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Incentivised leadership

A new model for managing partner compensation

Reputations at risk
Navigate client guidelines on conflicts of interest

10 Questions: Vicky Brackett
A new series of interviews on life as managing partner

American frontier
Expansion strategies for overseas law firms

Reputations at risk

Clients' conflicts requirements are becoming increasingly challenging, warns Frank Maher. He provides some tips on navigating their outside counsel guidelines

Reputation is all a law firm has to sell, but it can be irreparably damaged by taking on a matter which results in a conflict of interests. Large corporates and other entities, particularly American ones, are increasingly seeking to impose their own rules that go far beyond regulatory requirements, reflecting the shift in the balance of power between lawyer and client. The more powerful the client – some of which have more in-house lawyers than the firms they instruct – the more onerous the terms they are seeking to impose.

One may ask what risk this poses to lawyers' independence? It is a risk which the Solicitors Regulation Authority of England & Wales (SRA) has identified in its Risk Outlook 2014/2015. Outcome 3.2 of the SRA's Code of Conduct also requires that firms' systems identify financial interests and commercial relationships.

So, professional conduct issues are engaged, as well as commercial risk. However, lawyers pitching for work and anxious to meet targets may be more concerned about securing their panel appointment than the details of a client's lengthy outside counsel guidelines (OCGs).

In this article, we look at some clients' perceptions of conflicts, examples of provisions in OCGs and some challenges to watch out for. We also provide practical steps which firms can implement to help protect themselves.

> **"Sometimes OCGs are sent after a firm has been appointed – and to the accounts department, rather than the client partner"**

Client perceptions

Clients' requirements may seem lengthy and tedious in detail, but clients – even major corporates – see things rather differently when their lawyers do not meet their expectations in relation to conflict issues. The duty to avoid conflicts is rooted in the fiduciary duty of loyalty and, consequently, any failings of the lawyer may result in emotions running very high.

The fallout can be considerable – the OCGs may assert US jurisdiction and result in disqualification applications, in addition to claims for damages and a disgorgement of profits. For those who say they would never agree to a US jurisdiction clause, more anon.

Even major international firms with sophisticated systems have been caught out on conflicts issues, despite the best of intentions, and faced the wrath of clients. Disciplinary complaints have been threatened and occasionally carried through, valuable work has to be turned away and costs written off. Firms which have experienced a serious conflict problem will know only too well the pain which can be generated by the whole process.

Those who have read the biography of Steve Jobs by Walter Isaacson will have noted his dismay that Google ended up competing with Apple after Google's CEO had been on Apple's board. The author reports how Jobs felt 'betrayed' and 'ripped off'. Imagine how he would have felt on learning that one of the law firms advising Apple also represented Google – even if on an unrelated matter.

There can be a big enough challenge juggling the potentially-conflicting requirements of conduct rules in the firm's home jurisdiction with those of overseas

offices and overseas lawyers employed by the firm, causing further sets of rules to apply; sometimes they cannot be reconciled with each other. Increasingly, however, OCGs are posing the biggest challenge and putting considerable burdens on law firms' compliance systems.

The following examples from Wal-Mart's OCGs illustrate this point. "Wal-Mart reserves the right to make an independent determination whether Outside Counsel has an actual or potential conflict of interest.

"Wal-Mart may conclude that an actual conflict of interest exists if Outside Counsel or Outside Counsel's law firm represents a significant competitor of Wal-Mart or its subsidiaries or affiliates."

Consider also the following from Boston Scientific Corporation's OCGs: "It is important that you are sensitive to both direct conflicts and indirect conflicts, i.e., conflicts that may arise from your firm's advocacy of other clients' positions which conflict with BSC's business objectives. If your firm is designated as a 'BSC preferred provider,' we expect that the firm will not take public positions adverse to BSC (e.g., in litigation or administrative proceedings)."

Different clients have different perceptions of what actions may be to their detriment and which entities are their competitors.

Boston Scientific Corporation lists over 40 competitor companies which lawyers may not represent "regardless of the nature of the representation" without receiving permission from the corporation.

Other clients leave it to law firms to discern who their competitors may be, or invite them to read the corporation's Securities and Exchange Commission filings, the results of which are only as good as on the day they were written.

"Some OCGs may put the firm's duty of confidentiality to another party at risk"

The task of identifying competitors becomes even more difficult in a rapidly-changing corporate environment, with subsidiaries being bought and sold, particularly when the law firm in question may not be advising on corporate matters.

From the clients' perspectives, it may be possible to understand why they perceive a need for these provisions, but how compliance may be policed within a large law firm may be less easy to understand.

Lawyers may strive to define the entity of the client as narrowly as possible, but clients frequently wish to extend this not only to the whole corporate structure but also more widely to include its affiliates, while being unable or unwilling to provide a comprehensive list of those organisations.

One major company (which became a major headline bankruptcy case) had a list of corporate affiliates on its website, updated daily; this ran to 18 pages if printed out. But, at least it was possible to check for affiliates, in theory at least.

