

Pennsylvania Adopts Ancillary Business Rule

Laurel S. Terry

On August 15, 1996, Pennsylvania became the first state to adopt a rule of professional conduct that provides explicit guidance on the topic of ancillary businesses. Pennsylvania's version of Rule 5.7 differs, however, from ABA Model Rule 5.7 in some significant respects. According to Aims C. "Joe" Coney, Jr., the Kirkpatrick and Lockhart partner who spearheaded the effort to draft a new rule: "The goals of the ABA and Pennsylvania rules are quite similar, but we believe our rule improves upon the Model Rule."

The Adoption of Pennsylvania Rule 5.7

Changes to the Pennsylvania Rules of Professional Conduct often originate in the Pennsylvania Bar Association's ("PBA") Committee on Legal Ethics and Professional Responsibility. This committee first circulates the proposed rule to other PBA committees for input and then seeks the approval of the PBA Board of Governors and PBA House of Delegates. Upon approval by both these bodies, the proposed rule is submitted to the Pennsylvania Supreme Court as a general recommendation of the PBA.

Pennsylvania Rule 5.7 did not follow this track. Although Pennsylvania Rule 5.7 was proposed by the PBA Legal Ethics Committee, it had not received official PBA approval when adopted by the Pennsylvania Supreme Court. The PBA Board of Governors approved the rule on April 29, 1996, but the House of Delegates failed to approve the rule in what appeared to be a close voice vote on May 3, 1996. As the ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT, 12 Current Reports 304 (Sept. 4, 1996) reported, Rule 5.7 came to the Supreme Court's attention by way of a recommendation from the Disciplinary Board of the Pennsylvania Supreme Court. The Pennsylvania Supreme Court order adopting the rule was signed August 15, 1996; the rule became effective August 31, 1996. The adopted rule differs only slightly from the ethics committee's proposed rule.

The Impetus for Pennsylvania Rule 5.7

What led Pennsylvania to adopt a Rule 5.7 two years

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after ABA Model Rule 5.7 was promulgated? According to an "Explanatory Memorandum" that was provided by the PBA Committee on Legal Ethics to the PBA Board of Governors and House of Delegates, the impetus for studying the issue included the volume of inquiries received by the legal ethics Hotline from lawyers engaged in "ancillary" or "law-related" services, the complexity of the issues, the need for uniformity in responses, and the sense that a rule would provide protection to clients and additional guidance to lawyers.

With respect to the last point, the *Explanatory Memorandum* noted the troubled history of ABA Model Rule 5.7. It cited the original 1991 adoption of ABA Model Rule 5.7 by a vote of 197 to 186; the 1992 repeal of the rule by a vote of 190 to 183; and the adoption in February 1994 of a different version of ABA Model Rule 5.7. The *Explanatory Memorandum* also noted the very different approaches used in the two versions of the ABA rule: the first version substantively limited the manner in which lawyers could offer ancillary law-related services, whereas the second version did not limit lawyers' ability to provide law-related services, but merely stated when the Rules of Professional Conduct should apply to such activities. Tom Wilkinson, a partner with the Philadelphia firm of Cozen and O'Conner and chair of the PBA Committee on Legal Ethics and Professional Responsibility, explained that:

In view of the conflicting approaches taken by the ABA, we thought the lack of any rule might be confusing to Pennsylvania lawyers. I therefore asked the subcommittee that had been handling all of the ancillary business "Hotline" inquiries to develop a recommendation concerning Rule 5.7. The Committee was unanimous in its support of the rule as developed and the other interested PBA committees were very supportive.

The Rejection of ABA Model Rule 5.7

After determining that a rule would be desirable, the subcommittee turned to the content of the rule. Generally speaking, the Pennsylvania ethics committee prefers to have the Pennsylvania ethics rules track the language of the ABA Model Rules. As articulated in the *Explanatory Memorandum*, the benefits include "national uniformity, the availability of a wider body of case law to draw upon, and easier passage of the rule by the PBA House of

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Delegates and the Pennsylvania Supreme Court.” Notwithstanding its stated preference to adopt new ABA Model Rules verbatim, the Pennsylvania ethics committee’s version of Rule 5.7 differed substantially from ABA Model Rule 5.7.

