

All in the Family? Corporate Family Conflicts & Letters of Engagement (Part I)

BY ROY SIMON

Like the late, great Ray Charles, I've got Georgia on my mind. A recent unpublished Georgia state court case, *McKesson Information Solutions LLC v. Duane Morris LLP*, 2006- CV-121110 (Fulton County Superior Ct. Nov. 8, 2006), is getting national press. The opinion is noteworthy because the Georgia court rejected language in Duane Morris's engagement letter expressly identifying its clients as two specific McKesson entities "and not any parent, subsidiary or affiliated entities." The court also invalidated Duane Morris's advance conflict waiver, implicitly addressing difficult choice of law questions in the process. This month, in Part I, I will lay out the background for the opinion. Next month, in Part II, I will discuss and evaluate the opinion.

Background: Duane Morris's Letter of Engagement

McKesson Corporation, with \$80 billion in annual revenue, is the sixteenth largest corporation in the Fortune 500. Its vast business operations are divided into three unincorporated "business segments." One of these segments is denominated in McKesson's SEC filings as "McKesson Provider Technologies," which provides software, hardware, automation, services, and consulting to hospitals, physicians, and others in the healthcare field.

On April 27, 2006, two entities in the Provider Technologies segment, McKesson Medication Management LLC ("MMM") and McKesson Automation, Inc. ("MAI"), retained the Harrisburg, Pennsylvania office of Duane Morris LLP as local counsel for a bankruptcy matter pending in the United States Bankruptcy Court for the Middle District of Pennsylvania. The same day, a Duane Morris partner sent a four-page letter of engagement to a lawyer at the law firm of Morris, Manning & Martin LLP in Atlanta, which represented the two McKesson affiliates. The letter of engagement, which referred to the two affiliates collectively as "McKesson," contained the following advance waiver paragraphs:

Given the scope of our business and the scope of our client representations through our various offices in the United States and abroad, it is possible that some of our present or future clients will have matters adverse to McKesson while we are representing McKesson. We understand that McKesson has no objection to our representation of parties with interests adverse to McKesson and waive any actual or potential conflict of interest as long as those other engagements are not substantially related to our services to McKesson.

We agree, however, that McKesson's consent to, and waiver of, such representation shall not apply in any instance where, as a result of our representation of McKesson, we have obtained proprietary or other confidential information of a non-public nature, that, if known to such other client, could be used in any such other matter by such client to McKesson's material disadvantage or potential material disadvantage. ...

I recently published a two-part article in *NYPRR* about advance conflict waivers – see *Advance Conflict Waivers In New York (Parts I and II)*, *NYPRR*, Sept. and Oct. 2006 – so I do not intend to go over that ground again here, but the advance waiver paragraphs are essential background for understanding the McKesson case.

Far more significant for this column is the language in Duane Morris’s engagement letter identifying the clients. That language provided:

This will also confirm that unless we reach an explicit understanding to the contrary, we are being engaged by and will represent McKesson Medication Management LLC and McKesson Automation, *and not any parent, subsidiary or affiliated* entities of McKesson Medication Management LLC and McKesson Automation, and that we are not being engaged to represent any officers, directors, members, partners, shareholders or employees of McKesson Medication Management LLC and McKesson Automation. [Emphasis added.]

Within two weeks, Duane Morris agreed to three changes requested by McKesson’s outside counsel, Morris, Manning & Martin. Specifically, Duane Morris agreed to delete language in the engagement letter giving Duane Morris the right (1) to charge a premium fee for any work that had to be done on an “immediate and emergency basis” requiring the firm to set aside other ongoing projects, (2) to charge a late fee of 1% per month for bills not paid within thirty days, and (3) to identify McKesson on Duane Morris’s list of representative clients. McKesson’s lawyer did not ask for any changes to the advance waiver paragraphs or to the paragraph identifying the clients solely as McKesson Medication Management LLC and McKesson Automation. On May 19, 2006, Duane Morris sent McKesson’s lawyer a revised engagement letter with the deleted language neatly lined through.

