

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

FORMAL OPINION 2008 - 2

**CORPORATE LEGAL DEPARTMENTS AND CONFLICTS OF INTEREST
BETWEEN REPRESENTED CORPORATE AFFILIATES**

QUESTIONS

When inside counsel represent corporate affiliates: (a) under what circumstances must they consider the propriety, under DR 5-105 and DR 5-108, of representing or continuing to represent those affiliates? (b) may a conflict between those affiliates be waived? (c) are there steps that can be taken in advance that will enhance the possibility that inside counsel may continue to represent some or all of the affiliates after a conflict arises?

SUMMARY OF OPINION

Inside counsel representing corporate affiliates must consider possible conflicts between those affiliates under DR 5-105 and DR 5-108.¹ This Opinion describes several steps that inside counsel may take to enhance the possibility that the representation of at least one affiliate, typically the parent corporation, may continue, in the face of a conflict with another corporate affiliate.

I. INTRODUCTION

It can scarcely be debated that inside counsel play a critical role in advising their corporate clients. *See, e.g., In re Teleglobe Commc'ns Corp.*, 493 F.3d

¹ As used in this Opinion, "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."

345, 369 (3rd Cir. 2007) (observing that there has been “rapid growth in both importance and size of in-house, or corporate counsel” and that “the primary advantages of in-house (rather than outside) counsel are the breadth of their knowledge of the corporation and their ability to begin advising senior management on important transactions at the earliest possible stage, often well before anyone would think to hire a law firm”) (citation omitted); Carl D. Liggio, *The Changing Role of Corporate Counsel*, 46 Emory L.J. 1201, 1207 (1997) (“This decade [the 1990s] is seeing a markedly different legal profession in which employed counsel are playing the dominant role. They are supplanting retained counsel as the primary legal advisors to management. Law firms, whose role will become increasingly episodic in the services that they provide, will be primarily transaction dependent, providing legal services only on those matters specifically referred to them by the general counsel’s office.”)

In fulfilling this critical role, inside counsel are subject to the same ethical responsibilities as outside counsel. In particular, New York’s Code of Professional Responsibility (the “Code”) defines a law firm to include a corporate legal department. 22 NYCRR Part 1200.1²

The caselaw has begun to address conflicts arising when inside counsel represent corporate affiliates and has focused on the erosion of a parent’s attorney-client privilege when an affiliate is acquired by a hostile third party. *See, e.g., In re Teleglobe Commc’ns Corp.*, 493 F.3d at 373:

It is inevitable that on occasion parents and subsidiaries will see their interests diverge, particularly in spin-off, sale, and insolvency

² We leave for another day the question whether a corporate legal department should be defined to be a law firm.

situations. When this happens, it is wise for the parent to secure for the subsidiary outside representation. Maintaining a joint representation for the spin-off transaction too long risks the outcome of *Polycast [Tech. Corp. v. Uniroyal, Inc.]*, 125 F.R.D. [47, 49 (S.D.N.Y. 1989)], and *Medcom [Holding Co. v. Baxter Travenol Lab.]*, 689 F. Supp. [842, 844 (N.D. Ill. 1988)] — both cases in which parent companies were forced to turn over documents to their former subsidiaries in adverse litigation — not to mention the attorneys’ potential for running afoul of conflict rules.

This Opinion will address conflicts facing inside counsel more broadly.

II. CONFLICTS AND THE CORPORATE LEGAL DEPARTMENT

In analyzing the conflicts facing inside counsel that represent corporate affiliates, it is important to divide the discussion into two distinct scenarios. The first is when inside counsel represent a parent corporation and one or more of the parent’s wholly owned affiliates.³ The second is when inside counsel represent (a) a parent and one or more affiliates that the parent controls, but does not wholly own, or (b) several affiliates controlled, but not wholly owned, by a common parent.

