

MEMORANDUM

TO REF Attorneys, Paralegals and Law Students

DATE March 2, 1990

FROM Gary Brown *GB*

RE New York City Bar Association Formal Opinion 1990-1

Attached please find a copy of Formal Opinion 1990-1 recently issued by the Committee on Professional and Judicial Ethics of the New York City Bar Association. The opinion discusses the situation where a lawyer is representing both a cooperative corporation and a sponsor after a conversion.

As you will see, the opinion discusses the conflict of interest that can exist in this situation, and concludes that "the preferable course in general would be for a lawyer to decline to represent the cooperative corporation if the lawyer has represented the sponsor throughout the conversion process and proposes to continue that representation."

Accordingly, all offering plans and amendments which disclose that one lawyer will represent both the sponsor and the cooperative corporation should also disclose the existence of Formal Opinion 1990-1 and the possibility for conflict of interest discussed therein.

Formal Opinion No. 1990-1

In Formal Opinion 1988-5, the Committee addressed ethical questions arising in a variety of circumstances in which lawyers who are shareholders in a cooperative apartment corporation are active in the affairs of their building or are called upon to provide legal services for different constituencies in the building, *e.g.*, the board of directors, a fellow shareholder or a potential purchaser. The situations discussed in that opinion did not include that of a lawyer representing both a cooperative corporation and the sponsor after a conversion of the building from rental apartments, and this opinion is intended to address that subject.

The inquirer is contemplating acting as the lawyer for a sponsor during the process of converting rental apartments into cooperative ownership and then continuing as the lawyer for both the sponsor and the cooperative corporation after the conversion. The inquirer asks whether the lawyer for the sponsor during the conversion process may continue such dual representation after conversion if the lawyer agrees to withdraw from the dual representation when a specific conflict between the two clients arises. The inquirer asks further whether the fact that the tenants themselves control the board of directors of the cooperative corporation and thus have the power to discontinue the services of that corporation's lawyer is sufficient to justify such dual representation if it would otherwise be ethically impermissible.

By way of background, the inquirer notes that the sponsor typically functions throughout the conversion process in many different capacities. The sponsor usually is the owner of the building undergoing conversion at the outset. As owner of the building, the sponsor is also the landlord of the building and continues to operate as landlord after the conversion with respect to all tenants who choose to remain as rental tenants rather than purchase shares in the cooperative corporation and obtain from it a proprietary lease. The sponsor creates the cooperative corporation and initially owns all shares of such corporation. Through the conversion, the sponsor sells these shares to certain of the rental tenants, who may be represented by their own tenants' association and who generally will retain their own counsel. The sponsor usually also sells shares to certain purchasers who are not rental tenants and these purchasers typically retain their own counsel.

Initially, according to the inquirer, the sponsor is the controlling shareholder in the corporation. As the creator of the corporation and its controlling shareholder, the sponsor appoints its own agents to the board of directors of the cooperative corporation. Although some of the sponsor's directors often resign within 30 days following conversion in favor of directors appointed by the tenant shareholders, the sponsor frequently continues to be the controlling shareholder of the cooperative corporation for some period of time.

The inquirer has further advised that the sponsor may act in other capacities throughout the conversion process and may continue to act in various capacities after all the shares of the cooperative corporation have been sold. The sponsor often will act as the managing agent of the cooperative corporation. The sponsor may also be a lessee from the cooperative corporation with respect to any commercial space in the building. The sponsor also frequently is the holder of the mortgage on the building.

The inquirer already has concluded that the interests of the tenant shareholders are adverse to the interests of the sponsor in virtually all capacities in which the sponsor might act. Indeed, during the conversion process itself and prior to actual conversion, the tenants' association customarily employs independent counsel to represent its interests vis-a-vis the sponsor as the original landlord, the seller of the cooperative corporation's shares, the entity that appoints the initial board of directors of the corporation, the controlling shareholder and the holder of unsold shares. The issue, however, is the likelihood that the interests of the cooperative corporation will conflict with the interests of the sponsor after the conversion and the ethical implications of that likelihood for the lawyer proposing to represent both.

