AVOIDING CONFLICTS WITH CLIENTS BY THE USE OF
ENGAGEMENT LETTERS AND
WAIVERS OF CONFLICT

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History and Overview

Why engagement letters? The growth of law firms, the increasingly national scope of client relationships and transactional practices, the greater frequency of disqualification challenges, and the higher financial stakes of unresolved conflicts of interest – all of these have been cited as causes for the increased attention to the formalities of engagement of attorneys. Further, the point of engagement has been seen as a decisive moment in which professional liability is created or avoided. In the words of one insurer commenting on a damage award against a law firm, the only malpractice in a given situation may have been the decision to take on the representation.

Throughout the national legal community, there has been a movement toward formalized engagement agreements. On a state level, there is a clear movement toward bar or statutory requirements and policies favoring written engagement agreements. The primary motivation for these requirements appears to have been regulation of fee arrangements with unsophisticated clients and in litigation matters. Contingency fee arrangements have long required written agreements. Many "non-traditional" fee arrangements in transactional representations fall within the technical classification of contingency fees. Such arrangements have often been documented pursuant to the corresponding rules. The trend toward formalized engagements now, however, extends to more routine arrangements. Among the states in the vanguard in requiring written statements of engagement in standard hourly fee situations were California, New Jersey, Pennsylvania, and Virginia. The District of Columbia has also moved toward this policy. More widely, state and local bar associations and ethics task forces have recommended or expressed a strong preference as an "ethical principle" for formal engagement letters in routine transactional representations. In making these recommendations, they have had the strong support of the

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1 An overview of one’s state’s process and the logic of a Reporter for that bar can be found in D.C. Wells, “Engagement Letters in Transactional Practice: A Reporter’s Reflections,” 51 Mercer L. Rev 41 (1999).
major insurers of law firms, who are themselves recommending the routine use of engagement letters in first-time engagements for transactional representations.²

Do engagement letters reduce risk of liability? Is this movement toward formalized engagement procedures good news for the profession? The answer appears to be a resounding "maybe" with some clear instances of engagement letters that would have better been left unsigned. Engagement practices are important in reducing potential liability, but engagement letters have also been a source of increased liability in situations where individual lawyers or firms did not understand the issues that were involved, or did not perform the obligations that were undertaken or implied in the engagement process.

In some areas of transactional practice, the use of formal engagement letters as a condition of a representation is well established. Transactional practices in which fees are dependent on success have long used written engagement agreements. Initial public offerings, merger and acquisition work, leveraged buyouts and other representations involving substantial uncertainty of result and potential exposure to third parties and regulators have routinely used engagement agreements to deal with fee arrangements that are not based on hourly rates or are subject to payment by third parties. Where a transaction includes topics within a specialty practice or requiring specialized competence, engagement letters have been used to define the responsibilities of the attorney. Engagement letters specifying the allocation of responsibilities or scope of advice have been particularly important in practices in which special risks or greater liabilities attach to certain elements of the advice, such as land use or zoning advice, compliance advice to regulated financial institutions, and securities underwriting representations. Where engagements may involve potential liability to third parties, allocation of responsibility and

² Support for standardized engagement letters as a routine or mandatory practice is not universal. A proposal from the New York State Bar Association’s Corporate Counsel Section met with opposition from several other Sections of that association and from members of the bar. For an informal survey of the reactions to this somewhat one-sided proposal of a committee of in-house counsel, see "Corporate Update – Hiring Counsel; Model Contract leaves No Detail Unresolved," N.Y.L.J., June 10, 1993.
indemnification provisions in engagement letters have been routine. In recent years, we have also become accustomed to engagement letters somewhat fixated on fee, staffing and disbursement policies as mandated by institutional lenders and investors.

The drive toward formal engagement letters for these purposes has created a convenient setting to document other terms of the engagements. Further, the opportunity to document the ground rules for the relationship between attorney and client has altered the consequences of failing to spell out those rules in writing. Not surprisingly, presumptions applied to the interpretation of engagement letters have proven to run against lawyers. Engagement letters are, after all, documents with an intended legal effect often negotiated without independent counsel, with a group of experienced lawyers as the party adverse to the client.

The Risks of Proceeding Without an Engagement Letter

What are the risks of omitting an engagement letter or documenting too few of the terms of an engagement? Many insurers encourage the use of engagement letters as part of a general policy favoring more deliberate scrutiny of new client matters. There are also specific risks that can be addressed by the written engagement agreement:

- **Loss of benefits of special fee arrangements.** If there is intended to be a non-traditional fee arrangement, any premium fee may be disallowed if not documented in writing.

