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# THE LEGAL REGULATION OF LAWYERS' CONFLICTS OF INTEREST

RICHARD A. EPSTEIN\*

THIS lecture addresses the conflicts of interest that face lawyers in the ordinary practice of private law. The subject is one of intrinsic interest to all lawyers and economists who have an interest in the structure of law firms and law practice. More to the point, however, this subject has forcibly been brought to my attention in an autobiographical way. I regard myself as a full-time academic lawyer and as a part-time practitioner. One of the things that has always struck me in my limited practicing life is that, notwithstanding my initial ignorance of the legal rules that govern conflicts of interest, over the years I have been drawn into a succession of conflict-of-interest situations. I have been forced to turn down assignments that I dearly would have liked to undertake, to write detailed letters of explanation to past and present clients, and to obtain clearances and waivers from people after disclosure in order to participate in a case. The problem of conflicts of interest has not been coextensive with the nature of my legal practice, but it has been a major issue, if not a thorn in my side. In at least one case my legal work was the object of extensive litigation in which I was obliged to remain quiet in a deposition before (happily) a claim of work-product and attorney-client privilege was sustained.

For reasons I shall discuss later, I suspect that my position is not unique. It is not possible for any lawyer in practice today to avoid the conflict-of-interest question. To get a conflict-of-interest question wrong may, from the perspective of the lawyer, be worse than losing a case for a client. Moreover, such errors could well expose the errant lawyer to a wide range of sanctions, including disqualification, forfeiture of fees, disciplinary proceedings, and perhaps in extreme cases even criminal sanctions.

Normally, propositions of legal ethics are thought to contain obvious injunctions about the importance of not stealing from client trust funds. In truth, however, the legal regulation of conflicts of interest is a rich and subtle area that has a great deal to do with the way in which legal practice is organized. Every lawyer encounters the rules of the game, and must be prepared to respond to them *before* particular problems arise. For this reason, conflicts of interest is such a vital subject to members of the legal profession.

It is important, therefore, to understand what should be done at sev-

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eral levels to deal with this problem. First, it is necessary to ask the reason why the question of conflict of interest assumes any importance at all. Second, it is necessary to summarize briefly the rules that govern conflicts of interest. Third, it is necessary to ask how firms and lawyers should behave in response to conflict of interest. Finally, it is necessary to ask whether any reforms in the current law and practice of conflict of interest could improve the overall operation of the legal system. In this short lecture I shall try to survey some of the key issues that arise in this area.

### I. WHY CONFLICTS OF INTEREST?

Before dwelling on those special features that concern conflict of interest for lawyers, it is useful to recall that at one level lawyers are simply agents that people hire in order to help them in the affairs of life. As long as the gathering or interpreting of information is costly, it often pays to hire someone else to do your work for you, and to pay that person a sum of money for his or her troubles. The usual rule of joint gains from trade through contract applies to an agency relationship as much as it does to anything else. The agent provides services whose value to the principal are greater than the fee that is charged, while the cost of providing that service is less to the agent than the fee that is received. Both sides therefore can gain from the relationship, which is why these arrangements are so common. Concomitantly, it is quite clear that the parties would *not* normally content themselves with a contract that required the principal to pay the fee and then the agent to do exactly as he pleased.

At one level, therefore, this attorney-client contract is no different from any other and is entitled to the same high level of presumptive respect. Yet, for the lawyer (or at least the lawyer turned transaction-cost economist), a contract is an exchange of promises waiting for something to go wrong. The business portion of the transaction—the services or goods that are exchanged—may be infinitely varied, depending on the subject matter of the bargain. The list of contractual risks that have been identified in the legal literature, however, are remarkably constant across a very broad spectrum of transactions.

One of these problems is aptly called that of “agency costs,” which is the economic equivalent of the conflict-of-interest question. In any contract, it is easy to promise the moon, but tempting to deliver only a slice of green cheese. The promise may determine the scope of the obligation, but it is the performance that ultimately matters, and it becomes necessary to find ways to monitor what the agent does in order to see that inferior goods and services are not substituted for the higher-quality product that was initially promised. This basic proposition about agency costs applies to lawyers as much as it does to anyone else. The lawyer gets only a part of the total gain of his action, be it by fee or by commission, but bears the full cost of his own actions. The risks of self-interest are such that the attorney may not undertake actions that work for the

benefit of the client because of the high costs of doing them. Therefore, contractual strategies have to be devised to prevent these various forms of contractual backsliding to take place, because if they are frequent enough, then the market for superior service at a higher price will collapse given the pervasive problems of nondelivery.