Canon 5 of The Lawyer's Code of Professional Responsibility (the "Code") requires a lawyer to exercise independent professional judgment on behalf of a client. DR 5-105(A) and (B) provide that a lawyer shall decline multiple representation, or having undertaken multiple representation shall discontinue it, if the exercise of his independent professional judgment on behalf of a client will be or is likely to be adversely affected or if it would likely involve him in representing differing interests, except to the extent permitted under DR 5-105(C). Whether a lawyer's representation of both the sponsor and the cooperative corporation would be likely to affect adversely the lawyer's independent professional judgment on behalf of either client or involve the lawyer in

representing differing interests will depend on the facts and circumstances of each case. Nevertheless, the Committee finds it difficult to conceive of a situation in which a lawyer should not conclude that his or her representation of both the sponsor and the cooperative corporation is "likely to involve" the representation of "differing interests" (defined in the Code to encompass interests that are "inconsistent" or "diverse", as well as those which are "conflicting"). In this regard, a lawyer should be mindful of EC 5-18, which admonishes that a lawyer employed or retained by a corporation owes allegiance to the corporation and not to a stockholder, director, officer, employee, representative, or other person connected with the corporation, such as in this case the sponsor.

Nevertheless, DR 5-105(C) permits a lawyer to represent multiple clients in a situation covered by DR 5-105(A) "if it is *obvious* that he can adequately represent the interest of each *and* if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each." (Emphasis added.) As the Committee indicated in Formal Opinions 80-7 and 81-4, "the touchstone of this provision of the Code is the adverse effect that competing interests of more than one client have on the attorney's capacity to exercise full professional judgment on behalf of each client." EC 5-15 notes that a lawyer should resolve all doubts against the propriety of the representation of clients having potentially differing interests.

Whether the "obviousness" test can be met depends on the particular facts and circumstances, but, in general, the more issues that are likely to arise between the sponsor and the cooperative corporation, the less likely is the test to be satisfied. See N.Y. State 162 (1970). In any event, we agree with the opinion of the New York State Bar Association Committee on Professional Ethics that "[d]ual representation should be practiced sparingly and only when it is clear that neither party will suffer any disadvantage from it." N.Y. State 38 (1966), *quoted in* N.Y. State 162 (1970).

Recognition should also be given to the possibility of future disputes between the sponsor and the cooperative corporation. Potential conflicts between the sponsor as controlling shareholder and the tenant shareholders and other potential problems arising from the relationship between the sponsor and the cooperative corporation may arise. Before undertaking any such multiple representation, these

potential problems should be recognized, fully disclosed and consented to by both the sponsor and the cooperative corporation.

As we noted in Formal Opinion 1988-5, even if a lawyer concludes that multiple representation is initially proper in a given situation, if a non-waivable conflict later develops between the sponsor and the cooperative corporation, the lawyer may be forced to withdraw from both representations and may in some cases be forbidden by rules prohibiting disclosure of client confidences even from informing one or the other of the clients of the reasons for the withdrawal. Indeed, the Committee has been informed that in common practice if the lawyer for the sponsor does continue to represent the cooperative corporation after the conversion process, the lawyer will typically resign from representing the cooperative corporation when tenant shareholders develop interests conflicting with those of the sponsor as controlling and non-tenant shareholder. Declining representation of the cooperative corporation at the outset would spare all parties such disruption.

In conclusion, the Committee believes that the preferable course in general would be for a lawyer to decline to represent the cooperative corporation if the lawyer has represented the sponsor throughout the conversion process and proposes to continue that representation. Declining representation of the cooperative corporation at the outset would spare the lawyer's clients the expense and inconvenience caused by later withdrawal. *See* N.Y. City 81-27. Such a decision is consistent with the Code's admonishment to resolve all doubts against the propriety of any proposed multiple representation.

