CN v. McKercher

Conflicts and Current Clients

Malcolm Mercer

McCarthy Tétrault LLP

What is this all about?

- Lawyers, as fiduciaries, have a duty to avoid conflicting interests
- A conflicting interest can be a personal interest or a duty to another
- The *Neil* case provides a good example of a conflicting duty
- The *Strother* case provides a good example of a conflicting personal interest

What is this all about?

- When we talk about conflicting interests, we are not talking about actual impairment the work entrusted to the fiduciary but rather the risk of impairment
- A trustee borrowing trust property provides a good example.
- There is a conflict between the trustee's personal interest and the trustee's duty to beneficiaries for the trustee decide to borrow, even on perfectly reasonable commercial terms
- It is for the beneficiary, not the trustee, to determine whether the risk should be accepted

What is this all about?

- For this reason, the English courts sometimes refer to potential conflicts in contradistinction to an actual conflicts
- Using this language, a potential conflict exists where there is a risk that the competing personal interest or duty will compromise that which is entrusted to the fiduciary – and it is not for the fiduciary to decide whether the risk is acceptable
- The English courts say that an actual conflict exists where it is no longer a matter of risk of impairment. There is impairment. And consent is no solution.

What is this all about?

- For lawyers, this is old news. Where our duty to our client is potentially impaired by our self-interest or by our duty to another person then we have a conflict
- A conflict may be waived by the client with informed consent but there are limits to waiver
- Nothing has changed other than rebranding
- This old concept of a conflict of duty with interest or duty with duty is now called the “substantial risk principle”

The Substantial Risk Principle

- In *R. v. Neil*, Justice Binnie said:
  - I adopt, in this respect, the notion of a "conflict" in § 121 of the *Restatement Third, The Law Governing Lawyers* (2000), vol. 2, at pp. 244-45, as a "substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person".

The Substantial Risk Principle

- This definition of a conflict has been cited with approval by the Supreme Court of Canada in:
  - *Strother v. 3464920 Canada Inc., 2007 SCC 24*
  - *Galambos v. Perez, 2009 SCC 48*
  - *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd., 2011 SCC 23*
  - *Sun Indalex Finance, LLC v. United Steelworkers, 2013 SCC 6*
  - *Canadian National Railway Co. v. McKercher LLP, 2013 SCC 39*

The Substantial Risk Principle

- Probably the most important take away should be that the substantial risk principle always applies

- If a lawyer's self-interest or duty to another gives rise to substantial risk of material impairment of client representation, then the lawyer has a conflict

Acting against a current client

- The *Neil* case established a new conflicts rule that applied in a particular context, namely, where a lawyer acts for one client adverse to another current client

- This is the “bright line” rule

Acting against a current client

- Justice Binnie in *Neil* said that
  - The bright line is provided by the general rule that a lawyer may not represent one client whose interests are directly adverse to the immediate interests of another current client — *even if the two mandates are unrelated*— unless both clients consent after receiving full disclosure (and preferably independent legal advice), and the lawyer reasonably believes that he or she is able to represent each client without adversely affecting the other.

Acting against a current client

- He also said that
  - In exceptional cases, consent of the client may be inferred. For example, governments generally accept that private practitioners who do their civil or criminal work will act against them in unrelated matters, and a contrary position in a particular case may, depending on the circumstances, be seen as tactical rather than principled. Chartered banks and entities that could be described as professional litigants may have a similarly broad-minded attitude …

Acting against a current client

- To be clear, the “bright line” rule didn’t replace the substantial risk principle

- In *Neil*, a conflict was found on the basis of the substantial risk principle, not the “bright line” rule

The subsequent controversy

- But the difficult question was what about situations where there was no risk to client representation yet the bright line rule applied

- Was the bright line rule over-broad and, if so, what is the implication of over-breadth

The subsequent controversy

- A couple of examples may help:
  - A lawyer acting for a bank as a mortgage lender in one matter and then acting for a different borrower in another completely different matter
  - A lawyer acting for a very large company in a real estate transaction and then against the same company in a slip and fall case

The subsequent controversy

- There were different views about this question
  - Some thought that the rule was overbroad and that it shouldn’t apply if it could be shown that there wasn’t actually any real risk
  - Some thought that acting directly adverse to immediate interests of a current client always caused substantial risk
  - Some thought that an overbroad rule was justified by its clarity and that a clear rule was required
  - Some thought the question irrelevant as the SCC had decided the point

