

# Confidentiality, Loyalty, and Conflicts of Interest: Ethical Considerations for Counsel Representing Multiple Franchise Parties

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## I. INTRODUCTION

Franchise representations often involve a web of overlapping relationships—franchisor and franchisee, multiple franchisees within the same system, and insurers. Those relationships create recurring ethics issues for counsel, particularly around confidentiality, loyalty, and conflicts of interest. This paper surveys common scenarios in franchise practice where these duties collide and offers a practical framework grounded in the ABA Model Rules of Professional Conduct—especially Rules 1.4, 1.6, 1.7, and 1.8. Using hypotheticals, it addresses (i) representing a franchisor and franchisee jointly against a third party, (ii) representing competing franchisors, (iii) positional and business conflicts that arise when counsel serves both franchisor and franchisee, and (iv) insurer-funded defenses in which reporting obligations and control-of-defense provisions may test counsel’s independent judgment. The goal is to help franchise counsel spot potential conflicts early, and address them appropriately.

## II. REPRESENTING FRANCHISOR AND FRANCHISEE AGAINST A THIRD PARTY

**Hypothetical:** *A customer enters a store operated by a franchisee. The customer injures himself in the store and files a lawsuit naming the franchisee and the franchisor as defendants. Attorney Alpha regularly represents the franchisor in litigation. May Attorney Alpha represent both the franchisee and the franchisor?*

To determine whether representation of both the franchisee and the franchisor is permissible, attorneys should look to the American Bar Association Model Rules of Professional Conduct (the “Model Rules”). Model Rule 1.7 states that, absent several exceptions, attorneys “shall not represent a client if the representation involves a concurrent conflict of interest.”<sup>1</sup> The process an attorney should go through to determine whether representation is permissible is also explained in the comments to Model Rule 1.7. First, an attorney should “clearly identify the client or clients.”<sup>2</sup> Second, the attorney should “determine whether a conflict of interest exists.”<sup>3</sup> Then, the attorney should “decide whether the conflict is consentable.”<sup>4</sup> If the conflict is consentable, the attorney should “consult with the clients affected under [Model Rule 1.7(a)] and obtain their informed consent, confirmed in writing.”<sup>5</sup>

A concurrent conflict of interest exists if (1) the representation of one client will be directly adverse to another client, or (2) there is significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client, or a third person, or by a personal interest of the lawyer.<sup>6</sup> The comments to Model Rule 1.7 indicate what is considered a “material limitation.” Specifically, the comments state “a conflict of interest exists if there is a significant risk that a lawyer’s ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer’s other responsibilities or interests.”<sup>7</sup> To assist lawyers in deciding whether they are materially limited, “[t]he critical questions are the likelihood that a difference in interests will eventuate and,

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<sup>1</sup> See ABA Model Rule 1.7(a).

<sup>2</sup> See Comment 2 to ABA Model Rule 1.7 cmt.

<sup>3</sup> See *id.*

<sup>4</sup> See *id.*

<sup>5</sup> See *id.*

<sup>6</sup> See ABA Model Rule 1.7(a)(1)-(2).

<sup>7</sup> See Comment 8 to ABA Model Rule 1.7 cmt.

if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client."<sup>8</sup> Franchise attorneys should also review the franchise agreement, related agreements, and any documents describing the standards required to maintain the franchise location. These documents might help the attorney determine whether they are materially limited in their representation of all of the parties or whether there is a potential conflict of interest.

If an attorney concludes that there is a conflict of interest, the next step is to determine whether the conflict is consentable.<sup>9</sup> "Consentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest."<sup>10</sup> Model Rule 1.7 states that notwithstanding the existence of a conflict of interest, representation of a client is permissible if: (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; (2) the representation is not prohibited by law; (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or proceeding before a tribunal; and (4) each affected client gives informed consent, confirmed in writing.<sup>11</sup>

The informed consent requirement requires that "each affected client be aware of the relevant circumstances and of the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client."<sup>12</sup> "When representation of multiple clients in a single matter is undertaken, the information must include the implications of the common representation, including possible effects on loyalty, confidentiality and the attorney-client privilege and the advantages and risks involved."<sup>13</sup>

If an attorney determines that there is a concurrent conflict of interest that is not consentable, the representation should be declined pursuant to Model Rule 1.16. The rule explains that "a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if the representation will result in violation of the Rules of Professional Conduct."<sup>14</sup>

In this hypothetical, Attorney Alpha should first determine whether a conflict of interest exists. If there is a direct conflict of interest, then Attorney Alpha must decide whether the conflict is consentable. If there is not a direct conflict of interest, Attorney Alpha must determine whether there is significant risk that the representation of the franchisee will be materially limited by Attorney Alpha's responsibilities to the franchisor. If Attorney Alpha concludes that there is a significant risk that representation of the franchisee will be materially limited, then he must decide whether the potential conflict is consentable by determining whether: (1) he can provide competent and diligent representation to the franchisor and franchisee, (2) the representation is not prohibited by law; (3) the representation does not involve assertion of a claim by the franchisee against the franchisor or vice versa. Additionally, both the franchisor and franchisee give informed written consent to the representation. If it is not consentable, Attorney Alpha should decline representation pursuant to Model Rule 1.16.

