IDENTIFYING THE CLIENT IN THE CORPORATE SETTING

Hypotheticals and Analyses*

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∗ These analyses primarily rely on the ABA Model Rules, which represent a voluntary organization's suggested guidelines. Every state has adopted its own unique set of mandatory ethics rules, and you should check those when seeking ethics guidance. For ease of use, these analyses and citations use the generic term "legal ethics opinion" rather than the formal categories of the ABA's and state authorities' opinions -- including advisory, formal and informal.

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Introduction

Because all ethics duties and in most situations privilege ownership depends on properly identifying the "client," it should come as no surprise that lawyers must always know their clients' identity at all times.

With corporate clients, this can be easier said than done. To at least a certain extent, corporations are usually treated in the law as if they were "persons" – although there are limits to that legal approach.

- Justin Berton, Corporation Not A Person In Carpool Lanes, S.F. Chronicle, Jan. 8, 2013 ("Some people will do anything to get out of a traffic ticket."; "It is the rare motorist, however, who hopes his explanation will overturn more than 100 years of Supreme Court rulings and challenge the legal notion of corporate personhood."; "Jonathan Frieman, a 56-year-old San Rafael resident and self-described social entrepreneur, failed to convince a Marin County Superior Court jurist Monday after he argued that he was not alone when a California Highway Patrol officer pulled him over in October while driving in the carpool lane."; "Instead, Frieman admitted that he had reached onto the passenger's seat and handed the officer papers of incorporation connected to his family's charity foundation."; "By Frieman's estimation, if corporations are indeed persons as was first established in the 1886 Supreme Court case Santa Clara County vs. Southern Pacific Railroad Company, and he offered evidence that a corporation was traveling inside his vehicle -- riding shotgun, of course -- then two people were in his car."; "'The question of personhood is a very poignant one,' Frieman said before he entered the courtroom. 'This is designed to bring a very strong point to bear upon the legal system. Corporations have grown into large, huge, fictional entities. Now I am taking their power and using it in order to drive in the carpool.'"; "The issue of corporate personhood rocketed to public consciousness in 2010, when the United States Supreme Court ruled in the Citizens United case that the First Amendment barred the government from limiting companies' independent political expenditures. But Frieman says he's been driving stretches of carpool lanes along Highway 101 for the past decade with his papers in the front seat, waiting to get pulled over and set his legal battle in motion."; "He noted, though, he had not buckled in the corporation papers."; "Ford Greene, Frieman's attorney, pointed to California vehicle code section 470, which says the definition of a person includes 'natural persons and corporations.' The signs on the freeways ask carpoolers to carry '2 or more persons' which, Greene said, 'is constitutionally vague.'").

To make matters more complicated, properly identifying the "client" sometimes can be independent of such formal legal status, and counter-intuitive. A 2017 example shows how difficult the analysis can be.

- Clemens v. NCAA (In re Estate of Paterno), 168 A.3d 187, 196-97, 197 (Pa. Super. Ct. 2017) ("In summary, the Engagement Letter consistently draws a distinction between Penn State's board of trustees and the Task Force. The letter consistently identifies the Task Force as the party for whom FSS was performing services. Appellants do not cite any legal authority precluding an entity such as Penn State from hiring and paying a law firm to represent a task force of the entity's creation. Nor do Appellants cite any authority precluding the parties from limiting the attorney-client relationship to the law firm and the task force, if desired. Furthermore, Appellants cite no authority to support their contention that the Task Force, in order to become a client of FSS, needed to be a distinct legal entity. The signature on the Engagement Letter Steve A. Garban, chair of Penn State's board of trustees was necessary, given that the trustees were paying FSS's bills. We therefore do not view Garban's signature as 'fatally inconsistent' with a conclusion that the Task Force was the client, as Appellants claim." (footnote omitted) (emphasis added); "In summary, Appellants have failed to offer any authority upon which we can conclude that the trial court erred, as a matter of law, in finding that FSS confined its representation to the Task Force. We will not disturb the trial court's finding, supported by the record, that Penn State cannot assert attorney-client privilege because it was not the client of FSS." (footnote omitted) (emphasis added)).

And sloppy client identification can result in awkward if not disastrous consequences.

- JAE Properties, Inc. v. AMTAX Holdings 2001-XX, LLC, No. 19cv2075-JAH-LL, 2020 U.S. Dist. LEXIS 80797, at *7, *8, *24 (S.D. Cal. May 7, 2020) (addressing a situation in which Investor Limited Partner Amtax sought communications between co-General Partner JAE and lawyer Hartman; noting that Hartman claimed that he only represented JAE – and not the limited partnership itself; explaining that "JAE has produced documents in this litigation where Hartman identified himself in writing in at least three instances as legal counsel for both the Partnership and the General Partners (including JAE)"; further explaining that Hartman admitted representing the limited partnership "in certain limited capacities," but argued that language mentioning a more general representation was merely "boilerplate language" resulting from "my unintentional failure to remove such language left over from prior correspondence" and "essentially an inadvertent oversight on my behalf"; rejecting Hartman's excuses – concluding that "it was reasonable for [Investor Limited Partner] Amtax to believe that Hartman would protect Amtax's individual interests as a member of the Partnership"; requiring General Partner JAE and Hartman to produce their otherwise privileged communications).

Whether or not corporations or other legal entities themselves can be treated as "persons," lawyers who represent such incorporeal entities must communicate with and ultimately take direction from actual persons. Those persons might also be clients, but not necessarily.

So the bottom line is that lawyers should always explicitly indicate whom (or what) they are representing at all times and in every situation.

In some situations, it is as important or even more important to explicitly disclaim an attorney-client relationship than it is to affirm one.

- Meredith Hobbs, <u>Holland & Knight's Lesson? Get a Disclaimer</u>, Fulton County Daily Report, May 21, 2012 ("Legal malpractice lawyers say the best way for lawyers to protect themselves from the situation Holland & Knight finds itself in – on the hook for $34.5 million in damages for malpractice claims brought by unhappy real estate investors – is by having individuals involved in complex multi-party transactions sign waivers saying the firm doesn't represent them."; "Holland & Knight's lawyers weren't able to persuade the jury that the firm represented only Shailendra Group and some of the development entities the plaintiffs formed with Shailendra – but not the individual plaintiffs themselves, according to court documents."; "Holland & Knight's case could have been bolstered by a waiver specifying that then-partner Reeder Glass didn't represent the plaintiffs individually or provide them legal advice in the series of complex, multi-party real estate deals he handled for Shailendra Group and its investment partners, [Christine Mast, malpractice defense lawyer] said."; "One problem is that lawyers and clients may work on deals over an extended period of time, <u>[Linley Jones, attorney handling plaintiffs malpractice,] said. 'Often they become very chummy. The lines of lawyer, friend and counselor can become blurred. That can make it awkward to send a letter saying you don't represent someone to a person you went to dinner with the night before</u>.'"; "The malpractice lawyers agreed that relationship creep became a pitfall for Holland & Knight. The firm started out representing Shailendra Group, but then formed business entities for Shailendra and the other investors, according to the public record, said plaintiffs malpractice lawyer Rickman Brown of Evans, Scholz, Williams & Warncke.").

In- house lawyers might think they have an easier time than outside lawyers properly identifying their "client." When applying the ethics rules, in-house lawyers must remember that the law department in which they practice is within the definition of "firm" in every jurisdictions's ethics rules.

> "Firm" or "law firm" denotes a lawyer or lawyers in a law partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization or the legal department of a corporation or other organization.

ABA Model Rule 1.0(c).

An ABA Model Rule Comment confirms this approach, but then generates what many in-house and outside lawyers are surprised to learn is uncertainty about the client's identity.

> With respect to the law department of an organization, including the government, there is ordinarily no question that the members of the department constitute a firm within the meaning of the Rules of Professional Conduct. There can be uncertainty, however, as to the identity of the client. For example, it may not be clear whether the law department of a corporation represents a subsidiary or an affiliated corporation, as well as the corporation by which the members of the department are directly employed. A similar question can arise concerning an unincorporated association and its local affiliates.

ABA Model Rule 1.0 cmt. [3].

This type of uncertainty triggered one of America's largest bars to recommend steps that few if any in-house lawyers have ever taken -- treating their employer/client's subsidiaries (presumably even wholly -owned subsidiaries) as separate clients for both loyalty and information flow purposes.

- Illinois LEO 17-05 (5/2017) (analyzing the loyalty (conflicts) and confidentiality implications of parent company's in-house lawyer's dealings with corporate subsidiaries of the lawyer's client/employer; recommending: (1) that lawyer treat subsidiaries as separate clients for loyalty/conflicts purposes, including even obtaining consents or prospective consents in the event of any "competing interests"; and (2) also treat subsidiaries as separate clients for confidentiality purposes, including even analyzing how confidential information will be shared among the corporate affiliates; "<u>For the in-house lawyer, there is no one size fits all test for identifying the client. It may change depending on the circumstances of the representation</u>. Is it the single corporate parent (whose interests may be considered to preempt the interests of any subsidiary, or in any case, be able to provide informed consent to any conflict waiver or disclosure of confidential information)? Or is it the legally distinct individual subsidiaries? Recognizing subsidiaries as separate clients seems to be acknowledged in the IRPC noted above, particularly IRPC 1.13. For practical purposes, <u>treating subsidiaries as distinct clients would seem the better practice if for no other purpose than to focus the in-house lawyer's attention on identifying and addressing problematic legal and ethical issues</u>."; "With respect to conflicts of interests, when an in-house lawyers is called upon to provide legal services to a related corporate entity that is not the lawyer's direct employer, the lawyer must be careful to recognize the potential for competing interests. . . . As with any representation, the in-house lawyer must consider and, if applicable, apply IRPC 1.7. Although impacted by client identification, the interests of intra-family corporate entities may or may not be considered aligned. <u>If the interests are determined to conflict, an in-house lawyer can consider a number of actions to address and resolve the conflict. First and foremost is to obtain, if possible, the subsidiary's and parent's consent to the representation as permitted by IRPC 1.7(b). Counsel may also consider obtaining advance conflict waivers</u>, limiting the scope of the representation to eliminate the potential conflict, or retaining outside counsel."; "<u>Perhaps even thornier issues than conflicts arise with respect to confidentiality under IRPC Rule 1.6</u>. Virginia State Bar Opinion 1838 provides that an in-house lawyer must maintain a subsidiary's confidences unless the subsidiary consents to disclosure. In most corporate contexts, maintaining this confidentiality from the corporate parent, and perhaps other subsidiaries, is likely unworkable and doesn't reflect the work of an in-house legal department. . . . Attempting to maintain confidentiality between related corporate entities, but particularly between a subsidiary and a parent, tends to disregard corporate ownership and hierarchy. . . . In these situations, <u>as with conflicts of interest, a prudent course for the in-house lawyer may be to memorialize in writing how confidential information will be treated, obtain</u>

> advance consent for disclosure, or retain outside counsel.") (emphases added)).

That the large and sophisticated Illinois Bar would recommend what many if not most in -house (and even outside) lawyers would understandably view as a far-fetched and unwieldy process highlights the challenges lawyers face when representing entities and their constituents (either other entities or real persons). But regardless of the challenges, in- house and outside lawyers must at all times always know whom they represent, and whom they don't represent.

Identifying the Client Within a Corporate Entity

Hypothetical 1

As the General Counsel of your publicly traded client, you naturally find yourself dealing with complicated situations. You just received a call from one of your client's directors, who serves on the Audit Committee. She has asked you to hire an outside law firm to assist the Audit Committee in conducting an internal corporate investigation into possible accounting irregularities. A prominent local lawyer comes immediately to mind, and within five minutes you have him on the phone. Before you can explain the situation in any detail, he asks you a simple question.

Who will be the outside law firm's client in this representation --

(A) The board member who called you?

(B) The Audit Committee?

(C) The Board of Directors?

(D) The corporation?

(E) The corporation's shareholders?

(D) <u>THE CORPORATION (ACTING THROUGH THE BOARD OF DIRECTORS)</u>

Analysis

As in so many other contexts involving ethics, the attorney-client privilege and other doctrines, the key to beginning the analysis involves properly defining the client. There are many constituencies inside a corporation that could establish a separate attorney-client relationship with an outside or an in-house lawyer.

"Default" Position: Corporation as the Client

The "default" position is that a lawyer advising a corporation's constituent represents the corporation as an institution.

> A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

ABA Model Rule 1.13(a).

In several cases, courts applied this "default" position in situations in which the lawyers apparently did not clearly identify their client.

For instance, one court held that WilmerHale represented "the entire corporation, and not just the Audit Committee" (meaning that the firm's communications with corporate employees deserved privilege protection).[1] An earlier New York state court case held that a lawyer providing advice to a company's Special Litigation Committee represented both the committee "and the corporation as a whole" -- which the court equated as representing "the plaintiff shareholders."[2]

Not surprisingly, the "duly authorized constituents" from whom a corporation's lawyer takes direction normally is the board of directors. Absent unusual circumstances (some of which are discussed below), the board has the power to hire lawyers to represent the corporation's interests. Some lawyers have learned to their regret that the majority of a board makes the final decisions.

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1 Lawrence E. Jaffee Pension Plan v. Household Int'l, Inc., 244 F.R.D. 412 (N.D. Ill. 2006).

2 Weiser v. Grace, 683 N.Y.S.2d 781, 786 (N.Y. Sup. Ct. 1998) (assessing plaintiff shareholders' efforts to obtain documents from the special litigation committee of defendant company; "The court recognizes that some of the documents sought may contain privileged matter which may be immune from discovery, notwithstanding their relevance to issues of good faith and the reasonableness of the investigation. Thus, an in camera review is the appropriate procedural vehicle to ensure that those privileges are not violated, while permitting plaintiffs to obtain the discovery necessary to challenge the SLC's [Special Litigation Committee] good faith. However, the court notes that the application of the attorney-client privilege is problematic. The SLC's counsel represents both the SLC and the corporation as a whole (e.g., the plaintiff shareholders). Under such circumstances, the attorney-client privilege would not bar discovery of all communications between counsel and the SLC."; noting that the Garner doctrine might entitle plaintiffs to review the documents, and ordering an in camera review to assist in that determination).

- Eagle Forum v. Phyllis Schlafly's American Eagles, Case No. 3:16-cv-946-DRH-RJD, 2018 U.S. Dist. LEXIS 53284 at *3, *3-4, *5, *7, *9, *9-10 (S.D. Ill. Mar. 29, 2018) (addressing a situation in which two Eagle Forum board members retained lawyer Rohlf on behalf of that corporation "to provide … 'representation and counsel with respect to governance matters, Board disputes and litigation as necessary'" (internal citation omitted); noting that Rohlf's firm entered an appearance on Eagle Forum's behalf in an Illinois state court action filed by other Board members (which named Eagle Forum as a nominal defendant); explaining that those other Board members soon exercised their power "as the majority of the Eagle Forum Board of Directors" to suspend Eagle Forum's President and Treasurer – and sought to depose Rohlf; further explaining that Plaintiffs (having a Board majority) argued that "Eagle Forum, not Joel Rohlf, controls its privilege and can waive it" and that Eagle Forum's privilege "did not, and could not, pass to the individual Plaintiffs from the control group . . . who retained [Rohlf] for the purpose of preventing the individual Plaintiffs from taking control of the organization"; rejecting Rohlf's argument that the "clear fissure in Eagle Forum's Board and management" was "an occurrence akin to an acquisition"; ultimately concluding that "at all relevant times hereto [Plaintiffs] constituted the majority of Eagle Forum's Board of Directors" – and therefore "have had control over Eagle Forum, and ultimately its privilege").

