

Your Client Is A Corporation - Are Its Affiliates Clients Too?

BY STEPHEN GILLERS

Conflict of interest rules have become exponentially more complex in the last 25 years. Rules governing conflicts in the corporate family can be especially daunting. If you represent one company, are its corporate affiliates also your clients? It would be easy to sympathize with a lawyer who, confused by bar opinions and caselaw, concluded that crossing his fingers provided insurance just as useful as trying to tease out, much less to implement, the applicable principles. But the sympathy would be brief. While risk is not entirely avoidable, it can be managed and contained. Self-help is the key to peace of mind.

ABA Opinion 95-390 set forth three distinct tests for identifying when representation of one member of a corporate family (e.g., parent or subsidiary) will be deemed a representation of its affiliates (e.g., co-subsidiary or parent). If (1) two members of a corporate family are "alter egos;" or if (2) in representing one company a firm acquires relevant confidential information about its affiliate; or (3) if legal matters for all corporate family members are handled by a single in-house legal department conflict rules may prevent the firm from accepting a matter adverse to the non-client affiliate. In situations (1) and (3), the conflict will exist for all matters adverse to the affiliate while the firm represents the affiliated client. In situation (2), the conflict may forever forbid all adverse representation to which the confidential information is relevant.

New York County Bar Adds Two Vague Tests

The ABA's tripartite test is only the beginning. The New York County Bar Association has added two other tests. Each is too vague for practical use and neither has found resonance in other authority. The tests ask whether a corporate client or its non-client subsidiary "reasonably believes that an attorney-client relationship exists between the subsidiary and counsel to the parent;" or whether the parent client's interests "would be materially adversely affected by the action against its subsidiary." NYCLA Opinion 684 (1991). What a parent company "reasonably believes" states an objective test whose answer is hard to predict. In the ABA Opinion, the prospect of a materially adverse effect on a client was deemed insufficient to constitute the kind of direct adversity that conflict rules forbid.

Looking to the ABA's three-part test, we must make some further distinctions. The second of these tests - has the firm acquired relevant confidential information about the non-client corporate family member? - is broadly accepted. *Decora, Inc. v. DW Wallcovering, Inc.*, 899 F. Supp. 132 (S.D.N.Y. 1995) (Koeltl, J.) (also permitting ex parte proof of receipt of relevant confidences); *Brooklyn Navy Yard Cogeneration Partners, L.P. v. PMNC*, 663 N.Y.S.2d 499 (Sup. Ct. Kings Co. 1997). This second test is, in fact, but a particularized application of a rule that operates outside the world of corporate family conflicts. That rule posits that when, in representing a client, a non-client that is not the client's adversary shares confidential information with the client's law firm (or allows the client to do so), the firm will not thereafter be allowed to make adverse use of the information. The authorities are worth knowing. For example, in

Analytica, Inc. v. NPD Research, Inc., 708 F.2d 1263 (7th Cir. 1982), a company was deemed a client for conflict purposes where it gave a law firm confidential information to enable the firm to advise an employee on the most tax-efficient way to transfer company stock to the employee. In *Glueck v. Jonathan Logan, Inc.*, 653 F.2d 746 (2d Cir. 1981), a law firm that represented a trade association was disqualified from an action adverse to an association member where the member had provided the firm with confidential information to enable it to further association's interests. And most noteworthy, because least predictable, is *Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft*, 81 Cal. Rptr. 2d 425 (Ct. App. 1999), in which a law firm that received confidential information about an insured by virtue of its representation of the insured's underwriter could not oppose a subsidiary of the insured in a substantially related matter.

Other Tests Get Mixed Reactions

The two other tests in the ABA Opinion have encountered mixed reactions. Some cases appear to treat the existence of a common corporate legal department as nearly determinative, or at least these cases address the issue summarily on their particular facts. *Hartford Accident and Indemnity Co. v. RJR Nabisco, Inc.*, 721 F. Supp. 534 (S.D.N.Y. 1989) (Walker, J.); *Ramada Franchise System, Inc. v. Hotel of Gainesville Associates*, 988 F. Supp. 1460 (N.D. Ga. 1997). Other cases, however, have identified a common legal department as one, but not a conclusive, factor in a conflicts analysis. *Apex Oil Co., Inc. v. Wickland Oil Co.*, 1995 WL 293944 (E.D. Ca. 1995); *Reuben H. Donnelly Corp. v. Sprint Publishing & Advertising, Inc.*, 1996 WL 99902 (N.D. Ill. 1996).