Application of OCGs

Clients are sometimes upfront about their requirements at the request for proposals (RFP) or tender stage. However, others adopt more opaque processes; sometimes OCGs are sent after a firm has been appointed. The firm may have submitted its own carefully-crafted terms, but the OCGs may say they take precedence. Worse still, they may be

10 STEPS TO AVOID GETTING CAUGHT OUT BY CLIENT-IMPOSED CONFLICT RULES

1. Tidy up your firm's records, as no conflicts system will work without clean data. Do you have longstanding clients open under a multitude of matter numbers with slightly differing versions of the name, some perhaps historic and long fallen out of use? Are there typographical errors which may prevent search hits? Does your system log potential clients for whose work you are pitching?
2. Ensure concluded matters are properly closed off so that clients are identified as former clients where applicable.
3. Ensure your conflicts system picks up not just client names but also, for example, property, patents or other subject matters, as well as matters for which full descriptions have been kept confidential with the use of project names.
4. Centralise your client engagement records – most large firms do, though it is less common in smaller jurisdictions.
5. Ensure all client-imposed terms are subject to a central process of prior approval, whether through the firm's general counsel, conflicts partner, managing partner or similar.
6. Ensure those involved in pitches (including business development staff) understand the importance of having terms checked at the earliest possible stage, and alert accounts staff to the risks and consequences of terms being sent to them.
7. Ensure partners and staff understand the dangers of OCGs being received after appointment and the need to raise it through the central process (see #3 above).
8. If proposed terms are unduly onerous, consider asking for more work to justify the obligation.
9. Ensure your lateral hiring process picks up on any OCGs from clients that the lateral may plan on bringing to the firm.
10. Train your partners and staff on how to manage conflicts of interest; workshops with case studies work well. If something does go wrong, it will help to minimise the damage if you can show you had regular training as part of your risk management processes.

sent to the accounts department rather than the client partner.

Another way onerous terms can come in through the back door is through lateral hires and mergers, bringing in clients to whom commitments have already been made.

OCGs may have an incidental side effect of overriding provisions which firms have crafted for their own protection in their carefully-drafted standard terms, such as the right to refer to clients in publicity, or the sharing of information with associated entities practising under the firm's brand name – not to mention limitations on liability; the last of these may come as a surprise to US clients in any event. They may also contain other provisions which are onerous, for example asserting the jurisdiction of US courts (which may have insurance coverage implications too).

Definition of conflicts

Some OCGs require that the firm immediately advises the client of any potential representation which may involve a conflict of interest, as defined by the client. This can be difficult, as it may put the firm's duty of confidentiality to another party at risk.

It is becoming increasingly common for clients to require the firm to contact them for consent regarding any 'actual or potential conflict of interest', including 'business conflicts' as if they were true legal conflicts.

What constitutes a 'potential conflict' is a matter of some debate, and the combination of both the potential and the business issues can make it very difficult, if not impossible, for firms to identify and address these issues.

Medical device technology provider Medtronic stipulates: "Outside counsel is required to advise Medtronic immediately of any actual or potential representation which may be or may become adverse to the interests of Medtronic or of any situation that otherwise may involve a Conflict of Interest [a defined term], including issue Conflicts (such as where a firm asserts a legal position adverse to the interests of Medtronic on behalf of another client in another case) and representation of Medtronic competitors. Questions about whether another client competes with Medtronic should be addressed to in-house counsel. Medtronic expects loyalty from its outside counsel and may regard as an actual or potential conflict of interest the representation of another party, which may have differing interests, whether such interests be conflicting, inconsistent, diverse or otherwise discordant. The foregoing description of "Conflict of Interest" may be broader than any otherwise applicable definition under outside counsel's local bar rules or canons of ethics."

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US ethics rules

The ABA Model Rules of Professional Conduct form the basis of ethics rules in most states in the USA, although the rules applicable in individual states may vary significantly. Model Rule 1.7 provides that "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest". (This is stricter than the SRA's Code in the UK, as it applies also to unrelated matters and may fuel transatlantic differences in expectations.)

Guidance notes to the model rules address positional conflicts and general economic competition. Comment 24 observes that "positional conflict does create a conflict of interest if, for example, 'a decision favoring one client will create a precedent likely to seriously weaken the position taken on behalf of the other client'."

Meanwhile, Comment 6 says "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".

This poses problems, first through lack of clarity (what does 'ordinarily' mean?). Secondly, OCGs may – and often will – go the extra mile in seeking to bar lawyers from acting in such circumstances.

Waiver requirements

Some OCGs set out demanding requirements for seeking waivers (which will only apply where there is no legal conflict in relation to the same or related matters). They may ask for:

- the identity of the other client;
- the work to be performed;
- the identity of the individuals who will do the work;
- the steps to be implemented to preserve confidentiality; and
- whether the subject matter or point of law in either instruction is one of significance.

They may also seek assurance that the matter will not be litigated, or even become 'fundamentally antagonistic', and that the firm will withdraw if it does.

Practical steps

Some firms may be particularly risk averse and avoid acting for other companies in the same industry sector, but that can be easier said than done. Clients may diversify or take stakes in companies in other business sectors.

Such a risk-averse approach may also be impracticable for some practice areas, particularly intellectual property; firms develop their expertise in a sector by acting for a variety of clients within it.

Others may take a high-risk strategy of hoping that they are not caught, or at least not caught out too badly by clients.

The box '10 steps to avoid getting caught out by client-imposed conflict rules' may help to mitigate the risks, whatever your firm's risk appetite. Unfortunately, however, there is no quick fix. mp

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