

Assessing Conflicts Issues within the Corporate Family

BY ROY SIMON

One of the most difficult tasks in checking for conflicts of interest is detecting conflicts within the corporate family. This article provides some ideas for spotting a corporate family conflict before it leads to a motion to disqualify. Of course, if an opposing party will consent to a particular conflict, that will nearly always solve the problem. Some corporate clients will even agree to an advance waiver of all litigation against the corporation's affiliates, at least as to unrelated matters. But what if an opposing party won't consent to being sued by a law firm that represents another corporate family member?

First impressions: Brooklyn Navy Yard

In New York, there was little law on corporate family conflicts until about five years ago. In 1997, defendant Parsons Corporation moved to disqualify LeBoeuf, Lamb, Greene & MacRae ("LeBoeuf") on grounds that LeBoeuf was currently representing a Parsons subsidiary in Moscow regarding the subsidiary's dealings with the Russian Federation in an unrelated matter. The Supreme Court called the disqualification issue a "case of apparent first impression in this State." *Brooklyn Navy Yard Cogeneration Partners, L.P. v. PMNC*, 174 Misc.2d 216, 663 N.Y.S.2d 499 (N.Y. Sup. Ct. 1997). The court immediately established the following analytical framework:

This court holds that disqualification under these circumstances will lie only if the nature of the law firm and its practice together with the type and scope of the legal work done for the subsidiary make it realistic and plausible to assume that confidential information was or would be acquired that would give the plaintiff an unfair advantage over the defendant . . . [T]his Court is rejecting, abinitio, the theory propounded by the defendants that the two corporations should be treated as one entity for conflicts purposes since no evidence has been submitted to demonstrate that the "dominion [of the parent over the subsidiary is] so complete, [the] interference so obtrusive" as to rebut the presumption that they are separate and distinct legal entities.

The court then noted that the subsidiary, RMP, was "a very large corporation that employs 3,400 people and had sales in 1995 of approximately \$545,000,000, a tangible net worth of \$281,943,000 and a working capital of \$46,421,000." The record lacked any evidence "to demonstrate the parent's control or dominion over the day to day activities, or for that matter, the long range plans of the subsidiary, other than the fact that they share common legal and accounting departments and have some officers in common."

As to whether the "possibility of disclosure" existed, the Supreme Court considered two factors: "1) The nature of the law firm and the informal or formal character of its practice insofar as it sheds light upon whether confidential information about the client would have been shared among the members of the firm" and "2) The type of legal work done for the client insofar as it may have put the firm in the position of acquiring confidential information that could be used in an adversarial manner." Applying these two

factors, the court said the legal work done for defendant's subsidiary was "highly specialized" and had "absolutely nothing in common with the subject matter of the present controversy." Moreover, LeBoeuf was a "highly structured and formal law firm," and LeBoeuf's work for the subsidiary was performed by a "geographically isolated" partner. "These factors render nugatory the risk that confidential information was or would be acquired with respect to the defendant-parent corporation that would be used to its detriment in the instant litigation," the court said. The Second Department affirmed. 254 A.D.2d 447, 679 N.Y.S.2d 312 (1998). Citing DR 5.105(B), the Second Department said: "The fact that the plaintiffs' counsel represented a separate subsidiary of the defendant The Parsons Corporation on matters entirely unrelated to the present litigation is not likely to adversely affect the exercise of the independent judgment of the plaintiffs' counsel or involve it in representing differing interests."

In 2002, however, two different judges in the Southern District of New York distinguished *Brooklyn Navy Yard* and disqualified law firms for opposing a subsidiary of a corporate client. I now turn to those cases.

JPMorgan Chase v. Federal Insurance

The first case, *JPMorgan Chase Bank v. Liberty Mutual Insurance Co.*, 189 F. Supp.2d 20 (S.D.N.Y. 2002), began with a moral tone: "Even in an age of convenience," Judge Rakoff said, "for a law firm to bring a multi-million dollar claim on behalf of one corporate client against the primary subsidiary of another of that law firm's corporate clients might be expected to raise some eyebrows. In this case, it also requires the law firm's disqualification." The case began in the wake of Enron's collapse. On behalf of JPMorgan Chase ("JPM Chase"), the law firm of Davis Polk & Wardwell ("Davis Polk") filed suit against Federal Insurance Company ("Federal"), a large insurance company that is the primary subsidiary of The Chubb Corporation ("Chubb"), which Davis Polk had represented since 1967. Here, however, Davis Polk was seeking to enforce Federal's obligations to JPM Chase on \$183 million in surety bonds.

