Can Ariz. Nonlawyer Ownership Create A New Type Of Atty?

By **Andrew Halaby** (October 14, 2021)

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Arizona's new alternative business structure, or ABS, law is creating ABS compliance lawyer jobs. Some Arizona lawyers are wondering whether they might go into business as compliance lawyers-for-hire.

Background

Effective Jan. 1, Arizona adopted an ABS law that is first of its kind in the U.S. Nonlawyers may own a law-practicing entity, provided the entity takes the form of an Arizona ABS that satisfies Arizona's conditions for ABS licensure.

At this writing, the Arizona Supreme Court has issued 12 ABS licenses upon recommendation of the Committee on Alternative Business Structures and at least eight more applications are being reviewed, with regulatory staff of the Arizona Administrative Office of the Courts Certification and Licensing Division determining whether to recommend approval to the committee.

One condition of licensure is that the ABS appoint an Arizona lawyer as its compliance lawyer. Under the pertinent regulation, Arizona Code of Judicial Administration, Section 7-209, the compliance lawyer "is responsible for ensuring compliance with the rules governing ABSs," Arizona's ethics rules and Section 7-209,[1] and also bears responsibility to the Arizona Supreme Court for said compliance.[2]

A Recent Development

The issue of whether a compliance lawyer could serve more than one ABS was, until recently, more theoretical than real. The pertinent regulation requires that a compliance lawyer be a manager or employee of the ABS.[3] The regulation does not define "manager." A limited liability company manager certainly would seem to qualify.[4]

Otherwise, as a matter of employment law and human resources practicalities, most managers — as that term ordinarily is used — are employees. It appeared unlikely that many ABSs or candidates for compliance lawyer positions would savor the prospect of multiemployer employment in the important compliance lawyer role.

However, with its last grant of ABS licenses on Sept. 30, it appears that the Arizona Supreme Court is open to ABSs whose compliance lawyers are in private practice. The question becomes whether Arizona lawyers practicably may hang out the shingle as an independent contractor compliance lawyer, or ICCL, for hire by multiple ABSs.

I can offer no definitive answer. But here, presented in brief is a primer of some basic considerations, viewed exclusively through the lens of Arizona law.[5]

Can an Independent Contractor Discharge the Compliance Lawyer's Regulatory Obligations?

Section 7-209 imposes extensive requirements on compliance lawyers. These include, but are not limited to, ensuring:

- ABS lawyers' compliance with their ethical and professional responsibilities;[6]

- Compliance by the ABS's authorized persons,[7] i.e., persons with certain levels of ownership interest or control in the ABS;[8] and

- Ensuring others employed, associated with or engaged by the ABS do not cause or substantially contribute to a breach of Section 7-209 or the ethical and professional obligations of lawyers.[9]

There is some question as to whether these obligations properly can be performed as an independent contractor, let alone one serving more than one ABS. At a minimum, anyone considering assuming that role for an ABS should ensure that the ICCL has sufficient contact with and authority from ABS leadership, in order to properly discharge these obligations.

With Whom Does the Compliance Lawyer Have an Attorney-Client Relationship?

More precisely, the questions are (a) whether accepting the role of compliance lawyer is tantamount to forming an attorney-client relationship, and (b) if so, with whom?

As to (a), the answer probably is, "Yes, it is."

Setting aside the multiple, sometimes thorny substantive law issues surrounding formation of an attorney-client relationship,[10] ABS compliance lawyers will, as a practical matter, want to be able to have privileged communications with their principals. To have privileged communications requires an attorney-client relationship.[11]

Assuming the compliance lawyer forms an attorney-client relationship with the ABS — sometimes for clarity referred to herein as the ABS entity client — issue (b) recasts as whether clients of the ABS become clients of the compliance lawyer. I would argue that, in the abstract, they do not.

The compliance lawyer position exists to serve the ABS entity client in the discharge of its regulatory and ethical obligations, not to serve as lawyer to the ABS's clients. As a general proposition, inside counsel to business entities do not, by that fact alone, become counsel to their customers.[12] And according to the emerging consensus, law firms are entitled to inside counsel, even vis-à-vis current clients.[13]

To say that an ABS's clients are not automatically its compliance lawyer's clients, though, does not resolve all concerns.

