New York's Tough (Maybe Too Tough) Disclosure Rules

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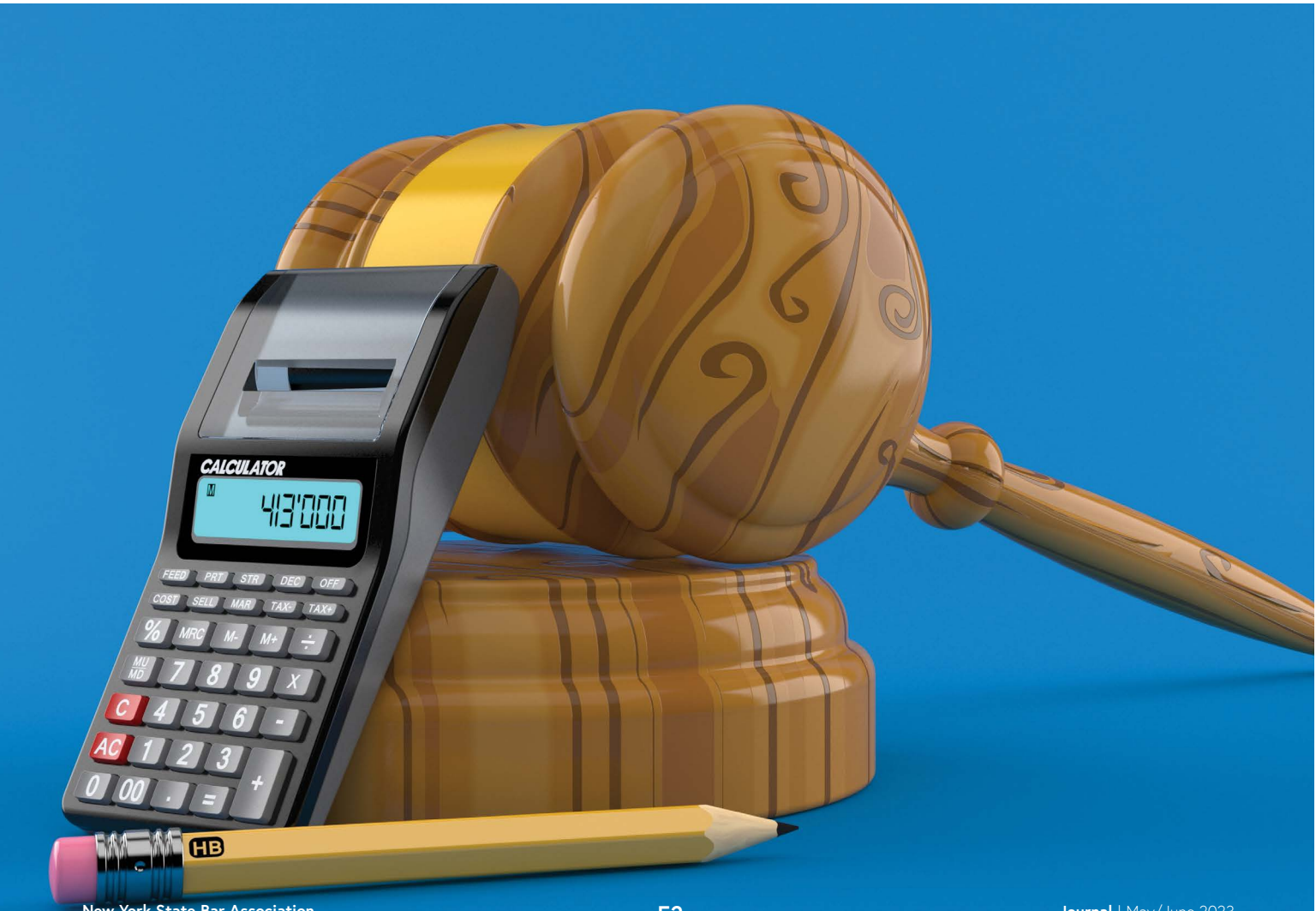

To the Forum:

The Jones Company needs advice on a real estate transaction that has complicated federal and local tax ramifications. The company is considering hiring one of the following:

(a) Archie Anderson is both a New York-admitted attorney and a CPA. Anderson has separate websites for his work as an attorney and as an accountant, advertises both his law firm and accounting firm separately to the general public, and keeps separate books and records for each. Anderson says he will handle the real estate transaction through his law firm and provide the necessary tax services through his accounting firm, at a lower hourly rate but one higher than the accounting firm, Smith & Taylor, across the street.