Representation of Corporate Constituents Rather than the Corporation

Although the "default" position normally defines the client as the corporation itself rather than any of its constituents, courts sometimes find that lawyers have or could have established an attorney-client relationship with one of the corporation's constituents.

Perhaps most significantly in the corporate governance context, lawyers may represent a subset of a board of directors -- rather than the entire board.

- In re Sampedro, No. 3:18-MC-47 (JBA), 2020 U.S. Dist. LEXIS 24114, at *6 (D. Conn. Feb. 11, 2020) (relying on a corporation board member's declaration "affirming that '[i]n February 2018, the subset of the [corporate] board of directors engaged [a law firm] to provide advice on the appropriate structure'" of an engagement (first alteration in original); noting that this meant that "the attorney from [that law firm] was not a third party to an attorney-client relationship, and no waiver occurred by virtue of her inclusion in the email communication").

- Gilmore v. Turvo, Inc., C.A. No. 2019-0472-JRS, 2019 Del. Ch. LEXIS 316, at *3, *7 (Del. Ch. Aug. 19, 2019) (unpublished opinion) (addressing a situation in which several Turvo directors met on May 21, 2019 to investigate another director's (also the CEO) expense account misconduct; noting that those directors retained Latham & Watkins to advise them and adopted a resolution retaining Latham & Watkins "effective as of May 10, 2019" – explaining that "the resolution's retroactive language was intended to allow Turvo to pay [Latham's] legal fees"; explaining that the ousted director/CEO pointed to Delaware law in seeking privileged communications between the other directors and Latham between May 10 and May 21; denying the effort, and explaining that "it was entirely within [the board's] business judgment to determine that the company should pay the Preferred Directors' fees by deeming Latham to have been working on behalf of the company prior to May 21").

In that situation, lawyers representing a subset of the board may withhold from the other board members their privileged documents and communications.

- Moore Bus. Forms, Inc. v. Cordant Holdings Corp., Civ. A. Nos. 13911 & 14595, 1996 Del. Ch. LEXIS 56 (Del. Ch. June 4, 1996) (assessing a dispute between a corporation and a plaintiff shareholder who had sued the corporation over the right of the shareholder's designee to review information furnished to other board members; ultimately granting the shareholder's motion to compel discovery, because the shareholder was entitled to the information that its designated director was entitled to see; noting that the company could have included a different provision in the stockholder agreement or arranged for appointment of a special committee; "Under either scenario the special committee would have been free to retain separate legal counsel, and its communications with that counsel would have been properly protected from disclosure to Moore [shareholder] and its director designee. Neither approach was followed here.") (emphasis added).

This somewhat counterintuitive scenario also carries serious privilege waiver risks if those lawyers lose sight of their client's identity.

In 2008, the Northern District of California held that Howrey represented only the Special Committee of a company's Board, and not the Board itself -- concluding that the Special Committee and the Board did not even share a "common interest."

> The court notes that not only is the Board not Howrey's client such that the attorney-client privilege does not attach, the

> Board also does not have a common interest with the Special Committee since it was the Special Committee's mandate to ascertain whether members of the Board . . . may have engaged in wrongdoing.

SEC v. Roberts, 254 F.R.D. 371, 378 n.4 (N.D. Cal. 2008).[3]

Defining the lawyer's "client" in this way can have dramatic effects. The Northern District of California found that Howrey's communications with Board members who did not serve on the Special Committee did not even deserve privilege protection.

> The notes with respect to communications between Howrey and the Board or members of the Board that are not members of the Special Committee are not protected by the attorney-client privilege since they are not with respect to communications between Howrey and its client, the Special Committee of the Board.

Id. at 383 (emphasis added). This was a remarkable finding, because in most situations a corporation's lawyer can rely on the Upjohn standard to protect the lawyer's communications with other constituents of the corporation (such as employees) even if the lawyer does not separately represent them.

In addition to aborting the privilege, defining the client relationship so narrowly can destroy the privilege in another way. The Northern District of California held that

3 SEC v. Roberts, 254 F.R.D. 371, 378 n.4, 378 (N.D. Cal. 2008) (assessing privilege issues in connection with an internal corporate investigation of possible options backdating at McAfee, conducted by the Howrey law firm; concluding that the McAfee Board and the Special Committee did not share a common interest; "The court notes that not only is the Board not Howrey's client such that the attorney-client privilege does not attach, the Board also does not have a common interest with the Special Committee since it was the Special Committee's mandate to ascertain whether members of the Board . . . may have engaged in wrongdoing. In this respect, this court disagrees with the conclusion reached in In Re BCE West, L.P., No. M-8-85, 2000 U.S. Dist. LEXIS 12590, 2000 WL 1239117 (S.D.N.Y. Aug. 31, 2000)."; finding that Howrey's disclosure to the Board triggered a waiver; "Certain instances of waiver are straightforward. When Howrey 'detailed for the Board the various stock option issues, improprieties and erroneous option grant dates that were discovered in the investigation,' . . . it waived the work product privilege with respect to its conclusions regarding which option grant dates were improper or erroneous."; ultimately finding a broad scope of waiver, although applied on an interviewee-by-interviewee basis -- so that Howrey's disclosure of its opinions about the interview or the interviewee triggered a subject matter waiver covering materials that the law firm created during that interview; allowing discovery by McAfee's former executive, who was defending against an SEC action).

Howrey waived the attorney-client privilege by reporting to the full board its finding following an options backdating investigation.

> Certain instances of waiver are straightforward. When Howrey 'detailed for the Board the various stock option issues, improprieties and erroneous option grant dates that were discovered in the investigation,' . . . it waived the work product privilege with respect to its conclusions regarding which option grant dates were improper or erroneous.

Id. This finding undoubtedly came as a shock to the lawyers and their "client," the Special Committee. Such a privilege dispute highlights the risks of failing to have carefully defined the "client."

In 2008, a Delaware state court handling a derivative case assessed a similar situation, in which Orrick Herrington was hired by a single-member Special Committee of its client's board of directors -- to investigate possible options backdating.[4] That court

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[4] Ryan v. Gifford, Civ. A. No. 2213-CC, 2008 Del. Ch. LEXIS 2, at *3, *10, *10-11, *11, *12, *12 n.9, *16, *17-18 (Del. Ch. Jan. 2, 2008) (unpublished opinion) (addressing a situation in which the law firm of Orrick Herrington and forensic accounting firm LECG conducted an investigation into possible options backdating by executives and directors of Maxim; noting that Maxim's board established a Special Committee composed of a single director, which was not an "independent Special Litigation Committee" under Delaware law; explaining that the single-member Special Committee retained Orrick, who did not provide a written report but instead presented an oral report to a Maxim board meeting attended by three directors represented by the law firm of Quinn Emanuel in the derivative action that prompted Orrick Herrington's investigation; noting that Maxim's board found that some directors received backdated options, but did not take any action to recover any damages; further explaining that Maxim "provided details of this work to third-parties, including NASDAQ and publicly to investors (through the SEC Form 8-K). Moreover, the Special Committee itself provided a number of documents to the SEC, the United States Attorney's Office, and Maxim's current and former auditors."; also noting that "the director defendants in this case have specifically made use of the Special Committee's findings and conclusions for their personal benefit and have argued to this Court that the Special Committee's exoneration of them should be accorded deference. The director defendants have made these arguments in a brief, opposing plaintiffs' motion to amend the complaint, in which coincidentally Maxim has expressly joined. Further, the director defendants have extensively relied upon the Special Committee's findings both in opposing plaintiffs' motion for summary judgment and in support of their own motion for summary judgment. At the time of the November 30 decision, in their unamended summary judgment brief, the director defendants explicitly rely upon the unwritten 'findings' of the Special Committee that purport to absolve the director defendants of liability." (footnote omitted); "[T]he director defendants have submitted an amended brief in support of their motion for summary judgment that purports to disavow reliance on the Special Committee's findings, despite their explicit reliance thereon in the first brief in support of their motion."; noting that in an earlier opinion "the Court ruled that Maxim, its Special Committee and Orrick must produce all material[s] related to the Special Committee's investigation that were withheld on grounds of

also found that Orrick Herrington waived the attorney-client privilege protection by orally reporting on its investigation to the full board, which included several directors who themselves were targets of the investigation (and who were accompanied at the board meeting by their personal lawyers from Quinn Emanuel).[5]

When lawyers represent a corporate constituent such as a subset of the board of directors, a change in control of the corporation obviously triggers several issues –-including ownership of those lawyers' files.

Several courts have dealt with this issue in the bankruptcy context. That situation also includes the complicating factor of bankruptcy trustees' duties.

In 2006, the Alabama Supreme Court held that a bankrupt company's trustee could not gain access to documents created by Skadden, Arps -- because that law firm represented just the company's outside directors, not the company.

- Ex parte Smith, 942 So. 2d 356, 357-58, 360-61 (Ala. 2006) (addressing efforts by a bankruptcy trustee to obtain communications that the bankrupt company's outside directors had with the Skadden law firm before the bankruptcy; finding that the following language in the outside directors'

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attorney-client privilege."; "The Court also directed Orrick to turn over its work-product, including its interview notes, for in camera review. Orrick does not seek to appeal any aspect of this Court's ruling, including the ruling that plaintiffs have made a showing of good cause to obtain its non-opinion work product."; "[I]t is worthwhile to repeat that the relevant factual circumstances here include the receipt of purportedly privileged information by the director defendants in their individual capacities from the Special Committee. The decision would not apply to a situation (unlike that presented in this case) in which board members are found to be acting in their fiduciary capacity, where their personal lawyers are not present, and where the board members do not use the privileged information to exculpate themselves."; noting that Maxim did not appeal the court's earlier decision that the Garner doctrine overcame any privilege claim; after explaining that the court's Garner determination "provides an independent basis" for its conclusion requiring Maxim to disclose the documents; also noting the directors' essentially inaccurate description about whether they were relying on Orrick Herrington's report; "At the time of the November 30 decision, however, the director defendants explicitly asserted that the findings of the Special Committee were entitled to deference from this Court. Moreover, even if this Court ignores the suspicious timing of the director defendants' purported disavowal of reliance on the investigation, Maxim seeks to further avail itself of the Special Committee's report, which will redound to the benefit of the director defendants."; declining to certify an appeal. (emphasis added)).

[5] Id. at *23.

> retainer letter with Skadden created a separate attorney-client relationship between the outside directors and Skadden, that allowing them to withhold the documents from the bankruptcy trustee: "'We are pleased that you as outside directors (the "Outside Directors") of Just For Feet, Inc. (the "Company") have decided to engage [the Skadden law firm] to assist you in your review of various matters relative to the Company. . . . With respect to the Company and its subsidiaries and parties affiliated with the Outside Directors generally, it is our understanding that the [Skadden law firm] is not being asked to provide, and will not be providing, legal advice to, or establishing an attorney-client relationship with, the Company, its subsidiaries, any such affiliated party or any Outside Director in his individual capacity and will not be expected to do so unless the [Skadden law firm] has been asked and has specifically agreed to do so.'" (underscored emphasis added); explaining that "if a corporate officer or director can have a personal attorney-client privilege with regard to communications with corporate counsel concerning the general affairs of the company, then directors and officers can have their own personal outside counsel and their communications with counsel regarding their personal rights and liabilities will be privileged, even though those communications pertain to matters relating to the affairs of the company. We hold that the outside directors and the Skadden law firm were free to form their own attorney-client relationship, to which JFF was not a party, regarding the directors' individual personal rights and liabilities stemming from 'various matters relative to the Company.'").

In 2015, Southern District of New York Judge Abrams also dealt with privileged communications' ownership after a bankruptcy. Krys v. Paul, Weiss, Rifkind, Wharton, & Garrison LLP (In re China Med. Techs., Inc.), 539 B.R. 643 (S.D.N.Y. 2015).[6]

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[6] Krys v. Paul, Weiss, Rifkind, Wharton, & Garrison LLP (In re China Med. Techs., Inc.), 539 B.R. 643, 654, 655, 656, 658 (S.D.N.Y. 2015) (holding that a bankruptcy liquidator could waive the attorney-client privilege that belonged to a company's Audit Committee, but could not waive the Audit Committee's work product protection, which belonged solely or jointly to the Audit Committee's lawyer's at Paul Weiss; "The issue now before the Court is whether the capacity of the Audit Committee to retain independent counsel and to conduct unfettered internal investigations that implicate corporate management should thwart the statutory obligation of a trustee in bankruptcy to maximize the value of the estate by conducting investigations into a corporation's prebankruptcy affairs."; "Weintraub [CFTC v. Weintraub, 471 U.S. 343 (1985)] did not squarely address the circumstances here. Its analysis was limited to whether privileges asserted by a corporation's counsel were waivable by that corporation's trustee in bankruptcy. The asserted privileges here relate to an investigation by Appellees on behalf of a corporation's audit committee, and the precise relationship between that committee and the corporation is disputed. Despite these factual distinctions, however, the same considerations that weighed in favor of the trustee in Weintraub weigh in favor of Appellant here."; "It is true that the Audit Committee was 'independent' in some sense. It could retain counsel, and it legitimately expected that its communications with counsel would be protected against intrusion by management. But the Audit Committee is not an individual, nor is its status analogous to that of an individual. Instead, it was a committee constituted by CMED's Board of

China Medical's Audit Committee had hired Paul Weiss to conduct an internal investigation into the company's possible financial improprieties. After the company declared bankruptcy, the Bankruptcy Court held that Paul Weiss's privileged communications and work product belonged to the Audit Committee -- which meant that the company's Liquidator could not waive those protections and access or disclose the communications or the documents. In re China Med. Techs., Inc., 522 B.R. 28 (Bankr. S.D.N.Y. 2014).

The Southern District of New York reversed the Bankruptcy Court's decision about privilege ownership, but not about work product protection ownership.