January 29, 1990

Formal Opinion No. 1988-5

Many New York attorneys participate in the affairs of their cooperative or condominium apartment buildings, and also may be called upon for legal assistance relating to the affairs of the corporations or their tenants or both. Ethical questions arise in a variety of circumstances, some of which may not be immediately apparent. The purpose of this opinion is to alert the Bar to some of these questions.

RELEVANT GENERAL PRINCIPLES

Canon 5 of the Code of Professional Responsibility requires a lawyer to exercise independent professional judgment on behalf of a client. The lawyer's professional judgment must be exercised solely for the benefit of the client and free of compromising influences and loyalties. EC 5-1. The diverse interests that may arise include the personal interests of the lawyer, EC 5-2 *et seq.*, interests of multiple clients, EC 5-14 *et seq.*, and desires of third persons, EC 5-21 *et seq.*

In the first instance, a lawyer-tenant must take into account his or her property interest in the cooperative or condominium apartment. DR 5-101(A) provides that:

Except with the consent of his client after full disclosure, a lawyer shall not accept employment if the exercise of his professional judgment on behalf of his client will be or reasonably may be affected by his own financial, business, property, or personal interests.

See EC 5-3; N.Y. State 162 (1970); N.Y. City 247 (1932); *cf.* N.Y. City 525 (1940). In many instances, the lawyer's investment in an apartment is substantial. In addition, the lawyer-tenant's relationships with other tenants and with respect to the amenities of the building may, more subtly, be influences that could possibly compromise the lawyer's duty of undivided loyalty to a client. In determining whether the lawyer's professional judgment "reasonably may be affected" by the lawyer's own interests, an objective standard is applied. Accordingly,

In the cooperative context, the lawyer must carefully consider whether his interest as an owner and as a tenant could affect the exercise of his or her independent professional judgment on behalf of the corporation, either generally or as to specific matters. In the normal course of events, the lawyer's proprietary interest is coextensive with that of other tenants. Such interest should not prohibit the lawyer from acting as an officer or director of a cooperative or otherwise participating in the affairs of the corporation. But such interest may well be relevant in evaluating the propriety of providing legal services to the corporation or others.

While, in general, the interest of the lawyer may be coextensive with the interests of other members, and not immediately perceived as interfering with the exercise of independent judgment, circumstances may arise where the property or other interests of the lawyer-tenant may conflict with the interests of the board or other tenants. Conflicts are particularly likely in the event of litigation between the cooperative corporation or the board of directors and another tenant in the building. For example, a tenant may sue the board to compel it to permit him to construct an alteration to his apartment, *e.g.*, *Demas v. 325 West End Avenue Corp.*, 127 A.D.2d 475, 511 N.Y.S.2d 621 (1st Dep't 1987), or to sell his apartment to a buyer rejected by the board, *e.g.*, *Bernheim v. 136 East 64th Street Corp.*, 128 A.D.2d 434, 512 N.Y.S.2d 825 (1st Dep't 1987), or the board may sue a tenant to compel him to remove an illegal pet or alteration. The lawyer's property or personal interests could well be adverse to the board's if the lawyer-tenant had a similar problem, or was a friend of the other tenant.

A lawyer's personal interests reasonably may be expected to affect professional judgment, and accordingly, under DR 5-101(A), the

(Footnote continued)

adversely affect the representation, we believe that lawyers should decline the representation in such cases. Rule 1.7(b)(1) of the Model Rules of Professional Conduct provides that client consent will not cure the conflict unless "the lawyer reasonably believes the representation will not be adversely affected . . ." The comment to this Rule makes clear that even with consent, a lawyer cannot serve as both a director of and counsel to a corporation "[i]f there is material risk that the dual role will compromise the lawyer's independence of professional judgment." In N.Y. State 589 (1988), the Committee on Professional Ethics of the New York State Bar Association stated its belief, with which we concur, that this comment "accurately reflects the relevant concerns under the principles articulated in the Code of Professional Responsibility."

lawyer may not accept an engagement to represent the cooperative in such litigation unless the board consents after full disclosure of the possible effect on the lawyer's professional judgment.⁴ Even with the board's consent, however, we believe that the representation should not be undertaken if there is a material risk that the lawyer's advice or services would be adversely affected by the conflict, EC 5-2, for example, in a lawsuit between the cooperative and member of the lawyer's family.

