

Can Screening Cure Conflicts? Yes and No

BY ROY SIMON

If your law firm is hit with a motion to disqualify based on a conflict of interest, does a screen cure the conflict? In the New York Rules of Professional Conduct, the answer is yes and no. The conventional answer is “no” if the conflict is caused by another client or former client of your law firm (Rule 1.10), but “yes” if the conflict is caused by a lawyer who has moved from public service to private practice (Rule 1.11). Two recent cases twisted around this conventional wisdom.

In this column I will report on one of the cases, *Axon v. Axon*, Index No. 53650/09 (Kings County Supreme Ct., May 24, 2010). In a future issue, I will write about the other case, *Chernick v. Essex Equity Holdings USA, LLC*, Index No. 600995/2010 (N.Y. County Supreme Ct., 2010) (Yates, J.), a thoughtful opinion on screening former government employees that I strongly recommend reading.

***Axon v. Axon*: Court Orders Blank Rome to Set Up a Chinese Wall**

Since 2008, the law firm of Blank Rome has been representing Franklin Credit Management Company (“FCMC”) in two litigation matters pending in New Jersey. A man named Thomas Axon is the majority shareholder, President, and Chairman of the Board of Directors of FCMC. In those capacities, Mr. Axon is involved in every aspect of FCMC’s day-to-day operations.

Sometime after Blank Rome began representing FCMC in the two litigation matters, Mr. Axon sued his wife for divorce. She hired Blank Rome to represent her in the divorce action.

Mr. Axon moved to disqualify Blank Rome. He argued that by defending FCMC in these lawsuits, Blank Rome had access to sensitive, “confidential and proprietary” information relating to the company, including but not limited to a recent restructuring and reorganization of FCMC and its subsidiaries. Consequently, he urged, Blank Rome could obtain confidential information relating to his private and personal finances, thus giving Mrs. Axon an unfair advantage in the divorce litigation. To support his position, the plaintiff submitted the affidavit of attorney Cynthia Berman, a former Blank Rome attorney and now Deputy Counsel to FCMC. In a blistering statement, Ms. Berman stated:

Blank Rome’s representation of Noreen Axon in the instant matrimonial action is directly adverse to its representation of Franklin Credit.... During the course of its representation of Franklin Credit, several Blank Rome attorneys have received and have had access to sensitive, confidential and proprietary information concerning Franklin Credit and Franklin Credit’s President and CEO, Plaintiff, Thomas Axon.... The sensitive, confidential and proprietary information that we provided to Blank Rome included, but was not limited to, information concerning [FCMC]’s loan origination programs, compliance procedures and corporate downsizing.... Of particular import to the financial issues that will likely be addressed in this matrimonial proceeding, were a ... reorganization and restructuring

[that] has had and will continue to have a profound effect on [Thomas Axon’s] finances and fiscal security.... Blank Rome has been privy to sensitive, confidential and proprietary information about

[FCMC] and the value of [plaintiff's] interest therein that will... be a source of contention in this matrimonial action.... Moreover, Blank Rome's ability to access to [sic] such confidential information of [plaintiff] is on-going....

Thus, plaintiff sought to characterize the conflict as one in which Blank Rome represented one current client (Mrs. Axon) in a matter that was "directly adverse" to another current client (FCMC), and that Blank Rome's access to FCMC's confidential information was giving Mrs. Axon an unfair advantage in her divorce case.

Defendant countered by citing *Tekni-Plex, Inc. v. Meyner and Landis*, 89 N.Y.2d 123 (1996), a well known Court of Appeals case written by revered former Chief Judge Judith Kaye to establish the test for disqualification when a lawyer opposes a former client. Defendant recited three requirements for disqualification: (1) the attorney presently or in the past represented the objecting party; (2) the matters involved in both representations were substantially related; and (3) the interests of the present client and former client are materially adverse. Defendant said none of these applied.