The conflicts of interests that are faced within a law firm are extensive and many of them are not subject to legal regulation at all. Thus, consider first the implicit conflict of interest in any employment relationship. The established law firm is often called upon to train the new associate. Doing so requires sharing with that associate something of the tricks of the trade. There is a body of legal expertise to be learned: elements of the craft, knowledge of certain portions of the court system, and often today, knowledge of the detailed operation of a particular industry or trade. The conflict of interest arises when the young lawyer wishes to leave the firm and go elsewhere before the law firm has recouped its initial investment. But again, the legal system should not provide any explicit remedy for this conflict, because there is no uniform expectation across firms about how the problem should be handled. The default rule, which allows the associate to leave at will, has the advantage of simplicity and places a small but useful incentive on the firm to state that it "expects" the associate not to work for the crosstown firm before two years have elapsed. Here, there is a further question of whether such clauses, if explicit, should be regarded as a restraint of trade, but that question takes us too far afield here, as our major concern is with conflicts between lawyer and client, and not employment conflicts within the firm.

Once the focus shifts to the relationship between lawyer and client, there are many conflicts inherent in the contracting relations. The lawyer and the client must settle on a payment system—flat fee for services, contingent fee, hourly fee—and it is not a case where one arrangement fits all situations. But the relevant conflict-of-interest question here is of a different sort, and concerns the lawyer's use and control over the client's private information. The goal is to be sure that any information the client gives to the lawyer in order to obtain legal assistance does not become in the lawyer's hand a weapon to be used against the client. In principle, information is treated like a good handed over for a limited purpose, and the risk is strictly analogous to that of the bailee's conversion of a chattel by sale or misuse. It is more difficult to prevent the misuse of information, however, because information cannot be returned to the client in the same way a china bowl can be returned to a bailor. Because information is power, the lawyer must guarantee against its misuse in order to obtain the information in the first place. Preserving, indeed creating, exclusive rights over this form of property is not easy because these rights cannot be enforced by any system of physical possession of documents. Given the elemental nature of the problem, conflict-of-interest regulation is not driven by external control; it is driven by the

internal demands of the marketplace. That is, this form of regulation emerged through the natural interaction of lawyers and their clients. Just as I in my day-to-day experience as a novice consultant always found myself making up rules for conflict of interest as I went along, so, I discovered, has everyone else within the profession. What started out as the standard response to a pervasive agency cost problem has crystallized over time into a fairly strong set of legal norms that, for the most part, seem to work well.

One of these norms is to impose an obligation of confidentiality on the lawyer so that the information that is transferred will not be passed on to others who could use it to hurt the client. But that strategy will not be uniformly successful. Information does not always depreciate in value, and it may well be impossible for a client to trace the source of a leak if one should occur. It is therefore advisable to find other ways to prevent this form of disruption from taking place, and one such strategy is to adopt a rule that keeps the information out of the hands of any person who is likely to use it in a fashion adverse to the client's interest. The client has no incentive to entrust information to a lawyer, or indeed to any other agent, if it can be used against the client later on. The simple question, "do you represent any other person who could use this evidence against me?" is designed to cut off the problem of leakage before it occurs. It is designed to separate the lawyer from temptation so that the breach will not have to be remedied after it occurs, when it is so difficult to identify both the source of the leak and the consequences that flow from it.

Even this level of precaution, however, will not control against the potential for abuse. Quite simply, the relevant information remains with the firm even after the representation is over. After the documents are returned, the knowledge remains in the mind of the lawyer. Any subsequent representation of a second client whose interests are adverse to those of the first client poses a serious risk of the misappropriation of information. It is also clear that the first client has no business leverage over the law firm, because their relationship is over and no new one is contemplated. At this point, the only possible remedy is legal: a suit to bar the second representation to protect the confidentiality of the information. But here too the coercive nature of the remedy does not mean that it is not contractual in origin. The ordinary situation where an employer seeks to restrain the new job opportunities of a former employee in order to protect customer lists or sensitive trade information involves similar issues. The inability to place information in a box and to keep it there requires that alternative forms of protection be devised. The broad boundaries that are often established substitute the risk of overclaiming for the risk of underprotection, that is, preventing employees from using their other natural talents in order to be sure that they do not misuse their information. The neutralization of the lawyer from the process is the price paid for allowing the initial information transfer, because no

lesser means of restriction will suffice under the circumstances. So long as the selection of lawyers is generally open, the legal prohibition against the practice is supportable because it is difficult in the multitude of legal specialties to find any alternative rule that is likely to command respect.

