Divided Loyalty: Ethical Considerations in Representing Joint Ventures

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“Integrity without knowledge is weak and useless.”
– Samuel Johnson

INTRODUCTION

Joint ventures have become increasingly common in the construction industry.¹ Issues related to the formation and operation of joint ventures for construction projects have been the subject of considerable commentary.² Less attention has been devoted to the ethical issues raised by outside or inside counsel that represents a venturer (or a proposed venturer) providing legal services to a joint venture (or related to a proposed joint venture). This article analyzes the issues involved with such representation through the prism of four ethical scenarios which can arise in construction projects involving joint ventures: (1) drafting a joint-venture agreement for multiple parties, (2) charging a co-venturer for pre-joint-venture due diligence work (including legal work), (3) “loaning” counsel for a venturer to a joint venture, and (4) representing multiple parties on a project and simultaneously representing only certain those parties on other projects.

I. DRAFTING A JOINT VENTURE AGREEMENT FOR MULTIPLE PARTIES

Parties forming a joint venture will occasionally request that either in-house or outside counsel for one of the proposed venturers draft the joint venture agreement for the parties. The rationale for such an arrangement is a perceived lack of conflict between the parties and a desire to avoid the legal costs of all parties engaging counsel. While such arrangements (or other related scenarios involving joint representation) can be feasible, they bring complications that should be considered by the parties and their counsel.

A. Model Rule 1.7 (Concurrent Conflicts)

Model Rule 1.7³ prohibits a lawyer from “represent[ing] a client if the representation involves a concurrent conflict of interest.”⁴ A “concurrent” conflict is defined as a situation where the “representation of one client will be directly adverse to another client” or where “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.” The comments to the Model Rules identify drafting a joint venture agreement for multiple parties as an instance where a lawyer “is likely to be materially limited in the lawyer’s ability to recommend or advocate all possible positions that each might take because of the lawyer's duty of loyalty to the others.”

However, Model Rule 1.7 allows a lawyer to accept a representation involving a concurrent conflict of interest, provided four conditions can be met. First, the lawyer must “reasonably believe[] that the lawyer will be able to provide competent and diligent representation to each affected client.” Second, the representation must not be “prohibited by law.” Third, the representation must not “involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal.” Finally, “each affected client [must] give[] informed consent, confirmed in writing.”

Informed, written consent is one of the most critical aspects of an effective waiver of a concurrent conflict of interest. Informed consent requires a lawyer to have “communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.” To do so, lawyers must advise clients regarding all conflicts or potential conflicts in relationship to the lawyer’s representation of the client’s interests and how they could affect the lawyer’s exercise of independent professional judgment for the clients. Informed consent therefore should include pre-engagement written communications between counsel and potential clients regarding issues such as the effect of joint representation on the attorney-client privilege, confidentiality and withdrawal in the event of a conflict.
Representations of multiple clients with potentially conflicting interests have been ruled acceptable by courts and disciplinary bodies where the four conditions of Model Rule 1.7(b) reasonably are met. On the other hand, proceeding with multiple representations of clients in a concurrent conflict situation without the proper written waivers can result in legal claims against the lawyer from the clients as well as bar discipline.

B. Model Rule 1.9 (Duties to Former Clients)

Clearing the hurdle of Rule 1.7 does not end the potential legal issues involved in jointly representing multiple clients (such as in forming a joint venture). Such an arrangement may lead to ethical complications in any subsequent litigation regarding the joint venture. Model Rule 1.9, for example, prohibits a lawyer “who has formerly represented a client in a matter” from thereafter representing “another person in the same or a substantially related matter in which that person’s interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing” unless written, informed consent has been obtained. Rule 1.9 also prevents a lawyer “who has formerly represented a client” from “us[ing] information relating to the representation to the disadvantage of the former client except as these Rules would permit or require” or from “reveal[ing] information relating to the representation except as these Rules would permit or require with respect to a client.”

