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Problem solved? Assessing the Supreme Court's Latest Statement on the Law Governing Conflicts of Interest

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Cases commented on:

Canadian National Railway Co v McKercher LLP, [2013 SCC 39](#).

On July 5 2013 the Supreme Court issued its much anticipated judgment in *Canadian National Railway v McKercher LLP*. The case invited the Court to reconsider its “bright line” rule for current client conflicts, as previously set out by the Court in *R v Neil*, [2002 SCC 70](#). The bright line rule provides that, absent client consent, a “lawyer may not represent one client whose interests are directly adverse to the immediate interests of another current client – *even if the two mandates are unrelated*” (*Neil* at para 29, emphasis in original).

In substance similar to the American Bar Association’s Model Rule 1.7(a), the bright line rule was a change to Canadian law, imposing obligations on lawyers with respect to their current clients that had not previously been stated in Canadian case law or codes of professional conduct. It generated much controversy in the profession. In 2008 the Canadian Bar Association (CBA) issued a report on conflicts strongly criticizing the bright line rule ([available here](#)). In 2010 the Federation of Law Societies issued its own report on conflicts, taking a position different from that of the CBA ([here](#)). The CBA responded to the Federation in August 2010 ([here](#)) and the Federation issued a further report on the matter in 2011 ([here](#)).

Given that controversy, the Supreme Court’s brief, clear and unanimous judgment in *McKercher* reaffirming the bright line rule is most welcome. Despite its humble brag that it would not “mediate the debate” (at para 17) the Court has resolved much of the controversy about the nature of lawyers’ obligations to their current clients. That being said, the judgment ought not to be considered the final word on the matter. In addition to containing some analytical weaknesses that may create future uncertainty, the judgment’s decision to remit the question of remedy to the trial court leaves its ultimate implications unclear.

After briefly summarizing the decision, this post will note some of those analytical issues and uncertainties.

The Judgment

The alleged conflict in *McKercher* arose from the McKercher firm’s decision to represent the plaintiffs in a \$1.75B class action suit against Canadian National Railway (CNR). At the time it accepted that retainer, the firm was acting for CNR in three current cases. Nonetheless, it did not advise CNR that it was acting in the class action, and nor did it seek CNR’s consent. CNR only learned of the representation when the statement of claim was filed in the class action. At that

time, McKercher acted to terminate its representation of CNR in its current matters, except for one matter which was terminated by CNR itself.

CNR applied for an order removing McKercher from the class action representation. That action succeeded at motions court but was reversed at the Saskatchewan Court of Appeal. The Court of Appeal found that McKercher had not breached its duty of loyalty to CNR and, in any event, as a large corporate client CNR had given implied consent to McKercher acting against it.

The Supreme Court reversed the Saskatchewan Court of Appeal's judgment. The Court began by noting the courts' inherent jurisdiction and supervisory power over the conduct of litigation. That power is to "protect clients from prejudice and to preserve the repute of the administration of justice, not to discipline or punish lawyers" (para 13). The courts also have power to set the terms of the fiduciary relationship between lawyers and clients (para 14). Both of these powers are distinct from those of the law societies, who are charged with ensuring the "good governance of the profession" and are not necessarily bound by the standards articulated by courts (para 15); "[l]aw societies are not prevented from adopting stricter rules than those applied by the courts in their supervisory role" (para 16).

With respect to conflicts of interest, the Court said that the law addresses two types of prejudice — the possible misuse of confidential information and the potential impairment of the lawyer's representation of her client (para 23). For former clients the issue is usually with respect to confidential information; for current clients the issue may be either the potential misuse of confidential information or jeopardizing of effective representation (para 23). The "risk to effective representation" is prevented in two ways, by the bright line rule and by the substantial risk principle. If a representation is not prohibited by the bright line rule, "the question becomes whether the concurrent representation of clients creates a substantial risk that the lawyer's representation of the client would be materially and adversely affected" (para 38).

