

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

BY ROY SIMON

Last month, in Part I of this article, I provided detailed background for *McKesson Information Solutions LLC v. Duane Morris LLP*, 2006-CV-121110 [Fulton County (GA) Superior Ct. Nov. 8, 2006], a significant opinion that has received national press. This month, I will discuss and evaluate the opinion.

To recap the essential background, in April 2006, two corporations named 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. A Duane Morris partner sent an engagement letter to Morris, Manning & Martin LLP in Atlanta, outside counsel for MAI and MMM. The letter, which referred to the two affiliates collectively as "McKesson," contained the following 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. ...*

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.]

Morris, Manning & Martin asked for some changes to other paragraphs in the engagement letter, but did not ask for changes to either of these paragraphs.

In July 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"), another McKesson entity. Duane Morris's two clients in the Pennsylvania bankruptcy matter (MMM and MAI) were not involved in the Arbitration in any way, but MIS demanded that Duane Morris withdraw from the Arbitration. When Duane Morris refused, MIS filed a complaint in a Georgia state court in Atlanta seeking to enjoin Duane Morris from representing its clients in the Arbitration. After hearing live testimony from legal ethics experts on both sides, the court issued an opinion disqualifying and enjoining Duane Morris from acting as counsel against MIS in the impending Arbitration.

The court's opinion addressed three key issues: 1) Did Duane Morris's representation of the plaintiffs against MIS in the Arbitration create a concurrent conflict of interest with Duane Morris's representation of MMM and MAI in the Pennsylvania bankruptcy matter? 2) Should the court apply the Pennsylvania Rules of Professional Conduct or the Georgia Rules of Professional Conduct? and 3) Did the advance waiver provision in the Pennsylvania engagement letter cure the conflicts? I will first describe the court's opinion, and then evaluate it.

Was Duane Morris Opposing a Current Client?

The root question is: Was Duane Morris opposing one of its own current clients in the Georgia Arbitration? This is a corporate family question. No one disputed that MIS was a part of the McKesson corporate family. The question was whether Duane Morris's representation of MMM and MAI in the Pennsylvania bankruptcy matter meant that MIS was a current client of Duane Morris.

The court recognized that MAI, MIS and MMM were "separate and distinct legal entities for contract and liability purposes," but concluded that they were "a single entity for purposes of conflict of interest analysis." The court based this conclusion on a single authority, *Ramada Franchise Systems, Inc. v. Hotel of Gainsville Associates*, 988 F. Supp. 1460 (N.D. Ga. 1997). The *Ramada* case stood for the proposition that "instead of focusing on labels or form over substance, the court should look at the facts and circumstances and relationship of the parties." To evaluate those facts and circumstances, the *Ramada* court instructed the courts to examine four factors: (a) whether corporate subsidiaries are "inextricably intertwined" with their parent company, (b) whether the parent controls the legal affairs of the subsidiaries, (c) whether the subsidiaries have similar management, share headquarters, share corporate principles and business philosophy, and have the same legal department, and (d) whether senior officers have the same titles in the different subsidiaries.

Applying the *Ramada* factors, the Georgia court noted that MIS, MAI and MMM all share the same parent corporation, McKesson Corporation. Moreover, MIS and MAI are both part of the same business "segment" within McKesson Corporation, which is known by the fictitious name McKesson Provider Technologies ("MPT"). Every subsidiary within MPT "reports to the same principal executive officers," and the MPT subsidiaries "report their revenues as a single segment." Furthermore, MPT is headquartered in Georgia, and has "a single reporting president." Every MPT entity "reports to the same legal department," and "the same lawyers direct the legal judgment and policy of the outside lawyers representing the various MPT business entities."

In light of all this, the court concluded that 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." Therefore, Duane Morris represented MPT (through MAI) in the bankruptcy matter, and was simultaneously adverse to MPT (through MIS) in the Arbitration. That created a conflict of interest that would lead to the disqualification of Duane Morris unless the advance waiver provision in the engagement letter was effective to overcome the conflict.

Remarkably, the court's corporate family analysis never cited or quoted from the provision in the engagement letter defining Duane Morris's clients in the bankruptcy matter as MMM and MAI, "McKesson Medication Management LLC and McKesson Automation, and not any parent, subsidiary or affiliated entities" The court simply ignored that key language.

Which Jurisdiction's Ethics Rules Applied?

Before the court analyzed the advance waiver provision, it turned to the preliminary question of choice of law. The court concluded that because the arbitration was being held in Georgia and the bankruptcy proceeding was pending in Pennsylvania, the court needed to examine both the Pennsylvania Rules of Professional Conduct and the Georgia Rules of Professional Conduct in addressing the conflict of interest and disqualification issues. (It seems obvious to me that the court should also have addressed the choice of law question before analyzing the corporate family conflict issue, but for some reason the court considered the choice of law question relevant only to the advance waiver analysis.)