Although "recogniz[ing] that this is a difficult issue in a largely ill-defined area of the law," the Southern District of New York reversed the Bankruptcy Court's privilege

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Directors, and thus a critical component of CMED's management infrastructure."; "[T]he justifications for protected attorney-client communications dissipate in bankruptcy. Prebankruptcy, audit committees 'play a critical role in monitoring corporate management and a corporation's auditor.' . . . Without the prebankruptcy protection of attorney-client privilege, audit committees could not provide 'independent review and oversight of a company's financial reporting processes, internal controls and independent auditors,' nor could they offer a 'forum separate from management in which auditors and other interested parties [could] candidly discuss concerns.' SEC Release No. 8220, 'Standards Relating to Listed Company Audit Committees,' File No. 87-02-03, 79 SEC Docket 2876, 2003 WL 1833875, at *19 (Apr. 9, 2003). But as the Bankruptcy Court noted in its Opinion, 'any miscreants have left the company' in bankruptcy, . . .; corporate management is deposed in favor of the trustee, and there is no longer a need to insulate committee-counsel communications from managerial intrusion. Without a legitimate fear of managerial intrusion or retaliation in bankruptcy, Appellees' assertions as to a potential chilling effect ring hollow."; "Although the Court recognizes that this is a difficult issue in a largely ill-defined area of the law, it nevertheless respectfully disagrees with the legal determination of the Bankruptcy Court below. The Court finds that Appellant, as CMED's Liquidator, now owns and can thus waive the Audit Committee's attorney-client privilege, regardless of the Committee's prebankruptcy independence. The Bankruptcy Court's ruling to the contrary is hereby reversed."; "The Court's ruling as to attorney-client privilege does not extend, however, to Appellees' assertion of work product protections, which the Bankruptcy Court Opinion only peripherally addressed. . . . Importantly, because 'work product protection belongs to the Audit Committee's counsel and cannot be waived by the client' . . . it does not fall within the ambit of Weintraub. . . . Thus, even assuming that the Liquidator owns those documents for which Appellees have asserted work-product protection, he cannot waive this protection unilaterally. Appellant, at the very least, has not cited any cases suggesting otherwise.").

ownership determination -- holding that the company's Liquidator "now owns and can thus waive the Audit Committee's attorney-client privilege." Id. at 658.

The court formulated the key question in a way that presaged its holding -- emphasizing the nature of post-bankruptcy proceedings.

> The issue now before the Court is whether the capacity of the Audit Committee to retain independent counsel and to conduct unfettered internal investigations that implicate corporate management should thwart the statutory obligation of a trustee in bankruptcy to maximize the value of the estate by conducting investigations into a corporation's prebankruptcy affairs.

Krys, 529 B.R. at 654.

The court acknowledged the Audit Committee's independence, but also noted that the Committee was necessarily part of the company's "management infrastructure."

> It is true that the Audit Committee was "independent" in some sense. It could retain counsel, and it legitimately expected that its communications with counsel would be protected against intrusion by management. But the Audit Committee is not an individual, nor is its status analogous to that of an individual. Instead, it was a committee constituted by CMED's Board of Directors, and thus a critical component of CMED's management infrastructure.

Id. at 655.

The court also acknowledged that the Audit Committee's sole ownership of the privilege might make sense pre-bankruptcy, but that bankruptcy changed the analysis -- because after bankruptcy

> there is no longer a need to insulate committee-counsel communications from managerial intrusion. Without a legitimate fear of managerial intrusion or retaliation in bankruptcy, Appellee's assertions as to a potential chilling effect ring hollow. . . . If anything, the prebankruptcy interests of an audit committee are aligned with the interests of a trustee or liquidator in bankruptcy.

Id. at 656-57.

The court came to a different conclusion about the work product-protected documents at issue. The court cited one Southern District of New York decision[7] indicating that the work product protection belonged to the Audit Committee's lawyer and not to the Audit Committee itself. The court also quoted from a more recent Southern District of New York decision indicating that both the lawyer and the client own work product, and therefore the client alone cannot waive that protection.[8]

Interestingly, the China Medical decision did not cite or deal with several other recent decisions (discussed above) addressing privilege ownership in the context of a corporation's constituent such as an audit committee or its independent directors.

Not all law firms representing a subset of a board of directors have been successful in resisting discovery sought by a bankruptcy trustee now in control of the corporation. Not surprisingly, those law firms' failure sometimes rests in part on their inconsistency in properly identifying their "client."

In Kirschner v. K&L Gates LLP, 46 A.3d 737 (Pa. Super. Ct. 2012),[9] a Pennsylvania appellate court held that the liquidation trustee for Le-Nature could pursue

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[7] In re Suprema Specialties, Inc., Ch. 7 Case No. 02-10823 (JMP), 2007 Bankr. LEXIS 2304 (Bankr. S.D.N.Y. July 2, 2007) (not for publication).

[8] AP Links, LLC v. Russ, 299 F.R.D. 7 (E.D.N.Y. 2014).

[9] Kirschner v. K&L Gates LLP, 46 A.3d 737, 742, 743, 744, 749, 749 n.3, 749, 749-50, 750, 751, 753, 753 n.6, 754 (Pa. Super. Ct. 2012) (holding that a liquidation trustee can pursue malpractice, breach of fiduciary duty, and other claims against K&L Gates on behalf of a bankrupt company, despite a retainer letter explicitly indicating that K&L Gates did not represent the company, but instead represented only the special committee of a board of directors; explaining that after several of its senior financial executives resigned after accusing CEO Podlucky of financial improprieties, Le-Nature's board of directors determined that it was "in the best interest of the Company to appoint a special committee of independent directors" to investigate matters; noting that the Special Committee determined that "it was critical to retain on behalf of the company, legal counsel with experience in conducting such investigations; noting that K&L Gates's retainer letter contained the following provision: "'We understand that we are being engaged to act as counsel for the special committee and for no other individual or entity, including the Company or any affiliated entity, shareholder, director, officer or employee of the Company not specifically identified herein. We further understand that we are to assist the Committee in investigating the facts and circumstances

malpractice, negligence, breach of fiduciary duty and other claims against the law firm of K&L Gates -- despite an explicit provision in the firm's retainer letter disclaiming any representation of the company itself, and instead indicating that the company board's Special Committee was the firm's sole client.

After a number of Le-Nature's senior financial executives left the company and alleged that CEO Podlucky was engaging in financial improprieties, Le-Nature's board of directors unanimously passed a resolution indicating that it was "in the best interest of the Company to appoint a special committee of the independent directors to conduct an

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surrounding the aforementioned resignations and assist the Special Committee in developing any findings and recommendations to be made to the full Board of the Company with respect thereto. The attorney-client relationship with respect to our work, including our work product, shall belong to the Committee. Only the Committee can waive any privilege relating to such work.'"; noting that K&L Gates hired P&W as a financial expert pursuant to a retainer letter that contained the following sentence: "'P&W shall provide general consulting, financial accounting, and investigative or other advice as requested by K&L [Gates] to assist it in rendering legal advice to Le[-]Nature's.'" (alterations in original); explaining that K&L gave a draft of its investigation report to Podlucky, even though he was not a member of the Special Committee; reciting the report as finding no evidence that Podlucky had engaged in impropriety; pointing out that Poducky later hired K&L Gates on behalf of the company to prepare an initial public offering, but that eventually a custodian found "massive fraud" at the company, which caused it to declare bankruptcy; acknowledging that the trial court had dismissed the liquidation trustee's legal malpractice/negligence claim against the firm, because the firm had been retained to protect the interests of the shareholders rather than the company itself; reversing the trial court's finding, concluding "[t]he averments of the Amended Complaint, taken as true, establish that Le-Nature's, acting through its Board and the Board's Special Committee, sought the legal advice and assistance of K&L Gates's. Specifically, Le-Nature's sought K&L Gates's legal advice and assistance in investigating allegations of fraud, and in preparing findings and recommendations for action to be taken by Le-Nature's."; "As a committee of the Board, the Special Committee had the fiduciary duty to act in the best interests of not only the shareholders, but also the corporation."; "Contrary to the arguments of K&L Gates and Ferguson, no conflict of interest existed between Le-Nature's and the Special Committee as the Special Committee owed a fiduciary duty to act in the best interests of the company."; "By its Resolution, the Board authorized the Special Committee to retain counsel to conduct an investigation 'on behalf of the company.'"; "Under Delaware law, the Board could not authorize the Special Committee to act solely on behalf of investors. Such authorization would violate the Board's fiduciary duty to Le-Nature's. . . . [U]nder Delaware law, the Special Committee only could act in the best interests of Le-Nature's and its shareholders." (last alteration in original); "K&L Gates retained P&W to provide, inter alia, consulting, financial and investigative advice to K&L Gates 'to assist it in rendering legal advice to Le[-]Nature's.'" (alteration in original); "In addition to the foregoing, the Amended Complaint asserts that K&L Gates provided a draft of its Report not only to the Special Committee, but also to Podlucky. . . . Podlucky was not a member of the Special Committee."; also reversing the trial court's finding that the liquidation trustee could not seek damages because the company was already insolvent when K&L Gates prepared its report; the "trial court rejected Trustee's claim for damages because Le-Nature's was insolvent at the time K&L Gates prepared its Report in December 2003"; "[W]e conclude that Trustee seeks traditional tort damages. The fact of Le-Nature's insolvency does not negate the harm allegedly resulting from K&L Gates's professional negligence."; "Despite the fact that other courts may have determined that similar complaints involving Le-Nature's have alleged deepening insolvency as damages, we conclude that the Complaint before this Court does not, under Pennsylvania law."; "According to the Amended Complaint, these damages were reasonably foreseeable and K&L Gates's malpractice enabled Podlucky and the interested directors to continue their fraudulent activity.").

investigation" into the executives' resignations.[10] The board appointed three independent directors to serve on the Special Committee, who then determined that "it was critical to retain on behalf of the company, legal counsel with experience in conducting such investigations."[11] (emphases added)).

The Special Committee retained K&L Gates to conduct the investigation "on behalf of the Company." The law firm's retainer letter with the Special Committee contained the following paragraph:

> We understand that we are being engaged to act as counsel for the special committee and for no other individual or entity, including the Company or any affiliated entity, shareholder, director, officer or employee of the Company not specifically identified herein. We further understand that we are to assist the Committee in investigating the facts and circumstances surrounding the aforementioned resignations and assist the Special Committee in developing any findings and recommendations to be made to the full Board of the Company with respect thereto. The attorney-client relationship with respect to our work, including our work product, shall belong to the Committee. Only the Committee can waive any privilege relating to such work.

Id. at 743.

To assist the investigation, K&L retained a financial expert, P&W, pursuant to a retainer letter that contained the following sentence:

> P&W shall provide general consulting, financial accounting, and investigative or other advice as requested by K&L [Gates] to assist it in rendering legal advice to Le[-]Nature's.

Id. at 744 (alterations in original) (emphasis added). Thus, someone at K&L Gates probably used an off-the-shelf retainer letter when the firm hired a forensic accountant

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10 Id. at 742.

11 Id.

to assist in its investigation. But the retainer agreement identified the client as the company, -- which was inconsistent with K&L Gates's own retainer letter specifying that the firm represented the Special Committee and explicitly disclaiming representation of the company.

K&L Gates later sent a draft of its report to Podlucky, even though he was not a member of the Special Committee. The firm found no widespread fraud, and was later retained by Podlucky on behalf of the company to help with an initial IPO.

After new allegations of fraud, the company was placed in the hands of a custodian, and later declared bankruptcy.

The appellate court acknowledged that the trial court dismissed the claims against K&L Gates because the firm had been retained "solely to protect the interests of the remaining equity holders," rather than the company itself. Id. at 748.

The appellate court nevertheless reversed, concluding that

> [t]he averments of the Amended Complaint, taken as true, establish that Le-Nature's, acting through its Board and the Board's Special Committee, sought the legal advice and assistance of K&L Gates. Specifically, Le-Nature's sought K&L Gates's legal advice and assistance in investigating allegations of fraud, and in preparing findings and recommendations for action to be taken by Le-Nature's.

Id. at 749. The appellate court pointed to a number of facts in support of its conclusion.

- "As a committee of the Board, the Special Committee had the fiduciary duty to act in the best interests of not only the shareholders, but also the corporation."[12]

- "Contrary to the arguments of K&L Gates and Ferguson, no conflict of interest existed between Le-Nature's and the Special Committee as the Special

[12] Kirschner v. K&L Gates LLP, 46 A.3d 737, 749 (Pa. Super. Ct. 2012).

Committee owed a fiduciary duty to act in the best interests of the company."[13]

- "By its Resolution, the Board authorized the Special Committee to retain counsel to conduct an investigation 'on behalf of the company.'"[14]
- "Under Delaware law, the Board could not authorize the Special Committee to act solely on behalf of investors. Such authorization would violate the Board's fiduciary duty to Le-Nature's. . . . [U]nder Delaware law, the Special Committee only could act in the best interests of Le-Nature's and its shareholders."[15] (emphasis added)).
- "K&L Gates retained P&W to provide, inter alia, consulting, financial and investigative advice to K&L Gates 'to assist it in rendering legal advice to Le[-]Nature's.'"[16] (emphasis added)).
- "In addition to the foregoing, the Amended Complaint asserts that K&L Gates provided a draft of its Report not only to the Special Committee, but also to Podlucky. . . . Podlucky was not a member of the Special Committee."[17]

The appellate court also concluded that that liquidation trustee was seeking traditional tort damages from the law firm, which negated the relevance of whether or not the company was insolvent at the time K&L Gates provides its report.[18]

K&L Gates unsuccessfully sought the Pennsylvania Supreme Court's review of the appellate court's reinstatement of the malpractice action against it.

- Gina Passarella, K&L Gates' Appeal of Le-Nature's Trustee $500 Mil. Suit Denied, Legal Intelligencer, Apr. 25, 2013 ("The Pennsylvania Supreme Court has declined to take a case in which K&L Gates was appealing the reinstatement of a $500 million lawsuit against the firm by the trustee of

13 Id. at 749 n.3.

14 Id. at 749.

15 Id. at 749-50.

16 Id. at 750.

17 Id. at 750.

18 The court pointed to the theory of "deepening insolvency," but found that the complaint did not allege such a theory. "Despite the fact that other courts may have determined that similar complaints involving Le-Nature's have alleged deepening insolvency as damages, we conclude that the Complaint before this Court does not, under Pennsylvania law." Id. at 753 n.6.

bankrupt bottling company Le-Nature's."; "K&L Gates and co-defendant accounting firm Pascarella & Wiker had asked the justices to review the Superior Court decision to reinstate the professional negligence and breach of fiduciary duty case against them. The high court denied that request in a one-page order late Wednesday."; "K&L Gates and Pascarella & Wiker had argued the firms only had a duty to the special committee of Le-Nature's that hired them in 2003, and not to a trustee of the now-bankrupt company. Allegheny County Court of Common Pleas Senior Judge R. Stanton Wettick Jr. agreed, finding they had no obligation beyond the special committee and that the trustee could not claim damages for deepening insolvency of the company between the 2003 internal investigation and the 2006 collapse of the company."; "But Superior Court Judge John L. Musmanno said in his May 2012 opinion that the special committee had a duty to the company and K&L Gates was providing legal services to Le-Nature's through the special committee."; "'K&L Gates was retained to investigate the exact type of injury being inflicted upon Le-Nature's,' Musmanno said. 'By negligently conducting its investigation, K&L Gates affirmatively caused harm to Le-Nature's by concealing the looting of the company and wrongdoing by [former chief executive officer Gregory J.] Podlucky, and affirmatively representing that no evidence of fraud or misconduct existed.'"; "The amici law firms had argued in their brief to the Superior Court that 'for the first time,' the court ruled 'an implied attorney-client relationship could be inferred from circumstantial evidence even where two sophisticated parties have entered into a representation agreement that expressly disavows that such a relationship exists.' They argued the engagement letter between K&L Gates and the special committee expressly disavowed any relationship between the law firm and Le-Nature's.").

