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TransactionS

The Tennessee Journal of Business Law

A publication of
The Clayton Center for Entrepreneurial Law
of
The University of Tennessee College of Law

- Legal Clinic Expands into Business and Transactional Law
- ARTICLES

  Ethics 2000 and the Transactional Practitioner

  Combating the Costs of Doing Business: The Benefits of Implementing a Tennessee Drug-Free Workplace

  Multidiscliplinary Practices: A Proposed Solution to Effectuate the Inevitable

  Lawyers Doing Business with Their Clients: Identifying and Avoiding Legal and Ethical Dangers: A Report of the Task Force on the Independent Lawyer
- Cases and Other Items in the Areas of:

  Antitrust

  Banking

  Bankruptcy

  Conflict of Laws

  Employee Benefits

  Ethics

  Property

  Securities

  Tax

  Wills and Estates
- *Transactions*' Selection of Web Sites for Business Lawyers

Transactions: The Tennessee Journal of Business Law

A Publication of

The James L. Clayton Center for Entrepreneurial Law

of

The University of Tennessee College of Law

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Contents

NEWS & PUBLICATIONS

Faculty Notes ... 4
Legal Clinic Expands into Business and Transactional Law ... 6

ARTICLES

Carl A. Pierce, *Ethics 2000 and the Transactional Practitioner* ... 8
John R. LeBar, *Combating the Costs of Doing Business: The Benefits of Implementing a Tennessee Drug-Free Workplace* ... 26
Jon Coffin, *Multidisciplinary Practices: A Proposed Solution to Effectuate the Inevitable* ... 36
Sarah Stephens McNeal, *Lawyers Doing Business with Their Clients: Identifying and Avoiding Legal and Ethical Dangers: A Report of the Task Force on the Independent Lawyer* ... 48

BOOK REVIEW

George W. Kuney, *Bankruptcy in Practice* ... 50

SYNOPSES

Antitrust ... 52
Banking ... 52
Bankruptcy ... 54
Conflict of Laws ... 54
Employee Benefits ... 55
Ethics ... 57
Property ... 57
Securities ... 58
Tax ... 59
Wills and Estates ... 60

SPECIAL FEATURE

Transactions' Selection of Web Sites for Business Lawyers ... 62

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Complimentary copies of *Transactions* are being distributed to introduce this new journal to the legal community and, in particular, to regional business practitioners.

Transactions is published twice annually by the Clayton Center for Entrepreneurial Law at The University of Tennessee College of Law; subscriptions to *Transactions* are available at the rate of $20 per year, and include both regular issues and any special reports published during the academic year.

Faculty Notes

Prof. **Joan Heminway** was a featured panelist in two presentations at a Career Networking Conference at Brown University in Providence, R.I., on Jan. 26. The Conference was part of "Career Week 2002," a week-long series of programs for Brown students which focused on "self-assessment and career exploration while facilitating career-related connections between students and alumni." Prof. Heminway's panels were entitled "Legal Eagles" and focused on transitions to law school and careers in law. Additionally, Prof. Heminway has recently participated in several continuing legal education seminars. In October 2001 and March 2002, she participated in a continuing legal education seminar on basic legal issues impacting entrepreneurs presented by, among others, the Clayton Center for Entrepreneurial Law. In January 2002, Prof. Heminway participated in a continuing legal education program conducted at the College of Law regarding electronic research skills for transactional lawyers. On March 23, 2002, Prof. Heminway presented a lecture entitled "Federal Antitrust Law Basics: The Legal Environment of Antitrust" to students in UT's Executive MBA Program. On April 9, 2002, she conducted a CLE on entity formation issues for the Kingsport Bar Association. Prof. Heminway also recently consulted with a local law firm on employee stock option issues.

Last November, Prof. **Amy Hess** became the first Waller, Lansden, Dortch & Davis Distinguished Professor in Law. The professorship is supported by a generous endowment provided by the firm. Additionally, for the second time in her career, Prof. Hess received the Bass, Berry & Sims Award for Outstanding Service to the Bench and Bar. The first time she won this award was in 1994. This semester, Prof. Hess is a Distinguished Visiting Professor at the University of South Carolina School of Law. South Carolina has an endowment to bring in visitors every Spring. The other Distinguished Visitor this semester is Professor James J. White of the University of Michigan Law School. Prof. Hess is also currently negotiating with West Publishing Company to prepare the third edition of 4 volumes of *Bogert, The Law of Trusts and Trustees*. Bogert is an 18-volume treatise that Prof. Hess has been supplementing annually and updating since 1995. By the time this issue of *Transactions* is published, the negotiation should be completed.

Prof. **George Kuney** spoke and moderated a discussion titled "Combining Academic and Practical Training through an Entrepreneurship Program" on April 3 in Kansas City, Mo., as part of a day-long workshop regarding legal education and entrepreneurship sponsored by the Kaufman Center for Entrepreneurial Leadership. Later this year Prof. Kuney will also be participating in a panel discussion on similar topics at the annual meeting of the Southeastern Conference of the Association of Amercian Law Schools in July. His article "Bankruptcy Code Section 363(f): A Misinterpretation that Undermines the Chapter 11 Process" will be published in the June issue of *The American Bankruptcy Law Journal*. His article discussing the interplay between California's One Form of Action Rule relating to real property foreclosure and its One Action Rule relating to appellate review is being considered by a number of California journals. His article, "Fiduciary Duties of Directors and Officers of Insolvent Corporations" will be published in the Summer 2002 issue of the California Business Law Practicioner. His current scholarship focuses on methods of expediting chapter 11 reorganizations through asset sales and legislation that could improve this process. He is also serving as an editorial advisor for a treatise on small business reorganizations for CEB publications.

Prof. **Don Leatherman** just published an article at 15 *Taxation of Financial Institutions* 5 (2002) entitled "Should Notice 2001-45 Apply to Basis Shifts Within a Consolidated Group?" Prof. Leatherman is also drafting a response on behalf of the ABA to Reg. section 1.337(d)-2T. Additionally, Prof. Leatherman reports that he is completing a one- year term as Chair of the Committee on Affiliated and Related Corporations, Tax Section of the ABA and in June he will be speaking at the 18th Annual Texas Federal Tax Institute.

Prof. **Robert Lloyd** has added extensively to his commercial law tutorials available on the Internet. Links to all of the tutorials are available at www.law.utk.edu/cle/lessons.htm. He is also working on an article regarding damages for breach of contract in Tennessee. Anyone who would like a pre-publication copy of the article should e-mail him at lloyd@libra.law.utk.edu.

Prof. **Colleen Medill** was the keynote speaker at the Kansas Insurance Institute on Feb. 25 in Overland Park, Kan. The Insurance Institute is an annual regional conference for the insurance industry sponsored by the Kansas Department of Insurance. Attending the Institute were state officials and government regulators from the state insurance departments of Iowa, Kansas, Kentucky, Missouri, Nebraska, and South Dakota, as well as insurance agents, attorneys, and employee benefits consultants. Prof. Medill spoke on the recently released (Dec. 21, 2001) final recommendations of the President's Commission to Strengthen Social Security and the potential implications of Social Security reform for the insurance industry. Additionally, Prof. Medill's review of the book "ERISA Subrogation" has been published in the December 2001 issue of *the Tennessee Bar Journal*.

Prof. **Carl Pierce** has an article in the current issue of *Transactions*. It is entitled "Ethics 2000 and the Transactional Practitioner" and chronicles new developments in the ethics arena for transactional practitioners. This article is the basis for an upcoming CLE seminar produced by the College of Law in Memphis in early June.

Dean Tom Galligan reports that the College's tenured full professors have voted to recommend Prof. **Tom Plank** for promotion to the rank of full professor. Before joining the UT faculty in 1994, Prof. Plank was a partner specializing in real estate finance, commercial finance, bankruptcy, and securities with the Washington, D.C., office of Kutak Rock LLP. After law school, where he was editor-in-chief of the *Maryland Law Review*, he was a law clerk for the Chief Judge of the Maryland Court of Appeals, an associate with Piper & Marbury in Baltimore, Md., and an assistant attorney general for the State of Maryland. He has had articles published in the *Emory Law Journal*, the *American Bankruptcy Law Journal*, the *Wake Forest, Maryland, Connecticut, George Mason, Tennessee* and *American Bankruptcy Institute Law Reviews*, and the *William & Mary Bill of Rights Journal*. He is nationally recognized as an expert on mortgage backed and asset backed securities and other real estate and commercial law matters. Prof. Plank also recently made a presentation entitled "What Revised Article 9 Tells Us About the Bankruptcy Code" to the Debtor-Creditor Section at the annual meeting of the Association of American Law Schools in New Orleans. Prof. Plank noted that many bankruptcy scholars have decried Revised Article 9's expansion of secured credit, which may disadvantage unsecured creditors in bankruptcy reorganizations. Nevertheless, Prof. Plank suggested that Revised Article 9's expansion of secured credit against the bankruptcy trustee is part of a larger reaction to the current application of the bankruptcy code in ways that many in the business community see as fundamentally unfair and wasteful. In addition, he has won the 2002 Grant Gilmore Writing Award for Writing Excellence of Commercial Finance Topics, awarded by the American College of Commercial Finance Lawyers.

Prof. **Gary Pulsinelli** reports that he has enjoyed his first year at The University of Tennessee College of Law. He has spent his first year concentrating on teaching new courses, including Patent Law and Law, Science, and Technology. He will teach Intellectual Property next fall.

Prof. **Greg Stein's** chapter, "The Effect of *Palazzolo v. Rhode Island* on the Role of Reasonable Investment-Backed Expectations," was published this past February. The chapter appears in the book *Taking Sides on Takings Issues: Public and Private Perspectives* (Thomas E. Roberts, ed., ABA Publishing 2002). The chapter discusses the impact of the Supreme Court's regulatory takings case. Additionally, Prof. Stein's paper, "Takings Law and Expectations: The Supreme Court Restores '*Penn Central*,'" has been selected for presentation at the annual meeting of the Southeastern Conference of the Association of American Law Schools in July.

The Legal Clinic Expands into Business and Transactional Law

By Irmie K. Blanton III

Professors George W. Kuney and Paulette J. Williams have been working to expand the College of Law's existing legal clinic's scope of representations by adding a business law clinic course. Currently, the program has been approved by the full faculty, the Clinic Advisory Committee, and the Academic Standards Committee. The final approval needed is from the central university administration. Many of the details were fleshed out in the fall semester using the existing course offering to run selected pilot projects. Further structuring work will take place this summer as Professors Kuney and Williams prepare for one of the sections of the existing legal clinic course for the fall to pursue primarily business and transactional matters. The proposed Business Law Clinic will provide the University of Tennessee Legal Clinic with a means to better address the needs of its clients while providing its student attorneys with hands-on experience regarding business-related matters. Development of the course is a coordinated, cooperative effort between the Legal Clinic and The Clayton Center for Entrepreneurial Law.

Course Requirements & Information

As currently formulated, the course will be six credit hours. Students should expect to work approximately 20-25 hours per week, which is similar to the requirements of the existing clinic program. Class time is spent reviewing and introducing areas of substantive law and procedural law concepts, generally with a Tennessee-specific and practice-oriented perspective rather than the generalized perspective taught in traditional legal courses. The classroom component is in development, but will be modeled after the Advocacy Clinic program and will include outside speakers and will address practice issues, business matters, and substantive and procedural law.

The prerequisites for the course are Introduction to Business Transactions (or a waiver of that course for students with a business background), Business Associations, Fundamentals of Income Taxation, and Income Taxation of Business Organizations. Contract Drafting is a pre- or co-requisite. Although these prerequisite courses are drawn from the requirements for the Concentration in Business Transactions, the Business Law Clinic course is not a capstone for or even part of the Concentration; instead it provides students interested in business law in or out of the Concentration with an additional clinical education opportunity. Due to resource constraints, students who take the course are not eligible to take the regular Advocacy Clinic course.

Although 28 students expressed interest during preregistration this spring, the initial student enrollment will be limited to eight participants per semester. If additional faculty resources become available, the enrollment will be expanded. It is Professor Kuney's hope that by starting small, producing a quality educational experience for students involved, and generating success stories for the clinic's clients, additional resources may become available to expand the course. At a minimum, this incremental approach will allow the clinic and The Clayton Center for Entrepreneurial Law to focus on quality for all involved.

The Business Law Clinic will expand the kinds of representation that the clinic as a whole provides to the community and provide the students with transactional training opportunities.

Business Clinic Goals & Objectives

In formulating their proposal for the clinic, Kuney and Williams researched similar programs throughout the country. However, they did not have to look very far to find their primary model: the College of Law's Advocacy Clinic is the longest continually operated legal clinic in the country and is consistently ranked one of the top clinics in the nation.

The goal of the clinic is to provide students with actual experience as an attorney by providing opportunities for counseling clients, formulating strategy, and implementing solutions. It is the *student's* case and the *student's* client – clinic faculty serve as supervisors and resources to assist the students in representing their clients. The Business Law Clinic will expand the kinds of representation that the clinic as a whole provides to the community and provide the students with transactional training opportunities.

The Business Law Clinic will also serve as an opportunity for law students to get involved in the economic development of the community, a subject of academic

interest to Professor Williams. By providing support for the creation and success of small business operations in communities that are un- or under-served by the private bar, law students will help small businesses and start-up businesses. Clients will also include not-for-profit entities.

In developing the Business Law Clinic course, Professor Kuney has actively sought the involvement of the Knoxville Bar Association's Pro Bono Committee, chaired by attorney David Eldridge. Mr. Eldridge and attorney/alum Nick McCall have been supportive and have expressed an interest in partnering with The Clayton Center for Entrepreneurial Law and the Legal Clinic. All parties hope this partnership will allow business attorneys interested in pro bono activities to assist students and clients by leveraging existing resources to expand the number of clients and students served.

Student Work

Students will interview clients, assess legal needs, draft retention letters, develop a basic understanding of business entities and formation, and develop an understanding of basic deals such as asset purchases, leases, and simple financings. Students will be introduced to transactional checklists, timetables, and other planning tools used to efficiently complete transactional matters.

Organizations need legal assistance on a broad range of legal matters including: basic legal check-ups; choice and formation of business entity; arrangements between principals to prevent dissention and deadlock in the future; compliance with licensing and regulatory requirements; developing and implementing exit strategies; and negotiating and understanding leases for commercial space or equipment, agreements for the acquisition of real or personal property, and financing documents. Before an enterprise organizes itself as an entity and before it begins operation, its principals should be able to articulate its business plan and its vision of what the company will do or make. If a potential client does not have a business plan, students will give general advice and referrals to local sources of business assistance, such as the Pelissippi State Technical Community College's Small Business Development Center in Knoxville. The Small Business Development Center has been a source of client referrals and has partnered with The Center for Entrepreneurial Law on a number of occassions to produce seminars and publications for both the legal and lay entrepreneurial community.

Students will learn that their clients face a range of problems that are not specifically legal, but which have serious legal implications, such as whether to finance the business using debt, equity, or a combination of both. Students will also learn that many issues affect the success of a business—some legal, but many not. Students will learn to distinguish between the legal and the business issues and how the decisions regarding these issues can affect the success of the enterprise.

By the end of the semester the students will provide the client with a final letter, deliver final documents, and provide recommendations on remaining unresolved issues. The final letter addresses the matters committed to in the original retention letter, including the business' structure, operations, and the needs and goals of the owners. The level of document drafting that is required in the Business Law Clinic course will satisfy the College of Law's Planning and Drafting requirement for each student.

The key focus areas for Professors Kuney and Williams have been client and matter selection and designing an intake procedure that allows for an early go/no-go decision, a strictly delineated scope of representation, identification of who, exactly, is the client, and an effective game plan to identify the issues and tasks necessary to address and complete the representation. As Professor Williams stated: "We want the students to participate in a conscious decision-making process. The students will begin to understand which legal issues apply to an individual matter and then decide which projects to take on as a Legal Clinic attorney and how to limit the scope of representation."

Student Reactions

"I wish they had that here last year!" said student Thomas Eikenberry, a J.D./M.B.A. candidate in the Business Transactions concentration who has been working with business incubator Tech 2020 in Oak Ridge. That sums up the feelings of an entire class. Anna Paschal, a member of the Class of 2002 who will be working for Bass, Berry & Sims PLLC in Nashville after graduation, stated: "The only shortfall in the business law curriculum has been the lack of an opportunity to practice and reinforce what we learn in class. I am glad to see that future students will have that opportunity." With the approval of the course as a whole, future students will not be relegated to reflection on missed opportunities and will have the chance to participate in the Business Law Clinic themselves. We at *Transactions* wish Professors Kuney and Williams success in their efforts to expand the Legal Clinic's programs into the business arena.

Ethics 2000 and the Transactional Practitioner

By: Carl A. Pierce[1]

I. INTRODUCTION

At its mid-Winter meeting on February 5, 2002, the American Bar Association (ABA) House of Delegates (the "House") approved the report of the Ethics 2000 Commission (the "Commission"). With only three exceptions, the House approved the Commission's recommendations for changes to the ABA Model Rules of Professional Conduct.[2] With the concurrence of the Commission, the House further deferred action on the Commission's proposed amendments to Rules 5.5 (Unauthorized Practice of Law) and 8.5 (Disciplinary Authority; Choice of Law), pending receipt of the recommendations of the ABA Commission on Multijurisdictional Practice (the "MJP Commission"). This article reviews some of the changes to the Model Rules that are of special interest to transactional lawyers and those lawyers with institutional or organizational clients.

II. ORGANIZATIONAL CLIENTS

No substantive changes were made to Rule 1.13 (Organization as Client). Of note, however, was the Commission's rejection of a Reporter's proposal to amend Rule 1.13(c) to expand the remedial measures that a lawyer can take when, after admonition by the lawyer, the highest authority in the organization insists upon action or a refusal to act that is clearly a violation of law, and is likely to result in substantial injury to the organization. Rule 1.13(c) currently permits the lawyer to withdraw, but does not permit disclosure to prevent the misconduct. The Reporter's recommendation was that paragraph (c) be revised to provide that

> the lawyer may take further remedial action that the lawyer reasonably believes to be in the best interest of the organization. Such action may include revealing information otherwise protected by Rule 1.6 only if the lawyer "reasonably believes that:
>
> > (1) the highest authority in the organization has acted to further the personal or financial interests of members of that authority that are in conflict with the interest of the organization; and
> >
> > (2) revealing the information is necessary in the best interest of the organization."[3]

As explained by the Reporter, the proposal would restore to paragraph (c) language that was rejected by the House when it approved the Model Rules in 1983 and would permit disclosure outside the organization where such disclo-

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[1] Professor Pierce is an Associate Professor of Law, The University of Tennessee College of Law, and a reporter to the ABA Commission on the Evaluation of the Rules of Professional Conduct, commonly known as the Ethics 2000 Commission. The views stated here are those of the author and not the Commission.

[2] The House did not approve the Commission's proposal to amend Rule 1.5(b) to require that all fee agreements be communicated to the client in writing before or within a reasonable time after commencing the representation. Nor did the House approve a proposal to amend Rule 1.10 to allow law firms to use screening to prevent vicarious disqualification when a lawyer in private practice moves from one firm to another and is personally disqualified from representing a new client against a client the lawyer had represented while at the former firm. Finally, as discussed in greater detail below, the House rejected the Commission's proposal to amend Rule 1.6(b) to permit disclosure of information relating to a client's representation to the extent the lawyer reasonably believes necessary "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services." As a result of the House's action, the Commission withdrew its proposal to amend Rule 1.6(b) to permit disclosure to "prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services."

[3] Model Rules of Prof'l Conduct R. 1.13 (Proposed Draft Aug. 2001) *at* http://www.abanet.org/cpr/e2k-final_rules2.html.

sure was required in the best interest of the organizational client. The point is that sometimes such disclosure is required in the interest of the organization itself, without regard to the interest of those outside the organization who might be adversely affected by the misconduct. In support of his proposal, the Reporter noted that the disclosure in question would not be required, but simply permitted. He also emphasized that disclosure of confidential information would only be allowed if the highest authority in the organization was engaged in self-dealing.

During its deliberations, the Commission heard concerns about the possible civil liability of a lawyer who was permitted to disclose but failed to do so. It also was noted that in many of the cases in which disclosure would be permitted by the proposed change to Rule 1.13, disclosure would be permitted under the Commission's proposal to amend Rule 1.6(b) to permit disclosure reasonably necessary to "prevent a client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services."[4] In reply, it was noted that the proposed change calls for action to protect the organizational client, not the affected third persons, and would allow disclosure even though the lawyer's services had not been used in furtherance of the self-dealing by which the organization would be harmed.

By a close vote, the Commission rejected the Reporter's recommendation. The House of Delegates subsequently rejected the Commission's proposal to amend Rule 1.6(b). Thus, under the Revised Model Rules, disclosure beyond the organization is still *not* permitted even though necessary to prevent criminal conduct reasonably certain to cause substantial economic injury to both the organization and affected third parties. This issue may be revisited when the House reconvenes in August 2002.

Other suggestions for changes with respect to Rule 1.13 that were *not* incorporated into the Commission's report included a proposal to modify paragraph (b) to specifically require disclosure to the highest authority in the organization in cases in which prior remedial measures have been unsuccessful[5] and a proposal to extend the duty to take reasonable remedial measures within the organization to situations in which the lawyer learns that a constituent has previously committed a crime or fraud that could be imputed to the organization.[6] Finally, the Reporters and the Commission rejected a proposal to clarify how Rule 1.6 (Confidentiality) applies to communications within the organizational client. The proposal would have modified the Comment to explain that (1) the lawyer's duty to protect information given to the lawyer by an organizational constituent is a duty owed to the organizational client and not to the constituent who provided the information; (2) with respect to disclosure of such information to persons not associated with the organization, the lawyer must secure the informed consent of a duly authorized organizational constituent, who might not be the same person who provided the lawyer with the information; and (3) the lawyer must not disclose information relating to the organization's representation acquired from one constituent to other constituents unless explicitly or impliedly authorized by the organizational client in order to carry out the representation or as required by Rule 1.13(b). Ultimately, the Reporters noted that Rule 1.13 has provided a well-accepted framework for representing organizations and that they were very reluctant to open the door to tampering with a good thing.

III. <u>THE LAWYER AS INTERMEDIARY</u>

The House approved the Commission's recommendation to delete Rule 2.2 (Intermediary), a rule originally intended to recognize and legitimate a distinctive professional role—that of an impartial intermediary between clients—

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[4] *Id.* R. 1.13(c) (Proposed Draft Aug. 2001), *at* http://www.abanet.org/cpr/e2k-final_rules2.html.

[5] Richard W. Painter, *Testimony to the ABA Ethics 2000 Commission (May 13, 1998), at* http://www.abanet.org/cpr/painter.html (Last visited Apr. 16, 2002).

[6] *See, e.g.*, Tenn. Bar Assoc., Comm. for the Study of Standards of Prof'l Conduct, *Proposed Tennessee Rules of Professional Conduct* (December 3, 2001), *at* http://www.tbaorg/committees/Conduct/Exhibit-C/HTML/nefinalred-c.html (Rule 1.13(b) of the Tennessee Bar Association's Proposed Tennessee Rules of Professional Conduct requires the lawyer to take reasonable remedial measures if the lawyer knows that an officer or another person associated with the organization *has engaged* or is engaged in action, *has refused* or refuses to act, or intends to act or refrain from acting in a matter related to the representation that is or will be a violation of a legal obligation to the organization; or a violation that reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization.)

and to articulate the professional responsibilities of the lawyer who would play this role. As indicated in the Reporter's Explanation of Changes,

> The Commission is convinced that neither the concept of "intermediation" (as distinct from either "representation" or "mediation") nor the relationship between Rules 2.2 and 1.7 has been well understood. Prior to the adoption of the Model Rules, there was more resistance to the idea of lawyers helping multiple clients to resolve their differences through common representation; thus, the original idea behind Rule 2.2 was to permit common representation when the circumstances were such that the potential benefits for the clients outweighed the potential risks. Rule 2.2, however, contains some limitations not present in Rule 1.7; for example, a flat prohibition on a lawyer continuing to represent one client and not the other if intermediation fails, even if neither client objects. As a result, lawyers not wishing to be bound by such limitations may choose to consider the representation as falling under Rule 1.7 rather than Rule 2.2, and there is nothing in the Rules themselves that clearly dictates a contrary result.[7]

Rather than fix Rule 2.2 and clarify its relationship to Rule 1.7, which governs representations affected by a conflict of interest, the Commission chose to delete Rule 2.2 and to incorporate parts of its Comment into the Comment to Rule 1.7. While the full implications of this change remain to be determined, it seems fair to say that what Rule 2.2 recognized, legitimated, and attempted to regulate as a distinctive non-partisan professional role commonly played by transactional lawyers has once again been relegated to the status of a "representation affected by a conflict of interest between currently represented clients."[8] This action seems like a step backward rather than forward, and it remains to be seen whether the states that have adopted Rule 2.2 will follow the ABA lead and drop it from their Rules.