First, Blank Rome had never represented Thomas Axon, and did not even deal with him directly in the FCMC litigation matter. Rather, Blank Rome communicated directly with FCMC's in-house counsel. Defendant pointed out how "curious" it was that in his motion to disqualify, Mr. Axon had "not made any allegations that he himself ever imparted any personal information to Blank Rome which could be considered confidential." Second, Blank Rome argued that the divorce litigation was not substantially related to FCMC's two litigation matters. For example, one of the New Jersey cases challenged a foreclosure by alleging that FCMC had violated the Federal Truth in Lending Act, and plaintiff's personal finances had never been discussed. Third – and completely missing the point – Blank 2010 Rome argued that the interests of FCMC were not materially adverse to Mr. Axon's interests because if Blank Rome prevailed in the New Jersey litigation matters, the value of Mr. Axon's stock in FCMC would increase. After setting out the opposing arguments, the court began its discussion, and things really went off track. Because Blank Rome was simultaneously representing both FCMC and Mrs. Axon, the case raised interesting questions about conflicts among current clients.

Ever since the Second Circuit's classic opinion in *Cinema 5 Ltd. v. Cinerama, Inc.*, 528 F.2d 1384 (2d Cir.1976), it has been accepted wisdom in New York (and most other jurisdictions) that a law firm may not file suit against its own client in any matter, related or unrelated, without the informed consent of both the client suing and the client being sued. As Judge Van Graafeiland said in *Cinema 5*:

Putting it as mildly as we can, we think it would be questionable conduct for an attorney to participate in any lawsuit against his own client without the knowledge and consent of all concerned. ... Where the relationship is a continuing one, adverse representation is prima facie improper

The vital question, therefore, was whether Blank Rome's representation of FCMC also amounted to a representation of Thomas Axon, FCMC's Chairman, President, and majority shareholder. The court eventually worked its way around to this question, but it took a circuitous route. The opinion reminded me of the time I drove my kids to Bill Clinton's second inauguration and took the Garden State Parkway to escape the heavy traffic on I-95. We made it to Washington, D.C., but we went through Cape May, New Jersey, which was about three hours out of the way.

While I am digressing, let me mention (as I did a few months ago) the failure of the court system to educate judges about the new rule, and the failure of judges to keep up with developments in the ethics rules. The court mentioned at one point that New York "recently adopted the Model Rules of Professional

Conduct (April 2009),” which is semi-accurate, but the court never cited the new rules. Instead, the court began its analysis by quoting DR5-108(A) and (B). This was all irrelevant. DR5-108(A)(1) prohibited a lawyer from opposing a former client in a substantially related matter without the former client’s consent; DR5-108(A)(2) prohibited a lawyer from using or revealing a former client’s confidences or secrets absent an exception, and DR5-108(B) applied to conflicts that arise when lawyers move laterally from one law firm to another. None of this had anything to do with the facts of the case, as far as I could tell, because FCMC was Blank Rome’s current client, not its former client.

Nevertheless, the court methodically analyzed the situation as if it were a former client conflict, going through all three elements of *Tekni-Plex* (attorney-client relationship, substantially related test, material adversity). Eventually, the court meandered its way around to a relevant observation:

[T]he Court is aware that Blank Rome (the opposing counsel) was and is currently representing FCMC and not the plaintiff (the moving party). Although the defendant argues that in this case, the corporate representation of FCMC is not the same as any individual representation of the plaintiff (thereby failing to satisfy the requirement of the existence of a prior attorney-client relationship between the moving party and opposing counsel), this Court will address the additional requirements of DR§5-108 since the plaintiff and FCMC do appear to be inextricably related.

Reading the rest of the opinion was like reading one of those bad final exam answers where the student writes confidently but keeps getting things wrong. For example, on the substantial relationship element, the court said: “Surely, any information regarding plaintiff’s compensation package from FCMC would be discoverable by defendant during the prosecution of the divorce and hence, would not be deemed a secret or a confidence.” The court did not cite any authority for this proposition, and many cases say otherwise.