Model Rule 1.9 was invoked in a motion to disqualify in the matter Straub Clinic & Hosp. v. Kochi, which involved a petition to the Hawaii Supreme Court for a writ vacating a trial court’s order disqualifying plaintiff’s law firm. In Straub, plaintiff Straub Clinic and defendant the Kapiolani entities (composed of health care entities) formed a joint venture in order to “meet their computer needs” after being advised by a consulting firm to do so. The Torkildson law firm represented the venturers “in connection with the finalization of the . . . joint venture
agreement.”18 The Torkildson firm also later represented the joint venture in the negotiation of a contract to purchase computer software.19 Straub subsequently withdrew from the joint venture pursuant to a settlement agreement between the parties.20 Straub then sued the consulting firm that advised forming the joint venture, alleging it had intentionally misrepresented the advantages of the joint venture in order to earn more in consulting fees. Straub was represented in the suit by the Torkildson firm.21 As the suit approached trial, Straub stipulated to the consulting firm filing a third-party complaint against the Kapiolani entities seeking indemnification for Straub’s claims.22 The Kapiolani entities then moved to disqualify the Torkildson firm from representing Straub “on the ground that the Torkildson firm had formerly represented the Kapiolani entities and had been counsel for the Kapiolani entities in matters substantially related to the subject matter of the . . . suit,” including by drafting the joint venture agreement and performing legal work for the joint venture. The Kapiolani entities argued that disqualification was required because “Straub’s actions established an adversity between the parties.”23 Straub opposed the disqualification motion on the basis that the Kapiolani entities had consented to the former concurrent representation of the parties in the joint venture and because it argued there was no adversity.24

The Hawaii Supreme Court affirmed the trial court, finding Rule 1.9 required disqualification for reasons that included the failure of the Torkildson firm to “advise[] the Kapiolani entities of the risks inherent in joint representation” as well as the fact that the Kapiolani entities “were not advised by independent counsel through the course of the negotiations culminating in the implementation of the joint venture.”25 The court found that because the Torkildson firm had been the Kapiolani entities’ counsel during the formation of the joint venture, “it was reasonable for the Kapiolani entities to presume that the Torkildson firm
would not take an adverse position to it in future litigation concerning the formation of [the joint venture]."  

A key issue related to invoking Rule 1.9 is the issue of whether the co-venturers were former clients of the law firm for which disqualification is sought. For example, *Atwood v. Sipple* is a Georgia case involving a joint venture formed to purchase automobiles and then resell them. *Atwood* was an appeal of a judgment entered against the appellant after a complicated procedural history. On appeal, defendant Atwood argued, among other things, that the judgment should not have been entered for reasons, including that counsel for plaintiffs should have been disqualified because “counsel had allegedly represented both plaintiffs and defendants in the drafting of the joint venture agreement at issue” and therefore “obtained ‘privileged and confidential information’” regarding the defendant. The Georgia Court of Appeals noted that there was “conflict in the evidence as to whether the firm represented all three joint venturers or only the plaintiffs.” However, the court found that “[e]ven if the law firm represented all three joint ventures as argued,” disqualification was not required because “[i]n a situation where joint venturers all meet with counsel at the same time for purposes of discussing their venture, the privilege does not apply as between venturers.” *Atwood* did not directly address the obligations of Model Rule 1.9, but in addition to raising the key issue of what confidentiality and privilege can apply between jointly represented co-venturers, the case also highlights the dangers involved in counsel for one venturer engaging in discussions (and/or potentially providing legal advice) to co-venturers without an express written agreement setting out which parties are (and are not) represented by that counsel.
II. “BACK-CHARGING” FOR PRE-JOINT VENTURE DUE DILIGENCE

Contrasting ethical issues can potentially arise during formation of a joint venture when counsel involved in the formation of a joint venture represents only one of the venturers and does not act on behalf of the other co-venturers or the joint venture itself. For example, Party A, through its in-house or outside counsel, may perform a significant portion of the due diligence and preparation work needed to form a joint venture (including, for example, preparing a majority of the work on a bid for a project) before a joint venture agreement is actually executed. Without reimbursement, this would place Party A in the position of paying a disproportionate share of the cost of the due diligence for the joint venture, either through legal fees paid to outside counsel or internal overhead for its in-house counsel. Are any ethical issues implicated if Party A attempts to recoup some of those costs from Party B (the eventual joint venture partner), either through a provision for the payment in the joint venture agreement or as part of a post-formation charge to Party B?