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<sup>8</sup> See *id.*

<sup>9</sup> See Comment 2 to ABA Model Rule 1.7 cmt.

<sup>10</sup> See Comment 15 to ABA Model Rule 1.7 cmt.

<sup>11</sup> See ABA Model Rule 1.7(b)(1)-(4).

<sup>12</sup> See Comment 18 to ABA Model Rule 1.7 cmt.

<sup>13</sup> See *id.*

<sup>14</sup> See ABA Model Rule 1.16(a)(1).

**Hypothetical:** *Attorney Alpha examines whether a conflict of interest exists and determines that the franchisee could assert cross-claims against franchisor. May Attorney Alpha represent the franchisee and the franchisor?*

In this hypothetical, Attorney Alpha should not represent the franchisor and franchisee. If the franchisee asserts cross-claims against the franchisor, this would create a concurrent conflict of interest under Model Rule 1.7(a)(1) because representing the franchisee would be directly adverse to the franchisor. Such a situation cannot be consentable because Model Rule 1.7(b)(3) bars representation when “the assertion of a claim by one client against another client represented by the same lawyer in the same litigation.” Even if the franchisee has not yet asserted the cross-claims, such a scenario would create a significant risk that Attorney Alpha’s representation of the franchisee would be materially limited because it would involve advising the franchisee of the potential cross-claims against the franchisor, which would be against the interest of the franchisor. Thus, this would be a conflict of interest that cannot be remedied by informed consent by the parties and Attorney Alpha should refrain from representing both the franchisor and franchisee.

### III. REPRESENTING COMPETING FRANCHISORS

**Hypothetical:** *Franchisor A and Franchisor B operate in the same industry. Attorney Beta regularly represents Franchisor A in various legal matters and is currently representing Franchisor A in a breach of contract litigation. Franchisor B is attempting to open a store close in proximity to a store operated by Franchisor A’s franchisee but is unable to do so because of a recent lawsuit alleging violations of zoning laws. Franchisor B asks Attorney Beta to represent it in the lawsuit. May Attorney Beta represent Franchisor B?*

Franchisor A and Franchisor B operate in the same industry, meaning that if Franchisor B opens a store close to a store operated by Franchisor A’s franchisee, it is likely that it will have an adverse economic impact on Franchisor A. Because Franchisor A is a current client, Model Rule 1.7 applies to such scenarios. Specifically, Model Rule 1.7 prohibits an attorney from representing a client if “the representation of one client will be directly adverse to another client.”<sup>15</sup>

The American Bar Association (“ABA”) issued Formal Opinion 05-434, in which the ABA clarified the meaning of “directly adverse.”<sup>16</sup> The ABA explained that “[d]irect adverseness requires a conflict as to the legal rights and duties of the clients, not merely conflicting economic interests.”<sup>17</sup> Also, Comment 6 to Model Rule 1.7 explains that “simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients.”<sup>18</sup>

The ABA also noted, “courts have consistently upheld the general principle that business interests or economic adversity do not create ethical conflicts of interest under the Model Rules.”<sup>19</sup> For example, in *Curtis v. Radio Representatives, Inc.*, the client had asked the law firm prior to

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<sup>15</sup> See ABA Model Rule 1.7(a)(1).

<sup>16</sup> See ABA Standing Committee on Ethics and Professional Responsibility, *Formal Opinion 05-434* (December 8, 2004).

<sup>17</sup> See *id.*

<sup>18</sup> See Comment 6 to ABA Model Rule 1.7 cmt.

<sup>19</sup> See ABA Center for Professional Responsibility, *Corporate Outside Counsel Policies—Who do You and Who can You Represent?*, 24 *The Professional Lawyer* n.2 (June 15, 2016).

retaining its services, whether the firm represented any of the client's business competitors.<sup>20</sup> The firm never disclosed to the client that it was representing several stations, which were the client's competitors.<sup>21</sup> In the lawsuit, initiated by the law firm to recover money owed for legal services, the client argued that the firm violated Rule 5-105 of District of Columbia's disciplinary rules, which adopted the Model Rules.<sup>22</sup> The court held that "standing alone, defendant's bare allegation that it considers these stations to be competitors is not sufficient to establish a violation of DR 5-105."<sup>23</sup> Thus, merely being competitors that have adverse economic interests does not by itself prohibit an attorney from representing both clients.