The New Engagement: An Unrelated Arbitration

On July 19, 2006, Duane Morris entered an appearance as counsel for Nan and Alex Smith in an arbitration proceeding (“the Arbitration”) against McKesson Information Solutions LLC (“MIS”). MIS is the successor corporation to HBO & Company (“HBO”), which merged with McKesson in 1999. Before the McKesson-HBO merger, the Smiths had entered into certain non-competition agreements with HBO. Now, in the Arbitration, the Smiths accused MIS of breaching the agreements. Duane Morris’s two clients in the Pennsylvania bankruptcy matter (MMM and MAI) were not parties to the Arbitration and were not involved in the Arbitration in any way. Indeed, MMM, MAI, and MIS are all separate entities, with principal places of business in different states (Pennsylvania, Minnesota, and California, respectively), and the three companies have no common officers.

Just days after Duane Morris entered its appearance in the Arbitration against MIS, a McKesson lawyer notified Duane Morris that: (a) McKesson Corporation (the parent corporation of MIS, MMM, and MAI) treats the entire family of McKesson companies as a single entity for conflicts purposes; and (b) as a matter of policy, the McKesson Corporation never waives any conflicts. McKesson therefore objected to Duane Morris’s representation of the Smiths in the Arbitration and demanded that Duane Morris withdraw.

Duane Morris replied with an eight-page letter denying that its representation of the Smiths in the Arbitration created any conflict. The letter stated:

[T]he terms of the controlling Engagement Letter clearly set forth that our clients, for any and all purposes - including conflicts - are limited to McKesson Medication and McKesson Automation. We are unwilling to continue our representation of McKesson Medication and McKesson Automation under terms different than those in the Engagement Letter. ... If we do not reach agreement on this issue, we will regrettably have no other choice but to terminate our engagement with McKesson Medication and McKesson Automation....

Three days later, McKesson filed a "Verified Complaint for Emergency Injunctive Relief and Disqualification of Duane Morris LLP" in the Superior Court of Fulton County, Georgia. The Complaint pointed out that MIS, MAI and MMM "all share the same parent corporation" (McKesson Corporation) and that MIS (the Arbitration defendant) and MAI (one of Duane Morris's two Pennsylvania bankruptcy clients) "are both part of McKesson Provider Technologies business segment." The Complaint then made this remarkable statement:

Although MAI, MIS and MMM are separate and distinct legal entities for contract and liability purposes, they are a single entity for purposes of conflict of interest analysis, which focuses on the duty of loyalty and access to confidential information. ... The Provider Technologies business lines report to the same president, they report their revenues as a single segment, and they are represented by the same in-house lawyers. MIS, MAI and MMM also share the same business philosophy and principle, and in fact, participate in the same annual executive retreat, during which joint corporate direction, strategy and policy are decided. [Citations omitted.]

McKesson cited a Georgia federal case finding sister corporations to be the same "client," and another Georgia federal case invalidating an advance waiver clause very much like Duane Morris's clause in this case because it failed to specify the waiving client's prospective adversary. Finally, McKesson attacked Duane Morris's loyalty, stating:

[T]he facts at issue in the Arbitration are of such a nature that Duane Morris's adverse representation in the arbitration is a gross violation of loyalty to McKesson and MIS. The Arbitration attacks the heart of MIS's software products, thus implicating broad corporate policies regarding product development, leadership, general corporate strategy, acquisition strategy and organizational structure (which, importantly, is at issue here). This increases the potential that Duane Morris was in a position to learn confidential information in the Bankruptcy Matter that could be used in the Arbitration, as well as defending this complaint. The petitioners in the Arbitration also allege that MIS has engaged in fraudulent conduct. Then, bordering on extortion, Duane Morris has threatened to prejudice McKesson by withdrawing as MAI's and MMM's counsel from the Bankruptcy Matter. It is hard to imagine a more blatant breach of the duty of loyalty than to accuse your current client of fraud and then withdraw from the initial representation as pure punishment.

McKesson also pointed out that the same in-house lawyers monitoring the bankruptcy matter in Pennsylvania were monitoring the Arbitration in Georgia.