Perhaps not surprisingly, the law firm eventually settled the malpractice case -- paying nearly $24 million.

- Dan Packel, <u>K&L Gates' $24M Malpractice Deal OK'd In Le-Nature's Case</u>, Law360, Feb. 27, 2014 ("A Pennsylvania bankruptcy judge on Thursday approved a $23.75 million settlement between K&L Gates LLP and the liquidation trustee of defunct drink maker Le-Nature's Inc. in a legal malpractice case, a day after the accounting firm serving as co-defendant dropped its opposition.").

<u>Best Answer</u>

The best answer to this hypothetical is **(D) THE CORPORATION (ACTING THROUGH THE BOARD OF DIRECTORS)**. B 8/16

Resolving Intra-Corporate Disputes

<u>Hypothetical 2</u>

One of your law school classmates is interviewing for in-house law jobs. She is a careful planner, and she wants your reaction to two issues, "just in case they come up."

(a) If state law and the governing corporate documents require a majority board of directors vote to fire the company's lawyer, may she continue to represent the corporation if the board deadlocks on a motion to fire her?

(A) <u>YES</u>

(b) If the head of one corporate division gives your roommate direction that is contrary to the direction from the head of another corporate division, must she follow it?

(B) <u>NO (SHE SHOULD SEEK DIRECTION FROM A CORPORATE SUPERIOR)</u>

(c) If the head of a wholly-owned subsidiary gives her direction that is contrary to that given by the CEO of the corporate parent (her employer), must she follow it?

(B) <u>NO</u>

(d) If the head of a partially owned (but controlled) subsidiary gives her direction that is contrary to that given by the CEO of the majority - owning corporation (her employer), must she follow it?

<u>MAYBE</u>

<u>Analysis</u>

Lawyers representing corporations owe their duty to the corporation as an entity, not to any of its constituents. ABA Model Rule 1.13(a).

This basic rule seems easy to understand in the abstract, but can result in enormously difficult ethics situations for in-house and outside lawyers representing corporations.

Among other things, there might be some question about the identity of the client of a corporation's law department. ABA Model Rule 1.0 cmt. [3] explains that "[w]ith respect to the law department of an organization, including the government, there is ordinarily no question that the members of the department constitute a firm within the meaning of the Rules of Professional Conduct. There can be uncertainty, however, as to the identity of the client. For example, it may not be clear whether the law department of a corporation represents a subsidiary or an affiliated corporation, as well as the corporation by which the members of the department are directly employed."

(a) In-house and outside lawyers generally must follow the direction of a corporate client's duly-elected board.

If the board must follow a certain procedure to terminate the lawyer, the lawyer may continue representing the corporation until the board takes the required action.

- Virginia LEO 930 (6/11/87) (it is not improper per se for a lawyer to continue representing a corporate board when two members of the board are satisfied with the lawyer and two are not; the lawyer must serve the interests of the board as a whole).

Lawyers ignoring these principles can face serious consequences.

- Eagle Forum v. Phyllis Schlafly's American Eagles, Case No. 3:16-cv-946-DRH-RJD, 2018 U.S. Dist. LEXIS 53284 at *3, *3-4, *5, *7, *9, *9-10 (S.D. Ill. Mar. 29, 2018) (addressing a situation in which two Eagle Forum board members retained lawyer Rohlf on behalf of that corporation "to provide … 'representation and counsel with respect to governance matters, Board disputes and litigation as necessary'"; noting that Rohlf's firm entered an appearance on Eagle Forum's behalf in an Illinois state court action filed by other Board members (which named Eagle Forum as a nominal defendant); explaining that those other Board members soon exercised their power "as the majority of the Eagle Forum Board of Directors" to suspend Eagle Forum's President and Treasurer – and sought to depose Rohlf; further explaining that Plaintiffs (having a Board majority) argued that "Eagle Forum, not Joel Rohlf, controls its privilege and can waive it" and that Eagle Forum's privilege "did not, and could not, pass to the individual Plaintiffs from the control group . . . who retained [Rohlf] for the purpose of preventing the individual Plaintiffs from taking control of the organization"*;* rejecting Rohlf's argument that the "clear fissure in Eagle Forum's Board and management" was "an occurrence akin to an acquisition"; ultimately concluding that "at all relevant times hereto [Plaintiffs] constituted the majority of Eagle Forum's Board of Directors" – and therefore "have had control over Eagle Forum, and ultimately its privilege").

- Ky. Bar Ass'n v. Hines, 399 S.W.3d 750, 769 (Ky. 2013) (suspending for two years a lawyer who ignored a majority of a board and filed an action on behalf of the corporation; "[T]he simple fact is that Hines [lawyer] was hired by the corporation, which acts through its board and officers. . . . If some of the board members and shareholders were dissatisfied, they had remedies available, namely, a shareholder derivative suit. But that is not what Hines did. Instead, he filed suit directly on behalf of the corporation. He even admitted that his suit should have been a shareholder derivative suit as the litigation progressed. The fact that some of the board and shareholders were dissatisfied did not justify Hines's decision to side with them and presume they were the lawful controllers of the company, and then to file suit directly on behalf of the corporation."; "In fact, the decision whether to pursue litigation directly on behalf of the corporation is lodged solely with the board of directors." (emphasis added)).

(b) Lawyers representing corporations may also represent their divisions, but must take direction from the ultimate source of the corporation's authority.

The Restatement explains that lawyers representing corporate clients with separate divisions must follow the corporate client's decision-making process. This gives the corporation ultimate authority.

> Whether a lawyer represents affiliated organizations as clients is a question of fact. . . When a lawyer represents two or more organizations with some common ownership or membership, whether a conflict exists is determined primarily on the basis of formal organizational distinctions. If a single business corporation has established two divisions within the corporate structure, for example, conflicting interests or objectives of those divisions do not create a conflict of interest for a lawyer representing the corporation. Differences within the organization are to be resolved through the organization's decision-making procedures.

Restatement (Third) of Law Governing Lawyers § 131 cmt. d (emphasis added).

(c) Unlike corporate divisions, corporate subsidiaries are separate incorporeal entities.

But wholly- owned subsidiaries implicate essentially the same principle as that applicable in the context of divisions. That is because the subsidiaries and their employees (as well as their lawyers) all owe a fiduciary duty to the ultimate corporate parent.

The Restatement recognizes this basic approach.

> If an enterprise consists of two or more organizations and ownership of the organizations is identical, the lawyer's obligation is ordinarily to respond according to the decision-making procedures of the enterprise, subject to any special limitations that might be validly imposed by regulatory regimes such as those governing financial institutions and insurance companies.

Id.

A lengthy and thoughtful 2008 New York City LEO explained the same principle in more detail.

- New York City LEO 2008-02 (2/1/08) ("In analyzing the conflicts facing inside counsel who 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. 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). 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.";"It is inevitable that on occasion parents and subsidiaries will see their interests diverge, particularly in spin-off, sale, and insolvency 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 <u>Polycast [Tech. Corp. v. Uniroyal, Inc.</u>], 125 F.R.D. [47, 49 (S.D.N.Y. 1989)], and <u>Medcom Holding Co. v. Baxter Travenol Lab</u>.], 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."; "<u>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</u>. 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."; "<u>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 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</u>.' <u>Anadarko Petroleum Corp. v. Panhandle E. Corp.</u>, 545 A.2d 1171, 1174 (Del. 1988)."; "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. <u>Weinberger v. UOP, Inc.</u>, 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)."; "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."; "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."; "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."; "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."; "Alternatively, inside counsel can limit the representation of one or more affiliates to avoid conflicts."; "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." (emphases added)).

There may also be attorney-client privilege protection implications. One would think that communications between a corporate parent's in-house or outside lawyer with wholly-owned subsidiaries' employees would automatically deserve privilege protection if they otherwise meet the required content standard.

But at least one court required the corporate affiliates even in this setting to establish that the affiliates had a common legal interest.

- Au New Haven, LLC v. YKK Corp., No. 15-CV-03411 (GHW)(SN), 2016 U.S. Dist. LEXIS 160602, at *10, *20 (S.D.N.Y. Nov. 18, 2016) (rejecting

> defendants' argument that "entities under common ownership sharing privileged information are always considered to be a single entity for the purpose of attorney-client privilege" protection; instead holding that "[e]ntities that are under common ownership must still demonstrate that [the common interest doctrine] applies, such as by making a showing that a common attorney was representing both corporate entities or that they otherwise shared a common legal interest"; ultimately finding the privilege applicable).

This may seem more complicated than it really is -- because essentially by definition a corporate parent and its wholly-owned subsidiary must always share a common legal interest (the parent's).

(d) In the context of subsidiaries that are only partially owned (but still controlled) by the corporate parent, lawyers must bear in mind that the subsidiary has other owners whose interests must be protected (and which may differ from that of the majority-owning corporate parent).

The Restatement recognizes this key distinction.

Under the Restatement's analysis, the issue becomes complicated in the case of subsidiaries that are less than wholly-owned.

> On the other hand, when ownership or membership of two or more organizations is not identical, the lawyer must respect the organizational boundaries of each and analyze possible conflicts of interest on the basis that the organizations are separate entities. That is true even when a single individual or organization has sufficient ownership or influence to exercise working control of the organizations. . . .

Restatement (Third) of Law Governing Lawyers § 131 cmt. d. An illustration provides additional guidance.

> A Corporation owns 60 percent of the stock of B Corporation. All of the stock of A Corporation is publicly owned, as is the remainder of the stock in B Corporation. Lawyers has been asked by the President of A Corporation to act as attorney for B in causing B to make a proposed

> transfer of certain real property to A at a price whose fairness cannot readily be determined by reference to the general real-estate market. Lawyer may do so only with effective informed consent of the management of B (as well as that of A). The ownership of A and B is not identical and their interests materially differ in the proposed transaction.

Id. illus. 2.

The extensive 2008 New York City LEO explains the implications of this very different scenario involving partially-owned but controlled subsidiaries.

- New York City LEO 2008-02 (2/1/08) ("In analyzing the conflicts facing inside counsel who 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. 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). 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.";"It is inevitable that on occasion parents and subsidiaries will see their interests diverge, particularly in spin-off, sale, and insolvency 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."; "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. 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 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)."; "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)."; "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."; "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."; "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."; "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."; "Alternatively, inside counsel can limit the representation of one or more affiliates to avoid conflicts."; "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." (emphases added)).

A 2017 Illinois LEO provided cautious and probably rarely – followed advice about in- house lawyers best practices. Although apparently not limited to this partially - owned subsidiary context, the Illinois LEO's guidance is most appropriate there.

- Illinois LEO 17-05 (5/2017) (analyzing the loyalty (conflicts) and confidentiality implications of parent company's in-house lawyer's dealings with corporate subsidiaries of the lawyer's client/employer; recommending: (1) that lawyer treat subsidiaries as separate clients for loyalty/conflicts purposes, including even obtaining consents or prospective consents in the event of any "competing interests"; and (2) also treat subsidiaries as separate clients for confidentiality purposes, including even analyzing how confidential information will be shared among the corporate affiliates; "<u>For the in-house lawyer, there is no one size fits all test for identifying the client. It may change depending on the circumstances of the representation</u>. Is it the single corporate parent (whose interests may be considered to preempt the interests of any subsidiary, or in any case, be able to provide informed consent to any conflict waiver or disclosure of confidential information)? Or is it the legally distinct individual subsidiaries? Recognizing subsidiaries as separate clients seems to be acknowledged in the IRPC noted above, particularly IRPC 1.13. For practical purposes, <u>treating subsidiaries as distinct clients would seem the better practice if for no other purpose than to focus the in-house lawyer's attention on identifying and addressing problematic legal and ethical issues</u>."; "With respect to conflicts of interests, when an in-house lawyers is called upon to provide legal services to a related corporate entity that is not the lawyer's direct employer, the lawyer must be careful to recognize the potential for competing interests. . . . As with any representation, the in-house lawyer must consider and, if applicable, apply IRPC 1.7. Although impacted by client identification, the interests of intra-family corporate entities may or may not be considered aligned. <u>If the interests are determined to conflict, an in-house</u>

> lawyer can consider a number of actions to address and resolve the conflict. First and foremost is to obtain, if possible, the subsidiary's and parent's consent to the representation as permitted by IRPC 1.7(b). Counsel may also consider obtaining advance conflict waivers, limiting the scope of the representation to eliminate the potential conflict, or retaining outside counsel."; "Perhaps even thornier issues than conflicts arise with respect to confidentiality under IRPC Rule 1.6. Virginia State Bar Opinion 1838 provides that an in-house lawyer must maintain a subsidiary's confidences unless the subsidiary consents to disclosure. In most corporate contexts, maintaining this confidentiality from the corporate parent, and perhaps other subsidiaries, is likely unworkable and doesn't reflect the work of an in-house legal department. . . . Attempting to maintain confidentiality between related corporate entities, but particularly between a subsidiary and a parent, tends to disregard corporate ownership and hierarchy. . . . In these situations, as with conflicts of interest, a prudent course for the in-house lawyer may be to memorialize in writing how confidential information will be treated, obtain advance consent for disclosure, or retain outside counsel.") (emphases added)).

Thus, a subsidiary that is less than wholly-owned by its controlling parent must be considered a separate entity for conflicts, ethics and legal purposes. Of course, the controlling parent's lawyer may also represent the subsidiary. That normally would be a joint representation, with all the ethics, privilege and other implications of such representations. Among the most important implication is such lawyer's duty to avoid representing the corporate parent in oppressing or otherwise harming minority shareholders. This duty does not make those minority shareholders the lawyer's clients – it means that the lawyer must take the minority shareholders' interest into account when representing the corporation of which the shareholders are partial owners.

<u>Best Answer</u>

The best answer to **(a)** is **(A) YES**; the best answer to **(b)** is **(B) NO (SHE SHOULD SEEK DIRECTION FROM A CORPORATE SUPERVISOR)**; the best answer to **(c)** is **(B) NO**; the best answer to **(d)** is **MAYBE**.

B 8/16

Identifying the Client Within a Closely-Held Corporation

Hypothetical 3

You have represented a closely-held corporation for several years, dealing with each of the two owners and many of the corporation's employees. The two owners have been quarreling more vigorously than usual lately, and you wonder what that means for your representation.

If the two owners become acutely adverse, can you represent the corporation and one of the owners in litigation against the other owner?

MAYBE

Analysis

Identifying the client in the corporate context can become more difficult with closely-held corporations.

This corporate context differs from the perhaps even more difficult analysis facing lawyers who represent partnerships or LLCs (which share some of the characteristics of both corporations and partnerships).