IV. LAWYER RENDERING THIRD PARTY LEGAL OPINIONS

As recommended by the Commission and approved by the House of Delegates, Rule 2.3 (Evaluation for Use by Third Persons) provides:

> (1) A lawyer may provide an evaluation of a matter affecting a client for the use of someone other than the client if the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client.
>
> (2) When the lawyer knows or reasonably should know that the evaluation is likely to affect the client's interests materially and adversely, the lawyer shall not provide the evaluation unless the client gives informed consent.
>
> (3) Except as disclosure is authorized in connection with a report of an evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.[9]

Paragraphs (b) and (c) now clarify the relationship between Rule 2.3 and the lawyer's confidentiality obligations under Rule 1.6. The key point is that information relating to an evaluation is fully protected by Rule 1.6 and may be disclosed only if the client consents or the disclosure is impliedly authorized to carry out the representation. A new Comment [5] explains:

> In many situations, providing an evaluation to a third party poses no significant risk to the client; thus, the lawyer may be impliedly authorized to disclose information to carry out the representation. See Rule 1.6(a). Where, however, it is reasonably likely that providing the evaluation will affect the client's interests materially and adversely, the lawyer must first obtain the client's consent after the client has been adequately informed concerning the important possible effects on the client's interests. See Rules 1.6(a) and 1.0(e).[10]

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[7] Model Rules of Prof'l Conduct R. 2.2 (2001) (amended 2002) (reporter's explanation of changes), *available at* http://www.abanet.org/e2k-202report_passed.doc.

[8] For further discussion, *see* Carl A. Pierce, *ABA Model Rule 2.2: Once Applauded and Widely Adopted, Then Criticized, Ignored or Evaded, Now Sentenced to Death with Few Mourners, But Not in Tennessee*, 2 Tenn. J. Bus. L. 9 (2000).

[9] Model Rules of Prof'l Conduct R. 2.3.

[10] *Id.* R. 2.3 cmt. [5].

V. THE LAWYER AS DIRECTOR

The House approved a change to the Comment to Rule 1.7 that discusses the conflict of interests that might arise because a lawyer is a member of the governing board of an organizational client. As renumbered and revised, Comment [35] reads:

> A lawyer for a corporation or other organization who is also a member of its board of directors should determine whether the responsibilities of the two roles may conflict. The lawyer may be called on to advise the corporation in matters involving actions of the directors. Consideration should be given to the frequency with which such situations may arise, the potential intensity of the conflict, the effect of the lawyer's resignation from the board and the possibility of the corporation's obtaining legal advice from another lawyer in such situations. If there is material risk that the dual role will compromise the lawyer's independence of professional judgment, the lawyer should not serve as a director or should cease to act as the corporation's lawyer when conflicts of interest arise. The lawyer should advise the other members of the board that in some circumstances matters discussed at board meetings while the lawyer is present in the capacity of director might not be protected by the attorney-client privilege and that conflict of interest considerations might require the lawyer's recusal as a director or might require the lawyer and the lawyer's firm to decline representation of the corporation in a matter.[11]

As originally approved in 1983, the Comment suggested that conflicts should be resolved by the lawyer's resignation as a member of the governing board. As revised, the Comment acknowledges that the conflict might also be resolved by the lawyer's withdrawal as the organization's lawyer with respect to the matter that presented the conflict of interest. The Comment's last sentence is new and identifies two important implications of the lawyer's service on the board that the lawyer should discuss with the other members of the board.[12]

VI. CONFLICTS ARISING FROM LAWYER'S FINANCIAL INTEREST

The House approved a relaxation of the vicarious disqualification rule in cases of "personal interest conflicts," such as might arise if a lawyer representing a client in a business transaction has a financial interest in the other party to the transaction. Such conflicts can also result from a lawyer's ownership of shares in a client company. Previously, if a lawyer in a law firm had such a conflict, it was automatically imputed to all other lawyers in the firm by Rule 1.10(a). Rule 1.10(a), however, has now been amended so that personal interest conflicts will only be imputed to other lawyers in the firm if the personal interest of the lawyer disqualified by Rule 1.7 presents "a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm."[13] A new Comment [3] explains:

> The rule in paragraph (a) does not prohibit representation where neither questions of client loyalty nor protection of confidential information are presented. Where one lawyer in a firm could not effectively represent a given client because of strong political beliefs, for example, but that lawyer will do no work on the case and the personal beliefs of the lawyer will not materially limit the representation by others in the firm, the firm should not be disqualified. On the other hand, if an opposing party in a case were owned by a lawyer in the law firm, and others in the firm would be materially limited in pursuing the matter because of loyalty to that lawyer, the personal disqualification of the lawyer would be imputed to all others in the firm.[14]

Although this Comment might be read to suggest that most personal interest conflicts of a financial sort will be imputed to the firm, it really does no more than state the proposition that if one lawyer's ownership interest will

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[11] *Id.* R. 1.7 cmt. [35].

[12] *See also* ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 98-410 (1998) (discussing a lawyer serving as director of a client corporation); ABA Comm. on Bus. Law, *The Lawyer as Director of a Client*, 57 Bus. Law 387 (2000).

[13] Model Rules of Prof'l Conduct R. 1.10(a).

[14] *Id.* R.. 1.10 cmt. [3].

materially limit the representation of the client by other lawyers in the firm, then the conflict will be imputed to them. It provides no guidance about which financial conflicts will be imputed, taking into account the extent of the personally disqualified lawyer's financial stake, the relationship in the firm between the personally disqualified lawyer and the lawyers who will handle the matter, or whether the matter in issue is a lawsuit or a business transaction. Whether this change will make a major difference in the resolution of conflicts arising from lawyers having financial interests in either their clients or those with whom their clients do business remains to be determined by a case-by-case application of this completely new approach to vicarious disqualification.

VII. CONFIDENTIALITY

The House approved the Commission's proposal to amend Rule 1.6(b)(1) to permit a lawyer to disclose information relating to a client's representation to the extent reasonably necessary to prevent reasonably certain death or substantial bodily harm. No longer must the death or bodily injury be imminent or the result of a client crime. For business and transactional practitioners, this change is likely to have its greatest effect with respect to product safety and discharge of hazardous materials. As explained in Comment [6]:

> Paragraph (b)(1) recognizes the overriding value of life and physical integrity and permits disclosure reasonably necessary to prevent reasonably certain death or substantial bodily harm. Such harm is reasonably certain to occur if it will be suffered imminently or if there is a present and substantial threat that a person will suffer such harm at a later date if the lawyer fails to take action necessary to eliminate the threat. Thus, a lawyer who knows that a client has accidentally discharged toxic waste into a town's water supply may reveal this information to the authorities if there is a present and substantial risk that a person who drinks the water will contract a life-threatening or debilitating disease and the lawyer's disclosure is necessary to eliminate the threat or reduce the number of victims.[15]

The Commission, however, was unable to persuade the House to approve its proposal to add a paragraph to Rule 1.6(b) that would permit disclosure "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services."[16] As explained by the Commission, such a serious abuse of the client-lawyer relationship by the client forfeits the protection of Rule 1.6. The client can also prevent the disclosure by refraining from the wrongful conduct. The opponents of the Commission's proposal emphasized the overriding importance of confidentiality and voiced concern about the potential liability of a lawyer who was permitted by the ethics rules to disclose a crime or fraud but chose not to make the disclosure. Notwithstanding that only ten jurisdictions preclude all disclosure to prevent economic loss,[17] the nays prevailed. In light of this action, the Commission then withdrew its related proposal to permit disclosure to prevent, mitigate, or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.[18]

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[15] *Id.* R. 1.6 cmt. [6].

[16] *Id.* R. 1.6(b)(2) (Proposed Draft Aug. 2001) *at* http://www.abanet.org/cpr/e2k-final_rules2.html.

[17] Alabama, California, Delaware, District of Columbia, Kentucky, Louisiana, Missouri, Montana, Rhode Island, and South Dakota. Of the remaining forty-one jurisdictions, thirty-seven permit and four require disclosure to prevent a client from committing a crime or perpetrating a fraud that contributes to a crime. Of these, nine permit and two require disclosure to prevent the client from perpetrating a non-criminal fraud likely to result in substantial injury to financial interests or property of another. Twenty jurisdictions permit or require disclosure without regard to the magnitude of loss to the affected person. Only two jurisdictions limit disclosure to situations in which the client has used or is using the lawyer's services. In most jurisdictions, then, the Commission's proposal affords more protection to confidentiality than the rules currently in force. *See* Ethics 2000 Commission, *Comparison of Proposed Rules 1.6(b)(2) and (3) with Current State Ethics Rules*, on file with author.

[18] Sixteen jurisdictions currently permit or require disclosure to rectify substantial financial loss resulting from a client's commission of a crime or fraud in which the client used the lawyer's services. With regard to mitigation and rectification, then, the Commission's proposal affords less protection to confidentiality than the rules currently in force in most states. *Id.*

The Commission chose not to press for reconsideration, even as new concerns about lawyer silence in the face of client crimes or fraud were being voiced in the aftermath of the Enron bankruptcy. By way of a conforming amendment intended to preserve the Model Rule status quo, however, the House approved the reinsertion of the Model Rule Comment that categorically asserts that Rule 1.6 does not prevent a "noisy withdrawal" from a representation (*i.e*, informing third parties that the lawyer has withdrawn from the client's representation or withdrawing or disaffirming any opinion, document, affirmation, or the like). This reference to "noisy withdrawal" had been deleted from the Comment because it was not necessary given the Commission's proposal to allow the lawyer to more fully reveal the client's crime or fraud. The rejection of the Commission's proposal, however, made it necessary to once again assert that "noisy withdrawal" is not prohibited by Rule 1.6. In some cases, the allowable noise may be enough to prevent the fraud, but if not, at least it should decrease the likelihood that the client will be able to use the lawyer's representation or work-product in furtherance of the crime or fraud.[19]

Finally, the House of Delegates approved the Commission's recommendation that Rule 1.6(b) be modified to permit disclosure to the extent reasonably necessary for the lawyer to secure legal advice about the lawyer's compliance with the Rules of Professional Conduct or to comply with other law requiring disclosure. This latter exception should permit disclosures of a client's crime or fraud if, under applicable substantive law, the lawyer's silence would constitute aiding and abetting the client's crime or fraud.

VIII. CONFLICTS BETWEEN CURRENT CLIENTS IN UNRELATED BUSINESS TRANSACTIONS

For the most part, the changes to Rule 1.7 (Conflict of Interest: Current Clients) were intended to clarify, rather than change, the lawyer's responsibility in connection with a representation involving a concurrent conflict of interest. Such a conflict exists if the representation of one client is directly adverse to another client or 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. Faced with such a conflict in connection with transactional matters, the lawyer may only undertake the representation if the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client and each affected client gives *informed consent, confirmed in writing*. The requirement for confirmation in writing is new. The required writing, however, need not be signed by the client, but may consist of a writing sent by the lawyer to the client confirming an oral informed consent. There are also several new Comments of special interest to lawyers who represent organizational clients in transactional matters.

A. Directly Adverse Representation in Transactional Matters

Representation of a client that is directly adverse to another client is a representation affected by a conflict of interest. *That the matters in which the clients are represented are wholly unrelated does not matter.* The rationale for treating directly adverse representation as a conflict of interest is explained in a new Comment [6]:

> The client as to whom the representation is directly adverse is likely to feel betrayed, and the resulting damage to the client-lawyer relationship is likely to impair the lawyer's ability to represent the client effectively. In addition, the client on whose behalf the adverse representation is undertaken reasonably may fear that the lawyer will pursue that client's case less effectively out of deference to the other client, *i.e.*, that the representation may be materially limited by the lawyer's interest in retaining the current client.[20]

This conflict of interest principle has typically been analyzed in relation to a lawyer who is representing a client in a lawsuit and who is asked by another client to file suit against the first client with respect to an unrelated matter. Given the nature of litigation, it is quite easy to characterize suing one's client as taking action adverse to the client, and to postulate that suing one's client—even in an unrelated matter—is likely to impair the client-attorney relation-

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[19] For a useful discussion of the implications of this Comment, *see* ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 92-366 (1992).

[20] Model Rules of Prof'l Conduct R. 1.7 cmt. [6].

ship to an extent that it might actually impair the effectiveness of the lawyer's representation. Much less, however, has been said about the situation in which a lawyer who is representing a client in a business transaction is asked to undertake the representation of another client in a wholly unrelated business transaction to which the first client will be a party. Should this be treated as a representation directly adverse to the first client?

We now at least have a partial answer, as the House approved the Commission's recommendation to add a new Comment [7], explaining that:

> Directly adverse conflicts can also arise in transactional matters. For example, if a lawyer is asked to represent the seller of a business in negotiations with a buyer represented by the lawyer, not in the same transaction but in another, unrelated matter, the lawyer could not undertake the representation without the informed consent of each client.[21]

Although a full analysis of the implications of this new Comment [7] is beyond of the scope of this article, it bears emphasis that, for the purposes of identifying representations that are directly adverse to a client, this Comment equates the representation of buyers or sellers in buy-sale transactions with the representation of plaintiffs or defendants in lawsuits. This equation must be premised either on the assumption that there is the same amount of adversity in buy-sell transactions as in litigation, or at least sufficient adversity that the client will feel so betrayed that the client-attorney relationship will be so impaired that the lawyer will not be able to effectively represent the client. Given that there are significant differences between lawsuits and business transactions, not to mention between various kinds business transactions, such as the formation of a partnership or corporation as distinct from a buy-sell transaction, this bold equation of lawsuits and business transactions is at least thought-provoking and perhaps even a bit troubling.

One set of questions arise because the Reporter's explanation states that the new Comment [7] explains that directly adverse conflicts may arise in some transactional matters. If not all transactional matters, then which ones? This is important because if a transactional representation is not directly adverse to the client, no conflict of interest arises unless there is a significant risk that the representation will be materially limited by the lawyer's responsibilities to the other client. If, on the other hand, a transactional representation is deemed directly adverse to the client, it does not matter whether there is a significant risk that the representation will be materially limited. Here, a *per se* conflict of interest exists and, unlike personal interest conflicts, Rule 1.10(a) automatically imputes a direct adversity conflict to all lawyers associated in a law firm. Assuming that it is unlikely that representation in an unrelated transaction will materially limit the lawyer's representation in the other matter being handled for the client, then, this Comment makes a world of difference.

Which transactional representations, then, will be deemed to be directly adverse to another client who is party to the transaction? One answer, of course, would be all representations, but the Reporter's explanation indicates that was not the intention. The example in the Comment is that of the lawyer representing a buyer in one transaction being asked to represent a seller in an unrelated transaction. But what if the first client was being represented by the lawyer in connection with the formation of a partnership and the second client asked the lawyer to represent her in connection with the formation of an unrelated partnership in which the first client would be one of the partners? Is this a directly adverse representation or does it give rise to a conflict of interest only if the representation of the second client in the partnership deal will materially limit the representation of the client in the unrelated partnership deal? Clearly, the lawyer's representation of the second client will directly affect the first client. But is it correct to characterize the representation as adverse? Surely, it is not adverse in the way filing a lawsuit is adverse. There, the goal is to defeat the opponent. Even relative to buy-sell transactions, one can reasonably argue that there is a greater commonality of interest among prospective partners than between buyer and seller and, therefore, a less adversarial relationship between the prospective partners than would be expected between buyers and sellers. The less adversarial the relationship is, the less likely it is that the lawyer's client in the first transaction will feel betrayed by the lawyer's role on behalf of the client in the second, unrelated transaction. Since it is doubtful that reasonable clients would

[21] *Id.* R. 1.7 cmt. [7].

feel betrayed if the lawyer who was representing them in an unrelated transaction represented another person in connection with the formation of a business in which the client was asked to invest, the second representation should not be characterized as an adverse representation, even if representing a buyer would be considered adverse to the seller.

This, of course, leads to the bigger question raised by the new Comment [7]: Whether the prohibition against directly adverse representation should ever be applied to transactional matters—even the buy-sell transactions used as the example in Comment [7]—in which the opposing parties are seeking each others' consent to a transaction from which both expect to benefit? The key point is that, although parties to transactions may have differing interests and may even have disagreements to resolve, business transactions are typically less adversarial than lawsuits. Acting as a lawyer on behalf of the other party in a transaction with a client is often quite different than acting as a lawyer against one client's in an unrelated lawsuit. The question is whether, or to what extent, a client represented in a business transaction would feel betrayed if the lawyer represents someone else with whom the client is dealing in a completely unrelated transaction. It does not seem reasonable to assume that a client will be as troubled if her lawyer helps someone to dance with her at a different party as she would be if the lawyer were trying to beat her to a pulp in a different ring.[22]

This is not to suggest that the conflict of interest rule should never apply to the simultaneous representation of clients in unrelated transactions. In some transactions there might be sufficient adversity of interest and adversarial attitude to warrant thinking of the transactions as if they were lawsuits.[23] My sense, however, is that this would be the exception, not the rule. Rather than assuming this to be the rule, as does Comment [7], maybe it would have been better to say nothing. Then, the issue could be resolved by asking in each case, with reference to the realities of the business world, whether a representation in an unrelated transaction should be regarded as adverse to the client.[24] That approach would also permit differentiation between types of business transactions—such as the formation of a ongoing business relationship as distinct from the purchase-sale transaction used as the example in Comment [7].

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[22] This issue was addressed in a comment submitted to the Commission by William J. Wernz, an ethics counsel at Dorsey & Whitney, LLP. William J. Wernz, *Memorandum to the ABA Ethics 2000 Commission* (May 17, 1999), *at* http://www.abanet.org/cpr/wwernz.html (last visited Apr. 16, 2002). Mr. Wernz also based his comments on his eleven years as disciplinary counsel in Minnesota, during seven of which he was Chief Disciplinary Counsel. *Id.* With reference to the example used in the new Comment, Mr Wernz indicated that the incidence of "real" conflicts is "very low." *Id.* He therefore urged the Commission to clarify that the typical transactional representation directly adverse to a client in an unrelated matter would not automatically be treated as a conflict of interest. *Id.* Rather, in recognition that "occasionally" there might be a "real conflict" where the adverse transactional representation in the unrelated matter actually presented a significant risk that the lawyer's representation in the other matters being handled for the client, Wernz proposed that a directly adverse representation in an unrelated non-litigation matter be treated as a conflict of interest only if "there is a significant risk that the lawyer's professional relationship with one or both clients will be adversely affected by the representation." *Id.* With Comment [7], however, the Commission took a contrary view and clarified that a directly adverse representation in an unrelated business transaction is a representation involving a concurrent conflict of interest. *Id.*

[23] *Id.* In his comment to the Commission, Mr. Wernz offered two examples of what he thought would be a real conflict. *Id.* Assuming that a lawyer is representing a landlord in negotiation with a tenant and then is asked by the tenant to represent the tenant in an unrelated transactional matter. *Id.* Mr. Wernz conceded the possibility of a real directly adverse conflict that would significantly affect the lawyer's relationship with the landlord if either had significant animosity between the other, or if the representation of the tenant would be more valuable to the lawyer than the representation of the landlord. *Id.*

[24] *Id.* Instead of asking whether the representation was adverse, Mr. Wernz would revise the rule to provide that a conflict of interest exists if "in a non-litigation matter the lawyer represents only one client but another party to the matter is also the lawyer's client in another matter and there is a significant risk that the lawyer's professional relationship with one or both clients will be adversely affected." *Id.* Another possible alternative to the Commission's approach would be to limit the directly adverse conflict to litigation matters, so that in transactional matters the test would be whether there was a significant risk that the lawyer's representation of one or both of the clients will be materially limited by the representation of the other. *See id.* Yet another approach would be to treat a directly adverse representation in an unrelated transaction as a conflict interest, but to relax the vicarious disqualification rule for such conflicts as the Commission did with respect to personal interest conflicts - i.e., vicarious disqualification only if the representation by the other lawyers in the firm presented a significant risk of materially limiting the representation of the other client. *See id.* Although an analysis of all the nuances of these various approaches is beyond the scope this Comment, the point is that the Commission's approach needs to be evaluated with an awareness of the roads not taken as well as the road that was taken. *See id.*

One other aspect of this new Comment [7] should be considered. To this point, the discussion has focused on the client who is being represented by a lawyer who would undertake a representation on behalf of another client that is directly adverse to the first client. That would be the buyer in Comment [7], and, as explained in Comment [6], the concern is that the client may feel betrayed by his lawyer taking sides against him, even though it is in a transaction that bears no relationship to the matter in which the lawyer is representing him. Comment [7], however, also asserts that the seller would have to give informed consent to the lawyer's representation of the seller in its negotiations with the buyer who is represented by the lawyer in the unrelated matter. Comment [6] explains that this conclusion is based on the assumption that "the client on whose behalf the adverse representation is undertaken reasonably may fear that the lawyer will pursue that client's case less effectively out of deference to the other client, *i.e.*, that the representation may be materially limited by the lawyer's interest in retaining the current client."[25] The key point is that the lawyer is not representing any interests adverse to the seller. Thus, the lawyer must secure the informed consent of the seller to the lawyer's representation of the buyer only if there is a significant likelihood that the seller's representation will be materially limited by lawyer's responsibilities to the buyer. The problem is that it seems too much to conclude, as Comment [7] suggests, that whenever a lawyer represents a seller in a business transaction with a buyer the lawyer is representing in another unrelated transaction, there is a significant likelihood that the lawyer will so defer to her other client that the representation of the seller will be materially limited. In some situations this may occur, but surely not often enough to warrant the categorical assertion in Comment [7]. Hopefully Comment [7] will be read with regard to Comment [6]'s more tentative statement that the representation of the client on whose behalf the adverse representation is taken "may" be materially limited by the lawyer's interest in retaining the adverse party as a client.

B. Representing Interests Adverse to an Organizational Client's Affiliates

The House also approved the addition of a Comment that explains how Rule 1.7 applies when a lawyer represents an interest directly adverse to an affiliate of an organizational client. Comment [34] provides:

> A lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary. *See* Rule 1.13(a). Thus, the lawyer for an organization is not barred from accepting representation adverse to an affiliate in an unrelated matter, unless the circumstances are such that the affiliate should also be considered a client of the lawyer, there is an understanding between the lawyer and the organizational client that the lawyer will avoid representation adverse to the client's affiliates, or the lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client.[26]

This Comment endorses the position taken by the ABA Standing Committee on Ethics and Professional Responsibility that a lawyer who represents an organization does not, by the mere fact of such a representation, represent the organization's affiliates.[27] Thus, the lawyer does not represent an interest directly adverse to the lawyer's client if the lawyer represents a person in a transaction with or a lawsuit against an affiliate, such as a parent, a subsidiary, or a commonly-owned corporation. Only if the representation of the client would be materially limited by the representation adverse to the affiliate would there be a conflict of interest, and this would rarely, if ever, be the case if the matters were unrelated. Thus, absent an agreement or understanding between the lawyer and the organizational client, Rule 1.7 does not prohibit a representation of interests directly adverse to an affiliate of the client in an unrelated matter.