In the first scenario, inside counsel’s representation is not of entities whose interests may differ because the parent’s interests completely preempt those of its wholly owned affiliates. As a matter of corporate law, “in a parent and wholly-owned

³ This Opinion assumes that inside counsel for the parent provide legal services to the entire corporate “family.” But the analysis in this Opinion holds equally true when affiliates within the corporate family have their own legal departments that in turn report to a single lawyer, typically the general counsel of the parent. Under this circumstance, the conflicts of the parent’s legal department become those of each affiliate’s legal department, and vice versa. *See, e.g., ABCNY Formal Op. 2007-2; N.Y. State 793 (2006).*

subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders.” *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1988). See also *Aviall, Inc. v. Ryder Sys., Inc.*, 913 F. Supp. 826, 832 (S.D.N.Y. 1996) (“Because the officers and directors of a parent company owe allegiance only to that company and not to a wholly owned subsidiary, it is reasonable to conclude that a parent corporation itself is under no obligation to provide the subsidiary with independent representation It would be anomalous to impose a duty upon the corporation, an artificial person, when all the natural persons who are its officers and directors have no such duty, and there is no natural person to take up the duty.”), *aff’d*, 110 F.3d 892 (2d Cir. 1997).⁴

The analysis changes in the second scenario. In that scenario, inside counsel must act on the basis that the parent and each of its represented affiliates is a separate entity with separate interests. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983) (when the parent does not wholly own the affiliate, the joint directors of both parent and affiliate, “owe the same duty of good management to both” companies, and “this duty is to be exercised in light of what is best for both companies.”) This is so even when the parent “has sufficient ownership or influence to exercise working control of the [affiliate]” *Restatement (Third) of the Law Governing Lawyers*. §131, cmt. d. (2000).

In the second scenario, when inside counsel determine a conflict may exist between the parent and its represented affiliates, or between represented affiliates, inside counsel should consider whether joint representation of some or all of their clients

⁴ In *Aviall*, the court rejected a claim by a former subsidiary arising out of its former parent having dictated all the terms of the spin-off agreement, having failed to provide the former subsidiary with independent counsel, and having had an officer of the former parent sign the spin-off agreement on behalf of the former subsidiary.

comports with the Code. There are two principal Disciplinary Rules that apply: DR 5-105 and DR 5-108. DR 5-105(A) articulates when a lawyer must decline joint representation, and DR 5-105(B) articulates when a lawyer must discontinue joint representation. DR 5-105(C) sets forth two conditions that, when met, permit the lawyer and the law firm to undertake or continue an otherwise conflicted representation. DR 5-105 (A) – (C) provide:

- A. A lawyer shall decline proffered employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under DR 5-105 [1200.24](C).
- B. A lawyer shall not continue multiple employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the lawyer's representation of another client, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under DR 5-105 [1200.24](C).
- C. In the situations covered by DR 5-105 [1200.24](A) and (B), a lawyer may represent multiple clients if a disinterested lawyer would believe that the lawyer can competently represent the interest of each and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved.

DR 5-108, which governs "former client" conflicts, applies when a conflict develops between the parent and its represented affiliates, or between represented affiliates, and inside counsel seek to continue representing certain of the clients, while ceasing to represent the others. DR 5-108(A)(1) precludes a lawyer from representing another person "in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client."

Inside counsel should consider carefully these conflict-of-interest rules. Sometimes, a potential conflict will be apparent from the outset of the representation. At other times, the conflict may not become apparent until after the joint representation has begun. To pick just one example, at the outset of a litigation in which a parent and a majority-owned affiliate have been sued, their positions may appear identical and they may choose to be jointly represented by inside counsel. Then discovery may unexpectedly reveal that there is a basis for the parent to offload responsibility onto the affiliate.

III. THE EFFECT OF A CONFLICT OF INTEREST

Once it has been determined that a conflict of interest exists between represented corporate clients, inside counsel must withdraw from the representation, unless the Code otherwise permits. If the Code does not, the entire corporate legal department is barred from the representation because DR 5-105(D) provides that conflicts are imputed in a law firm:

While lawyers are associated in a law firm, none of them shall knowingly accept or continue employment when any one of them practicing alone would be prohibited from doing so under DR 5-101 [1200.20] (A), DR 5-105 [1200.24] (A) or (B), DR 5-108 [1200.27] (A) or (B), or DR 9-101 [1200.45] (B) except as otherwise provided therein.⁵

⁵ DR 5-101 (personal conflicts between lawyer and client) and DR 9-101(B) (representations by former government lawyers) are irrelevant to this Opinion.

