# THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK
## COMMITTEE ON PROFESSIONAL AND JUDICIAL ETHICS

## FORMAL OPINION 2007-3

**TOPICS:** Corporate-family conflicts; duty of loyalty; duty to preserve confidences and secrets.

**DIGEST:** When a law firm is approached to represent a client adversely to an entity that is a corporate-family member (an "affiliate") of a current corporate client, the law firm faces a potentially disabling corporate-family conflict. In response, the law firm should first ascertain whether its engagement letter with the current corporate client excludes affiliates as entities that the law firm also represents, or whether the engagement letter contains an applicable advance conflicts waiver from the current corporate client, thereby allowing the adverse representation. If consulting the engagement letter does not end the inquiry, the law firm must then analyze whether there is a corporate-family conflict. In performing this analysis, the law firm should consider whether: (a) the firm's dealings with the affiliate during the firm's representation of the current corporate client, the overlap between that client and the affiliate in personnel and infrastructure, or other facts would give rise to an objectively reasonable belief on behalf of the client that the law firm represents the affiliate; (b) there is a significant risk that the law firm's representation of either the current corporate client or the client in the adverse representation (the "adverse client") would be materially limited by the law firm's responsibilities to the other client; and (c) during its representation of the current corporate client, the law firm learned confidences and secrets from either the current client or the affiliate that would be so material to the adverse representation as to preclude the law firm from proceeding. If any of these conditions obtain, the law firm must secure informed consent before accepting the adverse representation. Law firms may seek to avoid corporate-family conflicts by defining the scope of representations before potential conflicts emerge, and by employing advance waivers when appropriate.

**CODE:** DR 4-101(B); DR 5-105(A), (B) & (C); DR 5-109; DR 7-101(A)(1) & (2).

## QUESTION

May a law firm accept a representation that is adverse to an affiliate of a current corporate client?

## DISCUSSION

### I. Conflicts Involving an Affiliate of a Current Corporate Client

In recent years, corporate merger and acquisition activity has eclipsed all previous records. At the same time, mergers between law firms have become increasingly common, with a resulting increase in the number of clients they represent. Against this backdrop, it is hardly

surprising that law firms today often find themselves approached[1] to undertake representations adverse to affiliates of current corporate clients.[2]

At times, the need to determine whether the adverse representation raises a corporate-family conflict will be avoided because either (1) the engagement letter, or another agreement, between the current corporate client and the law firm excludes affiliates as entities that the law firm also represents, or the current corporate client has waived the conflict in advance;[3] or (2) the law firm declines the representation because it does not wish to offend its current corporate client.

This opinion offers guidance in analyzing corporate-family conflicts when neither contractual nor business considerations dictate the outcome.[4]

### A. The Limits of the "Entity Theory" and of the "No-Affiliates" and "All-Affiliates" Positions.

We discuss below several "bright-line" tests that have been considered in analyzing corporate-family conflicts, and conclude that a more nuanced and fact-specific approach is necessary.

DR 5-109 and Model Rule 1.13 provide that a law firm retained by an organization represents the organization and not its constituents. Sometimes referred to as the "entity theory," this 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 constituent(s). DR 5-109. Therefore, DR 5-109 and Model Rule 1.13 suggest that, at least when the affiliate is a shareholder of the current corporate client—for example, the parent of a

[1] For a discussion of the subject of "thrust-upon" conflicts, see Ass'n of the Bar of the City of N.Y. Comm. on Prof'l and Judicial Ethics ("ABCNY"), Formal Op. 2005-5.

[2] In this opinion, the law firm's existing corporate client is referred to as the "current corporate client," or the "current client." The term "affiliate" has the same meaning as in Rule 405 of the General Rules and Regulations under the Securities Act of 1933. Rule 405, 17 C.F.R. § 230.405, defines "[a]n 'affiliate' of, or person 'affiliated' with, a specified person, [as] a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified." Thus, an "affiliate" is a corporate-family member of a current corporate client. The "adverse client" refers to the client that has approached the law firm to undertake a representation adverse to an affiliate of the current corporate client (the "adverse representation").

[3] For a discussion of advance conflicts waivers, see ABCNY Formal Op. 2006-1.