This proposal prompted a dissent by Larry Fox, a member of the Commission who, as a member of the Standing Committee on Ethics and Professional Responsibility, had dissented from the opinion in question. In his Ethics 2000 dissent and in support of a motion in the House to delete Comment [34], Fox argued that the ethics opinion has been criticized by the corporate community because of the view that any loss within a corporate family injures, and

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[25] Model Rules of Prof'l Conduct R. 1.7 cmt. [6].

[26] R. 1.7 cmt. [34].

[27] ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 95-390 (1995) (discussing conflicts of interest in the corporate family context).

therefore is directly adverse to, the enterprise as whole. Fox also voiced his concern that although large, sophisticated clients have figured out how to protect themselves from such adverse representation, smaller, less sophisticated enterprises would be disadvantaged by this exception to the rules of loyalty. The motion to delete failed.

C. Conflicts Arising From Changes in Organizational Affiliations

The House also approved the addition of a new Comment [5] that explains a lawyer's responsibilities when, in the midst of a representation, a conflict arises because of unforeseeable changes in corporate or other organizational affiliations. The new Comment reads:

> Unforeseeable developments, such as changes in corporate and other organizational affiliations or the addition or realignment of parties in litigation, might create conflicts in the midst of a representation, as when a company sued by the lawyer on behalf of one client is bought by another client represented by the lawyer in an unrelated matter. In these circumstances, the lawyer may withdraw from one of the representations in order to avoid the conflict. The lawyer must seek court approval where necessary and take steps to minimize harm to the clients. *See* Rule 1.16. The lawyer must continue to protect the confidences of the client from whose representation the lawyer has withdrawn. *See* Rule 1.9(c).[28]

This Comment embraces the view taken by some courts that, in certain situations in which a conflict of interest is thrust upon the lawyer by a client's conduct, it is unreasonable to require the lawyer to withdraw from representing both clients and that the lawyer should be permitted to withdraw from one of the two representations in order to avoid the conflict and to continue to represent the other client. Ordinarily, such withdrawal is not permitted under what has become known as the "hot potato" doctrine.

Although the new Comment [5] uses litigation matters in its example, it would also apply when a lawyer is representing Company A as the buyer in a sale of goods to Company B and also is representing Company C as the seller in a sale of goods to Company D. If Company C purchases Company B, the lawyer ends up representing Company A as the buyer in the transaction with Company C while simultaneously representing Company C as the seller in its transaction with Company D. With respect to Company C, who the lawyer still represents in the transaction with Company D, there is a directly adverse conflict because Company C may feel betrayed by the lawyer's representation of Company A, which is now dealing with Company C. Company A, on the other hand, may fear that the lawyer will materially limit its representation out of deference to Company C. Assuming that both representations are affected by a conflict of interest, the lawyer cannot represent both unless each consents. Absent consent, the "hot potato rule" precluded the lawyer from dropping one in order to represent the other. Not being allowed to represent both or to drop one and represent the other, the lawyer was left with no choice but to withdraw from both representations. When this situation is "thrust-upon" the lawyer by unforeseeable changes in organizational affiliations, however, Comment [5] now tells the lawyer faced with such a conflict that she can resolve it by dropping one of the clients. It also admonishes the lawyer to "take steps to minimize harm to the clients" in compliance with Rule 1.16 and "continue to protect the confidences of the client from whose representation the lawyer has withdrawn" in compliance with Rule 1.9(c).

Care must be taken to understand the limits of this Comment. Although the Comment's very broad reference to "changes in corporate and other organizational affiliations . . . [that] might create conflicts in the midst of a representation" suggests that all conflicts thrust upon a lawyer can be resolved by dropping one of the clients, it offers as an example the specific situation in which a company being sued by the lawyer on behalf of one client is bought by another client represented by the lawyer in an unrelated matter.[29] What results is a directly adverse conflict in which the lawyer is suing a client that he is representing in an unrelated matter. The fact that the matters are unrelated is a critically important limitation because dropping one client won't work if the matters are substantially related within the special meaning of Rule 1.9(a). This is because the client that the lawyer dropped could, as a former client, object to the continued representation of the other client on the ground that such continued representation was materially adverse to it in a substantially related matter.

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[28] Model Rules of Prof'l Conduct R. 1.7 cmt. [5].

[29] *Id.*

For both the lawyer and the clients faced with this situation, the key question is which of the two clients will be dropped. On this point, the Comment is unclear. It states that "[t]he lawyer must . . . take steps to minimize harm to the clients," which could be read to mean that the lawyer must drop the client which will be least disadvantaged by the lawyer's withdrawal.[30] But this is immediately followed by a cross-reference to Rule 1.16, which suggests that the admonition speaks only to what the lawyer must do to protect whichever client the lawyer chooses to drop.

Given free choice, the lawyer might simply drop the least valuable client. But maybe the client to be dropped should be the client that will suffer least from the loss of their counsel, without regard to the importance of the client to the lawyer. Or, perhaps, the lawyer should be required to withdraw from the representation of the client whose acquisition gave rise to the conflict. Or, if one of the clients objects and the other consents, perhaps the lawyer should be required to drop the client who objects. While resolution of this issue will have to wait for another day, one has to at least question whether a lawyer should be allowed to drop the least valuable client subject only to a duty to act reasonably to minimize the adverse affect on that client.

One additional point should be made about the reference in new Comment [5] to one client buying another. A corporation can buy another in many different ways. Purchase by merger or consolidation in which the two corporations legally become one indeed gives rise to the directly adverse conflict addressed by the Comment. If, on the other hand, the purchase was consummated by a triangular merger, a share exchange, a sale of assets, or any other mechanism by which the purchased company remains or becomes part of a separate entity that is affiliated with of the purchasing company, the result would be a representation by the lawyer of interests directly adverse to an affiliate of the client, rather than the client itself. In such a case, a conflict of interest may not arise because, as explained in new Comment [34], "[a] lawyer for an organization is not barred from accepting representation adverse to an affiliate in an unrelated matter, unless the circumstances are such that the affiliate should also be considered a client of the lawyer or there is an understanding between the lawyer and the organizational client that the lawyer will avoid representation adverse to the client's affiliates or the lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client." If the transactional matters are unrelated, however, it is unlikely that either representation would be materially limited by the other. Thus, the lawyer does not face the choice of which client to drop.

D. Advance Consents to Conflicts in Unrelated Transactional Matters

Some uncertainty may remain about the situations in which a lawyer must secure the informed consent of both clients in cases in which the representation of one is directly adverse to the other in a unrelated transaction. Lawyers and clients might decide to eliminate this uncertainty by agreeing in advance either: (1) that the lawyer will not undertake such a representation absent the client's informed consent; or (2) that the client will give an advance consent to any such conflicts as might arise during the course of the lawyer's representation. Indeed, if a client is not upset by the prospect that its lawyer might represent someone else in another, unrelated transaction to which it might be a party, why not give the informed consent at the outset of the representation? The question, of course, is whether this advance consent will be effective when the lawyer later undertakes a representation directly adverse to the client in an unrelated matter. With respect to this issue, the House approved the Commission's recommendation to add a new Comment [22] that discusses the effectiveness of a client's advance consent to a conflict of interests. It provides:

> Whether a lawyer may properly request a client to waive conflicts that might arise in the future is subject to the test of paragraph (b). The effectiveness of such waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. The more comprehensive the explanation of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the requisite understanding. Thus, if the client agrees to consent to a particular type of conflict with which the client is already familiar, then the consent ordinarily will be effective with regard to that type of

[30] *Id.*

> conflict. If the consent is general and open-ended, then the consent ordinarily will be ineffective, because it is not reasonably likely that the client will have understood the material risks involved. On the other hand, if the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, such consent is more likely to be effective, particularly if, e.g., the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation. In any case, advance consent cannot be effective if the circumstances that materialize in the future are such as would make the conflict nonconsentable under paragraph (b).[31]

The key point is that a direct adversity conflict in an unrelated matter is specifically identified as a type of conflict with respect to which an advance consent will be upheld, at least if the client is an experienced user of legal services and is represented by counsel. This will typically be the case when in-house lawyers retain outside counsel who will represent the organization in a transaction, and the outside counsel requests an advance waiver of direct adversity conflicts in unrelated transactions. Similarly, an organizational client might be willing to give an advance consent to its lawyer representing interests adverse to a subsidiary in a transaction that is not related to the lawyer's representation of the parent organization. These clients might not be as tolerant of directly adverse litigation, even in unrelated matters, and refuse to give an advance consent to such conflicts. Or with respect to transactional matters, the client might be unwilling to give advance consent to a directly adverse representation by the lawyer who is representing it, but would be willing to give advance consent to such a representation by other lawyers in the firm. Comment [27] provides, however, a framework for determining the validity of an advance consent and provides some assurance to transactional lawyers that an advance consent to direct adversity conflicts in unrelated transactions will be respected.[32]

IX. BUSINESS TRANSACTIONS WITH CLIENTS

The House approved the Commission's recommendation to revise Rule 1.8(a) and substantially expand the Rule's Comment. The House also added a new paragraph (k) that provides that the prohibition in Rule 1.8 (a) applies to all lawyers associated in a law firm if it applies to any of the lawyers associated in the firm. Rule 1.8(a), as revised, provides that

> A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:
>
> (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
>
> (2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
>
> (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.[33]

The changes in Rule 1.8(a) afford the client greater protection by requiring the lawyer to advise the client in writing of the desirability of seeking advice from independent legal counsel. If the client chooses not to do so, the lawyer must secure the client's informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role therein, with particular attention to whether the lawyer will be representing the client in the transaction. The requirement that the client's consent be in a writing signed by the client is more stringent than the

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[31] *Id.* R. 1.7 cmt. [22].

[32] *See also* ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 93-372 (1993) (discussing waiver of future conflicts of interest) (1993).

[33] Model Rules of Prof'l Conduct R. 1.8.

requirement that the client's consent to a representation affected by a conflict of interest be confirmed in writing. The addition of Rule 1.8(k) greatly broadens the applicability of Rule 1.8(a). If one lawyer in the firm is representing a client, no other lawyer in the firm can enter into a business transaction with that client without complying with Rule 1.8(a), regardless of whether they are participating in the representation.

New material in Comment [1] usefully emphasizes that the requirements of Rule 1.8(a) must be met even when the transaction is not closely related to the subject matter of the representation, as when a lawyer drafting a will for a client learns that the client needs money for unrelated expenses and offers to make a loan to the client. Indeed, Rule 1.8(a) applies even if the transaction is totally unrelated to the representation. Furthermore, it does not matter if it is the client who initiates the transaction. The Comment also usefully clarifies that Rule 1.8(a) does not apply to ordinary fee arrangements between client and lawyer, which are governed by Rule 1.5, but that it is applicable when the lawyer accepts an interest in the client's business or other property as payment of all or part of a fee.

A new Comment [3] explains the relationship between Rule 1.8(a) and Rule 1.7, which applies whenever the lawyer undertakes to represent the client in the transaction to which the lawyer will be a party. As explained in the Comment,

> the lawyer must disclose the risks associated with the lawyer's dual role as both legal adviser and participant in the transaction, such as the risk that the lawyer will structure the transaction or give legal advice in a way that favors the lawyer's interests at the expense of the client. Moreover, the lawyer must obtain the client's informed consent. In some cases, the lawyer's interest may be such that Rule 1.7 will preclude the lawyer from seeking the client's consent to the transaction.[34]

Thus, Rule 1.7 could preclude the lawyer from seeking the client's consent even though the lawyer had satisfied all the stringent requirements of Rule 1.8(a). This leads to a question not addressed by the Comment: Is it possible in such a situation for the client to be represented by another lawyer in the lawyer-party's firm? That lawyer must, of course, comply with Rule 1.8(a). However, because, the lawyer who is the party to the deal has a personal interest conflict, her Rule 1.7 disqualification will only be imputed to her partners or associates under revised Rule 1.10(a) if her interest in the transaction presents a significant risk of materially limiting the representation of the client by the lawyer who would handle the representation. This might not be the case where, for example, the lawyer-party was an associate and the lawyer handling the transaction was a partner. Thus, the Rule 1.7 conflict might not be imputable to the lawyer who would represent the client. Only Rule 1.8(a) would apply. Even if the conflict were imputed, Rule 1.10(d) provides that imputed conflicts may be waived by the affected client under the conditions stated in Rule 1.7. The key condition under Rule 1.7 is that the lawyer reasonably believe that the lawyer will be able to provide competent and diligent representation to the client. While the lawyer who is the party to the transaction might not be able to do so and therefore should not be allowed to seek the client's consent, it is certainly conceivable that another lawyer in the firm could provide the requisite competent and diligent representation notwithstanding the personal interest of the lawyer-party. Thus the 1.10(a) imputed disqualification could be waived, leaving the lawyer free to handle the representation in compliance with Rule 1.8(a).

Finally, a new Comment [4] addresses the situation in which the lawyer's client is represented by independent counsel in the transaction between the lawyer and the client. Comment [4] notes that this independent representation excuses the lawyer-party from advising the client in writing of the desirability of seeking independent legal counsel—an eminently sensible outcome. It also permits the disclosure requirement in Rule 1.8(a)(1) to be satisfied either by a written disclosure by the lawyer involved in the transaction or by the client's independent counsel. Absent consent of the independent counsel, however, Rule 4.2 (Communication with Person Represented By Counsel) would require that the disclosure by the lawyer-party be made to the independent counsel and not to the client. Finally, the Comment states that the fact that the client is independently represented in the transaction is relevant in determining whether the agreement is fair and reasonable to the client as required by Rule 1.8(a)(1). In this regard, however, one

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[34] *Id.* R. 1.8 cmt. [3].

might ask why Rule 1.8(a) should apply at all when the lawyer's client has retained independent counsel for the transaction. With a lawyer to protect her, the client should not need the protections of Rule 1.8(a).[35]

X. SEXUAL RELATIONS WITH CONSTITUENTS OF ORGANIZATIONAL CLIENTS

A new Rule 1.8(j) prohibits a lawyer from having sexual relations with a client unless a consensual sexual relationship existed between them before the client-lawyer relationship was formed. The related Comments do not offer a definition of sexual relations, but Comment [19] explains how the prohibition applies to lawyers who represent organizational clients. Without differentiation between in-house counsel or outside counsel, a lawyer for an organizational client may not have sexual relations with an organizational constituent who supervises, directs, or regularly consults with the lawyer concerning the organization's legal matters.[36] A new Rule 1.8(k) and Comment [20] provide that the prohibition against commencing sexual relations with a constituent of an organizational client is limited to the lawyer who is working with the constituent and will not be extended to other lawyers who are associated with that lawyer in a firm, so long as these lawyers are not also working with the constituent.

The new Comments do not explain the relationship between Rule 1.8(j) and Rule 1.7, the general conflict of interest rule, beyond noting in a new Comment [18] that sexual relationships that predate the client-lawyer relationship might materially limit the lawyer's representation of the client and thereby require compliance with Rule 1.7. What this suggests, of course, is that, in some circumstances, a lawyer who is personally prohibited from having sex with an organizational constituent by Rule 1.8(j) would also have been prohibited from doing so by Rule 1.7. This would be a personal interest conflict that, given the change to Rule 1.10(a) noted above, would not automatically be imputed to other lawyers in the firm, but could be imputed to them if the personal interest of the personally disqualified lawyer in the sexual relationship presents a significant risk of materially limiting the representation of the organization by other lawyers in the firm. While one could probably work such a plot line into a novel about corporate legal intrigue (*e.g.*, senior partner having illicit affair with CEO in circumstances in which CEO is engaged in misconduct that the lawyer might have to reveal to the board of directors by Rule 1.13(b)) the likelihood of such happenings in real life is sufficiently low that it should not be necessary to add sexual relationships to the firm's conflicts data base.

XI. COMMUNICATION WITH REPRESENTED ORGANIZATIONS

As approved by the House, Model Rule 4.2 now provides that:

> In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.[37]

The only change is the addition of a specific reference to a court order as a source of authority for a communication without the consent of the represented person's lawyer. Of primary importance for the transactional lawyer is the basic proposition that Rule 4.2 applies to the representation of clients in business transactions; the revision of the Comment that specifies those constituents of a represented organization who cannot be contacted without consent of

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[35] The Commission was willing to rely on independent counsel to protect a lawyer's client when the lawyer and client make an agreement prospectively limiting the lawyer's liability to the client for malpractice. *See Id.*R. 1.8(h)(1). For a recent comprehensive analysis of business transactions between lawyers and their clients, see ABA Task Force on the Independent Lawyer, *Lawyers Doing Business with their Clients: Identifying and Avoiding Legal and Ethical Dangers* (2001), *at* http://www.abanet.org/litigation/litnews/ethicsreport.html (last visited on Apr. 16, 2002).

[36] In ABA Formal Ethics Opinion 92-364, the ABA Standing Committee on Ethics and Professional Responsibility warned that a corporation's lawyer who is sexually involved with a corporate constituent might, in the interest of continuing the sexual relationship, refrain from reporting the constituent's misconduct to higher authorities as might be required by Rule 1.13(b). ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 92-364 (1992).

[37] Model Rules of Prof'l Conduct R. 4.2.

the organization's lawyer; and a clarification of the right of a lawyer to advise a client of the client's right to speak directly with a represented person even though the lawyer cannot do so.

With respect to the application of Rule 4.2 in the case of a represented organization, Comment [6] now provides:

> In the case of a represented organization, this Rule prohibits communications with a constituent of the organization who supervises, directs or regularly consults with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability. Consent of the organization's lawyer is not required for communication with a former constituent. If a constituent of the organization is represented in the matter by his or her own counsel, the consent by that counsel to a communication will be sufficient for purposes of this Rule. *Compare* Rule 3.4(f). In communicating with a current or former constituent of an organization, a lawyer must not use methods of obtaining evidence that violate the legal rights of the organization. *See* Rule 4.4, Comment [2].[38]

Of the various changes made to this Comment, the one of most pertinence to the transactional lawyer is the replacement of a more general reference to "persons having a managerial responsibility on behalf of the organization," which had been criticized as both ambiguous and over broad, with the more specific reference to "a constituent of the organization who supervises, directs, or regularly consults with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter." So reformulated, the Comment focuses more specifically on the constituent's authority in the matter at issue and her relationship with the organization's lawyer, which is consistent with the Rule's purpose to protect the client-lawyer relationship. It clearly includes the constituent with the authority to agree to the transaction in question, but broadens the swath of Rule 4.2's protection to also include constituents who may lack authority to close the transaction, but who are regularly consulting with the organization's lawyer about it.

There are three issues that might have been addressed in this Comment but were not. The first is whether a lawyer who knows an organization is represented by a general counsel, either in-house or by retainer of a law firm, should be deemed to know that the organization is represented by counsel in the specific matter in which the lawyer is representing a client. An ABA Ethics opinion concludes that the answer is no, but the issue could have been more conclusively put to rest had that answer been incorporated into the Comment.[39] Similarly, the Comment does not specify whether the lawyer is only prohibited from directly communicating with a constituent if the lawyer knows that the constituent is supervising, directing or regularly consulting with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter. As formulated, the Comment could be read to impose a strict responsibility on the communicating lawyer to assure that the constituent lacks authority with respect to the matter and is not supervising, directing, or regularly consulting with the lawyer. Clarifying this point would allow the lawyers involved to know who bears the burden of clarifying a constituent's authority or role in the matter.

The final issue not addressed by the Comment relates to a transaction in which both in-house and retained counsel are involved in the transaction as representatives of the organizational client. May the lawyer representing the other party to the transaction communicate directly with in-house counsel or must all communications be directed to the retained counsel? The question can be answered either way, depending on whether the in-house counsel is viewed as co-counsel with the retained firm—in which case direct communication with either co-counsel would be permitted—or whether the in-house counsel is simply viewed as a organizational constituent who is supervising, directing, or regularly consulting with the retained lawyer. This point could have been clarified by the addition of one sentence, but doing so would have required resolution of an issue that, when confronted, seems to strike a sensitive nerve with both retained and in-house counsel. Although it is always tempting to avoid rather than resolve sensitive issues, the frequency with which organizational clients are now represented by teams of in-house and retained lawyers suggests that this issue, no matter how sensitive, is now ripe for resolution.

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[38] *Id.* R. 4.2 cmt. [6].

[39] ABA Comm. on Prof'l Responsibility, Formal Op. 95-396 (1995) (discussing communication with represented persons).

The final piece of the Rule 4.2 puzzle that transactional lawyers must put into place relates to the prohibition in Rule 8.4 (a) against a lawyer knowingly violating the Rules of Professional Conduct "through the acts of another," and how this applies to direct communication with a represented person by the lawyer's client or a constituent of an organizational client.[40] Consider, for example, that a deal point arises, there is need for quick resolution, and the other party's counsel is unavailable. Or, there is reason to believe that a counteroffer sent to the other party's lawyer has not been communicated to the party. The issue is the extent to which the lawyer can arrange for and assist her client to communicate directly with the other party with whom the lawyer is not allowed to communicate by Rule 4.2.

This issue is now addressed in Comment [1] to Rule 8.4 and Comment [4] to Rule 4.2, which, when read together, make two points. First, a lawyer may not request or instruct an agent of the lawyer to make a communication that the lawyer was prohibited from making by Rule 4.2. Second, Rule 4.2 does not prohibit direct communication between the clients and that the lawyer is not prohibited from "advising a client concerning a communication that the client is legally entitled to make."[41]

This proposal prompted another dissent by Larry Fox, who argued that under the pretense of providing advice the lawyer will be able to "script" communications so that the client will simply be a conduit for a communication that the lawyer would not be allowed to make without the consent of the represented person's lawyer. Mr. Fox argued that lawyers should no more be permitted to script a client contact with a represented person than they should be permitted to script a communication to be delivered by the lawyer's paralegal.

The Commission successfully defended its proposal as a limited recognition of the right of the lawyer to both initiate and provide advice to the client about the client's communication with a represented party (or any other lawful conduct in which the lawyer is not permitted to engage). Such a right to render advice will not preclude courts and ethics committees from finding in an appropriate case that the lawyer did more than render advice and had so engineered the communication, or so encouraged or provided other assistance with respect to the communication, as to warrant the conclusion that the lawyer had made the communication through the acts of the client. Rather than try to resolve for all time all the issues that can arise when one tries to balance the protections afforded by Rule 4.2 against the right of the client to have advice and assistance of counsel with respect to the client's communication with the party with whom she is doing business, the Commission chose to establish a general framework within which courts and ethics committees can work to provide further guidance to lawyers about the nebulous boundary between rendering advice to a client about the client's communications and using the client as an agent to communicate with the represented person on the lawyer's behalf.

What, then, does a transactional lawyer do with Rule 4.2 and the uncertainty surrounding its application to represented organizations? One answer is to ignore the Rule, as some transactional lawyers do out of ignorance that the Rule applies to transactions as well as lawsuits. Another answer is to abide by the Rule and hope that problems will not arise and that the system of communication prescribed by Rule 4.2 will not seriously impede the efficiency with which the transaction can be executed. An alternative for transactional lawyers, however, is for the lawyers to agree in advance to a structure for communication between the organizational constituents and lawyers participating in the transactions.

For example, the lawyers might agree to permit each other to send a copy of their communications to the constituent of the organization who is supervising or directing the lawyer or has authority to obligate the organization in the transaction. Or by agreement, the lawyers could eliminate the uncertainty about the propriety of communicating with an in-house counsel when an outside lawyer has been retained to represent the organization in the matter. The point is that if Rule 4.2—viewed as a legal structure for communication among lawyers and organizational constituents involved in a business transaction between organizations—does not fit, a set of good transactional lawyers, with the concurrence of sensible clients, should be able to structure their own workable structure.

[40] Model Rules of Prof'l Conduct R. 8.4(a).

[41] *Id.* R. 4.2.