Lawyers in some law firms wear a counsel-to-firm-clients hat in some instances, and a counsel-to-the-firm hat in others. A compliance lawyer could, of course, engage in conduct vis-à-vis a client of the ABS that satisfies the substantive legal requirements to form an attorney-client relationship between that individual lawyer and that client.[14]

Moreover, law firm principals are, as a general proposition, subject to vicarious liability for the firm's professional torts.[15] It is unclear whether an independent contractor

compliance lawyer would avoid classification as a "principal" for vicarious liability purposes.[16]

At a minimum, it would seem a good idea to explicitly disclaim an attorney-client relationship between the compliance lawyer and any client of the ABS in the ABS's standard engagement letter.

Even if the ICCL Represents Only ABSs, and Not Their Clients, What Ethics Issues Must Be Considered?

To say the ICCL does not represent the ABS's clients does not end the analysis. Even if the ICCL only represents multiple ABSs, without representing their clients, the ICCL must contend with a number of personal ethical obligations. Beyond the catalog of ethical duties that any lawyer owes to any client,[17] a few appear salient to ICCLs.

First — and obviously — any compliance lawyer owes an ethical duty of confidentiality to the ABS entity client.[18] Even if the compliance lawyer has no attorney-client relationship with the ABS's clients, the compliance lawyer owes them a duty of confidentiality as well.[19]

Second, any compliance lawyer owes the ABS entity client an ethical duty to avoid conflicts of interest, meaning — equally obviously — an ICCL may not, absent informed consent, represent one ABS entity client against another.[20]

Third, even without direct adversity of that kind, each ABS entity client may have legal interests that raise conflict-of-interest concerns unique to an ICCL under Arizona Rule of Professional Conduct 1.7.

- Consider as one example, the compliance lawyer's duty under the Arizona Code of Judicial Administration, Section 7-209(G)(3)(b)(4) to "[e]nsure that a prompt report is made to the state bar of any facts or matters reasonably believed to be a substantial breach of the regulatory requirements of this code."

  One ABS may have a different view than another of what facts or matters qualify. An ICCL has to ensure that the ICCL's advice to one ABS entity client is not shaded by another ABS entity client's interests;[21] confidentiality obligations may limit the ICCL's ability to "waive around" the conflict issue;[22] and the withdrawal that may otherwise be required[23] may cause hardship to both clients.

  And if the ICCL has other clients besides ABSs, the ICCL potentially would have to address these issues with those clients of the ICCL too.

- Consider as another example the attorney-client privilege. Though it would seem beyond cavil that the compliance lawyer's communications with the ABS entity client are privileged,[24] an ICCL representing more than one ABS might confront differing client views as to whether the ICCL's communications with one are protected from the other.

  On this score, it might be a good idea for the ICCL and any ABS client to establish a common understanding upfront.

Fourth, and thornier, is the issue of whether the conflicts of each ABS's clients would be imputed to the other's, through the ICCL playing the compliance lawyer role for both ABSs. Broadly speaking, Arizona Rule of Professional Conduct 1.10(a) imputes the restrictions of Rule 1.7, a conflict of interest, and Rule 1.9, former-client obligations, to lawyers associated in a firm.

A rich body of opinion and commentary, including but not limited to the American Bar Association's Formal Ethics Opinion 88-356 and the State Bar of Arizona's Ethics Opinion 97-09,[25] addresses imputation in the somewhat analogous context of temporary lawyering.

The sum of these opinions is that whether a temporary lawyer's conflicts will be imputed to the firm — or vice versa — turns on the degree to which the temporary lawyer's work includes the normal incidents of working at a law firm, such as having access to all client matters and files, or instead such access being limited to the particular matters and files on which the temporary lawyer works.

One obvious difference between temporary lawyers and ABS compliance lawyers is that by its nature, a temporary lawyer's tenure is limited, while the compliance lawyer role is, for lack of a better word, permanent. Indeed, the regulation requires that a compliance lawyer for a particular ABS notify the Courts Certification and Licensing Division and the state bar within three days after leaving the position.[26]

Another is that a firm can limit a contract lawyer's access to particular client files or information — indeed, the ability to impose such limits is under Formal Opinion 88-356 central to the imputation analysis. In contrast, a compliance lawyer presumably must have access to any and all ABS client information necessary to satisfy the compliance lawyer's — and the ABS's — regulatory obligations.

