

ETHICAL CONSIDERATIONS THAT MAY ARISE IN BUSINESS TORTS CASES

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I. Attorney's Role

Under the ABA Model Rules, a lawyer cannot knowingly counsel or assist a client to commit a crime or fraud. But, a lawyer can give a candid opinion about the consequences that are likely to result from a client's conduct. ABA Model Rule 1.2(d) and Comment (9).

Consider: There is an important difference between analyzing the legal aspects of a client's conduct and recommending how a crime or fraud is committed. For an interesting case, see *Jasmine Networks, Inc. v. Marvell Semiconductor, Inc.*, 117 Cal. App. 4th 794 (2004) (review granted) (attached hereto); and ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT, Volume 20, Number 8. *Admonishment*

The attorney-client privilege does not apply where the attorney's services were sought or obtained to help the client plan or perpetrate a crime or fraud.

A lawyer must proceed as is reasonably necessary in the best interests of an entity where the lawyer representing an entity client knows that an officer, employee, or other person associated with the client is acting (or intends or refuses to act) in a matter related to the representation that is:

1. Either a violation of a legal obligation to the entity or a violation of law that reasonably might be imputed to the entity; and
2. Likely to result in substantial injury to the entity.

ABA Model Rule 1.13(b) provides:

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law

that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

What happens if, despite the lawyer's best efforts, this "highest authority" fails to timely address in an appropriate manner the illegal act or refusal to act, and the lawyer reasonably believes that the illegal conduct is reasonably certain to result in substantial injury to the entity, i.e., the lawyer's client?

Under ABA Model Rule 1.13(c):

(1) [if] despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 [dealing with Confidentiality of Information] permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

But, *beware*: ABA Model Rule 1.13(c) may directly conflict with your state's statutory duties of confidentiality under your state's state bar act.

ABA Model Rule 1.13(d) adds that:

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

Also for consideration on this topic is the fact that under ABA Model Rule 1.16(b), a lawyer may withdraw from representing a client where:

- (1) withdrawal can be accomplished without material adverse effect on the interests of the client;
- (2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;
- (3) the client has used the lawyer's services to perpetrate a crime or fraud . . .

II. Joint Defense Agreements

The Ninth Circuit has held that an implied attorney-client relationship between all defendants and attorneys who are parties to a joint defense agreement is established. *United States v. Henke*, 222 F.3d 633, 637 (9th Cir. 2000); see also ABA Comm. on Prof'l. Ethics and Grievances, Formal Op. 95-395 (1995) (attorney representing only one defendant in joint defense agreement owes fiduciary obligations to other defendants).

Notwithstanding the *Henke* case, the fiduciary obligation owed to the other defendants does not usually create "either a true attorney-client relationship or a general duty of loyalty" to the other defendants. Instead, an attorney's duty to other defendants in the context of a joint defense agreement is limited to the *duty of confidentiality*. *United States v. Stepney*, 246 F. Supp. 2d 1069 (N.D. Cal. 2003).

Risk: Depending on the circumstances, this implied attorney-client relationship may create a disqualifying conflict of interest.

III. Considerations in Class Actions

Sometimes there may be a tension between rules governing conflicts of interest generally, and policies underlying class action rules.

Adequacy of Class Counsel

"Adequate representation" in class actions refers to representation by the class representative *and* his or her counsel. Fed. R. Civ. P. 23(g)(4) (class counsel must fairly and adequately represent the interests of the class). Under *Gonzales v. Cassidy*, 474 F.2d 67 (5th Cir. 1973), and *In re Agent Orange Prods. Liab. Litig.*, 800 F.2d 14 (2d Cir. 1986), the class attorney is considered a "guardian" of the class and owes fiduciary duty to *each* member. This is sometimes also referred to as the "duty of undivided loyalty."

Prohibition on Dual Service

There might be an irreconcilable conflict of interest where the lawyer seeks to serve as both a class representative and as lead counsel for the class. The concern is that the lawyer might stand to gain much more in fees than any class member's individual

recovery. *Turoff v. May Co.*, 531 F.2d 1357 (6th Cir. 1976); *Susman v. Lincoln American Corp.*, 561 F.2d 86 (7th Cir. 1977); *see also* Fed. R. Civ. P. 23(a)(4) (“the representative parties will fairly and adequately protect the interests of the class.”).

Other courts have found that the mere fact that an attorney is a member of the class that he or she represents is not sufficient by itself to disqualify the attorney from acting as class counsel. *Pepper v. Sup. Ct. (Brentwood Country Club)*, 76 Cal. App. 3d 252 (1977).

However, consider that someone trying to serve in the dual capacity as class attorney and class representative may subject himself or herself to disqualification from class representation because he or she may be called on to testify as a witness in the action.