A. **DR 5-105(C)**

1. **The Disinterested Lawyer Test**

The first test under DR 5-105(C) is whether a “disinterested lawyer” would conclude that all affected clients can be competently represented if the conflicted representation were undertaken or continued. This is an “objective” test. It is not the subjective view of the individual lawyer, but what a “disinterested lawyer” would think. *See, Restatement (Third) of the Law Governing Lawyers* §122(2)(c) (2000). Professor Simon has defined the “disinterested lawyer,” for purposes of DR 5-105(C), as “an imaginary, hypothetical independent lawyer who has no personal or financial interest in continuing the representation of the client — a lawyer whose only aim is to give the client the best advice possible about whether the client should or should not consent to a conflict.” Roy Simon, *Simon’s New York Code of Prof’l Responsibility Annotated* 857 (2007). Furthermore, “[i]f a disinterested lawyer would conclude that any of the affected clients should not agree to the representation under the circumstances, the lawyer involved should not ask for such agreement or provide representation on the basis of the client’s consent.” EC 5-16. For an analysis of the considerations involved in the disinterested-lawyer test, see ABCNY Formal Op. 2004-2.

Given the inclination toward joint representation, inside counsel may conclude in some circumstances that they should engage independent counsel to conduct that analysis.

2. **Informed Consent**

DR 5-105(C) also requires the informed consent to the representation of the clients whose interests differ.

It is impossible to define fully the elements that make up informed consent. Rule 1.0(e) of the American Bar Association's Model Rules of Professional Conduct describes informed consent as:

...denot[ing] the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.⁶

The Restatement provides that:

[i]nformed consent requires that each affected client be aware of the material respects in which the representation could have adverse effects on the interests of that client. The information required depends on the nature of the conflict and the nature of the risks of the conflicted representation. The client must be aware of information reasonably adequate to make an informed decision.

Restatement (Third) of the Law Governing Lawyers §122, cmt. c(i) (2000). In any event, inside counsel must ensure that all affected clients are fully informed of the advantages and risks of joint representation. We have previously underscored that a client's sophistication is an important determinant of the degree of disclosure required to obtain informed consent, and when it comes to the advantages of being jointly represented by inside counsel, their clients will likely need little disclosure.⁷ At some corporations, especially large, multi-national corporations, inside counsel may have acquired sufficiently deep and broad relationships with the corporation to allow them to provide

⁶ See Comments [18] through [22] to Model Rule 1.7 for further amplification.

⁷ See page 11, below.

advice that considers all the different constituencies and issues that impact a complex organization's decisions on important matters. At the same time, these clients will also likely need little disclosure about at least certain of the risks of joint representation. Included among these are that the centralized legal department regularly represents members of the corporate family and may be motivated in part by a desire to maintain consistent positions across the corporate family, that the department's principal loyalty is to the parent, and that it is likely to take instruction from the parent, even if the parent is not a party to the particular representation. In the final analysis, given the value placed by some corporate clients on inside counsel's advice, those clients may be willing to give informed consent to a joint representation by inside counsel that those clients would reject if proffered by outside counsel.

Given the inclination toward joint representation, inside counsel may conclude in some circumstances that they should engage independent counsel to obtain informed consent.

Who, on behalf of an affiliate, has the degree of independence required to give informed consent under DR 5-105 is a question of corporate law beyond the scope of this Opinion.

IV. NAVIGATING CONFLICTS

Two useful mechanisms that a corporate legal department may employ in navigating conflicts between represented affiliates are an advance conflict waiver and limiting the joint representation to avoid conflicts.

A. Advance Conflict Waivers

This Committee discussed advance conflict waivers at length in ABCNY Formal Op. 2006-1 and, in the context of representing corporations and their constituents in governmental investigations, in ABCNY Formal Op. 2004-2.

Careful drafting of the advance waiver will enhance the possibility that inside counsel will be able to continue to represent one or more clients after a conflict arises. In the context of a joint representation of a parent and an affiliate, the advance waiver should:

- Identify for the clients the potential or existing conflicts with as much specificity as possible;
- Make clear to the clients that the confidences and secrets of the affiliate will be shared with the parent; and
- Obtain agreement from the affiliate that if inside counsel can no longer represent both parent and affiliate, inside counsel can continue to represent the parent irrespective of the confidences and secrets that the affiliate may have shared with counsel and irrespective of what work counsel may have performed for the affiliate.

As we said in ABCNY Formal Op. 2006-1, the validity of an advance waiver must be measured against DR 5-105.