The bright line rule is, as noted above, "the general rule that a lawyer may not represent one client whose interests are directly adverse to the immediate interests of another current client – *even if the two mandates are unrelated*" (cited in *McKercher* at para 27). That rule applies to both matters related to the retainer of the client against whom the firm seeks to act, and matters that are unrelated to that retainer. The rule is a blanket rule rather than merely a "rebuttable presumption" (para 29); it is not, however, a "rule of unlimited application" (para 30). The rule is limited in various ways. First, it only applies where the new representation is directly adverse to the immediate interests of the client. Second, it only applies where the representation affects the client's legal interests; an effect on, for example, the client's economic interests will not trigger the application of the rule. Third, the rule may not be invoked by a "party who seeks to abuse it" (para 36). Finally, the rule does not apply where it would be "unreasonable for a client to expect that its law firm will not act against it in unrelated matters" (para 37). This includes circumstances where the client is a "professional litigant" whose consent to the adverse representation may be inferred. This limitation on the bright line rule is to be assessed based on the nature of the firm-client relationship, the "terms of the retainer", and the "types of matters involved" (para 37).

The Court also suggested that it would be improper for a law firm to "summarily and unexpectedly drop a client simply in order to avoid conflicts of interest with existing or future clients" (para 44). In addition, a lawyer has a duty to "advise an existing client before accepting a retainer that will require him to act against the client" (para 46). This obligation exists even if the lawyer believes that the new representation would not violate the bright line rule (para 46).

Further, while the lawyer must obtain consent from the new client before disclosing the potential retainer, if the client does not grant that consent the lawyer “must decline to act for the new client” (para 47). The inability to disclose the information precludes the new retainer.

The Court concluded that McKercher had violated the bright line rule. The new retainer was directly adverse to the immediate legal interests of CNR and CNR was not acting tactically (para 51). It was reasonable for CNR to expect that McKercher would not act against it in this way (para 52). McKercher ought not to have terminated its retainers with CNR (paras 55-56) and it violated its duty of candour when it did not disclose the new retainer to CNR (para 57).

The Court declined, however, to decide whether McKercher ought to be removed from the class action litigation. Disqualification is necessary to avoid the improper use of confidential information, to prevent impaired representation and to maintain the “repute of the administration of justice” (para 61). Here no confidential information was at issue and McKercher no longer acts for CNR, so the only question is with respect to the administration of justice. Whether that issue requires disqualification ought to be considered by the trial judge taking into account “behaviour disentitling the complaining party from seeking the removal of counsel”, prejudice to the new client and the knowledge and belief of the new law firm in relation to whether they were truly in a conflict position (para 65).

Analysis

As noted, the virtues of the Supreme Court’s decision are its brevity, clarity and unanimity. In past conflicts cases the Court has on occasion been sharply divided (e.g., *Strother v 3464920 Canada Inc*, [2007 SCC 24](#)), and its judgments have in some cases been notably confusing (e.g., *Neil*). Here the Court clearly affirmed the bright line rule and also set out the criteria relevant for defining that rule’s scope.

Some of the analytical weaknesses with the judgment are relatively minor and, hopefully, will not undermine its usefulness in guiding lower courts, lawyers and law societies. As an example, the Court surprisingly appears to misread its earlier judgment in *Neil*. The Court stated in *McKercher* that the bright line rule test was set out in *Neil* but found not to have been violated because the Ventrakaman firm, whose conduct was at issue in *Neil*, did not act for clients in a way that was *directly* adverse to their legal interests. That view of the facts of *Neil* is, with respect, difficult to support.

In *Neil* the Ventrakaman firm represented Neil in defending a criminal case in relation to his conduct of his paralegal practice. It also represented his assistant, Helen Lambert, in a divorce action, and was taking preliminary steps towards representing Lambert in the event she was also criminally charged. Finally, the firm represented Darren Dobranko in regularizing his divorce that had originally been improperly prepared by Neil.

