

ADVISORY ETHICS OPINION 87-10

SYNOPSIS:

DR 5-105 prohibits a law firm from representing two clients in litigation in which one client is a party and the other client's employees will testify, and the potential exists that their testimony will provide the basis for future litigation between the clients.

FACTS:

A law firm asks the Committee whether a conflict of interest prohibited by DR 5-105(B) or some other provision of the Code, will arise if, in the following circumstances, it undertakes to represent the plaintiff bank and Y Company simultaneously. The facts are taken verbatim from the letter of inquiry.

Y Company is in the business of marine financing. What it does is arrange through boat dealers to obtain applications to Y Company from retail purchasers of boats for marine financing of the consumer transaction. Y Company then undertakes an investigation of the application, and makes a recommendation as to whether or not it should be approved. If Y Company recommends approval of an application it forwards it to one of many banks with which it has an agreement to do business. The relationship between Y Company and the banks is that of independent contractor, and not of agent or employer/employee. The bank then makes an independent decision based on its review of Y Company's work up of the loan and the loan application itself to decide whether to fund the transaction. If it decides to fund the transaction, Y Company closes the deal with Y Company funds, and then assigns the paper to the bank.

Y Company earns a fee based on the difference between the interest rate charged the customer and the interest rate charged by the bank.

One particular such financing transaction has gone bad since the borrower has declared bankruptcy. The bank that funded that transaction has brought an adversary proceeding against the floor planner for the boat dealership that sold the boat, and the bank which finances the business operations of the boat dealership, each of whom claimed a higher priority secured interest in the boat that was collateral for the consumer marine financing transaction. Among the claims made are claims by the defendants that the individual who purchased the boat was not a buyer in the ordinary course of business, and therefore this buyer took subject to the floor plan and general inventory liens.

In addition to a direct assertion of lien priority, the plaintiff bank asserts that the liens of the floor planner and defendant bank should be equitably subordinated to its purchase money lien due to negative credit information concerning the purchaser which was allegedly available to the floor planner and defendant bank, but allegedly not disclosed to Y Company's employee who did the credit investigation and work up. Plaintiff bank relied on that credit investigation and work up according to the plaintiff, but did not do any independent verification of that credit investigation and work up.

Defendant floor planner and defendant bank claim that the investigation and loan work up performed by Y Company is inaccurate and sloppy. Testimony of the employees of Y Company who participated in the investigation will be put on at the trial by both sides, both to attempt to demonstrate the accuracy and nature of the information provided to plaintiff bank by the defendants, and in an effort to demonstrate the inaccuracy of the information transmitted by Y Company and the sloppiness of its investigation and work up.

DISCUSSION:

Y Company, the loan initiator, is not a party to the proceeding. Its employees will be witnesses, however, and their testimony will center on what they were told (and were not told) about the purchaser and on what other measures they took to verify that the information they were passing on to the plaintiff bank was accurate and reliable.

So long as it can be established with certainty that the plaintiff bank's reliance on Y Company's credit report was undercut by the concealment practiced by the defendant floor planner and the defendant bank, rather than by faulty investigative work on the part of Y Company, the plaintiff bank and Y Company seem to stand together, as common victims of third-party concealment. But the stated facts, and especially the second reason for which Y Company's employees will be called to testify, raise the spectre that Y Company's credit investigation was done negligently.

We would strain our role if we attempted to make conclusions of substantive law. We venture, nonetheless, that absent a disclaimer or other liability-limiting provision in the agreement between Y Company and the plaintiff bank, a finding that Y Company's credit investigation was done negligently eventually would provide the basis for a claim against Y Company by the plaintiff bank. The plaintiff bank, we assume, would be equally upset if Y Company's investigation failed to shed light on the borrower's status as a buyer in the ordinary course of business, as it would if the investigation failed to turn up "negative credit information."

Canon 5 of the Code of Professional Responsibility states: A Lawyer Should Exercise Independent Professional Judgment on Behalf of a Client. Ethical Consideration 5-14 declares that Canon 5 precludes a lawyer's "acceptance or continuation of employment that will adversely affect his judgment on behalf of or dilute his loyalty to a client." The representation of two or more clients having differing interests, as noted by EC 5-14, will bring Canon 5 into play.

Ethical Consideration 5-15 provides guidelines for lawyers asked to represent multiple clients. Foremost is the advice that all doubts that his judgment may be impaired or his loyalty divided should be resolved "against the propriety of the representation." There are corollary absolutes in EC 5-15: "A lawyer should never represent in litigation multiple clients with differing interests; and there are few situations in which he would be justified in representing in litigation multiple clients *with potentially differing interests*." (Emphasis added).

Disciplinary Rules 5-105(A) & (B) mandate that a lawyer shall decline proffered employment, and shall not continue multiple employment, if his independent professional judgment in behalf of a client will be or is likely to be adversely affected by his acceptance of the proffered employment or by his representation of another client, or in either event if it would be likely to involve him in representing differing interests. The only exception, covered in DR 5-105(C), is that

a lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each.

DR 5-105 and the quoted Ethical Considerations lead us to determine that it would be unethical for one law firm to represent the plaintiff bank and Y Company in the adversary proceeding. That Y Company is not a party is not important. Its employees will be interrogated on matters determinative of Y Company's negligence in investigating and reporting on the borrower's status and creditworthiness. Forewarned on Y Company's potential liability to the plaintiff bank, the lawyer would be dividing his loyalty from the start if he went into the proceeding solely intent on proving that deceit by the defendant floor planner and the defendant bank caused the plaintiff bank's misfortune. In shifting seas, a lawyer could hardly represent the plaintiff bank adequately if he were not prepared to turn on Y Company's employees in the event doing so would lay the groundwork for a future action against Y Company. Y Company's interests would obviously conflict with that strategy. Accordingly, a waiver would be ineffective to resolve the conflict.