More subtle questions arise where a lawyer-director is asked to represent the cooperative in a commercial or corporate transaction. In most cases, the lawyer's property and personal interests should coincide with those of the other tenants and the board. However, that will not always be the case. The greatest potential for conflicting interests arises in transactions involving other tenants in the building. For example, the board may ask the lawyer to represent it in connection with the sale of an apartment by another tenant. The lawyer should be sensitive to the possibility that his personal feelings about the selling tenant and the prospective buyer may influence his professional judgment. To the extent there are no matters to be negotiated by the lawyer in connection with the transaction, the problem is somewhat alleviated. *Cf.* N.Y. City 81-4 (a lawyer can represent both a mortgagor and a mortgagee "[i]f the parties themselves have agreed to the terms without an attorney, and if the attorney's work is mostly ministerial," and the parties have consented after full disclosure). If, however, the prospective buyer seeks concessions or promises from the board (for example, to make certain repairs), the lawyer's property interests will be implicated and the need for his impartial judgment will increase. In all such cases, the board must be fully informed of, and consent to, the possible effect on the lawyer's judgment before the lawyer may accept the engagement.

Finally, we note that in all cases where a cooperative seeks to retain a lawyer-tenant as counsel, the board should be fully informed of the risk of a later withdrawal by the lawyer if differing interests should

⁴ In extreme cases, such as where the lawyer seeks to represent the cooperative in a business transaction with an entity owned or controlled by the lawyer, DR 5-104(A), informed consent may require that an independent attorney advise the board regarding the conflict. *See Goldman v. Kane*, 3 Mass. App. Ct. 336, 341, 329 N.E.2d 770, 773 (1975).

arise, see EC 5-3,⁵ and that in no circumstances may a lawyer represent the board in any litigation if it appears that he "ought to be called as a witness" in the matter. DR 5-101(B).

II.

THE LAWYER-TENANT AS ATTORNEY FOR A CO-TENANT

Careful consideration should be given whenever a co-tenant requests representation in connection with a matter relating to the cooperative or condominium. If the lawyer is neither a member of the cooperative's board of directors, nor the attorney for the cooperative, the question is whether the lawyer's professional judgment may reasonably be affected by the lawyer's property or personal interests. DR 5-101(A). The potential for such impairment is most evident where a co-tenant seeks to retain the lawyer-tenant as counsel in an action against the cooperative.⁶ Again, informed consent would permit such representation unless there is a material risk that the conflict would impair the representation.

Not so readily apparent are the potential difficulties in the lawyer-tenant's representation of a co-tenant in the sale of an apartment. While the immediate "adversarial" interests are between the purchaser and seller, and no direct conflict exists in representation of the seller only, the corporation's interest and the lawyer's interest as a tenant-shareholder may be affected by the transaction. For example, the lawyer-tenant may personally dislike the proposed buyer, who is to be the lawyer's new neighbor, or, conversely, if the proposed buyer is not approved by the corporation's board of directors, the lawyer-tenant may not be able to advise the seller objectively as to whether he has a legal claim against the corporation. In another situation, the cooperative, and therefore the lawyer as a tenant, may have an interest in requiring the seller to repair or restore the apartment prior to its sale in

⁵ We do not decide here whether DR 5-101(A) requires withdrawal if, after accepting employment, a conflict arises between the cooperative's interests and the attorney's interests. Some authorities have argued that withdrawal is not required in such circumstances. See American Bar Foundation, *Annotated Code of Professional Responsibility* 193-94 (1979).

⁶ The lawyer must decline the representation if he "ought to be called as a witness" in the litigation. DR 5-101(B).

accordance with the terms of the proprietary lease even if the buyer has raised no objection.