(b) Bill Baker is a New York-admitted attorney whose practice emphasizes real estate. He does not do tax work, but his brother-in-law, Carl Carlson, has an accounting firm in which Baker has a one-third ownership interest. Carlson offers his firm's accounting services to the general public (i.e., not just to Baker's clients). Baker says he will handle the legal work but will refer the accounting/tax work to Carlson, who also charges more than Smith & Taylor.

(c) Davis & Davis is a 30-lawyer real estate firm that has a CPA as a full-time employee. The CPA only does work for Davis & Davis clients. Davis & Davis bills the CPA at an hourly rate that is also higher than the highest rate charged by Smith & Taylor.

Under New York Rule of Professional Conduct 5.7, what disclosures must each of these providers make to The Jones Company, and what conflict waivers (if any) must they obtain?

Finally, would your answer change if each provider was doing purely legal work on the real estate deal for The Jones Company, and The Jones Company asked for help with a local tax filing on an unrelated matter that requires no tax law expertise?

Sincerely,

Big Boss Jones

Dear Big Boss Jones:

You correctly focus on New York Rule of Professional Conduct 5.7(a) ("Rule 5.7(a)" or the "Rule"), which is intended to guide lawyers asked to provide either a combination of legal and nonlegal services or only nonlegal services. Here, we assume from the question that the accounting work involved can legally be performed by a non-lawyer accountant, making it a "nonlegal service" under Rule 5.7.[1] The three law firms Jones Company is vetting – Anderson, Baker and Davis & Davis – are thus being asked to provide both the legal service of handling the real estate transaction and the nonlegal service of giving accounting advice, requiring them to follow Rule 5.7(a).

But choosing the correct rule is only the beginning. The black letter of Rule 5.7(a) and the Rule's comments impose different requirements, with one more onerous than the next.

The Obligation Imposed by Rule 5.7(a) Itself

New York's version of Rule 5.7(a) differs markedly from its counterpart in the Model Rules or in any other state. At bottom, the Rule is designed to eliminate client confusion as to when a law firm's *nonlegal* services are subject to the ethics rules. We summarize the Rule's lengthy provisions as follows:

> **Rule 5.7(a)(1):** Where the nonlegal services being provided "are not distinct" from the legal services, the lawyer or law firm is subject to the ethics rules as to both the legal and nonlegal services.
>
> **Rule 5.7(a)(2):** Even where the nonlegal services *are* "distinct" from the legal services, the lawyer or law firm performing the nonlegal services is still bound by the ethics rules if "the person receiving the services could reasonably believe that the nonlegal services are the subject of a client-lawyer relationship."
>
> **Rule 5.7(a)(3):** Similarly, a lawyer or law firm that "is an owner, controlling party or agent of, or that is otherwise affiliated with," an entity providing nonlegal services is bound to the ethics rules *as to the nonlegal services* if the person receiving those services could reasonably believe the nonlegal services are the subject of a client-lawyer relationship.
>
> **Rule 5.7(a)(4):** For purposes of (a)(2) and (a)(3), the lawyer or law firm must assume the person receiving the nonlegal services believes the services are the subject of a client-lawyer relationship unless "the lawyer or law firm has advised the person receiving the services in writing that the services are not legal services" and that the protection of the client-lawyer relationship does not cover them (the "Rule 5.7(a)(4) Disclaimer").

Though ponderous, Rule 5.7(a) is really very simple. It is designed to avoid client confusion as to whether the bundle of protections that accompany legal services – client confidentiality, freedom from conflicts of interest and maintaining professional independence, to name a few – apply when a lawyer provides nonlegal services.[2] When the legal and nonlegal services are "so closely entwined that they cannot be distinguished from each other," the two sets of services are considered not "distinct," and the ethical rules are deemed to apply to both.