With respect to the disinterested lawyer test, we wrote:

The disinterested lawyer test should be applied both when the advance waiver is given and again when the subsequent adverse matter arises. In the first instance, the lawyer examines the type of representation and prospective client that is anticipated and the potential adversity of interests. In the second instance, the lawyer examines the actual client and matter and the actual adversity that has developed. If the actual conflict is materially different from the conflict envisioned by the waiver, the waiver will be ineffective. If the actual conflict is not materially different, the waiver will also be ineffective if the actual conflict is nonconsentable.

With respect to the informed-consent test, we wrote:

The “adequacy of disclosure and consent” will depend upon the circumstances of each case. We agree with NYCLA Ethics Opinion No. 724 that, in general, “the client or prospective client should be advised of the types of possible future adverse representations that the lawyer envisions, as well as the types of clients or matters that may present such conflicts.”

Some opinions have emphasized the sophistication of the client in judging the degree of required disclosure, and this too is an important consideration. Sophisticated clients need less disclosure of the “implications,” “advantages,” and “risks” of advance waivers before being able to provide informed consent. Similarly, Comment 22 to ABA Model Rule 1.7, with which we also agree, observes that the effectiveness of advance waivers is determined “by the extent to which the client reasonably understands the material risk that the waiver entails,” placing the emphasis, for the sophisticated client, on the client's understanding of risks rather than detailed disclosure by the lawyer. For the sophisticated clients described above, blanket or open-ended advance waivers that are accompanied by relatively limited disclosure about the prospective conflicting matters should nevertheless be enforceable. (citations omitted)

Consistently with the discussion on pages seven and nine above, in connection with the advance waiver, inside counsel may conclude in some circumstances that they should engage independent counsel to conduct the disinterested lawyer analysis and to obtain informed consent.

It also bears emphasis, as stated above, that the person giving informed consent to the advance waiver on behalf of the affiliate must have the degree of independence from the parent, or from other affected affiliates, required by applicable corporate law.

B. Limiting Representation to Avoid Conflicts

Alternatively, inside counsel can limit the representation of one or more affiliates to avoid conflicts. This Committee explored at length the conditions for doing this in ABCNY Formal Op. 2001-3, in which we concluded:

[T]hat a representation may be limited to eliminate adversity and avoid a conflict of interest, as long as the lawyer's continuing representation of the client is not so restricted that it renders her counsel inadequate and the client for whom the lawyer will provide the limited representation consents to the limitation. In obtaining consent from the client, the lawyer must adequately disclose the limitations on the scope of the engagement and the matters that will be excluded. In addition, the lawyer must disclose the reasonably foreseeable consequences of the limitation. In making such disclosure, the lawyer should explain that separate counsel may need to be retained, which could result in additional expense, and delay or complicate the rendition of legal services.

Limiting the representation of an affiliate is at times accompanied by retaining other counsel — for example, outside counsel — to represent the affiliate on those matters in which conflicts preclude joint representation. Separate counsel can protect the affiliate's interests in the conflicted matter, while allowing inside counsel to perform other useful roles for both clients.

CONCLUSION

In analyzing the conflicts facing inside counsel that represent corporate affiliates, this Opinion describes two distinct scenarios. The first is when inside counsel represent a parent corporation and one or more of the parent's wholly owned affiliates. The second is when inside counsel represent (a) a parent and one or more affiliates that

the parent controls, but does not wholly own, or (b) several affiliates controlled, but not wholly owned, by a common parent.

In the first scenario, inside counsel's representation is not of entities whose interests may differ, as a matter of corporate law. In the second scenario, inside counsel must act on the basis that the parent and each of its represented affiliates is a separate entity with separate interests. In the second scenario, when inside counsel determine that a conflict may exist between corporate affiliates that they jointly represent, or intend to jointly represent, inside counsel should consider whether joint representation comports with the requirements of DR 5-105(C), or whether independent counsel should be engaged to represent at least some of the clients. If inside counsel conclude that joint representation may pass muster, they may also conclude in some circumstances that they should engage independent counsel to help satisfy the "disinterested lawyer" and "informed consent" tests required by DR 5-105(C). In all events, a robust consent process should be employed, emphasizing a full explanation of the advantages and disadvantages of joint representation. The propriety of joint representation should be revisited as circumstances change.

Two potentially useful mechanisms that can help inside counsel navigate conflicts are an advance conflict waiver and limiting their representation to avoid conflicts.

Sensitivity to conflicts between represented affiliates will help forestall judicial criticism and avoid unnecessary curtailment of inside counsel's continued functioning in their expected capacity.

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