- Sprengel v. Zbylut, No. B256761, 2015 Cal. App. LEXIS 971, at *1-2 (Cal. Ct. App. Oct. 29, 2015) (adding a footnote to a previous opinion; "'Defendants contend that, in this particular case, we may reject Sprengel's claim of an implied attorney-client relationship under the first prong of the section 425.16 test because (1) the undisputed evidence shows they 'were hired only to represent the LLC [Purposeful Press],' not Sprengel and (2) under 'settled,' 'black letter law,' an attorney for an LLC owes no professional duties to the LLC's individual members. Even if we were to assume that defendants' evidence established they were properly retained to represent the LLC only (a fact Sprengel disputes), <u>defendants have cited no authority holding that an attorney for an LLC has no obligations to the LLC's individual members. Instead, defendants rely solely on cases holding that an attorney for a corporation generally does not represent the corporation's officers or shareholders in their individual capacities. . . . Our courts have applied a different rule in the context of partnerships, explaining that a five-part factual inquiry is used to 'determine whether in a particular case the partnership</u>

attorney has established an attorney-client relationship with the individual partners.'" (emphasis added) (citations omitted)).

- Rahmani v. Venture Capital Properties LLC, No. 650655/2015, 2016 NY Slip Op 31976(U), at 2-3 (N.Y. Sup. Ct. Oct. 17, 2016) (disqualifying a lawyer from representing a plaintiff in an arbitration adverse to an LLC and two of the LLC's members, because the lawyer was representing the LLC in other matters; "In this case, Mr. Castro seeks to represent plaintiffs in the JAMS arbitration against defendant VCP while simultaneously representing VCP in three litigations in this court. When an attorney represents a limited liability company, he is deemed as a matter of law to represent each of its members (see Flores v. Williard j. Price Assocs, LLC, 20 AD 3d 343, 344, 799 N.Y.S.2d 43 [1st Dept 2005]; see also Steven's Distribs., Inc., 2010 NY Slip Op 31839[U], 2010 NY Misc LEXIS 336 at *16). Accordingly, by virtue of Castro's representation of VCP, Castro also represents the individual defendants Ebi Khalili and Josh Ramani because they are members of VCP. Thus, by representing plaintiffs in the arbitration against defendants, he is effectively 'suing his client,' in violation of Rule 1.7.").

Lawyers representing joint ventures face their own set of challenges. A "contract" joint venture is not a separate legal entity, but instead involves the joint venture partners each contributing some of their own employees to work on a cooperative effort alongside employees from the other partner. It is not difficult to imagine both the conflicts and the privilege implications of that scenario.

In contrast, an "entity" joint venture is essentially a closely held corporation.

This document does not analyze lawyers' special difficulties in representing their clients involved in joint ventures, or representing joint ventures themselves. But it is worth noting the malpractice risk that those lawyers face.

- Nelson Bros. Prof'l Real Estate, LLC v. Freeborn & Peters, LLP, 773 F.3d 853, 855, 857-58 (7th Cir. 2014) (upholding a $1,000,000 jury award against a law firm for favoring one member of a joint venture over another member; "Representing as he did a joint venture of Alliance Equities and Nelson Brothers, Hannon was obligated to be loyal to both. The plaintiffs argue that he breached his duty to them in a variety of respects, for example by favoring Alilance Equities, his original client, over Nelson Brothers."; "Freeborn & Peters argued at trial that it didn't represent the plaintiffs at all, but that is

> wrong. It represented both parties to the joint venture, Alliance Equities and Nelson Brothers, and Nelson Brothers and the Nelsons are inter-changeable. A reasonable jury could find that the law firm violated its ethical obligations to the plaintiffs by not warning them of the firm's conflicts of interest, by drafting agreements that reflected favoritism toward Alliance Equities and concealing the favoritism from the plaintiffs (as by not revealing that Alliance Equities would be controlling the below-$50,000 expenditures – which later resulted in the decision to pay the law firm $49,999 owed to the gap lender), and by failing to advise the plaintiffs of the risks to them created by the badboy guarantees and the mechanics' liens on the shopping center, and finally by closing the deal for the shopping center without providing for an escrow to cover the liens.").

<u>Explicit Representations in the Context of Closely-Held Corporations</u>

Only a surprisingly few number of cases deal with the ethics implications of lawyers representing closely-held corporations. The cases focus on a number of topics involving the ramifications of attorney-client relationships. Of course, the most acute problems involve lawyers' ability to represent a closely-held company against one of its owners, or jointly represent the company and one owner against another owner. In other cases, courts address the ability of a closely-held corporation's owner to file a malpractice action against the company's lawyer. Some cases discuss an owner's attempt to obtain the company lawyer's files.

Before turning to the majority "default" rule and the minority rule applying to lawyers who represent closely-held corporations, it is worth noting an obvious point.

Lawyers can intentionally represent a closely-held corporation and/or its constituents. Those representations can be sole representations, or joint representations. Importantly, any intentionally represented corporation or constituent deserves all the rights that clients possess, absent some contractual limitation in a retainer agreement or elsewhere.

It should go without saying that a lawyer representing a closely-held corporation or similar entity must follow that entity's governing documents in her retention and representation.

- Morristown Heart Consultants, PLLC v. Patel, No. E2018-01590-COA-R9-CV, 2019 Tenn. App. LEXIS 362, at *18-19, *19-22 (Tenn. Ct. App. July 24, 2019) (addressing a situation in which two doctors owned a PLLC; noting that the doctor who owned 50 percent of the financial rights and 66 percent of the governing rights hired a lawyer to represent the PLLC in advising it about the doctors' memorandum of understanding and the effect of the other doctor's suspension by a hospital; noting that the other doctor, with 50 percent financial ownership but only 33 percent of the governing rights, sought access to the lawyer's files; acknowledging that the doctor who hired the lawyer had the majority of governing rights, but explaining the operating agreement required actions such as retaining counsel to be discussed and voted on at an official PLLC meeting; also pointing to the "at issue" waiver doctrine; finding no reversible error in the trial court's granting the 33 percent owner doctor access to the lawyer's files; noting that the trial court had found that the managing member doctor had not followed the proper procedure for voting on the lawyer's retention or arranging for the other doctor's written consent under the Operating Agreement – meaning that PLLC "had not properly authorized" the lawyer's hiring).

In 2003, the California Bar dealt with a lawyer who was simultaneously representing a closely-held corporation and a CFO (on unrelated personal matters). California LEO 2003-163 (2003).

The Bar dealt with two scenarios -- in which either the CFO himself or the corporation's President informed the lawyer about the CFO's possible sexual harassment of several company employees. The Bar outlined the two scenarios as follows:

> Lawyer serves as an outside attorney for a closely-held corporation, Corp. Lawyer handles most of Corp's general legal matters, including alerting Corp to, and advising Corp about, potential liabilities. Corp has been run for some time by its two principal shareholders, Prexy, the President, and CFO, the Chief Financial Officer, who are old friends.

> Lawyer has represented CFO on a number of personal matters not related to Corp. Some of CFO's personal matters remain pending, including the purchase and sale of real and personal property, a reckless driving charge, and family matters. Most recently, CFO consulted Lawyer on a modification of a support matter relating to his former marriage, and this support issue remains open. Lawyer does not represent Corp and CFO as joint clients on any single matter.
>
> Lawyer learns that CFO might have sexually harassed several Corp employees. We are asked to consider Lawyer's duties if she learns of the possible sexual harassment in either of two ways: (1) CFO goes to Lawyer's office and asks to speak to Lawyer privately on a 'personal matter,' Lawyer asks CFO to continue, and CFO admits incidents of sexual harassment; or (2) Prexy tells Lawyer that Prexy has learned of a particular incident of sexual harassment by CFO, plus rumors of several others, and needs Lawyer's advice concerning what Corp should do.

Id.

The California Bar explained that if the CFO himself provided the information, the lawyer had to keep it secret from the corporate client.

> Assuming that CFO did have an objectively reasonable basis for believing that CFO was speaking to Lawyer in confidence as CFO's personal attorney, then Lawyer's duty to preserve CFO's secrets would prevent Lawyer from revealing any information about the sexual harassment that Lawyer learned directly from CFO or as a result of her representation of CFO. Such information would be embarrassing or detrimental to CFO. This restriction means that Lawyer could not reveal CFO's admitted harassment to anyone affiliated with Corp, including Corp's Board or Prexy.

Id.

Because maintaining the confidentiality of the information would "impede Lawyer's ability to discharge her duties to Corp," the lawyer would have to withdraw from representing the closely-held corporation if the CFO did not consent to the lawyer's disclosure to the corporation of the protected client information about his alleged sexual harassment. Id.

> If CFO denies Lawyer permission to share with Corp the information that CFO has given to Lawyer, then Lawyer must withdraw from representing Corp on those matters to which the confidential information given to the lawyer by CFO is pertinent.

Id.

In the second scenario, the lawyer acquired information from the President about the CFO's possible sexual harassment. That scenario involved a completely different conclusion.

Although the lawyer obviously could discuss the pertinent information with the company's executives, the lawyer could not give advice adverse to her other client (the CFO) -- even though the lawyer's representation of the CFO on personal matters bore no relationship to the company.

> We now turn to the second variant of the hypothetical, which posits that Lawyer learns of CFO's alleged harassment from Prexy, the President of Corp, not from CFO. Under these facts, Lawyer learns the information about CFO as a result of Lawyer's representation of Corp, not CFO. Thus, Lawyer is not obligated to treat the information as CFO's client secret. Nevertheless, Lawyer still faces a potential conflict between Lawyer's duties to Corp and Lawyer's duty of loyalty to CFO. . . . If Lawyer were to provide advice to Corp about how to react to the allegations that CFO has committed sexual harassment, then Lawyer will be giving legal advice to Corp that is adverse to CFO. Such advice would almost certainly involve potential adverse employment consequences to CFO, as well as civil liability.

Id.

Because the lawyer could not "cure the conflict by unilaterally dropping CFO as a client," the lawyer could advise the company about the sexual harassment only with the CFO's consent -- which the lawyer could request only if the company authorized the disclosure of the company's protected client information to the CFO. Id. And the CFO's failure to consent would require the lawyer's withdrawal from representing the company on that matter.

> If Corp will not allow Lawyer to seek CFO's consent, or if CFO declines to waive the duty of loyalty, then Lawyer must withdraw from representing Corp if Lawyer cannot advise Corp competently without violating Lawyer's duty of undivided loyalty to CFO. Lawyer is obligated to withdraw from representing Corp only to the extent necessary to resolve the conflict of interest. On the facts presented to us, we believe that Lawyer would have to withdraw from her representation of Corp to the extent that Lawyer's representation includes identifying and assessing potential claims against Corp arising from CFO's conduct.

Id.

These principles apply with equal force to all corporations and their constituents, but lawyers representing clients in a closely-held corporation context are more likely to intentionally represent constituents -- thus triggering all of the dilemmas involving confidential information and conflicts.

In 2014, a New Jersey court dealt with conflicts within a closely-held corporation. Comando v. Nugiel, 93 A.3d 377 (N.J. Super. Ct. App. Div. 2014). In that case, a law firm representing a closely-held corporation and one of its two owners faced a disqualification motion filed by the other owner. She claimed that the law firm had also represented her on related matters. The court described the law firm's work for the closely-held corporation.

> In early 2011, Comando [owner seeking the law firm's disqualification] and Nugiel [other owner] formed 10 Centre [closely-held corporation] as a holding company to acquire and manage real property that would become RCP's [tenant owned by Nugiel] headquarters. According to Nash [lawyer], Nugiel requested [Nash] and NMM [Nash's law firm] to provide legal representation in "(1) the formation of the limited liability company, (2) preparation of the RCP lease for the property, (3) preparation of an operating agreement for [10 Centre], and (4) [assistance] with legal issues surrounding obtaining the financing needed by [10 Centre] to purchase the new headquarters" for RCP. There is no mention of the preparation or existence of a new engagement letter for these new legal services and nothing to explain what role Comando had in engaging NMM.
>
> NMM incorporated 10 Centre and served as its registered agent. In preparation of 10 Centre's operating agreement, Nash acknowledged he conducted conference calls with Nugiel and Comando, summarized provisions of the drafted documents, and emailed a memo to both Nugiel and Comando regarding modifications of the agreement terms.
>
> Nash also assisted with the preparation, modification and execution of an 'agreement for purchase and sale' of the realty ultimately acquired by 10 Centre. In the purchase of the realty, Nash assisted with the preparation, review and execution of several agreements related to the intricate multi-million dollar acquisition and the financing and re-financing of a bridge loan. It is unclear whether he provided individual legal advice to Nugiel regarding this transaction, while also acting as 10 Centre's counsel. Nash also drafted a lease agreement allowing RCP to lease the property acquired by 10 Centre for twenty years at a flat rent. In this regard, Nash insists he took direction from Nugiel and "never gave [] Comando any personal advice or counsel on those issues."

<u>Id.</u> at 380-81 Ialterations in original).

In resisting the owner's disqualification motion, the law firm relied on one of its lawyer's memoranda "accompanying transmittal of 10 Centre's proposed operating agreement, in which he stated":

> "As an initial matter (and as you both know) I must stress that I represent [Nugiel] and RCP [] in several matters. I have drafted the attached based on your instructions, but <u>I do not represent [Comando] in connection with these matters.</u> [Comando], this operating agreement is a complicated document, I advise you to obtain separate counsel to advise you and advocate for your interests in connection with the attached. Review of this cover note is not a substitute for a careful review of the attached with your own counsel. Please let me know if you would like me to refer an attorney to you. "

<u>Id.</u> at 381 (alterations in original) (emphasis added).

However, the court rejected the lawyer's argument that his law firm had never represented Comando.

> <u>This assertion contradicts</u> his claim of serving as counsel for the corporation not its members and also <u>his written representations contained in an opinion letter delivered to TD Bank in respect of the highly complex financing arrangement. In issuing his legal opinion, Nash stated NMM "acted as special counsel</u> to 10 Centre Drive, LLC (the 'Borrower'), RCP Management Company, Inc. (the 'Equity Guarantor') and Mary Faith Radcliffe and <u>Elizabeth Comando</u> (each, an 'Individual Guarantor' and collectively, the 'Individual Guarantors') in connection with the closing . . . of a $1,500,000 mortgage loan from you to Borrower (the 'First Mortgage Loan') and a $350,000 bridge loan from you to Borrower (the 'Bridge Loan,['] and together with the First Mortgage Loan, the 'Loan Facilities')."

<u>Id.</u> at 381 (emphases added).

The court found that the law firm had represented Comando, and criticized the trial court for not having conducted an evidentiary hearing focusing on the extent of that representation.

> [W]e conclude the record is far too limited and contains material factual disputes making this court unable to discern the full extent and nature of NMM's prior legal representation of Comando, which could only have been determined following an evidentiary hearing. <u>The evidence certainly shows NMM provided limited legal services to her</u> and also rendered extensive legal services to 10 Centre, as well as RCP and Nugiel. . . . Regarding Comando's claim of disqualification based on her prior representation, although <u>we conclude the judge inaccurately found NMM provided no legal representation to her</u>, the record does not allow this court to fully assess the extent and nature of that representation. Nevertheless, NMM's complete withdrawal renders the question moot.

<u>Id.</u> at 379-80 (emphases added).

The law firm apparently saw the handwriting on the wall, because it had already withdrawn from representing the closely-held corporation by the time the court dealt with the now-moot disqualification motion.

Even more recently, a California court carefully analyzed the status of a lawyer's attorney-client relationship with a closely-held corporation -- ultimately concluding that the law firm's current representation of the corporation prevented the firm from representing one of its owners against the corporation itself.

