LEGAL ETHICS:

CONFLICTING INTERESTS

IN

RELATED PARTY TRANSACTIONS

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LEGAL ETHICS:
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IN
RELATED PARTY TRANSACTIONS

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Summary: *A lawyer who has a solicitor-client relationship with a controlling person and the controlled public corporation may be asked to be retained by the corporation on a related party transaction in which the controlling person or an affiliate may participate with interests that are not aligned with those of the corporation. In such a transaction, the lawyer cannot fulfill his or her fiduciary duty of loyalty owed to each client nor zealously represent various adverse interests of multiple clients on potentially contentious issues impartially with candid advice. The recommended proper practice is for the lawyer to disclose fully his or her conflicting interest in the proposed transaction to a committee of independent directors of the controlled public corporation, its proper governance forum in such circumstances, and to advise the committee that he or she cannot be retained by the controlled corporation or by the committee to act for the corporation, and that the committee needs to retain its own independent counsel to advise the committee in fulfilling its mandate to represent and act for the controlled public corporation in the transaction.*

Introduction

This practice note provides a preliminary analysis of the lawyer's professional responsibilities, in the context of related party transactions involving public corporations, where the lawyer may have a "conflicting interest" as a result of past, current or prospective solicitor-client relationships with one or more of the parties to the transaction or their respective affiliates. The possibility of a "conflicting interest" arising in a related party transaction increases where the

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[1] Principal, Emerson Advisory. The views expressed in this practice note are those of the author only and do not reflect or represent the views or opinions and are not made on behalf of any person, firm or corporation with which the author may be associated.

public corporation is controlled, or is part of a controlled group of companies, and the lawyer is the external corporate counsel to the public corporation and also has or had a solicitor-client relationship with multiple affiliated clients such as the controlling person and/or one or more of the controlling person's affiliates. The use of the phrase "conflicting interest" refers to a circumstance where a lawyer, in providing advice to a client, has a conflict of interest under legal principles articulated by the courts or under the codes of professional conduct adopted by the applicable provincial self-regulating law societies.

Conflicts of interest are among the most important ethical priorities for the legal profession.[2] The requirement for ethical behaviour by members of the legal profession is founded, among other things, on the fiduciary nature of the lawyer-client relationship and the duties of loyalty, candour and transparency owned by a lawyer to his client, which are imposed for client protection, arising out of that relationship. The lawyer' duty of loyalty to a client is "essential to the integrity of the administration of justice and is of high importance that public confidence in that integrity be maintained… The value of an independent bar is diminished unless the lawyer is free from conflicting interests."[3] As stated by Binnie J., in delivering the majority judgment of the Supreme Court of Canada in *Strother v. 3464920 Canada Inc.* [4]:

> "A fundamental duty of a lawyer is to act in the best interest of his or her client to the exclusion of all other adverse interests, except those duly disclosed by the lawyer and willingly accepted by the client."

This practice note does not attempt to review issues of "conflicting interests" of lawyers across broad corporate or commercial practice areas. It appears prudent and appropriate that the important issue of addressing legal conflicts of interest be discussed and analyzed in specific contextual circumstances. As commented above, the context of this discussion of "conflicting interests" is limited to related party transactions involving public corporations and does not include conflict of interest situations that involve a lawyer's personal financial or other interests in such cases.

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2 Adam M. Dodek, *"Canadian Legal Ethics: Ready for the Twenty-First Century at Last"*, (2008) 46 Osgoode Hall Law Journal 1.

3 *R. v. Neil,* [2002] 3 S.C. R. 631 at paras. 12 and 13.

4 [2007] 2 S.C.R. 177 at para. 1.

Commercial Conflict of Interest and a Lawyer's "Conflicting Interest"

It is useful to differentiate between a "conflict of interest" that generally exists between the parties to the related party transaction and the "conflicting interest" that a lawyer may have due to solicitor-client relationships. The "conflict of interest" between the parties in a related party transaction is commercial in nature in the classic sense that the economic, business or financial interests of the parties are not aligned, or when the parties have adverse interests such as where one party is a seller and the other party is a buyer. The "related party transaction" definition in MI 61-101[5] appropriately reflects various commercial conflicts of interest. The fact that there is a commercial conflict of interest between the parties to a related party transaction does not mean that each lawyer retained to represent a party to that transaction has a "conflicting interest". While a lawyer advising only one party in a related party transaction may not have a "conflicting interest", a "conflicting interest" can, of course, exist for the lawyer formally representing only a single client in such circumstances.

Recent Decisions of the Supreme Court of Canada[6]

The duty of a lawyer to his client to avoid conflicts of interests flows from the fiduciary duties of the lawyer to his client which includes the duty of loyalty and good faith and a duty not to act against the interests of the client.[7] The essence of the lawyer's duty of loyalty was referred to in *R. v. Neil* as follows:

> "The general duty of loyalty has frequently been stated. In *Ramrakha v. Zinner* (1994), 157 A.R. 279 (C.A.), Harradence J.A., concurring, observed, at para. 73:
>
> "A solicitor is in a fiduciary relationship to his client and must avoid situations where he has, or potentially may, develop a conflict of interests. … The logic behind this is cogent in that a solicitor must be able to provide his client with complete and undivided loyalty, dedication, full disclosure, and good faith, all of which may be jeopardized if more than one interest is represented." [8]

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[5] Multilateral Instrument 61-101 "*Protection of Minority Security Holders in Special Transactions*", (2008) 31 OSCB 1321 (February 1, 2008).