The consensual origin of the conflicts-of-interest rules is further revealed in the form of the regulation. Conflict-of-interest rules are normally waivable by a client after full disclosure. These waivers should not be casually assumed, given the strong structural reasons that clients have to keep information confidential and loyalties strong. But the detailed rules surrounding waivers are not my concern here, because with a waiver, conflict-of-interest rules operate as default rules and not as coercive ones. It is important, therefore, to ask whether the rules set the appropriate baseline where the parties have not explicitly addressed the conflict-of-interest issue.

Initially, it might be erroneously assumed that the belief in freedom of contract should lead us to a background norm that denies any prohibition against a conflict of interest. I believe that this is a mistake. I have little doubt that, if asked, most clients and most lawyers "would have" thought that the conflict-of-interest prohibition was so important that it "should have been understood" as part of their business relationship. While these counterfactual assertions are on occasion convenient fictions invoked by judges who wish to do exactly what they please in resolving contractual disputes, I don't think that this cynical view carries the day in this instance. The problem of conflicts of interest is too recurrent and too important for parties to treat it as a matter of whim or fancy. The expectations of ordinary parties may be unexpressed, but at least in this context they are powerful and real. Indeed, in some cases I suspect that the reason for contractual silence is not ignorance of the background norms, but rather it is a conscious desire not to displace them. Leaving well enough alone is both a cheap and reliable strategy.

This conclusion is reinforced by looking at the improper use of inside information, a subject that has been extensively regulated under the securities laws but that rests in part on a secure contractual foundation. Suppose that a law firm receives confidential investment information from a large corporate client. Could it immediately use that information to trade in the stocks of that client? I think that this conduct would be regarded as wholly inappropriate, even if there were no statutory prohibition against insider trading and no explicit contractual understanding on the subject. The law firm receives cold cash as compensation for services, not the right to use client information for its own speculation. Otherwise, the firm's use of information could not be controlled by the client, and the shift in share prices as a consequence of the law firm's trading could not be calculated. If the corporate client had wanted to find a joint venturer, then it could have made that marriage in some other market. The strong separation of legal functions from investment functions is thus understood as part of the normal attorney-client relationship. De-

fault rules should be structured to recognize that conclusion, and the same is true with respect to conflicts of interests in legal representation.

## II. INSTITUTIONAL CONFLICTS OF INTEREST

Other forms of potential conflicts of interest do not lend themselves to the same sorts of legal treatment, because they do not involve the use of private information, but they are still vitally important to understanding the practice of law. Let us suppose that a large firm represents an important chemical company in its product liability litigation. The firm will be constrained in the way it conducts the remainder of its business, even if it keeps confidential all the facts that it receives from that client. By virtue of its institutional position, the law firm will have to take certain strong positions on some general and critical propositions of product liability law: it will have to opt, for example, for narrow definitions of product defect and for broad accounts of defenses based on plaintiff's product misuse. Given these institutional constraints, the firm will find it uncomfortable to represent a plaintiff in an unrelated case if its forceful representation depends on taking a diametrically opposed view toward product liability law. It is not possible to think like a populist plaintiff and a prudent defendant at the same time.

This problem of inconsistent forensic positions depends not only on the nature of the client base, but also on the kinds of issues that are likely to become the subject of litigation. When I started as a torts teacher in the late 1960s, the major questions on a lawyer's plate were not repetitive questions of vast institutional significance. The difficult sort of question that might be posed to an academic, for example, would involve a delicate question of proximate causation, where the question was whether some freakish natural event or some bizarre act of a third party was sufficient to sever causal connection. The many subtleties of proximate causation preoccupied the greatest tort scholars during the first half of this century, and were in fact the kinds of issues to which I initially directed my scholarly attention. But for these purposes the key question is not intellectual interest or intellectual difficulty, but the influence of tort issues on institutional structure. The key word, therefore, is "freakish." If the litigation involved a low-probability, fact-dense issue, it was possible to take a defendant's case in one hand and a plaintiff's case in another.