While preparing the \$183 million lawsuit, Davis Polk was simultaneously representing Chubb in preparing and filing an SEC Form S-3. Under the heading "Recent Developments" the S-3 stated that "Chubb has obligations under outstanding surety bonds relating to Enron affiliates [of] approximately \$220 million." The bulk of these obligations consisted of the same surety bonds at issue in JPM Chase's dispute with Federal. Without Chubb's prior knowledge or consent, Davis Polk filed suit against Federal on the very same day that it filed the S-3 on behalf of Chubb. When Chubb demanded Davis Polk's withdrawal in the JPM Chase litigation, Davis Polk responded that "because Davis Polk only represented Chubb and not Federal, New York law did not preclude its representing JPM Chase against Federal." Federal then moved to disqualify Davis Polk.

Judge Rakoff first noted that Davis Polk's representation of Chubb was related to JPM Chase's suit against Chubb. JPM Chase was delighted to see Chubb acknowledge in an S-3 that Federal's security bonds were obligations of Chubb, but Chubb probably would not have approved such wording "if it had known that Davis Polk would simultaneously bring suit on these bonds against Federal." Furthermore, the relationship between Chubb and Federal was "extremely close and interdependent, both financially and in terms of direction." Specifically:

Financially, Federal accounts for over 95% of Chubb's total revenue and over 90% of Chubb's total net income. In terms of direction, Chubb and Federal operate from the same New Jersey headquarters and, since 1967, have shared the same Board of Directors. They also share certain

common officers; of particular relevance here, the General Counsel (and a Senior Vice President) of Chubb, Joanne L. Bober, is also the General Counsel (and a Senior Vice President) of Federal.

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[I]t is wholly artificial to separate Chubb and Federal Just from the fact that Federal accounts for more than 90% of Chubb's business and that Chubb and Federal share identical corporate headquarters, an identical board, and an identical general counsel, it is obvious that the two share a wealth of common interests adversely impacted by the lawsuit in question....

These factors made the JPM Chase case "patently unlike" *Brooklyn Navy Yard*, where the court had held only that a law firm's advice to a defendant's remote Moscow subsidiary on Russian law matters that had "absolutely nothing in common with the subject matter" of the litigation before the court did not preclude the law firm from suing the subsidiary's parent. Accordingly, the JPM Chase court disqualified Davis Polk from representing JPM Chase against Federal.

Discotrade v. Wyeth-Ayerst International

Three months later, Judge Buchwald decided *Discotrade Ltd. v. Wyeth-Ayerst International, Inc.*, 200 F. Supp.2d 355 (S.D.N.Y. 2002). Discotrade had sued Wyeth-Ayerst International, Inc. ("WAI") for fraud, breach of contract, and breach of the implied covenant of good faith and fair dealing. WAI moved to disqualify Discotrade's counsel, Dorsey & Whitney, on the ground that Dorsey & Whitney was currently representing Wyeth Research and Wyeth Pharmaceuticals Inc. ("Pharmaceuticals"), two companies related to WAI, in various matters. The court therefore considered a summary of the corporate relationships to be "essential":

Wyeth, Inc. ("Wyeth") wholly owns AHP Subsidiary Holding Corp. ("AHP") which, in turn, wholly owns, inter alia, WAI and Pharmaceuticals, both New York corporations. Wyeth Research ("Research") is an operating unit or division of Pharmaceuticals. All of the directors of Pharmaceuticals are also directors of WAI, and the two corporations share several common officers, most notably Bernard J. Poussot, who serves as President to both corporations. According to WAI, there is "substantial integration of [Pharmaceuticals] [and WAI] day-to-day activities," such as the use of the same computer network, e-mail system, travel department, and health benefit plan. Furthermore, WAI's and Pharmaceuticals' financial reports are consolidated and Wyeth's Chief Financial Officer serves as CFO to both corporations. Finally, WAI and Pharmaceuticals are both served by Wyeth's "in-house" law department, and virtually all legal correspondence relating to WAI and Pharmaceuticals is upon Wyeth letterhead.