[6] See, Alice Woolley, Richard Devlin, Brent Cotter and John M. Law, *"Lawyers' Ethics and Professional Regulation"*, (LexisNexis Canada 2008), Chapter 7, 'The Duty of Loyalty and Conflicts of Interest".

[7] *R. v. Neil, supra*, at para. 18.

[8] *Ibid*., at para. 25

In connection with analyzing a conflict of interest in connection with legal, as contrasted to disciplinary, proceedings[9], the Supreme Court of Canada stated in *R. v. Neil*[10]:

> "The general prohibition is undoubtedly a major inconvenience to large law partnerships and especially to national firms with their proliferating offices in major cities across Canada. Conflict searches in the firm's records may belatedly turn up files in another office a lawyer may not have been aware of. Indeed, he or she may not even be acquainted with the partner on the other side of the country who is in charge of the file. Conflict searches are often inefficient. Nevertheless it is the firm not just the individual lawyer, that owes a fiduciary duty to its clients, and a bright line is required. 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." [Emphasis in original][11]

Following that above quoted statement, Binnie J., for the Supreme Court of Canada in *R. Neil*, then went on to say that a lawyer would have a conflict with his or her duty of loyalty owed to a client with the following statement:

> "I adopt, in this regard, the notion of a 'conflict' in s. 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

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[9] In *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235, Sopinka J. stated at 1262:

> "...it must be borne in mind that the legal profession is a self-governing profession. The Legislature has entrusted to it and not to the court the responsibility of developing standards. The court's role is merely supervisory, and its jurisdiction extends to this aspect of ethics only in connection with legal proceedings."

[10] See, Richard F. Devlin and Victoria Rees, *Beyond Conflicts of Interest to the Duty of Loyalty: From Martin v. Gray to R. v. Neil*, (2006) 84 Can. Bar Rev. 433.

[11] *R. v. Neil*, [2002] 3 S. C. R. 631 at para. 29.

> lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person.' " [12]

This test requires that the impact must be "material and adverse". While it is sufficient to show a possibility (rather than a probability), the possibility must be more than speculation[13] and create a "substantial risk".[14]

The *Neil* formulation of a lawyer's "conflicting interest" was applied by the Supreme Court of Canada in the subsequent cases of *Strother v. 3464920 Canada Inc.*, [2007] 2 S.C.R. 177 at paras. 51 and 56, and *Galambos v. Perez*, [2009] 3 S.C.R. 247 at para. 31. (The Supreme Court of Canada's judgment in the *Strother* case was a split 5:4 decision, with Binnie J., who wrote the unanimous opinion of the Court in *Neil*, also writing for the 5:4 majority in *Strother*. In writing for the dissenting Judges in *Strother*, McLachlin C.J. restricted the above quoted principle in *Neil* by limiting its application only to the duration of contracts of retainer ("Whether an interest is 'directly' adverse to the 'immediate' interests of another client is determined with reference to the duties imposed on the lawyer by the relevant contracts of retainer."[15]). The majority opinion in *Strother* held, however, that the duty of loyalty remained in force as long as the client continued as a client of the firm with an ongoing solicitor-client relationship, even though the original written retainer had expired.[16])

Misuse of Confidential Information

It is important to state that this practice note comments on the ethical responsibilities of lawyers to abide by their duty of loyalty to a client in transactions where the concern of misuse of confidential information is not a contentious issue, and the lawyer has not received any confidential information that was, or is, relevant to the matter in which he or she proposes to act. The duty of loyalty to clients includes the much broader principle of avoidance of conflicts, irrespective whether or not confidential information plays a role. The duty of loyalty to a client includes the obligation that the lawyer is to "avoid situations where he has, or potentially may, develop a conflict."[17] "Loyalty includes putting

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[12] *Ibid.*, at para. 31.

[13] *Strother v. 3464920 Canada Inc.*, [2007] 2 S.C.R. 177 at para. 61.

[14] *Ibid.*, at para. 69.

[15] *Strother, supra,* at para. 149.

[16] *Ibid.*, at para. 53.

[17] *Supra,* note 8.

the client's business ahead of the lawyer's business."[18] The Supreme Court of Canada in *R. v. Neil* stated that the following view of Ground J. concerning the duty of loyalty to current clients, insofar as the legal profession is concerned and irrespective of the issue of confidential information, is "unassailable":

> "I am of the view that the fiduciary relationship between the client and the professional advisor, either a lawyer or an accountant, imposes duties on the fiduciary beyond the duty not to disclose confidential information. It includes the duty of loyalty and good faith and a duty not to act against the interests of the client. [Emphasis added (in the Supreme Court of Canada decision)]"[19]

While this note does not deal with the issues concerning the very important disqualifying conflicts of interest factor of the use of confidential information to the disadvantage of a former client, it is important to remember that this issue is, in practice, often a very practical concern that can result in law firms being disqualified under equitable legal principles from representing clients adverse in interest to former clients for whom the firm acted and obtained confidential information.[20]

The potential misuse of confidential information is heightened in circumstances that arise out of solicitor-client relationships with multiple clients in related party transactions with adverse interests. (See, *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235; *R. v. Neil*, [2002] 3 S.C.R. 631; and Allan C. Hutchinson, *Legal Ethics and Professional Responsibility* (2nd ed., 2006), Chapter 7, and at pp. 143-154.)) While some law firms apparently take the view that multiple clients that are part of a controlled group of companies implicitly waive solicitor-client privilege and consent to the transfer of confidential information among clients within the controlled group because the controlling person of the group has access to all information in the group, it is submitted that any such waiver and consent may only be validly provided on behalf of any single client that is a public corporation by the informed consent of a committee of independent directors of that client.