Matters are quite different today. Now that litigation focuses on main-line questions of institutional liability, the spillovers across cases dominate virtually everything else. Of necessity there is a high degree of voluntary specialization. Voluntary sorting of firms by specialty will become the order of the day. Product defense firms do defense work; other firms do plaintiff's work. Still other firms do insurance work that regulates conflicts between product defendants and their insurers. The level of separation will increase because with mass torts and other forms of modern tort litigation, institutional issues (the role of custom, statutes, or the history of asbestos, Agent Orange, or DES) will play a large role in

thousands of individual cases. Only in an age where lawsuits turned on individualized facts could a single firm take cases for both plaintiffs and defendants alike.

This conflict over principles and causes, however acute, is not one for which any legal remedy is appropriate. The positions that law firms take in litigated cases is a matter of public record, so there is no risk of misusing private factual information. To be forewarned, therefore, is to be forearmed, so the prospect of disqualification (the key sanction where confidential information is at issue) is of no particular relevance. Public coercion is necessary to preserve private information only where there is a subsequent representation with an adverse interest. In cases of inconsistent overall legal approaches, self-help and market segmentation should suffice.

### III. CONFLICTS, FIRM STRUCTURE, AND FIRM PRACTICES

The problems of specialization are worthy of some further comment. The pressure on both market segmentation and conflict disqualifications have risen in recent years, and I believe that this point is tied to the degree of specialization within the law and to the nature of the institutional litigation that has become ever more common. Whereas years ago it was often possible for a single lawyer to hang up a shingle that announced expertise in corporations, torts, commercial litigation, or securities law, today these broad fields are giving way to narrower areas of specialization, both for counseling and litigation. Torts becomes medical malpractice and products liability claims. Medical malpractice becomes obstetrical or neurological disorders. Products liability is a hopelessly broad category. There are lawyers who specialize in drugs, in chemicals, in machine tools, in mass torts, in guns or beer or cigarettes. Corporations becomes mergers and acquisitions, or proxy fights, and so on down the line. This specialization has become necessary in the practice of law, as it was in the medical field, in order to maintain professional competence, even if many academics, such as myself, are incurable generalists.

Specialization has powerful consequences for the range of clients that lawyers are able to serve in the ordinary course of their business. Today it is less possible to draw clients from a wide range of different work. Instead, when the stakes are very large, clients want lawyers who have real experience in a given area, just the way a patient with a brain tumor wants to hire a physician who has done many similar surgeries. But while the only constraint on the surgeon is that of time, the same is not true for the lawyer. The huge concentration of cases in a narrow area of expertise increases the pressure of the conflicts-of-interest question. The very knowledge that makes a lawyer marketable today may be the same information that makes it impossible for him or her to undertake certain forms of business tomorrow. The experience in an area that attracts future clients embraces the confidential knowledge that may make it impossible to serve them.



The problem is exacerbated when one recalls that the conflict-of-interest rules operate not only at the level of the individual lawyer, but also at the level of the firm. If some lawyers inside the firm take one client in a given area, then others within that firm are effectively barred from representing clients with adverse interests, either because they face the loss of business from the first client, or because of the threat of disqualification.<sup>1</sup> In that setting it becomes clear that one can no longer regard the size of the firm as an exogenous factor that operates independently of the conflict-of-interest rules. Sheer size thus creates conflicts of interest that no amount of planning can avoid. Firms will reconfigure themselves in order to avoid the systematic conflicts that they may otherwise face. One obvious implication of the theory is that firms cannot represent both plaintiffs and defendants in institutional litigation. Less obviously, perhaps, it is also very difficult for a single firm to specialize in both the defense of an underlying tort action and in the insurance coverage dispute between insurer and insured that so often accompanies the tort litigation. The insurance firm is interested in minimizing the level of liability *ex post*, while the plaintiff's lawyers assiduously seek to expand it.