The subsequent controversy

- The Canadian Bar Association established a Task Force on Conflicts of Interest.
- The CBA's conclusion was that the bright line rule should be understood as presumptive i.e. that where it could be shown that there was no real risk then there is no conflict
- The CBA's position was that clients should be entitled to their choice of counsel and lawyers to act as they choose absent risk

The subsequent controversy

- The Federation of Law Societies considered the CBA position but did not adopt it
- There were three committee reports from two FLSC committees on the point
- The first two reports proposed a model rule that expressly provided lawyers could not act directly adverse to the immediate interests of current clients
- Ultimately, the substantial risk principle was adopted as the model rule while the bright line rule was described in the commentary

Along comes *McKercher*

- The CBA Task Force reported in August, 2008
- The FLSC Model Code was adopted in December, 2011
- In December 2008, the McKercher firm issued a Statement of Claim in a putative class action
- In September 2009, the McKercher firm was disqualified by the chambers judge
- In September 2011, Saskatchewan Court of Appeal set aside the disqualification order
- In July 2013, the Supreme Court of Canada allowed the appeal and referred the matter back for a rehearing. McKercher has since resigned the retainer.

McKercher – The facts and issues

- Facts
  - McKercher LLP acted for CN in four matters:
  - Wallace named Plaintiff in class action
  - Class 100,000 grain growers alleged overcharge for transportation
  - $1.7 billion potential claim

Facts

- McKercher acts for Wallace
  - Consent not sought
  - CN not advised

McKercher – Supreme Court of Canada

- Court of Appeal set aside disqualification order
- CN appealed on basis
  - scope of McKercher duty to CN
  - not follow bright line rule
  - alternatively not properly follow CBA rule of substantial risk
  - no reasonable belief able to represent each client without affecting other client

McKercher – Supreme Court of Canada

- McKercher response
  - Bright line rule not a categorical prohibition
  - Instead no conflict of interest in the absence of a substantial risk that representation on matters acting on would be materially and adversely affected by representation of other client
  - CN a “professional litigant”
  - No confidential information

McKercher – Supreme Court of Canada

- Intervener – CBA
  - Unrelated matter rule is presumptive not categorical
  - Must be substantial risk of material impairment of client representation, otherwise too broad
  - Factors to consider include:
    - Size of client – an individual v. large corporation
    - Confidential information
    - Nature of the matters
    - Same lawyer?

McKercher – Supreme Court of Canada

- Intervener – Federation
  - Focus on public interests
  - Maintain trust that exist between lawyers and clients
    - Not maintained if act against current client even if matters unrelated
    - Fiduciary duty of loyalty to client protects integrity of the administration of justice
      - Otherwise public confidence is lost
    - If a conflict, only act with expressed or implied consent
    - Rule clear, functional and easily applied and understood

McKercher – Supreme Court of Canada

- Appeal hearing January 24, 2013
  - Court actively questioning counsel for all four parties
  - Concerned existing client might refuse consent where there is no confidential information or material risk to representation
  - ? – scope of unrelated matters
    - Does there need to be a strategic link
    - Can the link consist of $1.7 billion claim, and allegation of “dishonest” conduct

McKercher – Supreme Court of Canada

- Concern breach of duty of loyalty and candour
  - Manner in which the files “dumped”
  - Preparing the case while acting for CN
  - Suing client and in effect alleging “dishonesty”

McKercher – Reasons released

Canadian National Railway Company v. McKercher LLP and Gordon Wallace, CBA and Federation of Law Societies of Canada, Interveners, 2013 SCC 39 (July 5, 2013)

- McLachlin C.J. (LeBel, Fish, Abella, Rothstein, Cromwell, Moldaver, Karakatsanis and Wagner JJ. concurring)

The Bright Line Rule

- Reaffirmed Bright Line Rule
- Rejected argument that Rule rebuttable

  "The bright line rule is precisely what its name implies: a bright line rule. It cannot be rebutted or otherwise attenuated. It applies to concurrent representation in both related *and* unrelated matters."

  (*CN,* at para. 41)

The Bright Line Rule - clarification

[32] … The rule applies where the *immediate legal* interests of clients are *directly* adverse. It does not apply to condone tactical abuses. And it does not apply in circumstances where it is unreasonable to expect that the lawyer will not concurrently represent adverse parties in unrelated legal matters.

