the rule governing business transactions with clients? Third, would the ownership interest affect the lawyer's judgment on behalf of either client?

22. We have held that there is no express prohibition against a lawyer lending a client funds in connection with a non-litigated matter, although a loan transaction between a lawyer and client is a business transaction that involves potential conflicts of interest. *See* N.Y. State 600 (1989). *Cf.,* Rule 1.8(e) (While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to the client except as set forth in the rule). Consequently, the lawyer should ensure that the client understands the potential conflict and the fact that, at some point in the future, the lawyer may need to withdraw from representing the client. We warned that, despite the fact that the lawyer-lender is extending a benefit to the client, the lawyer should exercise caution when considering personal involvement in client affairs.

23. The rules of business transactions with clients are currently found in Rule 1.8(a), which provides that a lawyer may not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise independent professional judgment for the protection of the client, unless:

> " (1) the transaction is fair and reasonable to the client and the terms of the transaction are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
> (2) the client is advised in writing of the desirability of seeking, and is given a reasonable opportunity to seek, the advice of independent legal counsel on the transaction; and
> (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction"

24. In N.Y. State 913 (2012), the Committee discussed the ethical issues that arise when a lawyer is paid with client stock. As we explained there, the starting point for determining whether a lawyer's compensation for legal services is appropriate is that, under Rule 1.5(a), the lawyer may not accept a fee the amount of which would leave a reasonable lawyer "with a definite and firm conviction that the fee is excessive." Rule 1.5(a) sets out the factors that should be used to determine excessiveness. However, we also concluded that Rule 1.8(a) (business transactions with a client) applies to negotiation of a fee in which a lawyer is to receive an equity interest in a client company, despite the clause in Rule 1.8(a) that makes the rule applicable only if the client expects the lawyer to exercise professional judgment on behalf of the client in the business transaction. In N.Y. State 913, we found that the common situation in which the lawyer will receive stock as a legal fee involves a "nascent venture" lacking a public

market and offering consideration of indeterminate value and liquidity in lieu of cash, although our conclusion was not limited to this situation.

25. Accordingly, the lawyer may accept stock in Client B's corporation as long as the lawyer determines that the fee is not excessive for the work performed by the lawyer, the terms of the transaction are fair and reasonable to Client B, Client B is advised in writing of the desirability of seeking the advice of independent legal counsel and is given a reasonable chance to do so, and Client B signs a writing that describes the transaction and the lawyer's role in the deal, including whether the lawyer is acting for the client in the acquisition of the stock.

26. Finally, the lawyer must determine whether acceptance of stock in payment of all or part of the legal fee would negatively affect his judgment on behalf of either client -- Client A if the amount of the fee from Client B would encourage the lawyer to violate the confidences of Client A, and Client B if the fact that the lawyer has an ownership interest in the lender causes him or her to elevate his own economic interests over those of Client B.

If Lawyer Accepts Ownership Interest in Lender Corporation, May Lawyer Continue to Represent the Borrower in Matters Unrelated to the Loan?

27. As noted above, Rule 1.7(a) prohibits a lawyer from representing a client if a reasonable lawyer would conclude that either (a) the representation will involve the lawyer in representing differing interests, or (b) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests. Mere ownership of stock in the lending corporation would not involve the lawyer in representing differing interests. Whether ownership of such stock would involve a significant risk that the lawyer's professional judgment on behalf of a Client A will be adversely affected depends on the value of the stock. The lawyer should also consider whether the relationship with Client B and the importance of lawyer's continuing representation of Client B would affect the lawyer's professional judgment on behalf of Client A.

CONCLUSION

A. A lawyer who regularly represents both Client A and Client B may represent Client B in negotiating a loan agreement in which Client B would lend money to Client A, if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
(2) the representation is not prohibited by law;
(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
(4) each affected client gives informed consent, confirmed in writing."

B. Whether the lawyer may properly request Client A to waive conflicts that might arise in the future if Client A defaults on the loan and Client B wishes the lawyer to sue Client A on its

behalf, is subject to the conditions set forth in Rule 1.7(b) and on the sophistication of the clients and their experience with legal representation.

C. If the consent complied with Rule 1.7(b) and both clients consented to such adverse representation, the lawyer would not have to withdraw from representing Client A in unrelated matters.

D. If Client B is willing to make the loan to Client A only if the lawyer uses knowledge from the representation of Client A to help Client B determine the nature and value of Client A's collateral for the loan, the lawyer may disclose such information only if Client A gives informed consent to the disclosure.

E. The lawyer may accept stock in Client B as all or part of the fee in the lending matter as long as the lawyer determines that the fee is not excessive for the work performed by the lawyer, the terms of the transaction are fair and reasonable to Client B, Client B is advised in writing of the desirability of seeking the advice of independent legal counsel and is given a reasonable chance to do so, and Client B signs a writing that describes the transaction and the lawyer's role in the deal, including whether the lawyer is acting for the client in the acquisition of the stock.

F. It is unlikely that acceptance of stock in Client B would require the lawyer to withdraw from representing Client A in matters unrelated to the loan.

17-13