DELAWARE STATE BAR ASSOCIATION

COMMITTEE ON PROFESSIONAL ETHICS

OPINION 1982 - 1

The Committee has been asked by a Delaware law firm for its opinion as to whether the law firm's appearance on behalf of a creditor in a mortgage foreclosure action against a certain debtor would constitute a conflict of interest and, therefore, be barred under the Delaware Lawyers' Code of Professional Responsibility (hereinafter "Code").

The Delaware firm requesting the opinion was retained to complete a title examination, secure title insurance and prepare mortgage papers with respect to a loan being made by a certain bank to an individual debtor. In the commitment letter sent by the bank to the individual debtor, the Delaware law firm was designated as attorney for the individual debtor. According to the debtor, that designation was originally made by the bank without consulting him. According to the law firm, it was not consulted by the bank before the designation was made. In any event, the commitment letter was executed by the debtor.

The commitment letter designating the law firm as the debtor's attorneys was never sent to the law firm. Instead, the firm received instructions from the bank to do a title examination of the property to be mortgaged, secure title insurance for the bank on the property, and prepare a bond and mortgage for the transaction. The law firm was directed to return all papers to the bank for settlement. The law firm accomplished the tasks directed by the bank and sent the mortgage docu-

ments to the bank. No member of the firm attended the settlement at which the loan was effectuated. In addition, the firm was never advised by either the bank or the debtor that it had been designated as the debtor's firm in the commitment letter. Prior to the closing, the firm had no contact with the debtor, provided no counsel to the debtor and received no communications from the debtor, confidential or otherwise.

The fees for the work performed were billed by the firm to the bank. However, the firm was aware that a usual provision of the terms of a loan are that the debtor will pay the bank's expenses for loan closing work, including attorneys' fees. The debtor states that he paid the fees which the firm had billed to the bank and says that he was told by the bank that the fees were for work performed by the firm as his counsel. However, the firm advises that, in the past, it has not sought to collect fees directly from a debtor and, in situations where the loan is not closed, the fees are paid by the bank and not the debtor.

Subsequent to the effectuation of the loan, the debtor has allegedly defaulted on his obligations with respect to the loan. The bank has requested the law firm to take action, including the initiation of foreclosure proceedings, in an effort to satisfy the debt. The present attorney for the debtor has advised the law firm that his client believes the firm has a conflict of interest and may not represent the bank in proceedings against the debtor. The debtor believes the law firm was his counsel in the loan transaction and, therefore, would be

precluded from representing an interest adverse to that of a former client. It is with respect to this issue raised by the debtor that the Committee has been asked to opine.

In an effort to prepare an opinion, the Committee requested by letter that the debtor's present counsel provide to it any facts upon which the debtor relies in claiming that the law firm was retained as his counsel with respect to the loan transaction. In particular, the debtor was asked to inform the Committee of any communications that he received from or sent to the law firm acknowledging or confirming the representation. In addition, the debtor was asked to inform the Committee of any communications between the law firm and him, particularly any confidential communications. In his response to the Committee's letter, no specific response to these inquiries was made by the debtor. Apparently, in order to establish an attorney-client relationship, the debtor relies solely upon the fact that the firm was designated by the bank as his counsel and the fact that the firm's fees were ultimately paid by him. There is no dispute that neither the debtor nor the firm ever acknowledged to the other the existence of an attorney-client relationship and that there were no communications between the debtor and the firm during the loan transaction.

ISSUE

Is the law firm precluded by the Code of Professional Responsibility from representing the bank in the foreclosure action against the individual debtor?

In the existing Delaware Lawyers' Code of Professional Responsibility the rules respecting conflicts of interest are scattered among various of the disciplinary rules. See, e.g., DR 4-101, DR 5-101, DR 5-104, DR 5-105, DR 5-107 and DR 9-101. There is no single or comprehensive disciplinary rule treating the subject of representation against former clients. In the proposed Model Rules of Professional Conduct, specific rules treating conflicts of interest are set forth, including a specific rule dealing with representations against former clients. Although these rules have not been formally adopted by the American Bar Association or by the Delaware Supreme Court, in certain areas, including the present area, these rules are an authoritative statement of the current ethical obligations of attorneys. With respect to representations against former clients, the Model Rule provides as follows:

> Rule 1.9 Conflicts of Interest: Former Client
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> A lawyer who is representing a client in a matter shall not thereafter:
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> (a) Represent another person in the same or a substantially related matter if the interest of that person is adverse in any material respect to the interests of the former client unless the former client consents after disclosure; or
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> (b) Use information relating to the representation to the disadvantage of the former client unless the former client consents after disclosure or the information has become generally known.

