

# Corporate Family Conflicts: The City Bar Speaks

BY ROY SIMON

In a recent opinion, N.Y. City 2007-3, the New York City Bar's Committee on Professional and Judicial Ethics asked a very simple question: "may a law firm accept a representation that is adverse to an affiliate of a current corporate client?" This article summarizes and comments on the opinion.

This is an old and divisive topic. Ethics committees have been debating it for years. For example, N.Y. County Lawyers Op. 684 (1991) concluded that an attorney may oppose a current client's subsidiary if the adverse action would not materially affect the corporate client's interests. ABA Formal Ethics Op. 95-390 (1995) – one of only a handful of ABA opinions containing multiple dissents – concluded that a lawyer who represents a corporate client "is not by that fact alone necessarily barred from a representation that is adverse to a corporate affiliate of that client in an unrelated matter." My articles in NYPRR have also discussed corporate family conflicts before – see *All in the Family: Corporate Family Conflicts & Letters of Engagement (Parts I and II)* (NYPRR Dec. 2006 and Jan. 2007) and *Assessing Conflicts Issues Within the Corporate Family* (NYPRR Jan. 2003).

But though the issue of corporate family conflicts is old and divisive, N.Y. City 2007-3 marks the first time that the City Bar's ethics committee has addressed the topic in detail.

## The Backdrop

In ABA Formal Op. 95-390, *supra*, the ABA ethics committee noted that the issue of corporate family conflicts is one that "has arisen with increasing frequency because of '[t]he proliferation of national or multi-national public corporations owning or partially owning subsidiaries which may also be national or multi-national [and] the spawning of varied types of corporate affiliates.'" In N.Y. City 2007-3, the committee noted that in recent years "corporate merger and acquisition activity has eclipsed all previous records." This is déjà vu all over again.

However, the City Bar added another factor that ABA Formal Op. 95-390 did not mention – "mergers between law firms have become increasingly common, with a resulting increase in the number of clients they represent." The City Bar is right to add the law firm merger factor. When two law firms merge – let's say Bigger & Bigger LLP merges with Better & Better), the client list of the merged law firm (Bigger & Better LLP) includes the client lists of both of the pre merger law firms (minus a few clients with conflicts that cannot be resolved, or clients who leave because of dissatisfaction with the merger). The law firm merger factor does not alter the intellectual analysis of the conflict problem, but it makes the need for clear guidance more urgent.

Against this backdrop, the City Bar said, it was not surprising that law firms today are often asked to undertake representations adverse to affiliates of their current corporate clients. This is not a problem, the City Bar said, when (1) the engagement letter (or some other agreement) between the current corporate client and the law firm provides that the law firm does not represent the current client's affiliates, or (2)

the current corporate client has waived the conflict in advance; or (3) the law firm declines the representation because it does not wish to offend its current corporate client.

In my own experience, the third situation tends to swallow the first two. Even when the ethics rules and/or contractual agreements with the client do not forbid the representation, most law firms will not sue their own clients because it is bad for business. Many law firms also will not seek to oppose affiliates of their clients in transactions. Law firms are concerned that the decline in future business from an angry current corporate client will more than offset the gain from accepting a new representation adverse to the current corporate client. Many law firms will not even risk asking the current client to consent to the conflict. If the law firm is truly loyal to its client, and is truly a team player, why would the firm ask for permission to sue or otherwise oppose that client's affiliate?

N.Y. City 2007-3 does not address any of these situations. Rather, the opinion "offers guidance in analyzing corporate-family conflicts when neither contractual nor business considerations dictate the outcome." In other words, the City Bar's opinion addresses the situation in which a lawyer has to decide as a matter of law whether a current corporate client's affiliate is also a current client. On this score, the City Bar discussed and rejected several "bright-line" tests for analyzing corporate-family conflicts. Instead, the City Bar concluded that "a more nuanced and fact-specific approach is necessary."