In the conduct of those various matters the lawyer who represented Lambert and Dobranko did two things that were improper. First, he attended a meeting with Neil in order to obtain confidential information that he could use to mount a cut-throat defence of Lambert in the event she was criminally charged. Second, he advised Dobranko to report some of Neil’s conduct to the police in order to increase the allegations against Neil, again to benefit Lambert if she was criminally charged.

I agree with the Court in *McKercher* that this does not require the application of the bright line rule as articulated in *Neil*. But I would suggest that the reason for this is that the problematic conduct against Neil was *not* unrelated to the firm's representation of him — indeed, the conduct had the almost certain likelihood of undermining the firm's representation of him in his criminal case. As a consequence, the new scope of the bright line rule established by *Neil* — that a lawyer could not act against a current client in a matter unrelated to the representation of that client — was unnecessary for the determination of the result.

But this was not the reason for distinguishing *Neil*'s facts offered in *McKercher*. Rather the Court suggested that the Ventrakaman firm's actions were not *directly* adverse to Neil's interests. It seems to justify this conclusion on the basis that the formal retainers of the Ventrakaman firm for Neil, Lambert and Dobranko were unrelated (e.g., para 34). But while the Ventrakaman firm had not formally taken on Lambert as a client in her criminal case, they had done so *de facto*, and in cases and in codes of conduct it is never necessary for a lawyer to be formally retained for the lawyer-client relationship to begin and for obligations with respect to avoiding conflicts of interest to arise. Here none of the firm's improper actions make sense except insofar as they were intended to further Lambert's legal interests at the *direct* expense of Neil's in their respective and related criminal cases. The fact that the firm acted for Lambert in a divorce matter had essentially nothing to do with the firm's wrongdoing on her behalf; that wrongdoing all arose out of its pending representation of her in the criminal case. Again, it was done to advance Lambert's legal interests at the direct expense of Neil's. For that reason, the facts of *Neil* do seem to involve the law firm acting in a manner that was directly adverse to Neil's legal interests.

The Court's problematic explanation of *Neil* is in substance inconsequential; the Court was correct that the result in *Neil* is consistent with confining the bright line rule to cases where the representation is directly adverse to the legal interests of a current client. At the same time, this misunderstanding does undermine some of the judgment's authority, and creates difficulty in understanding how *McKercher* and *Neil* relate to one another.

A second issue with the Court's judgment that may be more significant is its suggestion that the bright line rule and the substantial risk principle are distinct tests for identifying the existence of a conflict of interest, with the substantial risk principle applying in circumstances where the bright line rule has not been satisfied. In the American law from which both the bright line rule and the substantial risk principle are derived, the substantial risk test is what defines when a conflict arises; the bright line rule is relevant as a way of identifying whether or not there is a substantial risk. Thus, and as stated by Justice Binnie in *Neil*,

I adopt, in this respect, the notion of a “conflict” in section 121 of the Restatement Third, The Law Governing Lawyers (2000), vol 2, at 244-45, as a “substantial risk that the lawyer’s representation of the client would be materially and adversely affected by the lawyer’s own interests or by the lawyer’s duties to another current client, a former client, or a third person (*Neil* at para 31).

The bright line test was a way of determining whether that conflict arose.

It is not clear why the Court would suggest that the bright line rule is distinct from, rather than part of, the substantial risk principle. Further, it is hard to see how the bright line rule would be justified unless its purpose was to determine whether there was a substantial risk that the lawyer's representation would be affected. As the Court notes in *McKercher*, the fundamental

point of the conflicts jurisprudence is to ensure effective representation of clients; absent a threat to that representation, on what basis ought the lawyer to be disqualified?

It may be that in stating the law in this way — that the substantial risk principle was applied when the bright line rule was not violated — the Court did not intend to suggest that the bright line rule is unrelated to the substantial risk principle. It may be possible to argue that the bright line rule is part of the substantial risk principle, but that once the rule has not been found to be violated one considers the application of the principle more generally. That argument would be supported by the Court’s statement at paragraph 26 that the “appeal concerns the risk to effective representation”. Certainly, that interpretation would be better for the overall development of the law on conflicts of interest in Canada.