Two separate and equally important principles underly the reason for this rule. First, the rule is premised upon a duty of loyalty

owed by the attorney to his client. In simplest terms, a lawyer should not be permitted to switch sides in a transaction, even in a subsequent representation that relates to that transaction. Otherwise, the sense of loyalty and fidelity so necessary to the attorney-client relationship would be undermined. Secondly, a lawyer must preserve those confidences disclosed to him by a client or former client. The failure to preserve such confidences will cause serious detriment to the client or former client and, in addition, would further undermine the attorney-client relationship.

The significance of these two principles is that the resolution of the conflict question does not turn solely upon whether the subsequent representation would involve the utilization of confidences disclosed by the former client in a prior representation. Certainly, if the subsequent representation does involve the utilization of such confidences, the representation is precluded. However, the absence of confidential communications in the prior representation that might be relevant to the subsequent representation does not end the ethical inquiry. See Drinker, supra, at 109.

Even absent confidential communications in the prior representation which are relevant to the subsequent representation, a lawyer is precluded from taking a subsequent, adverse representation against a former client if that representation involves the same matter as the original representation or a matter substantially related to it. This rule is premised upon the duty of loyalty. Thus, a lawyer is prohibited from negotiating an agreement on behalf of one party and subsequently

attacking its legal sufficiency on behalf of another. See, e.g., In re Evans, Ariz. Supr., 556 P.2d 792 (1976). Also, an attorney is prohibited from switching sides to enforce a negotiated agreement. In re Cipriano, N.J. Supr., 346 A.2d 393 (1975).

The foregoing analysis is reflected in the Model Rule concerning representations against former clients. Under that rule, a lawyer may not represent another person "in the same or substantially related matter if the interest of that person is adverse in any material respect to the interests of a former client." And may not, in a subsequent representation or otherwise, "use information relating to the [prior] representation to the disadvantage of the former client." Proposed Model Rule 1.9. These are alternative grounds for disqualification.

In applying these rules to the present case, the Committee concludes that the law firm, if it had represented the individual debtor in the original loan transaction, would be precluded from representing the bank in a foreclosure action or any other action against the individual debtor which relates to or arises from that loan transaction without the consent of the debtor. The law firm would be barred from such representation even if it could be established that the firm had no communications or real contact with its nominal client, the individual debtor. Thus, the apparent absence of such communications in the present case would not permit the law firm to undertake the subsequent representation if the individual debtor had been its client. However, the threshold and central issue in this dispute is whether the individual debtor was ever the client of the law firm.

It is elementary that the conflict rule here in issue has no application if the individual debtor was not the client of the law firm in the original loan transaction. See, Matter of Palmieri, N.J. Supr., 385 A.2d 856, 860 (1978); U. S. Industries, Inc. v. Goldman, S.D.N.Y., 421 F.Supp. 7 (1976) and Lane v. Chowning, 8th Cir., 610 F.2d 1385 (1980). The determination of whether an attorney-client relationship exists is primarily a question of fact and is resolved under the general principles of contract law. Matter of Palmieri, supra, at 859. As stated by the New Jersey Supreme Court:

> ... [R]epresentation is inherently an aware, consensual relationship, one which is founded upon the lawyer affirmatively accepting a professional responsibility ... [S]uch acceptance need not necessarily be articulated in writing or in speech, but may, under the circumstances, be inferred from the conduct of the parties.

Matter of Palmieri, supra, at 859.

Because the attorney-client relationship must be consensual and must involve some acceptance of the relationship by the attorney, the fact that a party may communicate confidential information to an attorney does not preclude that attorney from subsequently representing a third party against that party unless that party was his client at the time the communications were made, Young v. Oak Crest Park, Inc., N.Y. App., 428 N.Y.S.2d 69 (1980), or unless the communications were made in consultation with the attorney about a possible, though never accepted representation. Martin v. Materazzi, Del. Super., 80C-MY-59 (August 31, 1981) (Unreported Opinion of Taylor, J.). Thus, in the present case,

the establishment of confidential communications between the debtor and the law firm would not, alone, establish an attorney-client relationship. However, the existence of such communications or the absence of such communications may be evidence which suggest whether an attorney-client relationship exists as a matter of fact. In the present case, the absence of any communications of any type between the debtor and the law firm belie the debtor's suggestion that he considered the law firm to be his counsel with respect to the original loan transaction.