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[18] *Strother v. 3464920 Canada Inc.,* [2007] 2 S.C. R. 177 at para. 36, quoting *R. v. Neil, supra,* at para. 24.

[19] *R. v. Neil*., at para. 18.

[20] In both these cases, the defendant law firm was disqualified from representing a new client against the plaintiff, who was a former client from whom the defendant law firm obtained confidential information in a prior retainer on an unrelated matter: *Ford Motor Co. of Canada v. Osler, Hoskin & Harcourt*, (1996) 27 O.R. (3d) 181 (Ont. Ct. Gen. Div.); *Chapters Inc. v. Davies, Ward & Beck LLP*, [2000] O.J. No. 4973 (Ont. Sup. Ct., Commercial List).

Negligence

This practice note also does not deal with the issue of negligence in the provision of legal advice to a client, even where the lawyer has a "conflicting interest" in providing advice to the client, but only with the lawyer's responsibilities to comply with applicable legal principles, including the lawyer's duty of loyalty to the client, and the rules of professional conduct. The topics of a lawyer having a "conflicting interest" and whether he or she was negligent in providing legal advice are quite separate and distinct and subject to different legal tests and remedies by the client. As stated by the Supreme Court of Canada in *Galambos v. Perez*:

> "…there is an important distinction between the rules of professional conduct and the law of negligence. Breach of one does not necessarily involve breach of the other. Conduct may be negligent but not breach rules of professional conduct, and breaching the rules of professional conduct is not necessarily negligence. Codes of professional conduct, while they are important statements of public policy with respect to the conduct of lawyers, are designed to serve as a guide to lawyers and are typically enforced in disciplinary proceedings. They are of importance in determining the nature and extent of duties flowing from a professional relationship: …They are not, however, binding on the courts and do not necessarily describe the applicable duty or standard of care in negligence. …"[21]

Federation of Law Societies of Canada and Canadian Bar Association

The principal jurisdictions of the courts are to supervise ethics in legal proceedings and to deal with claims brought by clients against lawyers arising out of the solicitor-client relationship for breach of fiduciary duty, breach of contract and negligence. The law societies of the various provinces have the responsibilities to develop professional standards and to enforce those professional standards through disciplinary proceedings.

Following the recent decisions of the Supreme Court of Canada dealing with a lawyer's conflict of interest or "conflicting interest" in solicitor-client relationships, a current debate and disagreement has arisen between the Federation of Law Societies of Canada (the Federation) and the Canadian Bar Association (CBA) with respect to the interpretation of the Court's decisions on a lawyer's duty of loyalty to a client and with respect to recommendations for a model code of

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[21] *Galambos v. Perez, supra,* at para. 29.

professional conduct defining a "conflicting interest" to be adopted by the provincial bodies governing the legal profession.

While it is not the purpose of this note to explore the respective positions of these organizations on these matters, the fact that both organizations recently established committees to study, report on and make recommendations concerning lawyers' conflicts of interest reflects the importance of this ethical issue as a matter of public interest as well as to the legal profession.

The research, analysis and recommendations of the CBA and the Federation with respect to conflicts of interest are set out in the following documents:

- CBA Task Force on Conflicts of Interest, "*Conflicts of Interest: Final Report, Recommendations & Toolkit"* (August 2008)
- Federation of Law Societies of Canada, "*Advisory Committee on Conflicts of Interest Final Report*" (June 2, 2010)
- Canadian Bar Association, "*Response to Federation of Law Societies of Canada Advisory Committee on Conflicts of Interest Final Report*" (August 2010)

Law Society of Upper Canada's Rules of Professional Conduct

While the recent reports of the Canadian Bar Association and the Federation of Law Societies of Canada have appropriately reflected enhanced emphasis on the importance of the ethical rules of conflict of interest, for lawyers licensed to practice in the Province of Ontario, the applicable code of conduct is set by the Law Society of Upper Canada (LSUC).[22] The Rules of Professional Conduct of the LSUC dealing with "conflicting interests" of its licencees are set out in Rule 2.04 "Avoidance of Conflicts of Interest".

Subrule 2.04(1) provides that:

> "A conflict of interest or a conflicting interest means an interest
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> (a) that would be likely to affect adversely a lawyer's judgment on behalf of, or loyalty to, a client or prospective client, or

[22] See, Gavin MacKenzie, *"Lawyers and Ethics – Professional Responsibility and Discipline"* , (Fifth Edition, Carswell) 2009, including Chapter 22, "Conflicts of Interest", and Part IV, "The Regulation of the Profession".

> (b) that a lawyer might be prompted to prefer to the interests of a client or prospective client."

Subrule 2.04(3) then provides that:

> "A lawyer shall not act or continue to act in a matter when there is or is likely to be a conflicting interest unless, after disclosure adequate to make an informed decision, the client or prospective client consents."