- **Liability for specialized advice.** In the absence of an express disclaimer of responsibility or a provision for the delivery of advice by other counsel, a lawyer may incur liability for imputed advice or for failure to provide services in specialty areas that the lawyer did not expect or intend to provide.

- **Reliance by non-client third parties.** Without an express disclaimer of a right to reliance by non-client parties, a lawyer may incur liability to third parties where access to or reliance upon the advice was known or foreseeable.

- **Conflict of interest and disgorgement.** Absent an express waiver, the lawyer will have liability for a conflict of interest. This liability may include the obligation to
disgorge the full amount of fees (and not merely the profit component of such fees) taken during a period of conflict of interest or during any other breach of ethical standard. Where the breach involves a failure to obtain a waiver, the fees at issue may include all fees paid by both clients.

- **Disqualification.** The lawyer may face disqualification threats, which now arise in transactional representations as well as in litigation. The major dangers of disqualification outside the context of litigation may be the injury to the client relationship, the obligation to disgorge fees and damage to reputation.

- **Loss of credentials.** A law firm’s overall operation may be tainted involuntarily by an inappropriate representation, resulting in exclusion from target markets in which eligibility may be determined by regulators or other parties with the power to determine whether a choice of counsel is acceptable.

- **Unintended clients.** The law firm may find itself with unintended obligations to a non-client, such as the never-to-be client prospect from a failed beauty contest\(^3\) or a proposed client rejected by the firm.

Real estate and other transactional practitioners are relatively late arrivals to the use of formal engagement letters. Many remain uncertain about the ground rules for use of such letters and their benefits and risks. The discussion here is concerned with the basic terms of a typical transactional or advisory engagement letter, with some of the current issues emerging in use of engagement letters, and with the issues of ethical walls in resolving conflicts of interest.

**Basic Elements of Typical Engagement Letters**

Most recommended forms\(^4\) of engagement letters include provisions to cover the following:

\(^3\) See, ABA Committee on Ethics and Professional Responsibility, Formal Opinion 90-358 (disqualification issues in preemployment interview). A sample agreement to deal with such situations may be found in "Conflicts of Interest Issues," Task Force on Conflicts of Interests, 50 Business Lawyer 1391, 1396-1401 (August 1995) (hereafter "Task Force on Conflicts").
• **Identity of the client.** Some forms make provision for multiple clients, or clients not yet in existence. A typical formula is "John Doe and his wholly owned company" or "John Doe and the partnership of which he is now or will in the future become a general partner." In several states, however, the identification of multiple clients may be self-defeating, in that it can be taken as evidence of acknowledged conflict of interest at the outset of the engagement. If multiple clients are identified, a law firm is wise to deal also with the possibility of future conflict among them.\(^5\)

• **Scope of representation and excluded subjects.** Among the subjects frequently excluded are matters involving foreign law, matters to be handled by in-house or other designated counsel, issues of compliance with regulations of specialized governmental agencies, land use and zoning opinions, and tax assessment challenges.

• **Fee and billing arrangements.** Hourly rates, disbursement charges, frequency of rate changes, exclusion of overhead recovery charges, retainer terms and application, and other policies are routinely specified by clients. If fee splitting or compensation for non-legal services is contemplated, the arrangement may need to be disclosed and given consent by the client.

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• **Waiver of past or current conflicts.** Where there is possible conflict with former clients, express waivers may not be required for unrelated matters. Express waiver of current conflicts is necessary regardless of “relatedness”, and should be mirrored by a waiver from the other affected client.

• **Execution by client.** The requirement of an engagement letter may not actually require an agreement to be signed by a client. If the requirement is one to provide the client with certain engagement and fee terms in writing, it may be satisfied by delivery of a letter to the client without its countersignature. Such informational letters are often used to confirm terms of routine engagements or billing practices. Where a waiver or a contingency fee agreement is involved, the client should execute the letter.

Where fee agreements are dictated by bar requirements, the essential terms usually include the client’s identity, the assignment, the fee arrangement, and evidence of the client’s execution or acceptance. Some recommended forms go much further to include details of the client’s legal position and affiliations, dispute resolution mechanisms, provisions for termination of the relationship, allocation of responsibilities between firm and in-house counsel, total fee estimates or caps, staffing commitments and provisions regarding potential reliance by third parties. Some proposed forms, however, stop short of requiring even the client’s signature and suggest only that the letter be sufficient to put the client on notice of the terms of the engagement and all necessary disclosures.

