

April 6, 1998

State Bar Association of North Dakota
Attn: Sandy Tabor, Executive Director
P.O. Box 2136
Bismarck, North Dakota 58502

RE: Request for Ethics Committee Opinion

Dear Ms. Tabor:

On behalf of this firm, an interpretation of the Rules of Professional Responsibility is being requested on the following matters:

When a lawyer and shareholder in this law firm, a professional corporation, leaves this firm and accepts employment at a competing law firm in the same city:

1. May this law firm continue to acquire the stock of the leaving lawyer under Stock Redemption Agreement, which provides for the purchase, annually, of 10% of the stock owned by the lawyer with the annual purchases continuing over a period of 8 consecutive years and during which period the lawyer continues to be a shareholder in this law firm; see e.g. Rule 1.17 and other Rules; and
2. During the buy-back period, may this law firm permit the leaving lawyer to continue to be a shareholder in this firm while employed at a competing firm; see e.g. Rule 5.1; Rule 5.4 and other Rules; and

3. If the leaving lawyer continues to be a shareholder in this firm, will this firm be subject to imputed confidentiality issues and imputed disqualification issues because of the lawyer's dual status with this firm and a competing firm; see e.g. Rule 1.6, 1.7, Rule 1.9, and Rule 1.10 and other Rules.

Yours truly



cc: Alice R. Senechal, Chairman, Ethics Committee

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STATE BAR ASSOCIATION OF NORTH DAKOTA
ETHICS COMMITTEE
Opinion No. 98-04

MAY 1998

May 6, 1998

The Committee has received a request for an opinion regarding a lawyer's continuing stock ownership in a law firm organized as a professional corporation when the lawyer has left the firm and is practicing law with a competing law firm in the same city.

FACTS

The opinion request involves a situation in which a lawyer and shareholder ("the Lawyer") in a North Dakota law firm ("the Law Firm"), which is organized as a professional corporation, has left the Law Firm and accepted employment in a competing law firm ("the Second Firm") in the same city. The requesting attorney has informed the Committee that the Second Firm is also organized as a professional corporation but the Lawyer leaving the Law Firm is working for the Second Firm as an employee and not as a shareholder in that firm.

The requesting attorney has also told the Committee the Law Firm pays no dividends to its shareholders. However, the Law Firm has a Stock Redemption Agreement with its shareholders. Under that Agreement the Law Firm starts to buy back a shareholder's stock at a certain age, buying 10% of the shareholder's stock each year for ten years. The stock purchase price is a set dollar value, which was established a number of years ago based on the value of the firm. The Law Firm has started this redemption process with the Lawyer; the Law Firm has purchased 20% of the Lawyer's stock over the past two years.

The requesting lawyer has told the Committee the Law Firm has a weekly meeting of its shareholders, which the Lawyer would have a right to attend as a shareholder, although the Lawyer has resigned as a director and stated that he would not attend the weekly meetings. As a shareholder, the Lawyer also has the right to have access to the Law Firm's corporate records.

The opinion request asks three questions:

1. May the Law Firm continue to acquire the Lawyer's stock under the Stock Redemption Agreement over the next eight years, annually purchasing 10% of the stock the Lawyer owns? The Lawyer would continue to be a shareholder of the Law Firm during that period.
2. During the buy-back period, may the Law Firm permit the Lawyer to continue to be a shareholder in the Law Firm while being employed at the Second Firm?

3. If the Lawyer continues to be a shareholder in the Law Firm, will the Law Firm be subject to imputed confidentiality issues and imputed disqualification issues under the Rules of Professional Conduct because of the Lawyer's status as a shareholder of the Law Firm and an employee of the Second Firm?

DISCUSSION

Continuing Purchases of Stock under the Stock Redemption Agreement

The requesting attorney's first question is whether the Law Firm may continue to make annual purchases of the Lawyer's stock in the Law Firm under the Stock Redemption Agreement while the Lawyer is a member of another law firm.

The question refers specifically to N.D.R. Prof. Conduct 1.17. Rule 1.17 concerns the sale of a law practice. Rule 1.17 does not apply to the facts presented here. It is the Committee's understanding the Law Firm is not purchasing the Lawyer's "law practice." That is, the Lawyer is not ceasing to practice in total, in a particular area of specialty or practice, or even in the same geographic area. See Comment, N.D.R. Prof. Conduct 1.17.