Suffice it to say that an ICCL's ABS clients' conflicts could be imputed to one another through the ICCL. To the extent that premise is sound, it follows that the ICCL would, at least arguably, owe an ethical obligation to disclose the pertinent risks to each ABS client and obtain the informed consent of each to the multi-ABS-client arrangement.[27]

It follows that the ICCL ought to consider running each ABS entity client's conflicts through the ICCL's own conflict check database.

Other Issues and Risks

One, to the extent a compliance lawyer has an attorney-client relationship with an ABS, that compliance lawyer presumably owes fiduciary duties to the ABS.[28] As a practical matter, these may not matter much where a compliance lawyer is working for only one ABS, as most companies do not sue their in-house counsel for breach of professional duties.

But they may matter more where an ICCL is working for more than one ABS, if something goes awry in the ICCL's discharge of professional obligations in that role.

Two, compliance lawyers likely will want professional liability coverage. It will be important to see how professional liability insurers view the prospect of covering an ICCL serving more than one ABS.

Three, though not especially germane to Arizona, law elsewhere is developing to the effect that some independent contractors will be considered employees for state employment law

purposes.[29] If an ABS is considering hiring an ICCL rather than an employee compliance lawyer, law to that effect may limit some of the benefits the ABS hoped to obtain through that choice.

Finally, there is the issue of ICCL compensation. Given the role the authorities expect ABS compliance lawyers to play, sufficient resources should be devoted to discharging the role.

Conclusion

The ultimate answer to the question, of whether an Arizona ABS compliance lawyer work for more than one ABS is maybe, but there are a lot of issues.

Hopefully the foregoing questions inform the associated analysis, enabling both ABSs and prospective ICCLs to make good decisions.

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[1] ACJA § 7-209(A).

[2] § 7-209(G)(3)(c).

[3] § 7-209(G)(3)(a)(2).

[4] See A.R.S. § 29-3407(C).

[5] How other states might view these or related issues, under the law of those states, is beyond this piece's scope.

[6] § 7-209(G)(3)(b)(1).

[7] § 7-209(G)(3)(b)(2).

[8] § 7-209(A).

[9] § 7-209(G)(3)(b)(3).

[10] See Restatement (Third) of the Law Governing Lawyers § 14.

[11] See Grassmueck v. Ogden Murphy Wallace, P.L.L.C ., 213 F.R.D. 567, 571 (W.D. Wash. 2003) ("[T]here can be no assertion of attorney-client privilege if there is no attorney-client relationship.").

[12] Cf. Arizona Rule of Professional Conduct ("Ethics Rule" or "ER") 1.13. Arizona's Ethics Rules follow the general structure of the ABA's Model Rules of Professional Conduct.

[13] See generally Steve Merouse, The Privilege Applied In-Firm (ABA Aug. 28, 2019), available
at https://www.americanbar.org/groups/litigation/publications/litigation_journal/2018-19/summer/the-privilege-applied-infirm/.

[14] Restatement § 14.

[15] Restatement § 58.

[16] See generally Restatement § 58.

[17] See, e.g., ER 1.1 (competence), ER 1.3 (diligence), ER 1.4 (communication), and ER 1.9 (obligations to former clients).

[18] ER 1.6(a).

[19] See ER 1.6 cmt. 5.

[20] ER 1.7.

[21] See ER 1.7(a)(2).

[22] See ER 1.7 cmt. [18].

[23] See ER 1.16(a)(1).

[24] A.R.S. § 12-2234.

[25] These opinions are not binding. ABA ethics opinions comment on model rules, which have no force of law in and of themselves. And after North Carolina Bd. of Dental Examiners v. FTC, 135 S. Ct. 1101 (2015), and 2019's promulgation of the Arizona Ethics Advisory Committee opinion-issuance process embodied in Arizona Supreme Court Rule 42.1, State Bar of Arizona ethics opinions arguably have less persuasive force than they once did.

[26] ACJA § 7-209(G)(3)(b)(6).

[27] Cf. ER 1.2(c) ("A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.").

[28] See, e.g., Thomas W. Morgan et al., Professional Responsibility Probs. & Mat'ls 70 (13th Abridged Ed. 2018).

[29] See Dynamex Ops. West v. Superior Court , California Supreme Court (2018).