**What Can an Engagement Letter Do?**

In deciding what an engagement letter should include, it is advisable to understand what an engagement letter can, and cannot, achieve. Among the benefits that it may achieve are:

• **Define the client.** An engagement letter can define the client or, more specifically, the person or entity to whom the duties of an attorney are owed and by whom the duties can be waived. The letter can, and should, resolve the issue of who among an affiliated group is the actual client, and whether a group or its constituent members are the client/clients. The engagement letter may clarify the specific representative of
the entity to which attorney’s fiduciary duty is owed and therefore by whom that duty or any conflict may be waived.

- **Exclude non-clients.** An engagement letter can specifically exclude as a client known or foreseeable parties who can be put on notice or joined in the engagement letter to cut off future claims of reliance or representation. This, like the definition of client, can be modified by subsequent behavior.

- **Define the scope of the agreed representation.** An engagement letter can define the scope of the agreed representation and specify the topics excluded from the representation. It may deal with questions such as what is the subject matter or transaction covered by the services, what is the goal or conclusion anticipated, and how is achievement of that objective to be established. The engagement letter may also establish the special expertise, such as zoning, land use, regulatory compliance, or foreign law, which is included or excluded from the responsibilities of the retained law firm. As to excluded topics, the letter may establish who will provide advice on the excluded topics, laying a basis for the law firm’s own reliance on that other group or firm.

- **Provide against future disputes.** An engagement letter can anticipate conflicts within affiliated groups and clarify the role of the lawyer in the event of such disputes. By negotiation at the commencement of the relationship, the letter can make some provision for those future dispute situations in a neutral atmosphere. A later citation back to the terms of the letter may help a law firm extricate itself.

- **Fees, retainer, disbursements, etc.** An engagement letter may specify a non-traditional fee structure, the terms of any retainer payment or application, and any other economic conditions such as special levels of staffing.6

• **Client’s representations to lawyer.** An engagement letter can document the factual basis for a lawyer’s decision to accept a client, such as the key representations made by the client to induce the lawyer to accept the engagement. The letter may also record the disclosures made to the attorney, including which affiliations were disclosed, what financial capacity was represented, and what role the client intended to take in the transaction. The letter may also describe what billing arrangements the client accepted. The disclosures may protect a law firm later found to have been misled, but can be a two-edged sword if blatantly untrue.

• **Waivers and disclosure of conflicts.** An engagement letter may establish waivers by the client as to known disputes or conflicts. It may also establish the disclosures or agreements made by the attorney to obtain those waivers, such as promises of reciprocal waivers or so-called "ethical" walls. The letter may also record disclosures made to put a client on notice of other clients with competitive business interests whose existence, while not disqualifying representations under applicable ethical standards, may create tension in this client relationship.

• **Exclusion of any representation.** A letter in the nature of an engagement letter, but actually intended to document disengagement can limit the obligations undertaken by the receipt of information or delivery of preliminary advice for a "beauty contest" or discussion with a potential client. Even a conversation that does not result in a representation may be held to impose some degree of liability for legal advice or confidentiality, or may bar other representations.

**What Engagement Letters May Not Achieve**

Engagement letters are most useful in confirming in writing the basic terms of an engagement that has been otherwise agreed. They may be approached as negotiated free-standing written agreements with adversarial parties (i.e., the client) anticipating future litigation, but are often less useful when prepared in that light. Many lawyers recognize that complex engagement letters have a chilling effect on a client’s ardor, much like the chilling effect of ante-nuptial agreements in the context of a somewhat different process of mutual seduction. Lawyers
are therefore reluctant to request certain types of agreements or effective provisions. Putting aside the possibility of adverse impact from overreaching demands, there are real limitations on what engagement letters can hope to achieve. Among the issues are:

- **Prospective waivers.** Engagement letters have limited usefulness in obtaining waivers of future conflicts. The problems are many.\(^7\) Can there ever be adequate disclosure of future disputes? Will a prospective waiver be sufficiently informed and unambiguous? Do the parties (a law firm and its client) have equal access to the information needed to evaluate the significance of a prospective waiver? Can all the parties in interest be identified or given notice or made to join?\(^8\)