[4] This opinion sets forth what is ethically permissible. Of course, a law firm may take a more restrictive view of corporate-family conflicts, and may decline new representations that are nonetheless permissible under this opinion.

subsidiary—the law firm could represent a new client adversely to the parent on a matter unrelated to the representation of the subsidiary, because 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.[5]

Similarly to the entity theory, the "no-affiliates" position holds that a law firm representing one member of a corporate family "never (by that fact alone), or hardly ever, represents any other affiliated entity. . . ." Wolfram at 299. Under the no-affiliates position, 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. So, for example, under the no-affiliates position, a law firm representing a holding company whose sole, wholly owned subsidiary is a bank, could represent a new client in litigation adverse to the bank, without the consent of the holding company, as long as the litigation involving the bank is unrelated to the work that the law firm has performed for the holding company.[6]

At the other end of the spectrum 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. . . ." Wolfram at 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. Therefore, under this position, if the current corporate client is a tiny foreign subsidiary of a large holding company with hundreds of subsidiaries—both domestic and foreign—in unrelated industries, all of which are held for investment purposes, the law firm cannot represent a new client adversely to any of the hundreds of subsidiaries in the holding company, absent the consent of the tiny foreign subsidiary.

As this analysis shows, the "entity theory" and the "no-affiliates" and "all-affiliates" positions can yield indefensible results. Thus, a more nuanced and fact-specific approach to corporate-family conflicts is necessary.

## II. Ethical Duties Underlying the Analysis of Corporate-Family Conflicts

Two core ethical duties animate the analysis of corporate-family conflicts: the attorney's duty of loyalty and the attorney's duty to preserve the confidences and secrets of a client.[7]

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[5] Charles W. Wolfram, Corporate-Family Conflicts, 2 J. of the Inst. for the Study of Legal Ethics 295, 308 (1999) ("Wolfram").

[6] A narrow exception exists to the no-affiliates position—the "alter-ego" exception—that extends the law firm's conflicts to affiliates considered to be alter-egos of the firm's client. This exception imports a test, which originated in the entirely unrelated context of corporate liability and considerations of veil-piercing and which is shaped by very different considerations, to corporate-family conflicts. Many cases and commentators have rejected using the alter-ego test to analyze corporate-family conflicts. See, e.g., Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft, 69 Cal.App.4th 223, 249, 251-52 (1st Dist. 1999); 1 Geoffrey C. Hazard and W. William Hodes, The Law of Lawyering § 17.9, at 17-29 (3d ed. 2005); Wolfram at 346-47.

[7] The attorney's duty of zealous representation under DR 7-101 also plays a role in analyzing corporate-family conflicts. Under DR 7-101(A)(1) and (2) a lawyer may not "fail to

A lawyer is a fiduciary. Cinema 5 Ltd. v. Cinerama, Inc., 528 F.2d 1384, 1386 (2nd Cir. 1976). As a fiduciary, an attorney "is charged with a high degree of undivided loyalty to [the] client." In re Kelly, 23 N.Y.2d 368, 375 (1968). EC 5-1 states that "[t]he professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of the client and free of compromising influences and loyalties." DR 5-105(A) prohibits a lawyer from undertaking a representation if the lawyer's independent professional judgment on behalf of the client is likely to be adversely affected, or if the representation is likely to involve the lawyer in representing differing interests. Under DR 5-105(C), the lawyer may accept the adverse representation only "if a disinterested lawyer would believe that the lawyer can competently represent the interests of each [client] and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved." See also Model Rule 1.7.

An attorney also has the important duty to preserve client confidences and secrets, and to refrain from using those confidences or secrets to the disadvantage of the client, or for the advantage of the lawyer or another person, absent the client's consent after full disclosure. DR 4-101(B).[8] See also Model Rule 1.6. When an attorney is faced with undertaking a representation adverse to an affiliate of a current corporate client, the attorney must be mindful of not violating this duty, even inadvertently.

## III. Considerations in Determining Whether a Law Firm May Accept a Representation Adverse to an Affiliate of a Current Corporate Client

### A. Is the Affiliate De Facto a Current Client of the Law Firm?

Whether the adverse representation raises a corporate-family conflict requiring informed client consent rests in part on whether the affiliate is de facto a current client of the law firm. When the engagement letter, or another agreement, has not defined the law firm's clients to exclude affiliates, and when there is not an advance waiver allowing the law firm to act adversely to the affiliate, then the law firm must consider whether the affiliate is de facto a current client. Although this will turn on the specific facts and circumstances of each representation, set forth below are questions that the law firm should consider in this connection.