Duane Morris argued that because the engagement letter between it and MMM/ MAI was negotiated and performed in Pennsylvania, the parties reasonably expected that, Pennsylvania law would apply. The court rejected that argument. Because Duane Morris had undertaken to represent the Smiths against MIS in an Arbitration pending in the State of Georgia, and because Duane Morris included lawyers who were members of the Georgia Bar, the court determined that the Georgia Rules of Professional Conduct governed Duane Morris's conduct in the Arbitration. The court cited the choice of law provision in the ethics rules of both jurisdictions (Georgia Rule 8.5 and Pennsylvania Rule 8.5), which are essentially the same, but the court seemed uncertain which part of the rule applied, and its one-line analysis of Rule 8.5 did not seem integral to the court's determination on the choice of law question.

Was the Advance Waiver Provision Valid?

The court began its analysis of the advance waiver provision with Georgia Rule 1.7 ("Conflict of Interest: General Rule"), and Comment 8 to that Rule, which provides that ordinarily "a lawyer may not act as advocate against a client the lawyer represents in some other matter, even if the other matter is wholly unrelated." The court acknowledged that under Georgia Rule 1.7(b) a lawyer may represent a client despite a conflict if each affected client consents to the representation in writing, but the court pointed out that consent under Rule 1.7(b) is valid only if the client has received "reasonable and adequate information about the material risks of the representation."

Duane Morris relied on the advance waiver provision in its engagement letter. The court analyzed this provision under a single federal case, *Worldspan, L.P. v. The Sabre Group Holdings, Inc.*, 5 F. Supp.2d 1356 (N.D. Ga. 1998), which had stated:

[F]uture directly adverse litigation against one's present client is a matter of such an entirely different quality and exponentially greater magnitude, and 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, if not in plain language, at least by irresistible inference including reference to specific parties, the circumstances under which such adverse representation would be undertaken, and all relevant like information.* [Emphasis added.]

The court noted that Duane Morris's engagement letter did not refer to any particular parties or to the circumstances under which adverse representation would be undertaken. Accordingly, the court found that "MMM and MAI could not have reasonably anticipated that Defendant would actually consider representation of the Smiths in the concurrent action where the adverse party is attacking McKesson Corporation products and accusing it of fraudulent conduct."

Going further, the court noted its obligation to "ensure that the trust and loyalty owed by lawyers to their clients are not compromised." Here, the court said, Duane Morris's representation of the Smiths against MIS while simultaneously representing MAI and MMM, which are both part of the parent company, McKesson Corporation, gave rise to a possible "breach of loyalty and of possible disclosure of information that may adversely affect MIS in the impending arbitration," especially because the Smiths were "attacking the very existence of MIS's line of software products" and because the Smiths had accused MIS of "fraudulent behavior." The advance waiver provision in Duane Morris's engagement letter could not "override its ethical obligations to its clients." Moreover, given that it was still early in the Arbitration, the Smiths would suffer "no prejudice" if the court disqualified Duane Morris. The court therefore disqualified Duane Morris and enjoined it from representing clients adverse to MIS in the Arbitration.

Evaluating Judge Moore's Decision

I disagree with Judge Moore's decision. In my view, the court conducted only a superficial analysis of the McKesson corporate family and of advance waiver issues, and completely missed the most important issue in the case. I am especially puzzled that a state court relied entirely on two federal district court cases for key propositions, without seriously analyzing the policies underlying those cases or examining contrary opinions from other jurisdictions.

To analyze Judge Moore's opinion thoroughly, however, I would need to undertake an extensive inquiry into Georgia law. That would not be productive for New York lawyers. This is the New York Professional Responsibility Report, not the Georgia Professional Responsibility Report, so an essay on Georgia law would not interest most of our readers. Therefore, I will take the situation presented in the McKesson case and analyze it under New York law, as if I were writing a judicial opinion in the next N.Y. case to come along on these issues. I will therefore assume the following facts, which are almost identical to the *McKesson* case:

The arbitration in which McKesson seeks to disqualify Duane Morris is pending in New York (rather than Georgia); and Duane Morris is representing MAI and MMM in a bankruptcy matter pending in Pennsylvania. The engagement letter in the bankruptcy matter defines Duane Morris's clients solely as MAI and MMM "and not any parent, subsidiary or affiliated entities" of MAI or MMM. The engagement letter has no choice-of-law clause, but it does contain an advance waiver provision exactly like the one I quoted above. While the bankruptcy matter in Pennsylvania is still pending, Duane Morris enters an appearance on behalf of the plaintiffs in an arbitration accusing McKesson Information Systems ("MIS") of fraudulent and unethical behavior in its business practices. McKesson demands that Duane Morris withdraw, and, when Duane Morris refuses, McKesson files a motion to disqualify in the New York Supreme Court.