A different set of issues arises if the lawyer is either a board member or counsel for the cooperative. In either case, the lawyer-tenant would owe fiduciary duties to the cooperative that could conflict with the representation of another tenant in a matter relating to the cooperative. See N.Y. State 589 (1988). Where the lawyer is also counsel for the cooperative, he or she may represent an individual tenant-stockholder "only if the lawyer is convinced that differing interests are not present." EC 5-18. For example, where a lawyer who represents the cooperative is requested to represent both the cooperative and a tenant in a sale of the tenant's apartment, the lawyer must determine whether in fact there are adverse interests between the parties, such as a dispute over unpaid maintenance. In cases where the lawyer's role on behalf of the cooperative is largely ministerial and there are no adverse interests between the cooperative and the selling tenant, the dual representation would be permissible with the informed consent of both parties.

On the other hand, the lawyer must be sensitive to situations where the selling tenant is in fact aligned with the buyer in seeking concessions from the cooperative to the buyer in order to facilitate the sale. In such cases, as in cases where the cooperative's lawyer is asked to enforce a claim on behalf of a co-tenant against the cooperative or the board of directors, we do not believe it will ever be "obvious" that the lawyer can "adequately represent the interest of each," DR 5-105(C), and accordingly, the conflict could never be cured by consent. EC 5-15.⁷ Even if the dual representation is initially proper, if a nonwaivable conflict later develops between the cooperative and the tenant, the lawyer may be forced to withdraw from both representations and may in some cases be prohibited by the rules prohibiting disclosure of client confidences even from informing one or the other of the clients of the reasons for the withdrawal.

⁷ In addition, such a dual representation could lead to a breach of the duty to keep client confidences and secrets, DR 4-101, or a breach of the duty to represent a client zealously, DR 7-101(A).

III.

THE LAWYER-TENANT AS ATTORNEY FOR A PURCHASER

The interests of a purchaser of shares in the cooperative apartment can be quite different from the interests of the cooperative as a whole, creating areas of actual or potential conflict of interests. Potential conflicts include negotiation of a recognition agreement whereby the cooperative corporation may recognize a lending bank's lien on the new owner's shares, and negotiation with the corporation as to alterations or other questions under the proprietary lease or house rules. Additionally, the prospective purchaser needs to be approved by the board of the building, representing another potential for conflict of interest, whether the lawyer-tenant is acting as board member or as a lawyer for the corporation. If the lawyer-tenant is the lawyer for the corporation, acting also for the potential purchaser clearly constitutes representation of differing interests. Accordingly, the lawyer-tenant may act only if it is "obvious" that he can adequately represent both the cooperative and the purchaser and each party consents after full disclosure of the conflict between the cooperative and the purchaser and the lawyer-tenant's personal and property interests in the transaction. DR 5-105(A).

Whether the "obviousness" test can be met depends on the particular facts and circumstances, but in general, the more issues there are to be negotiated between the board and the applicant, the less likely it will be satisfied. *See* N.Y. State 162 (1970). Conversely, if there is nothing to be negotiated, and the lawyer is acting primarily in a ministerial capacity, the conflict may be waivable. N.Y. City 81-4; N.Y. County 615 (1973). In any event, we agree with the opinion of the New York State Bar Association Committee on Professional Ethics that "[d]ual representation should be practiced sparingly and only when it is clear that neither party will suffer any disadvantage from it." N.Y. State 38 (1966), *quoted in* N.Y. State 162 (1970).

Recognition should also be given to the possibility of future disputes between the purchaser and the corporation. Problems of rental payments or other relationships between tenant and corporation may arise. They should be recognized, fully disclosed and consented to by both the cooperative and the purchasing tenant, and it should be clearly

agreed that the representation is limited to completion of the purchase transaction and does not extend into the future.

IV.