**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**

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(footnote continued)

seek the lawful objectives of the client through reasonably available means," or "prejudice or damage the client during the course of a professional relationship." For example, simultaneously representing the adverse client and the current corporate client can chill the law firm's vigor on behalf of either client.

[8] According to Professor Roy Simon, "[t]ogether with the duty of loyalty, this is the most important duty in the Code, and is the bedrock of the adversary system and the attorney-client relationship." Simon's N.Y. Code of Prof'l Responsibility Annotated 479 (2006 ed.).

**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. But the circumstances of a particular representation may be such that the current corporate client has an objectively reasonable belief that some or all of its affiliates have de facto become the law firm's clients. This may occur, for example, when the 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. Although under New York law a subsidiary is legally distinct from its parent, even if it is wholly owned and the two corporations share stockholders, officers, directors, and offices,[9] these facts may nevertheless give rise to a reasonable belief that both entities are clients of the law firm. This is especially true 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 caselaw on motions to disqualify in the context of corporate-family conflicts identifies the following factors as relevant to determining whether the affiliate has de facto become a client of the law firm:[10]

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[9] See N.Y. County Lawyers' Ass'n Comm. on Prof'l Ethics, Op. 684 (1991) (citing 13 N.Y. Jur. 2d Bus. Relationships § 30 (1981) and related references therein).

[10] See Discotrade v. Wyeth-Ayerst Int'l Inc., 200 F. Supp. 2d 355 (S.D.N.Y. 2002) (disqualifying firm from representation adverse to sister corporation of a current client because their relationship "is so close as to deem them a single entity for conflict of interest purposes"; the sister corporations were subsidiaries of a single corporate parent, shared the same board of directors, as well as several senior officers including their president, "interacted intimately, for example by using the same computer network, e-mail system, travel department, and health benefit plan," and shared common letterhead, business cards, and e-mail addresses); JPMorgan Chase Bank v. Liberty Mutual Ins. Co., 189 F. Supp. 2d 20 (S.D.N.Y. 2002) (disqualifying firm from representation adverse to the primary subsidiary of a current client, when relationship between the parent and subsidiary "is extremely close and interdependent, both financially and in terms of direction"; subsidiary accounted for 95% of parent's total revenue and over 90% of its total income, subsidiary and parent operated from same headquarters, shared the same board of directors, and had certain common officers, including the same general counsel); Travelers Indemnity Co. v. Gerling Global Reins. Corp., No. 99 CIV. 4413(LMM), 2000 WL 1159260 (S.D.N.Y. Aug. 15, 2000) (disqualifying firm from representation adverse to the sibling of a former corporate client, when "there is substantial overlap in their corporate structure"; the sibling corporations "share common offices in New York City, and the same computer network and systems. Additionally, the two companies maintain common human resource and payroll departments and corporate services staff. Finally, there is significant overlap between senior management positions . . . including the chairman, president, chief operating officer, chief financial officer, and chief actuary."; "They even share the same . . . travel agents, mail services, credit card issuers, and annual employee gatherings.") (internal citations omitted); Hartford Accident and Indemnity Co. v. RJR Nabisco, Inc., 721 F. Supp. 534 (S.D.N.Y. 1989) (declining

- 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?; and
- 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, the presence of one or more of these factors may not warrant the conclusion that the affiliate has de facto become a client. 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.

**B. 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?**

The law firm's duty of loyalty also requires the law firm to determine whether there is a significant risk that its representation of either its current corporate client or the adverse client will be materially limited by its responsibilities to the other client. For example, we agree with the Committee on Standards of Attorney Conduct of the New York State Bar Association that "before 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."[11] Under those

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to disqualify firm from representation adverse to parent of former client that was the parent's wholly owned subsidiary, in a matter unrelated to the prior representation, but holding that parent corporation was a client of the firm through its subsidiary because "[c]ertain aspects of their separate corporate identities notwithstanding, the parent corporation attached considerable importance to the products liability litigation against its subsidiary and, accordingly, supervised the subsidiary's litigation. . . . If the parent and subsidiary were in fact distinct and separate entities for representation purposes, then there would have been no need for the parent's general counsel to have retained this supervisory role.").