### **Flaws in Three Popular Current Approaches**

N.Y. City 2007-3 begins by noting that DR 5-109 and model rule 1.13 both provide that "a law firm retained by an organization represents the organization and not its constituents." This "entity theory" means that although the law firm may be "dealing with the organization's directors, officers, employees, members, shareholders, or other constituents," when "it appears that the organization's interests may differ from those of the constituents with whom the lawyer is dealing," the law firm must act in the best interests of the organization, rather than of its constituents. Therefore, DR 5-109 and model rule 1.13 suggest that a law firm can oppose a mere share-holder of the current corporate client – including the parent corporation that owns all or most of the client – at least on a matter unrelated to the representation of the client/subsidiary. The theory would be that the parent is not the law firm's client. But "the entity theory has never been interpreted so expansively as to create a rule that a law firm represents only its current corporate client, and none of the client's affiliates."

Another theory similar to the entity theory is the "no-affiliates" position. According to Charles Wolfram, author of the venerable treatise MODERN LEGAL ETHICS (West 1986), the no-affiliates position asserts that a law firm representing one member of a corporate family "never (by that fact alone), or hardly ever, represents any other affiliated entity." If the no-affiliates position is always correct – if a law firm never (or hardly ever) represents any of a client's affiliates – then it would follow, the City Bar said, that "a law firm could almost always represent a new client adversely to the affiliate of a current corporate client if the new matter is unrelated to the lawyer's representation of the current client." That would be true under the no-affiliates position even if a law firm represented a holding company whose sole, wholly owned subsidiary is a bank (meaning the bank is the sole source of the holding company's revenue). The firm could file suit against the bank on behalf of the new client without the consent of the firm's client (the holding company) as long as the suit against the bank is unrelated to the law firm's work for the holding company. That cannot be right.

At the other end of the spectrum, City Bar said, lies the “all-affiliates” position, which holds that “a lawyer who represents one member of a multi-member corporate family is always deemed to represent all others as well.” MODERN LEGAL ETHICS 298-99. Under the all-affiliates position, a law firm “could never represent a new client in a matter that was adverse to an affiliate of a current corporate client without the current client’s consent.” For example, if the current corporate client is a “tiny foreign subsidiary of a large holding company with hundreds of subsidiaries in unrelated industries, all of which are held for investment purposes,” the law firm must not oppose any of the subsidiaries in any matter without the consent of the current client, the tiny foreign subsidiary.

Thus, both the “entity theory” and the “no-affiliates” and “all-affiliates” positions can yield “indefensible results.” a more nuanced and fact-specific approach is needed. Before developing a more nuanced and fact-specific approach, however, the City Bar paused to review two “core ethical duties” that “animate the analysis of corporate-family conflicts” – loyalty and confidentiality.

Regarding the duty of loyalty, a lawyer is a fiduciary. The City Bar cited *Cinema 5 Ltd. v. Cinerama, Inc.*, 528 F.2d 1384, 1386 (2nd Cir. 1976), *In re Kelly*, 23 N.Y.2d 368, 375 (1968), EC 5-1, DR 5-105, and ABA model rule 1.7 to flesh out concepts of loyalty.

Regarding the duty of confidentiality, City Bar cited DR 4-101 and ABA model rule 1.6. When an attorney opposes a current corporate client’s affiliate, the City Bar said, “the attorney must be mindful of not violating this duty, even inadvertently.” With that abstract foundation in place, the City Bar turned to specifics.

### **May a Law Firm Oppose a Client’s Affiliate Without The Client's Consent?**

The ultimate question in conflicts analysis is whether the adversary affiliate is “de facto” a current client of the law firm. This “will turn on the specific facts and circumstances of each representation,” but the committee began describing specific questions that a law firm ought to consider before accepting an engagement to oppose a current corporate client’s affiliate. I will quote all of these questions in full. The questions are:

**Question 1.** *Does the current corporate client have an objectively reasonable belief that its affiliate has de facto become a current client of the law firm, either because of the law firm’s relationship and dealings with the affiliate during the representation, or because of significant overlaps in personnel and infrastructure between the corporate client and its affiliate?*