XII. IN-PERSON, TELEPHONIC, AND REAL-TIME ELECTRONIC SOLICITATIONS OF IN HOUSE CORPORATE COUNSEL

The House approved an extension of the prohibition in Rule 7.3(a) against in-person and live telephone solicitation to include real-time electronic contact — such as a chat room or instant messaging. At the same time, however, Rule 7.3(a) was also amended to permit in-person, live telephone, and real-time electronic solicitation if the person contacted is a lawyer or a person with whom the communicating lawyer has a close personal relationship. The current rule only permits such contact with a person with whom the lawyer has a family or prior professional relationship. These exceptions also apply to the requirement in Rule 7.3(c) that written, recorded, or electronic communications to persons known to be in need of legal services in a particular matter be clearly labeled as "Advertising Material."

Of particular importance is the exception for communication with lawyers. The reason for this exception — currently recognized in Illinois[42] and Massachusetts[43] — is that lawyers do not need to be protected from overreaching by other lawyers. The most important effect of this exception is that lawyers will be able to make in-person or live telephone contacts with in-house corporate counsel or to any organizational employee who is a lawyer. Nor would written communications to such corporate constituents need to be labeled as "Advertising Material."

The Commission did not approve a Reporter's recommendation to permit in-person solicitation if the prospective client was "a business, nonprofit or government organization, and the lawyer seeks to provide services related to the organization." The proposed exception tracks the rule in Connecticut.[44] Massachusetts has a comparable exception.[45] The Reporter argued that organizational clients regularly deal with vendors of all kinds of goods and services and with a wide variety of legal issues arising in connection with the organization's activities, and that, in such a context, there is insufficient risk of overreaching to warrant a *per se* ban on lawyer solicitation, either as a matter of policy or constitutional law. The Commission disagreed, taking the position that the representatives of many organizations, particularly non-profit and governmental organizations, are as vulnerable to lawyer overreaching as anyone else. Whether a complete ban on solicitation of prospective organizational clients will pass constitutional muster remains to be determined by the Supreme Court.[46]

XIII. MULTIJURISDICTIONAL TRANSACTIONAL PRACTICE

In this era of multi-state, indeed multi-national, business transactions, transactional lawyers are regularly engaged in some form of multi-jurisdictional practice. What is not clear is whether some, or even most, instances of transactional practice violate Model Rule 5.5(a)'s prohibition against a lawyer practicing law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction. This is a hot topic and was addressed by the Commission, but the House deferred consideration of the Commission's proposal pending submission of the Report of the MJP Commission. This issue is of particular importance for transactional practitioners.

Pertinent to transactional practice, the Commission's proposed Rule 5.5 provides that a lawyer representing a client in a business transaction in a jurisdiction in which the lawyer is not licensed to practice does not engage in the unauthorized practice of law if the lawyer falls into any one of three "safe harbors:" (A) the lawyer is an employee of a client and is acting on the client's behalf, or, in connection with the client's matters, on behalf of the client's

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[42] Illinois defines "solicit" to mean "contact with a person other than a lawyer." Ill. Rules of Prof'l Conduct R. 7.3 (2000).

[43] Mass. Rules of Prof'l Conduct R. 7.3(e)(1) (2000).

[44] Connecticut permits personal and live telephone contact "if the prospective client is a business organization, a not-for-profit organization or governmental body and the lawyer seeks to provide services related to the organization." Conn. Rules of Prof'l Conduct R. 7.3(a)(4) (2000).

[45] Mass. Rules of Prof'l Conduct R. 7.3(e)(4).

[46] *See* Edenfield v. Fane, 507 U.S. 761 (1993) (invalidating ban against accountants soliciting business clients, but calling attention to fact that a CPA, unlike a lawyer, is not a professional trained in the art of persuasion).

commonly owned organizational affiliates; (B) the lawyer acts with respect to a matter that arise out of or is otherwise reasonably related to the lawyer's representation of a client in a jurisdiction where the lawyer is admitted to practice; or (C) the lawyer associates in the matter a lawyer admitted to practice in this jurisdiction who actively participates in the representation.

For purposes of public discussion, the MJP Commission has proposed an alternative to the Ethics 2000 proposal. The alternative proposal employs what can be called a "safe harbor plus" approach — the "plus" being a general proposition that permits practice in the jurisdiction by a lawyer licensed elsewhere "when the lawyer represents a client on a temporary basis in the jurisdiction if the lawyer's services do not create an unreasonable risk to the interests of the lawyer's client, the public or the courts." To this is added a list of safe harbors, which are identified as examples of situations in which the provision of legal services on a temporary basis does not create an unreasonable risk to the interests the lawyer's client, the public, or the courts. In addition to two safe harbors that are similar to the second and third safe harbors in the Ethics 2000 proposal, the MJP Commission has added two safe harbors pertinent to transactional practitioners. One applies to services "performed for a client who resides or has an office in a jurisdiction in which the lawyer is authorized to practice." The other applies to services "governed primarily by federal law, international law, the law of a foreign nation, or the law of a jurisdiction in which the lawyer is admitted to practice. In a separate provision, the proposal permits a lawyer employed by a client, or its commonly owned affiliates, to engage in transactional practice on a regular basis, subject only to the requirement that the lawyer not have established an office or other permanent presence in the jurisdiction in which she is not licensed. Yet another proposal exists—identified by its proponents as the 'Common Sense Proposal'—that permits transactional practice by lawyers not licensed in the jurisdiction if (A) the lawyer is an employee of a client and acts on the client's behalf or on behalf of the client's organizational affiliates, or (B) the lawyer performs services for a client on a temporary basis, does not establish a systematic and continuous presence in this jurisdiction, and does not hold out to the public that the lawyer is licensed to practice law in this jurisdiction. This is the most liberal of the proposals. The House will likely consider these proposals when it reconvenes in August 2002.

XIV. CONCLUSION

The House's approval of most of the Ethics 2000 Commission's proposal for revision of the ABA Model Rules was the culmination of a process that began in 1997. In part, the new rules provide a new starting point for further reflection about the professional responsibilities of those lawyers who engage in transactional practice on behalf of organizational clients, whether as in-house or retained counsel.

This article identifies some of the new starting points and raises some questions about the differences between transactional practice and litigation; whether professional norms that make sense in a litigation practice may not be appropriate in a transactional practice; and, if not, what the norms of conduct for transactional practice should be. Clearly, many unasked or unanswered questions remain about the professional responsibilities of transactional practitioners. Consequently, there may be a need for closer scrutiny of both time-honored answers and those answers that were approved for the first time by the House and now are part of the Model Rules.

Combating the Costs of Doing Business:
The Benefits of Implementing a Tennessee Drug-Free Workplace

By: John R. LaBar[1]

I. INTRODUCTION

In this day and age, many factors go into the "cost of doing business." One is substance abuse by employees in the workplace. Substance abuse in the workplace affects a business in many different ways. Close to half of all workers' compensation claims are related to substance abuse in the workplace, and substance abusers file three to five times as many workers' compensation claims as compared to non-substance abusers.[2] Additionally, substance abusers incur medical costs almost 300% higher than non-abusers, are two and a half times more likely to be absent eight or more days a year than non-abusers, and are nearly one-third less productive than non-abusers.[3]

In order to help combat the problem of substance abuse in the workplace, the Tennessee General Assembly passed the "Workers' Compensation Reform Act of 1996" (the "Act").[4] The Act provides employers who implement a drug-free workplace several significant benefits.[5]

II. BENEFITS

The major benefits for an employer to enact a drug-free workplace can be broken down as follows.

A. Reduction in Workers' Compensation Insurance Premiums

Employers who adopt a "Drug-Free Workplace Program," as prescribed in the Act, qualify for reduced workers' compensation insurance premiums.[6] The covered employer's workers' compensation insurance company or self-insured pool program administrator is notified by the Tennessee Department of Labor when an employer's Drug-Free Workplace Program is certified.[7] To receive certification, the employer must (1) comply with the Act's notice

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[2] Tenn. Dep't of Labor, Employer's Program Development and Implementation Guide (2000) (citing "Working Partners," a National Conference Proceedings Report which was sponsored by the U.S. Department of Labor, the Small Business Association, and the Office of National Drug Control Policy), *available at* http://www.state.tn.us/labor-wfd/dfwp.html.

[3] *Id.*

[4] Tenn. Code Ann. §§ 50-9-101 through –113 (2001).

[5] The intent of the General Assembly in enacting this law was to promote drug-free workplaces in order that employers in Tennessee "could be afforded the opportunity to maximize their levels of productivity, enhance their competitive positions in the marketplace, and reach their desired levels of success without experiencing the costs, delays, and tragedies associated with work-related accidents resulting from drug or alcohol abuse by employees." 1996 Tenn. Pub. Acts 944. In addition, the General Assembly stated that it was their intent that drug and alcohol abuse be discouraged and that employees who choose to engage in drug or alcohol abuse face the risk of unemployment and the forfeiture of workers' compensation benefits. *See id.*

[6] Tenn. Code Ann. § 50-6-418.

[7] Tenn. Comp. R. & Regs. 0800-2-12-.02(5) (2002). Additionally, pursuant to Section 50-9-102 of the Tennessee Code, the Commissioner of Labor and Workforce Development has the power to adopt rules pertaining to the implementation of Drug-Free Workplace Programs. *See* Tenn. Code Ann. § 50-9-102.

requirements and (2) file the form supplied by the commissioner for that purpose with the Workers' Compensation Division of the Department of Labor.[8]

The employer is rebuttably presumed to be entitled to all applicable benefits under the Drug-Free Workplace Program as soon as the Drug-Free Workplace Program application form is filed.[9] The actual discount an employer can receive by instituting a Drug-Free Workplace Program varies according to the employer's individual insurer and insurance plan, but under Section 50-6-418 of the Tennessee Code, it must be at least five percent.[10]

Because the plans detailing the discounts provided by an insurer were required to take effect January 1, 1997, an employer who implements a Drug-Free Workplace Program today can readily ascertain the actual discount that will apply to its workers' compensation insurance costs from its insurer.[11] The insurance company or self-insured pool program administrator must apply the premium credit granted under the Drug-Free Workplace Program to such policy directly upon receipt of notification from the Tennessee Department of Labor that an employer's program has been certified. Otherwise, the insurance company or pool administrator must make payment for the credit effective after the annual final premium audit has been completed.[12]

B. Presumption That an Employee's Injury was Caused by Illegal Drugs if There is a Positive Test

If a worker is injured in the course and scope of his or her employment with an employer who has implemented a Drug-Free Workplace Program and the employee tests positive for a drug at a prescribed level under the Act governing a Drug-Free Workplace, a rebuttable presumption is created that the injury was caused primarily by the presence of the drug.[13] The employee may be disciplined, including termination, and forfeits his or her eligibility for workers' compensation medical and indemnity benefits. If an injured worker refuses to submit to a drug or alcohol test, the proximate cause of the injury is presumed to be (in the absence of a preponderance of the evidence to the contrary) the influence of drugs or alcohol as set forth in the Act.[14]

C. Discharge, Disciplinary Action, or Refusal to Hire is Deemed "For Cause"

Another benefit of the Drug-Free Workplace Program is that a covered employer who discharges or disciplines an employee or refuses to hire a job applicant in compliance with the rules governing a Drug-Free Workplace, is considered to have discharged, disciplined, or refused to hire such employee or job applicant "for cause."[15]

D. Drug or Alcohol Use Alone is Not Considered a "Disability"

An employee or job applicant whose drug or alcohol test result is confirmed as positive in accordance with the rules governing Drug-Free Workplace programs shall not, by virtue of the drug test result alone, be deemed to have a "handicap" or "disability" as defined under federal, state, or local handicap and disability discrimination laws.[16]

E. Forfeiture of Workers' Compensation Medical and Indemnity Benefits

If an employer implements a Drug-Free Workplace Program in accordance with the notice, education, and procedural requirements developed by the Department of Labor's Division of Workers' Compensation, the employer may

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[8] Tenn. Dep't of Labor & Workforce Dev. Form LB-0393 (ed. 9-97).

[9] Tenn. Code Ann. § 50-9-104(b).

[10] In addition, Section 50-6-418 of the Tennessee Code provides that the Commissioner of Commerce and Insurance may determine that a five-percent discount is actuarially unsound for that insurer. In such a case, that insurer may be allowed to provide a discount that is less than five percent. However, as of August 29, 2001, no such waivers have been granted. *See* Tenn. Code Ann. § 50-6-418.

[11] *Id.* § 50-6-418.

[12] Tenn. Comp. R. & Regs. 0800-2-12-.02(5).

[13] Tenn. Code Ann. § 50-6-110(c)(1).

[14] *Id.* § 50-6-110(c)(2).

[15] *Id.* § 50-9-108(b).

[16] *Id.* § 50-9-108(a).

require an employee to submit to a test for the presence of drugs or alcohol. If drugs or alcohol are found to be present in the employee's system at a level set by statute or rule adopted pursuant to the Drug-Free Workplace provisions, the employee may be terminated and may forfeit eligibility for workers' compensation medical and indemnity benefits.[17]

III. CREATION OF A DRUG-FREE WORKPLACE PROGRAM

An employer must utilize the following steps to create a Drug-Free Workplace Program.

A. Compose a Written Substance Abuse Policy

The first step in implementing a Drug-Free Workplace Program is for the employer to compose a written substance abuse policy. The policy should expressly prohibit the use of illegal drugs and/or abuse of alcohol by any employee. The company's substance abuse policy should also spell out the consequences of any policy violations. In addition, the written substance abuse policy must address the following issues:

1. the types of drug or alcohol testing an employee or job applicant may be required to submit to and the actions the covered employer may take against an employee or job applicant on the basis of a positive confirmed drug or alcohol test result;[18]

2. a statement advising the employee or job applicant of the existence of the employer's substance abuse policy;[19]

3. a general statement concerning confidentiality;[20]

4. the procedures for employees or job applicants to confidentially report use of prescription or nonprescription medications being tested under the employer's substance abuse policy to a medical review officer, after the testing process has revealed a positive confirmed result for alcohol or drug use;[21]

5. the consequences of refusing to submit to a drug or alcohol test;[22]

6. a representative sampling of names, addresses, and telephone numbers of employee assistance programs and local drug and alcohol rehabilitation programs;[23]

7. the process to contest or explain a result;[24]

8. a statement informing the employee or job applicant of his responsibility to notify the laboratory that performed the drug test of any administrative or civil action brought pursuant to Section 50-9-105 of the Tennessee Code, the section covering the general requirements of an employer's Drug-Free Workplace Program;[25]

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[17] *Id.* § 50-6-110(c)(1); *See infra* note 26. The denial of benefits is just a presumption and may be rebutted by a preponderance of the evidence that such drug or alcohol was not the proximate cause of the injury or if, before the accident, the employer had actual knowledge of and acquiesed to the employee's presence at the workplace while under the influence of drugs or alcohol.

[18] *Id.* § 50-9-105(a)(1).

[19] Tenn. Code Ann. § 50-9-105(a)(2) (2001).

[20] *Id.* § 50-9-105(a)(3).

[21] *Id.* § 50-9-105(a)(4).

[22] *Id.* § 50-9-105(a)(5).

[23] *Id.* § 50-9-105(a)(6).

[24] *Id.* § 50-9-105(a)(7). This process must comply with the requirements of Chapter 0800-2-12-.10 of the Rules of the Department of Labor, Division of Workers' Compensation. Tenn. Comp. R. & Regs. 0800-2-12-.10 (2002).

[25] Tenn. Code Ann. § 50-9-105(a)(8).

9. a list of all classes of drugs, including alcohol, for which the covered employer may test.[26] This list shall describe all drugs by brand name or common names, as applicable, as well as by chemical name;[27]

10. a statement regarding any applicable collective bargaining agreement or contract and the right to appeal to the applicable court;[28] and

11. a statement notifying employees and job applicants of their right to consult with a medical review officer for technical information regarding prescription and nonprescription medicine.[29]

B. Notification Statement

The employer must give notice to all employees that complies with the requirements of Section 50-9-101(b) of the Tennessee Code, which states that a condition of employment in a Drug-Free Workplace is for an employee to refrain from reporting to work or continue working if there is a presence of drugs or alcohol in his or her body. In addition, if an injured employee refuses to submit to a test for drugs or alcohol, the employee forfeits eligibility for workers' compensation medical and indemnity benefits.[30]

C. Passage of Sixty Days

An employer shall ensure that at least sixty days elapse between a one-time general notice to all employees that a Drug-Free Workplace Program is being implemented and the effective date of the program.[31] The notice shall also indicate that, on the effective date of the program, Section 50-6-110(c) of the Tennessee Code will apply to that employer. The employer should ensure that all employees are given a copy of the substance abuse policy and sign a drug and alcohol testing consent form.

D. Include Notice of Drug or Alcohol Testing on Vacancy Announcements

An employer must also include notice of drug or alcohol testing on vacancy announcements for positions for which drug or alcohol testing is required.[32] A notice of the covered employer's drug or alcohol testing policy must also be posted in an appropriate and conspicuous location on the covered employer's premises, and copies of the policy must be made available for inspection by the employees or job applicants during regular business hours in the employer's personnel office (or other suitable location).[33] As a practical matter, all new employees should be asked to sign a separate "Pre-Employment Drug Testing Consent and Release Form." This requirement is in addition to all employees being given an employee handbook containing all of the employer's policies, including the provisions stating that the employer's premises are a Drug-Free Workplace.

E. Subject to the Provisions of Any Applicable Collective Bargaining Agreement

The application of the provisions and rules of the Drug-Free Workplace Program are subject to the provisions of any applicable collective bargaining agreement.[34]

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[26] An employer will be required to test employees and job applicants for the following drugs: 1. Alcohol (not required for job applicants): (a) .10% by weight blood alcohol concentration for non-safety sensitive positions, and (b) .04% by weight blood alcohol concentration for safety sensitive positions; 2. Amphetamines: 1,000ng/mL; 3. Marijuana (cannabinoids): 50ng/mL; 4. Cocaine (benzolylecgonine): 300ng/mL; 5. Opiates (codeine, morphine, heroin): 300ng/mL; and 6. PCP (phencyclidine): 25ng/mL. Tenn. Comp. R. & Regs. 0800-2-12-.03(17)(a).

[27] Tenn. Code Ann. § 50-9-105(a)(9). Additionally, under this requirement, a covered employer may also test an employee for additional substances beyond those mandated by the Drug-Free Workplace Program statute, as long as the employer obtains the prior written consent of the employee. *Id.*

[28] *Id.* § 50-9-105(a)(10).

[29] *Id.* § 50-9-105(a)(11).

[30] *Id.* § 50-9-101(b).

[31] *Id.* § 50-9-105(b).

[32] *Id.* § 50-9-105(c).

[33] Tenn. Code Ann. § 50-9-105(c) (2001).

[34] *Id.* § 50-9-105(d).

F. Application Form

An employer seeking any of the benefits conferred by the Drug-Free Workplace Program shall file with the Workers' Compensation Division of the Department of Labor the form promulgated by the Commissioner for that purpose.[35] From the date of receipt by the Tennessee Department of Labor, Division of Workers' Compensation, an employer shall be rebuttably presumed entitled to all benefits associated with a Drug-Free Workplace Program.

Employers will begin to accrue the premium discount on their workers' compensation insurance on a pro rated basis as of the date of certification.[36] The employer's workers' compensation insurance company or self-insured pool program administrator must apply to such policy the premium credit granted under the Drug-Free Workplace Program directly upon receipt of notification from the Tennessee Department of Labor or make payment for such credit effective after the annual final premium audit has been completed. Before granting any premium credit to an employer, an insurance carrier or self-insured pool shall obtain a true copy of the Drug-Free Workplace application form submitted by the employer to the Tennessee Department of Labor.[37]

IV. ONGOING REQUIREMENTS

After implementing a Tennessee Drug-Free Workplace, an employer must meet several ongoing requirements to remain in compliance with the applicable statutes. In particular, an employer must comply with the following requirements.

A. Re-certify Employer's Compliance

Employers must re-certify their compliance with the requirements of the Drug-Free Workplace Program each year with the Tennessee Department of Labor. This can be accomplished by submitting a Tennessee Drug-Free Workplace Application Form at the renewal of the worker's compensation insurance policy or before the anniversary date of the original Tennessee Department of Labor certification.

B. Employee Education/Awareness Required for Certification

Each year, employers must provide at least one hour of an education/awareness program for all employees about substance abuse in the workplace.[38] Such a program may include: (1) a general explanation about the addictive disease of substance abuse; (2) the effects and dangers in the workplace of commonly abused substances; and (3) reinforcement of the employer's policies and procedures regarding workplace substance abuse.[39] In addition, an employer should remind employees of any relevant employee-assistance programs and/or substance abuse treatment options.

C. Supervisor Training Required for Certification

In addition to the employee substance abuse education/awareness program, employers must provide all supervisory personnel with a minimum of two hours per year of workplace substance abuse recognition training.[40] This training should include the following: (1) how to recognize the signs of substance abuse in the workplace; (2) how to document and corroborate signs of employee substance abuse; and (3) and how to refer substance-abusing employees to proper medical providers for treatment. This training may be completed on one specific date or by two one-hour training sessions held on different dates during the year.

Moreover, supervisors should complete workplace substance abuse recognition training before an employer implements a drug and alcohol testing program that includes testing based on "reasonable suspicion," and/or attempting to

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[35] *Id.* § 50-9-104(b).

[36] This is the date of the application's approval by the Tennessee Department of Labor, Division of Workers' Compensation.

[37] Tenn. Comp. R. & Regs. 0800-2-12-.15(1) (2002).

[38] *Id.* 0800-2-12-.13(1).

[39] *Id.*

[40] *Id.* 0800-2-12-.13(2).

refer an employee to an employee assistance program or other provider for substance abuse treatment.

The employee education/awareness and supervisory training component of the Drug-Free Workplace Program is meant to be flexible so that employers may be creative in conducting these programs. Thus, employers may utilize speakers, workshops, videos, written material, in-house supervisors that have been educated on how to train employees, and/or a presentation by supervisors regarding aspects of workplace substance abuse. No matter how the required supervisory training component is structured, employers should keep appropriate records in order to document the completion of the employee education/awareness program and supervisor training requirements.

D. Required Testing

The testing requirements imposed upon an employer who implements a Tennessee Drug-Free Workplace are as follows.

1. Job Applicant Drug or Alcohol Testing

A covered employer must, after a conditional offer of employment, require job applicants to submit to a drug test. The employer may then use a refusal to submit to a drug test or a positive confirmed drug test as a basis for refusing to hire a job applicant.[41] An employer may test job applicants for alcohol after a conditional offer of employment. Temporary, leased, seasonal, or former workers who have tested negative for substance abuse within the preceding twelve months are not required to undergo job applicant testing by a covered employer.[42] However, any worker who has not been tested, or has tested positive within the preceding twelve months must submit to job-applicant testing. An employer may still choose to test temporary, leased, seasonal, or former workers. However, such testing is not mandatory under the Drug-Free Workplace Program requirements.

2. Upon Reasonable Suspicion

An employer must require an employee to submit to reasonable-suspicion drug or alcohol testing.[43] "Reasonable suspicion" means drug testing based on a belief that an employee is using or has used drugs or alcohol in violation of the employer's policy.[44] Reasonable suspicion may be drawn from specific objective and articulable facts and reasonable inferences drawn from those facts in light of experience.[45] Among other things, such facts and inferences may be based upon:

a. observable phenomena while at work, such as direct observation of drug or alcohol use or of the physical symptoms or manifestations of being under the influence of drugs or alcohol;

b. abnormal conduct or erratic behavior while at work or a significant deterioration in work performance;

c. a report of drug or alcohol use, provided by a reliable and credible source;

d. evidence that an individual has tampered with a drug or alcohol test during the employee's employment with his/her current employer;

e. information that an employee has caused, contributed to, or been involved in an accident at work; or

f. evidence that an employee has used, possessed, sold, solicited, or transferred drugs or alcohol while working on the employer's premises or while operating the employer's vehicle, machinery, or equipment.