As for Duane Morris's engagement letter, McKesson basically dismissed the crucial paragraph in the engagement letter plainly identifying Duane Morris's clients solely as MMM and MAI, "and not any

parent, subsidiary or affiliated entities,” This limitation was relevant only to legal fees, not to conflicts, McKesson said. Identifying the client “merely means that MAI and MMM are the McKesson subsidiaries that are contractually responsible for the engagement and payment of services for Duane Morris. This language does not apply to a conflict of interest analysis. ... Thus, by representing MAI, Duane Morris is in effect representing MIS.”

Duane Morris responded forcefully, pointing out that McKesson’s outside counsel had reviewed and specifically approved the engagement letter, including the term identifying the client, the term reciting the client’s agreement that Duane Morris does not represent any affiliates, subsidiaries, etc., and the term granting a prospective waiver of future conflicts. Moreover, Duane Morris argued, its engagement letter provision identifying the specific clients and making clear that parents, subsidiaries, and affiliates were not clients, was in accord with the approach recommended by ABA Formal Ethics Op. 95-390 (1993) for avoiding corporate family conflicts. Responding directly to McKesson’s arguments, Duane Morris said:

MIS takes the unbelievable position that this language actually means that Duane Morris represents MIS, but that MIS does not have to pay Duane Morris. MIS therefore concludes that Duane Morris has accepted a per se representation of all McKesson entities under its internal fictitious business segment “McKesson Provider Technologies” (“MPT”), even though the parties never agreed to this obligation and the Engagement Letter makes no mention of MPT.

As for confidential information, Duane Morris said it had had only “limited direct contact with any employee at any McKesson-owned entity” and had received “little or no confidential information belonging to any McKesson-owned entity.” More specifically, Duane Morris had “certainly received no confidential information related to MIS at all.” Indeed, since undertaking the bankruptcy court engagement about four months earlier, Duane Morris had spent only a meager 16 hours of legal services on the matter.

But then Duane Morris entered the quagmire of advance conflict waivers. Although advance waivers are now widely accepted, and are endorsed both in the ABA Model Rules (see Rule 1.7, Comment 22 and ABA Formal Ethics Op. 05-436) and in the Restatement of the Law Governing Lawyers (see § 122, Comment d), they are not universally accepted, and the leading Georgia opinion, *Worldspan L.P. v. The Sabre Group Holdings, Inc.*, 5 F.Supp.2d 1356 (N.D. Ga. 1998), is downright hostile to them. The Worldspan court said:

[F]uture directly adverse litigation against one's present client is ... so unusual given the position of trust existing between lawyer and client, that any document intended to grant standing consent for the lawyer to litigate against his own client must identify that possibility ... including reference to specific parties, the circumstances under which such adverse representation would be undertaken, and all relevant like information.

Duane Morris bravely tried to distinguish the *Worldspan* opinion, but it is always hard to fight a battle on the adversary’s home ground, so Duane Morris also argued that the advance waiver provision in its engagement letter was governed by the law of Pennsylvania, where the Harrisburg, Pennsylvania offices of Duane Morris are located and where the bankruptcy matter is pending. Under Pennsylvania law, advance conflict waivers of the sort used by Duane Morris are apparently valid. But the engagement letter lacked a choice of law provision (it could have said, “All issues of professional conduct arising

during this engagement will be governed by Pennsylvania law, including the Pennsylvania Rules of Professional Conduct”), and, in any case, it is unclear whether a Georgia court would be obligated, on either legal or equitable grounds, to enforce an advance waiver clause that would be unenforceable under Georgia law.

The Hearing: McKesson’s Expert

On October 31, 2006, the Hon. Thelma Wyatt Cummings Moore of the Fulton County Superior Court held a full-blown hearing on McKesson’s motion to disqualify, complete with opening statements, lay witnesses, opposing experts, and oral arguments. At the hearing, McKesson was represented by Joseph Manning, a name partner at Morris, Manning & Martin. He said that Duane Morris was “our” current counsel representing MAI in the bankruptcy in Pennsylvania. He then focused directly on the advance waiver provision in Duane Morris’s engagement letter, as well as the rather subtle differences between Georgia’s conflict rules and Pennsylvania’s conflict rules, and he called an ethics professor from Georgia State Law School, Clark Cunningham, to elaborate. (Cunningham was an unusual expert witness. McKesson had offered to retain him on an hourly basis, but he said he did not think it would be appropriate for him to be paid, so he appeared by subpoena.)