The *Explanatory Memorandum* set forth the reasons for the departure from ABA Model Rule 5.7. (Since the Pennsylvania Supreme Court offered no explanation for its rejection of ABA Model Rule 5.7, one might assume that its reasons were similar.) The explanation offered was as follows:

The Committee on Ethics has found ABA Model Rule 5.7 of limited utility. In a survey of 20 past inquiries to our committee’s Hotline, we found the rule would have applied or afforded guidance in less than half. The rule applies in just two situations: first, when the providing of non-legal services is not distinct from the providing of legal services, and, secondly, when the non-legal services are provided by a separate entity controlled by the lawyer. Of the twenty surveyed inquiries, none involved the first category, and less than half involved the second. Furthermore, ABA Model Rule 5.7 does not address the special questions which we believe arise when the lawyer, even though he may not control the separate entity, acts as an employee or agent thereof in providing the non-legal services; over two-thirds of the surveyed inquiries involved that situation.

In addition to citing the ABA rule’s lack of utility, an earlier version of the Explanatory Memorandum, presented by the subcommittee to the committee, noted that ABA Model Rule 5.7 had been very controversial and that it had not been adopted by any state, thus making it easier to justify a departure from the ABA rule.

Pennsylvania Viewed Its Goals as Consistent with the Goals of ABA Model Rule 5.7

Although the language and the structure of Pennsylvania Rule 5.7 differ substantially from ABA Model Rule 5.7, the goals of these two rules are substantially similar. The PBA Committee identified two goals with respect to Rule 5.7. It determined:

- 1) the rule should ensure that the Rules of Professional Conduct apply in those situations in which it is appropriate; and
- 2) the rule should ensure that if a lawyer is somehow involved with a non-legal services business, the customers of that business understand that they are not receiving the protection of a client-lawyer relationship.

The Pennsylvania Committee believed that these two goals were consistent with the goals of ABA Model Rule 5.7. The *Explanatory Memorandum* cited Hazard & Hodes’ treatise in support of its conclusion that Pennsylvania’s first goal was consistent with Model Rule 5.7 (“the key divide [in Rule 5.7] is whether a lawyer providing law-related services will or will not also have to comply with all of the other Rules of Professional Conduct.”)¹

The *Explanatory Memorandum* also cited comments 1 and 7 of the ABA Model Rule to support its conclusion that Pennsylvania’s goals were consistent with those of the ABA rule. Comment 1 states “Principal among these [potential ethical problems] is the possibility that the person for whom the law-related services are performed fails to understand that the services may not carry with them the protections normally afforded as part of the client-lawyer relationship.” Comment 7 further notes:

The risk of such confusion is especially acute when the lawyer renders both types of services with respect to the same matter. Under some circumstances the legal and law-related services may be so closely entwined that they cannot be distinguished from each other, and the requirement of disclosure and consultation . . . cannot be met. In such a case a lawyer will be responsible for assuring that both the

lawyer’s conduct and, to the extent required by Rule 5.3, that of nonlawyer employees in the distinct entity which the lawyer controls complies in all respects with the Rules of Professional Conduct.

Thus, although Pennsylvania chose to depart from the language and structure of ABA Model Rule 5.7, it saw its approach as fundamentally consistent with the goals of the ABA rule.

The Structure of Pennsylvania Rule 5.7

Rule 5.7(a) Requires a Lawyer to Use the RPC’s for Certain Nonlegal Services

Both the Pennsylvania and ABA rules establish a hierarchy that identifies certain situations to which the Rules of Professional Conduct (RPC’s) absolutely must apply and other situations to which they might or might not apply. In establishing this hierarchy, however, the Pennsylvania and ABA approaches are similar but not identical.