- **Obligating future clients.** Engagement letters may not anticipate all changes or evolutions of the client’s identity or membership. Engagement letters will rarely anticipate the rights of a client or its successors in interest in a changed transaction. Is today’s developer tomorrow’s managing member, or next week’s bankrupt-in-possession? What are the rights of an entity to-be-formed and other investors who

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\(^7\) Few aspects of engagement letters engage the emotion of attorneys to the same degree as prospective waivers. The academic analysis of prospective waivers and their treatment in the courts has not been particularly favorable, and at least one commentator has urged that the somewhat random but often draconian consequences of their unenforceability is a positive force for legal ethics. See, e.g., R.W. Painter, “Advance Waiver of Conflicts,” 13 Geo. J. Legal Ethics 289 (2000).

\(^8\) The test of an acceptable advance waiver is set out in New York County Lawyers’ Ethics Opinion No. 724 (1998). It is essentially the same test as a concurrent waiver, requiring great foresight from the attorney to anticipate all the facts that would be relevant at a future date. Since many firms maintain New York offices, they may find themselves defending prospective waivers under these standards. The application of the foresight test is reflected in subsequent cases. See, A. E. Davis, “Personal, Business or Financial Conflicts of Interest,” N.Y.L.J. (5/3/1999).
succeed to the business? Can there be disclosure or informed consent by an entity that does not yet exist?

- **Anticipating different or evolving transactions.** When an evolving representation moves beyond the expected engagement, who monitors the need for a new engagement letter? Only a fraction of the total number of firms using engagement letters routinely review or update them. Some are instituting a mandatory periodic review some months into the engagement.

- **Affirmative enforcement.** Engagement letters do not provide legally enforceable rights against clients except in very narrow circumstances, such as fee disputes or conflicts explicitly waived. Their main use is in defense of claims by the client or other parties, but conflict of interest claims are highly fact specific and among the hardest against which to defend by reliance on a letter. Who was the legal advisor to the client in the client’s decision to sign engagement letter? Who drafted the letter? Was the disclosure of the conflicting relationship total and accurate and did it convey everything relevant known by the law firm? Who monitored compliance with ethical walls or undertakings to segregate confidential information and protect against its use?

**Errors in Engagement Letters**

While some firms lavish attention on their opinion letter review process, few spend commensurate resources on the preparation of engagement letters or on administering compliance with them. In fact, few instances of liability can be traced damage awards directly to language in opinion letters. Several cases of liability can be traced to language in engagement letters. Among the errors reflected in these situations are:
• The wrong client(s). Identification of multiple parties or unincorporated groups as clients and/or identification of aggregate clients without provision for known or foreseeable conflicts of interest.9

• Incomplete disclosure. Failure to disclose and resolve existing conflicts of interest.10

• Incomplete waiver. Representation that a reciprocal waiver had been or will be obtained, when in fact the waiver is never received or is not fully reciprocal.11

• Acceptance of extra obligations. Specification or implication of a standard of performance higher than normal professional conduct.12 This can be implied from “puff” language.

9 An informal survey of counsel around the country indicates a wide range of tolerances for the acceptance of multi-client representations. In New York and California, multi-client representations of both partner and partnership are apparently viewed as risky to accept, possibly unethical, and inadvisable wherever liability under the securities laws was in issue. The fact that the lawyer once accepted a dual role was regarded as a permanent taint. In other states, and in particular in the states with a high level of developer activity, there appeared to be much more acceptance of such multi-party engagements. In those states, opinions differed in what roles for the lawyer was permissible in the event that the named clients came into conflict, but in general lawyers anticipated that they could retain some role in the dispute.

10 This is perhaps the most common source of liability. In one recent case, a firm disclosed a group of conflicting prior representations and obtained a waiver, but failed to note that one of the representations had continued into the earliest months of the new representation. The firm was ordered to disgorge all fees earned in the new representation and pay the costs of bringing in new counsel.

