

NEW YORK STATE BAR ASSOCIATION

Committee on Professional Ethics

Opinion 712 – 1/7/98 (38-98)

Topic: Conflict of interest; financial interest.

Digest: Where lawyer is beneficiary of trust holding stock in corporations which may become clients or opponents of clients, lawyer has no conflict of interest or disclosure obligation except on rare occasion when lawyer's exercise of independent professional judgment reasonably may be affected by lawyer's financial interest.

Code: DR 5-101, 5-105(D); EC 5-1, 5-2, 5-3.

QUESTION

A lawyer engaged in securities work at a firm is one of a number of co-beneficiaries and therewith beneficial owners of a securities trust invested in "blue chip" corporations, paying small annual dividends, and valued at under a million dollars. The lawyer has no influence in the trust's transactions, and it will be twenty years or more before any other significant benefit flows to the lawyer from the trust. In a number of matters, corporations in which the trust has invested are either clients or opponents of the firm's clientele. Does the lawyer's financial interest give rise to a conflict of interest when the lawyer or the law firm undertakes representation in these matters?¹

¹ The inquirer also raised a question concerning the possible role of federal regulations governing "insider trading". Although the question of when securities regulations apply is a matter of law beyond the Committee's jurisdiction, we note that any violation of law is apt to violate the Code. DR 7-102(A)(8).

OPINION

The inquiry implicates DR 5-101(A), which provides:

Except with the consent of the client after full disclosure, a lawyer shall not accept employment if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests.

This disciplinary rule is designed to protect against the risk that the lawyer's financial interests (or other interests) would tend "to dilute the lawyer's loyalty to the client," EC 5-1, or "make his or her judgment less protective of the interests of the client." EC 5-2.

Although lawyers are expected to avoid acquiring particular interests that might interfere with their professional judgment in an ongoing representation, ECs 5-2 and 5-3, lawyers cannot avoid all interests that might potentially bear on their future representation of clients. Thus, before undertaking a new representation, DR 5-101(A) requires the lawyer to consider whether the lawyer's interests may affect the lawyer's exercise of professional judgment in the representation. At one extreme, when there is no more than a fanciful, theoretical or "de minimus" risk that the lawyer's judgment will be affected adversely by a potentially relevant set of interests, DR 5-101(A) imposes no restriction. *Cf.* N.Y. State 655 (1993); N.Y. State 643 (1993). At the other extreme, DR 5-101(A) has long been understood to foreclose the lawyer from undertaking a representation, even with the client's consent after full disclosure, "if there is a reasonable probability (viewed objectively) that the lawyer's interests will affect adversely the advice to be given or the services to be rendered to the client." N.Y. State 595 (1988); *see* N.Y. State 688 (1997) at 3 n.2 (citing authority).² Under DR 5-105(D), a lawyer's personal conflict under DR 5-101(A) is automatically imputed to the lawyer's firm, so that if the lawyer may undertake a representation only with the client's consent after full disclosure or is foreclosed from doing so altogether, the same restriction would apply to all other lawyers in the firm.³

Thus, the question raised by this inquiry is whether, in any given matter in which the lawyer or the lawyer's firm would engage in the representation, the lawyer's professional judgment "will be" or "reasonably may be" affected because the lawyer has a financial interest in a trust which holds stock in a company that

² A proposed amendment to DR 5-101 would appear to codify this Committee's long-standing analysis.

³ This would not be true if amendments to DR 5-105(D) proposed by the New York State Bar Association are adopted.

is either a client or an opposing party in the matter. If it would be, then, under DR 5-105(D), the conflict would be imputed to the law firm, and the lawyer or the firm could undertake the representation, if at all, only with the client's consent after full disclosure.

The question whether the lawyer's "exercise of professional judgment...*will be...affected*" by the lawyer's financial interest is a subjective one, which the lawyer in this situation must resolve personally. The question whether the lawyer's judgment "*reasonably may be affected*" by the lawyer's financial interest is an objective one which invariably "will depend on many factors." N.Y. State 688 (1997). In this situation, relevant factors include: (1) the nature of the law firm's representation of, or adverse to, the corporation whose stock is held by the securities trust; (2) the likelihood that the value of the securities trust or the amount of income it produces will be significantly affected by the outcome of the representation; and (3) the extent to which a lawyer's judgment might be affected as a consequence.

We believe it would be the rare case in which, objectively speaking, a lawyer's judgment reasonably may be affected by the above-described financial interest. In most cases, the representation by the lawyer or law firm can be expected to have minimal or no impact on the value of the company's stock or the dividends it produces. Because it cannot be said that the lawyer's financial interest "reasonably may affect" the lawyer's exercise of professional judgment in such circumstances, disclosure and client consent would not be required.

The determination under DR 5-101(A) is not susceptible to a per se rule, however, because one can imagine the rare situation where the lawyer's judgment reasonably may be affected by the above-described financial interest. This may occur, for example, where the particular company's stock represents a significant part of the value of the securities trust and the value of the company's stock will be significantly affected by the transaction or litigation in which the lawyer would be involved. In such rare circumstances, it would be permissible to undertake the representation, if at all, only with the client's consent after full disclosure.

CONCLUSION

Subject to the limitation described above, the lawyer generally would have no obligation to disclose to a client that the lawyer has an interest in a securities trust holding stock in the client corporation or in a corporation that is adverse to the client.