In this hypothetical, it is possible that Attorney Beta may represent both Franchisor A and Franchisor B in their matters. The matters appear to be unrelated: Franchisor A is dealing with a breach of contract case, while Franchisor B is dealing with a zoning issue. Thus, Franchisor A and Franchisor B are merely competitors with adverse economic interests but representing either will not be "directly adverse" to the other. Because of this, Attorney Beta does not need the clients' consent to represent both. However, Attorney Beta must still ensure that she complies with Model Rule 1.7(a)(2) and must determine whether there is significant risk that one of the clients will be materially limited by her responsibilities to the other client. If Attorney Beta determines that there is no such risk, she may represent both Franchisor A and Franchisor B. If Attorney Beta determines that there is such a risk, she may not represent Franchisor B unless Model Rule 1.7(b) permits her to.

**Hypothetical:** *Attorney Beta represents Franchisor A in another litigation. Franchisor B asks Attorney Beta to represent it in an unrelated litigation. Upon reviewing the facts of Franchisor B's case, Attorney Beta learns that she will need to take a legal position opposite of her legal position in Franchisor A's litigation. May Attorney Beta represent Franchisor B?*

This situation is also covered by Model Rule 1.7. The comments to Model Rule 1.7 explain that "[o]rdinarily, a lawyer may take inconsistent legal positions in different tribunals at different times on behalf of different clients. The mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not create a conflict of interest."<sup>24</sup> However, a conflict of interest exists "if there is a significant risk that a lawyer's action on behalf of one client will materially limit the lawyer's effectiveness in representing another client in a different case. . . ."<sup>25</sup>

To determine whether representation of either client will be materially limited, the ABA provided several questions attorneys should ask themselves in Formal Opinion 93-377:<sup>26</sup>

- (1) Is the issue of such importance that its determination is likely to affect the ultimate outcome of at least one of the cases?

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<sup>20</sup> See *Curtis v. Radio Representatives, Inc.*, 696 F. Supp. 729, 730 (D.D.C. 1988).

<sup>21</sup> See *id.* at 730-31.

<sup>22</sup> See *id.* 735-37.

<sup>23</sup> See *id.* at 736.

<sup>24</sup> See Comment 24 to ABA Model Rule 1.7 cmt.

<sup>25</sup> See *id.*

<sup>26</sup> See ABA Standing Committee on Ethics and Professional Responsibility, *Formal Opinion 93-377* (October 16, 1993).

- (2) Is the determination of the issue in one case likely to have a significant impact on the determination of that issue in the other case?
- (3) Will there be any inclination by the lawyer, or her firm, to “soft pedal” or de-emphasize certain arguments or issues—which otherwise would be vigorously pursued—so as to avoid impacting the other case?
- (4) Will there be any inclination within the firm to alter any arguments for one, or both clients, so that the firm’s position in the two cases can be reconciled—and, if so, could that redound to the detriment of one of the clients?

If there is significant risk of material limitation, “then absent informed consent of the affected clients, the lawyer must refuse one of the representations or withdraw from one or both matters.”<sup>27</sup> “Factors relevant in determining whether the clients need to be advised of the risk include: where the cases are pending, whether the issue is substantive or procedural, the temporal relationship between the matters, the significance of the issue to the immediate and long-term interests of the clients involved and the clients’ reasonable expectations in retaining the lawyer.”<sup>28</sup>

The comments provide an example of when taking contrary legal positions poses a conflict: “when a decision favoring one client will create a precedent likely to seriously weaken the position taken on behalf of the other client.”<sup>29</sup> ABA Formal Opinion 93-377 indicates that such a situation is more likely to exist when the precedent is established in the same jurisdiction as the other matter.<sup>30</sup> The opinion explains that “if the two matters are being litigated in the same jurisdiction, and there is substantial risk that the law firm’s representation of one client will create legal precedent, even if not binding, which is likely materially to undercut the legal position being urged on behalf of the other client, the lawyer should either refuse to accept the second representation or (if otherwise permissible) withdraw from the first, unless both clients consent after full disclosure of the potential ramifications of the lawyer continuing to handle both matters.”<sup>31</sup> “If, on the other hand, the two matters will not be litigated in the same jurisdiction, the lawyer should nevertheless attempt to determine fairly and objectively whether the effectiveness of her representation of either client will be materially limited by the lawyer’s (or her firm’s) representation of the other.”<sup>32</sup>

In this hypothetical, it is possible for Attorney Beta to represent Franchisor B. The mere fact that inconsistent positions must be taken by Attorney Beta to represent Franchisor A and Franchisor B does not by itself prohibit Attorney Beta from representing Franchisor B in its litigation. However, Attorney Beta must determine whether there is a significant risk that she will be materially limited in her representation of Franchisor B because she is currently representing Franchisor A—a client she regularly represents. Attorney Beta should ask herself the four questions posed by the ABA to determine whether there is a significant risk she will be materially limited in her representation of Franchisor B. If the litigation involving Franchisor B takes place in the same jurisdiction as the litigation involving Franchisor A, then there is a greater chance that

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<sup>27</sup> See Comment 24 to ABA Model Rule 1.7 cmt.