The commentary in the LSUC's Rules following subrule 2.04(3) emphasizes the prejudice that the client may suffer if the client's lawyer has a "conflicting interest" as follows: "A client or the client's affairs may be seriously prejudiced unless the lawyer's judgment and freedom of action on the client's behalf are as free as possible from conflict of interest". The commentary makes it clear that any client consent must be "informed, genuine and uncoerced".

Subrule 2.04(6) deals with joint retainers as follows:

> "... where a lawyer accepts employment from more than one client in a matter or transaction, the lawyer shall advise the clients that
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> (a) the lawyer has been asked to act for both or all of them,
>
> (b) no information received in connection with the matter from one can be treated as confidential so far as any of the others are concerned, and
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> (c) if a conflict develops that cannot be resolved, the lawyer cannot continue to act for both or all of them and may have to withdraw completely."

Subrule 2.04(7) expands on the issue of joint retainers.

> "... where a lawyer has a continuing relationship with a client for whom the lawyer acts regularly, before the lawyer accepts joint employment for that client and another client in a matter or transaction, the lawyer shall advise the other client of the continuing relationship and recommend that the client obtain independent legal advice about the joint retainer."

The following commentary to subrule 2.04(7) is particularly instructive, especially in related party transactions where the lawyer has a continuing relationship with the controlling person and also has or proposes to have a solicitor-client relationship with the public corporation which will be involved in

the related party transaction with the controlling person. The commentary states that:

> "Although all parties concerned may consent, a lawyer should avoid acting for more than one client when it is likely that an issue contentious between them will arise or their interests, rights, or obligations will diverge as the matter progresses."

There are various legal and equitable remedies at law available to a client whose lawyer, in providing advice to the client, does so in breach of his legal duty of loyalty to the client because of the lawyer's "conflicting interest" that has not been consented to by the client.

With respect to allegations of breach of the rules of professional conduct, a complaint to the relevant governing body, or the commencement of an investigation by the governing body on its own initiative, may result in disciplinary proceedings against the lawyer.

Who is the client?

Clarifying and identifying the current "client" in a related party transaction is an important and critical initial issue at the commencement of a potential retainer, especially in the context of providing services on behalf of a client that is a controlled public corporation or within a controlled group of companies. In many situations where a public corporation is controlled, external corporate counsel retained by the public corporation may also have a former, current or prospective solicitor-client relationship with the controlling person of that public corporation or with one or more of its affiliates. The controlling person may not only elect a majority of the board of directors but may also occupy a senior non-executive or executive position with the public corporation or otherwise exercise authority or ultimate influence, directly or indirectly, with respect to the appointment of external corporate counsel for the public corporation. In many cases, the retainer of external corporate counsel by a controlled public corporation, although not appointed directly by the controlling person, may be subject to the condition of implicit approval of, or the non-exercise of a veto by, the controlling person.

It is important to remember that where an officer of the public corporation consults external corporate counsel for services on a corporate transaction, the officer is acting in a representative capacity on behalf of the public corporation and that the client is the corporation and not the officer. Where the officer of the public corporation appointing external corporate counsel is associated or affiliated with

the controlling person, including as a shareholder, director or officer of the controlling person, the external corporate lawyer's fiduciary duties are to and the client is the controlled public corporation and not the corporate officer or the controlling person, even though counsel may not have been appointed but for the consent, decision or influence of the controlling person or individuals within the controlled group of companies. These outcomes result whether or not the external corporate counsel also has a current or prospective or had a former solicitor-client relationship with the controlling person or an affiliate, including on matters that are unrelated to the retainer for the related party transaction.

For the purposes of this practice note, unless otherwise stated, it is assumed that external corporate counsel is not also asked to be retained to provide independent advice to the directors in their individual or personal capacity as directors, or any one or more of them, to the board of directors as a board or to a committee of the board of directors and that a joint retainer with the controlled public corporation and its directors is not involved.

Where an external corporate counsel is appointed to represent a controlled public corporation in a related party transaction, external corporate counsel first needs to analyze the relevant facts and circumstances within which the legal services are anticipated to be provided. In reviewing the relevant circumstances, the lawyer should identify the client and understand the entire nature and scope of the proposed transaction, the terms of the lawyer's retainer, the parties involved in and those who may be affected by the transaction (directly and indirectly), the interests of the client and how the interests of those parties in the transaction, and the interests of clients of the lawyer and of his or her firm who are not parties to the transaction, are, or may likely be, affected by the transaction. It is assumed that the lawyer does not have any conflicts arising from personal interests.

The lawyer needs to assess, based on the analysis, whether in the circumstances, he or she, or the firm, as the external corporate counsel for the public corporation, has, or is likely to have, a "conflicting interest" (with the meaning of the LSUC's Rules) or may, by accepting the retainer, be in breach of the lawyer's duty of loyalty to a former or current client under the legal and equitable principles enunciated by the courts.