Furthermore, the fact that the bank, as a matter of its agreement with the debtor, would charge the debtor for the bank's expenses, including counsel fees, in closing the loan does not, by itself, make the law firm counsel to the debtor.* In Berke v. Chattanooga Bar Association, Tenn. App., 436 S.W.2d 296 (1960), a Tennessee Appellate Court stated:

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* The Committee has studied the potential application of Interpretative Guideline No. 1 under DR 2-103 to this matter. The Committee concludes that this Guideline does not apply to resolve the issue before it. That Guideline requires certain disclosures by an attorney to a borrower, when the borrower is his client and has been referred to the attorney by a bank or other lender interested in the loan. Absent such disclosures, the lawyer is precluded from representing the borrower or billing the borrower, directly or indirectly, for his legal services. The application of that Guideline is premised upon the existence or potential existence of an attorney-client relationship. It does not provide any guidance as to when that relationship exists, which is the issue in this matter.

Since the Committee concludes that the firm was not acting and did not purport to act for the borrower, the disclosure obligations imposed by that Guideline were not violated and the sanctions created by that Guideline are inapplicable to this matter.

> Ordinarily a borrower who pays an attorney fee for preparation of papers for a loan from a lay person or agency has no confidential relationship with the attorney.

436 S.W.2d at 306.

If the payment of these counsel fees alone were to render the law firm counsel to the debtor, then a similar result might be reached in situations where a court orders one litigant to pay the counsel fees of another litigant or where the attorney fees of one party to a corporate transaction, such as a merger, were paid by another party to the transaction. Thus, in the present case, the fact that the individual debtor may have either reimbursed the bank for counsel fees paid by the bank to the law firm or paid the firm directly upon instruction by the bank does not render the law firm counsel to the individual debtor.

In order for an attorney-client relationship to exist in the present case, there must be some facts which show either expressly, impliedly or inferentially that the law firm consented to undertake the representation of the debtor. There are no such facts in this case. The only document which suggests that the law firm was counsel to the debtor was the commitment letter which was never delivered to the law firm. There was no other communication by the debtor to the law firm which would have even suggested to the law firm his belief that it represented him. The law firm did nothing with respect to the loan transaction which would have suggested to the debtor its undertaking of his representation. In short, there was no "meeting of the minds" between the firm and the debtor so as to create the contractual relation-

ship of attorney-client. Absent facts which expressly, impliedly or inferentially create such a contract, the law firm may represent the bank in an action against the debtor with respect to the original loan transaction.

This opinion of the Committee is not meant to resolve any issues between the bank and the individual debtor. In particular, this opinion does not resolve what legal consequences, if any, arise if the bank mistakenly led the debtor to believe that he was represented by the law firm in the loan transaction in issue.* Nor does the Committee resolve what ethical issues might arise, particularly with respect to the law firm's role as a potential witness in such a dispute, if such an issue between the bank and the debtor were to exist in the foreclosure action.

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* The issue before the Committee is the narrow question of legal ethics. The Committee cannot resolve the wider and more important substantive contractual issues that may exist between the bank and the debtor. If the bank's mistaken designation of the law firm as counsel to debtor caused the debtor real prejudice, the remedy for that prejudice would not be disqualification of the law firm because that disqualification would not cure the arguable prejudice initially incurred by the debtor in being unrepresented by counsel at the settlement. Thus, it appears to the Committee that the major issue arising from these facts is not an ethical matter between the firm and the debtor, but a substantive legal issue between the bank and the debtor.

Frederick P. Whitney, Esquire, a member of the Committee, dissented, stating his reasons as follows:

> I fully agree with the Opinion as written with the exception that when the bank in question secured from the debtor, a letter designating the law firm in question as the debtor's attorney, the said letter was never sent to the law firm. Since the bank kept the letter designating the law firm as debtor's attorney and instructed the law firm to do a title examination of the property to be mortgaged, etc. and to return all papers to the bank, the law firm was unable to advise the debtor of its position, there could be a conflict of interest in the future.
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> I am of the opinion that under the rules of the Superior Court, the law firm cannot represent the bank in this foreclosure proceeding.
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> ... [T]he Opinion would be correct if the debtor had not signed a paper designating the law firm as its attorney. The bank, in my opinion, was negligent in not sending out the letter to the law firm.

Dated: January 19, 1982