- <u>M'Guinness v. Johnson</u>, 196 Cal. Rptr. 3d 662, 673, 673-74, 674, 677, 678 (Cal. Ct. App. 2015) (holding that a law firm which represented a corporation owned equally by three shareholders could not represent one of the shareholders in counterclaims against the third shareholder and the company; "Johnson's [one-third owner of TLC, represented by the law firm in counterclaiming against another one-third shareholder and the company] position in opposing the motion was that the Firm had 'concluded its representation of TLC in early March 2012,' and it did <u>'not currently represent</u>

TLC in any matter whatsoever.' But this position is belied by (1) the specific terms of the client agreement, (2) the Law Firm's retention of TLC funds in the Firm's trust account, (3) the Law Firm's billing practices with respect to TLC, (4) the Law Firm's actions up through at least April 2013, and (5) the law addressing an attorney's role as counsel for a corporation."; finding that the law firm continued to represent TLC based on the law firm's retainer agreement; "The Law Firm's client agreement provided: 'Nature of Legal Representation: Advice and representation concerning TLC Builders, Inc. and other general legal work directed by you from time to time.' The agreement thus provided that the Firm's engagement was a broad and open-ended one."; also noting that the law firm retained a retainer amount in its trust account from the company, and continued to bill the company; "In the fifth paragraph of the client agreement, the Firm provided: 'You may terminate our relationship at any time. We may withdraw from representation with your consent or for good cause. . . . At the conclusion of our engagement, at your request and at your cost for any file review, copy and delivery charges, we will review and deliver your files to you, along with any of your funds or property in our possession, charged at our hourly rate.'"; "The terms of the agreement thus evidenced the parties' intent to establish an ongoing attorney-client relationship of an open-ended nature, terminable only by specific methods described in the agreement and under conditions that included the Firm's return of all property and funds to the client. . . . [T]here is no evidence TLC terminated its relationship with the Law Firm at any time. Nothing in the record indicates the Law Firm withdrew from the engagement (either with or without the client's consent)."; concluding that the law firm continued to represent TLC; "The Law Firm's actions controlling and limiting access by two of TLC's shareholders, officers, and directors to the aforementioned records suggest the Firm continued to act as TLC's corporate counsel as late as April 2013."; pointing to the law firm's retention of TLC's (the corporation) funds in its escrow account; after concluding that the law firm continued to represent TLC, disqualifying the law firm from suing a company that it was then currently representing; "Here, the record shows the Law Firm's representation of TLC had not terminated; therefore, the Firm's concurrent representation of TLC and Johnson as opposing parties in the litigation could not continue. Both M'Guinness and Stuart -- like the minority shareholder in Gong [Gong v. RFG Oil, Inc., 82 Cal. Rptr. 3d 416 (Cal. Ct. App. 2008)] -- alleged claims of breach of fiduciary duty against Johnson that involved alleged self-dealing, diversion of corporate opportunities, and wasting of corporate assets that harmed TLC. Under these circumstances, the Law Firm could not defend Johnson against these claims because Johnson's interests conflicted with the interests of the corporation. Additionally, the Law Firm could not act as Johnson's counsel in pursuing his amended cross-complaint that included claims for money against TLC."; "During oral argument, Johnson's counsel asserted that TLC did not have an active role in this case. Instead, he asserted, TLC was merely a stakeholder in a dispute between its three shareholders. But M'Guinness and Stuart alleged that Johnson committed acts that harmed TLC, and Johnson alleged tort claims against M'Guiness and Stuart that included allegations of self-dealing that harmed TLC. Johnson also alleged claims against TLC for money owed, belying the assertion that TLC did not have an active role in the litigation."; "[A]s a matter of corporate law, the Firm's ongoing duty to TLC precluded its representation of Johnson in a lawsuit involving allegations in which the interests of the corporation diverged from those of shareholder litigants. . . . The undisputed facts therefore showed the Law Firm had a concurrent representation conflict of interest that required its disqualification as Johnson's counsel in this case.").

If one closely-held corporation's owner brings his or her lawyers "to the deal," those lawyers may lose sight of their equal duty of loyalty to the owner and to the corporation which that owner only partially owns.

A 1994 Fairfax County Virginia case involved a large law firm lawyer running into this problem.

- Saundra Torry, <u>Judge Takes Firm to Task Over Conflicts of Interest</u>, Wash. Post, June 13, 1994 ("A Fairfax County judge last week hit prominent D.C. lawyer Deanne Siemer and her firm, Pillsbury Madison & Sutro, with a $500,000 legal malpractice judgment, finding that Pillsbury lawyers violated conflict-of-interest rules by siding against their own client, a lobbying firm. In a harshly worded opinion, Circuit Court Judge Jane Roush asserted that Siemer 'willfully ignored' the D.C. Rules of Professional Conduct for lawyers, and that the law firm shared the blame for failing to heed the warnings of junior associates that the 'dual representation . . . was rife with conflicts of interest.' According to trial testimony, when internal tensions erupted at the lobbying firm of Murphy & Demory (a District firm that is incorporated in Virginia), <u>Pillsbury lawyers assisted one partner, retired Adm. Daniel Murphy, in his plans to take control of the small corporation or divert its clients to a new firm, leaving Murphy & Demory to 'wither.' At the time, Pillsbury lawyers represented Murphy & Demory as a corporation, the judge ruled, and owed their allegiance to the entire firm, rather than to any individual officer.</u> The ruling came in a lawsuit filed by the lobbying firm and Willard L. Demory, the partner left behind when Murphy resigned to start a competing lobbying firm. In the midst of the feud between Demory and Murphy, Demory fired Pillsbury and hired John Dowd, of Akin, Gump, Strauss, Hauer & Feld. Demory's lobbying firm later sued Murphy for breach of contract and Pillsbury for malpractice. The judge also awarded Demory's firm $1 million on his claims against Murphy." (emphasis added); "<u>In a July 1992 computer e-mail</u>

message, Siemer [Pillsbury partner] asked [Pillsbury] associate Frazer Fiveash to research whether it was 'feasible for Dan [Murphy] to set up a new corporation and divert new business to [it] . . . while allowing the old corporation to wither. . . .' The message was used as a trial exhibit by the Akin, Gump legal team, which included Larry Tanenbaum, Joseph Esposito and Lucy Pliskin. At some points during the 1992 dispute, Pillsbury billed Murphy & Demory for the work it had done at Murphy's behest -- work that Demory knew nothing about. For instance, Pillsbury sent Murphy & Demory a $662 bill for researching Murphy's options, including forcing the company to dissolve. The bill, signed by Siemer, said the work had been on 'corporate matters.' Siemer, according to court records, later billed the company, at $305 an hour, for some of her time, too." (emphases added); "Siemer, with Pillsbury since 1990 and a onetime partner at Wilmer, Cutler & Pickering, also was haunted at trial by her own ethics expertise. She has written a book, 'Understanding Modern Ethical Standards,' for the National Institute on Trial Advocacy, a nonprofit group that teaches young lawyers how to try cases. Known nationally as a fierce litigator, Siemer is now the institute's chair-elect." (emphasis added)).

More recently, another large law firm faced financial exposure for not carefully identifying the "client."

- Meredith Hobbs, Holland & Knight's Lesson? Get a Disclaimer, Fulton County Daily Report, May 21, 2012 ("Legal malpractice lawyers say the best way for lawyers to protect themselves from the situation Holland & Knight finds itself in – on the hook for $34.5 million in damages for malpractice claims brought by unhappy real estate investors – is by having individuals involved in complex multi-party transactions sign waivers saying the firm doesn't represent them."; "Holland & Knight's lawyers weren't able to persuade the jury that the firm represented only Shailendra Group and some of the development entities the plaintiffs formed with Shailendra – but not the individual plaintiffs themselves, according to court documents."; "Holland & Knight's case could have been bolstered by a waiver specifying that then-partner Reeder Glass didn't represent the plaintiffs individually or provide them legal advice in the series of complex, multi-party real estate deals he handled for Shailendra Group and its investment partners, [Christine Mast, malpractice defense lawyer] said."; "One problem is that lawyers and clients may work on deals over an extended period of time, [Linley Jones, attorney handling plaintiffs malpractice,] said. 'Often they become very chummy. The lines of lawyer, friend and counselor can become blurred. That can make it awkward to send a letter saying you don't represent someone to a person you went to dinner with the night before.'"; "The malpractice lawyers agreed that relationship creep became a pitfall for Holland & Knight. The firm started out representing Shailendra Group, but then formed business entities for

Shailendra and the other investors, according to the public record, said plaintiffs malpractice lawyer Rickman Brown of Evans, Scholz, Williams & Warncke.").

Of course, such explicit representations may require consents from the corporate entity or its majority or minority shareholders.

- Vermont LEO 2014-2 (2014) ("[A] lawyer, who has represented a corporation and its sole shareholder, may subsequently represent the purchaser of the corporate shares and the corporation where the interests are materially adverse, provided that both the former shareholder and the new shareholder give informed consent to such representation, confirmed in writing. In addition, a lawyer may serve as an escrow agent of the pledged stock held as security in the sale, provided that both parties give informed consent.").

It is worth mentioning one more implication of lawyers' explicit representation of a corporation. As explained above, such an attorney-client relationship prevents the lawyer from adversity to the corporation -- absent its consent. This conflict of interest principle sometimes prevents lawyers from litigating against the corporation in intra-corporate control fights.

Closely-Held Corporations' Lawyers' Duty to Minority Shareholders

Lawyers have the power to define or disclaim attorney-client relationships. In a closely-held corporate context, it is even more important that in a normal corporate context to explicitly identify the client or clients. Failure to do so can result in disqualification, malpractice actions, or even worse sanctions.

Unfortunately, even lawyers who properly identify their "client" as only the corporate entity and not any of its individual owners face another dilemma that can affect their duties and (especially in the closely-held context) their day-to-day interactions. This is because lawyers representing corporations owe what might be described as a derivative duty to the minority shareholders. Such a duty does not rest on an attorney-client relationship, but instead on the corporate client's duty not to oppress such minority shareholders. Thus, a lawyer representing a corporation may not advise the corporation to, or assist it in, oppressing minority shareholders.

The Restatement acknowledges this duty:

> (2) Lawyer represents Client, a closely-held corporation, and not any constituent of Client. Under law applicable to the corporation, a majority shareholder owes a fiduciary duty of fair dealing to a minority shareholder in a transaction caused by action of a board of directors whose members have been designated by the majority stockholder. The law provides that the duty is breached if the action detrimentally and substantially affects the value of the minority shareholder's stock. Majority Shareholder has asked the board of directors of Client, consisting of Majority Shareholder's designees, to adopt a plan for buying back stock of the majority's shareholders in Client. A minority shareholder has protested the plan as unfair to the minority shareholder. Lawyer may advise the board about the position taken by the minority shareholder, but is not obliged to advise against or otherwise seek to prevent action that is consistent with the board's duty to Client.
>
> (3) The same facts as in Illustration 2, except that Lawyer has reason to know that the plan violates applicable corporate law and will likely be successfully challenged by minority shareholders in a suit against Client and that Client will likely incur substantial expense as a result. Lawyer owes a duty to Client to take action to protect Client, such as by advising Client's board about the risks of adopting the plan.

Restatement (Third) of Law Governing Lawyers § 96 cmt. g, illus. 2, 3 (2000).

Another Restatement provision similarly explains that lawyers representing corporations might owe duties to some of the corporation's constituents.

> For purposes of identifying conflicts of interest, a lawyer's client is ordinarily the person or entity that consents to the formation of the client-lawyer relationship . . . . For example, when a lawyer is retained by Corporation A, Corporation A is

> ordinarily the lawyer's client; neither individual officers of Corporation A nor other corporations in which Corporation A has an ownership interest, that hold an ownership interest in Corporation A, or in which a major shareholder in Corporation A has an ownership interest, are thereby considered to be the lawyer's client. In some situations, however, the financial or personal relationship between the lawyer's client and other persons or entities might be such that the lawyer's obligations to the client will extend to those other persons or entities as well. That will be true, for example, where financial loss or benefit to the nonclient person or entity will have a direct, adverse impact on the client.

Restatement (Third) of Law Governing Lawyers § 121 cmt. d (2000) (emphasis added)).

Although this principle applies in a normal corporate context, with closely-held corporations the risk of the majority shareholders abusing their status seems much more acute -- which places the corporations' lawyers in a difficult position.

Courts dealing with this scenario have had to reconcile two competing principles: (1) lawyers explicitly or implicitly (by operation of law) representing a closely-held corporation owe duties to the entity, not to its constituents; (2) although such lawyers do not have attorney-client relationships with the minority owners, they may owe some derivative duties to them.

Most courts emphasize the former principle when addressing such issues as disqualification, malpractice, file ownership, etc. A minority of courts emphasize the second principle. These competing approaches are discussed below.

Majority Approach: Lawyers Representing Closely-Held Corporations Can Represent the Corporation (and Sometimes the Majority Owners) Against the Minority Owners

As with all corporations, ABA Model Rule 1.13(a)'s "default" position recognizes that a corporation's lawyer represents the entity rather than any of its constituents.

In the closely-held corporate context, this principle focuses on the presence or absence of an attorney-client relationship with the minority owners. Before turning to many courts' adoption of the general "default" position, it is worth noting that corporate lawyers' arguable "derivative" duty to minority owners can affect those lawyers' ability to represent the corporations even in the absence of an attorney-client relationship with the minority owners. This is discussed below.

In analyzing the existence of an attorney-client relationship and the ability to represent a corporate client against minority shareholders, most courts follow the general "default" rule.

- <u>Weingarden v. Milford Anesthesia Assocs., P.C.</u>, No. NNHCV116016353S, 2013 Conn. Super. LEXIS 1239, at *20, *20-21, *22-23 (Conn. Sup. Ct. May 30, 2013) ("The other basis for the plaintiff's claim under rule 1.9 is that by representing Milford Associates, Mathieson represented the shareholders and thus the plaintiff as a shareholder is a former client of Mathieson. Such an argument is easily rejected in light of clear authority to the contrary. . . . <u>Rule 1.13 makes clear that a shareholder of an organization is not the client of that organization's lawyer absent some set of facts independently creating an attorney-client relationship.</u>" (emphasis added); "This principle is further supported in case law. In the analogous context of partnerships, '[a] partnership usually is a legal entity and is the lawyer's client. Thus a lawyer who represents a partnership does not thereby become counsel or owe a duty to the partners.'" (citation omitted); "The plain language of rule 1.13, the official comment to that rule, appellate case law explaining entity theory and the overwhelming stance taken in other Superior Court decisions makes it abundantly clear that the <u>plaintiff cannot establish an attorney-client relationship with Mathieson simply by relying on his status as a shareholder of an organization that Mathieson represented.</u> The plaintiff would have to demonstrate some other facts creating such a relationship, none of which have been shown here." (emphases added)).