The ABA and Pennsylvania rules are similar in that both apply the Rules of Professional Conduct to law-related services where those services are not “distinct” from legal services provided to a client.² The ABA and

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Pennsylvania rules differ with respect to the person providing the "nondistinct" nonlegal services. The ABA rule applies *only* if the same lawyer is providing the legal and nonlegal, law-related services. The Pennsylvania rule would apply if the legal services provided by one lawyer are viewed as "not distinct" from the nonlegal, law-related services provided by *another* lawyer.³ The *Explanatory Memorandum* justified this difference by reasoning that if legal and nonlegal services *are in fact indistinguishable*, even if provided by different lawyers in a firm, for example, then confusion is unavoidable and the Rules of Professional Conduct should apply. The committee further concluded that Pennsylvania Rule 5.7(a) set forth the only situation in which it was appropriate to apply, *without exception*, the Rules of Professional Conduct to the provision of nonlegal services.

Rule 5.7(b-d) Requires a Lawyer To Use the RPC's Unless the Lawyer Educates the Customer About the Lawyer's Role

In addition to specifying certain situations in which the RPC's must always apply, Pennsylvania Rule 5.7, like the ABA rule, sets forth certain situations in which the RPC's may apply. In these situations, however, the lawyer need not comply with the RPC's provided the lawyer educates the ancillary services' recipient about the lawyer's role. Although the Pennsylvania and the ABA approaches are once again similar, the details of these rules differ.

The ABA rule establishes one situation in which the RPC's may apply. ABA Model Rule 5.7(a)(2) requires a lawyer to comply with the RPC's with respect to nonlegal, law-related services in those situations where the services are provided

by a separate entity controlled by the lawyer individually or with others if the lawyer fails to take reasonable measures to assure that a person obtaining the law-related services knows that the services of the separate entity are not legal services and that the protections of the client-lawyer relationship do not exist.

In contrast to this approach, the Pennsylvania rule establishes two situations in which the RPC's may apply to the provision of nonlegal services. Neither of these two situations corresponds exactly to ABA Model Rule 5.7(a)(2). First, the Pennsylvania rule covers a lawyer who provides nonlegal services which are in fact distinct from the provision of legal services when the lawyer knows or should know that the recipient might believe that he or she was receiving the protection of a client-

lawyer relationship. In such a situation, the Pennsylvania RPC's apply *unless* the lawyer makes reasonable efforts to avoid any misunderstanding by advising the recipient that the services are not legal services and that the protection of a client-lawyer relationship does not exist.⁴

ABA Model Rule 5.7 simply does not address the situation of a lawyer who provides law-related services which are distinct from the legal services provided to a client. The Pennsylvania Ethics Committee believed it was important to cover this situation because even if the lawyer concludes the provision of nonlegal services is distinct from the provision of legal services, there is still a risk that the nonlegal services customer will be confused about the role and significance of the lawyer in the nonlegal services. Pennsylvania Rule 5.7 addresses this risk of confusion by imposing on the lawyer a duty to educate the customer if there is a chance the customer believes he or she is receiving the protection of a client-lawyer relationship.

Second, the Pennsylvania rule may require compliance with the RPC's in connection with nonlegal services where the lawyer is "an owner, controlling party, employee, agent, or is otherwise affiliated with an entity providing the nonlegal services." In this situation, the lawyer must comply with the RPC's if the lawyer knows or reasonably should know that the customer might be confused about the significance of the lawyer's presence. Once again, however, the lawyer can avoid application of the RPC's if the lawyer educates the customer about the role of the lawyer and the fact that the customer is not receiving legal services or the protection of a client-lawyer relationship.⁵

Although the ABA rule also addresses lawyers who are connected with entities providing nonlegal, law-related services, the substance of the ABA rule differs markedly from the substance of the Pennsylvania rule. (The ABA rule is triggered only if the law-related services are provided by a separate entity controlled by the lawyer individually or with others. Once the ABA and Pennsylvania rules are triggered, however, the requirements are quite similar.)

The *Explanatory Memorandum* contained the reasons for Pennsylvania's departure from the model rule; since the goal of this subsection was to avoid confusion on the part of the customers of the nonlegal services, the Pennsylvania drafters did not think it mattered whether the lawyer's involvement with the nonlegal services was that of owner, controller, employee or agent. Rather, the issue was whether a customer might be confused by the lawyer's involvement. (The *Explanatory Memorandum* cited the ABA comment, which justified its "entity"

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approach on the basis that the customer might be confused in such a case. The Pennsylvania drafters thought it more useful for the rule to address directly the underlying goal of avoiding customer confusion about the role of the lawyer. The *Explanatory Memorandum* reveals that the Pennsylvania drafters initially had considered issues such as how large an ownership interest would be needed to trigger the rule, but abandoned this approach once they realized that their goal was avoiding possible confusion by the recipient.)

