Feature Articles

Dealing with Outside Counsel's Conflict of Interest, Part II – The Relationship's Over, Let's Litigate

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Alice's outside law firm had ignored her letter alerting it to a serious conflict of interest. In fact, when the firm's "risk management" partner called, all he seemed to want was to keep her company's legal work.

Alice's COO wanted strong action ."Well, I hate to do this,," Alice muttered, "But I guess a lawsuit or ethics complaint will get their attention." Alice e-mailed legal ethics counsel, requesting a call later that day.

Part I of this article – Still Talking – dealt with the first three of eight considerations for corporate counsel when analyzing and responding to outside counsel's conflict of interest.

Sometimes outside counsel do not back down from a conflict of interest, even when the conflict is quite evident and serious. They may insist in continuing representations that involve significant potential violations of counsel's fiduciary duties of loyalty and confidentiality, as well as blatant violations of the ethics rules.

When that happens, corporate counsel may consider options described in this two-part series. As the first three considerations were covered in Part I, this articles begins with IV.

Consideration IV – Terminate the Conflicted Firm. Normally one consequence of a serious conflict of interest is that the affected client terminates the conflicted firm. This may occur promptly instead of the warning letter (Consideration II). More often, however, the client terminates the conflicted firm later in the process, after the two sides fail to reach a resolution or accommodation.
Although the law firm's representation of that client ends with termination, the firm must continue to protect the client's interests, including turning over client files and property.

Terminating a law firm is often the most psychologically challenging step for a client. It can also be quite difficult as it involves finding new counsel and moving matters from the conflicted firm. This process may take significant time and resources, and result in harmful delays to pending legal matters.

In light of such burdens, it may be helpful for corporate counsel to keep five things in mind. First, the corporate client is likely not demanding anything extraordinary from the conflicted firm, which must either ameliorate or terminate the conflicted representation..Under Missouri Supreme Court Rule 4-1.16(a)(1), a lawyer must withdraw from a representation when the representation results in a violation of the Missouri Rules of Professional Conduct. Included among such prohibited representations are those where the lawyer has a conflict of interest. Rule 4-1.7(a) opens with the pronouncement that, except with informed client consent, "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest." Mo. S. Ct. R. 4-1.7(a). Other conflict rules place similar obligations on conflicted counsel.

Second, the terminated law firm likely has significant responsibility for determining its fate. Often law firms that receive warning letters will apologize, end conflicted relationships, and readily refund fees and accept other limitations to avoid more serious consequences from a conflict interest.

Third, the client controls a lawyer-client relationship, which is a fiduciary relationship. The client is the principal and the lawyer is the agent/fiduciary, which means that the client can terminate the lawyer at any time. In fact, when a client terminates a lawyer,

the lawyer must withdraw. See Mo. S. Ct. R. 4-1.16(a)(3) (mandating a lawyer's withdrawal when the lawyer is discharged).

Fourth, because a lawyer is an agent/fiduciary, a terminated lawyer continues to owe certain duties to the client after termination. Rule 4-1.16(d) references these duties when it states:

Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

Fifth, terminating a conflicted relationship is often necessary if a client intends to pursue further remedies against a firm. Often courts see a failure to terminate outside counsel as a sign that corporate counsel and their employer are not really serious about the injuries caused by a conflict.

Sometimes it might be impractical to terminate a firm, even though termination is often an important step before filing a motion to prevent that counsel from representing an adversary. For example, a particular matter may require immediate attention, or lawyers at the conflicted firm may be the only ones who can properly handle a matter. In such circumstances, corporate counsel may retain the conflicted counsel, but should be prepared to make a strong case for why the firm should be disqualified from representing someone else. This includes distinguishing corporate counsel's own situation – where disqualification is apparently impractical – from the adversary's.

Consideration V – Forced Disqualification. A client may need to force the termination of the law firm's relationship with other clients whose representation created the conflict. When asking (as part of the warning letter) does not work, normally such protections must be sought through a motion to disqualify (for a representation involving pending litigation) or an injunctive action (when there is no pending litigation).
In either instance, the party seeking to disqualify a law firm ordinarily files a motion or complaint. This is supported by verified allegations by a corporate officer or other client representative that describes in detail the representations causing the conflict and the prior efforts undertaken (such as sending a warning letter) to resolve the conflict.