<sup>28</sup> See *id.*

<sup>29</sup> See *id.*

<sup>30</sup> See ABA Standing Committee on Ethics and Professional Responsibility, *Formal Opinion 93-377* (October 16, 1993). This opinion examined a former comment to Model Rule 1.7 but is still useful in demonstrating “when a decision favoring a client will create a precedent likely to seriously weaken the position taken on behalf of the other client.”

<sup>31</sup> See *id.*

<sup>32</sup> See *id.*

the inconsistent positions will have an effect. If Attorney Beta concludes that there is no significant risk of her being materially limited in her representation of Franchisor B, she may represent Franchisor B. However, if Attorney Beta concludes that there is a significant risk of being materially limited, she may still represent Franchisor B if she abides by Model Rule 1.7(b)(1)-(4).

#### IV. REPRESENTING FRANCHISORS AND FRANCHISEES

##### A. POSITIONAL CONFLICTS

**Hypothetical:** *You represent Taco the Town, Inc., a franchisor with over 500 locations nationwide. Your firm regularly litigates franchise termination cases, including enforcing post-termination restrictive covenants.*

*Taco the Town sues a former franchisee in federal court in State A, alleging breach of contract and violation of a two-year, five-mile noncompete. On Taco the Town's behalf, you take the position that franchise noncompete provisions are presumptively enforceable because franchisees are not "employees" and therefore are not subject to heightened scrutiny under state noncompete law. This is an open issue in State A. You brief this argument aggressively, urging the court to adopt a bright line distinction between franchisees and employees.*

*At the same time, Smoothie Operator, LLC, a franchisee of Blend-It-Your-Way Brands, Inc., contacts you and asks you to represent it in federal district court in State B. Smoothie Operator wants to sue its franchisor for declaratory relief that its post-termination noncompete is unenforceable. If hired, you would take the position that the noncompete is unenforceable because franchisees are economically dependent, lack bargaining power, and should be treated like employees or quasi-employees for purposes of restrictive covenant analysis. This is an open issue under the law of State B.*

*The two cases are in different jurisdictions and involve unrelated franchise systems with different noncompete clauses, but a similar legal issue.*

**Question 1: Are you automatically prohibited in all circumstances from taking opposite legal positions in different cases?**

**Answer:** No. Positional conflicts are not per se prohibited in all circumstances. Under Model Rule 1.7, the mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not automatically create a conflict of interest

Comment 24 to ABA Model Rule of Professional Conduct 1.7 states:

- Ordinarily a lawyer may take inconsistent legal positions in different tribunals at different times on behalf of different clients.
- The mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not create a conflict of interest.
- A conflict of interest exists, however, if there is a significant risk that a lawyer's action on behalf of one client will materially limit the lawyer's effectiveness in representing another

client in a different case; for example, when a decision favoring one client will create a precedent likely to seriously weaken the position taken on behalf of the other client.

- Factors relevant in determining whether the clients need to be advised of the risk include: where the cases are pending, whether the issue is substantive or procedural, the temporal relationship between the matters, the significance of the issue to the immediate and long-term interests of the clients involved and the clients' reasonable expectations in retaining the lawyer.
- If there is significant risk of material limitation, then absent informed consent of the affected clients, the lawyer must refuse one of the representations or withdraw from one or both matters.

**Question 2: Is there a conflict of interest even though the clients are in different franchise systems and are not adverse to each other?**

**Answer:** Probably yes—this looks like a classic positional conflict.

ABA Model Rule 1.7 provides:

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:...(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

Per ABA Model Rule 1.7 and Comment 24 to Model Rule 1.7, the key question is whether there is a significant risk that your action on behalf of Smoothie Operator will materially limit your effectiveness in representing Taco the Town in your ongoing representation of Taco the Town.

Arguing that franchisees are “independent business owners” in one case and “functionally employees” in another could risk undermining Taco the Town’s systemic enforcement efforts and damaging both clients’ confidence and trust. When noncompete legal issues are open in one state, lawyers often cite to analogous decisions in other states. Federal district court briefs and decisions appear on PACER, Westlaw and Lexis. The lawyer for franchisor Blend-It-Your Way Brands could easily locate the briefing you do for Taco the Town, and any victories you obtain for Taco the Town, and use them against Smoothie Operator.