As for the "alter ego" test, one court held that the test asks only whether as a matter of law an affiliate's formal corporate status should be ignored~ If so, the affiliate is deemed a client. But another court, reading the test more broadly, looked to see whether two members of a corporate family have a "unity of interests" which may include, for example, an integrated management structure. Compare *Brooklyn Navy Yard Cogeneration Partners, L.P. v. Superior Court*, 70 Cal. Rptr. 2d 419 (Ct. App. 1997) (applying the "alter ego" test as a matter of law and rejecting a "unity of interests" test), with *Morrison Knudsen Corp., supra* (holding that the existence or nonexistence of "alter ego" legal status is not determinative and accepting "unity of interests" as a legitimate consideration while also recognizing the need for case-by-case development).

Family Ties Not Enough

One thing, at least, seems clear: The fact that a non-client is a member of a client's corporate family will not, standing alone, make the non-client a client for conflicts purposes. Nor should it. *Ives v. Guilford Mills, Inc.*, 3 F. Supp. 2d 191 (N.D.N.Y. 1998) (Kahn, J.) (rejecting contrary dicta in *Stratagem Development Corp. v. Heron International, N. V.*, 756 F. Supp. 789 (S.D.N.Y. 1989); In re Wingspread Corp., 152 B.R. 861 (S.D.N.Y. 1993) (Brozman, J.) (alleged conflict created by adversary's subsequent acquisition of unrelated client). In *Reuben H. Donnelly Corp., supra*, the court, to illustrate the inadvisability of a contrary rule, noted that the client's parent "had over 250 subsidiary and affiliated entities," while the firm had "1098 lawyers spread over 20 world-wide offices."

Much else will not, however, be clear, at least not at the outset of a representation. So what may a firm do to protect itself from corporate family conflict rules that make identification and prediction of conflicts so difficult? Plenty. In large measure, the conflict rules are default rules. They are what you get if a lawyer and a client don't agree to some other rules. Courts will ordinarily respect informed consents, including advance consents if they are sufficiently specific, and corporate clients, especially those advised by in-house counsel, are certainly in a position to give informed consent. ABA Opinion 93-372.

Template For Retainer Agreements

Two of the predicates in Opinion 95-390 for corporate family conflicts - "alter ego" status and the existence of a common legal department - can each be narrowed or even eliminated by a clearly phrased paragraph in the firm's retainer agreement. Here's a template:

It is understood that we represent Bigco only and not any current or future members of Bigco's corporate family, notwithstanding that they are represented by lawyers in Bigco's general counsel's office or that for conflict purposes a court may deem them to be Bigco's alter ego. This means that we are free to represent a client in a matter that is adverse to any such affiliated company, including in litigation, during our representation of Bigco or after it terminates, so long as we have not received confidential information relevant to the matter in connection with our representation of Bigco.

More difficult to fashion is an advance waiver of conflicts arising under the second ABA test - i.e., if the firm wished to oppose a member of Bigco's family about which the firm had received confidential information while representing another member of Bigco's family, maybe even Bigco itself. Again we have an exemplification of a more general problem. Does a law firm, as a policy issue, ever wish to ask clients to agree to let it oppose the client in a substantially related matter once the representation has concluded?

Different Answers For Different Firms

Different law firms will answer this question differently. Many firms may ask for an advance consent in some circumstances but not others, depending on what the firm can anticipate and the client's relationship to the firm. Sticking with the corporate family situation, however, assume that a law firm does not want its representation of one member of Bigco's family to foreclose foreseeable work adverse to Bigco's other affiliates, even if the firm has received relevant confidential information about those affiliates. Maybe in exchange the firm will promise to erect a screen. The problem then is this: Who signs the consent? If Bigco is the client, can it waive an affiliate's conflict? If the affiliate is the client, can it waive Bigco's conflict? If the companies do not share a common legal department and are not alter egos as a matter of law, reasonable caution suggests that the consent should come from the non-client affiliate. That means, for example, that if Bigco is the client, it must either secure a conflict consent from its affiliate or have authority to consent on the affiliate's behalf.

The lesson here is clear: Planning can avoid much pain and also makes good business sense. That planning should include, at the least, a conversation with any client who is (or could become) a member of a corporate family which the firm is considered to represent by virtue of the particular matter. Once the client's identity is clarified, the understanding should be reduced to writing. Courts and bar ethics committees will be struggling with the ambiguities here for some time, but that does not mean that you have to as well.

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