Further justification for Pennsylvania subsections b through d is found in the comment to Pennsylvania Rule 5.7 and in the *Explanatory Memorandum*. Both analogized Rule 5.7 to Pennsylvania Rule 4.3(c). If a lawyer is dealing with someone who is not represented by counsel, and the lawyer knows or reasonably should know that person misunderstands the lawyer's role, then the lawyer must make reasonable efforts to correct the misunderstanding. Similarly, if the lawyer knows or reasonably should know that there is a risk that the customer of the nonlegal services will misunderstand the lawyer's role, then the lawyer should take reasonable remedial efforts to educate the customer.⁶

The *Explanatory Memorandum* also concluded that the disclosure encouraged by Rule 5.7 is a fairly modest burden to impose on a lawyer, but is a burden which could reap a substantial benefit in avoiding confusion, misunderstanding, ill will and loss of legal rights such as the attorney-client privilege.

The Relationship Between Rule 5.7 and Other RPC Provisions

The comment to Pennsylvania Rule 5.7 clarifies that even if a lawyer is not subject to all of the provisions of the Rules of Professional Conduct when providing nonlegal services, the lawyer is *always* subject to *some* of the Rules of Professional Conduct with respect to everything he or she does, including the provision of nonlegal services. Thus, for example, a lawyer violates Rule 8.4(c) if the lawyer engages in dishonesty, fraud, deceit or misrepresentation, regardless of whether that occurs in the context of providing legal representation to a client. Similarly, a lawyer providing nonlegal and legal services to a client must always consider whether other rules of professional conduct apply, such as Rules 1.7(b) and 1.8(a).

Terminology Differences Between the ABA and Pennsylvania Rules

In addition to their structural differences, the ABA and Pennsylvania rules use different terminology. The original version of ABA rule 5.7 spoke of "ancillary services"

or "ancillary non-legal services." The current ABA rule uses the language "law-related services." The Pennsylvania rule uses the terminology "nonlegal services." The *Explanatory Memorandum* offered the following reasons for Pennsylvania's differing terminology:

Once [our ethics Committee] determined what our position was substantively, our committee realized that it probably did not make sense to use the term "law-related services." The reason is that our proposed rule requires lawyer disclosure to avoid confusion *even if the lawyer is providing nonlegal services which in fact are wholly distinct from legal services*. In this situation, we thought it might be confusing to call these distinct nonlegal services "law-related services." The issue for us was whether there was a risk of recipient confusion by virtue of the lawyer's involvement, not whether the services in fact were or were not related to

the legal services. If the nonlegal services are completely unrelated so that there is no risk of confusion (e.g. the lawyer runs a gas station) then the rule simply is not triggered. (We used the term nonlegal services rather than the term "ancillary services" . . . because we thought the former was clearer and more clearly responded to our goals. The term "nonlegal services" is defined in the second sentence of comment [1]

as "those not prohibited as unauthorized practice of law when provided by a nonlawyer." While we recognize that there is not always a bright line between legal and nonlegal services, we believe that this line may be the clearest line available and that some line is necessary if we are to have a rule on this topic. Furthermore, to the extent that the line is particularly fuzzy, that may suggest that the legal and nonlegal services are indistinct, so that Rule 5.7(a) applies.)

A second terminology difference between the ABA and Pennsylvania rules is that the ABA rule refers to "the protections of the client-lawyer relationship," whereas the Pennsylvania rule refers to "the protection of the client-lawyer relationship." (The Pennsylvania Ethics Committee's proposed rule had used the word "protections.") Because the Pennsylvania Supreme Court did not offer any explanation for the change, it is difficult to tell whether it considered this change significant. (The other changes the Supreme Court made were grammatical changes.)

