Conflicts of Interest and Duty of Loyalty
(Strother v. 3464920 Canada Inc; CN v. McKercher LLP and Wallace)

BACKGROUND

Strother v. 3464920 Canada Inc

- In 2006, the Supreme Court of Canada (SCC) considered the circumstances in which lawyers can act for commercial competitors, and the limits on the duty of loyalty.
- Monarch retained Strother (then a partner at Davis & Co) to set up tax-sheltered syndication deals to finance film productions. They signed a retainer that prohibited Strother from acting for Monarch's competitors, which expired in December 1997. In the meantime, the federal government ended the tax shelter program, and Monarch got out of the film financing business. Strother learned that tax-sheltered financings were feasible under new rules. He signed an agreement with a new company in the tax-sheltered film financing business and left Davis & Co for what became a very profitable business venture. Monarch sued. The BC Court of Appeal concluded that Strother breached his fiduciary duty of loyalty to Monarch. It ordered that he disgorge all profits earned and that Davis & Co disgorge its profits from legal fees in acting for the second client in conflict with its duty to the first client.
- The CBA intervened; Terrence O'Sullivan and Paul Michell of Lax, O'Sullivan Scott acted on a *pro bono* basis. The CBA argued that the application of the rule in *Neil* must consider each individual case's circumstances, to avoid the risk of "an unnecessary expansion of the duty [which] may be as inimical to the proper functioning of the legal system as its attenuation". The following circumstances, among others, are relevant to determine the scope of a duty of loyalty:
  - the nature and duration of the retainer giving rise to the duty of loyalty;
  - the nature of the client's interest said to be at stake;
  - the nature of the adversity of interest alleged between the two clients (including whether the adversity relates to legal rights or commercial interests); and
  - whether the adversity of interest between the two clients arises from the matters in respect of which they have sought legal services.
- These arguments are consistent with the SCC's concern in *MacDonald Estate* (better known as *Martin v. Gray*), reaffirmed in *Neil*, to balance competing policy interests that include maintaining the integrity of the judicial system, the right of clients to counsel of their choice, and the preservation of reasonable mobility in the legal profession.
- In its June 2007 decision, the majority held that the retainer's scope is governed by contract. However, the solicitor-client relationship is overlaid with fiduciary responsibilities which provide a framework within which the lawyer performs the work and may include obligations that go beyond what the parties expressly bargained for. Fiduciary responsibilities include the duty of loyalty, of which an element is the avoidance of conflicts of interest. Strother was liable to disgorge personal profits when he let his personal interests conflict with his obligation to inform a current client that his earlier advice about the blocking of a tax saving measure might not be accurate. The Court clearly indicated that it is generally acceptable for a lawyer to represent business competitors, so long as confidential information is preserved, and reaffirmed the "bright-line rule" in *Neil* that a lawyer may not represent one client whose interests are directly adverse to the immediate interests of another current client unless both clients consent after receiving full disclosure.
- In response to *Strother* and other related SCC pronouncements, the CBA formed a Task Force on Conflicts of Interest to develop an effective and practical regime to deal with conflicts.

CN v. McKercher LLP and Wallace

- The SCC addressed the application of the "bright-line rule" articulated in *Strother* in its July 2013 decision, *CN. V. McKercher LLP and Wallace*, in which CBA intervened.

- In 2008, McKercher LLP began representing Wallace in a class action against CN Railway. When the claim was launched, McKercher was acting for CN on other matters. CN applied to disqualify McKercher from acting on the class action suit.

- The chamber judge concluded that McKercher should be disqualified from acting against its current client CN in the class action. The Saskatchewan Court of Appeal concluded that McKercher should not be disqualified, but reached the same conclusion as the chambers judge on the proper interpretation of the "bright-line rule".

- The CBA intervened on the issue of the scope of the duty to avoid conflicts. Malcolm Mercer, Eric Block and Brendan Brammall of McCarthy Tétrault LLP acted as pro bono counsel. It argued that the duty to avoid conflicts of interest does not categorically prohibit acting directly adverse to the immediate interests of a current client; rather that the bright-line rule should be understood as a "presumptive rule" guarding against the risk of material impairment of client representation.

- The July 2013 SCC ruling rejected the argument that the bright line rule is presumptive but limited its scope, remedying what, in the CBA's view, was the overbreadth of the rule. The Court clarified that the bright-line rule applies only where there is direct adversity to the immediate legal interests of a client. Further, the rule does not apply in unrelated matters where it is unreasonable for a client to expect that its law firm will not act against it. The Court held that McKercher crossed the bright line, and breached both its duties of commitment and candor. It sent the case back to the Saskatchewan Court of Queen's Bench to determine whether disqualification was an appropriate remedy.

CURRENT STATUS

- The CBA Task Force on Conflicts of Interest made recommendations to the Federation of Law Societies on amendments to its Model Rule to reflect *McKercher* decision. The FLSC Model Rule on Conflicts incorporates many of the recommendations made by the CBA.

- In its 2015 decision, *Canada (Attorney General) v. Federation of Law Societies*, the SCC referred to *McKercher* and *Neil*, stating that "[t]his body of jurisprudence demonstrates that this principle of commitment to the client's cause is sufficiently precise to provide a workable standard in that it can be applied in a manner that provides guidance as to the appropriate result." (para. 92)

NEXT STEPS

- The CBA Ethics and Professional Responsibility Subcommittee will continue to assess the impact of the decision on lawyers' ethical duties and provide its input to the Federation as needed on its Model Rule on conflicts of interest (see separate note).