

# Your Deal is in Litigation?

It's Time to Call Someone Else

BY CEDRIC LOGAN



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*This article looks at the relevant rules and case law regarding attorney obligations to decline representations in litigation where the individual attorney or law firm participated in the transaction at issue.*

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If you are a practicing lawyer, at some point in your career you have likely helped clients negotiate a business transaction, litigation settlement, agreement with regulators, or another type of contract. Clients hire lawyers to assist with these deals in part because they hope a good lawyer will reduce the chances that the deal will fall apart. They also believe it will help them avoid litigation or other adversity.

But even the best deals, drafted by the ablest attorneys, may ultimately result in litigation because negotiations fall apart, contracts are subject to different interpretations, and parties sometimes breach their contractual duties. When that happens, the client may ask the lawyer who advised on the deal to represent the client in court. After all, the lawyer who did the deal knows the facts better than anyone else (maybe even better than the client), and bringing another lawyer up to speed for the litigation may increase the client's short-term costs.

Although there are circumstances where a lawyer can represent a client even though the lawyer was involved in the underlying events, lawyers should proceed with caution in these circumstances. Aside from the well-known "lawyer as witness" rule, which generally prohibits lawyers from trying cases if they might be a witness, conflict-of-interest rules also may prohibit lawyers from taking cases where the lawyer's own advice or actions may be at issue in the case. Lawyers who ignore these rules risk disqualification by courts, malpractice suits, and harm to their professional reputations.

Below is a look at the relevant Colorado Rules of Professional Conduct (Colo. RPC or Rules) and case law regarding attorney obligations to decline representations in litigation matters where the individual attorney or law firm participated in the transaction at issue. Lawyers and law firms defy these rules at their own risk.

### **The Crucial Rules**

Like most states, Colorado's Rules are based on the American Bar Association (ABA) Model Rules of Professional Conduct. The Rules are binding on lawyers who are licensed in or

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practice in Colorado, and lawyers who violate the Rules are subject to discipline by the Office of Attorney Regulation Counsel. Further, lawyers who take on representations prohibited by the

Rules may be disqualified by Colorado state and federal courts.

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### **Rule 3.7**

Rule 3.7 is the "lawyer as witness" rule. Rule 3.7(a) prevents lawyers from representing clients where the lawyer is a necessary witness:

A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless:

1. the testimony relates to an uncontested issue;
2. the testimony relates to the nature and value of legal services rendered in the case; or
3. disqualification of the lawyer would work substantial hardship on the client.

This rule is frequently litigated in Colorado courts, and as a result, several opinions have interpreted and applied it.<sup>1</sup> These opinions note that lawyers who perform the dual roles of advocate and witness pose obvious difficulties, particularly at trial.<sup>2</sup> A comment to Rule 3.7 explains that "[c]ombining the roles of advocate and witness can prejudice the tribunal and the opposing party and can also involve a conflict of interest between lawyer and client."<sup>3</sup>

In other words, a lawyer who testifies at trial may confuse jurors, who may not appreciate the difference between evidence and argument.<sup>4</sup> Moreover, the lawyer may prejudice the opposing party by spinning facts in favor of her client; or, on the other hand, a testifying lawyer may be detrimental to her client, if, for example, she changes her legal arguments to place herself in a better light. Not all of these downsides are likely to be realized in every case, but the

risk that *someone's* interests will be harmed by attorney testimony provides ample justification for the rule.

While Rule 3.7(a) is limited to individual lawyers, Rule 3.7(b) imputes individual lawyers' conflicts to their law firms: "A lawyer may act as advocate in a trial in which another lawyer in the lawyer's firm is likely to be called as a witness unless precluded from doing so by Rule 1.7 or Rule 1.9." Thus, a lawyer may act as an advocate at a trial in which a member of the firm was a witness so long as the representation was not prohibited by Rule 1.9, which covers conflicts of interest with former clients, or Rule 1.7.

#### Rule 1.7

Rule 1.7 is the "concurrent conflict of interest" rule. It prevents lawyers from taking representations that present a conflict involving the lawyer's current interests. Rule 1.7(a)(2) provides:

[A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if . . . there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

Rule 1.7 is not litigated as frequently as Rule 3.7 in the context of a lawyer who negotiates a deal that winds up in court, but it nevertheless provides a critical check on a lawyer's ability to take such cases. The phrase "a personal interest of the lawyer" includes situations in which a lawyer's representation of a client is limited by the lawyer's interest in protecting and promoting her professional reputation.