3. Routine Fitness-for-duty Drug or Alcohol Testing

An employer must require an employee to submit to a drug or alcohol test if the test is conducted: (a) as part of a routinely scheduled employee fitness-for-duty medical examination where the examinations are required by law or

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[41] Tenn. Code Ann. § 50-9-106(a)(1) (2001).

[42] Tenn. Comp. R. & Regs. 0800-2-12-.05(1)(a).

[43] Tenn. Code Ann. § 50-9-106(a)(2).

[44] *Id.* § 50-9-103(15).

[45] *Id.*

regulation; (b) as part of the employer's established policy; or (c) if the drug or alcohol test is one that is scheduled routinely for all members of an employment classification group.[46]

However, the Drug-Free Workplace rules do not require an employer to conduct a drug or alcohol test if the employer's current personnel policy does not include drug or alcohol testing as part of their routine fitness-for-duty medical exams.[47]

4. Follow-up Drug or Alcohol Testing

Follow-up drug or alcohol testing is only required if the employee enters an employee assistance program for drug- or alcohol-related problems, or a drug or alcohol rehabilitation program.[48]

5. Post-accident Testing

After an accident that results in injury, an employer shall require the employee involved in the accident to submit to a drug or alcohol test in accordance with the following rules.

a. An employee injured at the workplace and required to be tested shall be taken to a medical facility for immediate treatment of the injury.[49] Specimens shall be obtained at the treating facility or a designated collection site under the procedures set forth for workplace drug and alcohol testing as designated by the procedures provided for by the United States Department of Transportation rules.[50] The specimens shall then be transported to an approved testing laboratory.[51]

b. No specimens shall be taken prior to the administration of emergency medical care.[52] However, once an injured employee has received the appropriate medical care, the employee must submit to testing.[53]

c. In the case of non-emergency injuries reported to an employer after the fact, the injured employee must submit to testing at the time the injury is entered into the employer's OSHA 200 Log (or any authorized replacement to this log).[54]

As previously discussed, if an injured worker refuses to submit to a drug or alcohol test, the proximate cause of the work-related injury is presumably the influence of drugs or alcohol.

E. Confidentiality of Test Results and Records

All information, including interviews, reports, statements, memoranda, and drug or alcohol test results, written or otherwise, received by an employer through a drug or alcohol testing program are confidential communications and may not be used or received in evidence, obtained in discovery, or disclosed in any public or private proceedings.[55] Release of such information is only authorized under the following conditions: (1) pursuant to a written consent form

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[46] *Id.* § 50-9-106(a)(3).

[47] Tenn. Comp. R. & Regs. 0800-2-12-.05(3).

[48] Tenn. Code Ann. § 50-9-106 (8). Additionally, any follow-up drug or alcohol testing must be conducted according to section 0800-2-12-.05(4) of the Official Compilation Rules & Regulations of the State of Tennessee.

[49] Tenn. Comp. R. & Regs. 0800-2-12-.05(5)(a).

[50] Procedures For Transportation [Of] Workplace Drug and Alcohol Testing Programs, 49 C.F.R. § 40 (2002).

[51] *Id.* at § 40.81. *See also* Tenn. Code Ann. § 50-9-110 (requirements for state approval of a testing laboratory).

[52] Tenn. Comp. R. & Regs. 0800-2-12-.05(5)(b).

[53] *Id.*

[54] *Id.* 0800-2-12-.05(5)(c).

[55] Tenn. Code Ann. § 50-9-109(a). Information on drug or alcohol test results for tests administered pursuant to a Drug-Free Workplace Program shall not be released or used in any criminal proceeding against the employee or job applicant. Information released contrary to this rule is inadmissible as evidence in any such criminal proceeding. Whether this provision binds the federal government is unclear and is not addressed in the statute. The main analysis to answer this question would be whether such proceeding is purely federal in nature or a federal matter applying state law. As such, this issue is resolved by conflict of laws analysis, which is beyond the scope of this article.

signed voluntarily by the person tested; (2) such release is compelled by a hearing officer or a court of competent jurisdiction pursuant to an appeal taken under the Drug-Free Workplace Program rules; (3) such information is relevant to a legal claim asserted by the employee; or (4) such information is deemed appropriate by a professional or occupational licensing board in a related disciplinary proceeding.[56] However, such information may be used in determining compensability under workers' compensation rules.

The confidentiality of any information acquired pursuant to a Drug-Free Workplace Program does not prohibit an employer, or an agent of such employer, or laboratory conducting a drug or alcohol test, from having access to employee drug or alcohol test information. Additionally, an employer may use such information when consulting with legal counsel in connection with actions brought under or related to the Drug-Free Workplace Program or when the information is relevant to an employer's defense in a civil or administrative matter.[57] Furthermore, the confidentiality of any information is not intended to prohibit disclosure among management as is reasonably necessary for making disciplinary decisions relating to violations of drug or alcohol standards of conduct adopted by an employer.[58]

V. ADDITIONAL OPTIONS BEYOND THOSE CONTAINED IN THE DRUG-FREE WORK PLACE PROGRAM

In addition to implementing a Drug-Free Workplace Program, employers may also enact several additional policies in order to prohibit their employees from using, possessing, or selling alcohol or illegal drugs while at work.

A. Searches of the Workplace

An employer may implement a policy that authorizes the employer to search an employee's property brought onto the employer's premises to make sure that there are no drugs or alcohol present in the workplace.[59] While an employee may argue that an employer's search of an employee's personal property located on the employer's premises constitutes a violation of an employee's "right to privacy," the relevant Tennessee case law appears to indicate that an employer's search of an employee's property located on the employer's premises is permissible if the employer secures the employee's consent to the employer's search policy, and thus eliminates any "reasonable expectation of privacy."[60]

If a search of an employee's property is made in accordance with an employer's search policy and an employee files an invasion of privacy lawsuit against the employer, the principal question that determines the outcome of such litigation will most likely involve the question of whether the employee had a reasonable expectation of privacy. As such, and in order to eliminate any "reasonable expectation of privacy" that an employee may have in his or her personal property located on the employer's premises, any workplace search policy that authorizes an employer's search of an employee's property located on the employer's premises should have at a minimum the following features: (1) the workplace search policy should be in written form, (2) the policy should include a list of the types of personal property the employer may search pursuant to the employer's workplace search policy,[61] (3) the policy

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[56] The written consent form must also comply with Section 50-9-109(b) of the Tennessee Code.

[57] Tenn. Code Ann. § 50-9-109(d).

[58] *Id.*

[59] Individual employers have sole discretion as to whether this policy takes the form of a written employment handbook or a separate written policy.

[60] As a practical tip, an employer can use a "tear-sheet receipt and acknowledgment" as the first page of an employer's handbook in order to document an employee's consent to all of an employer's workplace policies.

[61] This list should also include a catch-all provision in order to cover any and all items that may be excluded from the list of items that may be searched. For example, the catch-all provision could be written to include "...any other property located on the employer's premises."

should include a statement that a search of any or all property can be made, without notice, at any time,[62] (4) the policy should specify that the policy applies to all property at the workplace, whether owned by the employer or the employee, and (5) the policy should state that the retention of personal items of property at the workplace is at the employee's risk. Once an employer has composed a written policy concerning searches at the workplace, the policy should be distributed to all employees.[63]

B. Rehabilitation Agreements and/or Employee Assistance Programs

Another area where an employer may institute an additional option to a Drug-Free Workplace Program is in the area of employee assistance programs and rehabilitation agreements. Employers hope that if they provide an employee with the opportunity to obtain help and/or treatment for a drug problem without any employment penalty, that the possibility of civil litigation by employees affected with such problems will be minimized, if not altogether eliminated.

In *Cherry v. Suburban Manufacturing Co.*, the Tennessee Supreme Court reviewed the issue of employee rehabilitation agreements. [64] The court stated that where an employee signed a written agreement that he would enter a drug rehabilitation program to be reinstated to his job and where the employee subsequently refused to enter the rehabilitation program, the employer was justified in terminating the employee.[65] The court also found that the employee's refusal to enter the rehabilitation program was a willful violation of his agreement with his employer, constituting the kind of misconduct that disqualified an employee from receiving unemployment compensation.[66] This case seems to indicate that Tennessee courts will uphold the provisions of a rehabilitation agreement and permit an employer to discharge an employee who fails to honor the terms of such agreements.

C. Random Drug Testing

Finally, another important area where an employer may institute an additional policy beyond those set forth in the Drug-Free Workplace Program rules is random drug testing. Section 50-9-107 of the Tennessee Code states that the rules required to establish a Drug-Free Workplace Program "do not preclude an employer from conducting any lawful testing of employees for drugs or alcohol that is in addition to the minimum testing required."[67] As such, the Tennessee Drug-Free Workplace Program statutes do not specifically authorize nor prohibit random drug testing.[68]

Any time an employer institutes a random drug testing program, the employer is at risk of an employee filing an invasion of privacy claim. The Tennessee Supreme Court has recently addressed the issue of random drug testing for terminable-at-will employees. In *Stein v. Davidson Hotel Co.*, the court stated that "existing Tennessee statutes which relate to random drug testing in other contexts appear to favor the practice."[69] In addition, the court explained that there is "no well-defined public policy which is violated by a private employer discharging an at-will employee who

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[62] As a practical matter any time an employer adopts and enforces a policy authorizing random searches of employee property, it is likely that, sooner or later, an employee will sue his or her employer for invasion of privacy. As such, it is usually best for an employer to have some basis for believing that an employee's property may contain drugs or some other prohibited item before conducting a search in accordance with an employer's search policy.

[63] As a final note, the employer's policy should state that its purpose is to "avoid any claims of privacy expectations."

[64] 745 S.W.2d 273, 276 (Tenn. 1998).

[65] *Id.*

[66] *Id.*

[67] Tenn. Code Ann. § 50-9-107.

[68] *See* Tenn. Op. Att'y. Gen. No. 89-66 (Apr. 28, 1989)."

[69] 945 S.W.2d 714, 718 (Tenn. 1997).

tests positive for drug use on a random drug test."[70] Finally, the court stated that Tennessee's "constitutional guarantee of privacy is not a source of public policy which restricts the right of private employers to discharge terminable-at-will employees who test positive on random drug tests."[71]

All in all, it appears as if employer random drug testing of employees is gaining judicial acceptance in Tennessee. However, random drug testing, as of the date of this article, has not been given explicit statutory support. Therefore, employer random drug testing of employees still involves some risk of civil litigation to employers who institute such a policy.

VI. CONCLUSION

Overall, employers who implement a Tennessee Drug-Free Workplace gain several significant benefits. However, these benefits do come at a price. Employers who institute Drug-Free Workplace Programs are faced with several administrative and procedural burdens with which they must strictly comply if they wish to receive all of the benefits that a Drug-Free Workplace Program has to offer. The Tennessee Drug-Free Workplace statute offers employers a very useful tool in combating employee drug and alcohol abuse. It does not hurt that employers who implement such a program, in addition to receiving all of the other benefits set forth above, will receive a discount on their workers' compensation insurance premiums, which is something all employers can appreciate.

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[70] *Id.* at 718. Tenn. Op. Att'y. Gen. No. 89-66 (Apr. 28, 1989) states that the attorney general considers that "there is no constitutional prohibition for private employers to conduct certain types of drug tests." (*e.g.*, random drug tests). However, this statement does not apply to government actions (state or federal), which are subject to the strictures of the 4th Amendment. As such, while there is no explicit Tennessee prohibition against random drug testing, such testing should only be conducted after a specific policy is in place (and which will inform that employee that there is absolutely no expectation of privacy), and to be totally safe, should be based upon "reasonable suspicion" when possible.

[71] *Stein, supra* note 69 at 718.

Multidisciplinary Practices:
A Proposed Solution to Effectuate the Inevitable

By: Jon Coffin[1]

I. INTRODUCTION AND SCOPE

Few debates in legal and accounting circles have sparked as much interest in recent years as the issue of whether Multidisciplinary Practices ("MDPs") should be allowed in the United States. American Bar Association ("ABA") President William Paul said MDPs present "the most important issue the legal profession has faced in many, many years."[2] This issue has become even more contentious, and more public, following the Enron debacle.

There is a wide range of sub-issues and a mass of information regarding MDPs. This article is limited in scope to a brief explanation of what an MDP is; a review of the history of the debate and the positions of the various parties in interest, including the legal and accounting professions; a look at the proof of the inevitability of MDPs; a consumer-oriented lead-in to a solution; and a proposed solution to effectuate the inevitable endorsement of MDPs.

The solution proposed in this article applies only to the legal and accounting professions; inclusion of other professionals is beyond the scope of this piece. The proposed solution takes into account the interests of the members of the legal and accounting professions and the clients they serve, the stated positions of these professionals and their clients, the unspoken desires and needs that drive their strong opinions on the issue, and their proposals for compromise. More importantly, the approach to the solution takes into account likely criticisms by the general public regarding the arguments for or against MDPs.

Most articles regarding MDPs are somewhat biased toward one profession or the other, which results in a polarized presentation that assumes the rules and values of each profession are completely upheld. The perception among many is that these assumptions are flawed.

When examining MDPs, there are various parties in interest: the professions on a national level, the ABA and the American Institute of Certified Public Accountants ("AICPA"); the professions on a state level, such as the Tennessee Bar Association ("TBA") and the Tennessee Society of Certified Public Accountants; the federal and state task force groups set up to comment and report to the professions; and those on the receiving end of the services provided by those professions, *i.e.,* the businesses and individuals that pay for and depend on legal and accounting professionals. States have differing views on MDPs, and this article will use Tennessee as an example, as well as other states that are leading the charge for or against MDPs. There are reports issued by the different parties in interest, reports on those reports issued by others, and commentaries on the reports on reports by still others. To sift through and analyze this maze of reports, one must start with a basic understanding of the structure and nature of an MDP.

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[2] *The FAQs on MDPs*, *at* http://www.abanet.org/yld/tyl/nov99/newtoyou.html (last visited Mar. 3, 2002).

II. THE DEFINITION OF AN MDP

An MDP has been defined as

> [a] partnership, professional corporation, or other association or entity that includes [both non-lawyers and] lawyers and has as one, but not all, of its purposes the delivery of legal services to a client(s) other than the MDP itself or that holds itself out as providing nonlegal, as well as legal, services. It includes an arrangement by which a law firm joins with one or more other professional firms to provide services, including legal services, and there is a direct or indirect sharing of profits as part of the arrangement.[3]

MDPs have also been defined to include firms that "provide more than one professional service (including legal services)" where "members of more than one profession share the profits of these services."[4] MDPs often "include lawyers as partners, directors, or share owners."[5] The form of MDP defined above will hereinafter be referred to as an MDP in the "pure form."

This pure form of MDP is not currently sanctioned in the United States. Specifically, legal rules of professional conduct prohibit the unauthorized practice of law and prevent fee-sharing between licensed attorneys and non-lawyers.[6] Prohibitions on the unauthorized practice of law emanate from, among other things, concern over the quality of legal services provided to the public.[7] Prohibitions on fee-sharing address a fear of potential conflicts when non-lawyers are allowed to share fees with lawyers.[8] According to Philip Anderson, former president of the ABA, the main concern is not the unauthorized practice of law.[9] "The law that is being practiced by accounting firms now is being practiced by skilled lawyers . . . . These people are licensed to practice law, and they are good at what they do."[10] Thus, the concern of the legal profession, as expressed by the ABA, does not appear to be the unauthorized practice of law under Rule 5.5 of the ABA Model Rules of Professional Conduct (the "Model Rules"), but rather the conflicts that arise from fee-sharing, which is addressed by Rule 5.4 of the Model Rules.[11] In addition to imposing the ban on fee-sharing, Rule 5.4 states that "[a] lawyer shall not form a partnership with a non-lawyer if any of the activities of the partnership consist of the practice of law."[12] Accordingly, this rule has been a key factor in the ongoing debate over MDPs.

III. HISTORY OF THE DEBATE AND POSITIONS OF THE PARTIES

In the past few years, well-informed members of both the accounting and legal professions have extensively debated MDPs. The debate positions summarized in this article represent the majority views of the two professions. There are divisions within the accounting and legal professions as to whether MDPs should be allowed. The accounting profession, for the most part, supports the idea of MDPs, while the legal profession has come out against proposals allowing for the establishment of MDPs. Proponents of MDPs argue that clients want "one-stop shopping," stating that the nature of modern business has made rules preventing establishment of MDPs outdated and that

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[3] *Id.*

[4] Ramon Mullerat, *The Multidisciplinary Practice of Law in Europe*, 50 J. Legal Educ. 481, 481 (2000).

[5] *Id.*

[6] *The FAQs on MDPs, supra* note 2.

[7] Model Rules of Prof'l Conduct R. 5.5 (1998).

[8] *Id.* R. 5.4.

[9] Philip S. Anderson, *Facing Up to Multidisciplinary Practice*, 50 J. Legal Educ. 473, 475 (2000).

[10] *Id.*

[11] Model Rules of Prof'l Conduct R. 5.4, 5.5. Note, however, that Rule 5.5 is broad in application and it is easy to run afoul of it. Thus, this Rule cannot simply be ignored.

[12] *Id.* R. 5.4(b).

these rules are "obstacles to the delivery of efficient and reasonably priced professional services."[13] Opponents of MDPs view the rules prohibiting MDPs as protectors of the duties of confidentiality and loyalty that attorneys owe their clients.[14]

A. Position of the ABA

The MDP debate was triggered by attempted alliances between accounting firms and law firms, such as McKee, Nelson, Ernst & Young, and was "ignited with full force" by an ABA Commission proposal in 1999, updated by a final report supporting MDPs in 2000.[15] No vote was ever taken on the 1999 report, and the Commission went back to the drawing board.[16] In 2000, the ABA House of Delegates rejected a final report by the ABA Commission on Multidisciplinary Practice that recommended the endorsement of MDPs. The Commission had been set up in response to ABA concerns over accounting firms' incursion into the legal market.[17] The proposal would require MDPs to agree to hold non-lawyers to the same duty of loyalty to which lawyers are held.[18] In response to the ABA Commission's report on this matter, various state bar associations also formed groups to study the matter.

B. Positions of the States' Bar Associations

The New York State Bar Association's "MacCrate Report," which was originally issued prior to the ABA Commission's report, was finally adopted by its House of Delegates in November 2000, and states that the ABA's proposal does not adequately preserve the values of the legal profession.[19] The MacCrate Report was a factor in the ABA's abandonment of its initial stance on MDPs, a disappointment to accounting firms who supported the proposal.[20]

In June 2001, a task force of the State Bar of California issued a report endorsing MDPs.[21] The report suggested various models that would allow an MDP to maintain the core values of the legal profession, even if MDPs, in the pure form, were allowed.[22] Under the California task force report, the pure form MDP would require a separate certification program, which would help to bind MDPs to certain rules and regulations.[23] The task force report is currently being considered and commented on by the public, and further discussion will resume at a later date.[24]

A task force for the State Bar of Arizona has also been developing proposals for changes to Arizona's ethical rules to allow MDPs.[25] The president of the Arizona Bar, in a statement supporting MDPs, said that the

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[13] *The FAQs on MDPs*, *supra* note 2.

[14] Model Rules of Prof'l Conduct R. 5.4, 5.5.

[15] John Caher, *Multidisciplinary Practice Rules Adopted by State*, N.Y.L.J., July 25, 2001, at 1. The reports mentioned in the article are available at http://www.abanet.org/cpr/mdpreport.html and http://www.abanet.org/cpr/mdpfinalrep2000.html.

[16] Mary C. Daly, *What the MDP Debate Can Teach Us About Law Practice in the New Millennium and the Need for Curricular Reform*, 50 J. Legal Educ. 521, 531 (2000).

[17] Kimberly E. Frank et al., *CPAs' Perceptions of the Emerging Multidisciplinary Accounting/Legal Practice*, Acct. Horizons, Mar. 1, 2001, *available at* 2001 WL 17181533.

[18] *Report from the Multidisciplinary Practice Committee*, *at* http://www.tba.org/mdp.html (last visited Mar. 3, 2002).

[19] Caher, *supra* note 15, at 1.

[20] *Id.*

[21] *Member/Public Comment; The State Bar of California, at* http://www.calbar.org/2bar/3com/3cp0106.htm (last visited Mar. 3, 2002). The final report, released on January 7, 2002, is available at http://www.courtinfo.ca.gov/reference/documents/finalmjprept.pdf.

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] Daniel J. McAuliffe, *Degrading the Core Values of the Profession*, 38 Ariz. Att'y 32, 32 (2001).

> worldwide economy has become more competitive, more efficient, more demanding. Professionals are not insulated from these changes . . . . I believe lawyers can do what is right even if we practice with other professionals . . . . This debate is academic at best, and absurd at most. MDPs are reality. . . . The only professionals unable to provide services as MDPs are lawyers . . . . For example, accounting firms employ thousands of lawyers and compete with large law firms now.[26]

This position is interesting in that it looks at MDPs from a different slant—that rules prohibiting MDPs create a competitive disadvantage for law firms by restricting the services that they can provide and keeping money out of their pockets instead of the reverse, as so many others assume.

The TBA formed a task force to examine MDPs and states in its report that even if "lawyers are bound by the current duty of loyalty, effective integration into an MDP faces significant practical difficulties for lawyers and, more importantly, for their clients."[27] The task force report recognizes three core values in the legal profession: independent professional judgment, confidentiality, and avoiding conflicts of interest.[28] The TBA task force report acknowledges that accountants do have ethical rules that are somewhat analogous to those applicable to attorneys, but argues that accountants do not have the duty of loyalty that attorneys owe to their clients.[29] The report also notes that, regardless of the duties of the two professions on a stand-alone basis, there are conflicts of interest that develop when the two professions are integrated in a practice setting.[30] Two conflicts addressed by the TBA are disclosure and loyalty.[31] With regard to disclosure, under certain circumstances an auditor is required to disclose contingent liabilities when he or she knows of information that may lead to a financial loss by the client.[32] This same information, however, may be covered by attorney-client privilege and, accordingly, be undisclosable by an attorney.[33] The issue of loyalty deals with "cross-selling," which involves the marketing of different services offered by the same firm to the same client.

In terms of cross-selling, the TBA task force is concerned about a situation where an attorney in an MDP must refer his or her client to another service provider who is a member of the same MDP.[34] The concern of the task force is that the attorney's duty of loyalty to the client would clash with his or her entity law-based fiduciary duty of loyalty to the MDP.[35] The task force conclusion includes an opinion that "[a] relatively small percentage of lawyers will likely be involved in MDPs."[36] However, the numerous attorneys already working for Big 5 accounting firms might offer a different opinion.

C. The AICPA's Position

A survey of 1,000 members of the American Institute of Certified Public Accountants (the "AICPA") demonstrated that accounting firms already provide legal services in the United States and desire to provide additional services if MDPs are allowed.[37] The survey, conducted with the assistance of the AICPA, found that the majority of

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[26] Nicholas J. Wallwork, *The MDP Challenge*, 38 Ariz. Att'y 4, 4 (2001).

[27] *Report from the Multidisciplinary Practice Committee, supra* note 18.

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] Accounting For Contingencies, Statement of Financial Accounting Standards No. 5 (Financial Accounting Standards Bd. 1975).

[33] Model Rules of Prof'l Conduct R. 1.6 (1998).

[34] *Report from the Multidisciplinary Practice Committee, supra* note 18.