11 These situations amount to cases of fraud in the inducement, because the reciprocal waiver was promised but not obtained. Failures to coordinate mutual waivers and to monitor the subsequent activity for compliance with the terms of the waiver may occur much more frequently than reported cases would indicate.
• Failure to Maintain An Ethical Wall. Undertaking to establish an ethical wall that was not then adequately maintained.\textsuperscript{13}

Conflicts of Interest and Ethical Walls

With increased discussion of waivers to be obtained during the engagement process, firms are proposing ethical walls as an inducement, and perhaps the only available mitigation short of declining the representation, to address conflicts of interest. In dealings with such wall arrangements, there is confusion and, in a few instances, optimistic interpretation verging on

\textsuperscript{12} A recent instance of this problem relevant to transactional practice resulted in a claim against a law firm that had acted as lender’s counsel. The firm had executed an engagement letter prepared by the lender and has undertaken to confirm that the final loan documents conformed to the commitment approved by the client’s loan committee. The letter specified that "[t]he terms set forth in the enclosed loan approval term sheet or commitment disbursement form must be incorporated into the loan documents and none of those terms may be waived or modified by the loan officer without your receiving a signed approval therefor from a bank officer or committee which has sufficient authority." The commitment specified a particular method of valuing inventory. The law firm received and forwarded to its client without comment a valuation that used a different method resulting in a higher valuation. The loan failed. Based on the undertaking made in the letter, the law firm was held liable for the loss due to the inflated valuation. The separate negligence claim against the firm was dismissed, suggesting that the firm would not have been held to violate an applicable standard of care. Its liability was based solely upon the contract arising in the engagement letter. See, "Fox Rothschild Hit with $707,501 Jury Verdict Thanks to Wording in its Engagement Letter," Bank Lawyer Liability. January 30, 1996.

\textsuperscript{13} The issues are similar to those in cases in which firms have attempted to preserve the ability to represent a client in the event that a joint defense agreement with another party breaks down, by walling off the material used in the joint defense. In many cases, the issue is one of fact, as to whether the firm did all that it could reasonably do to separate the representations.
willful misunderstandings of what an ethical wall requires and which conflict issues it can and cannot resolve.14

Elements of an Ethical Wall

“Ethical walls”15 are arrangements by which a law firm isolates personnel and/or confidential information so that one representation can continue without regard to another potentially conflicting representation. Such arrangements first became familiar in the context of government attorneys returning to private practice, who could not engage in representations involving their former agencies or departments for a period of time. Law firms did not want to inherit that prohibition or disqualification with each new hire from an agency or department. The government could not reasonably insist on a total firmwide disqualification that would render its attorneys unemployable upon their return to the private sector, impacting its ability to hire the most talented attorneys. Procedures evolved by which such attorneys could return to private law firms and be kept isolated from impermissible representations.16 These procedures included:

14 One critical assessment of the trend is N.W. Hamilton and K.R. Coan, “Are We a Profession or Merely a Business?: The Erosion of the Conflicts Rules Through the Increased Use of Ethical Walls,” 27 Hofstra L. Rev 57 (1998).

15 The term “Chinese wall” is also used and appears to derive from the securities industry, where it has long been used to describe the institutional barriers erected between traders and investment bankers to protect against trading on confidential information. It is unclear which was perceived as the barbarian horde to be excluded.

• Notice to personnel of their new firms warning against communication with the newly hired attorneys about certain representations.

• Physical segregation of files and data from those representations to avoid inadvertent communication.

• Geographic separation of attorneys or conflicting matters to avoid inadvertent communication, including assignment of work to another office of a firm where available.

• Exclusion of the attorneys from specific assignments or clients.

• Exclusion of the attorneys from participation in certain fees.

• Reasonable and diligent supervision of the details of the wall’s implementation.17

Valuable guidance and model documents for the establishment of an ethical wall in the context of a laterally hired lawyer may be found in the Report of the Task Force on Conflict of Interests.18

Use of Ethical Walls for Former Representations

The idea that an ethical wall could avoid "imputed disqualification" of a firm has expanded to deal with the lateral hiring of nongovernmental lawyers, but with some skepticism about the public policy supporting that expansion.19 The idea has also been applied to argue for  


17 There is some, probably reasonable, discomfort with the degree to which ethical walls rely on self-monitoring by firms and lawyers with conflicts of interest. See NYU Formal Opinion, footnote 11 above, at 1355.