#### A Case in Point

To illustrate this potential conflict of interest, imagine a case in which a lawyer negotiates the sale of a client's subsidiary, but then a year later, the buyer sues the seller, arguing that the seller must indemnify the buyer for the subsidiary's liabilities. The seller's lawyer would have an ethical obligation to advance good faith arguments that the client does *not* have a duty to indemnify under the language of the contract, but would also have a natural

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instinct to defend her negotiation of the deal and drafting of the sale contract.

What if the client's best defense is that the contract was ambiguous, implying that the seller's lawyer did a sloppy job in drafting the contract? This potential conflict between the personal interest of the lawyer and the lawyer's obligations to her client may prevent the lawyer

from taking the representation, not to mention the fact that the lawyer may also be a necessary witness pursuant to Rule 3.7.

#### Key Cases

In addition to the Colo. RPC, practitioners should familiarize themselves with the controlling Colorado Supreme Court cases construing these Rules, as well as Colorado Bar Association Formal Ethics Opinion 78, which addresses in detail disqualifications of lawyer-witnesses.

#### Fognani v. Young

In the leading Colorado Supreme Court case on Rule 3.7, *Fognani v. Young*, the Court approved of CBA Opinion 78. *Fognani* also offers guidance in determining whether a lawyer is a necessary witness, and in assessing substantial hardship under Rule 3.7(a)(3), the scope of disqualification, and imputed disqualification.<sup>5</sup> *Fognani* established:

- Whether an attorney is likely to be a necessary witness should be determined on an ad hoc basis, given the circumstances of the case. Disqualification is not automatic simply because the opposing party has listed an attorney as a witness. The party moving for disqualification has the burden of demonstrating that the attorney is likely a necessary witness given the subject of the attorney's potential testimony, the importance of that testimony to the issues to be tried, and the availability of other witnesses to testify regarding the same issues.<sup>6</sup>
- In considering whether a disqualification would work a substantial hardship on the client, courts should consider "all relevant factors," including the stage of the case and financial hardship on the client. The client's access to alternate counsel may alleviate purported hardship.<sup>7</sup>
- While Rule 3.7 does not mention pretrial proceedings, courts have discretion to prohibit disqualified attorneys from some or all pretrial activities. Excluding disqualified attorneys from participating as advocates at depositions may be warranted because the jury might need to evaluate depositions and could be

confused by the attorney's dual role.<sup>8</sup>

- In determining whether to impute an attorney's disqualification to his entire firm, courts must follow Rule 3.7(b) and evaluate potential conflicts of interest under Rules 1.7 and 1.9. The client may waive the potential conflict, but such a waiver must be reasonable, and courts are not obligated to honor the client's position.<sup>9</sup>

Colorado courts have applied these rules and disqualified attorneys in a wide variety of contexts. Aside from what is traditionally thought of as "corporate law" matters (e.g., securities offerings, and mergers and acquisitions), lawyers also negotiate settlements, adjustments of insurance claims, agreements with regulators, and other types of transactional arrangements. Any of these deals or potential deals could wind up in litigation, and all of them require an analysis of Rules 3.7 and 1.7 if the lawyer who participated in the underlying transaction is later asked to represent the client in litigation.

#### **World Youth Day, Inc. v. Famous Artists Merchandising Exchange, Inc.**

One of the leading attorney disqualification cases in Colorado is *World Youth Day, Inc. v. Famous Artists Merchandising Exchange, Inc.*<sup>10</sup> This case involved negotiations between World Youth Day, a company that held a religious festival in Denver, and Famous Artists Merchandising Exchange, Inc. (FAME), a merchandising company to which World Youth Day attempted to grant a license to produce festival merchandise. World Youth Day and FAME signed a letter of intent to work with each other, and the parties commenced negotiations to finalize a detailed licensing agreement for the provision of merchandise. In those discussions, FAME was represented by an attorney, who also took on primary drafting responsibility for the licensing contract contemplated by the parties.<sup>11</sup>

But the negotiations fell apart. The letter of intent stated that the parties would arrive at a final agreement by March 1, 1993, but the first draft of the agreement was not sent to World Youth Day until March 16.<sup>12</sup> That draft agreement was rejected, and the following months saw a flurry of negotiations, telephone calls, a

short-form agreement, and a second, third, fourth, and fifth draft of the longer agreement (negotiated by FAME's lawyer), none of which were signed.<sup>13</sup> Because the deal seemed doomed to failure, FAME's lawyer purported to terminate the original letter of intent, but his authority to do so was questionable, and FAME would later claim that the letter of intent remained valid and controlling.<sup>14</sup>

World Youth Day sued FAME, alleging that the company was selling merchandise without paying royalties. FAME hired the lawyer who represented it in the contract negotiations to defend the company in the lawsuit.