The question of conflict of interest is also relevant to firms that are on the same side of the market. To see how this last point works, consider a firm that has four or five groups that specialize in corporate takeovers. When a large deal is on the horizon, it is clear that only one group within the firm can participate. Once it has a client, then the other groups are effectively foreclosed from representation by the conflict-of-interest rules that are involved. But why should those groups stay on the sideline? If the firm were to split into separate parts, then each of the groups involved could enter the fray without being foreclosed by what any other group has done. The pressure for the division of the firm into several distinct competing units is therefore insistent. The break-off of subunits is one way to respond to that situation.

It should not be supposed, however, that the conflict-of-interest question is the only force that influences the choice of firm size. For certain major corporate deals, it might well be necessary to assemble a large, integrated team of lawyers on short notice. The break-up of the single mega-law firm into a large number of equal pieces could well disable the firm from competing in that market. The actual distribution of firms by size and specialization in the marketplace is likely to be the result of a delicate minuet, as the various players try to trade off the gains and losses of various firm sizes. At any given moment it is highly unlikely that all firms will be of the same size. Nor is the equilibrium that forms at one time likely to prove stable, for the mix of firms may well depend on the nature of the deals that loom on the corporate horizon. The very large

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1. See Model Rules of Professional Conduct Rules 1.7, 1.10(a) & Comment [6].

firms of the 1980s may have to downsize today, when deals are more modest in their proportions.

The converse problem, it might be added, could arise with the proposed merger of two or more firms. If the two firms have inconsistent client bases, some of which will have to be turned away after merger, then they might not be able to consummate the deal. Despite the potential economies of scale that would result from the merger, both firms risk losing their ideal client composition.

Merger and break-up are not the only possible responses to the conflict-of-interest question. In an individual case, it may be possible to resolve, or at least side-step, a conflict by referring either or both sides in the case outside of the office. But there are risks involved. It is very difficult for a law firm to keep the unrelated business of a client that it is opposing in what might be a life-or-death matter. So it is possible that both clients will have to get separate counsel, in which case neither may return to the original fold. In order to forestall this problem, many firms develop a kind of buddy system, in which they refer certain matters to smaller firms who implicitly promise not to take the entire business. This promise can be informally bonded by making referrals to boutique law firms that are not capable of providing full-line services to a major corporate client. Alternatively, the firm can provide the smaller firm with a steady flow of business that can be cut off if the firm on referral makes a play to keep the client. The strategy may work well in most instances, but for some small firms the prospect of luring one large client may make it worthwhile to lose other sources of business.

The influence of conflict-of-interest regulations is not confined to those cases in which there are transformations in the organic structure of the law firm. They can also arise with the shift in personnel between firms. The issue recurs constantly because the mobility of labor in legal markets is as important as it is everywhere else. Competition between firms depends in part on the ability of one firm to lure away the partners and associates, whether disgruntled or contented, of one firm to another. If the conflict-of-interest rules become too stringent, then the newly hired lawyer will carry into the new environment infectious disabilities that will preclude his new firm from taking on new business, and disabilities that might require the firm to give up business that it already enjoys. The problem could be especially acute if the knowledge of any lawyer in the former firm were imputed to the lawyer who changed positions.

Fortunately, the rules are sensitive to these concerns and make two sensible accommodations to the basic problem. First, the knowledge of other members of the old firm are not imputed to the new lawyer unless there is reason to believe that there is some personal knowledge.<sup>2</sup> Second, the new lawyer may be assigned to matters that are independent of his former association. The changes in the composition of the workforce

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2. See *id.* Rule 1.9(b), (c) & Comments [7]-[9].

creates strong pressures to compartmentalize the information within a firm. There is a real cost of knowing things that are not needed in day-to-day work. The creation of the so-called "Chinese wall" to create separate zones within the firm, and the requirement that files be opened to lawyers only on a "need-to-know" basis, are some of the internal responses that firms have to make in order to cope with the conflict-of-interest problem.

Thus far I have spoken about the influence of conflict-of-interest concerns on the structure of firm practice. But these concerns have other practical implications as well. The most vivid way I can make the point is to ask a rhetorical question: When does a new firm face its first conflict-of-interest problem? If the answer given is, "when there is a genuine question of whether the firm can take the second client given that it now has the first client," then the answer is wrong.