18 See Task Force on Conflicts, footnote 2 above, at 1402-21.

19 The majority of states have not accepted this expansion in their formal ethics rules. The federal circuits are split, with the court of Claims and the 3rd, 6th, 7th and 11th Circuits permitting the use of ethical walls on a case by case basis. The other circuits have either not
representation of a current client in a matter adverse to a former client. The argument was made that, if a firm could establish that a lawyer had been sufficiently isolated and protected from access to confidential information from that former client, the firm could proceed with a representation adverse to the former client that was "unrelated" to the matters handled for its former client. The logic was somewhat circular: if the new matter did not involve or use "confidential information" obtained from the former client, it also was not a "related" matter in regard to work for the former client. The argument did not deal with the difference in the quality and amount of "soft" information that a firm retains about its former clients, their business and their organization, as compared with the more remote information likely to be transferred to a firm with a single laterally hired lawyer.

In each of these situations, the law firm was using an ethical wall to separate a current, active client’s representation from a former client represented by the same firm or by a former law firm or organization from which a lateral lawyer has moved. These situations would, under general ethical analysis, have required no waivers from the former client if unrelated. The walls reached the issue, or have rejected the application of the rule on the facts of a case without deciding the general rule. The first judicial approval of the concept appears to have been in the lower court decision in Kesselhaut v. U.S., 555 F. 2d 791, 792-3 (Ct. Cl. 1977) (per curiam). The concept therefore has a relatively short history as an ethical principle. The ABA did not accept the concept until 1988, and then only in regard to temporary attorneys (see ABA Formal Op. 88-356). While the ABA has expanded its view slightly, it has been strongly criticized by one commentator. See R. Bateman, "Return to the Ethics Rules as a Standard for Attorney Disqualification: Attempting Consistency in Motions for Disqualification by the Use of Chinese Walls," 33 Duq. L. Rev. 249 (Winter 1995), footnote 65-67 and related text.

Courts have been less comfortable with the application of ethical walls to deal with potential conflicts among a single firm’s clients, even where former clients are involved. See, Analytic, Inc. v. NYD Research, Inc., 708 F 2d 1263 (7th Cir. 1983) (rejecting the effect of a Chinese wall in a “substantially related” Matter); and Schiessel v. Stephens, 717 F2d 417 (7th Cir. 1983) (analysis of burden of proof).
were constructed to preserve the firm’s record that its current representation was unrelated and untainted by information obtained in the earlier representation. Thus no waiver was required.

**Ethical Walls in Conflict Between Current Clients**

Where the greatest problems with ethical walls have arisen is in the grey area between former clients, inactive clients, and current clients. Compared to the screening of conflicts that come from former representations, screening of conflicts between current clients is significantly less reliable in achieving its intended benefits.\(^{21}\) General ethical rules prohibit the representation of a client in a matter adverse to another current client, unless a waiver is obtained from both clients after appropriate disclosure and unless there is no impediment to the firm’s full advocacy of its client’s interest in the representation.\(^{22}\) Among the implications of these rules are:

- **Screening between current clients requires consent.** Ethical walls cannot be imposed against a current client without its consent. The idea that a firm may avoid the duty to obtain a waiver by announcing its unilateral creation of a wall is erroneous.\(^{23}\) Even less acceptable is the use of screening to evade the disclosures on which consent must be premised.

\(^{21}\) See, NYU Formal Opinion, footnote 11 above, at 1240-1241 and related footnotes.

\(^{22}\) The distinction in obligations in regard to conflict of interest between former and current clients is apparently widely misunderstood. See, Talk Force on Conflicts, footnote 2 above, at 1385. This distinction leads to the suggestion by some lawyers to include a bright-line termination procedure in the initial engagement letter.

\(^{23}\) Ethical walls created after an ethical problem has arisen and without the adverse party’s consent has also failed to protect a firm without regard to engagement issues. A firm attempted to avoid sanctions or disqualification by walling off attorneys who had improperly communicated with an adverse party represented by counsel. The court nonetheless disqualified the firm, finding that the ethical wall must be in place before the conflict arises and that such walls did not resolve the particular ethical violation. See, "Milbank Disqualified in Chase Suit," Manhattan Lawyer (August 29-September 11, 1989).
• **Screening is effective only for matters disclosed.** An ethical wall preserves only the right to proceed in a matter to the extent disclosed to the client in obtaining the waiver. When work adverse to the client’s interests has already been undertaken when the waiver is requested (as is often the case when an inadvertent conflict comes late to the attention of the firm), the failure to acknowledge that work may invalidate the waiver. Work done before the wall is erected may also be disqualifying, regardless of the subsequent arrangements. When the waiver is obtained on the basis of representations that an ethical wall will be constructed or that certain staff will be isolated from a matter, the waiver is only as reliable as the monitoring of compliance with those representations. When an ethical wall is applied to changed circumstances or in an attempt to shelter an expanded or additional representation, the situation is subject to all of the vulnerabilities of any other prospective waiver.