The Model Rules allow a non-client to pay a lawyer’s fees, provided the client gives informed consent, provided there is no interference with the lawyer’s independence, professional judgment or the attorney-client relationship, and provided that information relating to the representation is protected as required by Model Rule 1.6. Provided that an in-house lawyer (or outside lawyer working for Party A) is not influenced adversely to Party A because Party B later reimburses costs and/or fees incurred by the lawyer in providing due diligence for the proposed joint venture (which would appear likely), Mode Rule 1.8 does not appear to present a bar to the reimbursement of the legal fees already incurred by Party A so long as the attorney-client relationship between Party A and its counsel is preserved and confidentiality protected in the arrangement. Issues involving Model Rule 1.8 likely would be further reduced if the parties
agreed after the legal work had already been performed that Party B will pay Party A a lump sum in consideration of the legal and/or non legal work performed by Party A in preparing to form the joint venture. Agreements that Party B would pay some or all of Party B’s legal costs entered into before the due diligence legal work was performed likely would require more attention to the issues implicated by Model Rule 1.8.

The practical reality is that counsel for Party A in performing due diligence and preparation work for the potential joint venture will have contact, and sometimes significant contact, with personnel for Party B. Given that Party A does not intend for its inside or outside counsel to represent all parties or the joint venture, once formed, Party A will need to take extra precautions in this situation to avoid creating a reasonable belief in Party B that its counsel was representing Party B. As discussed in Section I and otherwise herein, the general test for the creation of an attorney-client relationship is whether the purported client had a “reasonable” belief that an attorney-client relationship existed. Subject to practical business realities, Party A should make clear in writing that the pre-joint venture due diligence work being performed by counsel for Party A does not mean it is also counsel for Party B or the joint venture (or risk potentially creating a reasonable belief in Party B that an attorney-client relationship was formed).

III. “LOANING” COUNSEL TO JOINT VENTURES

It is not uncommon for a company with in-house counsel (or established relationships with outside counsel) to enter into joint ventures with partners that lack in-house counsel or the resources (or the will) to keep outside counsel retained on an ongoing basis during a project. In such situations, in-house or outside counsel for a venturer sometimes are informally “loaned” to a joint venture on an as-needed basis to deal with its legal needs (outside the context of a form
secondment). The question not frequently enough asked in such situations is whether such a “loan” of counsel’s services requires consent and waiver under Model 1.7 as a concurrent conflict of interest.

A. Texas Supreme Court Professionalism Committee Opinion 512

This issue was addressed by the Texas Supreme Court Professionalism Committee in a June 1995 ethics opinion. The committee addressed the issue of whether “the in-house lawyer of a corporation [could] represent a joint venture in which the corporation is a venturer”? More specifically, the committee addressed whether a company which participates in joint ventures could “make its in-house lawyers available, from time to time, to provide legal services to the joint venture” by effectively “loaning” them to the joint venture (either with or without compensation).

The committee concluded that “even though a conflict or potential conflict of interest exists in the lawyer’s representation of the employing corporation and the joint venture to which the lawyer is loaned, such multiple representation is permissible if (1) the corporation and joint venture consent after full disclosure and (2) the lawyer reasonably believes that the lawyer’s representations of the corporation and of the joint venture will not be materially affected.” The committee cautioned that “the ‘loaned’ in-house counsel must recognize that the joint venture is his client. . . . and that loyalty is an essential element in the lawyer’s relationship with that client.” The committee also found that “the required consent could not be given on behalf of the joint venture by the corporation employing the lawyer.” Instead, “consent must be obtained from an authorized employee of the joint venture, if the joint venture has its own employees, or from the other joint venturers.” Finally, the committee found that “[t]he disclosure to the joint
venture and the joint venture’s consent should also include the fact that the lawyer may be paid by the corporation and not the joint venture.”