Professor Cunningham pointed out that Georgia has modified ABA Model Rule 1.7(b). “[B]efore a lawyer can ask a client to waive a conflict of interest either at the moment or prospectively in Georgia,” Professor Cunningham testified, “that lawyer has to provide in writing to the client reasonable and adequate information about the material risk of the representation.” In other words, he said, “the only way a future waiver could possibly satisfy certainly Georgia [Rule] 1.7(b)(2) would be if it provides enough information so the client understands the risks that they are taking by agreeing to that waiver now or in advance.”

Professor Cunningham then explained why Duane Morris’s attempt at an advance conflict waiver was “absolutely not” valid under Georgia Rule 1.7(b)(2):

Well, first there is nothing in here that provides any information about the material risks of this waiver. There is nothing that says here are the risks that you're incurring about allowing us in advance to represent people adverse to you. There is no indication there is a risk, and it's very hard to imagine how there could be reasonable and adequate information about the material risk without the engagement letter describing ... who the other adverse party might be, what type of claims they might be and so on.

There is another provision in this letter which I find really makes this purported waiver even more egregious....McKesson agrees that the law firm is not obliged to even notify McKesson when they undertake a matter that's adverse to McKesson. ... Not only are they assumed to agree in advance not to object to any ... case that's not substantially related, ... but they don't even know about it. So they're not in any way warned at all, all of a sudden their law firm is representing someone adverse to them

Professor Cunningham reinforced his conclusions by explaining *Worldspan LP v The Sabre Group, supra*, the Georgia federal court case that had generally condemned advance conflict waivers.

At this point the questioning turned to the choice of law issue. McKesson's counsel began attacking Duane Morris's expert, Steven Krane of Proskauer Rose in New York City, who is currently the Chair of the ABA Standing Committee on Ethics and Professional Responsibility (which writes the ABA's formal ethics opinions). Mr. Krane had submitted an affidavit stating that the validity of the advance conflict waiver should be assessed under the Pennsylvania Rules of Professional Conduct. Professor Cunningham sharply disputed that, and explained what Sean Smith (the Duane Morris lawyer in Atlanta handling the Arbitration against MIS) should have done when the plaintiffs in the Arbitration asked him to represent them:

[I]t's obvious to me that what Mr. Smith needs to do is look at the Georgia Rules to make a decision about whether he should take on that case. One of the questions then becomes obviously it presents a potential conflict. A concurrent conflict. Then the issue – there is an engagement letter executed in Pennsylvania – is to look at whether their engagement letter meets his professional obligations in Georgia, which might under some circumstances allow him to proceed with informed consent of both clients. He then needs to look at that engagement letter – which of course was written for a Pennsylvania case – to see whether it meets Georgia standards. I'm merely just surprised by Mr. Krane's assertion that Pennsylvania Rules apply to that decision

Cross-Examining McKesson's Expert

Cross-examination of Professor Cunningham began like this:

- Q. Your entire testimony today is premised on the idea that there is a conflict of interest ...
- A. Yes.
- Q. What is that conflict?
- A. For purposes of my analysis of whether the engagement letter is an effective waiver, I'm assuming for ... conflict's purposes that two members of McKesson corporate family should be treated as the same client.
- Q. Are you here to give an expert opinion that that assumption is true?
- A. No, I'm not.

The cross-examination then turned to the provision in the engagement letter defining the client. Here is the exchange:

- Q. [Y]ou specifically would agree with me that McKesson Medication and McKesson Automation on the one hand, and Duane Morris on the other hand, agreed that absent an explicit understanding to the contrary, Duane Morris only represents Medication and Automation, right?
- A. That's what the sentence says.
- Q. Clearly if there is not a conflict there is no need to consider prospective waivers as an issue in this case; is that right? There is nothing to waive?
- A. ... Conflict of interest for purposes of [Georgia Rule] 1.7 is a situation where there is a risk that a lawyer's exercise independent professional judgment on behalf of one client may be affected by responsibility the lawyer has to another client or to a third party. That's what it means to be a conflict of interest. Doesn't

require there be any actual harm involved, only that there be a risk that the lawyer might conduct his representation of one client differently because of a duty to another client. So with that understanding, the lawyer has to – that risk has to be present for a lawyer to have a duty to either avoid the conflict or attempt to resolve it through informed consent.