Pennsylvania Rule 5.7 represents an effort to improve upon the ABA Model Rule, to offer needed guidance to the many lawyers providing nonlegal services, and most importantly, to benefit clients by encouraging greater communication between lawyers and clients in an area where

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misunderstandings easily could occur. Thus, Pennsylvania has not only become the first state to adopt a rule that provides explicit guidance on the topic of ancillary businesses, but also has offered an alternative to ABA Model Rule 5.7 for states interested in providing guidance concerning lawyers' ancillary services. It will be interesting to observe whether other states follow Pennsylvania's lead in this area.

Endnotes

1. HAZARD & HODES, 2 THE LAW OF LAWYERING §5.7:101 at 8.26.6 (2d ed. 1994 supp.)
2. Compare ABA Model Rule 5.7(a)(1) with PA RPC 5.7(a).
3. *Id.*
4. See PA RPC 5.7(b) and (d).
5. See PA RPC 5.7(c) &(d).
6. See also PA RPC 1.13(d) ("In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.")

Pennsylvania's New Rule

Rule 5.7 Responsibilities Regarding Nonlegal Services

(a) A lawyer who provides nonlegal services to a recipient that are not distinct from legal services provided to that recipient is subject to the Rules of Professional Conduct with respect to the provision of both legal and nonlegal services.

(b) A lawyer who provides nonlegal services to a recipient that are distinct from any legal services provided to the recipient is subject to the Rules of Professional Conduct with respect to the nonlegal services if the lawyer knows or reasonably should know that the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship.

(c) A lawyer who is an owner, controlling party, employee, agent, or is otherwise affiliated with an entity providing nonlegal services to a recipient is subject to the Rules of Professional Conduct with respect to the nonlegal services if the lawyer knows or reasonably should know that the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship.

(d) Paragraph (b) or (c) does not apply if the lawyer makes reasonable efforts to avoid any misunderstanding by the recipient receiving nonlegal services. Those efforts must include advising the recipient that the services are not legal services and that the protection of a client-lawyer relationship does not exist with respect to the provision of nonlegal services to the recipient.

COMMENT:

[1] For many years, lawyers have provided to their clients nonlegal services that are ancillary to the practice of law. Nonlegal services are those that are not prohibited as unauthorized practice of law when provided by a non-lawyer. Examples of nonlegal services include providing title insurance, financial planning, accounting, trust services, real estate counseling, legislative lobbying, economic analysis, social work, psychological counseling, tax return preparation, and patent, medical or environmental consulting. A broad range of economic and other interests of clients may be served by lawyers participating in the delivery of these services. In recent years, however, there has been significant debate about the role the Rules of Professional Conduct should play in regulating the degree and manner in which a lawyer participates in the delivery of nonlegal services. The ABA, for example, adopted, repealed and then adopted a different version of Rule 5.7. In the course of this debate, several ABA sections offered competing versions of Rule 5.7.

[2] One approach to the issue of nonlegal services is to try to substantively limit the type of nonlegal services a lawyer may provide to a recipient or the manner in which the services are provided. A competing approach does not try to substantively limit the lawyer's provision of nonlegal services, but instead attempts to clarify the conduct to which the Rules of Professional Conduct apply and to avoid misunderstanding on the part of the recipient of the nonlegal services. This Rule adopts the latter approach.

The Potential for Misunderstanding

[3] Whenever a lawyer directly provides nonlegal services, there exists the potential for ethical problems. Principal among these is the possibility that the person for whom the nonlegal services are performed may fail to understand that the services may not carry with them the protection normally afforded by the client-lawyer relationship. The recipient of the nonlegal services may expect, for example, that the protection of client confidences, prohibitions against representation of persons with conflicting interests, and obligations of a lawyer to maintain professional independence apply to the provision of nonlegal services when that may not be the case. The risk of such confusion is especially acute when the lawyer renders both types of services with respect to the same matter.

Providing Nonlegal Services That Are Not Distinct From Legal Services

[4] Under some circumstances, the legal and nonlegal services may be so closely entwined that they cannot be distinguished from each other. In this situation, confusion by the recipient as to when the protection of the client-

lawyer relationship applies are likely to be unavoidable. Therefore, Rule 5.7(a) requires that the lawyer providing the nonlegal services adhere to all of the requirements of the Rules of Professional Conduct.