On the material adversity element, the court said that the plaintiff had failed to demonstrate that the interests of the defendant and FCMC are materially adverse because “[b]oth the plaintiff and the defendant are shareholders of FCMC and each possesses a marital interest in the company and a shared benefit if the company succeeds.” True, but totally irrelevant. The question raised by the motion to disqualify in *Axon v. Axon* was whether the interests of Mrs. Axon were materially adverse to the interests of Mr. Axon, which they obviously were. (I’ve always taught my students that material adversity can be readily determined by the “v” test – if two parties are on opposite sides of the “v” in litigation, then their interests are materially adverse.) The court didn’t consider material adversity in the context of the divorce litigation.

And yet eventually the opinion made two good points regarding the relationship between confidentiality and conflicts – which brings us to the part about the screen.

As a factual matter, the court rejected plaintiff’s conclusive assertions that while representing the corporate entity (FCMC) Blank Rome had acquired confidential information about the individual (Thomas Axon). The court stated:

This Court finds that the plaintiff has not gone beyond such broad, generalized assertions by showing or outlining the nature and substance of any confidential information belonging to the plaintiff; while it is not a necessity to go into detail about the claimed secrets and confidences, Ms. Berman’s affidavit lacks the specificity required to support the claim that the defendant has access to plaintiff’s “confidences and secrets.” Ms. Berman, in her affidavit only refers to passing along information regarding FCMC’s

corporate and financial activities - she does not report that she or anyone else divulged any personal information about the plaintiff to Blank Rome.

Therefore, the court refused to disturb defendant's right to select counsel of her choice. Nevertheless, as a policy matter, to ensure fairness going forward, the court ordered a remedy:

[I]n this rather unusual set of circumstances, and in order to protect the parties' interests and their right to privacy, this Court will direct that from here on in, a "Chinese Wall" be constructed around the Blank Rome attorneys involved with the matrimonial action. This will shield the plaintiff to the extent that the Blank Rome attorneys on the New Jersey matters and the lawyers for the matrimonial action shall not have any contact with each other regarding the content of their work on said matters. [Citations omitted.]

This seems like a sound approach, and suggests a distinct category of conflict of interest that is neither a conflict between two current clients (a "differing interests" conflict) nor a conflict between a current client and a former client (a "substantially related" conflict). When a law firm represents an entity while opposing an individual who is wound up in the entity – "inextricably related," as the *Axon* court put it – there is a danger that the lawyer will abuse the relationship of trust and confidence with the entity client by seeking out the entity's confidential information not for the purpose of serving the entity but for the purpose of opposing the individual. In fact, even if the law firm acts completely in good faith and seeks confidential information from the entity only to advance the interests of the entity, without any thought about the suit against the individual, there is a danger that some of the confidential information about the entity will concern the individual and therefore give the law firm an unfair advantage in representing its other client against the individual.

In *Axon*, even though the plaintiff could not persuade the court that Blank Rome had actually acquired confidential information in the past from the entity (FCMC) that would give it an unfair advantage in the litigation against the plaintiff (Mr. Axon), the court recognized the danger that Blank Rome's representation of the entity could lead to an unfair advantage in the future. The court therefore ordered Blank Rome to set up a screen between the lawyers representing the entity and the lawyers opposing the individual who was bound up with the entity. That is a sensible and workable prophylactic measure – but I have never seen it before in the context of a concurrent conflict of interest.

Yet as I thought about it, I realized that the situation that arose in *Axon v. Axon* can arise in many guises. In many situations, a lawyer who is representing one client and opposing a party related to that client may not fit the traditional conflict categories, yet the situation can raise concerns about confidentiality. Let's consider a few.