Often the party filing such a motion or lawsuit seeks expedited treatment, and possibly review in camera or by a judge not tasked with resolving related substantive issues. Where a separate lawsuit is filed, the request for injunctive relief may be coupled with claims for disgorgement and damages (Considerations VI and VII).

Consideration VI –Disgorgement. A client bringing claims against its (former) counsel may also seek disgorgement for past fees paid. Consideration III discussed that a client harmed by a firm's conflict may demand a discount or refund of fees. This step involves a more serious, formal demand for a refund, usually through civil claims for breach of contract and breach of fiduciary duty.
The premise for such disgorgement is the notion that the agent-fiduciary lawyers violated their fiduciary duties to their clients, and should therefore be required to disgorge any fees earned from their disloyalty. The Restatement (Third) of the Law Governing Lawyers § 37 summarizes the law on disgorgement:

A lawyer engaging in clear and serious violation of duty to a client may be required to forfeit some or all of the lawyer's compensation for the matter. Considerations relevant to the question of forfeiture include the gravity and timing of the violation, its willfulness, its effect on the value of the lawyer's work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies.

Missouri law allows for disgorgement. See, e.g., International Materials Corp. v. Sun

Corp., Inc., 824 S.W.2d 890, 894-95 (Mo. 1992). But there is little clear precedent stating when disgorgement should occur, or exactly what fees should be subject to disgorgement.

Consideration VII – Damage Claims. Corporate counsel may also consider filing damage claims for breach of contract and fiduciary duty, as well as potential claims for legal malpractice or fraud. Such claims suffer from the ordinary difficulties faced when suing a law firm, for example unwillingness of some judges to hold lawyers accountable, and the need in some malpractice claims to prove "the case within the case."

The biggest hurdle in a conflict situation, however, is often proving damages. Often a conflict alone does not result in significant monetary damages unless the client can point to something the conflicted firm should have but did not do, or did not do well. Absent such evidence, a disgorgement claim – particularly one coupled with allegations of breach of fiduciary duty and a prayer for punitive damages – often provides the best means for pursuing monetary claims against a conflicted firm.

Consideration VIII – Filing a Disciplinary Complaint. A client may seek disciplinary sanctions based upon a conflicted representation. Normally this involves submitting a form or letter, often with supporting documents, to the Missouri Office of Chief Disciplinary Counsel. The OCDC will then open a file, request a response from the conflicted counsel, and proceed with an investigation or disciplinary action if appropriate.

Corporate counsel may file a disciplinary complaint pursuant to their Rule 4-8.3(a) duty to report certain misconduct by other lawyers. In conflict situations, however, the conduct often does not rise to the level where it calls into question the conflicted lawyer's honesty, trustworthiness, or fitness to practice, meaning the requirements of Rule 4-8.3(a) are not satisfied. Even where Rule 4-8.3(a) is not satisfied, however, a lawyer or client may always choose to file a disciplinary complaint where there is a reasonable basis for that complaint.

Like damage claims, a disciplinary complaint against a conflicted firm suffers several shortcomings. Often a pure conflict of interest will result in relatively minor discipline, unless other aggravating factors (such as dishonest conduct or a significant loss to the client) are present. Also, while sometimes restitution is ordered, normally disciplinary complaints do not result in the injured client receiving compensation. In addition, discipline can generally be imposed only on lawyers, not on a firm, and it may take a year or more to resolve a disciplinary complaint.

For these reasons, and because lawyers must be careful not to violate the ethics rules themselves when threatening a disciplinary complaint, corporate counsel (or their outside ethics counsel) often wait to file an ethics complaint until after the conflict of interest is otherwise resolved. Or corporate counsel may file the complaint, but notify disciplinary counsel that litigation is pending, and suggest that no action be taken until the underlying litigation is finished.

Conclusion. Learning outside counsel has a serious conflict of interest often leads to feelings of distrust and betrayal. In this two-part series, I have tried to offer a practical guide for seeking resolution of such issues. Hopefully the conflict can be resolved quickly and without unnecessary expenditures of time and money. In the most serious circumstances, corporate counsel may find it necessary to litigate.

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