[5] In such a case, a lawyer will be responsible for assuring that both the lawyer's conduct and, to the extent required by Rule 5.3, that of nonlawyer employees comply in all respects with the Rules of Professional Conduct. When a lawyer is obliged to accord the recipients of such nonlegal services the protection of those Rules that apply to the client-lawyer relationship, the lawyer must take special care to heed the proscriptions of the Rules addressing conflict of interest (Rules 1.7 through 1.11, especially Rules 1.7(b) and 1.8(a), (b) and (f)), and to scrupulously adhere to the requirements of Rule 1.6 relating to disclosure of confidential information. The promotion of the nonlegal services must also in all respects comply with Rules 7.1 through 7.3, dealing with advertising and solicitation.

[6] Rule 5.7(a) applies to the provision of nonlegal services by a lawyer even when the lawyer does not personally provide any legal services to the person for whom the nonlegal services are performed if the person is also receiving legal services from another that are not distinct from the nonlegal services.

Avoiding Misunderstanding When A Lawyer Directly Provides Nonlegal Services That Are Distinct From Legal Services

[7] Even when the lawyer believes that his or her provision of nonlegal services is distinct from any legal services provided to the recipient, there is still a risk that the recipient of the nonlegal services will misunderstand the implications of receiving nonlegal services from a lawyer; the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship. Where there is such a risk of misunderstanding, Rule 5.7(b) requires that the lawyer providing the nonlegal services adhere to all the Rules of Professional Conduct, unless exempted by Rule 5.7(d).

Avoiding Misunderstand When a Lawyer is Indirectly Involved in the Provision of Nonlegal Services

[8] Nonlegal services also may be provided through an entity with which a lawyer is somehow affiliated, for example, as owner, employee, controlling party or agent. In this situation, there is still a risk that the recipient of the nonlegal services might believe that the recipient is receiving the protection of a client-lawyer relationship. Where there is such a risk of misunderstanding, Rule 5.7(c) requires that the lawyer involved with the entity providing nonlegal services adhere to all the Rules of Professional Conduct, unless exempted by Rule 5.7(d).

Avoiding the Application of Paragraphs b and c

[9] Paragraphs b and c specify that the Rules of Professional Conduct apply to a lawyer who directly provides or is otherwise involved in the provision of nonlegal services if there is a risk that the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship. Neither the Rules of Professional Conduct nor paragraphs (b) or (c) will apply, however, if pursuant to paragraph (d), the lawyer takes reasonable efforts to avoid any misunderstanding by the recipient. In this respect, Rule 5.7 is analogous to Rule 4.3(c).

[10] In taking the reasonable measures referred to in paragraph d, the lawyer must communicate to the person receiving the nonlegal services that the relationship will not be a client-lawyer relationship. The communication should be made before entering into an agreement for the provision of nonlegal services, in a manner sufficient to assure that the person understands the significance of the communication, and preferably should be in writing.

[11] The burden is upon the lawyer to show that the lawyer has taken reasonable measures under the circumstances to communicate the desired understanding. For instance, a sophisticated user of nonlegal services, such as a publicly-held corporation, may require a lesser explanation than someone unaccustomed to making distinctions between legal services and nonlegal services, such as an individual seeking tax advice from a lawyer-accountant or investigative services in connection with a lawsuit.

The Relationship Between Rule 5.7 and Other Rules of Professional Conduct

[12] Even before Rule 5.7 was adopted, a lawyer involved in the provision of nonlegal services was subject to those Rules of Professional Conduct that apply generally. For example, Rule 8.4(c) makes a lawyer responsible for fraud committed with respect to the provision of nonlegal services. Such a lawyer must also comply with Rule 1.8(a). Nothing in this rule is intended to suspend the effect of any otherwise applicable Rule of Professional Conduct such as Rule 1.7(b), Rule 1.8(a) and Rule 8.4(c).

[13] In addition to the Rules of Professional Conduct, principles of law external to the Rules, for example, the law of principal and agent, may govern the legal duties owed by a lawyer to those receiving the nonlegal services.

Code Comparison:

There is no counterpart to this Rule in the Code.