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Is 'hot potato doctrine' now applicable in Massachusetts?

By Thomas F. Maffei and Jessica Gray Kelly

In an important new decision, the Supreme Judicial Court has held that "a law firm may not undertake representation of a new client where the firm can reasonably anticipate that a conflict will develop with an existing client, and then choose between the two clients when the conflict materializes." *Bryan Corporation v. Abrano*, 475 Mass. 504 (June 14).

Although the SJC stated that it was not adopting the "hot potato doctrine," which other courts have used to limit a lawyer's ability to "drop" one client in favor of another client, the court's reasoning and analysis leads to the conclusion that the hot potato doctrine now applies in Massachusetts.

The facts of the case are straightforward. Bryan Corp. is a closely held company with three shareholders, one of whom owned 51 percent of the company. In March 2014, the company's treasurer and outside legal counsel retained the law firm to defend the company in a collection action. The law firm and the company executed an engagement letter. The law firm answered the complaint, began drafting discovery requests and responses, and reviewed documents on behalf of the company.

Shortly after the firm began working on the collection case, a dispute erupted between the two minority shareholders and the majority shareholder of the company.

On June 30, 2014, the company's treasurer (who also was the husband of one of the minority shareholders) called the law firm to discuss "a different matter" from the collection action. That different matter arose in late June when the majority shareholder stopped payment of the minority's 2014 profit distribution.

The minority owners claimed that the majority shareholder was engaging in a "freeze out" and had violated the Massachusetts Wage Act.

During a call the next day, the law firm explained that, if the dispute was not resolved, it could represent the minority shareholders but, because there would be a conflict of interest, the law firm would have to withdraw from representing the company in the collection action.

That same day the minority shareholders began demanding payment of their share of the 2014 profits.

The intra-company dispute was not resolved. At a July 15, 2014, board meeting, the majority shareholder elected a new board of directors, and it became clear that the shareholders were not going to resolve their dispute.

The law firm agreed to represent the minority shareholders against the company and the majority shareholder.

A week later, on July 21, the law firm sent a letter to the majority shareholder and the company on behalf of the minority shareholders demanding payment of the year-end profits. The firm sent the company a letter two days later withdrawing as counsel in the collection action and offering to assist in transferring the collection case file to other counsel. The law firm formally withdrew from the collection action on July 31, 2014.

Eight months later, in the ensuing shareholder litigation, the majority shareholder moved to disqualify the law firm, which was at that point representing only one of the minority shareholders.

The motion argued that the three-week long simultaneous representation of the company in the collection action and the minority shareholders in the shareholder dispute was an impermissible conflict of interest under Rule 1.7.

The Superior Court allowed the motion. The SJC took the case on direct appellate review.

As framed by the court, the key issue was whether the law firm "should have known at the time it agreed to represent the minority shareholders, that their interests were adverse to, or were likely soon to become adverse to, those of the company."

The SJC answered that question in the affirmative and concluded that the law firm violated the duty of loyalty under Rule 1.7, which required it either to decline representation or to seek the informed consent of the company prior to representing the minority shareholders.

Analyzing Rule 1.7 and case law, the court reiterated that the duty of loyalty prevents a lawyer from representing a client if the representation is "directly adverse to another client" or when there is a "significant risk" that the representation will be "materially limited" by the lawyer's responsibilities to another client, and emphasized the importance of trust between the lawyer and client — even when the client is a corporation.

The SJC wrote that it was immaterial whether the minority shareholders became clients of the law firm on July 1 — when the minority shareholders first called the law firm about the shareholder dispute — or on July 15 – when the majority shareholder voted in a new board of directors.

In the court's view, it was clear that the minority shareholders were directly adverse to the company when they demanded the checks they believed the company had a legal obligation to pay.

At that point, the SJC said, the law firm had two options: seek consent from the company or decline the representation of the minority shareholders.

What the court did not mention was a potential third option: Before undertaking

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to represent the minority shareholders, the law firm could have withdrawn from representing the company in the collection action under Rule 1.16 (b)(1), governing withdrawals, so long as its withdrawal would not cause any "material adverse effect" on the company. Once it withdrew from the collection action, the firm could have been adverse to the company, as a former client, under Rule 1.9, since there was no substantial relationship between the collection action and the shareholder dispute.

That, apparently, is what the law firm intended after concluding that the collection action was a very discrete matter, that it had been representing the company in that matter for only three months, and that the two matters were completely unrelated.

Rather than recognizing the third option, the SJC held that "it was improper for [the law firm] to withdraw prior to the completion of the [collection] action" in order to represent the minority shareholders.

By basing its decision solely on the duty of loyalty, the court did not consider the parties' arguments relating to Rule 1.9 or that the law firm's withdrawal from the collection action had no "material adverse" effect on the company. In other words, even if the law firm had complied with its obligations under Rules 1.9 and 1.16, the brief simultaneous representation merited disqualification.

The only conclusion from the SJC's holding is that the "hot potato doctrine" now applies with full force in Massachusetts and that lawyers are never free to withdraw from representation — even when there is no material adverse effect on the current client — in order to take on a new client that is, or may become, adverse to the current client.

Assuming that doctrine now applies to Massachusetts lawyers, it might have been preferable to make the new rule apply prospectively, thereby allowing the minority shareholder in *Bryan Corporation* to continue with counsel of his choice, another strong policy consideration for the courts.

The court's seemingly blanket prohibition on withdrawing from one client to take on another client, where the withdrawal is required to avoid a conflict, is, perhaps, tempered by the SJC's reference to the absence of anything in the law firm's engagement letter that would have permitted a withdrawal.

Based on that comment, law firms would be well-advised to include in their engagement letters a provision dealing with potential conflicts and the firm's ability to withdraw from the representation should a conflict arise. Such a provision may protect the law firm from disqualification. MLW

Thomas F. Maffei and Jessica Gray Kelly practice at Sherin & Lodgen in Boston, where they represent lawyers and law firms in professional liability and bar discipline cases.