If I Were the Judge...

The first question in analyzing legal ethics issues is to determine which jurisdiction's legal ethics rules apply. In New York, choice of law questions relating to legal ethics issues are governed by DR 1-105(B)(1) of the New York Code of Professional Responsibility, which provides as follows:

In any exercise of the disciplinary authority of this state, the rules of professional conduct to be applied shall be as follows:

1. For conduct in connection with a proceeding in a court before which a lawyer has been admitted to practice (either generally or for purposes of that proceeding), the rules to be applied shall be the rules of the jurisdiction in which the court sits, unless the rules of the court provide otherwise; ...

The New York Code of Professional Responsibility does not define the term "court" but it does define the term "tribunal" to include "all courts, arbitrators and other adjudicatory bodies." Since DR 1-105(B)(1) uses the term "court" rather than "tribunal," a threshold question is whether DR 1-105(B)(1) applies to arbitration proceedings. The logical view is that it does. *See* SIMON'S NEW YORK CODE OF PROFESSIONAL RESPONSIBILITY ANNOTATED 102 (Thomson West 2006 Ed.) ("Although DR 1-105(B)(1) uses the term 'court' instead of the broader term 'tribunal,' the word 'court' should be read as if it said 'tribunal.'"). Therefore, we will look to the New York Code of Professional Responsibility, not the Pennsylvania Rules of Professional Conduct, to decide the main substantive question at issue here: Does Duane Morris have a conflict of interest if it represents two McKesson entities (MMM and MAI) in a Pennsylvania bankruptcy proceeding while simultaneously representing two other plaintiffs in an arbitration proceeding adverse to yet another McKesson entity (MIS).

An essential question to ask when addressing a conflicts of interest issue is: Who is the client? In New York, a client is any person who reasonably believes that he or she (or it) is a client. Here, MIS asserts in its motion to disqualify Duane Morris that it is a current client of Duane Morris by virtue of Duane Morris's concurrent representation, in an unrelated Pennsylvania bankruptcy matter, of MMM and MAI, both of which are "sister corporations" of MIS. Given this argument, it is tempting to delve into the intricacies of corporate family doctrine. Whether representation of one member of a corporate family automatically (i.e., by operation of law) constitutes representation of other members of the same corporate family is a complex, factually intensive inquiry that has occupied the time and resources of many courts and litigants and has produced varying results. *See* Roy Simon, *Assessing Conflicts Issues Within The Corporate Family* (NYPRR 3/03).

But we do not need to delve into McKesson's corporate family structure here, because MMM and MAI have agreed, as reflected in Duane Morris's letter of engagement, that Duane Morris was "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" That language demonstrates that Duane Morris does not represent MIS (or any other McKesson subsidiary) unless (a) MMM and MAI lacked authority to agree to that restriction (which is a question of agency law), or (b) MIS independently formed an attorney-client relationship with Duane Morris (which is a question of contract law).

On the agency law issue, we might have some difficulty finding the answer if Duane Morris had negotiated the terms of its bankruptcy engagement with, for example, a rogue low-level officer who had no authority to bind other McKesson family entities. But here, the engagement letter in the bankruptcy matter was negotiated by the very same law firm—Morris, Manning & Martin, a major Atlanta firm with over 170 lawyers – that now claims MIS is a client of Duane Morris as a matter of law, by virtue of Duane Morris's representation of other McKesson subsidiaries in the bankruptcy matter.

During the negotiations over the engagement letter in the bankruptcy matter, Morris, Manning & Martin played an active role. For example, it demanded changes in provisions of the engagement letter relating

to premium fees for emergency work, interest on overdue payments, and Duane Morris' right to list McKesson as a client on Duane Morris's web site.

But Morris, Manning & Martin did not ask for any changes in the paragraph identifying Duane Morris's clients solely as MMM and MAI, "and not any parent, subsidiary or affiliated entities" As McKesson's outside counsel, Morris, Manning & Martin plainly had at least implied authority, and probably express authority, to bind MMM and MAI to an agreement that provided that Duane Morris did not represent any parent, subsidiary or affiliate of MMM and MAI.

That agreement is plain and unambiguous. Duane Morris's only McKesson clients are MMM and MAI. MIS cannot now sneak within the scope of Duane Morris's bankruptcy engagement letter by urging that MIS is part of the same monolithic, indivisible corporate family.

MIS urges that representation of MAI and MMM automatically translates into representation of MIS because the three entities share the same parent (McKesson Corporation), are part of the same fictional (Provider Technologies) segment within McKesson Corporation, report to the same principal executive officers, and use the same McKesson in-house lawyers to direct their outside lawyers. Absent any agreement to the contrary, these factors might ordinarily be sufficient under New York law to establish that representation of any entity in the McKesson family necessarily means representation of every entity in the McKesson family.