B. Al-Yusr

The case of Al-Yusr Townsend & Bottom Co. v. United Mid East Co., demonstrates the potential pitfalls when counsel represents a joint venture during its formation or operation and one of the venturers later wishes to use the counsel in a dispute against a co-venturer related to the joint venture. The case involved a joint venture formed by AYTB and UME to construct a saltwater treatment plant. During the course of the project, the owner issued extensive revised drawings which materially affected the scope of the project. The joint venture was “afforded an opportunity” to submit a claim to the owner “with respect to the way in which the contract should be modified to reflect the [resulting] extra costs and delays.” The joint venture hired attorney Blackburn “to assist with the preparation of that claim proposal and to provide legal advice and representation with respect to the Joint Venture’s contractual obligations to [the owner] and the legal implications of” the changes to the work. As part of this representation, Blackburn engaged in numerous communications with both venturers which he described as confidential. Blackburn also prepared a claim report for the joint venture and described the report in a communication to UME as “work product, including . . . legal opinions and analysis conducted on UME’s behalf, and as such it is a privileged communication between attorney and client,” apparently with the goal of cloaking the document in the attorney-client privilege. After Blackburn completed the claim report, his representation of the joint venture ceased. About nine months later, AYTB “acquired information which led it to believe that improper actions were being taken by [UME] with respect to the Joint Venture” which caused the joint venture to lose $25.5 million. AYTB then hired Blackburn to sue UME for various breaches of
the joint venture agreement which related to “the same extra and unanticipated costs . . . for which Mr. Blackburn was previously retained to render legal advice for the Joint Venture’s claim” against the owner.

UME moved to disqualify Blackburn, arguing that “the Rules of Professional Conduct prohibit his representation of [AYTB] because [AYTB] has interests materially adverse to a former client” under Model Rule 1.9. The court first examined whether UME was a former client. The court found that because the interests of co-venturers were “so intertwined . . . with those of the joint venture as a whole” that it “certainly would be reasonable” for a member of a joint venture to expect that the attorney representing a joint venture was representing its individual members as well. The court concluded such an expectation was sufficient to “form the basis of a[] potential implied attorney-client relationship” (subject to the specific facts of a case). The court then found that under the facts of the case “it was reasonable for [UME] to believe that Mr. Blackburn was representing them because of his characterizations of their communications as privileged and confidential” as well as the use of the word “clients” in his communications with them. The court next examined whether under Model Rule 1.9 the issues in the case were “the same or a substantially related matter” as “those at issue during Mr. Blackburn’s representation of the Joint Ventures.” After considering factors such as the nature and scope of the prior representation, the nature of the present lawsuit and whether the client in the course of the prior representation might have disclosed detrimental confidences which could be relevant to the present action, the court found the matters were “the same or a substantially related matter” and therefore Model Rule 1.9 required disqualification.

Al-Yusr is distinguishable from a “loaned” counsel scenario in that Blackburn was not originally counsel for AYTB, which was loaned to the joint venture. However, the result in Al-
Yusr arguably would be the same if the facts were changed to make Blackburn long-time counsel for AYTB which was “loaned” to the joint venture to assist in making a claim against the owner (particularly without a waiver-of-conflicts letter acknowledged by UME which disclaimed any attorney-client relationship with UME). In such a scenario, UME still could claim that UME reasonably regarded Blackburn as representing UME and that Blackburn should be disqualified from representing AYTB in any action against UME. Potentially more troubling would be if in-house counsel for AYTB had been “loaned” to the joint venture for the purpose of the claims investigation. In such a situation, an argument that in-house counsel for AYTB also represented UME could include an aggressive demand for all of in-house counsel’s internal communications with its employer regarding the claims investigation because the attorney-client privilege had been waived as to UME through the joint representation. Accordingly, both venture participant and counsel should proceed with caution in situations in which counsel (inside or outside) for one of the venturers is “loaned” to a joint venture to avoid unintended results.