If there are already meaningful differences in the existing state law of State A and State B (for example the content of state noncompete statutes, or existing analogous precedent), or meaningful factual distinctions between Smoothie Operator and Taco the Town franchisees and their noncompete clauses, you may be able to effectively make different arguments on behalf of each client simultaneously in States A and B based on state statutory language and case-specific facts rather than broad legal theories.

If you are engaged to systematically enforce Taco the Town non-competes across the country (including possibly in State B in the future), Taco the Town may reasonably expect that you will not create harmful precedent for it in State B or other states. If Taco the Town only franchises in a handful of states (not including State B), and has no plans to expand beyond the handful of states where it currently operates, and you can draw meaningful distinctions between States A and B, you may be more free to advocate on behalf of Smoothie Operator in State B without it impacting Taco the Town (or your representation of Taco the Town).

### **Question 3: May you proceed with both representations?**

**Answer:** Possibly. If you reasonably believe that you can “provide competent and diligent representation to” both Smoothie Operator and Taco the Town, then under Model Rule 1.7(b) you can proceed if both Smoothie Operator and Taco the Town give informed consent, confirmed in writing.

### **Question 4: What is “informed consent”?**

**Answer:** Per Model Rule 1.0(e) "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

### **Question 5. Is written disclosure required even if you believe no real harm will occur?**

**Answer:** Probably yes.

At minimum, there is probably a “significant risk” that representation of Smoothie Operator will be materially limited by the lawyer's responsibilities to Taco the Town, so written disclosure is required under Model Rule 1.7.

Written disclosure is also required under Model Rule 1.4(a)(1): “A lawyer shall (1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent” is required by these Rules.”

### **Question 6: What is your safest course of action?**

**Answer:** Safest options include:

1. With respect to the Smoothie Operator/ Taco the Town conflict, decline the Smoothie Operator matter as that was the second potential representation
2. More broadly, for litigation that involves recurring franchise issues, choose to represent franchisors or franchisees. This does not mean you must always represent franchisors or franchisees for all legal work.
  - Doing transactional work for both franchisors and franchisees may be less problematic
  - Doing litigation that does not involve recurring franchisor-franchisees issues (for example, many vendor breach-of-contract claims) may be less problematic
3. Draft the scope of engagement narrowly in engagement letters – for example, we will handle the franchisee-landlord dispute only (and will not advise on other issue, like issues between the franchisee and its franchisor).

## **B. BUSINESS CONFLICTS**

**Hypothetical:** *You represent several franchisors in their FDD work and represent potential franchisees (of other systems that are not owned by your franchisor clients or their affiliates) in evaluating FDDs.*

### **Question 1: Is this likely a conflict for purposes of Model Rule 1.7?**

**Answer:** Probably not. There is likely not a significant risk that your simultaneous representation of franchisors and franchisees with respect to FDD preparation (franchisors) and FDD review (franchisees) will materially limit your responsibilities to such clients (the test under Model Rule 1.7).

### **Question 2: If it is not a legal conflict, what business conflicts do I need to consider?**

You'll want to think about client perceptions of loyalty and increased risk of future conflicts.

Franchisor or franchisee clients often assume their counsel is "on a side." If you represent some franchisors, franchisee clients may worry you are less on their side and advocate less aggressively for them (and vice versa for franchisor clients). Franchisees in particular may worry that you are more aligned with franchisor clients, who tend to be repeat players (annual FDD) vs. one-off.

Clients may be concerned that your representation of "the other side" will cause indirect harm to "their side". For example, on the franchisor-side, lawyers typically argue against caps on franchisees' personal guaranties; on the franchisee-side, lawyers often argue for caps on franchisees' personal guaranties. If you (on behalf of franchisees) persuade several franchisors to agree to such caps, your franchisor clients may think you are not helping franchisors industry-wide in their negotiating position. (Of course, you may be facilitating deals that would not otherwise happen at all without such concessions, in which case at least arguably everyone wins.)

With respect to increased risk of future conflicts, you will need to consider the speed with which parties become adverse unexpectedly. For example, a franchisee you represent in an FDD review later has a franchise agreement dispute with their franchisor; a franchisor client acquires a brand where you already represent franchisees; and non-adverse matters spawns indemnity issues. This can result in disqualification motions, forced withdrawals, disrupted strategy, and client frustration.

## **V. REPRESENTING FRANCHISORS IN INSURANCE-FUNDED LITIGATION**

**Hypothetical:** *Plaintiffs Dough & Behold, LLC allege that bakery café franchisor Scone but Not Forgotten, Inc. ("SBNF") made negligent and misleading representations during the franchise sales process and in the FDD, inducing them to sign a franchise agreement and invest significant capital. Plaintiffs assert claims for negligent misrepresentation, violation of state franchise disclosure statutes, and unfair competition / consumer protection statutes.*

*SBNF tenders the suit to its insurance carrier, and the carrier accepts defense (without issuing a reservation of rights letter). The carrier appoints panel counsel (you). The carrier imposes litigation guidelines, including: pre-approval for discovery, experts, mediation, and settlement authority; detailed early case assessments; and upload of "all significant documents," including sales materials and internal emails.*

### **Question 1: Who is your client in this insurer-funded defense?**

**Answer:** The insured (SBNF) is definitely your client. The trickier question is whether the insurer is also your client. Whether the insurer is also your client varies by state law.