- <u>Nilavar v. Mercy Health Sys.</u>, 143 F. Supp. 2d 909, 914, 915, 917 (S.D. Ohio 2001) (holding that the lawyer who represented a closed corporation did not also represent a major shareholder, and therefore could be adverse to the shareholder; "<u>The fact that SRI was a close corporation does not lead to the conclusion that Plaintiff reasonably believed that he personally had an unrestricted attorney-client relationship with Mehnert.</u> Between 1970 and

1983, SRI consisted of six physician-shareholders . . . . When Dr. Bavendam retired in 1983, the corporation was restructured, with the five remaining principals receiving equal shares in the corporation . . . . At the time, accordingly, Plaintiff would have had a twenty percent (20%) interest in the corporation. By 1991, SRI had approximately eleven principals . . . . Thus, assuming that each principal had an equal interest in the corporation, Plaintiff held approximately a nine percent (9%) interest in SRI at that time. As stated by the <u>Correspondent Servs.</u> [<u>Correspondent Servs. Corp. v. J.V.W. Inv. Ltd.</u>, No. 99 Civ. 8934 (RWS), 2000 U.S. Dist. LEXIS 11881 (S.D.N.Y. Aug. 16, 2000)] court, even twenty percent is 'a far cry from the 50-50 ownership stake in <u>Rosman</u> [<u>Rosman v. Shapiro</u>, 653 F. Supp 1441 (S.D.N.Y.1987)].' Therefore, the degree to which Plaintiff shared an ownership interest in SRI does not provide a strong basis for the conclusion that Plaintiff believed, at the time that he communicated with SRI's corporate counsel, that he was communicating with Mehnert as his personal attorney." (emphasis added); "Although Plaintiff has stated in his affidavit that he was not informed by Mehnert that Frost & Jacobs was representing SRI alone, even when his and SRI's interests were aligned and, therefore, that Plaintiff should retain counsel to protect his interests, Plaintiff has not indicated that he entered into individual transactions or agreements with SRI, which would have warranted consultation with separate counsel. Plaintiff has not stated that he would have engaged separate counsel with regard to certain transactions, but for his belief that Mehnert and Frost & Jacobs were acting for his benefit, as well as for the benefit of SRI. . . . In short, Plaintiff has not indicated, in any respect, that he believed that Mehnert and Frost & Jacobs implied that they were provided legal services for him personally, as well as for SRI, with regard to any transaction between himself and SRI. Accordingly, Plaintiff has not presented evidence to support the conclusion that Mehnert's failure to inform Plaintiff that he and Frost & Jacobs were acting solely for SRI led Plaintiff reasonably to believe that Mehnert had acted as his personal counsel."; "Plaintiff has provided no evidence that: (1) either Mr. Mehnert or Frost & Jacobs provided personal legal services to him, unconnected with the corporation; (2) either Mr. Mehnert or Frost & Jacobs provided specific services for SRI principals, in addition to the corporation . . .; or (3) that he paid for any legal services by Frost & Jacobs, ... In essence, Plaintiff has not provided evidence that he reasonably believed that Mr. Mehnert and Frost & Jacobs represented him <u>individually</u>, in addition to SRI, thus creating an attorney-client relationship between Frost & Jacobs and himself. Rather, Plaintiff's evidence indicates that he believed that his communications with Mr. Mehnert were confidential vis-à-vis MHS-WO [Mercy Health Systems – Western Ohio], but not vis-à-vis SRI and its principals. Therefore, Plaintiff has not established that he personally had an attorney-client relationship with Mr. Mehnert or Frost & Jacobs. Accordingly, Plaintiff's Motion to Disqualify Frost & Jacobs is OVERRULED." (emphases added) (footnote omitted)).

- Correspondent Servs. Corp. v. J.V.W. Inv. Ltd., No. 99 Civ. 8934 (RWS), 2000 U.S. Dist. LEXIS 11881, at *36, *36-37 (S.D.N.Y. Aug. 16, 2000) (refusing to disqualify Shaw Pittman from adversity to an individual who owned an interest in the corporation that Shaw Pittman represented; finding that the attorney-client relationship existed between Shaw Pittman and the corporation rather than the individual; "Here, the words and actions of the parties demonstrate that Shaw Pittman was engaged to act as attorney for JVW [corporation], not Kelleher [individual seeking to disqualify Shaw Pittman] individually. First, Kelleher concedes in an affidavit that he was 'acting on behalf of JVW' when he identified Shaw Pittman as a potential firm to represent JVW in the attempt to recover the missing assets. . . . Although Kelleher also asserts in the affidavit that Shaw Pittman was retained 'to act as the attorneys for JVW, Waggoner, and myself,' . . . this statement is not supported by any of the documents submitted in connection with these motions." (emphasis added); "Caruso wrote to Kelleher after the conference call with Kelleher and Duperier. The letter is addressed to Kelleher as Director of JVW and Trustee, stated that 'As the Director and Trustee, you no doubt possess E-mail, documents, etc. in your computer, in originals, or in first-stage fax copies,' and requested that copies of those be sent to Shaw Pittman to provide a background to the case. According to Caruso's (Shaw Pittman attorney) uncontradicted affidavit, Kelleher then faxed Caruso a quantity of materials consisting largely of JVW corporate documents and correspondence between Kelleher and others on JVW corporate letterhead. In addition, Shaw Pittman's retainer was paid by JVW, not Kelleher, and Shaw Pittman's engagement letter stated that Shaw Pittman was 'pleased to have been engaged to represent J.V.W. Investments, Ltd.' for the purpose, inter alia, of recovering 'amounts due and owing to J.V.W. Investments, Ltd.' Shaw Pittman sent a bill on November 17, 1998 to 'J.V.W. Investments Ltd.' At Kelleher's address. Other documents support the conclusion that Kelleher, likewise, considered Shaw Pittman to be JVW's attorneys."

- Jesse v. Danforth, 485 N.W.2d 63, 66, 67, 68, 68-69, 69 (Wis. 1992) (holding that a law firm's pre-incorporation representation of individuals did not prevent the law firm from adversity to two of the individuals on unrelated matters; "We conclude that the entity rule does extend to Drs. Danforth and Ullrich such that DeWitt's [Law firm] pre-incorporation involvement with Drs. Danforth and Ullrich is properly characterized as representation of MRIGM [a corporation created by the law firm at the direction of 23 doctors, including the two individual doctors now seeking to disqualify the law firm from adversity in an unrelated matter], not Drs. Danforth or Ullrich, i.e., DeWitt's client was and is MRIGM, not Drs. Danforth or Ullrich."; "If a person who retains a lawyer for the purpose of organizing an entity is considered the client, however, then any subsequent representation of the corporate entity by the very lawyer who incorporated the entity would automatically result in dual representation. This automatic dual representation, however, is the very situation the entity rule was designated to protect corporate lawyers against."; We thus provide the following guideline: where (1) a person retains a lawyer for the purpose of organizing an entity and (2) the lawyer's involvement with that person is directly related to that incorporation and (3) such entity is eventually incorporated, the entity rule applies retroactively such that the lawyer's pre-incorporation involvement with the person is deemed to be representation of the entity, not the person." (emphasis added); "In essence, the retroactive application of the entity rule simply gives the person who retained the lawyer the status of being a corporate constituent during the period before actual incorporation, as long as actual incorporation eventually occurred."; "This evidence overwhelmingly supports the proposition that the purpose of Flygt's pre-incorporation involvement was to provide advice with respect to organizing an entity and that Flygt's involvement was directly related to the incorporation. Moreover, that MRIGM was eventually incorporated is undisputed."; also finding that the individual doctors could not disqualify the law firm based on confidential information they gave the lawyer [who handled the incorporation]; "Drs. Danforth and Ullrich also contend that they provided certain confidential information to attorney Flygt that should disqualify DeWitt under SCR 20:1.6, the confidential information rule. Defendants point to questionnaires Flygt provided to the physicians involved in the MRI project which inquire, in part, as to the physicians' personal finances and their involvement in pending litigation."; "Because MRIGM, not the physician shareholders, was and is the client of DeWitt, and because the communications between Drs. Danforth and Ullrich were directly related to the purpose of organizing MRIGM, we conclude that Drs. Danforth or Ullrich cannot claim the privilege of confidentiality."; finding that the law firm's current representation of a malpractice plaintiff suing the two doctors was not "directly adverse" to the corporation, even though the malpractice case could result in the doctors losing their licenses and therefore depriving the corporation of two shareholders and its president).

Under this majority approach, a closely-held corporation's lawyer generally can represent the corporation in litigation against one or more of the corporation's constituents, because the lawyer has an attorney-client relationship with the corporate entity and not the constituents.

- Records v. Geils Unlimited Research, LLC, Civ. A. No. 12-11419-FDS, 2013 U.S. Dist. LEXIS 106375, at *8-9, *11-12, *12, *16, *16 n.5, *21 (D. Mass. July 30, 2013) (holding that even in the context of a close corporation, a lawyer can represent the corporation and some shareholders in litigation with other shareholders; "The First Circuit has held that '[a]bsent some evidence of true necessity, [the court] will not permit a meritorious disqualification motion to be denied in the interest of expediency unless it can be shown that the movant strategically sought disqualification in an effort to advance some improper purpose.' Fiandaca, 827 F.2d at 830-831 [Fiandaca v. Cunningham, 827 F.2d 825 (1st Cir. 1987)]. Furthermore, the great majority of cases where motions to disqualify as untimely involved motions filed on the eve of trial. . . . Here, the litigation is still in its relative infancy. Accordingly, the Court will not deny the motion to disqualify attorney Butters and his firm is untimely."; "Plaintiffs seem to suggest that an attorney can never represent a corporation in a claim brought by a shareholder of that corporation. But it is well-settled that '[a] lawyer retained by a corporation represents the corporate entity, not its shareholders, employees, or directors.'. . . Indeed, if plaintiffs' theory were correct -- and counsel for a corporation necessarily must represent the interests of all the shareholders -- it would lead to an absurd result: no corporation could ever retain counsel in a suit brought by a shareholder. That, obviously, cannot be the rule." (emphases added); "There may be circumstances, particularly involving close corporations, where an attorney for a corporation might in fact be precluded from representing that corporation in a claim brought by a minority shareholder. T&A may be such a close corporation, and individual defendants Justman, Klein, Salwitz, and Blankfield together appear to represent a majority of shareholder interests."; "[P]laintiffs have cited to no authority holding that counsel here owes a fiduciary duty to the minority shareholders, or that such a duty would survive the filing of a claim against the corporation by a minority shareholder. If there are facts in this case that might bear on the creation of such a duty, they have not been made part of the record. Under the circumstances, it does not appear that Butters owes a fiduciary duty to Geils, and, even if such a duty once existed, it may have terminated when his interests become [sic] adverse to the corporation. Accordingly, the Court will not disqualify attorney Butters on that basis." (footnote omitted) (emphasis added); "In Bovee v. Gravel, 174 Vt. 486, 811 A.2d 137 (2002), the Vermont Supreme Court addressed the issue of whether an attorney for a close corporation owes a separate duty of care to individual shareholders. The court surveyed opinions from a number of jurisdictions across the country and concluded as follows: 'Although a few courts have evinced a willingness to recognize an attorney's duty to care to the shareholders of a closely-held corporation, these decisions are generally based on circumstances demonstrating a relationship between the attorney and a small number of shareholders approaching that of privity. See, e.g., United States v. Edwards, 39 F. Supp. 2d 716, 731-32 (M.D. La. 1999) ("The issue of attorney-client relationship becomes more complicated in the case of a small closely-held corporation with only a few shareholders or directors. In such cases, the line between individual and corporate representation can become blurred."); Rosman v. Shapiro, 653 F. Supp. 1441, 1445 (S.D.N.Y. 1987) (counsel for closely-held corporation consisting of two fifty-percent shareholders represented both corporate entity and individual shareholders).'"; "'Many courts, however, have refused to recognize a duty to nonclient shareholders even in such closely-held corporations. See Skarbrevik v. Cohen, England & Whitfield, 231 Cal. App. 3d 692, 282 Cal. Rptr. 627, 634-36 (Ct. App. 1991) (counsel for close corporation owed no duty to nonclient shareholder); Brennan and Ruffner, 640 So. 2d 143, 145-46 (Fla. Dist. Ct. App. 1994) ('where an attorney represents a closely-held corporation, the attorney is not in privity with and therefore owes no separate duty of diligence and care to an individual shareholder'); Felty v. Hartweg, 169 Ill. App. 3d 406, 523 N.E.2d 555, 557, 119 Ill. Dec. 799 (Ill. App. Ct. 1988) (declining to recognize corporate attorney's duty to shareholders, court observed that 'even in closely-held corporations, minority shareholders often have conflicting interests with the corporation')." (citation omitted)); "Rule 3.7 provides that a lawyer who is a necessary witness 'shall not act as an advocate at trial.' (emphasis added). Therefore, it is not necessary to disqualify attorney Butters at this juncture. Indeed, plaintiffs . . . have yet to explain the testimony they intend to elicit from Butters. If plaintiffs in the future can meet their burden of showing that necessary testimony could not be acquired from another witness, it might then be appropriate to disqualify attorney Butters from serving as trial counsel. However, 'that future possibility provides no basis for disqualifying [Butters] from continuing to represent [defendants] in pre-trial activities.'" (citation omitted)).

- Stanley v. Bobeck, 2009-Ohio-5696, ¶ 16 (Ohio Ct. App. 2009) (reversing a lower court's order disqualifying a lawyer who had represented a limited liability company from representing the company in an action brought by a member of the limited liability company; "The trial court made an exception to this rule by concluding a closely-held corporation is different from a large corporation because it is more like a partnership. No exception, however, was made regarding close corporations in the Rules of Professional Conduct. There is also no case law indicating that a different standard applies when the corporation is a closely-held corporation. Moreover, there is no evidence that Stanley [member of the limited liability company] believed that MRFL [law firm] was acting as his personal attorneys when representing Sunshine I as Stanley never conferred with MRFL on legal matters. Therefore, because there was no prior attorney-client relationship between Stanley and MRFL, the first prong of the Dana [Dana Corp. v. Blue Cross & Blue Shield Mut. of N. Ohio, 900 F.2d 882 (6th Cir. 1990)] test was not met." (emphases added)).