World Youth Day moved to disqualify FAME's lawyer. The court conducted a detailed analysis of the lawyer's ethical obligations and ultimately disqualified him pursuant to Rule 3.7.<sup>15</sup> The court held that FAME's lawyer was likely a necessary witness because he participated in numerous

lengthy negotiations with World Youth Day regarding FAME's rights and responsibilities in selling festival merchandise.<sup>16</sup> In fact, FAME's lawyer was the only available witness for his client on a variety of issues that were material to the litigation, including whether he had the authority to cancel the letter of intent. The court concluded that allowing the lawyer to participate in depositions and trial would risk confusing jurors, who might not understand the lawyer's dual role of advocate and witness.<sup>17</sup>

Although the court in *World Youth Day* did not mention Rule 1.7, the court's concern regarding a potential conflict of interest is present throughout the opinion. The court acknowledged the tension that FAME's lawyer might feel in defending his client while also trying to preserve his own reputation. The court reasoned that the lawyer's dual role put him in the "awkward position" of defending his

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client—which could involve an argument that he exceeded his authority when he purported to terminate the letter of intent—while also trying to defend his own actions during the negotiation process.<sup>18</sup> This “catch 22,” according to the court, “taints not only his client’s case, but the legal system generally.”<sup>19</sup> Therefore, while the court did not cite Rule 1.7 as the basis for the lawyer’s disqualification, the court’s analysis would support a finding that the lawyer faced a concurrent conflict of interest and was obligated to withdraw from the representation.

**FDIC v. Isham**

The interplay between Rules 1.7 and 3.7 was also illustrated in *FDIC v. Isham*, which involved a lawyer who represented his client in connection with negotiating a memorandum of understanding with regulators and later advised his client regarding compliance with that memorandum of understanding.<sup>20</sup> The regulators subsequently sued the client for allegedly breaching the memorandum of understanding, and the client hired the same lawyer to represent it in the litigation. The court disqualified the lawyer on the grounds that his prior advice and negotiation of the memorandum of understanding would be at issue:

[The lawyer’s] dual role taints the legal system. [The lawyer] will be in the awkward position of testifying either that he gave proper legal advice to the defendants, which would undercut their defense, or that he gave them improper legal advice, which would harm his professional reputation.<sup>21</sup>

**FDIC v. Sierra Resources, Inc.**

In *FDIC v. Sierra Resources, Inc.*, a small law firm had advised its client regarding a stock transaction involving a secured promissory note. After the proposed transaction collapsed and suit was filed, the client hired the same law firm to defend it.<sup>22</sup> Applying DR 5-102(A) of the former ABA Model Code of Professional Responsibility, the court disqualified the law firm from the litigation, holding that the firm’s lawyers were necessary witnesses.<sup>23</sup> The court reasoned:

[B]y counseling [its client] in this business transaction, [the law firm] put itself in the

position of having [the lawyer] acquire factual information which made his testimony necessary when the transaction evolved into litigation. When the client then retains the same law firm to represent its interest in the litigation, counsel faces the possibility of disqualification.

“[I]f an attorney chooses to become intimately involved in the client’s business, then he or she must be prepared if the matters involved result in litigation. This may be displeasing to firms that wish to have some members act as businessmen and others as litigators. But when these firms place themselves in the position of having an attorney acquire information that makes his testimony necessary, they must accept the consequences.”<sup>24</sup>

In other words, there is nothing inherently wrong with an attorney’s intimate involvement with a client’s business—in fact, such engagement may be exemplary client service. But lawyers and clients should engage in such a relationship with the understanding that they may need to hire a different lawyer in the event of litigation.

**Prevent Ethical Dilemmas Before They Happen**

As these cases demonstrate, lawyers negotiating deals should be mindful that they may have to decline related litigation work under Rules 3.7 and 1.7. Of course, lawyers should not stop doing transactional work or litigation; rather, they should carefully consider whether, if litigation erupts from a transaction, it would be in the client’s best interest to have a different lawyer handle the lawsuit.