The services here are not that "closely entwined." Your question suggests that they can be separated, with a lawyer being able to perform the real estate transaction and a nonlawyer accountant being able to perform the tax services, as Anderson and Baker are offering. This means the ethical rules do not automatically apply to the nonlegal services, though there is a danger that Jones Company "could reasonably believe that the services are the subject of a client-attorney relationship" – especially where the same law firm performs both sets of services, as with Davis & Davis and (arguably) Anderson.[3] Anderson, who is having his separate accounting firm perform the accounting services, can protect himself by providing The Jones Company the Rule 5.7(a)(4) disclaimer in writing.

firm's own employees – is considered a business transaction with a client governed by Rule 1.8(a), New York's strictest conflicts rule.[5] Rule 1.8(a) requires that: (a) the "business transaction" be fair and reasonable to the client; (b) the terms of the transaction be "fully disclosed"; (c) the client be informed of the advisability of seeking, and is given a reasonable opportunity to seek, the advice of independent counsel; and (d) the client give informed consent, confirmed in writing, to the essential terms of the transaction. No other New York conflicts rule requires this level of disclosure.[6] The three law firms here all must comply with this heightened disclosure because each, by providing nonlegal services to the client, engages in a "business, property or financial transaction" with the client within the meaning of Rule 1.8(a).

"Whether a law firm partially or entirely owns an interest in an ancillary business that functions separate and apart from the law firm or has its own employees perform certain nonlegal functions, the New York Rules require the firm to obtain heightened disclosures from the client."

The proposed arrangement with Davis & Davis actually creates the greatest risk of confusion for the client, since a firm employee will perform the accounting services. But the law firm will almost certainly have the client sign a single retainer letter encompassing all the firm's services, indicating that all those services – legal and nonlegal – will be covered by the ethical rules. That makes even more sense given the law firm's ethical obligation to supervise its nonlawyer employees, and its responsibility for any resulting ethical lapses.[4]

The Obligation Imposed by the Comments to Rule 5.7

Unfortunately, the requirements of Rule 5.7(a)'s black letter are not the only hurdle Anderson, Baker and Davis & Davis face. The Comments indicate that they may have to make further – and more harrowing – disclosures.

Whether a law firm partially or entirely owns an interest in an ancillary business that functions separate and apart from the law firm (as Anderson and Baker do) or has its own employees perform certain nonlegal functions (as with Davis & Davis), the New York Rules require the firm to obtain heightened disclosures from the client. The Comments to Rule 5.7 make this clear. They state that an arrangement where a law firm provides nonlegal services to a client – whether through a separate business the law firm owns *or through the law*

It gets worse. Under Rule 1.7(a)(2), a lawyer is deemed to have a conflict of interest where "there is a significant risk that the lawyer's professional judgment on behalf of the client will be adversely affected by the lawyer's own financial, business, property or financial interests." As applied to Rule 5.7(a), the theory is that the law firm's decision to use its own nonlegal services provider – whether a separate firm or an employee – favors its own interests because the client might find a cheaper or better provider elsewhere. Comment 5A to Rule 5.7 explicitly requires this personal interest conflict to be waived in writing.[7] So, once again, all three lawyers or law firms involved here have to get The Jones Company to waive the conflict under Rule 1.7(a)(2), as well as under Rule 1.8(a).

We must note that these conflict waiver requirements will probably come as quite a surprise to most New York lawyers, including those you have approached. Both Comment 5A to the New York Rules and the ethics opinions we cite suggest *two separate types of conflicts* are created every time a New York lawyer so much as recommends a nonlegal services provider, whether from their own firm or a firm they separately own. This is at odds with the way law firms generally operate. After all, law firms regularly provide services that could be considered "nonlegal" services in order to support the firm's legal work. They may employ paralegals, in-house investi-

gators, e-discovery providers, fiduciary administrators or – you guessed it – accountants to assist clients with various nonlegal tasks in the course of the attorney-client relationship. It is neither common practice, efficient nor logical to require law firms in the above examples to have to suggest to their clients that similar nonlegal help may be obtained more cheaply elsewhere, much less to have clients execute heightened disclosures under the conflict of interest rules every time the firm assigns work to nonlegal professionals who work in-house at the firm.

Perhaps N.Y. Rule 5.7 and its Comments should be amended to more closely track with the Comments to Model Rule 5.7, which barely mention Rule 1.7 and limit the need to make a Rule 1.8(a) disclosure to a situation where the referral is to a *separate business* owned or controlled by the lawyer.[8] But until then, you should expect the lawyers offering to provide nonlegal services to The Jones Company through companies they own or their own employees to ask for Rule 1.7 and Rule 1.8(a) conflict waivers.