The first conflict of interest question for any firm arises when the *first* client walks into the law firm. The willingness to take the first client *forecloses* the ability to take other clients, either because of the general positions that must be adopted or because of the actual conflicts that can emerge in ongoing litigation. Therefore, to take a small client in a large case may well block the firm from taking another client whose stake in the litigation is far greater. Moreover, once the initial client is accepted, any effort to negotiate a subsequent release is likely to be so ticklish that it is better not attempted at all.

The point was brought home to me years ago when an insurance executive with whom I worked commented in passing that he was unable to hire his first-choice firm for a mass tort litigation because the firm had already committed itself to another, more marginal litigant in the case. He expressed the wish that the law firm, with whom he had had business relations in the past, had called him first before accepting this client. The advice seems sufficiently wise that I pass it on here. The initial clients and causes selected by the firm will influence its subsequent areas of specialization and growth. It is critical, therefore, to be aware of conflict-of-interest problems before they arise in concrete form, and not only afterwards.

#### IV. LEND-LEASE FOR LAWYERS

There are still other ways in which the demands of mass litigation influence the practice of law. The typical lawsuit involves a huge number of individual plaintiffs arrayed against a large class of institutional defendants. The most obvious concern on both sides of the line is the duplicative costs of running so extensive a show. There is a clear effort to economize on acquiring the information about the particular facts associated with the litigation. There is a question of what the physical properties of certain substances are, questions of prior regulatory approvals for placing products on the markets, questions of what key officials knew or did not know when the product was first marketed, and so on. As long

as the facts and legal issues are repetitive, it pays to reduce the number of times that persons on the same side of a case will subject those facts to an independent examination. In part, the problems of duplication are solved by a division of responsibility among the firms charged with handling the litigation. In part, however, the problem is insoluble, a testament to the extraordinary waste that crops up in major civil litigation today.

For these purposes, it is important to realize that conflicts of interests in mass tort litigation can arise when the same lawyer is retained by parties who are on the *same* side of mass litigation. The problem has been of great importance for academic consultants, like myself, whose expertise lies in free association, far from the issues of day-to-day management in major tort litigation. While the co-defendants' overall objective is the same—to minimize exposure to suit—their initial positions may be different because of what they knew and what they did. For example, one of two defendants may face a risk of punitive damages that the other does not. But even if their practical positions are the same, they may well wish to pursue different strategies in facing a common threat. The imperfect parallelisms of their position give rise, up front, to a conflict of interest for any lawyer who attempts to represent them jointly. It does not follow, however, that this conflict of interest poses an absolute bar to that representation, for both clients may choose to waive their objections after disclosure.

Yet, the question of waiver in this context is far more subtle than a simple “all-or-nothing” question. Owing to the continuing interest of both firms in the matter, the waivers may themselves become fairly complicated agreements between the relevant clients and the attorneys. The gains from joint representation are often understood as sufficiently large so that it is efficient to allow the conflict to occur, to mitigate its adverse effects, and to run the irreducible risk that some major dislocation may occur in the future. In my experience the waivers that are obtained in these joint representation agreements assume the status of a “lend-lawyer” agreement, reminiscent, at least by way of allegory, of the famous “lend-lease” agreement of Churchill and Roosevelt just before World War II.

The obvious benefits of these lend-lawyer agreements is that they permit two clients to share the expertise of a single lawyer. This arrangement has of course the obvious benefit of reducing the total bill, given that the second client does not have to educate the lawyer from scratch about the details of the case. There are more subtle benefits that are generated as well. First, the use of the same lawyer by separate clients increases the likelihood that the co-defendants (or co-plaintiffs) will forge a common strategic alliance against the other side. The uniform views of a single outsider are exerted against both firms. The ability to reduce dissonance within the coalition makes it more difficult for individual defendants to be picked off in settlements, and it reduces the internal con-

flicts between co-parties over the many strategic decisions (do we take an interlocutory appeal now, or await the completion of discovery?) that can easily divide parties on the same side of a case. Second, the use of a smaller number of lawyers reduces the likelihood of a breach in confidentiality. The fewer the persons who have to be entrusted with confidential information, the less likely a damaging leak.