The Model Rules of Professional Conduct do not answer whether a lawyer retained and paid by an insurer to defend its insured represents the insured, the insurer, or both, leaving room for a jurisdictional split.<sup>33</sup>

Many jurisdictions hold that defense counsel represents both the insured and the insurer, at least where there is no conflict.<sup>34</sup>

Other jurisdictions hold that the insured is the sole client of defense counsel appointed by the insurance carrier.<sup>35</sup>

### **Question 2: Can you allow the insurer to interfere with your professional judgment with respect to defending SBNF?**

**Answer:** No.

Model Rule 1.8(f) provides: A lawyer shall not accept compensation for representing a client from one other than the client unless:

- (1) the client gives informed consent;
- (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
- (3) information relating to representation of a client is protected as required by Rule 1.6.

Similar to Model Rule 1.8(f), Model Rule 5.4(c) provides: "A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."

State ethics committees have also addressed this issue. The Utah State Bar Ethics Advisory Opinion Committee has opined: "An insurance defense lawyer's agreement to abide by insurance company guidelines or to perform insurance defense work for a flat fee is not *per se* unethical. The ethical implications of insurance company guidelines must be evaluated on a case by case basis. An insurance defense lawyer must not permit compliance with guidelines and other directives of an insurer relating to the lawyer's services to impair materially the lawyer's independent professional judgment in representing an insured. If compliance with the guidelines will be inconsistent with the lawyer's professional obligations, and if the insurer is unwilling to modify the guidelines, the lawyer must not undertake the representation. Flat-fee arrangements

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<sup>33</sup> See Obligations of a Lawyer Representing an Insured Who Objects to a Proposed Settlement Within Policy Limits, ABA Formal Op. 96-403 (August 2, 1996), available at

[https://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/ethics-opinions/96-403.pdf](https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/ethics-opinions/96-403.pdf)

<sup>34</sup> See Footnote 6 to Ethical Obligations of a Lawyer Working Under Insurance Company Guidelines and Other Restrictions, ABA Formal Op. 01-421 (February 16, 2011), available at

[https://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/ethics-opinions/01-421.pdf](https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/ethics-opinions/01-421.pdf)

<sup>35</sup> See Footnote 7 to Ethical Obligations of a Lawyer Working Under Insurance Company Guidelines and Other Restrictions, ABA Formal Op. 01-421 (February 16, 2011), available at

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for insurance defense cases are unethical if they would induce the lawyer improperly to curtail services for the client or perform them in any way contrary to the client's interests. Obligations of lawyers under the Utah Rules of Professional Conduct, including the duty zealously to represent the insured, cannot be diminished or modified by agreement.”<sup>36</sup>

**Question 3: If you uncover information that you reasonably believe will hurt coverage, can you share that information with the carrier without the insured’s informed written consent? Is that still true if the carrier’s guidelines require you to disclose such information?**

**Answer:** No. You cannot share such information without the insured’s informed consent, even if the carrier’s guidelines require you to disclose such information.

If you reasonably believe that disclosure of the insured’s confidential information to the insurer will affect a material interest of the insured adversely, you must not disclose such information without the informed consent of the insured.<sup>37</sup>

A lawyer must not permit compliance with “guidelines” and other directives of an insurer relating to the lawyer’s services to impair materially the lawyer’s independent professional judgment in representing an insured or result in the lawyer’s inability to provide competent representation to the insured.<sup>38</sup>

*Buchanan v. Leonard*, 428 N.J. Super. 277, 52 A.3d 1064 (App. Div. 2012), provides a cautionary tale. There, a lawyer named Buchanan agreed to file a fraudulent Chapter 13 bankruptcy petition for his clients. His clients sued Buchanan for malpractice, and Buchanan tendered to his carrier, who assigned the case to a defense lawyer named Leonard. The insurance company never questioned the issue of coverage and did not issue a reservation of rights letter. In the course of defending Buchanan, Leonard discovered Buchanan’s underlying fraud. Leonard wrote to the insurance company seeking authority to settle the malpractice case. In his status report to the insurer, Leonard revealed that Buchanan filed a fraudulent Bankruptcy Petition: “This letter is an admission of bankruptcy fraud by [Buchanan] and [the Kerrs]. If the statute of limitations on the crime had not run, [Buchanan] would be subject to up to [five] years in prison and/or a fine of up to \$5,000. If the letter is disclosed at trial, the insured is still subject to discipline, which could include a period of suspension of his license.”<sup>39</sup>