IV. ETHICAL CONSIDERATIONS INVOLVED WITH MULTIPLE PROJECTS WHERE PARTICIPANTS OVERLAP

The ethical issues involved in joint ventures become more complex in situations where a joint venture participant which is “loaning” counsel to the joint venture or otherwise having its counsel advise or assist the joint venture has other relationships with the owner or other joint venture participants. For example, what if Party A has loaned its counsel to the joint venture to help negotiate a change order with the owner while Party A is separately is negotiating another change order or claim with the same owner on another project (with significantly greater dollar significance to Party A)? Or what if Party A has loaned counsel to the joint venture and there is a need to negotiate a change order with an affiliate of Party A that is a subcontractor to the joint venture? Similarly, what if Party A has loaned its counsel to a joint venture with Party B when
Party A (or an affiliate) is a subcontractor to Party B on another project? As joint venture participation in the construction industry has expanded, the potential ethical dilemmas confronting inside or outside counsel which represent both a venturer and joint ventures in which they participate (and/or other venturers) also has grown. These dilemmas are not always susceptible to precise answers.

The basic framework for addressing these types of ethical issues is Rule 1.7 and its admonishment that a lawyer cannot engage in a representation when there is a significant risk the representation will materially limit representation of other clients. The comments to Rule 1.7 provide some further guidance by defining a conflict of interest to include a situation where “there is a significant risk that a lawyer’s ability to consider [or] recommend . . . an appropriate course of action for the client will be materially limited as a result of the lawyer’s other responsibilities or interests.” The Model Rules also in other contexts provide further guidance as to dealing with the potential conflicts of representing multiple clients that may have differing interests. For example, Rule 1.8 addresses making or accepting offers of settlement in multiple representation situations. The comments to Rule 1.8 provide that “[d]ifferences in willingness to make or accept an offer of settlement are among the risks of common representation of multiple clients by a single lawyer. Under Rule 1.7, this is one of the risks that should be discussed before undertaking the representation, as part of the process of obtaining the clients’ informed consent.” Similarly, the comments to Rule 1.7 provide that it is ethical for a lawyer to take inconsistent legal positions in different tribunals for different clients, provided that there is not a “significant risk that a lawyer’s action on behalf of one client will materially represent the lawyer’s effectiveness in representing another client in a different case” (such as when a decision favoring one client will significantly weaken the position taken on behalf of the
other client). In such a situation, when there is a “significant risk of material limitation,” the lawyer must refuse one of the engagements or withdraw from both in the absence of informed consent from both clients.

Ultimately, in these more difficult “close-call” situations, a lawyer is advised to fully disclose potential conflicts, subject to the other restrictions of the rules, to ensure the clients’ consent to potential conflicts is informed. Where continued representation of a joint venture participant as well as one of the joint venture becomes problematic because of such potential or actual conflicts, withdrawal by the lawyer from the representation of one or both clients is required absent informed consent from both parties.

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1 See 12 Am. Jur. 2d Proof of Facts 295 § 1 (2010) (“Use of joint ventures has become increasingly common as a . . . means of acquiring the great concentration of economic resources, knowledge, and skills required to accomplish large-scale construction projects involving public buildings, superhighways, tunnels, bridges, dams, canals, and atomic reactors; joint ventures have also been utilized for the exploitation and development of natural resources . . . for the development and sale of real estate subdivisions and housing projects . . .”).


3 References herein are to the American Bar Association’s Model Rules of Professional Conduct (the “Model Rules”). The Model Rules have been adopted, in some form, in all states except California. However, variations exist between the Model Rules and the rules adopted by individual states. Therefore, it is important to check the specific rules of any states in which you practice as those rules may vary from the Model Rules discussed herein.

4 Model Rule 1.7(a).

5 Model Rule 1.7(b).

6 Model Rule 1.7 (cmt. 8).

7 Model Rule 1.7(b)(1-4).

8 “General and open-ended waivers are generally not effective. Comprehensive waivers are more likely to be effective, as are those agreed to by sophisticated clients.” In re IH 1, Inc., 441 B.R. 742, 746 (Bankr. D. Del. 2011.).

9 Model Rule 1.0(e).

10 See In re Guardianship of Lillian P., 617 N.W.2d 849 (Wis. Ct. App. 2000) (waiver requires lawyer to disclose nature of all conflicts or potential conflicts in relationship to lawyer’s representation of client’s interests and how they could affect lawyer’s exercise of independent professional judgment for client; client must understand risks involved in not choosing other representation).