“Corporate affiliation, without more, does not transform all of a current corporate client’s affiliates into clients of the law firm,” the City Bar noted. New York law makes a subsidiary “legally distinct” from its parent. But sometimes a current corporate client will have “an objectively reasonable belief that some or all of its affiliates have de facto become the law firm’s clients” – for example, if a law firm is counsel to the parent of a wholly owned subsidiary, and the two corporations share the same officers, directors, or in house counsel. This would be especially dangerous if the adverse representation would require the law firm to oppose the same representatives of the affiliate with whom it has regularly communicated while representing the corporate client. “Otherwise, an attorney could negotiate in the morning on behalf of the same person whom the attorney is cross-examining in the afternoon.”

The City Bar then extracted the following factors from the case law on motions to disqualify in the context of corporate-family conflicts:

- Do the current corporate client and its affiliate share the same directors, officers, management, or other personnel?
- Do the current corporate client and its affiliate share the same offices?
- Do the current corporate client and its affiliate share the same legal department (or report to the same general counsel)?
- Do the current corporate client and its affiliate share a substantial number of corporate services?
- Is there substantial integration in infrastructure between the current corporate client and its affiliate, such as shared computer networks, e-mail, intranet, interoffice mail, health benefit plans, letterhead and business cards, etc.?

Standing alone, these factors may be insignificant. But “the greater the overlap between the current client and its affiliate, and the more that overlap relates to both the existing representation of the current corporate client and the adverse representation, the more objectively reasonable the belief will be that the affiliate has de facto become a client of the law firm.”

**Question 2.** *Is there a significant risk that the law firm’s representation of either the current corporate client or the adverse client in the adverse representation will be materially limited by the law firm’s responsibilities to the other client?*

In an unusual move, the City Bar next invoked the language of proposed rule 1.7 of the New York rules of Professional Conduct as proposed by the New York State Bar association’s Committee on Standards of attorney Conduct (“COSAC”):

[B]efore accepting a representation adverse to an affiliate of a corporate client, a lawyer should consider whether the extent of the possible adverse economic impact of the representation on the entire corporate family might be of such magnitude that it would materially limit the lawyer’s ability to represent the client opposing the affiliate with loyalty and zeal.

According to those circumstances, “rule 1.7 will ordinarily require the lawyer to decline representation adverse to a member of the same corporate family, absent the informed consent of the client opposing the affiliate of the lawyer’s corporate client.” The standard under New York’s DR 5-105(B) would be the same.

**Question 3.** *During its representation of the corporate client, did the law firm learn confidences and secrets from either the client or its affiliate that would be so material to the adverse representation as to preclude the law firm from proceeding?*

The City Bar noted that a law firm may have acquired confidences and secrets either (a) directly from the client, or (b) from the affiliate, for the benefit of the current client. The law firm may be unable to continue representing one client without using or disclosing the confidential information of the other, but that is prohibited without consent. If the client refuses consent (or if the law firm does not obtain consent), the law firm may not oppose the affiliate.

## **Conclusion: Avoiding Conflicts Is the Best Solution**

I often tell my students: “you don’t want to win a legal malpractice suit against you. [dramatic pause.] You want to avoid a suit or grievance against you. The City Bar therefore appropriately ended its opinion with advice about methods for avoiding corporate family conflicts.

The easiest avoidance technique is for the lawyer and client to “define the scope of the engagement before a potential conflict emerges and the situation becomes contentious.” In ABA Formal Opinion 95-390, the ABA embraced this approach and called it the “best solution ....” But the City Bar noted that this approach has limits because a lawyer may not ethically agree to any restriction “unnecessarily compromising the strong policy in favor of providing the public with a free choice of counsel.” Thus, the law firm and client should not enter into an agreement which places “excessive restrictions” on the lawyer’s right to practice – “for example, by restricting the law firm from any representation adverse to hundreds of corporate affiliates, both here and abroad.”

In sum, the City Bar has not solved the problem of corporate family conflicts, but it has moved the ball well down the field.

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