[35] *Id.*

[36] *Id.*

[37] *Id.*

large accounting firms would choose to merge with law firms or hire lawyers as employees.[38] According to the same survey, however, small accounting firms and solo practitioner accountants would choose to enter into contracts to deal exclusively with a particular law firm.[39]

The AICPA's position was presented in a speech in New York by AICPA general counsel Richard Miller.[40] Miller opposed the ABA's position, claiming that current market forces support the idea of MDPs.[41] He also noted that accounting firms are already operating as MDPs by providing services beyond basic tax and audit work, and that the lawyers currently working at accounting firms are not practicing law, but are working as part of "multidisciplinary teams."[42] Finally, Miller claimed that clients favored MDPs because they would provide "increased choice, cost-effectiveness and convenience."[43] The AICPA decided that it was necessary to revise the current prohibition on MDPs in order to address the changing needs of accounting clients, while at the same time maintaining the core values of the accounting profession.[44]

D. MDPs in Other Countries

Although many other countries allow MDPs, some countries have voiced opinions against the establishment of MDPs. For example, Dutch authorities pursued efforts to prevent MDPs on the ground that they would violate antitrust laws.[45] However, a major accounting firm in Europe was able to reverse these efforts.[46] A careful examination of the effect of MDPs on competition in the United States is warranted, but is beyond the scope of this article.

E. Clients

The legal and accounting professions have lobbied long and hard for or against the use of MDPs in the interest of their clients. Or have they? The reality is that the clients they serve may not have the same interest in, or passion for, the debate. A survey sponsored by both the legal and accounting professions in Illinois showed that although 76% of business executives were not opposed to MDPs, only 20% would consider making use of the MDPs' expanded serviceability.[47] Eighty-five percent of those surveyed said that they would find a new service provider if their CPA or attorney were to join forces with an attorney or CPA whom they did not know.[48]

The survey, which was sent to 2,000 manufacturing and service businesses, also found that the perceived advantages of MDPs touted by some parties are not important to business executives.[49] These advantages include single billing, one-stop shopping, and a single point of contact.[50] Some perceived disadvantages of MDPs, on the other hand, were very important to the business executives.[51] These include increased conflicts of interest and loss of

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[38] *Id.*

[39] *Id.*

[30] *MDPs Closer to Becoming a Reality in the UK and the US*, Acct., Mar. 26, 2001, at 1, *available at* 2001 WL 14108969.

[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] David Jackson, *Accountancy Firms Drive One-Stop-Shop Concept*, Bus. Day, Aug. 2, 2001, at 7, *available at* 2001 WL 5966161.

[46] *Id.*

[47] *Illinois Business Executive's Opinions on Multidisciplinary Practices, at* http://www.icpas/business/MDP.htm (last visited Mar. 3, 2002).

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.*

confidentiality.[52] The survey responses led one commentator to observe that advocates of MDPs "have claimed that clients were eager for one-stop-shopping for professional services. They simply are not. Less than one in four prefers a combined practice to separate providers."[53]

Yet, the Illinois survey has neither silenced nor drastically altered the debate. Proponents of MDPs continue to argue that clients do indeed want one-stop shopping. Accountants argue that due to the overlapping services provided by law and accounting firms, clients do not know where to go for help.[54] "Many business consumers are beginning to ask for a single entity that they can trust to deal with all of their business problems."[55]

IV. THE INEVITABILITY OF THE MDP

Although pure MDPs are not sanctioned in the United States, rules of professional conduct do not prevent lawyers and CPAs from working together in other locations such as Europe, Canada, and Australia.[56] Consequently, PricewaterhouseCoopers employs 1,600 attorneys in 42 countries around the world[57] and Arthur Andersen acquired a law firm in Australia.[58]

Even in the United States, attorneys work at CPA firms in large numbers. In fact, CPA firms are the largest employers of attorneys in the country.[59] Law firms that have entered into strategic alliances with CPA firms are actually circumventing the applicable rules of ethics, such as the Model Rules mentioned above. For example, Big Five accounting firm Ernst & Young formed an alliance with the Washington law firm McKee Nelson LLP, in an attempt to form and operate McKee, Nelson, Ernst & Young.[60] It has become difficult to define where the legal profession ends and the accounting profession begins. MDPs would perhaps provide a way for the two professions to work together in the interests of clients instead of competing against each other for turf.[61]

New York recently became the first state in the United States to establish rules regarding MDPs.[62] The New York rules, which became effective in November of 2001, allow a limited form of MDP whereby lawyers and non-lawyers, such as CPAs, can share fees.[63] New York State Administrative Judge Jonathan Lippman stated that MDPs are "a fact of life in many jurisdictions around the country. It's basically going on unregulated now. We're the first state to do something about it."[64] The New York approach requires the attorneys in an MDP to remain solely responsible for legal work and seeks to maintain the attorney-client relationship by adding two new sections to the New York Code of Professional Responsibility.[65] The new rules stop short of allowing a pure MDP by maintaining a "firewall" between

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[52] *Id.*

[53] *Illinois Business Executive's Opinions on Multidisciplinary Practices, supra* note 47.

[54] Lewis E. Elicker , *MDPs Could Open New Doors of Opportunity*, Pa. CPA J., Oct. 1, 2001, at 28, *available at* 2001 WL 18412263.

[55] *Id.*

[56] Frank, *supra* note 17.

[57] *Id.*

[58] Anderson, *supra* note 9. The fate of Andersen and its global network is, of course, unpredictable in light of post-Enron events.

[59] Frank, *supra* note 17.

[60] Christopher Terry, *Accounting Firms Tally the Many Challenges of Globalization*, Chi. Law., Sept. 2001, at 67.

[61] Elicker, *supra* note 54.

[62] Manny Topol, *New York State Makes Regulatory History*, Newsday, Aug. 13, 2001, at C08, *available at* 2001 WL 9245141.

[63] *Id.*

[64] *Id.*

[65] Caher, *supra* note 15.

the two professions and allowing a side-by-side business arrangement as opposed to an all-inclusive firm.[66] The rules contain a presumption against the New York MDP that can be rebutted by notice to the client in the form of an engagement letter.[67] The Georgia State Bar may follow New York's lead and also allow some form of MDPs.[68] Other states are studying the idea, and have voiced both support and opposition to MDPs, but none have taken definitive action.

Although the debate over whether to allow MDPs in the United States rages on, MDPs have been operating in disguise for some time now. Allowance of MDPs in their pure form seems inevitable. Judge Lippman has stated that "the legal profession is moving inexorably toward [MDPs]—especially involving lawyers and accountants."[69] It does not matter that law firms do not want it to happen. It does not even matter that clients may not want it to happen. According to the president of the ABA, "[t]he bar associations and the state supreme court committees do not have enough money to pursue litigation against any one of the Big Five in court and everyone knows it, especially the accounting firms."[70] The Big Five accounting firms are wealthy and determined, and preventing the official allowance of MDPs would be like damming the Mississippi River with toothpicks.

Having come to the conclusion that MDPs are inevitable, the next question is what to do to resolve the ethical dilemmas created by MDPs. A solution to the MDP debate must be found to meet at least some of the needs and desires of all parties in interest, including (most importantly) the clients.

V. A CONSUMER-ORIENTED LEAD-IN TO A SOLUTION

In the end, those who will determine whether MDPs are successful are the end-users of the services the MDPs provide—their clients. These end-users must be confident in a product that is produced by a system of self-regulated, self-policing professionals. This warrants a rather cynical approach to a solution that will address the doubt of clients and the general public.

The legal profession already has rules in place that protect lawyers' financial interests in the name of client service. Although the Model Rules do not allow for screening, the ethics rules in some states provide that an attorney in a conflict of interest situation may be "screened" by his or her law firm in order that the firm might continue to represent a client with whom the attorney has a conflict. The legal profession expects a lawyer's clients to trust that this screening process really works. Yet the profession is not willing to admit that it would be possible for a client's confidences similarly to be maintained in an MDP. Apparently, members of the legal profession are capable of keeping a secret when they are getting all of the money, but are unable to keep a secret when doing so would allow accountants to share in the wealth.

Yet the legal profession is not the only one motivated by profits. Accountants, specifically auditors, have an obligation to the public to be independent of their clients.[71] Note that "independence" has a different meaning for the two professions. Auditor independence is defined as a "condition of accountant having no bias and being neutral regarding the client or another party in performing the audit function."[72] Thus, the accountant must not be subject to influence by the client.[73] Attorney independence, on the other hand, means that the attorney will not be subject to influence by anyone other than the client.[74]

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[66] *Global Investing—Let the Buyer Beware of One-Stop Shopping*, Fin. Times, Aug. 30, 2001, *available at* 2001 WL 26848024.

[67] Anthony E. Davis, *New Rules on Cooperative Business Arrangements with Non-lawyers*, N.Y. L.J., Sept. 6, 2001, at 3.

[68] *State Bar of Georgia May Lift Ban on Fee-Sharing*, The Law., Aug. 6, 2001, *available at* 2001 WL 11472845.

[69] Joel Stashenko, *Lawyers Get More Business Latitude*, Times Union Albany, N.Y., Aug. 13, 2001, at B2.

[70] Anderson, *supra* note 9.

[71] AICPA Code of Prof'l Conduct R. 101.

[72] Barron's Dictionary of Accounting Terms 206 (2d ed. 1995).

[73] AICPA Code of Prof'l Conduct R. 101.

[74] Model Rules of Prof'l Conduct R. 1.7 (1998).

Auditor independence comes at a price. Compliance work is becoming less profitable and CPAs are moving into more of a consulting role, which is highly profitable. Auditing and accounting fees for the Big Eight were 70 percent of total revenues in 1976, as opposed to only 34 percent in 1998 for the Big Five.[75] The change from 1976 to 1998 represents a move away from the more traditional accounting and auditing services that CPAs provide towards other services, including tax planning and accounting, broad-based consulting, valuations and related opinions, investment advising, technology counseling, litigation support, etc. This expansion of the services that CPAs are attempting to provide hints at an undeniable profit motive behind the CPA argument in favor of MDPs. With this expansion comes an obvious loss of pure independence. The Securities and Exchange Commission has expressed concern over a loss of independence when accountants also perform consulting services.[76] Consultant/auditors who give clients business advice hope that their advice will pay off. Accordingly, when accountants audit the financial statements of clients for which they have acted as consultants, the possibility increases that earnings will be manipulated with "cookie-jar reserves," valuations will be adjusted, and contingencies will be overlooked, resulting in false confidence presented to the public.

VI. A PROPOSED SOLUTION TO EFFECTUATE THE INEVITABLE (THE 3 "P"S)

A. Protecting Confidentiality and Independence

While the argument that the professions owe a duty to maintain "core values" for the benefit of the public sounds good in theory, it may very well be watered down when actually applied. What then, is the real problem and the real solution? Users of financial statements, such as lenders, investors, and shareholders, want to be able to rely on the independence of the auditor that prepared the statements. Although it is in the best interests of these financial statement users that the auditor be aware of all the confidences of the company being audited, the company itself has an interest in maintaining confidentiality with its attorney. Thus, the attorney may become aware of certain things that would be required to be disclosed as a contingent liability on the financial statements if the auditor, who happens to be a partner of the attorney, is aware of them.[77] This conflict of interest can be eliminated through rules that require careful screening of the auditors as to that information. This is actually not a new concept to the attorney-accountant relationship. Currently, auditors require their clients to make requests of their attorneys for information, known as "legal letters" or "audit letters," on pending legal matters that may require disclosure in the financial statements. Attorneys gauge their response based on their client's consent or simply provide boilerplate language that refuses to divulge privileged information.[78] Auditors in an MDP who are subject to screening would be privy to exactly the same response. Thus, their liability for giving a clean opinion on materially misstated financial statements would not change in the MDP context, and both confidentiality and independence would be protected.

B. Providing Incentives for Compliance with Special Professional Conduct Rules Applicable to MDPs

It is possible to maintain auditor independence and attorney confidentiality at the same time, but how can clients be sure that the MDPs will do so? One might address this question by asking another; that is, why do people trust attorneys in firms without accountants or other professionals to maintain confidentiality? Is it because the legal profession has a long history of distinguished service? Is it because attorneys are an elite group of people who are naturally born with ethics and honesty? Of course not! Clients know that if confidentiality is not maintained, attorneys will be disbarred, fined, or otherwise disciplined.

Attorneys are forced to maintain independence and confidentiality by rules that are enforced by the threat of taking away a license that is difficult to earn and to maintain. CPAs have a similar licensing requirement. Interestingly,

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[75] Frank, *supra* note 17.

[76] Terry, *supra* note 60 (discussing the SEC oversight role of accountants, which is limited to those who perform services for publicly traded companies).

[77] Accounting for Contingencies, Statement of Financial Accounting Standards No. 5 (Financial Accounting Standards Bd. 1975).

[78] ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (1975).

market studies have shown that CPAs have the reputation as the most trusted professionals, with lawyers in second place.[79] In the wake of the Enron scandal, such a study might produce different results. However, regardless of which profession is most trusted, "*where* one works does not make one more or less willing to protect client confidentiality . . . ."[80] The answer then, is to require every member of an MDP to maintain an additional license that is acquired by the passing of an ethics and substance exam, and is maintained by the completion of continuing education geared towards practice in an MDP. Members of MDPs would be required to maintain both their law or CPA license and a newly constituted MDP license. The threat of being prevented from practicing in the MDP will serve to assure compliance.

The thought of creating a new designation in addition to "Esq." and "CPA" is not foreign. The AICPA recently examined a possible "XYZ" (now called "IISBP") designation in which business professionals such as CPAs and lawyers could be recognized to have knowledge in the areas of accounting, business law, business planning, corporate finance, human resources, information technology, marketing, and operations.[81] The proposed credential would be accompanied by a code of ethics that would include rules on integrity, competence, and even confidentiality.[82] A similar structure could be developed for members of an MDP. Concern over the differences between the ethics rules in the two professions would be eliminated. In December 2001, however, the AICPA voted down the "XYZ" designation. Nonetheless, the point made in this article—that such an additional designation, although perhaps not popular with practitioners, is still a reasonable consideration, and quite necessary to maintain adequate regulation over MDPs—remains valid.

One might question the formation of a new professional license due to the difficulty involved with obtaining yet another license, and argue that it would be much easier to simply require members of an MDP to comply with the highest ethical standard of either accountants or attorneys. However, it is this difficulty that will provide incentives to follow the applicable rules, for fear of license revocation. Having a separate professional license also will be beneficial to the general public in sorting out who's who and what's what once the legal and accounting professions merge. The public is already confused over what services lawyers and accountants actually provide, and the addition of MDPs without a separate credential would confuse the matter further. The credential would provide the public with an identifiable measure of skill and ability. Finally, sorting out the rules of the two professions and determining which one has the "highest" standard in each substantive area may prove to be more difficult than it appears.

To some extent, the TBA seems to agree with the solution of an additional licensure requirement as recommended in this article. The TBA task force recommendation to the ABA noted opposition to MDPs, but stated that if they were to be allowed, "a separate classification of lawyers [should] be established for those lawyers who choose to participate in an MDP in order to distinguish to the consuming public that the protections of the traditional [attorney/client] duty of loyalty will not be available in the context of an MDP."[83] The solution described in this article does create a new classification, but it also provides for the continuance of the duty of loyalty. It is important to note that the core values of both the accounting and legal professions have been considered and addressed through the solution recommended in this article, and both sets of values have been preserved.

C. Preventing Conflicts of Interest Between the Client and the MDP

Once the MDP is formed, and confidentiality and independence are protected, there is still a potential conflict between the duty of loyalty to the client and the fiduciary duty to the MDP. This concern, expressed by the TBA task force and noted above, also can be put to rest. Fiduciary duty arises out of common law, or more specifically, agency law. It is also governed by statute to a certain extent with respect to certain forms of entity in certain jurisdictions. For

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[79] Elicker, *supra* note 54.

[80] Margaret Milner Richardson, *Changes, Choices, and Challenges for the Legal Profession,* 50 J. Legal Educ. 477, 480 (2000) (emphasis added).

[81] *See* http://www.globalcredential.aicpa.org.

[82] *Id.*

[83] *Report from the Multidisciplinary Practice Committee*, *supra* note 18.

example, section 8.30 of the Model Business Corporation Act defines general standards of conduct that directors of a corporation must follow in order to comply with duties of loyalty and care that they owe to their shareholders.[84] In the partnership context, section 404 of the Revised Uniform Partnership Act requires a duty of loyalty and care between partners.[85] Does this mean a director cannot make a decision that hints of favor to a customer or other third party? Of course not! Decisions made in the interests of third parties often help the company in the long run, and have been endorsed by statutes and courts. Similarly, an attorney who refers a client to a service provider outside the MDP would be helping the MDP in the long run by developing trust and good faith. Therefore, there would be no breach of fiduciary duty.

Attorneys pledge to "sacrifice [their] own financial interests" and "subordinate [their] personal interests to the interests of the client."[86] Therefore, it would be an unpersuasive argument to say that an attorney who is faithful enough to his client to sacrifice his own direct benefit will refuse to sacrifice the benefit of his business associates and his indirect benefit. The argument that MDPs will take away from clients their choice of service providers is also flawed. In countries where MDPs are allowed, no MDP has captured the majority of the market share, thus proving that the choice to utilize a traditional service provider will continue.[87] This statistic also begs the question of what all the fuss is about in the first place!

Despite the fact that referral of a client outside the MDP will not breach the fiduciary duty to the MDP, one might argue that an attorney will be motivated by profits and will not be likely to refer the client to anyone but his or her partner in the MDP. This argument is not persuasive. For one thing, attorneys are subject to conflicts of interest in situations where they may be better off financially by making a decision not in the best interest of their clients. Thus, the threat to a client's best interests would not be significantly increased by offering legal services through MDPs. Additionally, law firms and CPA firms already share clients. Through networking, attorneys have accountants with whom they feel comfortable recommending clients, and accountants have the same type of relationships with attorneys. Thus, as an accountant or attorney, the natural instinct is to recommend a law firm or CPA firm, respectively, with which you and your other clients have been working on a mutually beneficial basis through the years. With MDPs, the accountants or lawyers you trust would be in the same office, instead of down the street. Management of the MDP would control the quality of the work by firing incompetent members, just as an individual attorney would control the quality of accounting work, or an individual accountant would control the quality of legal work his or her client received by changing referrals. Such control would be more effective in an MDP setting. For example, attorneys in MDPs will have both accountants and other attorneys at their disposal in evaluating the quality of another accountant's work, while attorneys outside of MDPs will have only other attorneys to help evaluate the accountant down the street.

Furthermore, the use of engagement letters would be required to establish the scope of the service that the MDP agrees to provide to the client. These letters are an ideal place for disclosures by the MDP of potential conflicts of interest and other instructive statements (*e.g.*, that clients should consider using as many or as few of the services offered by the MDP as they see fit.) The clients that use both the accounting and legal services offered by an MDP are probably going to be sophisticated clients who are able to make an informed decision on the service providers they wish to employ. And cross-selling legal and accounting services is no more conflicting than a tax lawyer sending his client down the hall to the litigator's office when the client gets in trouble with the IRS.

VII. THE IMPACT OF ENRON

The recent Enron debacle impacts the discussion in this article. The Securities and Exchange Commission began a formal investigation into Enron Corporation after the release of a 2001 third quarter earnings report announced a

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[84] Model Bus. Corp. Act § 8.30 (1979).

[85] Unif. P'ship Act § 404 (1997).

[86] *Report from the Multidisciplinary Practice Committee, supra* note 18.

[87] Elicker, *supra*, note 54.

loss of $618 million.[88] Subsequently, Enron filed a Chapter 11 petition, the largest bankruptcy filing in United States history by what was once the seventh-largest company in the nation.[89] In January 2002, the Department of Justice joined the fray when it an announced a criminal investigation into the matter.[90] On March 20, 2002, Arthur Andersen pleaded innocent to obstruction of justice charges relating to the Enron document shredding scandal.[91] At the heart of the matter is alleged inappropriate behavior by Enron's independent audit firm, Arthur Andersen LLP ("Andersen"), and Enron's attorneys, including the law firm of Vinson & Elkins.[92] Enron, with the help of its accountants and attorneys, allegedly created special purpose partnerships that removed debt from Enron's balance sheet and materially misstated its earnings.[93] Recently, David Duncan, the former Andersen partner that was in charge of the Enron account, pleaded guilty to an obstruction of justice charge for helping destroy Enron records.[94] The plea by Mr. Duncan has given prosecutors "a potent weapon in their case against Andersen."[95] Unless a settlement agreement is reached, the Andersen trial will begin on May 6, 2002.[96]

Scrutiny and criticism of this behavior, mostly targeted at Andersen, has led to scrutiny and criticism of the accounting profession as a whole, especially with regard to its self-regulated status. Harvey Pitt, chairman of the Securities and Exchange Commission, has proposed the need for policing of the accounting profession by a group of outside experts.[97] Prior chairman Arthur Levitt extended this concern to analysts, investment bankers, and lawyers as well, stating that a review of both financial accounting standards and legal ethical standards is necessary.[98] It has also been proposed that a form of "screening" be applied to accounting firms to prevent contact between auditors and their consulting colleagues.[99]

The Enron debacle makes it even more imperative that the proposed solution offered in this article be considered. If any solution to the MDP quandary is to be adopted, the events emanating from the Enron debacle are proof that an additional regulatory scheme is necessary to restore public trust in the accounting profession. If no action is taken, the accounting profession will continue to operate unofficial MDPs in the current unregulated environment.

VIII. CONCLUSION

To summarize, there are three main objectives that will effectuate the proposed solution. These are: protecting confidentiality and independence; providing incentives for compliance with special professional conduct rules applicable to MDPs; and preventing conflicts of interest between the client and the MDP itself. An MDP solution that meets these objectives should be adopted to properly regulate the provision of legal and accounting services through MDPs. The solution proposed in this article meets these objectives.

First, members of the MDP would be required to abide by a separate code of ethics, which would screen accountants from confidential information obtained by lawyers during the course of representation in a manner

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[88] Adrian Michaels, et al., *Seven Months in the Death of a Global Giant*, Fin. Times, April 11, 2002, at 26.

[89] *Id.*

[90] *Id.*

[91] Richard B. Schmitt, *Andersen: Called to Account: Andersen Gets an Early Date for Federal Trial*, Wall St. J., Mar. 21, 2002, at C1.

[92] Mike France, et al., *One Big Client, One Big Hassle*, Bus. Wk., Jan. 28, 2002, at 38.

[93] *Id.*

[94] Richard B. Schmitt & Devon Spurgeon, *Leading the News: Andersen Weighs Making Concessions; Firm Hopes to Delay Trial As It Maps Out Strategy On Handling Star Witness*, Wall St. J., Apr. 11, 2002, at A3.

[95] *Id.*

[96] *Id.*

[97] Jonathan D. Glater, *How Will Washington Read the Signs? New Oversight for Accounting*, N.Y. Times, Feb. 10, 2002, § 3, at 13.

[98] Arthur Levitt, *Who Audits the Auditors?*, N.Y. Times, Jan. 17, 2002.

[99] Richard S. Dunham, *The Fallout for Bush and Congress*, Bus. Wk., Jan. 28, 2002, at 42.

consistent with current attorney confidentiality obligations. Second, accountants and attorneys providing services through the MDP would be required to obtain and maintain a license separate from their CPA and/or law license. Third, the potential conflicts of interest between the client and the MDP itself either already exist without MDPs, or can be resolved or mitigated without additional legislation.

This solution is similar to "The Fully Integrated Model," a solution to MDPs suggested by the ABA's Commission in their proposal to the ABA,[100] and therefore can be merged with or into that model or any modification of that model. The Fully Integrated Model allows the establishment of a professional services firm in which lawyers and non-lawyers practice,[101] and has been described as "a single professional services firm . . . with organizational units, such as accounting, business consulting, and legal services."[102] The ABA model is similar to the solution proposed in this article in its commentary on cross-selling of services and screening of confidential information. The Fully Integrated Model is different from the proposed solution in that it requires a change in the existing legal ethics rules, but not a new set of conduct rules geared solely toward MDPs. Thus, the ABA model does not appear to have the same degree of regulatory control that is needed to assure compliance by all members of the MDP. The first ABA proposal, issued in 1999, did have an annual administrative audit requirement and included a written "promise" by the MDP not to interfere with lawyers' responsibilities under the rules of professional conduct.[103] The revised 2000 report has no such requirements.[104]

There is more to this article's solution than a simple relaxation of the current legal ethics rules regarding fee sharing and the unauthorized practice of law. The solution proposed in this article requires the establishment of a whole new credential, with its own conduct rules, that is made available only to CPAs and attorneys. Further analysis would be needed before admitting insurance companies, financial institutions, securities firms, and other professional service firms. While recent events may make implementation of the proposed solution more difficult, a careful analysis of both the positive and negative aspects of MDPs should be considered in order to create the most effective and efficient system for legal and accounting professionals, as well as their clients.