Specifically, the lawyer must consider whether the nature of the past or current solicitor-client relationships with the client or its affiliates, including a controlling person, and any past and current retainers or relationships with any of the parties to the related party transaction or with their respective affiliates would be likely to affect adversely the lawyer's judgment on behalf of, or loyalty to, a

client or prospective client, *or* might prompt the lawyer to prefer the interests of one client or prospective client over another.[23]

It is, of course, necessary for the external corporate counsel to continue to be aware if any previously undisclosed facts become apparent or changed circumstances arise during the course of the retainer. As transactions involving public corporations develop, the terms of or parties to the proposal may change or new facts emerge providing a more detailed level of understanding. If there are new or changed factors, external corporate counsel would need to reassess whether a "conflicting interest" has occurred or is likely to develop. If a "conflicting interest" arises or is discovered during the course of a retainer, subrule 2.04(3) of the LSUC's Rules of Professional Conduct is applicable and the lawyer cannot continue to act unless in compliance with Rules.

Part of the duty of loyalty to a client is the duty of candour with the client on matters relevant to the retainer. If a conflict is revealed or emerges during the retainer, the client should be among the first to hear about it.[24] As the lawyer's duties to the client are for the protection of the client, it is necessary that the lawyer provide full and candid disclosure to the client as soon as the lawyer determines that a "conflicting interest" has occurred or is likely to develop. Such disclosure to the client puts the client on notice that there is an issue with respect to the quality of the independence of the legal advice that it is receiving and thereby permits the client to make an informed decision whether to retain independent counsel or, depending on the circumstances, provide an informed consent to the continuance of the retainer.

Failure of a lawyer candidly to advise a client of a "conflicting interest" is not only prejudicial to the client but also denies the client the timely opportunity to find new counsel and to protect the client's right to disinterested legal advice.

Lawyer's Duty to Disclose to the Client Matters Relevant to the Retainer

It is the duty of the lawyer, at the commencement of and during the retainer, to disclose to the client any matter that is relevant to the retainer, including in particular facts that may relate to possible or potential "conflicting interests". One aspect of the duty of loyalty that a lawyer owes to the client is the

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[23] LSUC Rules of Professional Conduct, section 2.04(1).

[24] *R. v. Neil, supra,* at para. 19.

duty of candour.[25] In *Struthers v. 3464920 Canada Inc.*, the majority opinion of the Supreme Court of Canada quoted Story J. as follows:

> "No man can be supposed to be indifferent to the knowledge of facts, which work directly on his interests, or bear on the freedom of his choice of counsel. When a client employs an attorney, he has the right to presume, if the latter be silent on the point, that he has no engagements, which interfere, in any degree, with his exclusive devotion to the cause confided in him; that he has no interest, which may betray his judgment, or endanger his fidelity.
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> "(*Williams v. Reed*, 29 F. Cas. 1386 (1824))"[26]

As stated by the Supreme Court of Canada in that case following its citation of the above quote: "The client cannot be taken to have consented to conflicts of which it is ignorant." This principle that a lawyer has a duty to disclose conflicts of interest to the client endures throughout the course of the retainer.[27]

What is the Scope of the Retainer?

When a lawyer is retained by a client, the scope of the retainer is governed by contract, written or oral. The client and the lawyer agree on the scope and extent of the services that the lawyer is to provide and the other contractual terms of the contract.[28] It may not, however, be customary to enter into a formal written engagement letter containing the full scope of the legal services to be rendered when external corporate counsel is retained by a public corporation to provide services on a particular public transaction.

When the retainer is oral and not reduced to writing, it is customary, as well as sensible, to imply, unless the specific factual circumstances and relationships otherwise clearly demonstrate, that the client has requested and the lawyer has agreed to provide to the client the normal and customary scope of complete legal services that are usually associated with and required by the client in the context of the transaction. In the situation of advising on related party transactions involving public corporations, expert legal services are required by the public corporation to

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[25] *Ibid.*

[26] *Strother v. 3464920 Canada Inc., supra,* at para. 55.

[27] The commentary following rule 2.04(3) of the LSUC's Rules of Professional Conduct confirms this position: "A lawyer should examine whether a conflict of interest exists not only from the outset but throughout the duration of a retainer because new circumstances or information may establish or reveal a conflict of interest."

[28] *Strother v. 3464920 Canada Inc., supra,* at para. 34.

deal with the multiple and interrelated issues that need to be addressed in complying with various multijurisdictional corporate, securities and corporate governance laws and regulations, policies and instruments that are applicable to such complex transactions in the national, and frequently, international, public marketplace. Unless specifically otherwise agreed between the client and the lawyer, it would be unusual for the public corporation to restrict the scope of the retainer of external corporate counsel to only certain limited and selected areas of the required interwoven full suite of specialized legal and regulatory issues that need to be addressed in a complex corporate securities transaction. The relationship between the public corporation and the external corporate counsel retained in a public transaction generally includes the usual terms and expectation that external corporate counsel is to commit fully to the client's complete cause and to provide zealous representation of the client with the full complement and range of legal services necessary to pursue and implement the objectives and protect the interests of the client in the transaction in question.

Public corporations seek to retain external corporate counsel who is experienced in providing advice on these complex public transactions and who has the specialized expertise that is required to identify, address and solve the issues that have to be dealt with in these circumstances. Indeed, public corporate clients generally expect that the experienced external corporate counsel that they retain will provide not only technical legal advice on all the relevant issues, but will also counsel them on the impact and effect that the legal and regulatory environment will likely have on the business judgments and commercial decisions that need to be made in order to implement the transaction successfully. Rather than restricting the scope of specialized and experienced external legal counsel, the public corporation usually expect that such counsel will use his or her legal, business and commercial skills and expertise accumulated from advising on similar issues on previous transactions to provide advice to and to assist the client during its decision-making process in reaching final conclusions on the embedded commercial terms of the transaction which are ultimately recorded in the definitive legal documentation. As in other areas of corporate and commercial law involving complex transactions, experienced external corporate counsel are generally retained for their legal expertise and their acquired business and commercial experience in their specialized fields of practice and are expected to provide advice to their clients on the business and commercial terms reflected in the executed agreements between the parties to the transaction, using the skills and knowledge that legal counsel gained from practice in the area in question.