THE LAWYER-TENANT AS ATTORNEY
FOR A TENANTS' GROUP WITH RESPECT
TO A CONVERSION PLAN

Finally, we turn to the question of whether a lawyer residing in a rental building may represent a tenants' committee formed in response to an announced conversion plan. Although the property interests of a lawyer may initially be co-extensive with those of the members of a tenants' group or committee, and not currently interfere with the exercise of the lawyer's independent judgment, if the likelihood of such interference can reasonably be foreseen, the lawyer should explain the situation to the tenants' group, including the risk of later withdrawal and the serious disruptions that may ensue. The lawyer should decline or withdraw from employment unless the tenants' group consents to the continuance of the relationship after full disclosure. DR 5-101(A); EC 5-3. Issues upon which the lawyer's personal or financial interests may diverge from other tenants could include, for example, whether to try to defeat the conversion plan, what parts of the building to seek to have the landlord repair and how to allocate the maintenance among the apartments in the building.

If the lawyer believes that there is no reasonable possibility that the lawyer's interest in his or her own apartment will at some point adversely affect the services the lawyer will render to the tenants' committee, it would be proper for the lawyer to undertake the representation, provided (1) full disclosure is made to the prospective clients of the lawyer's interest and of the potential risks and conflicts that could arise from that interest and (2) each of those clients thereafter consents to the lawyer's retention. See N.Y. City 80-87. (Given the changing composition of tenants' groups, such consents may be difficult to obtain throughout the representation.) In the case of a lawyer-tenant involved with a cooperative conversion, however, we caution that in many circumstances it is reasonably foreseeable that the lawyer's financial and property interests could diverge from the interests of other tenants and thus interfere with the lawyer's representation of other tenants. A lawyer should accept or continue such representation only

after the most careful consideration and should resolve all doubt against the propriety of the representation. EC 5-15.

An additional ethical consideration arises from the possibility that at some point in the conversion process the interest of the constituent members of the tenants' committee may diverge. If the lawyer's exercise of independent professional judgment on behalf of some tenants will be or is likely to be adversely affected by his or her representation of others, the lawyer must discontinue the multiple employment, DR 5-105(B), unless it is obvious that the lawyer can adequately represent the interests of each group and each group consents after full disclosure of the possible risks and effects of such representation. DR 5-105(C); *see also* EC 5-16, EC 5-19, N.Y. City 81-4. While each case depends on its own facts, we caution that in many instances it will not be obvious that a single attorney -- particularly one who is also a tenant -- will be able to represent adequately the interests of numerous tenants in the entire conversion process.

Assuming compliance with DR 5-101 and DR 5-105, representation of a tenants' committee by a tenant is not inherently unethical. However, the prospect of diverging interests between the lawyer and some of his or her clients, or among the individual members of a tenants' committee, is sufficiently possible that the better practice may be to decline such representation at the outset and spare the clients the expense and inconvenience caused by later withdrawal. *See* N.Y. City 81-27.

CONCLUSION

Lawyers who participate in the affairs of the cooperative or condominium apartment buildings in which they live should be sensitive to the ethical issues that may arise. At the heart of these issues is Canon 5 of the Code of Professional Responsibility, which requires a lawyer to exercise independent professional judgment on behalf of a client. The Ethical Considerations and Disciplinary Rules under Canon 5, as well as others that may be applicable, should be carefully considered in the context of the various roles that lawyers may play. As tenants, lawyers have a property or personal interest that may affect the exercise of their professional judgment. When acting as a lawyer for the corporation, for sellers or buyers of apartments or for tenants' committees, a lawyer may be dealing with multiple and diverse interests that may adversely affect the independence of his or her

professional judgment or the lawyer's duty of loyalty to a client. Service on the board of directors of the building corporation raises further ethical problems if the lawyer also proposes to function in a professional capacity.

This opinion is intended to serve as a guide to assist the Bar in dealing with these questions. We emphasize that, as with conflicts of interest in general, lawyers who participate in the affairs of the cooperative or condominium apartment buildings in which they live should resolve all doubts against the propriety of the proposed representation.

July 14, 1988