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ETHICS

Intrafamily Corporate Conflicts Under Ethics Rules

Assume that your law partner represents Minicorp, a small company, in some routine matter. Along comes Newcorp, a prospective new client with a tantalizing piece of business: a large, complex litigation against Megacorp, a multinational corporation with numerous subsidiaries. You perform a quick mental calculation; the proposed new case will keep your firm busy for months, and generate substantial fees.

There is only one catch: Minicorp is a wholly-owned subsidiary of Megacorp. Your first reaction is shock, followed by disbelief, anger and bargaining, as you envision this lucrative piece of business slipping through your fingers. Then you decide to review your options under the ethics rules.

New York's new Rules of Professional Conduct (RPC), which were adopted by the Appellate Divisions on April 1, 2009,¹ explicitly prohibit a lawyer from accepting or continuing a representation which would "involve the lawyer in representing differing interests."² In addition, a lawyer may not accept a representation when "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests." (RPC 1.7 (a) (2)).

But most lawyers are already aware of the proscription on representing conflicting interests and the ban on conflicts with the lawyer's own personal interest. These broad principles do not answer the parent-subsidiary dilemma, or resolve the hypothetical posed in the introductory paragraph of this article.

Internet ethics maven William Freivogel, host of the Web site Freivogelonconflicts.com, posits two schools of thought on the perennial parent-subsidiary conflict dilemma. Some courts and commentators adopt a rule of per se disqualification in intrafamily conflicts:

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If you represent a subsidiary, neither you nor your partners may sue or engage in any representation adverse to the parent, or, in some extreme formulations, any other member of the corporate family.

Other authorities engage in a totality of the circumstances analysis, dubbed by Mr. Freivogel as the "weighing rule."³ New York, as we shall see, adheres to the totality of the circumstances approach.

While, as mentioned, the official text of RPC 1.7, as approved by the Appellate Divisions, does not directly answer the hypothetical question posed in our introduction, the commentary of the New York State Bar Association (which is not adopted by the Appellate Divisions), provides some guidance.

According to the state bar, an intrafamily conflict is not a professional conflict, and does not require informed consent, unless one of several factors is present. These include: (a) a prior understanding with the client not to sue its affiliates; (b) a situation in which the differing interests may affect the lawyer's professional judgment; (c) whether representing a component entity will

compromise confidential information acquired in representing the parent, or vice versa; (d) whether both organizations actively report to the same legal department and general counsel; and (e) whether the new case substantially affects the bottom line of the existing client, or of the organization as a whole.⁴

To illustrate the problems involved in analyzing intrafamily conflicts, Professors Lisa Lehrman and Philip Schrag describe a hypothetical case in which a law firm is asked to bring a personal injury claim against the subsidiary of an existing client.⁵ The law firm, A&B, currently represents Transport Inc., the parent of Pearl Bus Company. A&B is approached by Dori Hathaway to represent her in a personal injury claim against Pearl.

Whether A&B can represent Hathaway depends on a variety of factors. If Pearl is fully insured for the claim, then the financial impact on the parent is minimized. Alternatively, if Pearl is uninsured or underinsured, then the impact on the parent could be significant.

The nature of the two representations could affect the flow of confidential information within the law firm. If A&B handles real estate closings for Transport in Oregon, it is unlikely to have access to confidential information that would affect the prosecution of a personal injury action against Pearl in the Bronx. On the other hand, if A&B has access to confidential information about the subsidiary's past claim history or insurance coverage, this could be a factor against permitting the new representation.

The professional judgment factor is a rule of reason. If the firm's representation of a parent accounts for a significant percentage of the firm's income, and the proposed new work is relatively insignificant, that could affect the lawyer's professional judgment.

In the Hathaway bus accident hypothetical above, if Transport was A&B's largest client, and Hathaway had a soft-tissue claim against the subsidiary, it is not difficult to imagine the pressures that would come to bear against the lawyer representing Hathaway.

Conversely, if the work for Transport, the parent, was insignificant, and Hathaway's alleged catastrophic injuries entitled her to

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a multi-million dollar verdict, there might be pressure to favor Hathaway's interests over those of Transport. Even in the absence of an actual conflict of interest, a lawyer might nevertheless make a business judgment not to undertake representation against the affiliate in the face of the parent's opposition, particularly where the parent is a major client.

New York's totality of the circumstances approach to intrafamily conflicts has a long history. The New York County Lawyers' Association Committee on Professional Ethics, in a 1991 ethics opinion interpreting former Disciplinary Rule 5-105,⁶ considered whether a lawyer for a corporate client could concurrently represent a client with interests adverse to the corporation's subsidiary in an unrelated matter.⁷

The NYCLA committee declined to adopt a per se rule of disqualification, reasoning that, absent a contrary agreement, a subsidiary is not a client of the law firm representing the parent corporation.

Rather, a conflict would arise in one of three circumstances: "(1) either the parent or the subsidiary reasonably believes that an attorney-client relationship exists between the subsidiary and counsel to the parent; (2) counsel to the parent is privy to confidential information regarding the subsidiary which, if used in the proposed representation, would be detrimental to the subsidiary's interests; or (3) the parent corporation's interests would be materially adversely affected by the action against its subsidiary."