Addressing "Conflicting Interests" in Related Party Transactions

An external corporate counsel may be asked to be retained by a controlled public corporation where the lawyer, or his or her firm, has a past or current solicitor-client relationship with the controlling person and where the parties to the related party transaction in question include the public corporation and the controlling person, or an affiliate, in circumstances in which the commercial interests of the parties are adverse and not aligned. This situation may arise where such an external corporate counsel has a continuing relationship with both the controlling person and the controlled public corporation and regularly acts for each of them on normal corporate matters not involving conflicts of interest between them. It is not unusual for controlling persons to prefer, nor uncommon in practice, to have the controlling person's counsel also act, in the normal course, for corporations it controls.

Where External Counsel is to Represent both the Controlled Public Corporation and the Controlling Person

In light of the "conflicting interest", the external corporate counsel needs to advise the public corporation of his or her "conflicting interest" with the controlling person, which disclosure would include the full particulars of the facts underlying the "conflicting interest". The lawyer would also advise the public corporation, first, that he or she cannot advise both the public corporation and the controlling person on the transaction and, second, that, in light of the lawyer's solicitor-client relationship with the controlling person, he or she cannot advise the public corporation even if the lawyer is not advising the controlling person on the transaction, in either case without the informed consent of both the controlling person and the public corporation.

If the external corporate counsel is advising the controlling person on the related party transaction, it is, however, difficult to understand that the counsel could propose also to advise the controlled public corporation on the same transaction, even with the consent of both parties. The duty of the lawyer to commit fully to the cause of the client, to provide a zealous representation of the client's interests and not to 'soft peddle' the pursuit of the client's objectives out of concern or preference for another client with adverse interests and to comply with the lawyer's duty of loyalty, which encompasses the duty of candour, to the client on all matters relevant to the retainer (ignoring for the moment the obligation that no information received in connection with the joint retainer from one client can be treated as confidential so far as any of the matters are concerned) make it

practically impossible for the lawyer to represent both parties in these circumstances.

Where the external corporate counsel has a continuing relationship with the controlling person for whom the lawyer acts regularly but is to represent the controlling person in this particular transaction, there are issues that affect the validity and integrity of any informed consent of the public corporation to act for it. Concerns arise because the corporation is controlled by a party to the proposed transaction who is adverse in interest to the public corporation and with whom the lawyer has a solicitor-client relationship. It is clear that any consent from an officer of the public corporation who is also part of the control group or otherwise associated or affiliated with the controlling person would not be valid. The controlling person cannot indirectly provide a consent on behalf of the controlled corporation through an intermediary it has appointed as an officer of the controlled corporation. It appears reasonable that any consent from another executive or instructing officer of the public corporation is not appropriate because of the lack of effective independence of such an officer from the controlling person, even where the controlling person is not formally part of executive management. Executive officers of a controlled public corporation, including in-house general counsel, are in a difficult position because of the influence over their careers, employment arrangements and compensation awards that can be exercised, often subtly and indirectly but effectively, by a controlling person over a period of time. There is also a question whether a non-affiliated executive officer, even the CEO, has the proper internal corporate authority to consent on behalf of the corporation to retain a lawyer who has such a "conflicting interest", including in light of the officer's position as management in the controlled corporation and in light of the circumstances that the controlling person proposes to enter into a transaction with the corporation in which it has an adverse commercial interest.

Rule 2.04(7) of the LSUC's Rules of Professional Conduct provides the following requirements for a lawyer with a "conflicting interest" in circumstances where the lawyer has a solicitor-client relationship with the controlling person and is asked also to represent the controlled corporation:

> "Except as provided in subrule (8.2) [which deals with joint retainers concerning a mortgage or a loan], where a lawyer has a continuing relationship with a client for whom the lawyer acts regularly, before the lawyer accepts joint employment for that client and another client in a matter or transaction, the lawyer shall advise the other client of the continuing relationship and recommend that the client obtain independent legal advice about the joint retainer."

The question is: who can properly and appropriately act for and make the decisions for the 'client', the controlled corporation, in these circumstances? The proper governance forum within the controlled public corporation to deal with issues of retaining external corporate counsel who has a "conflicting interest" with the controlling person is one composed of those members of the board of directors of the corporation who are independent of management and of the controlling person (commonly referred to as a committee of independent directors). (The issue of director "independence" in controlled public corporations is a topic for another day.)

In light of the commercial conflicts of interest between the corporation and the controlling person arising out of the related party transaction, the committee of independent directors is the only appropriate governance mechanism to negotiate and approve, on behalf of the corporation, all issues relating to the transaction between the corporation and the controlling person, including the identification, selection process and appointment of external corporate counsel to advise the corporation. As the committee of independent directors will be acting for and on behalf of the corporation in the related party transaction with the controlling person, the external corporate counsel for the controlled public corporation should be appointed by that independent committee and should take instructions only from and provide formal legal advice only to that committee of independent directors.