Objection by Some Class Members to the Settlement

“[A]s long as the interest of the class in continued representation by experienced counsel is not outweighed by the actual prejudice to the objectors of being opposed by their former counsel,” where some class representatives object to a negotiated settlement, class counsel may continue to represent the balance of the class representatives and the class. *Lazy Oil Co. v. Witco Corp.*, 166 F.3d 581 (3d Cir. 1999); *In re Agent Orange Prods. Liab. Litig.*, 800 F.2d 14 (2d Cir. 1986). Upon a motion to disqualify counsel, the court will “balance the interests.”

Miscellaneous Conflicts That May Arise

1. Previous representation of defendant;
2. Representation of another class against the same defendant;
3. Representation of another plaintiff (non-class) against the same defendant; or
4. Representing factions within the same class, or suing class members for fees.

Pre-Certification Ethical Considerations

Banning communications with class members is a presumptive violation of the First Amendment and is allowed only on finding a “likelihood of serious abuse.” *Gulf Oil Co. v. Bernard*, 452 U.S. 89, 103-104 (1981). There the Court found that an order prohibiting plaintiffs and lawyers from communicating with potential class members interfered with efforts to inform potential class members of lawsuit’s existence and made it difficult to obtain information about the merits of the action from persons they sought to represent. ABA Model Rule 7.2, Comment (4) excludes the notification of class action members from the solicitation prohibition contained in Rule 7.3. Additionally, under Fed. R. Civ. P. 23(d)(1)(B), the court may issue orders that:

(B) require—to protect class members and fairly conduct the action—giving appropriate notice to some or all class members of:

- (i) any step in the action
- (ii) the proposed extent of the judgment; or

- (iii) the members' opportunity to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or to otherwise come into the action.

Fee-Splitting as Form of Solicitation

Do not use fee-splitting (with lawyers or non-lawyers, i.e., class representatives) as a means of attracting clients. Such conduct may constitute improper solicitation. ABA Model Rule 5.4(a), entitled "Professional Independence of a Lawyer," provides:

a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

(1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;

(2) a lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price;

(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and

(4) a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.

Settlement and Attorneys' Fees

Defendants will want to settle their total liability, including attorneys' fees to plaintiff's counsel, where attorneys' fees are recoverable as additional damages, such as in a civil rights or employment action. It is not clear whether class counsel is ethically banned from negotiating its fees with the opposing party as part of a class-action settlement. *See Evans v. Jeff D.*, 475 U.S. 717, 738-43 (1986) (holding that there is no ethical problem where attorney agreed to waive fee claim in order to obtain greater relief for class in action under 42 U.S.C. § 1983). Because an attorney is required to evaluate a settlement offer on the basis of the client's interest, without considering his or her own interest in the fee obtained, there may be no ethical problem. Also, since a lawyer is obligated to

abide by a client's decision whether to settle a matter, under ABA Model Rule 1.2(a), the settlement, including negotiated fees in a case where fees are awardable as damages, may be ethically sound.

One thing is clear, however, it would be unethical for counsel to "sell out" the class under any scenario.

IV. Fee Agreements in Business Torts Cases

1. Hourly Rate Fees
2. Contingent Fees

ABA Model Rule 1.5(c) states:

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in a writing signed by the client and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

A contingency fee based on the client's recovery is not considered a pecuniary or financial interest in the client's "property" adverse to the client so as to raise ethical concerns or the necessity to advise the client to seek independent counsel, and so forth.

There are some statutory limitations in certain cases, i.e., in California, for example, under the Medical Injury Compensation Reform Act of 1975 (MICRA), as to the maximum percentage that may be charged. Generally, however, there is no contingent fee percentage beyond which the fee is "unconscionable." In California, one court upheld a 50% contingent fee percentage. *Matter of Van Sickle*, 4 Cal. State Bar Ct. Rptr. 980, 989, fn. 13 (Rev. Dep't 2006). In another California case, however, a fee exceeding 50% was deemed excessive. *Swanson v. Hempstead*, 64 Cal. App. 2d 681, 688 (1944).

3. Modifications on Contingent Fee Arrangements

- a. The fee arrangement can be structured so that the percentage is applied to net or gross recovery, i.e., before or after deducting litigation costs;
- b. The fee arrangement can be made on a tiered basis, that is, with a different percentage payable according to the stage of proceeding at which recovery is obtained. In fact, ABA Formal Op. 94-389 states a preference for the several-tier approach because it presumably bears a direct relationship to the extent of service actually performed and time expended before recovery is obtained, so long as the total fee is not unconscionable;
- c. A sliding-scale contingency fee can be negotiated, where the contingency percentage charged decreases as the amount of recovery increases; or
- d. Hybrid agreements in cases (non-class actions) where attorneys' fees are awardable as damages—the attorney and client may negotiate an agreement which provides that the greater of the fees payable under the contingency fee arrangement, or the court-awarded fees, will be the attorney's fee charged to and payable by the client.

Attachment

Double-click on icon below to view Adobe Acrobat document (must have Adobe Acrobat Reader installed).



Smith - Business Torts attachment.pdf