The Committee on Professional and Judicial Ethics of the New York City Bar, in Ethics Opinion 2007-03, agreed that the existence of an intrafamily corporate conflict depends on several factors.⁸ As a threshold matter, the city bar recommends that a lawyer, when considering the possibility of an intrafamily conflict, first consult the firm's letter of engagement with the existing client, in order to ascertain the scope of representation, specifically whether the agreement defines the client to include other corporate affiliates.

In addition, the letter of engagement may contain an advance waiver of conflicts, which, depending on its level of specificity, may or may not be enforceable. The lawyer should then consider the reasonable expectations of the existing client, based on a number of factors, including whether the current client and its affiliate share directors, officers and the same legal department, along with other aspects of corporate infrastructure.⁹

In addition to examining overlapping structure among corporate affiliates, the city bar also urged practitioners to consider the impact of the proposed representation on the entire corporate family.

As a matter of common sense, Rule 1.7 would not permit a lawyer to represent one corporate affiliate while simultaneously representing an adverse party in a matter which could threaten to bankrupt the entire corporate family. Finally, lawyers must consider the need to preserve client confidences and secrets to which they may have had access in the course of representing the current client.

Waiver and Consent

The ethics rules often, but not always, permit a client to waive a conflict, even in those situations in which there is an actual divergence of interest. RPC 1.7 (b) provides that, notwithstanding a concurrent conflict of interest, a lawyer may still represent a client if all four of the following factors are met:

(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.¹⁰

The requirement of informed consent is satisfied when the lawyer has "adequately explained to the [client] the material risks of the proposed course of conduct and reasonably available alternatives."¹¹ But it should be noted that court decisions are not always as lawyer-friendly as ethics committees in assessing

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written waivers. In the event a current client claims a conflict of interest, courts are likely to scrutinize the conduct of counsel, and the adequacy of a written waiver.

Even in the case of a sophisticated client, the courts frequently require a significant degree of specificity before they will honor an advance waiver.

Judge Jed Rakoff, in *GSI Commerce Solutions Inc. v. BabyCenter, LLC*,¹² disqualified a law firm from representing a client adverse to BabyCenter, a subsidiary of pharmaceutical manufacturer Johnson & Johnson, on the ground that the law firm, Blank Rome, had represented the corporate parent in an unrelated matter.

The law firm's engagement letter with the corporate parent purported to limit the scope of the firm's representation: "Unless agreed to in writing or we specifically undertake such additional representation at your request, we represent only the client named in the engagement letter (i.e., J&J), and not its affiliates, subsidiaries, partners, joint venturers,

employees, directors, officers, shareholders, members, owners, agencies, departments, or divisions."¹³

Notwithstanding the limitation in the engagement letter, which the court found to be equivocal, the court disqualified Blank Rome, finding that there was sufficient overlap between the corporate infrastructures of the two companies as to render them, in effect, a single company for conflict of interest purposes:

Among other things, BabyCenter shares accounting, audit, cash management, employee benefits, finance, human resources, information technology, insurance, payroll and travel service and systems with J&J. Of particular relevance here, BabyCenter does not maintain its own legal department, but instead relies on J&J's Law Department for legal services (along with outside counsel retained by it or by it through J&J).¹⁴

In addition, the court determined that the law firm's advance conflict waiver "fails to provide the unequivocal express waiver that would be necessary to prevent Blank Rome's disqualification here." Accordingly, the court disqualified the lawyers from pursuing claims adverse to their client's subsidiary.

Conclusion

A law firm which represents a corporation is not per se disqualified from representing other corporate affiliates. Rather, a lawyer contemplating accepting representation adverse to the affiliate of a current client should consider the factors enumerated above, including the closeness of the relationship between the two companies, the sharing of confidential information, and the impact of the proposed representation on the corporate family. An advance conflict waiver, while permissible under RPC 1.7 (b), is likely to be subject to judicial scrutiny to ensure that the client's informed consent was specifically obtained and duly informed.

1. 22 NYCRR 1200 et seq., http://nycourts.gov/rules/jointappellate/NY%20Rules%20of%20Prof%20Conduct_09.pdf.

2. RPC 1.7 (a) (1).

3. http://web.me.com/billfreivogel/Freivogel/Corporate_Families.html.

4. RPC 1.7, comments [34]-[34B], <http://www.nysba.org/Content/NavigationMenu/ForAttorneys/ProfessionalStandardsforAttorneys/RevisedRulesofProfessionalConduct.pdf>.

5. Lisa Lerman and Philip Schrag, *Ethical Problems in the Practice of Law* (Aspen 2008) at 404.

6. DR 5-105 barred representation that "would be likely to involve the lawyer in representing differing interests...."

7. NYCLA Ethics Op. 684, www.nycla.org.

8. <http://www.abcnyc.org/Ethics/eth2007.htm>.

9. <http://www.abcnyc.org/Ethics/eth2007.htm>.

10. RPC 1.7 (b).

11. RPC 1.0 (j).

12. 2009 U.S. Dist. LEXIS 65226 (S.D.N.Y. July 27, 2009).

13. 2009 U.S. Dist. LEXIS 65226 at *2.

14. 2009 U.S. Dist. LEXIS 65226 at *8.