13 See Legal Ethics, Law. Deskbk. Prof. Resp. § 1.7–1 (2011-12 ed.) (“A lawyer’s involvement with a conflict of interest may subject the lawyer to claim of a breach of duty to the client. . . . Or it may serve as the basis of a
malpractice action allowing the client to recover damages. Furthermore, a conflict of interest may subject the lawyer to state bar discipline.

14 Model Rule 1.9(a).
15 Model Rule 1.9(c).
16 917 P.2d 1284 (Hawaii 1996).
17 Id. at 1286.
18 Id.
19 Id.
20 Id.
21 Id.
22 Id. at 1287.
23 Id.
24 Id.
25 Id. at 1290.
26 Id.
28 Id. at 274.
29 Id. at 275-276.
30 Id. at 276.
31 Id.
32 Model Rule 1.8(f).
34 Tex. Comm. on Professional Ethics, Op. 512, V. 58 Te x. B.J. 1147 (1995). Opinion 512 interprets Texas Disciplinary Rules of Professional Conduct Rule 1.06, which varies from Model Rule 1.7. However, the issues involved in Texas Rule 1.06 are analogous to the issues involved with Model Rule 1.7.
35 Id.
36 Id.
37 Id.
38 Id.
39 Id.
41 Id. at *1.
42 Id.
43 Id.
44 Id.
45 Id. at *2.
46 Id.
47 Id.
48 Id.
49 Id.
50 Id. (emphasis added). The court in Al-Yusr first appeared to make the blanket conclusion that an attorney-client relationship exists between counsel for a joint venture and the members of the joint venture without the need for any further analysis. See id. (“While no Pennsylvania law addresses the issue of whether an attorney-client relationship exists between an attorney representing a joint venture and the individual members of that joint venture, the nature of a joint venture compels this Court to conclude that such a relationship does exist”). However, the court then stated representing a joint venture merely forms the potential “basis” of a simultaneous attorney-client relationship with the members of the joint venture and examined the specific conditions of the interactions between the parties to determine if an attorney-client relationship in fact was formed. Id.
51 Id. at *4.
52 Id.
53 Id. at *5.
See, e.g., In re Valero Energy Corp., 973 S.W.2d 453 (Tex. Ct. App. 1998) (joint venture partner unsuccessfully moved to compel production of privileged documents from co-venturer by arguing in-house counsel for co-venturer also had been its lawyer). Although the Court of Appeals of Texas rejected the motion to compel in Valero, it is conceivable the arguments made in the case to compel the production of the privileged documents (such as the argument the co-venturer effectively paid for part of the in-house lawyer’s services because the services were billed to the joint venture or that the co-client exception to the attorney-client privilege required disclosure of the documents) could be persuasive to a court in another jurisdiction, particularly under facts similar to Al-Yusr.

54 See, e.g., In re Valero Energy Corp., 973 S.W.2d 453 (Tex. Ct. App. 1998) (joint venture partner unsuccessfully moved to compel production of privileged documents from co-venturer by arguing in-house counsel for co-venturer also had been its lawyer). Although the Court of Appeals of Texas rejected the motion to compel in Valero, it is conceivable the arguments made in the case to compel the production of the privileged documents (such as the argument the co-venturer effectively paid for part of the in-house lawyer’s services because the services were billed to the joint venture or that the co-client exception to the attorney-client privilege required disclosure of the documents) could be persuasive to a court in another jurisdiction, particularly under facts similar to Al-Yusr.

55 Model Rule 1.7 (cmt. 8).
56 Model Rule 1.8(g).
57 Model Rule 1.8 (cmt. 13).
58 Model Rule 1.7 (cmt. 24).
59 Id.
60 See, e.g., Legal Ethics, Law. Deshbk. Prof. Resp. § 1.7-1 (2011-12 ed.) (“[P]rudence requires that lawyers should err on the side of disclosure” in obtaining informed consent in multiple representation situations). See also Model Rule 1.7 (cmt. 19) (commenting on what occurs where clients refuse to allow counsel to make required disclosures for informed consent).
61 Id.