• **Other ethical issues of independence.** An ethical wall, even when approved, does not resolve the law firm’s conflict of interest arising from the reality of its relationship with the second client or the future loss of revenues from a client in retaliation for the firm’s actions in the adverse proceeding. A client may waive a conflict, but may do so with the expectation of reminding its firm of the consequences of an adverse outcome of the matter against it. The law firm simply may not be able to represent both clients.

• **All affected clients must agree.** An ethical wall, or any other solution that involves a waiver, requires the agreement of all affected clients. Some lawyers appear to believe that only one client’s agreement is required, or that the client whose arrival is second in time is required to accept a walling of its representation.

• **Ethical walls are never binding on a court.** Courts have broad authority to disqualify a firm even if a contractually specified ethical wall has been properly maintained. In general, judges have not been deferential to firms in enforcing waivers over sincere objections of clients. Where courts impose the consequences of waiver on clients,

24 See, NYU Formal Opinion, footnote 11 above, at 1257 and footnote 184.
there is almost invariably a sense that the courts regarded the claims as pretextual based on acquiescence, obvious knowledge, or the sophistication of the complaining client or its new law firm.

The existence of ethical walls also reopens the issue of what defines a client and its interests. Generally, state bars have divided into two schools of analysis. 25The ABA rules applied in some states have tended to define a client in terms of technical corporate structure, distinguishing between engagement by a company and by a subsidiary or shareholder. In contrast, the so-called "New York" rule has looked to economic interest and has judged adversity in terms of the persons or entities potentially affected, through direct or indirect association. Under this latter analysis, a transactional representation may be adverse simply because a successful result for one client may result in a competitive disadvantage for another. A typical example of this is the role of a law firm in its client’s creation of a new financial product or innovative tax structure, or in its pursuit of acquisition or investment targets.

In many large firms, we have seen the growth of single client groups that are understood to operate behind de facto walls in regard to other representations by the same firm that involve work for competitors of that client. A classic situation in which these walls come into play is bidding for a particular deal or property, in which a firm wants to retain the ability to represent whichever client prevails. These walls are often not documented by written agreement, but they are clearly part of the conditions under which the engagement is understood to operate. Their violation is a frequent and direct cause for the termination of relationships. Large law firms with the desire to represent competitors in certain markets want to be able to treat this type of wall

25 The question of what law governs an ethical issue in multistate practice is a difficult one. One approach is that of the ABA in Model Rule 8.5 (jurisdiction of admission or, if admitted in more than one jurisdiction, location of predominant effect will govern). It may be unlikely that courts will cede authority over action that amounts to misconduct in their own jurisdictions, particularly if done by lawyers not admitted there. See, Task Force on Conflicts, footnote 2 above, at 1426.
arrangement as both ethical (in the broad sense of the New York definition of responsibility to a client) and economically acceptable in the practical sense of the client’s larger interests. Client group walls are likely to become an expected and necessary feature of large transactional practice, if they succeed in operating in a manner that convinces clients of their benefits in giving access to special skills or resources of large firms without compromise of other interests.

Conclusion

Engagement letters are here to stay, but they are not panaceas for problems of conflict and ethical dilemma. They will become increasingly routine as part of the establishment of an attorney/client relationship and firm operations. They may assist in quality control in regard to new clients, in defining fees and other economic terms of the engagement, and in clarifying the responsibilities of the attorney. They will continue to create risk, however, when they are used for more than simple definition of client and fee structure. The risk may arise in the language of the letters, in the terms of the representations, in the inducements offered for their execution, and in the implementation of the terms and requirements of the letters. Among the requirements that are most problematic are those for "ethical" walls.

The best guidelines may be these: Keep the letter as short, specific, and non-controversial as possible. Do not approach the letter as a marketing or client development opportunity. Do not attempt to create in the wording of the letter a solution to a problem that you have not mentioned or have been unable to resolve in discussion with the client. Be prepared to invest significant resources in the monitoring and enforcement of the undertakings made in the letter. Learn to live with ethical walls of greater and lesser formality. Make sure that your colleagues accurately understand the ethical rules and recommendations of your insurers, and the risks of the incomplete or inconsistent application of those principles. Recall, finally, that the correct and prudent course in some situations will continue to be to decline the representation.