The preceding paragraph uses the term that the external corporate counsel appointed by the independent committee of directors is 'counsel for the controlled public corporation'. That reference is purposeful and the phrase employed in the sense that, while such counsel is retained by and advises the committee of independent directors, it is that committee which is, in the context of the related party transaction with the controlling person, the governance forum that represents and acts for the interests of the controlled corporation and its stakeholders, other than the controlling person but including the non-controlling shareholders (who are often the majority equity owners in a dual-class structured controlled public corporation). Such external corporate counsel retained by the committee of independent directors is frequently referred to as 'counsel for the committee of independent directors', but the substance and essence of the duty and role of such counsel in the circumstances posed is to protect and represent the best interests of the ultimate 'client', namely, the corporation, through the forum of the independent committee, and to advise the independent committee in carrying out its mandate to act for the corporation in the related party transaction.

Where the External Counsel is to Represent Only the Controlled Corporation

External corporate counsel proposed to be retained may act regularly for the controlled corporation in a continuing relationship on routine corporate matters where the lawyer does not have a "conflicting interest" in advising on those files. Such counsel might well, however, have a solicitor-client relationship with the controlling person and, in the context of a related party transaction between the controlled corporation and the controlling person, the counsel would have a "conflicting interest", even where the controlling person retained another firm to represent it in the related party transaction.

In these circumstances, it would be incumbent on external corporate counsel to advise the controlled corporation that he or she cannot advise the corporation on the proposed related party transaction with the controlling person without the fully informed consent of both the controlling person and, on behalf of the corporation, the informed consent of the committee of independent directors. The requirement to advise fully and to seek and obtain the consent of the committee of independent directors is crucial. As commented earlier, external corporate counsel's "conflicting interest" with the controlling person cannot be consented to or 'cleansed' on behalf of the controlled corporation by the controlling person indirectly or by those individuals who may be affected by or subject to the influence of the controlling person. Any implied or express consent by or on behalf of the controlled corporation, other than by those who are in a position to assess and are subject to a fiduciary duty as directors to act solely in the best interests of the controlled corporation, independently of the controlling person and its interests, would not be valid.

A very serious issue arises if the external corporate counsel who regularly acts for the controlled corporation and has a "conflicting interest" with the controlling person does not disclose the "conflicting interest" to the committee of independent directors and seek the informed consent of the independent directors to act for the corporation, even where such counsel is not advising the controlling person in the transaction. In these circumstances, the lawyer would be in breach of the duty of loyalty as articulated by the Supreme Court of Canada in *R. v. Neil, supra.* In addition, with respect to the LSUC's Rules of Professional Conduct, subrule 2.04(3) would clearly apply in regards to such counsel providing advice to the controlled corporation. As noted earlier, it would be normal to expect that the retainer of external corporate counsel by the controlled public corporation would encompass the full range of usual and required services and would not be restricted to exclude advice to the board of directors or committees of the board.

There are those who argue that it is common and accepted corporate practice that a firm acting for the controlling person and its group of controlled public corporations need not disclose its 'conflicting interest' to a committee of independent directors nor seek the consent of the committee to act for the corporation on a related party transaction with the controlling person. This position is supplemented, as noted below, with the corollary that such firm's retainer is limited and restricted only to provide advice to the corporation through management, and that the contentious and conflicting issues between the corporation and the controlling person are understood to be left for negotiation and approval by that independent committee, who are entitled to seek their own separate counsel. It is submitted there is ample evidence over many years that there are other more established and recognized corporate practices to the contrary and that the above articulation of common and accepted corporate practice is neither sustainable nor appropriate.

First, where external corporate counsel does not disclose its 'conflicting interest', accompanied by appropriate advice, the committee of independent directors is entitled to assume that external counsel does not have a 'conflicting interest' in representing the corporation. The committee assumes that the advice that the corporation receives from such external counsel is untainted and free of 'conflicting interests'. Not put on notice that such advice is subject to 'conflicting interests', the committee may properly assume that it may safely rely on advice provided to the corporation through management of which it may become aware or which may submitted by management to the board of directors or the committee for guidance. Any presence of such external counsel at meetings of the board of directors or the committee, even where formal advice is not provided by such counsel, adds further to the representation that such counsel is acting without encumbrance and rendering independent advice which the board and its committees, as well as management, are entitled to rely on. The committee of independent directors, not being advised or aware that unconflicted advice is not present, is not triggered or cautioned to initiate a process to seek its own independent legal advice. If the committee of independent directors does not resolve on its own initiative to retain its own legal advisor, the committee and the corporation are left in the position that they do not have the benefit of independent legal advice in making decisions on the terms and other aspects of the related party transaction with the controlling person.