No North Dakota Rule of Professional Conduct prohibits the Law Firm from continuing to make purchases under the Stock Redemption Agreement with the Lawyer. As discussed below, however, the Lawyer's continuing ownership of stock in the Law Firm during the redemption period while he is practicing at another firm in the same city does pose ethical difficulties for the Lawyer and members of both firms.

Continuing Ownership of Stock in One Firm While Practicing in Another

The second question asked is whether the Lawyer may continue to be a shareholder of the Law Firm while employed at the Second Firm. No North Dakota Rule of Professional Conduct expressly prohibits the Lawyer from being a shareholder in the Law Firm while being employed at the Second Firm.¹ However, there may be serious ethical consequences as a result of that situation, as discussed below.

¹ North Dakota law would prohibit the Lawyer from both being a shareholder in the Law Firm and having an ownership interest in another professional organization established under N.D.C.C. ch. 10-31. N.D.C.C. § 10-31-06 provides: "No individual may be simultaneously an executive or owner of more than one professional organization." As used in the statute, the term "professional organization" means professional corporations, limited liability companies, and limited liability partnerships established under N.D.C.C. ch. 10-31. N.D.C.C. § 10-31-01(9). The term "owner" is defined as "a shareholder of a professional corporation, a member of a professional limited liability company, or a partner of a limited liability partnership." N.D.C.C. § 10-31-01(5). Therefore, the attorney may not retain ownership of any stock in the Law Firm while holding any ownership interest in another law firm organized as a professional organization under N.D.C.C. ch. 10-31.

Conflict of Interest and Imputed Disqualification Issues

The third question concerns the application of conflict of interest and imputed disqualification rules if the Lawyer remains a shareholder of the Law Firm while he is an employee of the Second Firm.

The basic issue to be considered in analyzing this question is whether the Lawyer's continuing stock ownership makes the Lawyer a member of the "firm" of the requesting lawyer, i.e., of the Law Firm. Application of a number of ethical rules to this situation may depend upon whether the Lawyer is considered a member of the Law Firm as well as a member of the Second Firm he has now joined.

The "Terms" section of the North Dakota Rules of Professional Conduct states: "'Firm' or 'law firm' denotes a lawyer or lawyers in a private firm, lawyers employed in the legal department of a corporation or other organization and lawyers employed in a legal services organization. See Comment, Rule 1.10." The Comment to N.D.R. Prof. Conduct 1.10 states, in relevant part:

Definition of "Firm"

For purposes of the Rules of Professional Conduct, the term "firm" includes lawyers in a private firm, and lawyers employed in the legal department of a corporation or other organization, or in a legal services organization. Whether two or more lawyers constitute a firm within this definition can depend on the specific facts. For example, two practitioners who share office space and occasionally consult or assist each other ordinarily would not be regarded as constituting a firm. However, if they present themselves to the public in a way suggesting that they are a firm or conduct themselves as a firm, they should be regarded as a firm for purposes of the Rules. The terms of any formal agreement between associated lawyers are relevant in determining whether they are a firm, as is the fact that they have mutual access to confidential information concerning the client they serve. Furthermore, it is relevant in doubtful cases to consider the underlying purpose of the rule that is involved. A group of lawyers could be regarded as a firm for purposes of the rule that the same lawyer should not represent opposing parties in litigation, while it might not be so regarded for purposes of the rule that information acquired by one lawyer is attributed to another.

As these quotations indicate, the Rules of Professional Conduct and the Comments to the Rules do not provide a clear answer to the specific question presented here: whether a shareholder of a law firm is necessarily a member of the "firm." The Comment to Rule 1.10 states a person could be considered a member of a law firm for some purposes but not for others. The Comment also states one factor to be considered in determining whether associated lawyers constitute a firm is the terms of any formal agreement between attorneys. The Comment indicates another factor is the public perception of whether lawyers are a firm. See also *Heringer v. Haskell*, 536 N.W.2d 362, 366 (N.D. 1995) ("Certainly concerns about the public's

perception of the legal profession, particularly as it relates to confidentiality of client information, bears some relevance when we examine and interpret the Rules [of Professional Conduct]").