When the dust has settled, all sides can gain. The lawyer receives more work; the first client has a greater influence on the views of the second; the second client has lower costs in training the lawyer; and the increased likelihood of a common approach redounds to the benefit of all. Nonetheless, it is clear that the common arrangement may eventually fall apart if some strong disagreement of principle arises between the parties that makes it impossible for the joint representation to continue. A parting of the ways might become inevitable if, for example, one client decided to sue another for indemnification and contribution—a move that is relatively infrequent given that any suit between co-defendants increases the chances of plaintiff's success.

But if the infrequent does happen, what then? As a first approximation, it seems clear that the lawyer who has engaged in the joint representation is under a duty to withdraw from the case given that he possesses confidential information from both sides. Yet it may be possible to alter that situation by contract after disclosure: to make it clear that in the event that the conflict does arise, one client, typically (but not necessarily) the lending client, has the right to insist on the exclusive loyalty of the lawyer. It is quite possible that this arrangement will prove so awkward that the lawyer will choose to withdraw even if allowed to stay on. Nevertheless, the presence of a clause of this sort in the lend-lawyer agreement may reduce the possibility of a complete withdrawal by the attorney. Where the non-controlling client knows that the joint representation may be ruptured, it can protect itself in part by limiting the information that it passes over to the other client. In addition, there is typically so much sharing of information between co-defendants that disqualification of the shared expert may be unwarranted because all the information that he possesses has been shared between clients during the period of joint representation. In this setting, the rights of the first client to control the use of the shared lawyer should *ex ante* be welcomed by both sides because it makes possible the joint representation in the first place. I have been in several of these situations during my career, and all have worked out well to date. I shall keep my fingers crossed.

## V. SETTING THE RULES OF THE GAME

Thus far my discussion has focused on the origins of conflict-of-interest problems and on the responses that firms and lawyers can make to them. In order to round out this discussion it is useful to examine briefly the legal rules that should be used to regulate this system. Of course, the basic rule is one that allows waiver after disclosure to dominate. But

even the presence of a powerful contractual solution does not eliminate the need for some general legal approach to the subject. Contracts themselves are often incomplete, and do not specify the exact consequences that flow if and when a conflict of interest emerges.

In dealing with the necessary legal response, it is possible to adopt one of two general models. The first of these models takes the position that it is never quite clear what a conflict of interest is, so that the proper judicial response is to evaluate the facts and circumstances of each case in deciding what should be done. Given the absence of clarity in the rules, the impulse would be to impose relatively minor sanctions on the lawyers who deviate from the accepted conflict of interest standard, such as it is. Firms with conflicts of interest will be allowed to collect their fees for services rendered, and perhaps the work product of discovery and document analysis will be preserved for the benefit of the successor firm.

I believe, however, that the alternative model is the correct one. That model works from the assumption that it is desirable, first, to have bright-line rules, and, second, to impose very heavy sanctions on those law firms that deviate from these rules. The point of the strategy is not heartless cruelty. It is an effort to structure incentives so as to minimize the number of violations that take place in order to avoid the difficulties of running a clean-up operation, at enormous inconvenience and expense to everyone, after the conflicts have occurred.

Let me give some examples of the kind of bright-line rules that I think should play a role in this area. One is that as soon as a client has given a firm any private information about his internal affairs, that firm cannot take an interest adverse to that client if there is any chance that the information that has been handed over will be material to some subsequent dispute.<sup>3</sup> Obviously, if the information that has been handed over is in response to a government antitrust suit, then it cannot be used in a private suit. But the prohibition goes deeper. If the information is handed over in order to guide the lawyer on a tax matter, it cannot be used against the client in a subsequent dispute over an employment contract, a situation ably analyzed by Judge Posner in the *Analytica* case.<sup>4</sup> There is no requirement that there be a common core between the legal issues or legal theories involved in the two disputes. It is quite enough that there is a common core of facts so that the lawyer in the second case can use against the client facts or information acquired in the prior representation.

One essential feature of this position is to refuse to allow causal questions to cloud the disqualification question. If the lawyer possesses information adverse to a former client, then he is barred from handling the case. There is no requirement to show how this information would be used, or whether that use would compromise the position of the former

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3. See *id.* Rules 1.8(b), 1.9(a), 1.7 & Comment [4].