Lawyers and law firms can take steps to mitigate the risks of being disqualified or disciplined under Rules 3.7 and 1.7 and to preserve their ability to continue to represent their clients. Adopting practice standards for intake processes and for advising clients can prevent improper or embarrassing situations before they occur. Suggested best practices are:


- When asked to take on a representation arising out of prior work, explain the potential conflicts to the client and obtain the client’s consent to proceed, confirmed

in writing.<sup>25</sup>

- Consider recommending a different lawyer in the firm to handle the litigation representation. However, as instructed by Rule 3.7(b), this accommodation should be explored only if the representation poses no conflicts under Rules 1.7 and 1.9.
- Recommend that the client hire “shadow” counsel who can be involved with the case and step in to try the case if the lawyer is ultimately disqualified from serving as trial counsel.<sup>26</sup>
- Refer the client to an independent lawyer for advice on whether the client should continue to use the lawyer as its litigation counsel. Doing so will ensure that the client’s decision to use the lawyer as litigation counsel is based on truly objective advice, untainted by the lawyer’s self-interest in keeping the client’s work.
- Simply decline the representation and refer the client to a different lawyer. Here, referral networks are key. Lawyers should develop relationships with fellow bar members so they can refer their clients for appropriate representation in litigation if a deal winds up in court. Lawyers can continue to give their clients excellent transactional advice, so long as lawyers are prepared to refer their clients to trustworthy litigators in the event that it becomes necessary to do so. Further, networking with litigators in advance is a good strategy to ensure that lawyers are referring their clients to the right person for the job.
- Adopt robust client and matter intake processes that identify whether the new matter arises out of a previous matter. Lawyers who scrutinize potential conflicts before an engagement will reduce the need for an awkward phone call later on to advise the client that it must hire someone else halfway through a big case.

**Conclusion**

Rules 3.7 and 1.7 and case law construing these rules provide critical ethical boundaries for Colorado transactional lawyers. The consequences for violating these rules can be significant for

individual attorneys, their clients, and the profession. Best practices, including reliable client referrals, comprehensive client advice, and early detection of potential ethical issues, keep clients happy and promote the ethical practice of law. 



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#### NOTES

1. See, e.g., *Stanton v. Encompass Indem. Co.*, 2012 WL 3638795 at \*4 (D.Colo. Aug. 23, 2012); *In re Estate of Myers*, 130 P.3d 1023, 1025 (Colo. 2006); *Fognani v. Young*, 115 P.3d 1268, 1272 (Colo. 2005).
2. See, e.g., *Fognani*, 115 P.3d at 1272 (noting that a lawyer-witness is subject to impeachment as “obviously interested” and may be “placed in the unseemly position of arguing his own credibility to the jury”) (citation and quotation marks omitted).
3. Colo. RPC 3.7, cmt [1].
4. See *Murray v. Metro. Life Ins. Co.*, 583 F.3d 173, 178 (2d Cir. 2009).
5. *Fognani*, 115 P.3d at 1271-74.
6. *Id.* at 1273-74.
7. *Id.* at 1275-76.
8. *Id.* at 1276-77.
9. *Id.* at 1277-78. See *Dunn v. Miceli*, 2015 WL 1868134 at \*5-8 (D.Colo. Apr. 22, 2015) (disqualifying attorney from entirety of litigation even though discovery had not yet commenced).
10. *World Youth Day Inc. v. Famous Artists Merchandising Exchange, Inc.*, 866 F.Supp. 1297 (D.Colo. 1994).
11. *Id.* at 1299-1300.
12. *Id.* at 1299.
13. *Id.* at 1299-1300.
14. *Id.* at 1300-01.
15. *Id.* at 1303-04.
16. *Id.* at 1303.
17. *Id.* at 1303-04.
18. *Id.* at 1303.
19. *Id.*
20. *FDIC v. Isham*, 782 F.Supp. 524, 527-28 (D.Colo. 1992).
21. *Id.* at 528.
22. *FDIC v. Sierra Resources, Inc.*, 682 F.Supp. 1167 (D.Colo. 1987).
23. *Id.* at 1170-72.
24. *Id.* at 1171 (citation omitted).
25. See Colo. RPC 1.7(b)(4).
26. See CBA Formal Op. 78 (2012) (discussing use of “shadow” counsel).



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