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[100] *See Hypotheticals and Models, at* http://www.abanet.org/cpr/multicomhypos.html (last visited Mar. 4, 2002); *American Bar Association Commission on Multidisciplinary Practice Report to the House of Delegates, at* http://www.abanet.org/cpr/mdpfinalrep2000.html (last visited Mar. 4, 2002).

[101] Daly, *supra* note 16, at 526.

[102] *See Hypotheticals and Models, supra* note 100.

[103] *See Report, at* http://www.abanet.org/cpr/mdreport.html (last visited Mar. 4, 2002).

[104] *See American Bar Association Commission on Multidisciplinary Practice Report to the House of Delegates, supra* note 100.

Lawyers Doing Business With Their Clients: Identifying and Avoiding Legal and Ethical Dangers: A Report of the Task Force on the Independent Lawyer

By: Sarah Stephens McNeal[1]

In the last decade, there has been a huge increase in lawyer investments in their clients.[2] In 2001, the Task Force on the Independent Lawyer (the "Task Force") published a report examining issues surrounding lawyers investing in their clients and client transactions (the "Report"). The American Bar Association's Section of Litigation commissioned the Task Force[3] in 1995 to address two issues: (1) lawyers serving on the boards of directors of their clients and (2) lawyers investing in their clients and client transactions.[4] The Task Force first focused its attention on the issue of lawyers serving on the boards of directors of their clients, and in 1998 issued a report summarizing its conclusions.[5] The Report is a study of the second assignment of the Task Force, the issue of lawyers investing in their clients and client transactions.

The Task Force concluded that "lawyer investments in their clients and client transactions can raise significant issues of ethics and professionalism," some of which are so broad that neither the lawyers nor their clients will fully understand the consequences of those transactions or the rules governing those transactions.[6] The most obvious risk to the client that arises is the possibility that lawyers could take advantage of their clients by giving the client advice that furthers the lawyer's interest rather than the client's, potentially resulting in "professional discipline or enhanced malpractice exposure."[7]

The Task Force did not recommend a *per se* rule against lawyers entering into business transactions with their clients; instead, the Task Force recognized some benefits that may arise from such a relationship.[8] Additionally, the Task Force recognized that some of the risks mentioned earlier are less likely to be present when the attorney and the client have equal bargaining power or when the attorney's legal work is unrelated to the client's business transaction. The Task Force further found that even if these two circumstances are not present, the common law rules of fiduciary duty and legal ethics are sufficient to protect clients and to guide attorneys through the transactions.[9]

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[2] Ronald J. Cohen, et al., *Lawyers Doing Business With Their Clients: Identifying and Avoiding Legal and Ethical Dangers, at* 40 (2001).

[3] The task force included both law school professors specializing in legal ethics and practicing attorneys who represented both individuals and corporations as either in-house or outside counsel. *Id.* at 2.

[4] *Id.* at 1-2.

[5] The report cautioned against attorneys serving on the boards of directors of their clients and recommended alternatives to such service. *Id.* at 3.

[6] *Id.* at 3-4.

[7] *Id.* at 4. The Report noted that "when an attorney enters into a business venture or partnership with a client, the role morphs from advocate, advisor, and confidant, to potential defendant, co-conspirator, aider, abettor, and tortfeasor," resulting in increased civil liability to the attorney. Additionally, malpractice claims against attorneys who enter into business transactions with their clients may not be covered by malpractice insurance. *Id.* at 49.

[8] Cohen, et al., *supra* note 2*,* at 5-6. The Task Force recognized that some of the benefits of such a relationship include strengthening the bond between attorneys and their clients, helping the attorney to provide higher quality legal services, and increased opportunities for attorneys to profit.

[9] *Id.* at 6-7. The Report went into great detail examining lawyers' ethical and fiduciary duties and differentiating between those duties. The Report compared and examined the common law of fiduciary duty, and those sections of the Canons of Professional Ethics, the Model Code of Professional Responsibility, the Model Rules of Professional Conduct, state variations from the Model Rules, proposals before the Ethics 2000 Commission, and the Restatement of the Law Governing Lawyers that would be implicated in a business transaction between a lawyer and his or her client. *See id. at* 12-40.

The Task Force recommended that, because of the risks inherent in lawyers transacting business with their clients, the lawyers and clients should "think long and hard before they enter into a business transaction together."[10] The Task Force listed some specific questions for both the attorney and the client to consider before entering into such a transaction, including: which party initiated the investment; what is the nature of the investment to both the attorney and the client; whether the attorney's involvement as an investor will damage the attorney-client relationship; whether the attorney's investment will increase the risk of claims against the attorney if the investment does not succeed; whether the lawyer's malpractice insurance will cover any potential claims; and whether insider trading regulations will have an impact on the lawyer's investment.[11]

The Report acknowledges that there are a number of factors that should guide the lawyer and client in deciding whether a transaction is acceptable, and that the Report could not provide "easy answers" to this difficult situation.[12] The Report also admits that it is not a roadmap in determining whether a particular attorney-client transaction is permissible; rather, its purpose is to help attorneys plan in advance to avoid problems. However, the Report discusses some of the most common types of business transactions between lawyers and their clients, including: a lawyer's receipt of valuable gifts from clients; a lawyer's being designated as a beneficiary in a will or trust; a lawyer's acceptance of a security interest in a client's property; and in-house counsel being compensated with stock or stock options. In discussing these common business transactions, the Report coverts the special rules implicated by and common concerns involved in those particular types of transactions.[13]

The Report addresses conflicts of interest concerns, both to an individual attorney and to the law firm as a whole, and the applicable imputation rules.[14] The Report notes that there are few cases or ethics opinions addressing imputation rules where attorney-client business transactions are involved, but nonetheless offers some guidance on identifying the imputation provisions of the Model Rules, the Code, and the Restatement, as they may potentially apply to attorney-client business transactions.[15] Additionally, the Report recognizes that when conflicts arise in a typical attorney-client relationship, screening mechanisms can be used to avoid the imputation of a particular lawyer's conflicts to a law firm. However, the Report concludes that traditional screening programs are ineffective in recognizing the conflicts inherent in attorney-client business transactions.[16]

The Task Force hopes the Report will help lawyers and clients identify potential conflicts in these situations and help lawyers deal with those conflicts when they originally appear, rather than after problems have already arisen.[17] Additionally, the Task Force hopes the Report will encourage lawyers and clients who are considering entering into business transactions together to both conduct a full analysis of the situation and draft a written disclosure of and consent to the risks involved in that transaction.[18] The Report finally recognizes that "implementation of its precepts demands constant policing [and] is an obligation lawyers owe their clients and also themselves."[19]

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[10] *Id.* at 7.

[11] *Id.* at 7-9.

[12] *Id.* at 9.

[13] *See id.* at 55-105.

[14] Cohen, et al., *supra* note 2, at 111.

[15] *See id.* 111-15. The Report also noted that although the common law of fiduciary duty addresses this issue, there are no decisions applying the law to business transactions between a lawyer or a principal and his or her client or fiduciary. *Id.* at 111.

[16] *Id.* at 117.

[17] *Id.* at 9.

[18] *Id.* at 10. The Report stated that the Task Force "cannot overemphasize the disclosure obligation." *Id.* at 53. However, in some transactions even consent is insufficient to allow the transaction to proceed. *Id.* at 118.

[19] *Id.* at 119.

Book Review: *Bankruptcy in Practice*

Reviewed by George W. Kuney[1]

The American Bankruptcy Institute's slate of publications about the bankruptcy system has been augmented in 2002 by a fine work from Professor John D. Ayer and Michael L. Bernstein.[2] In *Bankruptcy in Practice*, these co-authors have successfully bridged the gap between classroom theory, courtroom procedure, and practical information.[3] The book blends a doctrinal discussion of cases as examples of processes and procedures to provide a useful primer for any attorney with a general, non-bankruptcy practice, or one seeking entry into the field. This book is perhaps the best publication that this reviewer has seen to date in terms of demystifying the bankruptcy process, explaining the substantive statutes, discussing their policy grounds, detailing proper procedures, and introducing the various players and their motivations.

The book begins in Chapter 1 with an overview of the policy roots of bankruptcy law and describes the process and basic procedures. This section is written in a conversational tone in plain English and includes reference to all the important antecedents to current bankruptcy law without the ponderous tone that is sometimes taken in other works. The authors set the stage for easy comprehension of the balance of the book with this chapter, which outlines the plot of and characters in the bankruptcy story. As Professor Ayer has said before, to understand the bankruptcy process, one must view it as a story, a novel if you will, complete with characters that have public and private motivations that fuel the plot.

In Chapter 2, the authors tackle a fundamental point for those with limited knowledge of the bankruptcy system—how one gets information about a case, a court, or a ruling. To those that lack the knowledge necessary to make the bankruptcy system transparent, the bankruptcy court may appear to be a black hole into which debtors and creditors' assets and claims disappear only to be spit out at some later unpredictable time in an unfathomable fashion. This chapter identifies the sources of law, including key rules of bankruptcy procedure that relate to notice, motion practice, fundamental motions, and disputes that arise early in a case, discovery, dischargability, and how to file a proof of claim to preserve a creditor's rights. The chapter closes with an extensive list of Web sites for courts, government and non-governmental organizations, and learning resources that is invaluable in making the bankruptcy process transparent to the uninitiated.

Chapters 3 and 4 delve into bankruptcy jurisdiction and procedure. As someone who has had the pleasure of reading (and compelling students to read) cases on bankruptcy jurisdiction and procedure, I can say that the presentation is remarkably clear and concise. At the same time it does not shirk away from thorny problems, including: "arising in," "arising under," and "related to" jurisdiction created by non-Article III bankruptcy courts serving as units of Article III district courts and the famous Supreme Court decision of *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*;[4] confusing appellate procedure involving resort to optional bankruptcy appellate panels or the district court; abstention and remand; state sovereign immunity in the wake of *Seminole Tribe v. Florida*;[5] and the interplay of state and federal courts in the determination, review, and enforcement of each other's judgments.

Chapter 5 presents a good discussion of the "ins and outs" of bankruptcy, specifically, how, when, and if one

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[2] Professor Ayer is a Professor of Law at the University of California at Davis, and a former Bankruptcy Judge and practitioner. Mr. Bernstein is a partner in the bankruptcy practice group at Arnold & Porter in Washington, D.C.

[3] John D. Ayer & Michael L. Bernstein, Bankruptcy in Practice (American Bankruptcy Institute, 2002).

[4] 458 U.S. 50 (1982).

[5] 517 U.S. 44 (1996).

can or should seek refuge in the bankruptcy system and, if so, under which type of proceeding. The discussion of so-called "bankruptcy-proofing" is somewhat limited as it does not discuss fundamental principles underlying the practice such as focusing on limiting or eliminating the debtor's property rights in assets and providing for automatic termination or acceleration of rights in contracts, leases, and notes, but its discussion of securitization is plain and clear and will make this powerful but often misunderstood technique understandable to the lay person and non-commercial lawyer alike. The chapter concludes with a very useful set of sample questions for an initial debtor interview and a checklist of items that are part of the initial filing of any bankruptcy case.

The remaining chapters discuss Chapter 11 and its alternatives, the automatic stay, property of the estate, debtor in possession management, use, sale and lease of assets, executory contracts, liens, claims, priority and distributions, the trustee's avoiding powers, preferences, fraudulent transfers, discharge and dischargeability, and confirmation of plans. Each of these traditional bankruptcy topics is presented in the same clear and concise fashion as the preceding chapters.

One fault, which can be directed mainly at the publisher and not the authors, is the lack of a detailed table of contents, index, or table of authorities. The book is 484 pages long, and the only means for finding, or finding again, a particular discussion is a one-page table of contents with 19 entries. Especially because the book so effectively discusses the *gestalt* created by the bankruptcy code, rules, case law, and practice, incisive discussions are not necessarily located under the chapter heading that one might first select. Any second edition should remedy this flaw.

If the book has any serious shortcoming in terms of content, it is in its usefulness in law school teaching. Frankly, the material is so well organized and clearly presented, and policy, black letter law, case law, and procedure down to the impact of local rules are so neatly woven together that the book leaves little analytical exercise for law students. This "failing" makes the book indispensible for practitioners of any sort seeking to understand, penetrate, and navigate the bankruptcy system. For many of the readers of this review, this "failing" may be all the endorsement that is necessary.

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Synopses

Antitrust

Tying Arrangements: Effect of Technical Innovation on an Antitrust Claim. *Logic Process Corp. v. Bell & Howell Publ'n Sys. Co.*, 162 F. Supp. 2d 533 (N.D. Tex. 2001).

By Chris Raybeck

Computer products are occasionally subject to tying arrangements, which are illegal schemes by sellers to bundle products or services together. Although product compatibility among competing brands weakens producers' ability to tie products, constant technical innovation within the computer industry hampers compatibility. The United States District Court for the Northern District of Texas recently declared that a tying arrangement did not exist where one hardware producer upgraded software format and, in the process, eliminated the need for a competitor's hardware.

Throughout the eighties and early nineties, Logic Process Corporation ("Logic Process") produced and sold computer equipment, offered upgrades, and sold support services and maintenance agreements for its equipment to, among other businesses, Texas motorcycle dealers. During this period, Bell & Howell Publications Systems Company ("Bell") produced and sold computer equipment and software that contained dealers' prices for motorcycle parts ("price book information"). Because Bell's price book information was on cassette tape format, Bell's software was compatible with Logic Process' computers, and the companies often shared customers.

In 1996, however, Bell upgraded its price book information format to CD-ROM, which the Logic Process machines could not use. Therefore, dealerships that were Logic Process customers had to purchase Bell computers (or other IBM compatible computers) to use Bell's price book information. When Bell refused Logic Process' request for a decoder key, Logic Process brought suit under federal and state antitrust laws claiming that Bell tied its computer hardware to its price book software.

A tying arrangement, illegal under both the Sherman and Clayton Antitrust Acts, requires a buyer to purchase an undesired product or service in order to obtain a desired product or service. To prove a tying arrangement, a plaintiff must show that: (1) "there [are] two separate and distinct products, as opposed to components of a single product;" (2) "the two products [are] tied together, or customers [are] coerced into buying the tied product;" (3) "the seller possess[es] substantial economic power over the tied product;" (4) "the tie restrain[s] free competition in the market for the tied product"; and (5) "the tie affect[s] more than an insubstantial volume of commerce."

The thrust of Logic Process' claim was that Bell placed the price book information in CD-ROM format to force dealerships to buy Bell's computer equipment instead of Logic Process' equipment. However, the court found that Bell's distribution of the price book data exclusively in CD-ROM form did not coerce dealerships into buying Bell's equipment because Bell had the right to upgrade and discontinue services as it saw fit. Because the court found that Bell's behavior did not amount to coercion, it found no tying arrangement. Additionally, the court stated that Bell owed no duty to relinquish decoding information to Logic Process.

Ultimately, the court was reluctant to hold Bell responsible for Logic Process' extinction. Therefore, when a plaintiff's competitor creates or improves a product while eliminating compatibility, the plaintiff should not expect a claim of a tying arrangement to be successful.

Banking

Disclosure of Customer's Identity in Response to Suspected Illegal Activity Not Violative of the Federal Right to Privacy Act. *Villalba v. Coutts & Co.*, 250 F.3d 1351 (11th Cir. 2001).

By Stephanie Mashburn

The United States Court of Appeals for the Eleventh Circuit held that a bank's alleged disclosure of a customer's attempt to transfer funds out of a frozen account to the government fell within the statutory defense to liability for disclosure of customer's identity and nature of suspected illegal activity to the government.

Villalba, a resident of Colombia and Spain, had an account with Defendant bank (the "Bank"), which was authorized to engage in foreign banking. The District Court for the Southern District of New York ordered the Bank to arrest, attach, and seize Villalba's funds due

to the Government's complaint alleging that the funds in the account were obtained from money laundering. A Bank employee told an Assistant U.S. Attorney that Villalba had attempted to wire transfer $500,000 out of her account. Villalba filed this suit, alleging that the Bank's disclosure of the wire transfer violated the Right to Financial Privacy Act ("RFPA").

On a motion for summary judgment, the Bank claimed that, even if the alleged disclosure occurred, it was protected from liability by 12 U.S.C. § 3403(c), which allows any financial institution to notify a government authority of a possible violation of a statute or regulation. Such information may include the name of the individual and the nature of the suspected legal activity. Villalba argued that that this defense should not have been allowed for the first time on a motion for summary judgment. The court disagreed and held that "a court may consider an affirmative defense that did not appear in the answer, if the plaintiff has suffered no prejudice from the failure to raise the defense in a timely fashion." Villalba's argument that the Bank should have filed a Suspicious Activity Report ("SAR") concerning the transfer also failed. The court held that the failure to file a SAR, although mandated by 31 C.F.R. § 103.18(b)(3) (2001), would not preclude a jury from finding that the person making the disclosure had a reasonable suspicion of illegal activity.

In sum, the court found that the Bank's disclosure of the attempt to wire funds out of Villalba's account was proper under 12 U.S.C. § 3403(c). This is a significant case for financial institutions because it provides protection for banks that release information on account holders and are later sued by those accountholders.

The General Inapplicability of an Injury-Discovery Rule to the Fair Credit Reporting Act. *TRW Inc. v. Andrews*, 534 U.S. 19 (2001).

By Joseph A. Schmidt

The United States Supreme Court held that an injury-discovery rule was generally inapplicable to section 1681p of the Fair Credit Reporting Act ("FCRA" or the "Act"). The Court concluded that section 1681p of the FCRA implicitly stipulated that the statute of limitations period of the Act generally commenced from the date an injury occurred, and not from the date an alleged injury was discovered or should have been discovered by a plaintiff. However, the Court noted that an injury-discovery rule exception would be applicable to section 1681p of the FCRA in rare cases "…involving a defendant's willful misrepresentation of material information."

The FCRA requires credit reporting agencies to observe "reasonable procedures" to prevent unlawful discovery of consumer credit information. Section 1681p of the FCRA explicitly provides that any private action to enforce the Act must be brought "within two years from the date on which the liability arises." However, a private action may be brought within two years after a plaintiff discovers or should have discovered an alleged injury in cases "involving a defendant's willful misrepresentation of material information."

The plaintiff alleged that the defendant improperly disclosed her credit information to various third parties on July 25, September 27, and October 28, 1994, and on January 3, 1995. The plaintiff did not discover the allegedly improper disclosures until May 31, 1995. The plaintiff sued the defendant on October 21, 1996.

The United States Supreme Court held that an injury-discovery rule was generally inapplicable to the FCRA. First, the Court noted that it has "never endorsed the Ninth Circuit's view that Congress can convey its refusal to adopt a discovery rule only by explicit command, rather than by implication from the structure or text of the particular statute." Second, the Court noted that prior holdings implied an injury-discovery rule to toll the statute of limitations only in cases "where the cry for [such a] rule is loudest," such as fraud or concealment, latent disease, and medical malpractice and was inapplicable when the applicable statute was "silent" on the issue. Finally, the Court noted that it was a "cardinal principle of statutory construction" that "a statute ought, upon the whole to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." The Court reasoned that the Ninth Circuit's view would render the language evidencing the Act's injury-discovery rule exception in cases "involving a defendant's willful misrepresentation of material information…superfluous, void, or insignificant." The language evidencing the exception would be made superfluous, void, or insignificant because the Ninth Circuit's view would make the injury-discovery rule exception the general rule for resolving the issue of when the statute of limitations begins to run, rather than a narrow exception to the injury-occurrence rule.

This decision highlights the increased reliance of the Court on plain language interpretation of statutes. Prac-

titioners should consider the legislative purpose, history, pertinent case law, and, perhaps above all, the applicable principles of statutory interpretation in any attempt to resolve the thorny issue of when a statute of limitations begins to run.

Bankruptcy

Scope of Discharge of Obligations in Bankruptcy. *Kennedy v. Medicap Pharmacies, Inc.*, 267 F.3d 493 (6th Cir. 2001).

By Mark Aaron

A discharge under section 727 of the Bankruptcy Code clears all debts that arose before entry of the order for relief. The Code defines debts as liabilities on "claims." In *Kennedy*, the Sixth Circuit Court of Appeals determined that a right to equitable relief for a breach of a covenant not to compete does not constitute a dischargeable claim.

The Kennedys and Medicap Pharmacies, Inc. ("Medicap") entered into a franchise agreement in 1994 that contained a covenant not to compete, effective upon the expiration or termination of the franchise agreement. Upon termination of the franchise agreement in December of 1997, the Kennedys breached the covenant by continuing to operate a pharmacy in the same location. Medicap sought to enjoin the Kennedys' continued operation; however, the Kennedys filed a bankruptcy petition in May of 1998 and obtained a discharge in June of 1999. The bankruptcy court granted Medicap an injunction against further breach of the covenant not to compete by the Kennedys. The United States District Court for the Western District of Kentucky affirmed the bankruptcy court's decision, and this appeal followed.

The Sixth Circuit held that "[a] right to an equitable remedy for breach of performance is a 'claim' if the same breach also gives rise to a right to a payment 'with respect to' the equitable remedy." The necessary relationship is present where either (1) the equitable remedy requires payment of money, or (2) payment of money is an "alternative" or "substitute" for the equitable remedy.

In this case, the injunction to prevent the future breach of a covenant not to compete did not fall within either category. The Sixth Circuit found that compliance with the injunction required only that the Kennedys desist operating their pharmacy in breach of the franchise agreement. No payments of money were necessary.

To determine whether the injunction would be an alternative or substitute for the payment of money, the Sixth Circuit looked to Iowa law, which governed the franchise agreement. Under Iowa law, an injunction is "designed to avoid irreparable injury and may issue only when the party seeking it has no adequate remedy." Medicap could not choose between money damages and equitable relief, because equitable relief for future injuries is only available when money damages are inadequate. The Sixth Circuit held that the injunction was not a claim and thus was not discharged in the Kennedys' bankruptcy.

The determination of whether a covenant not to compete is dischargeable in bankruptcy depends on applicable state law. When drafting or negotiating employment agreements, franchise agreements, or other documents that contain clauses not to compete, a transactional attorney is well advised to consult applicable state law and think about whether providing a liquidated damages provision as an alternative to equitable relief is in the client's best interests.

Conflict of Laws

Presumption of State Contractual Claims by Federal Treaty. *Asante Tech., Inc. v. PMC-Sierra, Inc.*, 164 F. Supp. 2d 1142 (N.D. Cal. 2001).

By Chris Riedl

When two corporations have their principal places of business in two different countries, the federal courts have original jurisdiction under 28 U.S.C. § 1331. Asante Technologies, Inc. ("Asante") sued PMC-Sierra, Inc. ("PMC") in California state court for allegedly providing computer chips that did not meet contract specifications. PMC removed to the District Court for the Northern District of California. Asante contested the removal but the district court denied to remand the matter to state court.

Both Asante and PMC are Delaware corporations. Asante has its principal place of business in Santa Clara, California. PMC has its corporate headquarters in Burnaby, British Columbia, Canada. However, PMC maintains an engineering office in Portland, Oregon, with which Asante had extensive dealings in development of the chips in question. PMC also directed Asante to place orders through an authorized distributor, Unique Technologies, in California. While Asante had extensive contact with PMC's Oregon office and placed most of its orders through California-based Unique Technolo-

gies, PMC issued important correspondence related to this conflict from the British Columbia office.

There was no single contract documenting the agreement between Asante and PMC. Asante claimed that its "Terms and Conditions," which were included with each order, made it clear that California law would govern performance of the order. PMC contended that its "Terms and Conditions of Sale" document made it clear that Canadian law would control.