[11] Report and Recommendations of Committee on Standards of Attorney Conduct, Proposed Rule 1.7, cmt. 34B, at 88 (2005). The Committee on Standards of Attorney Conduct

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."[12] The same standard applies under the existing provisions of the Code. DR 5-105(B).

### C. 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?

While representing the current corporate client, the law firm may have acquired confidences and secrets from the client directly—or from the affiliate to benefit the client—that are highly material to the adverse representation, so that the law firm cannot represent one client without using or disclosing the confidential information of the other. As we explained at length in ABCNY Formal Op. 2005-2, this circumstance would render the law firm unable to proceed, absent consent.[13]

## IV. Prophylactic Measures: Avoiding Conflicts Involving an Affiliate of a Current Corporate Client

The easiest way for a law firm to avoid corporate-family conflicts—at least those that may be anticipated—is to define the scope of the engagement before a potential conflict emerges and the situation becomes contentious. Law firm and client are best served by a frank discussion of potential corporate-family conflicts in advance. ABA Formal Opinion 95-390 (1995) has embraced this approach, stating that the "best solution to the problems that may arise by reason of clients' corporate affiliations is to have a clear understanding between lawyer and client, at the

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has proposed a revision of the Code of Professional Responsibility for consideration by the House of Delegates of the New York State Bar Association.

12 Id.

13 See also, e.g., Restatement (Third) of Law Governing Lawyers, § 20 cmt.d (2000) ("Sometimes a lawyer may have a duty not to disclose information [to a client], for example because it has been obtained in confidence from another client..."); ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 95-390 (1995); N.Y. County Lawyers' Ass'n Comm. on Prof'l Ethics, Op. 684 (1991). See also Westinghouse Elec. Corp. v. Kerr-McGee Corp., 580 F.2d 1311, 1320-21 (7th Cir. 1978) (holding that a fiduciary relationship may result when confidential information is divulged by members of a trade association to counsel for the association, with a reasonable belief that counsel is acting for their benefit).

very start of the representation, as to which entity or entities in the corporate family are to be the lawyer's clients, or are to be so treated for conflicts purposes."[14]

Accordingly, law firm and client may choose to define their relationship by agreeing to an advance conflict waiver or by delineating in the engagement letter, or other agreement, those affiliates that the law firm is undertaking to represent. But care should be taken in this regard because "[a] lawyer may not ethically ask for nor may a lawyer agree to any. . . restriction unnecessarily compromising the strong policy in favor of providing the public with a free choice of counsel." See ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 94-381 (1994); Wolfram at 349. Thus, the law firm and client should be mindful of entering 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.

## CONCLUSION

Given today's ever-burgeoning corporate merger and acquisition activity, the increasing size and complexity of multi-national corporate structures, and frequent law-firm mergers, it is no surprise that law firms can find themselves faced with determining whether they may undertake simultaneous representations both for and against members of the same corporate family. Although some of these corporate-family conflicts may be averted by either (1) an engagement letter, or other agreement, that delineates which affiliates, if any, of a corporate client the law firm represents, or contains an applicable advance waiver; or (2) a business decision to forgo a new representation adverse to an affiliate of an important corporate client, a law firm may often be required to analyze whether it may accept a new engagement adverse to the affiliate of a current corporate client.

This opinion provides an ethical framework to analyze potential corporate-family conflicts. The law firm should consider whether the affiliate has de facto become a client of the law firm. The relevant considerations, which are highly fact-specific, include the nature of the law firm's relationship and dealings with the affiliate during its representation of the corporate client, as well as the presence of significantly overlapping personnel and infrastructures between the corporate client and its affiliate. The law firm should also consider (a) the presence of any material limitations on the law firm's responsibilities to either the current corporate client or the adverse client if the law firm were to accept the adverse representation; and (b) whether the law firm learned confidences and secrets during the representation of the corporate client that would be so material to the adverse representation as to preclude the law firm from proceeding. Although these determinations are not always easily made, a thoughtful analysis should help the law firm decide whether it may proceed without the informed consent of one or both clients.

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[14] For the Committee's views and recommendations concerning advance waivers, please refer to ABCNY Formal Op. 2006-1.