A similar point of ambiguity arises with respect to the Court’s treatment of the relationship between the lawyer’s duty of loyalty and the lawyer’s status as a fiduciary. At paragraph 25 the Court notes that the duty of loyalty relates to the ability of the lawyer to perform her fiduciary duties. In going on to set the scope of the bright line rule and the substantial risk principle, however, the Court does not make any further mention of the fiduciary obligations of the lawyer. It thus remains unclear whether the duty of loyalty and effective representation owed by the lawyer is in fact constrained by the lawyer’s fiduciary obligations, or is in some respect free standing.

A concern of the judgment arises from the comments made by the Court about the factors relevant to the determination of whether McKercher ought to be disqualified. The Court states that the only relevant consideration is the administration of justice, noting with respect to effective representation “nor is it required to avoid the risk of impaired representation. Indeed, the termination of the CN retainers that McKercher was working on ended the representation” (para 66). This statement is undoubtedly true. It seems problematic, however, to allow lawyers to avoid disqualification on the basis of impaired representation by pre-emptively abandoning their representation. Disqualification ought not to be punitive, but nor should lawyers be able to avoid consideration of the effect of the conflict on the effectiveness of their representation by breaching their obligations. In my view a more appropriate approach when assessing disqualification would be to assume that the law firm still acted for the affected client, and to consider whether that representation would have been impaired by the conflict.

Another point of note is the suggestion of the Court that law societies occupy a different regulatory sphere than the courts, and that there is no requirement that law societies have rules that follow the courts’. While technically correct, one can legitimately question whether it would be in the interests of either the profession or the public to have competing regulatory requirements with which lawyers must comply. While the courts may not have the power to dictate to law societies what their codes of conduct ought to say, any law society ought to be very cautious if adopting rules different from those articulated by the courts. As can be seen in the division between the law of confidentiality and the law of privilege, imposing different sorts of obligations on lawyers in the same area and to satisfy the same concerns of principle and policy, can create significant complexity and confusion. That complexity and confusion may be unavoidable in some cases, but it ought not to be accepted as a regulatory norm.

The last point relates to the application of *McKercher* by courts and lawyers going forward. Perhaps because of its brevity and unanimity, and the clarity of its analysis, it is tempting to see

McKercher as settling controversy on conflicts of interest. Given the Court's decision to remit the determination of the actual remedy to be given to CNR to the trial court, however, it is not obvious that this is the case.

While the Court was indeed unambiguous in its conclusion that McKercher had acted improperly — in violating the bright line rule, in dropping its CNR retainers and in failing to be candid — the lack of any conclusion about the appropriate remedy necessarily weakens the strength of those conclusions. If McKercher is not disqualified then what other remedy might CNR have? And absent some sort of remedy, then how much of a guarantee of loyalty does the bright line rule and the substantial risk principle actually create? The Court seems to suggest that the trial judge was better positioned than it to make the disqualification decision, but all of the relevant issues — the nature of the retainer, the behaviour of CNR, the effect on the class action plaintiffs if McKercher were to be disqualified, and the knowledge of McKercher about the legitimacy of its actions — were well aired in the case, and it is hard to see what further advantage a trial judge would have.

My speculation is that the Court did not make a decision on remedy because it was divided on that question, and could not achieve unanimity if it did so. If that speculation is correct, that reinforces the point that the judgment has not fundamentally determined how rigorous courts will be in preventing law firms from placing themselves in a position of conflict. Answering that question will depend not on a careful reading of *McKercher*, but on a study of how it is applied in subsequent cases. For that reason, while we know the bright line rule still applies, and we have the four factors relevant to assessing its scope, we still do not really know what it means for lawyers, their clients or the administration of justice.

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