The court found that PMC's place of business for the purpose of the contract in question was Burnaby, British Columbia, Canada. The court noted that authorized distributors are not normally considered agents, and was therefore unswayed by Asante's contention that United Technologies was an agent of PMC and California was PMC's place of business for this contract. This means that the two contracting corporations were from different countries. The United States and Canada have both signed and ratified the United Nations Convention on Contracts for the International Sale of Goods ("CISG"), an international treaty to govern international sales contracts. The CISG applies to contracts "between parties whose places are in different States." (In the context of the treaty, "different States" means different countries.) The court found that the CISG applied to the disputed contract.

Normally, the "well-pleaded complaint rule" governs the determination of whether a case arises under federal law. However, claims are held to have arisen under federal law where federal law completely preempts state law, as when a treaty governs. The court noted that CISG preemption of state law was an issue of first impression, but found that the treaty's purpose of providing uniform rules to govern contracts for international sale of goods indicate a clear intent to preempt state law.

Consequently, the court refused to remand the case to state court because the CISG treaty applied to the contract between these two corporations, and a federal treaty preempted state law, raising a federal question, even though the complaint purported to arise under state law.

Employee Benefits

ERISA Benefits Plan Awarded in Divorce Decree Evades Tax Lien by IRS. *Cooper Indus. v. Compagnoni*, 162 F. Supp. 2d 702 (S.D. Tex. 2001).

By Nathan McCoy

Applying federal tax lien law and the Employee Retirement Income Security Act ("ERISA"), the United States District Court for the Southern District of Texas held that a woman awarded the total value of her ex-husband's pension account and savings plan ("Plan") in a divorce decree was entitled to the Plan's entire proceeds because she held a priority interest over a lien placed upon the Plan by the IRS.

As part of an April 18, 1991, marriage dissolution, Jacqueline Compagnoni ("Compagnoni") was awarded a portion of the Plan from Cooper Industries, Inc. ("Cooper"). On December 31, 1991, the appellate court reversed and remanded with instructions to redistribute the assets of the Plan. Meanwhile, on March 8, 1993, the IRS assessed Compagnoni's ex-husband with a tax deficiency for the 1987 tax year. On April 8, 1993, the court recorded an order that Compagnoni was to receive the total value of the Plan. A qualified domestic relations order ("QDRO") was prepared so that Compagnoni could collect the proceeds of the Plan from Cooper. Cooper, however, claimed on April 16, 1993 that it needed additional information from the court before it could determine whether the QDRO was qualified.

On May 21, 1993, the IRS filed a notice of federal tax lien with respect to the ex-husband's tax liability for 1987 upon the Plan Administrator at Cooper. Subsequently, on July 20, 1993, Cooper determined that the QDRO was incontestably qualified. Unsure of which party it should distribute the proceeds to, Cooper filed an interpleader action seeking a declaratory judgment as to which of the claimants the pension rightfully belonged: Compagnoni or the Government.

The Government argued that it was entitled to the funds as a prior lien holder because its lien attached when it assessed the tax liability on March 8, 1993, the court did not make a final distribution decision of the pension benefits until after the IRS had already filed a notice of federal tax lien, and Compagnoni failed to perfect her interest in the Plan. In response, Compagnoni claimed that the April 8, 1993 judgment entitled her to

her ex-husband's pension benefits and asserted that her interest in the Plan was perfected when final judgment was recorded.

The court entered summary judgment in favor of Compagnoni because she had priority interest in the Plan. Normally, a federal tax lien or levy may be imposed upon an ERISA-qualified pension plan "at the time the assessment is made." However, priority of federal tax liens is generally determined by the common law rule of "first in time, first in right," and the lien may not be valid if applied against a "judgment lien creditor." According to Treasury Regulations, a judgment lien creditor is a person who "has obtained a valid judgment, in a court of record and of competent jurisdiction, for the recovery of specifically designated property or for a certain sum of money." However, a judgment lien creditor has not perfected a judgment lien "until the identity of the lienor, the property subject to the lien, and the amount of the lien are established" and has complied with state law requirements. Based on the Treasury Regulations, Compagnoni needed to be a judgment lien creditor *before* the IRS made its assessment for 1987 to be entitled to the Plan. Nonetheless, the property at issue was a pension benefits plan governed by ERISA. ERISA supersedes state laws that "relate to" employee benefit plans covered by the statute. Thus, according to the statute, even though the QDRO was not finalized until after the IRS placed its lien, the first order sufficiently conveyed the ex-husbands interest in the Plan to Compagnoni *before* the IRS placed its lien on the Plan. Ultimately, the court held that ERISA preempted any additional imposed state law measures requiring Compagnoni to perfect her interest in the Plan and awarded her with the entire proceeds of the Plan.

Knowing federal or state tax laws is not enough. Anytime pension plans are involved, a practitioner should be aware of ERISA and its ability to preempt traditional state and federal rules that normally apply in non-benefit situations.

Employer's Decision to Revoke Employee Pension Benefits will not be Enforced when the Employer does not Comply with ERISA Notice Requirements. *Sanford v. Harvard Indus.*, 262 F.3d 590 (6th Cir. 2001).

By Kenneth A. Corum

Applying the Employee Retirement Income Security Act ("ERISA"), the Sixth Circuit Court of Appeals held that an employer does not substantially comply with ERISA's notice requirements when it fails to advise employee beneficiaries of the steps they are required to take in order to obtain a full and fair review of the employer's decision to revoke the employee's pension benefits.

Sanford, an employee of Harvard Industries, filed a retirement application with Harvard's personnel department. The application was approved and Sanford retired. Four months later, Harvard discovered that the personnel department had incorrectly determined Sanford's eligibility. Subsequently, a second employee filed a grievance with Harvard complaining that Sanford had been incorrectly granted retirement.

A grievance hearing was conducted in which a majority of the members from the pension plan's central Board of Administration ("Board") attended. Sanford, however, was never informed about the meeting. The grievance committee decided to inform Sanford that he was ineligible for retirement and that he must return to work. Sanford refused and, thereafter, filed suit against Harvard seeking reinstatement of his benefits. Harvard continued to pay Sanford's pension benefits for two years, but filed a counterclaim for reimbursement.

Both the District Court and the Circuit Court of Appeals denied Harvard's counterclaim and ordered reimbursement of Sanford's benefits pending a final determination by the Board. The Circuit Court concluded that ERISA requires adequate written notice to any participant explaining why the benefits have been revoked and the steps the employee beneficiary must take in order to receive a review of the employer's decision. Employers that do not satisfy ERISA's notice requirements do not properly revoke their grant of retirement to employees; therefore, they must continue to make benefit payments until they comply with the procedural requirements required by the pension plan.

The decision highlights the importance of correctly determining whether employees are eligible for retirement benefits. However, when mistakes occur, the employer must act quickly to revoke benefits after providing adequate written notice to the employee, and by complying with every detail of their pension plan's appeal process.

Ethics

Equal Access to Justice: At Who's Expense? A Glance at IOLTA Programs. *Wash. Legal Found. v. Texas Equal Access to Justice Found.*, 270 F.3d 180 (5th Cir. 2001).

By Jimmy Summerlin

In this case, the United States Court of Appeals for the Fifth Circuit held that the plaintiffs perfected their property rights to interest income generated by funds held in the State of Texas's Interest on Lawyers Trust Accounts ("IOLTA") and that the State's "taking" of the interest income violated the "just compensation" clause of the Fifth Amendment.

Ethics rules in most states, including Texas, require client funds to be placed in an interest bearing trust account that permits withdrawal on demand. The Texas Supreme Court established an IOLTA program, which required attorneys to place client funds that are "nominal in amount" or "held for a short period of time" in the IOLTA program. IOLTA funds are necessarily those that would not earn interest in an individual trust account. Operating on the assumption that the interest earned on IOLTA deposits were not the client's property, the Texas Supreme Court mandated that all proceeds from the IOLTA program be paid to the Texas Equal Access to Justice Foundation (TEAJF) for distribution to non-profit organizations that provide legal services to low income persons.

In 1994, a Texas attorney and others challenged the Texas IOLTA program under the Fifth Amendment asserting that the "program impermissibly [had taken] interest earned from client-funds." The case had reached the United States Supreme Court before being remanded to the District Court. Although the U.S. Supreme Court held that "the interest income generated by funds held in the IOLTA accounts is the 'private property' of the owner of the principal," it remanded for a determination of whether there was an impermissible "taking" by the State. On remand, the district court held that the takings clause had not been violated because the plaintiffs "failed to show an identifiable compensable loss."

The Fifth Circuit reversed, holding that the plaintiffs had proven their property rights and that the property had been *per se* "taken" for public use. In addition, the court held that the IOLTA program had not provided a "reasonable, certain and adequate provision for obtaining compensation," and, therefore, the "just compensation" clause had been violated. However, because the Eleventh Amendment provided the appellees (the TEAJF and the justices of the Texas Supreme Court) "immunity from the monetary-restitution claim," the only available remedy was the declaratory and injunctive relief sought. Thus, the mandatory participation rules were declared void, the TEAJF was enjoined from informing the State Bar of non-participating attorneys, and the Texas Supreme Court was enjoined from (a) requiring attorneys "to handle client-funds in a manner designed to ensure that interest on those funds will accrue to anyone not designated by the client," and (b) disciplining any attorney for failure to participate in IOLTA.

This case will potentially devastate similar IOLTA programs in other states. The Texas IOLTA program provided the TEAJF with annual revenues exceeding $5 million, all of which was used to fund low-income representation. However, there is hope for legal service organizations in other states. A recent Ninth Circuit decision regarding Washington's IOLTA program held "that even if the IOLTA program constituted a taking . . ., there would be no Fifth Amendment violation because the value of . . . [the] compensation is nil." *Washington Legal Found. v. Legal Found. of Washington*, 271 F.3d 835, 864 (9th Cir. 2001) (applying an ad hoc analysis of the taking clause as opposed to the per se analysis applied by the Fifth Circuit). Thus, IOLTA funding to legal services foundations may not be done for yet, as the split between the circuit courts may again allow the taking and just compensation challenges to IOLTA programs to reach Supreme Court.

Property

Unreasonable Interference with the Use of an Easement. *Kovanda v. Vavra*, 633 N.W.2d 576 (Neb. Ct. App. 2001).

By Mark Pierce

When the owner of a servient tenement interferes with a dominant tenement's use of an easement, a court will enjoin any interference if it is unreasonable or materially impairs the use of the easement. The case of *Kovanda v. Vavra*, presented this issue to the Nebraska Court of Appeals in a conflict between adjacent agricultural landowners. The court held that an irrigation system and other use of the land over which the grantee possessed his easement constituted an unreasonable interference with the grantee's access, and enjoined the landowner from conducting any further activity restricting access to the easement.

When appellee Kovanda purchased his farmland, he knew the seller had granted an easement to appellant Vavra to cross the north thirty feet of the property. The easement conveyed the right to cross by "any mode of transportation desired." Vavra used it to access his property, where he raised crops and kept livestock. After Kovanda purchased the servient land, he extended his irrigation system to reach it. This meant that the system had to cross Vavra's easement.

The low clearance of the irrigation system prevented Vavra's machinery and equipment from traveling the easement. Furthermore, the system often broke down or became too deeply entrenched in the mud, leaving the easement blocked for up to eight days at a time. Neither Kovanda nor Pospisil (Kovanda's tenant of the acreage) contested the claim of appellants Vavra and Krupicka (Vavra's grandson and tenant) that the irrigation instrument blocked appellants' access to their land. The court focused on the use of the irrigation system by appellees in determining the principal issue: the relative rights of Vavra and Krupicka to use the easement versus those of Kovanda and Pospisil as owner and tenant of the servient acreage subject to the easement.

The applicable authority states that once the court determines the rights of the easement holder, the owner of the property over which the easement crosses may use his land in any way that does not interfere with the easement holder's rights, and any use of the easement land must be reasonable. The servient landowner may not create an unreasonable interference or material impediment to the easement. Consequently, the court decided that when the servient property owner unreasonably interferes with or obstructs the easement, the servient property owner shall be enjoined from conducting the activity that produced the interference or obstruction.

Kovanda illustrates that a court will uphold a grantee's easement as a valid property right against any unreasonable interference by the owner or tenant of the land crossed by the easement. While this appears to remove the servient landowner's right to do as he wishes with his land, this really is nothing revolutionary; laws such as zoning regulations effectively achieve similar results. When an individual purchases property that he or she knows is subject to an easement, zoning ordinance or other encumbrances, the buyer has no excuse or justification for interfering with the rights of others established by those legal techniques.

Securities

Court Refuses to Excuse Demand and Dismisses Shareholder Derivative Complaint Without Leave to Amend. *White v. Panic,* 783 A.2d 543 (Del. 2001).

By Scott Dill

The Delaware Supreme Court dismissed without leave to amend a shareholder derivative suit because the complaint did not provide a reasonable doubt that members of the board of directors were disinterested and independent or that their decision was protected by the business judgment rule.

On July 6, 1998, *U.S. News & World Report* published an article detailing several sexual harassment suits filed against Milan Panic, the Chief Executive Officer and member of the Board of Directors ("Board") of ICN Pharmaceuticals, Inc ("ICN"). Andrew White, an ICN shareholder, did not demand that the Board file a lawsuit to protect ICN's interests. Rather, he filed a derivative suit in Delaware's Chancery Court, naming ICN and the individual Board members as defendants.

White made two allegations in the complaint, based solely on the magazine article. First, he alleged that the Board knew about Panic's misconduct since 1992 but never sanctioned him for exposing ICN to potential liability. Rather, the Board established policies to minimize exposure of the suits in an effort to protect Panic. Second, he alleged that the Board used corporate funds to settle the lawsuits but did not require Panic to reimburse the company. Instead, the Board guarantied a bank loan to Panic and deposited $3,600,000 of corporate funds as collateral. In return, Panic pledged 150,000 shares in stock options to ICN and used the bank loan for settlement purposes.

The Board moved to dismiss the complaint because White did not file a pre-suit demand on the Board and failed to show in his complaint that demand should be excused. The Chancery Court agreed with the Board and dismissed White's complaint with prejudice. White appealed.

The Delaware Supreme Court affirmed the dismissal without leave to amend. First, the court considered how White's complaint might survive a motion to dismiss. If shareholders do not demand that the Board initiate a lawsuit on behalf of the corporation, shareholders can bring a derivative action to enforce a corporation's legal rights if demand would have been futile. Shareholders

can show futility by including facts in the complaint that raise a reasonable doubt that either the directors are disinterested and independent or that the challenged transaction was a valid exercise of business judgment. In this case, White did not demand that the Board initiate a lawsuit to protect ICN's legal rights against Panic. On appeal, White did not contest the Chancery Court's conclusion that the Board was disinterested and independent. Therefore, White's complaint could only survive a motion to dismiss if it raised a reasonable doubt that the Board's actions were the valid exercise of business judgment.

Second, the court determined that White did not raise a reasonable doubt that the Board's actions were not the valid exercise of business judgment. The Board's desire to eliminate lawsuits and avoid the costs of defending ICN trumped White's theory that the Board knew that Panic had engaged in misconduct but refused to protect ICN from liability. In addition, Panic provided consideration for ICN's loan guaranty in the form of stock options and ICN could assert its legal rights in the event it had to repay Panic's loan under the guaranty. These facts trumped White's theory that the Board wasted corporate assets. Consequently, the court dismissed the complaint because White's allegations failed to cast a reasonable doubt on the Board's business judgment.

Third, the court denied White an opportunity to amend his complaint. To encourage derivative plaintiffs to investigate their claims before filing a compliant, the court denies plaintiffs the opportunity to amend their complaints after the court affirms the Chancery Court's dismissal, unless the court clarifies pleading standards in its opinion. The court did not clarify pleading standards in this case. Consequently, the court denied White an opportunity to amend his complaint against ICN.

This case provides important procedural and advisory steps for business practitioners. Attorneys who represent shareholder derivative plaintiffs must make a pre-suit demand on a board of directors, ask to examine a corporation's books and records in an effort to find corporate mismanagement before filing a complaint, or include facts in a complaint that will overcome the strong presumption of the business judgment rule. Alternatively, attorneys who represent potential derivative defendants should advise board members to respect and uphold their fiduciary duties and create an affirmative record of doing so in an effort to reduce exposure to shareholder derivative suits.

Tax

Notice Should Be Given to the IRS Prior to Forfeiture of a Land Sales Contract for Property Subject to a Federal Tax Lien. *Orme v. United States*, 269 F.3d 991 (9th Cir. 2001).

By Patrick Thurman

Applying federal law, the United States Court of Appeals for the Ninth Circuit held that forfeiture of a land sales contract for property that is subject to a federal tax lien is a "sale of property," to which the statutory notice requirement applies. If notice is not given to the IRS prior to forfeiture under the contract, then the property is taken subject to the federal tax lien.

The Ormes owned a parcel of real property in Montana. In 1989, they entered into a land sales contract with the Burgesses in which the Ormes agreed to sell the land for $25,000. Under the default provisions of the contract, the Ormes had the option of terminating the contract if the Burgesses failed to comply with any of the covenants set forth in the contract. A quitclaim deed was held in escrow in the event of a termination.

In 1994, pursuant to 26 U.S.C. § 6321, the IRS filed a Notice of Federal Tax Lien against the Burgesses in the amount of $5,312. At this time, the Burgesses had established approximately $10,000 in equity, thus the government's lien could be fully satisfied by the equitable interest in the property.

In 1997, the Ormes exercised their right to terminate the contract and recorded the quitclaim deed. The Ormes, however, did not give notice of the Burgesses' forfeiture of the land sales contract to the IRS. When attempting to sell the property to another buyer, the Ormes discovered the federal tax lien and subsequently filed an action to quiet title.

The Court of Appeals applied federal law to decide in favor of the government. State law governs the divestiture of federal tax liens except to the extent that Congress has entered the arena. In this case, 26 U.S.C. § 7425(b) governs nonjudicial sales of property on which the government claims a tax lien. The forfeiture of a land sales contract is included in the definition of a "sale of property" under the plain language and legislative history of section 7425(c).

Under section 7425(b), a nonjudicial sale of property is made subject to federal tax liens if (1) the federal tax

liens were filed more than 30 days before the sale, and (2) notice of the sale is not given to the IRS in accordance with section 7425(c)(1). It is undisputed that the tax lien was filed more than 30 days before the forfeiture of the land sales contract and that the Ormes provided no notice to the IRS. Consequently, the Court ruled for the government and the Ormes received the Burgesses' equitable interest subject to the federal tax lien.

This opinion highlights the importance of checking the titles of real estate for junior liens when making dealings in real property. The government has a strong interest in protecting federal tax liens and provides strict regulations for those trying to circumvent them.

Wills & Estates

Will Not Declared Void for Undue Influence Despite Testator's Retention the Same Attorney as Used by a Beneficiary. *In re Estate of Maddox*, 60 S.W.3d 84 (Tenn. Ct. App. 2001).

By Rowlett Sneed

When a testator and beneficiary share the same attorney, what type of contact is permissible before the beneficiary's presence becomes so suspicious that it results in undue influence? Lawyers may often find themselves in the situation where they not only represent clients but also their family members. This situation can lead to conflicts of interest, especially in the area of wills and estates. The Tennessee Court of Appeals addressed this issue in *In re Estate of Maddux.*

Pauline Maddox of Sumner County, Tennessee, died in November 1995, leaving an estate worth $956,000. In her will, she left $250,000 to her only surviving child, Ms. Dorothy Virginia. As Ms. Wilson was an alcoholic and Ms. Maddox feared that she might squander her inheritance, Ms. Maddox left this money in a trust account and named Joe Whitaker as trustee, who was her grandson and Ms. Wilson's nephew. Furthermore, she left $185,000 each to Joe and his brother Allen. Ms. Maddox also bequeathed them her half-interest in the family farm as well as the opportunity to purchase her home from the estate. In August 1996, Ms. Wilson brought suit to contest Ms. Maddox's 1991 will and 1995 codicil claiming that Joe Whitaker had unduly influenced Ms. Maddox. The Chancery Court found that Joe Whitaker did have a confidential relationship with Ms. Maddox but did not unduly influence her.

Upon the death of their mother Ms. Polly Maddox Whitaker in 1989, Joe and Allen Whitaker drew close to their grandmother, Ms. Maddox, and remained close until her death. Toward the end of her life, Ms. Maddox began to rely more and more on these two grandsons for assistance with her business affairs and errands. When Allen Whitaker moved to Kentucky, Ms. Maddox began to rely increasingly on Joe for financial advice. On three occasions Ms. Maddox gave Joe general powers of attorney, but he never exercised them. Despite her relationship with Joe, Ms. Maddox remained a relatively independent woman.

In the early 1990's Ms. Maddox retained Mr. Ronnie Fox, a C.P.A. who had worked for Joe Whitaker, to prepare her tax returns. In addition, she hired Mr. Charles Beaty, an attorney, to prepare her will. Mr. Beaty attended the same church as Ms. Maddox and had also represented Joe Whitaker in several business transactions. While Joe Whitaker set up the meetings with Mr. Beaty for Ms. Maddox, he never attended them nor did he ever discuss Ms. Maddox's plans with Mr. Beaty. In 1995, Ms. Maddox retained Ms. Sue Dunning, who had been associated with Mr. Beaty and had assisted Ms. Maddox in the execution of her will four years earlier, to help her draft a codicil despite Ms. Dunning's insistence that she use Mr. Beaty instead. Among other aspects, the codicil reduced the amount Ms. Wilson's children were to receive in the will. At the time she drafted the codicil, Ms. Dunning was also representing Joe Whitaker in his divorce. Ms. Wilson's only contact with any of these professionals was with Mr. Beaty, who in 1994 at Ms. Maddox's request had represented Ms. Wilson in her divorce.

In a will contest, a court will declare a will void because either the testator lacked testamentary capacity or the will was procured by undue influence or fraud. Procedurally, after the proponents show that the will was executed in compliance with all legal formalities, the burden shifts to the contestants to prove undue influence. While the existence of a confidential relationship may be a good indicator that there was undue influence, the confidential relationship alone is not sufficient to prove it. The contestants must show that in addition to a confidential relationship, there was at least one suspicious circumstance to show that led to an abuse of that relationship. Once this has been established, the burden shifts back to the proponent to show that the will was fair. Often fairness is shown by a proof of independent advice.

The parties agree that Joe Whitaker had a confidential relationship with Ms. Maddox for the last five years of her life. She gave him her power of attorney, and while he never exercised it, Ms. Maddox relied on him for assistance with her personal and financial affairs. Although this fact was established, Ms. Wilson failed to prove the existence of any suspicious circumstances that resulted from the confidential relationship. Ms. Maddox was an independent woman who remained mentally acute. More importantly, the court determined that even though Ms. Maddox had received estate-planning advice from persons who also had provided services to Joe Whitaker, there was no evidence that Joe Whitaker had participated in Ms. Maddox's discussions with any of these persons nor had he actively steered Ms. Maddox to them. Additionally, Mr. Beaty and Ms. Dunning had represented the two parties in unrelated matters. Therefore, the court determined that the advice Ms. Maddox received was independent and that there were no suspicious circumstances surrounding her will.

This case is significant not only in its ruling, but also because the court mentioned four circumstances that suggests undue influence: (1) when a lawyer assists in the preparation of the will in which the lawyer himself receives a gift; (2) when a lawyer simultaneously represents the testator and a possible beneficiary in a financial matter that may affect the amount that the beneficiary might receive in the testator's will; (3) when a lawyer who prepares a will while representing one of the intended beneficiaries in an unrelated matter; and (4) when the lawyer who prepares the will has represented one of the intended beneficiaries in an unrelated matter that has been concluded. These examples will provide estate-planning lawyers better guidelines for rendering independent advice.

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For Their Generous Contribution of Time and Effort in Serving as Adjunct Professors in the Concentration in Business Transactions at The University of Tennessee College of Law during the Spring 2002 Semester

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