(*McKercher*, at para. 32)

The Bright Line Rule – Limited Scope

- Limited in scope
  - Immediate interests are directly adverse
  - Legal interest
  - No tactical use
  - Does not apply in circumstances where it is unreasonable for a client to expect that its law firm will not act against it in unrelated matters

Bright Line Rule – Direct/Immediate

[33] First, the bright line rule applies only where the *immediate* interests of clients are *directly* adverse in the matters on which the lawyer is acting. …

Bright Line Rule – Direct/Immediate

[34] This Court did not apply the bright line rule to the facts in *Neil*, because of the nature of the conflict. Neither Neil and Lambert, nor Neil and Doblanko, were *directly* adverse to one another in the legal matters on which the law firm represented them. Neil was not a party to Lambert's divorce, nor to any action in which Doblanko was involved. The adversity of interests was *indirect*: it stemmed from the strategic linkage between the matters, rather than from Neil being directly pitted against Lambert or Doblanko in either of the matters.

Bright Line Rule – *Legal* Interests

[35] Second, the bright line rule applies only when clients are adverse in *legal* interest. The main area of application of the bright line rule is in civil and criminal proceedings. *Neil* and *Strother* illustrate this limitation. The interests in *Neil* were not legal, but rather strategic. In *Strother*, they were commercial …

Bright Line Rule – Tactical Abuse

[36] Third, the bright line rule cannot be successfully raised by a party who seeks to abuse it. In some circumstances, a party may seek to rely on the bright line rule in a manner that is “tactical rather than principled”: *Neil*, at para. 28. …

Thus, clients who intentionally create situations that will engage the bright line rule, as a means of depriving adversaries of their choice of counsel, forfeit the benefit of the rule …

Bright Line Rule – Client Expectations

[37] Finally, the bright line rule does not apply in circumstances where it is unreasonable for a client to expect that its law firm will not act against it in unrelated matters. In *Neil*, Binnie J. gave the example of "professional litigants" whose consent to concurrent representation of adverse legal interests can be inferred:

> In exceptional cases, consent of the client may be inferred. … These exceptional cases are explained by the notion of informed consent, express or implied. [para. 28]

The Bright Line Rule – Client Expectations

[37] … In some cases, it is simply not reasonable for a client to claim that it expected a law firm to owe it exclusive loyalty and to refrain from acting against it in unrelated matters. As Binnie J. stated in *Neil*, these cases are the exception, rather than the norm. …

The Bright Line Rule – Client Expectations

[37] … Factors such as the nature of the relationship between the law firm and the client, the terms of the retainer, as well as the types of matters involved, may be relevant to consider when determining whether there was a reasonable expectation that the law firm would not act against the client in unrelated matters. Ultimately, courts must conduct a case-by-case assessment, and set aside the bright line rule when it appears that a client could not reasonably expect its application.

If Bright Line does not apply

- Where bright line is not implicated lawyer must still be satisfied that there is no substantial risk that the representation materially and adversely affect the client

- The substantial risk principle always applies.

- There is a conflict either if the bright line rule or the substantial risk principle applies

The Four Cs

– Duty to avoid conflicting interests
– Duty of commitment to client's cause
– Duty of candour
– Duty of confidentiality

(*CN,* at para. 19)

Duty of Commitment

- Commitment to client's cause
  - Not soft pedal
  - Representation of client not impaired because of another client or other interests
  - Not summarily drop a client in order to avoid conflict

Duties of Candour and Confidentiality

- Must be candid about matters relevant to effective
  - Must advise client before accepting retainer even if conclude outside Bright Line

- And must maintain confidentiality
    - If can't disclose, not act

Duty of Candour

- Chief Justice McLachlin:

  [47] I add this. The lawyer's duty of candour towards the existing client must be reconciled with the lawyer's obligation of confidentiality towards his new client. In order to provide full disclosure to the existing client, the lawyer must first obtain the consent of the new client to disclose the existence, nature and scope of the new retainer. If the new client refuses to grant this consent, the lawyer will be unable to fulfill his duty of candour and, consequently, must decline to act for the new client

Remedy

- Court inherent jurisdiction to remove firm
  - Disqualification
    - Avoid improper use of confidential information
    - Avoid risk of impaired representation
    - Maintain reputation of administration of justice

Confidential Information/Representation

[62] Where there is a need to prevent misuse of confidential information, as set out in *Martin*, disqualification is generally the only appropriate remedy, subject to the use of mechanisms that alleviate this risk as permitted by law society rules. Similarly, where the concern is risk of impaired representation as set out in these reasons, disqualification will normally be required if the law firm continues to concurrently act for both clients.