Citing *Cinema 5 Ltd. v. Cinerama, Inc.*, 528 F.2d 1384, 1386 (2d Cir.1976), Judge Buchwald began with the Second Circuit's instruction that "it is prima facie improper for lawyers to take on a representation that is directly adverse to a current client." The first question, therefore, was whether WAI was Dorsey & Whitney's "current client." (The court noted in a footnote that this inquiry is not nearly as rigorous as an "alter ego" or "piercing the corporate veil" analysis.) The court said:

We find that WAI is a "current client" of Dorsey & Whitney because the corporate relationship between WAI and Pharmaceuticals is so close as to deem them a single entity for conflict of

interest purposes. WAI and Pharmaceuticals are corporate subsidiaries of a single corporate parent, AHP, which is, in turn, a wholly-owned subsidiary of Wyeth. WAI and Pharmaceuticals share the same board of directors as well as several senior officers, including their President, Mr. Poussot. The two corporations also interact intimately, for example by using the same computer network, e-mail system, travel department, and health benefit plan. In short, WAI and Pharmaceuticals do not view each other as strangers, but more like members of the Wyeth family. Our conclusion is reinforced by the practical aspects of their relationship, including their common "Wyeth" letterhead, common "Wyeth" business cards, and common "Wyeth" e-mail addresses. WAI has met the burden of demonstrating that its relationship with Pharmaceuticals is so close that a conflict exists.

(In a footnote, the court added that "Dorsey & Whitney apparently represents Research, which is a division of Pharmaceuticals. Since a division of a corporation does not have separate legal status, the representation is deemed to be of Pharmaceuticals.") Because the defendants were Dorsey & Whitney's current clients, the firm's representation of Discotrade was "prima facie improper."

Discotrade tried to turn the tide by arguing that WAI was merely a "vicarious" client of Dorsey & Whitney as that term had been used in *Glueck v. Jonathan Logan, Inc.*, 653 F.2d 746, 749 (2d Cir.1981). *Glueck* however, was a fact-specific opinion holding only that the strict standards of Cinema 5 need not "inevitably be invoked whenever a law firm brings suit against a member of an association that the firm represents." Here, by contrast, Dorsey & Whitney represented the defendant's sister corporation. This made WAI a "traditional client" of Dorsey & Whitney, and the *Glueck* "vicarious client" exception did not apply.

Next, Discotrade argued that disqualification was improper because Dorsey & Whitney's representation of Pharmaceuticals was "wholly unrelated to the subject of the instant lawsuit." The court rejected this argument because the "substantial relationship" test "has been expressly rejected with respect to conflicts among current clients."

Finally, Discotrade invoked *Brooklyn Navy Yard*, but Judge Buchwald found it to be distinguishable. In *Brooklyn Navy Yard*, there was apparently no significant relationship between the two corporate affiliates. Here, WAI and Pharmaceuticals overlapped and interacted in many ways. Accordingly, the Discotrade situation was more like *JPMorgan Chase*, where the two sister corporations shared "identical corporate headquarters, an identical board, and an identical general counsel." Accordingly, even taking a "restrained approach," the court found it proper to disqualify Dorsey & Whitney.

Lessons from Brooklyn Navy Yard, JPMorgan Chase, and Discotrade

The Brooklyn Navy Yard opinion is important first and foremost because the Supreme Court explicitly rejected the theory that a parent and subsidiary are automatically a single client for conflicts purposes. Thus, a lawyer suing a current client's subsidiary is not necessarily suing a current client and will not necessarily be disqualified. Rather, the Second Department looked for two main factors. First, were the companies in the corporate family truly separate? Second, were the matters the law firm was handling for the various corporate family members related or unrelated? The Supreme Court in *Brooklyn Navy Yard* noted that the parent and subsidiary shared "common legal and accounting departments and have some officers in common," but that was not enough to transform the two companies into a single client

for conflict of interest purposes. Moreover, the matters the law firm was handling for the parent and subsidiary were "entirely unrelated" and were being handled by lawyers in geographically remote offices of a highly structured firm. Thus, the court found no threat to confidentiality and refused to disqualify the firm.