When the carrier read the report, it rejected the request to authorize the settlement, and instead withdrew its defense and declined all coverage under the policy, citing the policy’s “fraud exclusion.”<sup>40</sup>

Buchanan then turned around and sued Leonard for malpractice for sending the problematic status report to the insurer. Leonard maintained that he was merely providing the insurer with his candid assessment of Buchanan’s potential liability in the lawsuit. Buchanan contended, however, that Leonard had a duty to represent him with undivided loyalty. He asserts that Leonard breached that duty by stating as a fact that he committed a criminal offense. Buchanan contends

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<sup>36</sup> Utah State Bar Ethics Advisory Opinion Committee, 2002 WL 340262, at \*1; see also footnote 1 (gathering authorities that have considered insurance company guidelines)

<sup>37</sup> ABA Formal Opinion 01-421 (Ethical Obligations of a Lawyer Working Under Insurance Company Guidelines and Other Restrictions) (February 16, 2001) (available at

[https://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/ethics-opinions/01-421.pdf](https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/ethics-opinions/01-421.pdf))

<sup>38</sup> *Id.*

<sup>39</sup> See *Buchanan v. Leonard*, 52 A.3d 1064, 1067–68 (App. Div. 2012).

<sup>40</sup> *Id.*

that Leonard's statements virtually assured that the insurer would withdraw coverage.<sup>41</sup> On appeal, the appellate court held that the trial court should have allowed Buchanan to provide expert testimony on the standard of care that Leonard should have employed, and remanded for further proceedings.<sup>42</sup>

#### **Question 4: If coverage issues arise, what should you do?**

**Answer:** Generally, in most jurisdictions, you should recommend that the insured obtain independent coverage counsel and not advise on coverage issues yourself.<sup>43</sup>

#### **Question 5: The insurer wants to settle a case and the client (franchisor SBNF) refuses to settle. What are your options if the insurance policy authorizes the insurer to control the defense and to settle within policy limits within insurer's sole discretion?**

Model Rule of Professional Conduct Rule 1.2 provides, "A lawyer shall abide by a client's decision whether to settle a matter. "Model Rule 1.2 requires you to abide by the insured-client SBNF's decision regarding settlement, even if the insurance company has a contractual right to control settlement."<sup>44</sup>

If the insurer wants to settle a case and the insured SBNF refuses to settle, then you may not settle the case.

ABA Formal Opinion 96-403 advises, "If after accepting the limited representation offered under the insurance contract, the insured and the insurer disagree as to whether a proposed settlement is acceptable and, moreover, who has the right to decide that question under the insurance contract, the lawyer may consult with his client or clients as to the likely consequences of a proposed course of conduct or advise the parties to seek independent counsel, and indeed in some circumstances he may be required to do so. Rule 1.7(a). Thus, for example, the lawyer might remind the insured that the policy gives the insurer the right to control the defense and settle the claim without the consent of the insured or that rejecting the proposed settlement might result in a forfeiture of his rights under the policy. Ultimately, however, although the insurer hires the lawyer and pays his fee, the insured retains the power to reject the defense offered by the insurer under the policy and to assume the risk and expense of his own defense."

## **VI. Conclusion**

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<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> See, e.g., Topic: Tripartite Conflicts for Ins. Def. Couns., NYCLA Eth. Op. 751 (Sept. 20, 2017) (defense counsel with "longstanding and lucrative business relationship" with the insurance carrier "should advise the client to consult with an independent attorney about whether to make a disclosure to the insurance company" that would likely result in a disclaimer of coverage; "the lawyer's conflicting financial interest, inability to disclose the misrepresentation to the insurance carrier, and inability to continue the representation if fees will be covered by the insurance carrier and the insured does not disclose the misrepresentation creates the critical conflict dilemma for the lawyer in this scenario"); Board of Professional Responsibility of the Supreme Court of Tennessee, 1985 WL 1157806, at \*3 ("the attorney is ethically prohibited from representing or advising either the insured or insurer when a conflict arises between the insured and insurer over the coverage or terms of the policy of insurance. In such instances the attorney should advise either or both parties to seek independent legal advice and representation regarding the matter.")

<sup>44</sup> See ABA formal Ethics Formal Ethics Opinion 96-403 (Obligations of a Lawyer Representing an Insured Who Objects to a proposed Settlement within Policy Limits), available at [https://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/ethics-opinions/96-403.pdf](https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/ethics-opinions/96-403.pdf) ("So long as the insured is a client, however, the Rules of Professional Conduct--and not the insurance contract--govern the lawyer's obligations to the insured.")