Here, however, Duane Morris has expressly stated that it is representing only MMM and MAI -- and the McKesson family, through its outside counsel, has agreed to that limitation.

MIS may wish otherwise, but "unilateral beliefs alone do not confer upon them the status of defendant's clients." See *Griffin v. Anslow*, 17 A.D.3d 889, 892 (N.Y. App. Div. 3d Dept. 2005) (in a legal malpractice case, plaintiffs' "conclusory assertion" that they considered defendant to be their "personal attorney" did not defeat documentary evidence conclusively showing the absence of privity between plaintiffs and the attorney"). Thus, the central question here is not whether MMM and MAI are part of the same corporate family, or even part of the same segment within the corporate family. The question is whether specified entities within a corporate family may agree that a law firm represents only the specified entities and not the entire corporate family. In my view, a properly authorized entity within a corporate family undoubtedly may agree to retain a law firm solely for the subsidiary's own matters.

In other words, a corporate family -- even a corporate family whose family members are "inextricably intertwined" -- may contract with a law firm to represent only certain entities within the corporate family. If that were not possible, distinct and separately incorporated entities within the corporate family would lose autonomy, and law firms would lose the ability to define their clients by agreement with those clients. Here, Duane Morris has agreed with MMM and MAI that they are the firm's only clients in the bankruptcy matter, not MIS or McKesson Corporation or the McKesson Provider Technologies segment or any other McKesson affiliate or subsidiary. Therefore, Duane Morris does not represent MIS in the bankruptcy matter.

Nor has Duane Morris done anything that would create an implied attorney-client relationship with MIS, such as seeking or receiving confidential information from MIS. Accordingly, Duane Morris is not opposing one of its own current clients in this arbitration proceeding. MIS is not a client of Duane

Morris, and opposing MIS in this arbitration does not create a conflict of interest. Because there is no conflict, we need not consider the efficacy of the advance waiver provision in the engagement letter between Duane Morris and MMM/MAI. The advance conflict waiver provision is inapplicable and irrelevant here because the clients signing the letter have no conflict to waive.

Conclusion: In Praise of Defining the Client

That is the judicial opinion I would write if I were a New York judge examining these issues, and that is the opinion I think the Georgia court should have written.

I said earlier that I had recently written a two-part article in NYPRR about advance waivers and would not address advance waivers again here. But as I wrote this article, I realized that within corporate families, a well drafted provision defining the client as a specific, named entity (and excluding any parent, subsidiary, or other affiliate in the corporate family) is equivalent to a broad advance waiver provision from all other members of the corporate family. In other words, a well crafted provision defining the name of the client as a single, specified entity and none of its parents, subsidiaries, or affiliates within the corporate family means that the law firm will not create a conflict by later opposing other members of the client's corporate family. If a provision narrowly and unambiguously defining the client is negotiated with a sophisticated client (which to me means a client like McKesson that has repeatedly dealt with outside lawyers), and especially if the provision is negotiated with outside counsel for the corporate family itself, then courts should honor the provision.

That was exactly the situation in *McKesson Information Solutions LLC v. Duane Morris LLP*. The court in Georgia should have honored that provision and should have held that Duane Morris did not have a conflict and would not be disqualified. By refusing to honor the provision in the engagement letter defining the client, the Georgia court undermined the important policy of seeking to ensure a client's maximum options for choice of counsel.

If courts do not honor provisions defining the client as a specific entity (or entities) within a corporate family, then corporate families will eventually lose out, because they will have difficulty obtaining their choice of counsel for each separate matter. Large national firms like Duane Morris will often hesitate to take on an entity for a relatively small, one-shot matter that comes with a supersized potential for conflicts. This case is a good example. Since this article was written, we have learned that Duane Morris has withdrawn from representing MMM and MAI in the Pennsylvania bankruptcy matter so that the firm can continue its efforts to represent the plaintiffs in the arbitration proceeding against MIS. Personally, I think that Duane Morris's withdrawal from the bankruptcy matter was a mistake. The withdrawal might appear to confirm Judge Moore's finding of a conflict, and cynics will view the withdrawal as an opportunistic act of disloyalty – a classic “hot potato” situation. But the withdrawal plainly removes any conflict, and Duane Morris has therefore asked Judge Moore to reconsider her disqualification ruling. In addition, the firm has filed a direct appeal in Georgia's intermediate appellate court. If Judge Moore does not remedy her own errors, I hope the appellate court will do so.

Roy Simon is the Howard Lichtenstein Distinguished Professor of Legal Ethics at Hofstra University School of Law.