In *JPMorgan Chase*, the court was concerned with the same factors but saw a different picture. The two corporations were intimately linked, both "financially" and in terms of "direction." Financially, the subsidiary accounted for over 95% of the parent's total revenue and over 90% of its total net income. In terms of direction, the two companies operated from the same headquarters, shared the same Board of Directors, and shared certain common officers, including a common General Counsel/Senior Vice President. Moreover, the matters the law firm was handling for the affiliated corporations were closely related, so the law firm's actions on behalf of the parent could harm the subsidiary's position in the litigation against it.

In *Discotrade*, the court went further, focusing only on whether the affiliated companies were so closely linked that the party moving to disqualify the law firm should be considered the law firm's "current client." The court was persuaded that the moving party was a current client based on both formal and practical factors. Formally, the two subsidiaries in question shared a single corporate parent, the same board of directors, and several senior officers (including the same President). Practically, the two corporations used the same computer network, e-mail system, travel department, health benefit plan, letterhead, business cards, and e-mail addresses. Once the *Discotrade* court determined that the party moving to disqualify the law firm was the law firm's current client, the court turned a deaf ear to the argument that the law firm's representation of the moving party was "wholly unrelated" to its representation of the other party in the litigation. That standard, the court said, did not apply when a law firm sued its own client.

Conclusion

Before suing a corporate client's affiliate, a law firm should scrutinize the links among the corporate family members. Do they share officers, directors, general counsel, or headquarters? Are there obvious informal ties, such as similar e-mail addresses and letterhead? (*Discotrade* also mentioned a common computer network and health benefit plan, which may be more difficult to ascertain.) If the corporate family members are closely intertwined in terms of finances, leadership, and practical factors, they are likely to be considered a single entity for conflicts purposes.

When the corporate family members are considered a single entity, the law firm has to make a decision. If the representation the law firm is about to undertake against one corporate family member is "entirely unrelated" to the legal work the law firm is already doing for another corporate family member, then the opinions in *Brooklyn Navy Yard* and *JPMorgan Chase* suggest that the law firm might escape disqualification. But the opinion in *Discotrade* suggests that the law firm will be disqualified even if the matters are unrelated. Should the law firm take the risk of proceeding in the face of a motion to disqualify? Or should the law firm decline (or withdraw from) the new representation?

I think the answer should depend on how closely the corporations are related and how closely the matters are related. Two values are at stake - loyalty and confidentiality. If the matters are entirely unrelated, then confidentiality is not threatened. In this context, the very definition of "unrelated" is that

the confidential information the law firm acquires in one representation will have no relevance in the other representation, and therefore cannot be used to the opponent's disadvantage. But whenever the corporate family members themselves are closely related, loyalty is threatened. And whenever the matters in question are closely related, confidentiality is threatened.

Now we can make sense of the cases. In *Brooklyn Navy Yard*, the parent and subsidiary were not closely related and the matters in question were entirely unrelated, so neither loyalty nor confidentiality was at stake and disqualification was not warranted. In *JPMorgan Chase*, the parent and subsidiary were closely related and the matters were closely related, so both loyalty and confidentiality were at stake and disqualification was plainly appropriate. In *Discotrade*, the corporate affiliates were closely related but the matters were unrelated, so only loyalty was at stake, but a threat to loyalty was enough to justify disqualification. And if a case arises where the corporate family members are not closely related but the matters are closely related, then confidentiality may be at stake and disqualification may likewise be appropriate. In other words, if either loyalty or confidentiality is threatened when a law firm seeks to oppose a corporate affiliate of a current client, the court should ordinarily grant a motion to disqualify.

A law firm that studies the facts thoroughly and honestly should be able to determine where things fall on these twin sliding scales. If either the matters or the corporate affiliates are closely related, the law firm is likely to be disqualified, and if both are closely related then the law firm is almost certain to be disqualified. Only if the corporate family members are loosely related and the matters are essentially unrelated is the law firm likely to escape disqualification. If the law firm is not likely to escape disqualification, then it should decline the matter in the first place, or should exit as soon as the opposing party raises an objection or refuses to consent to the conflict. No law firm can profit by losing a motion to disqualify. Why take the risk?

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