Your Alternative Question

This question serves to underscore how broadly the conflict waiver rules apply under the New York Comments to Rule 5.7. Here, the law firms are being asked to provide a purely nonlegal service for The Jones Company, so there is no possible "confusion" between legal and nonlegal services as there is in your original question. Thus, the black letter of Rule 5.7 is not implicated at all, though Anderson may still want to protect itself by having the client execute a Rule 5.7(a)(4) disclaimer. Yet the need to obtain Rule 1.7 and 1.8(a) conflict waivers still remains.[9] So even if the nonlegal service is "distinct" from any legal services the lawyer is providing, the lawyer is still bound by the conflict rules and still must make clear that the lawyer's personal interests are implicated in deciding to perform the nonlegal task as opposed to, for example, recommending another, possibly cheaper nonlawyer provider. This is yet another reason to question the breadth of these Comments.

Sincerely,
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QUESTION FOR THE NEXT FORUM

To the Forum:

I am the defendant's counsel in a federal lawsuit against a New York State Trooper being sued for malicious prosecution. This case has been very slow-moving as plaintiff's attorneys consistently miss deadlines, such as serving the summons and complaint, expert witness disclosure and responding to discovery demands. They also failed to appear for several court conferences, at which I have mentioned to the court counsel's frequent missed deadlines. It is beginning to feel like a waste of time and my clients' money to continue defending them in a case the plaintiff has paid no mind to.

Most of the time, plaintiff's counsel has brazenly missed these deadlines without so much as an email, but on several occasions, they requested same-day extensions of deadlines to try to reach settlement. While each of these extensions was granted by the court, counsel never reached out to me with any sort of settlement demand. I have tried to contact their office multiple times, but have either been told that they are unavailable or receive no response at all.

Several days after missing the final pretrial conference, counsel filed an apologetic letter requesting an adjournment and that no blame be placed on the plaintiff. The letter cited numerous excuses for the missed deadlines and appearances, such as this being the handling-associate's first federal case, the supervising partners being busy with other cases and a sudden resignation of several support staff. The court has yet to take any action against plaintiff's counsel beyond entering an order establishing discovery deadlines (which, predictably, counsel has missed).

I am contemplating filing a motion to dismiss the case and call for sanctions on the grounds that defendant is now prejudiced by the plaintiff's lack of attention to the case. Would filing a motion to dismiss be ethical and proper in this instance as it might harm the plaintiff? What kind of sanctions might the plaintiff's attorneys face?

Sincerely,
Patience Isabel Waning

Endnotes

1. *See* Rule 5.7(c) ("'nonlegal services' shall mean those services that lawyers may lawfully provide and that are not prohibited as an unauthorized practice of law when provided by a nonlawyer").

2. *See* Rule 5.7(a), Comm. 1. "The risk of confusion is especially acute when the lawyer renders both legal and nonlegal services with respect to the same matter."

3. *See* Rule 5.7(a)(2) and (a)(3).

4. *See* Rules 5.3(a) ("a law firm shall ensure that the work of nonlawyers who work for the firm is adequately supervised . . . .") and 5.3(b) (setting forth when lawyer or law firm is responsible for nonlawyer's violation of ethics rules).

5. *See* N.Y. Rule 5.7, Cmt. 5A (requiring lawyer providing nonlegal services to comply, *inter alia,* with Rule 1.8(a)); *see also* N.Y. State Bar Ass'n Ethics Op. 896 (2011) (law firm providing both legal and lien search services through own employees required to comply with NY Rule 1.8(a)).

6. *Compare* N.Y. Rule 1.7(b)(4) (requiring only "informed consent, confirmed in writing" for most conflicts).

7. *See* N.Y. State Bar Ass'n Ethics Op. 1015 (2014) (Rule 1.7(a)(2) applies when lawyer is hiring or recommending separate provider to provide nonlegal services); N.Y. State Bar Ass'n Ethics Op. 958 (2013) (risks of conflicts under Rule 5.7 exist "whether or not the lawyer intends to perform the nonlegal services through the lawyer's firm . . . or through a separate entity that the lawyer owns or controls").

8. *See* Model Rule 5.7, Comm. 5.

9. *See* Rule 5.7, Comm. 5A ("[I]f the legal representation involves exercising judgment about whether to recommend nonlegal services and which provider to recommend, *or if it involves overseeing the provision of the nonlegal services,* then a conflict with the lawyer's own interests under Rule 1.7(a)(2) is likely to arise," going on to say lawyer "should" get waiver under Rule 1.8(a) as well) (emphasis added).