Second, the committee of independent directors would naturally be entitled to assume that the committee would fall within the recipients of legal services to be provided by external corporate counsel retained by the corporation. The

independent committee would operate under the normal impression that the committee was entitled to rely on the legal work of such external corporate counsel. The independent committee of directors would, however, have no actual knowledge that external corporate counsel has a "conflicting interest" and would assume that the work undertaken and advice furnished by external corporate counsel was untainted by any divided loyalties or conflicting duties. Documents and memoranda prepared by such counsel for the corporation relating to the related party transaction and provided to the independent committee during the course of its deliberations would be received by the committee on a similar basis. In addition, the independent committee would not be alerted to the fact that it should consider retaining its own independent counsel because it would be under the impression that it was entitled to rely on the legal advice from what appeared to the committee to be independent external corporate counsel as a consequence of counsel not disclosing the "conflicting interest" to the committee. The effective result of such non-disclosure is that the independent committee and thereby the corporate client is left without the benefit and protection of receiving the independent legal advice it thought it was receiving. It is extremely important that the independent committee of directors know that the involvement, participation and any advice, express of implied, provided by an external corporate counsel with a "conflicting interest" are subject to and provided in light of that "conflicting interest". The independent committee then has the ability to consider and assess its own position and responsibilities in light of that information and to seek its own independent legal advisor.

As commented earlier, some external corporate counsel who provide continuing advice to a group of controlled companies and have a "conflicting interest" with the controlling person also argue that its retainer with the controlled corporation is understood to be limited and restricted in scope and purpose to carrying out the instructions received from corporate management and that the retainer does not extend to providing advice to a committee of independent directors who would be expected to negotiate and approve the business and financial terms of related party transactions and other conflict of interest matters with the controlling person or its affiliates. It is also argued that it is common practice for such counsel not to take any steps and not to make disclosure to address potential conflicts of interest between the multiple clients within the corporate group. Part of the justification for these positions is that external counsel is usually dealing with and obtaining instructions from the same senior executives who overlap at each of the companies within the controlled group and who are fully aware of the affairs of the group and its members. As clients in these situations are "sophisticated", it is said to be understood by the members of the

group that external counsel acting for the controlled group of companies cannot provide advice or assistance on the area in which the conflict arises. In addition, it is argued that the controlled group of companies benefit from the advice of a single law firm because of the knowledge and familiarity of such counsel with the affairs of the entire group, including particularly in light of the complex corporate and tax structures that may exist among and within the controlled group. The argument is further augmented with the statement that the clients may often be sceptical that separate external counsel for a controlled public company will provide any added value and will not be able to provide fully informed advice on a timely and cost effective basis.

It is possible that a retainer may be agreed to be so contractually restricted. Such a restricted retainer, if it in fact exists, does not, however, satisfy the professional and legal responsibilities of a "conflicted" lawyer to a client which is a controlled public corporation with the group. As discussed earlier, neither a controlling person, nor its affiliates or associates, can provide a valid consent on behalf of the controlled corporation to its retainer of the controlled person's lawyer in a related party transaction in which the controlling person or its affiliates has an adverse interest with the result that there is no obligation on the external counsel to disclose its "conflicting interest".

If the "conflicted" lawyer is retained by management of the controlled corporation with a restricted retainer, it is necessary that such external corporate counsel clearly notify the committee of independent directors of the controlled public corporation in question of the particulars of counsel's "conflicting interest" and the terms of such an unusually restricted engagement of external corporate counsel, namely, that its retainer does not include advising the independent committee on the issues related to the business conflict of interest with the related party. Proper disclosures to the independent committee will extinguish the normal implication that the committee may take into account and rely on the work of such external corporate counsel without qualification, will make it properly aware of the "conflicting interest" of such counsel and, with knowledge that it is without a legal advisor, the committee would probably initiate its own process to engage its own independent counsel to advise it on its responsibilities.

When proper disclosure is made to the committee of independent directors by external corporate counsel of its "conflicting interest", it should include sufficiently adequate information of the relationship between counsel and his or her firm and the controlling person and its affiliates to allow the committee of independent directors to be in a position to make an informed decision. If the external corporate counsel understands or expects that the committee of

independent directors may rely on its advice (as opposed to such counsel only providing assistance, as requested, on internal corporate factual matters to separate independent counsel for the independent committee), it would be appropriate for the external counsel to advise the independent committee, together with the disclosure of the "conflicting interest", that the independent committee should obtain independent legal advice with respect to the implications of external counsel's "conflicting interest" and the duties of the independent directors in these circumstances.

It is quite likely that a controlling person would not object and likely prefer that the external corporate counsel to the corporation it controls and who has a solicitor-client relationship with it also be retained by the committee of independent directors. A controlling person might so consent, on condition that confidential information concerning the controlling person possessed by such counsel will not be disclosed to the independent committee. It is, however, most probable that the committee of independent directors would consider that external corporate counsel's "conflicting interest" with the party adverse in interest to the corporation in the related party transaction is a disqualifying factor to a retainer and that the independent committee would decide to engage its own independent counsel that is free of conflicts of interest and unencumbered in providing robust advice to the independent committee and thereby the corporation.

The same result that the committee of independent directors would retain its own legal advisor may also well occur where regular external corporate counsel to the controlled corporation does not have a "conflicting interest" with the controlling person or its affiliates. The committee of independent directors may conclude that the fact of the continuing relationship of external corporate counsel with the controlled corporation is, in itself, a sufficient indicator that such counsel might be inclined to 'soft peddle' its advice to the independent committee in order not to antagonize the controlling person or corporate management so that it would not be removed as counsel to the controlled corporation in the future. While it may well likely be the case that the committee of independent directors would still retain its own independent legal advisor to advise it in these circumstances, independent counsel for the independent committee could request regular external corporate counsel to assist it with respect to internal corporate factual matters with which it is familiar.