In this case the existence of the documents establishing the Lawyer as a shareholder of the Law Firm is significant. His status as a shareholder may give the Lawyer access to some of the Law Firm's corporate records, meetings, and, possibly, client information. Further, it is possible the public would consider a shareholder of a law firm organized as a professional corporation to be a member of the law firm. Accordingly, the Lawyer may be considered a member of the Law Firm as long as he owns stock in that professional corporation.

As such, the Lawyer -- as well as all members of the Law Firm and the Second Firm -- may face difficult conflict of interest and client confidentiality problems frequently. N.D.R. Prof. Conduct 1.10(a) provides: "Lawyers associated in a firm may not knowingly represent a client when any one of them practicing alone would be prohibited from doing so by these rules, except as provided by Rule 1.11 or Rule 1.12." Rules 1.11 and 1.12 are not relevant here. Under Rule 1.10(a) if any member of the Law Firm had a conflict of interest, generally so would the Lawyer, and if the Lawyer had a conflict of interest, generally so would all members of the Lawyer's new firm -- and vice versa. In other words, in most instances in which conflict of interest questions arise, both firms would be required to treat all of the members of both firms as members of each firm.

Given the fact that this opinion request concerns two competing law firms in the same city, the probability of frequent, real conflicts of interest in this situation seems very high. Particularly under those circumstances, the Lawyer's continued stock ownership in the Law Firm while practicing with another firm is ill-advised and likely to lead to ethical difficulties for the Lawyer and both law firms involved.

Even if the Lawyer is not considered a member of the Law Firm for all purposes, the Lawyer and the Second Firm will face conflict of interest issues in any matters in which the Law Firm is also involved, as long as the Lawyer is receiving payments under the Stock Redemption Agreement. North Dakota Rule of Professional Conduct 1.7 provides, in relevant part:

(a) A lawyer shall not represent a client if the lawyer's ability to consider, recommend, or carry out a course of action on behalf of the client will be adversely affected by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests.

(b) A lawyer shall not represent a client when the lawyer's own interests are likely to adversely affect the representation.

(c) A lawyer shall not represent a client if the representation of that client might be adversely affected by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

(1) The lawyer reasonably believes the representation will not be adversely affected; and

(2) The client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

As a stockholder in the Law Firm, the Lawyer will have a continuing personal interest in that firm. In particular, it will be financially significant to the Lawyer that the Law Firm's business continue to be at least lucrative enough to make the annual stock buy-out payments for the remaining eight years of the Lawyer's buy-out period. Given this situation, the Lawyer -- and under Rule 1.10(a) all members of the Second Firm -- would be required to consider and comply with the provisions of Rule 1.7 in any matter in which a Law Firm attorney and a Second Firm attorney were involved. At least in most instances the Lawyer and members of the Second Firm would be required to disclose the information about the Lawyer's stock ownership and the Stock Redemption Agreement and to obtain an informed consent from any client in any matter in which an attorney from the Law Firm represents another involved party.

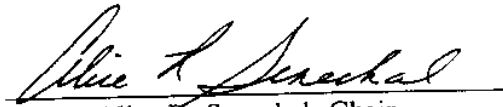
In conclusion, numerous difficult conflict of interest and confidentiality issues are likely to arise if the Lawyer continues to be a shareholder of or retains another financial interest in the Law Firm while practicing in another law firm in the same city. For that reason, it may be a prudent course of action for the Lawyer to terminate his continuing financial interest in the Law Firm as promptly as possible, if the Lawyer is practicing law as a member of the other firm.²

CONCLUSION

This opinion is provided pursuant to Rule 1.2(B), N.D.R. Lawyer Discipline, which states:

A lawyer who acts with good faith and reasonable reliance on a written opinion or advisory letter of the ethics committee of the association is not subject to sanction for violation of the North Dakota Rules of Professional Conduct as to the conduct that is the subject of the opinion or advisory letter.

This opinion was drafted by Laurie J. Loveland and was approved by the Committee unanimously on May 6, 1998.


Alice R. Senechal, Chair

² Of course, even if the Lawyer ceases to be a shareholder of the Law Firm, he must avoid conflicts of interest and disclosure of confidential information of former clients under N.D.R. Prof. Conduct 1.9.