Reputation of Administration of Justice

[63] The third purpose that may be served by disqualification is to protect the integrity and repute of the administration of justice. Disqualification may be required to send a message that the disloyal conduct involved in the law firm's breach is not condoned by the courts, thereby protecting public confidence in lawyers and deterring other law firms from similar practices.

Reputation of Administration of Justice

[64] … On the one hand, acting for a client in breach of the bright line rule is always a serious matter that on its face supports disqualification. The termination of the client retainers — whether through lawyer withdrawal or through a client firing his lawyer after learning of a breach — does not necessarily suffice to remove all concerns that the lawyer's conduct has harmed the repute of the administration of justice.

Reputation of Administration of Justice

[65] … where the lawyer-client relationship has been terminated and there is no risk of misuse of confidential information, there is generally no longer a concern of ongoing prejudice to the complaining party. In light of this reality, courts faced with a motion for disqualification on this third ground should consider certain factors that may point the other way. …

Consider these questions

- In circumstances where there is no real risk to client representation:
  - Would a reasonable client expect their lawyer not to act against them?
  - Will the court disqualify?

- What do we make of the statement by the Chief Justice “The main area of application of the bright line rule is in civil and criminal proceedings. ”

Consider these questions

- Of course, where there is substantial risk of material impairment of client representation, disqualification follows. But what if there is no such risk?

- As a practical matter, what does the bright line rule add to the substantial risk principle?

- Where does the bright line rule apply beyond litigation, if at all?

And there are other questions

- In *Neil*, Justice Binnie framed the bright line rule in terms of fiduciary law. In *McKercher*, the Chief Justice took care to apply the jurisdiction over the administration of justice.
- Does this mean that the bright line rule applies only to litigation before the courts and that the only judicial remedy is disqualification?
- How will the law societies deal with all of this? Is it professional misconduct to act where there is no real risk to the client?

Leading SCC Conflicts Cases for Lawyers

- *McDonald Estate v. Martin,* 1990 3 SCR 1235
- *R. v. Neil,* 2002 SCC 70
- *Côté v. Rancourt*, 2004 SCC 58
- *Celanese Canada Inc. v. Murray Demolition Corp.*, 2006 SCC 36
- *Strother v. 3464920 Canada Inc.* 2007 SCC 24
- *Galambos v. Perez, 2009 SCC 48*
- *Canadian National Railway Co. v. McKercher LLP,* 2013 SCC 39

Hypotheticals

Your firm is retained by a German law firm on behalf of its client HardwareCo to seek Canadian patent protection for an invention. The German firm is responsible for the world-wide patent strategy. You are instructed by the German firm. Your firm is retained by another current client to sue HardwareCo for in a major commercial dispute not involving the technology at issue in the patent prosecution.

Hypotheticals

Your firm decides not to act in the litigation against HardwareCo. The litigation is settled and your client now wants you to act in the negotiation of a joint venture agreement with HardwareCo.

Hypotheticals

You act for a small business in a breach of contract claim brought by a much larger plaintiff. Discoveries are completed. Trial is scheduled six months from now.

You have just learned that a current client has just taken an assignment of the claim. As a result, a current client has become the plaintiff.

Hypotheticals

Your firm acts for SloppyAir which is an airline that spreads its work around between many firms. Fred is the CEO of the firm's biggest client. SloppyAir has lost his luggage, again! Fred wants one of your associates to sue SloppyAir on Fred's behalf in Provincial Court.

Hypotheticals

Since deciding to sue SloppyAir in Provincial Court, you learn that your firm is acting for SloppyAir in a contractual dispute with the company to which SloppyAir outsources its baggage handling. Does this change anything?

Hypotheticals

Your firm acts for ConspireCo in a price-fixing class action. Another current client, RatCo, is a co-defendant represented by another law firm. There are no cross-claims but the defence strategies are inconsistent.

Hypotheticals

BigMiningCo is conducting a sale process for one of its major assets. Two longstanding firm clients are interested in bidding for this asset. Your firm wants to act for both clients using separate screened teams.