* * *

- Q.** Based on this engagement letter that we have been talking about, does Duane Morris represent McKesson Corporation?
- A.** I don't have a complete understanding of how the corporate family is structured, but if by McKesson Corporation you're referring to a corporate entity which is not... McKesson [Medication] Management or McKesson Automation, I would agree that the letter limits the representation to those two corporate entities.

Duane Morris's Expert

Before calling Steven Krane to the witness stand, Duane Morris explained to the court its perspective on the case:

... There is not a conflict here, plain and simple. The very first piece of any analysis of whether there is a conflict is to ask who is the client, and in this case you don't have to go any further than the engagement letter. This is what Professor Cunningham was talking about at the end of the cross examination ...

[O]n page three of the engagement letter, it tells us who the client is. Once you realize the party agrees to this up front, there is not a conflict. Waiver does not even come into play, because there is nothing to be waived. It's that plain and simple. That's really what frames the issue here.

Mr. Krane then took the stand. His testimony focused on the engagement letter provision identifying the client as MMM and MAI, and not any parent, subsidiary, or other affiliate of McKesson. Duane Morris asked whether this was a common paragraph in engagement letters. Mr. Krane answered that it was "very common" when a law firm was "taking on a representation of a piece of a large entity in a relatively small matter" Turning to the subject of advance conflict waivers, Mr. Krane called this a "paradigm" situation for the need for an advanced waiver:[Y]ou have a large law firm, offices around the country being engaged to serve as local counsel which is really a very very small, it's important engagement, but it's a very small engagement in the sense of the overall business of the firm and the firm wants to make sure that by accepting this engagement it's not precluded from taking on adverse matters that even in this case as to the two companies that are specifically named in the engagement letter. They want to be sure that that is understood upfront. If the client isn't willing to do that they're free to go find some other law firm to serve as local counsel ...McKesson's cross-examination predictably seized on Mr.Krane's use of the word "small":

- Q.** ...If you have a small client that you represent, and you used the word three or four times, in a "small matter," do you owe them ... less professional responsibility than you do a major corporation?

- A. You do if you have agreed to that up front. ... [Y]ou do not necessarily owe them the same level of professional responsibility. It depends on the contract between you....McKesson's attorney then asked Mr. Krane whether he agreed that the "Georgia Code of Professional Responsibility transcends mere contract law." That was a quote from a long-time Georgia federal judge, the Hon. Charles Moye. Mr. Krane respectfully disagreed with Judge Moye. "So you could say that by contract you could limit one professional responsibility to a large client but not to a small client?" McKesson's attorney asked. "In some ways, yes," Mr. Krane said. McKesson's attorney said he found that "disturbing."

Next, McKesson's attorney zeroed in on Georgia Rule 1.7(b):

Q. You think that 1.7(b) is irrelevant?

A. Yes, I do.

Q. It's not a matter of contract?

A. Well, ... the contract we are interpreting here was entered into in Pennsylvania for a Pennsylvania representation with Pennsylvania lawyers. That's the only lawyer-client agreement that we are talking about here, and the expectation of the parties who entered into that was that Pennsylvania law would apply not any other state in which matters happen to arise. So, yes, I agree. I believe that Georgia law is completely irrelevant

Q. So Georgia law professional responsibility is subservient to Pennsylvania?

A. The ... Georgia Law Rules of Professional Responsibility have nothing to do with the representation of these two McKesson entities in Pennsylvania ...

Q. Is it your position that this Court applying Georgia Rules of Professional Conduct has no jurisdiction to disqualify the Duane Morris firm?

A. No, it's my position this Court should apply the Pennsylvania Rules of Professional Conduct to the contract ... which was entered into for representation in Pennsylvania. That is the only lawyer client relationship that any McKesson entity has with Duane Morris and it's governed unquestionably by Pennsylvania law. At the close of the expert testimony, the lawyers presented oral arguments, and the court took the matter under advisement. Next month, I will discuss and evaluate the court's opinion.

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