4. See *Analytica, Inc. v. NPD Research, Inc.*, 708 F.2d 1263 (7th Cir. 1983).

client. The likelihood of adverse use is sufficiently great that there is no reason to require anyone to engage in costly and intrusive discovery to determine either the existence or the extent of the adverse use. It is better to make the prohibition clear and unambiguous. Once the boundaries of the prohibition are established, lawyers have a clear buoy around which to navigate: they can decline to take the second case. The client at this point still has a world of lawyers from whom to choose, and there is no need to decide which portions of the past legal effort may be preserved for the next lawyer and which have to be discarded altogether. The severity of the sanctions is justified in light of the way it reduces the probability of an initial violation of the conflicts-of-interest rules.

The second illustration of a clear prohibition arises out of the common situation where a single lawyer, often for reasons of cost and convenience, is asked to represent two parties with opposing interests. Two persons who intend to go into business together ask a single lawyer to represent both sides. At the outset the lawyer should drive home the potential conflict of interest,<sup>5</sup> but often the clients may rightly decide that the savings in cost make the risk worthwhile, especially if they have a business understanding of how they wish their deal to succeed. The question then arises of what should be done if there is a falling out between the two parties during the course of business. It may well be that one client sues the other, or that additional persons have been admitted into the business, further clouding the waters.

At this point the rule again must be clear. Unless the consent of all parties is obtained, however unlikely it is under the circumstances, then the lawyer who represented both sides can now represent neither.<sup>6</sup> Any law firm that has been hired to represent one side must promptly move to disqualify any other firm that seeks to remain in the case once having served both clients. The discovery and other work done before disqualification should be regarded as tainted, and the matter sent back to square one. As before, the purpose of the draconian prohibition is to make it crystal clear that this form of ambiguity will not be tolerated. The simple rule has more power if it is not encrusted with layers of unnecessary qualifications. While it may appear to cause hardship in individual cases, its long-term application is apt to prove more beneficial and benevolent. The firm that is forced to retire from the list in one case makes way for a second firm to receive the business. Yet in some future case, the roles may be reversed so that the first firm may receive new business that might not have come its way. The important thing is to preserve sound institutional structures, and to let the financial and business impacts in individual cases fall where they may. Any inequities are apt to wash out in the long run, at least where repeat players are involved.

There is yet one additional reason why clear disqualification rules of

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5. See Model Rules of Professional Conduct Rule 1.7(b)(2) & Comments [7], [11]-[12].

6. See *id.* Rules 1.7 Comments [11]-[12], 1.9 Comments [11]-[14].

this sort are required. During the 1980s, there were a number of important cases that addressed the appealability of disqualification orders. As is often the case with appeals, the key question is whether the appeal could only be brought at the end of the proceedings or whether an immediate appeal is possible. The problem can arise with either of two challenges: the disqualification may be allowed, and the firm that is disqualified may seek to get back into the suit. Alternatively, the firm is not disqualified, and the risk is that after the entire case is tried, the matter will have to be retried, after fresh discovery, because disqualification should have been ordered.

The problems with any rule are manifold. If one adheres to the standard, final judgment rule in these two situations, it is possible that an enormous injustice will take place, for an entire trial will roll back with a firm that should not be present, or without one that should be present. But the alternative of immediate appeal is scarcely any better, for that right can be exercised not only in the interests of justice, but also by firms that seek a strategic advantage in delay. No matter whether the appeal is allowed immediately or postponed to the end of trial, the error costs will remain high at least if the rules themselves are incapable of clear application. The need for *per se* rules in this context is of heightened importance because they reduce the need for appellate resolution of what is an otherwise difficult issue. Again, the hard issue of timing of appeals is largely skirted by a set of substantive rules on disqualification that calls for straightforward application in routine cases. We cannot ask for more than this from any general set of pronouncements.

In general, therefore, I think that we can regard the set of rules that govern conflicts of interest for lawyers as a modest success in a difficult area of law and business practice. The issue of conflict of interest is forced upon firms by the nature of modern institutional practice, by the importance of specialization in legal practice, and by the imperative business need to restrict access to confidential information. Any set of rules that is put forward to deal with these problems is apt to produce dislocations in some cases and occasional injustices in others. But once lawyers recognize, as I believe they have, that conflicts of interest are an unavoidable part of legal practice, then they should be resigned to the inevitable set of problems that are apt to crop up as part of the daily life cycle of the profession.