Ethics issues in franchise matters are rarely limited to a single “yes or no” conflicts analysis. Because franchise systems often involve repeat-player relationships, overlapping interests, and insurer participation, counsel must continually reassess who the client is, what information may be shared, and whether representation will be materially limited as facts develop. The hypotheticals above illustrate that many franchise conflicts are potentially consentable—but only after counsel identifies all affected clients, evaluates the situation, and makes the disclosures necessary for informed consent confirmed in writing.

Practically, franchise counsel can reduce risk by (i) defining the client and the scope of the engagement with precision, (ii) addressing confidentiality and information-sharing expectations at the outset of any common representation, (iii) using conflict checks and periodic “conflicts refresh” protocols as new parties, affiliates, and insurers enter the picture, and (iv) documenting consent (or declining/withdrawing) promptly when interests begin to diverge. Where an insurer funds the defense, counsel should be especially cautious about reporting obligations and litigation guidelines, remembering that payment arrangements cannot dilute independent professional judgment or the duty of confidentiality. Taking these steps early can be the difference between an efficient defense and a late-stage disqualification fight that harms the client, delays the case, and exposes counsel to avoidable malpractice risk.

## APPENDIX

### APPLICABLE AMERICAN BAR ASSOCIATION MODEL RULES

#### **Model Rule 1.6: Confidentiality of Information**

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;

(6) to comply with other law or a court order; or

(7) to detect and resolve conflicts of interest arising from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client.

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

#### **Model Rule 1.7: Conflict of Interest: Current Clients**

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
- (4) each affected client gives informed consent, confirmed in writing.

**Model Rule 1.8: Current Clients: Specific Rules**

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

- (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
- (2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
- (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

- (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client; and

(3) a lawyer representing an indigent client pro bono, a lawyer representing an indigent client pro bono through a nonprofit legal services or public interest organization and a lawyer representing an indigent client pro bono through a law school clinical or pro bono program may provide modest gifts to the client for food, rent, transportation, medicine and other basic living expenses. The lawyer:

(i) may not promise, assure or imply the availability of such gifts prior to retention or as an inducement to continue the client-lawyer relationship after retention;

(ii) may not seek or accept reimbursement from the client, a relative of the client or anyone affiliated with the client; and

(iii) may not publicize or advertise a willingness to provide such gifts to prospective clients.

Financial assistance under this Rule may be provided even if the representation is eligible for fees under a fee-shifting statute.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and

- (2) contract with a client for a reasonable contingent fee in a civil case.
- (j) A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them when the client-lawyer relationship commenced.
- (k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

**Model Rule 1.9: Duties to Former Clients**

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

- (1) whose interests are materially adverse to that person; and

- (2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter; unless the former client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

- (1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

- (2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

**Model Rule 1.10: Imputation of Conflicts of Interest: General Rule**

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless

- (1) the prohibition is based on a personal interest of the disqualified lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm; or

- (2) the prohibition is based upon Rule 1.9(a) or (b) and arises out of the disqualified lawyer's association with a prior firm, and

- (i) the disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom;

- (ii) written notice is promptly given to any affected former client to enable the former client to ascertain compliance with the provisions of this Rule, which shall include a description of the screening procedures employed; a statement of the firm's and

of the screened lawyer's compliance with these Rules; a statement that review may be available before a tribunal; and an agreement by the firm to respond promptly to any written inquiries or objections by the former client about the screening procedures; and

(iii) certifications of compliance with these Rules and with the screening procedures are provided to the former client by the screened lawyer and by a partner of the firm, at reasonable intervals upon the former client's written request and upon termination of the screening procedures.

(b) When a lawyer has terminated an association with a firm, the firm is not prohibited from thereafter representing a person with interests materially adverse to those of a client represented by the formerly associated lawyer and not currently represented by the firm, unless:

(1) the matter is the same or substantially related to that in which the formerly associated lawyer represented the client; and

(2) any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(c) that is material to the matter.

(c) A disqualification prescribed by this Rule may be waived by the affected client under the conditions stated in Rule 1.7.

(d) The disqualification of lawyers associated in a firm with former or current government lawyers is governed by Rule 1.11.

#### **Model Rule 1.13: Organization as a Client**

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the

extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

#### **Model Rule 1.16: Declining or Terminating Representation**

(a) A lawyer shall inquire into and assess the facts and circumstances of each representation to determine whether the lawyer may accept or continue the representation. Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the Rules of Professional Conduct or other law;

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client;

(3) the lawyer is discharged; or

(4) the client or prospective client seeks to use or persists in using the lawyer's services to commit or further a crime or fraud, despite the lawyer's discussion pursuant to Rules 1.2(d) and 1.4(a)(5) regarding the limitations on the lawyer assisting with the proposed conduct.

(b) Except as stated in paragraph (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(3) the client has used the lawyer's services to perpetrate a crime or fraud;

(4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;

(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

(6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

(7) other good cause for withdrawal exists.

(c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.