Representing a small business. The issue of confusing or conflating an organizational client with the organization's individual constituents can arise whenever a lawyer represents a corporation, especially a small one. That is the purpose and the lesson of Rule 1.13(a), formerly DR5-109(A), which provides as follows:

When a lawyer employed or retained by an organization is dealing with the organization's directors, officers, employees, members, shareholders or other constituents, and it appears that the organization's interests may differ from those of the constituents with whom the lawyer is dealing, the lawyer shall

explain that the lawyer is *the lawyer for the organization and not for any of the constituents*. [Emphasis added.]

Thus, the issue that arose in *Axon v. Axon* will surface whenever a lawyer for a small company later seeks to oppose one of the company's officers, directors, or major shareholders. I have written about this issue in NYPRR– see *Who Is Your Client in Small Business Matters?* (NYPRR Dec. 1999) (discussing *Catizone v. Wolff*, 71 F. Supp.2d 365 (S.D.N.Y. 1999)).

Corporate families. When a lawyer represents a corporation, does the lawyer automatically represent the other members of the corporate family? Generally, at least in New York, the answer is no. I have written about this issue also in NYPRR– see *All in the Family? Corporate Family Conflicts & Letters of Engagement (Parts I & II)* (NYPRR, Dec. 2006 & Jan. 2007); *Assessing Conflicts Issues Within the Corporate Family* (NYPRR, Jan. 2003). But in some circumstances – especially where the lawyer for one corporate family member gains confidential information that may be useful in opposing another corporate family member – the courts will disqualify the corporation's lawyer from acting adversely to an affiliate.

Trade associations. Suppose a lawyer represents a trade association, but also opposes one of the trade association's members. By representing the trade association, does the lawyer also represent each of the trade association's members? No, definitely not.

Per Rule 1.13(a), a member of a trade organization is just a constituent, not a client – unless, of course, the lawyer independently develops an attorney-client relationship with the member. These issues arose in two well-known cases, *Glueck v. Jonathan Logan, Inc.*, 653 F.2d 746, 749 (2d Cir. 1981) and *Westinghouse Electric Corp. v. Kerr-McGee Corp.*, 580 F.2d 1311 (7th Cir. 1978). In *Glueck*, the court denied a trade association member's motion to disqualify the trade association's lawyer because the lawyer was not representing the member – but the court recognized the danger that confidential information would migrate from the member to the association's lawyer, so the court imported the “substantially related” test, articulating a new rule that a lawyer for a trade association could oppose a “vicarious” client such as a trade association member only if the matters were not substantially related.

In *Westinghouse*, the court granted a member's motion to disqualify the trade association's law firm because, in the course of representing the association, the lawyer had obtained confidential information from Kerr-McGee, a member. The court famously said, “The client is no longer simply the person who walks into a law office.” By obtaining confidential information in its capacity as lawyer for the trade association, the lawyer had inadvertently created an attorney-client relationship with the trade association member.

Conclusion: We need a new rule

As flawed as the court's analysis was in *Axon v. Axon*, it perceived a problem that is not squarely addressed by the current rules. We need a new rule, focused on confidentiality rather than loyalty, that recognizes the middle ground between finding a disqualifying “differing interests” conflict and finding no conflict at all. The new rule – an exception to the broad imputation language in Rule 1.10(a) – would essentially provide that when a law firm's representation of an organizational client creates a danger that the law firm will obtain confidential information that could be used to the disadvantage of an individual constituent, then no lawyer in the firm shall represent any client in a matter materially adverse to the

interests of the individual constituent unless the lawyers for the organization are screened from all participation in the representation adverse to the individual, and vice versa. That would fill a void in the rules long recognized by case law, most recently in *Axon v. Axon*.

Roy Simon is the Howard Lichtenstein Distinguished Professor of Legal Ethics at Hofstra University School of Law. On Friday, June 11, Southern District Judge Alvin K. Hellerstein appointed Professor Simon to supervise communications between 9/11 lawyers and their clients to assure that communications are clear and contain full disclosure of the facts. The intent is to assure that a client's consent to the settlement is fully informed.

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