- Classic Coffee Concepts, Inc. v. Anderson, 2006 NCBC 21, ¶¶ 34, 35, 36, 37, 38, 39, 40, 47, 48, 49, 63, 76 (N.C. Super. Ct. Dec. 1, 2006) (declining to disqualify the law firm of Mayer Brown from representing the closely-held plaintiff company in a lawsuit against its former CFO and shareholder for refusing to sell his stock back to the plaintiff company pursuant to the terms of an agreement; noting that a Mayer Brown lawyer had represented the CFO/shareholder in connection with his guaranty of the company's loan to a lender; holding that the guaranty was not substantially related to the current dispute; explaining that Rules 1.7 and 1.13 applied to the closely-held corporation in the same way as to other corporations; explaining Mayer Brown's role as defendant's counsel in the limited guaranty matter; "During negotiation of the Stockholders Agreement and Anderson's [Defendant] Employment Agreement, Barrett [Mayer Brown lawyer] advised Anderson, Bailey, and Brinson that they were free to seek outside counsel to advise them in their individual capacity."; "When Anderson and Brinson sought Barrett's advice on the effect of designating Bailey as Chairman of Classic Coffee's Board, Barrett's response was directed to both Anderson and Brinson."; "MBR&M acted as special counsel to Anderson, Bailey, and Brinson in their capacities as guarantors under the Guaranty Agreement. There is no evidence that Barrett or MBR&M actually represented Anderson in any matters other than the Guaranty Agreement."; "The only information that MBR&M received from Anderson during its representation of him was a certification that he was not aware of any violations of existing laws and regulations that could 'materially adversely affect [Classic Coffee] or his ability to fill [sic] his obligations under the [Guaranty Agreement],' and a certification that Anderson was not involved in any pending or threatened lawsuits, investigations, or proceedings." (internal citation omitted); "During his employment, Anderson never entered into a written engagement for legal representation with Barrett or MBR&M. . . . He never received an invoice from or made any payment to Barrett or MBR&M . . . and MBR&M's services were billed to and paid for by Classic Coffee exclusively."; "Whenever Barrett discussed Anderson's Employment Agreement with him, Barrett informed Anderson that he represented Classic Coffee exclusively. . . . Barrett never advised Anderson that he was acting on his behalf or that he did not need to seek separate counsel."; "Anderson never informed Barrett that he considered him to be his personal attorney . . . and Anderson never stated to any third party that he considered Barrett to be his personal attorney."; "[T]his representation is not substantially related to the claims before the Court because: (a) the Guaranty Agreement is separate from the transactions that give rise to the claims in this case; and (b) MBR&M did not obtain information during its representation that would materially advance Classic Coffee's position here."; "The Guaranty Agreement is separate from the transactions that give rise to the claims in this case for two reasons: (a) neither Anderson nor Classic Coffee have alleged any cause of action arising out of the Guaranty Agreement; and (b) the Guaranty Agreement, the Stockholders Agreement, and Anderson's Employment Agreement are separate and distinct transactions between different parties and concerning different subject matters."; "Classic Coffee's claim for breach of contract arises exclusively out of the Stockholders Agreement . . . and none of Anderson's four counterclaims arise out of the Guaranty Agreement . . . . Anderson's reference, in paragraphs 60 and 61 of his Answer and Counterclaims, to the Guaranty Agreement as a source of irritation does not state a claim is an insufficient basis for disqualifying MBR&M."; "In <u>First Republic Bank</u> <u>[First</u>

Republic Bank v. Brand, 51 Pa. D. & C. 4th 167, 184-85 (C.P. Phila. 2001)], the court outlined several factors for determining whether a corporation's attorney had entered into an attorney-client relationship with the corporation's stockholder. . . . These factors include: '(1) whether the stocholder was separately represented by other counsel when the corporation was created or in connection with its affairs; (2) whether the stockholder sought advice on and whether the attorney represented the stockholder in particularized or individual matters, including matters arising prior to the attorney's representation of the corporation; (3) whether the attorney had access to the stockholder's confidential or secret information that was unavailable to other parties; (4) whether the attorney's services were billed to and paid by the corporation or the stockholder; (5) whether the corporation is closely-held; (6) whether the stockholder could reasonably have believed that the attorney was acting as his individual attorney rather than as the corporation's attorney; (7) whether the attorney affirmatively assumed a duty of representation to the stockholder by either express agreement or implication; (8) whether the matters on which the attorney gave advice are within his or her professional competence; (9) whether the attorney entered into a fee arrangement; and (10) whether there was evidence of reliance by the stockholder on the attorney as his or her separate counsel or of the shareholder's expectation of personal representation.'" (internal citation omitted)); "These rules [1.7 and 1.13], in combination, clearly contemplate representation of a corporation by corporate counsel in situations where the corporation's interests are adverse to one of its constituents. Furthermore, they make no exception for closely-held corporations like Classic Coffee. Since the North Carolina Revised Rules of Professional Conduct do not establish a per se rule against corporate counsel representing a closely-held corporation against one of its stockholders or directors, the Court declines to create such a rule here."). `

- Rhode Island LEO 2005-10 (11/10/05) (holding that a lawyer who represents a corporation can be adverse to constituents of the corporation; explaining the factual setting: "Two inquiring attorneys provided legal services to Corporation A relative to permits necessary for the development of real estate owned by the corporation. One inquiring attorney provided legal services relating to municipal permits; the other provided legal services relating to state environmental permits. Corporation A was then sold to a newly created corporation, Corporation B, which consisted of the same four principles and shareholders as Corporation A. The inquiring attorneys then also provided legal services to Corporation B relative to the permits for the original development project which Corporation B took over, but eventually abandoned because of financial reasons."; "Subsequently, Corporation B conveyed its tangible and intangible assets to Corporation C, an existing entity. The principals and shareholders of Corporation C are different from those of Corporation B. Corporation C wishes to proceed with the original development project, and has asked the inquiring attorneys to represent it relative to the necessary state and municipal permits."; "Meanwhile, however, two of the principals/shareholders of Corporation B, disgruntled by the decision to sell Corporation B's assets, have raised objections to the sale of Corporation C, and will likely pursue litigation in an attempt to void the sale. The real estate being developed which was the primary asset of Corporation B, was conveyed from Corporation B to Corporation C by warranty deed. The deed was signed by an authorized representative of Corporation B. The two disgruntled individuals have voiced opposition to the representation of Corporation C by the inquiring attorneys."; holding that the lawyer may represent the corporation adverse to constituents; "[T]he adversity in this dispute runs between two dissenting constituents of Corporation B and the remaining two constituents, and also between the two individual dissenters and Corporation C.").

In a more complicated scenario, applying the general rule may also permit lawyers to represent a closely-held company and some of its owners against other owners.

This type of representation represents a reliance on the principle that a corporation's lawyer does not represent minority owners. By definition, representing the corporation itself and some owners against other owners involves a dispute related to corporate control. This is quite different from the corporation's lawyer taking matters adverse to minority shareholders on issues unrelated to the corporation.

But some courts allow lawyers to represent both the corporation and one of its owners against its other owners. Of course, the lawyer will be in a position to do so only if the owner/client controls the corporation, and can consent it to jointly retaining that lawyer.

- <u>Coldren v. Hart, King & Coldren, Inc.</u>, 190 Cal. Rptr. 3d 655, 646, 653-54 (Cal. Ct. App. 2015) (holding that the same law firm could represent another law firm and its 50 percent shareholder owner in a lawsuit filed by the other owner who had left the law firm; "Plaintiffs Robert S. Coldren (Coldren) and his wife, Brook Coldren, sued defendants Hart, King & Coldren, Inc. (HKC), and William R. Hart asserting several causes of action arising out of Coldren's departure from his law practice at HKC. Defendants appeal from an order disqualifying HKC's counsel, Grant, Genovese & Baratta, LLP (Grant Genovese), who had been representing both Hart and HKC. The court held there was an unwaivable actual conflict between the two. The court concluded a conflict existed because Coldren is a 50 percent shareholder of HKC, and HKC could have duties to Coldren that were in conflict with Hart's interests in defeating the litigation. Accordingly, the court ordered Hart to confer with Coldren on the appointment of 'neutral' counsel for HKC."; "We reverse. Coldren sued both Hart and HKC -- directly, not derivatively -- on essentially the same claims. He is seeking over $8 million in damages against both. Hart's interest is perfectly aligned with HKC's interest in seeing Coldren's claims defeated. Coldren's position seems to be that he can sue his company and then, because he is a 50 percent shareholder, have a say in its defense. That is not the law. Moreover, Grant Genovese's duty of loyalty, as counsel for HKC, runs to HKC, not its shareholders. HKC is free to defend itself and assert relevant counterclaims to the detriment of Coldren. Since there is no conflict, we reverse."; "The question is . . . do Hart and HKC 'have opposing interests in the lawsuit which the attorney would have a duty to advance simultaneously for each.'. . . Coldren has not identified any such opposing interests. He points vaguely to the fact that he is a 50 percent shareholder, but as the foregoing principles make clear, Grant Genovese's duty is to HKC, not its shareholders, and HKC is free to defend Coldren's lawsuit and assert relevant counterclaims.").

- <u>Havasu Lakeshore Invs., LLC v. Fleming</u>, 158 Cal. Rptr. 3d 311, 314, 319, 321 (Cal. Ct. App. 2013) (holding that a lawyer could represent a limited liability company and its managing members in a litigation against two members, each of whom owned approximately ten percent of the LLC interest; "The trial court disqualified a law firm from simultaneously representing a limited liability company, its managing member (a partnership), and the person who managed that partnership (who was not himself a member of the company) in a lawsuit against two of the company's minority members. The court found that the interests of the company and the nonmember individual <u>potentially</u> conflicted, and concluded the law firm could not jointly represent the company and the nonmember individual against the company's minority members. The court based its ruling on rule 3-310(C) of the State Bar Rules of Professional Conduct and <u>Gong v. RFG Oil, Inc.</u> (2008) 166 Cal.App.4th 209, 214-216 [82 Cal. Rptr. 3d 416] (Gong), both of which concern an attorney's duty of <u>loyalty</u> to simultaneously represented clients. Because no actual conflict of interest existed between the company and the individual who managed the company's managing member, and there was no reasonable likelihood such a conflict would arise, we reverse the court's ruling." (footnote omitted); "With respect to the cross-complaint, there is no conflict; the LLC's interests and Peloquin's are clearly allied. The LLC and the other cross-complainants seek to recover the LLC's property and to restore value to the LLC. Fleming Jr., in his respondent's brief, agrees these are the LLC's litigation goals. These goals are beneficial to every member of the LLC, including the Flemings in their status as members of the LLC, and to Peloquin, in his status as a partner and principal in the LLC's other members."; "Fleming Jr. cites no authority for the proposition that an attorney may never jointly represent an entity and its management against a non-managing minority member.").

It is worth noting that representing both a closely-held corporation and some of its owners in matters adverse to its other owners involves some risk. As explained more fully below, if the corporation changes hands because of a court order (based on a finding that the minority owners should control the corporation) or even a settlement, the corporation will undoubtedly fire the lawyer who had previously represented the lawyer's adversary (who now control the corporation). But the corporation is now the lawyer's former client. Among other things, that usually allows the corporation to access the lawyer's files. This is discussed fully below in connection with the minority view preventing lawyers from representing a closely-held corporation against its minority owners -- or at least warning them of such representations' danger.

This general rule also applies in reverse. Several cases have held that lawyers representing owners of a closely-held corporation do not necessarily represent the corporate entity when they file derivative actions against other shareholders -- even though the actions theoretically involve the lawyers representing the corporate entity's best interests.

- Simms v. Rayes, 316 P.3d 1235, 1238, 1238-39, 1239, 1240 (Ariz. 2014) (declining to disqualify Greenberg Traurig from simultaneously representing a minority owner of a limited partnership in a derivative case against other partners, while defending the minority owner in a lawsuit brought by the limited partnership; "As TP Racing [limited partnership] concedes, no attorney-client relationship exists between GT [Greenberg Traurig] and TP Racing. An attorney-client relationship exists when a person has manifested to a lawyer his intent that the lawyer provide him with legal services and the lawyer has manifested consent to do so. . . . Nothing in the record shows that TP Racing manifested to GT its intent that GT provide legal services to it or that GT manifested any consent to do so. GT's only attorney-client relationship is with Ron [minority partner of TP Racing]."; "The fact that GT's client Ron -- in his capacity as a minority partner of TP Racing -- has filed derivative claims on behalf of TP Racing changes nothing. Although no Arizona appellate court has considered the issue, <u>courts that have considered the issue have held that lawyers are not disqualified from representing clients who are simultaneously pursuing direct claims against a corporation and derivative claims on behalf of that corporation.</u>" (emphasis added); "Derivative actions allow a minority shareholder to pursue a claim on behalf of a corporation when the management of the corporation has refused to pursue the claim itself. . . . The corporation is merely a nominal party in a dispute between a minority shareholder and the management that controls the corporation. . . . The corporation thus is not a 'client' of the lawyer for the minority shareholder and the lawyer has no attorney-client relationship with it."; "<u>Because the lawyer in a derivative action has an attorney-client relationship only with the minority shareholder, nothing prevents the lawyer from also representing the minority shareholder on any direct claims against the corporation or its management that arise from the same set of facts.</u> The shareholder may sue directly for harms the mismanagement of the corporation has caused him personally, and derivatively for harms the mismanagement has caused the corporation." (emphasis added); "TP Racing nevertheless argues that even though no attorney-client relationship exists between GT and TP Racing, GT still has a conflict of interest under ER 1.7(a) because the derivative claims impose a fiduciary duty on GT to TP Racing that conflicts with GT's duty to Ron. Although a fiduciary duty does exist in a derivative action, it exists between the corporation or partnership and the minority shareholder or partner asserting the derivative claim. . . . Thus, Ron, as the minority limited partner asserting the derivative claim, has a fiduciary duty to act in TP Racing's interest. GT is counsel for the person having the fiduciary duty to TP Racing; the firm itself has no separate fiduciary duty to TP Racing.").

- <u>Shen v. Miller</u>, 150 Cal. Rptr. 3d 783 (Cal. Ct. App. 2012) (holding that a lawyer can represent the fifty-percent owner of a company in a derivative action and represent the same individual in an action against the other fifty-percent owner; noting that the lawyer also represented the fifty-percent owner in a wind-up lawsuit adverse to the company; rejecting the defendant half-owner's argument that the plaintiff's lawyer conflict because he was simultaneously representing the company in the derivative case while being adverse to it in the wind-up case; holding that the plaintiff's lawyer filed a derivative action "on behalf of" the company but did not represent the company; explaining that a lawyer representing a plaintiff in a derivative case is actually adverse to the company, although the company benefits if the plaintiff wins).

The general principle that a closely-held corporation's lawyer does not represent its shareholders implicates other issues -- such as standing to file malpractice actions against the lawyer, and ownership of the lawyer's files.

Thus, courts applying the general "default" rule usually conclude that a closely-held corporation's owner cannot file a malpractice action against the corporation's lawyer.

- Kelly Knaub, <u>McNees Wallace Freed From Malpractice Suit Over Stock Sale</u>, Law360, Mar. 11, 2014 ("The Pennsylvania Superior Court upheld a trial court decision letting law firm McNees Wallace & Nurick LLC off the hook in a case accusing the firm of committing legal malpractice in connection with All-Staffing Inc. (ASI) co-owner Alfonso Sebia's sale of stock during an acquisition of the company."; "In an opinion penned by Superior Court Judge Patricia H. Jenkins, the three-judge panel agreed with the Court of Common Pleas' determination that <u>McNees Wallace did not have an attorney-client relationship with Sebia and his wife Pamela, also a plaintiff, saying the firm had only represented ASI. Alfonso Sebia owned 50 percent of the company's stock, while his partner, Stan Costello, owned the other half.</u>" (emphasis added); "'Viewed in the light most favorable to the Sebias, the evidence fails to establish that it was reasonable for them to believe McNees was representing them,' the opinion says."; "ASI, which Sebia and Costello formed in 1992, was a privately held professional employment organization that provided payroll, human resources and workers' compensation insurance services to its clients. Things went awry in 2007 after California-based Dalrada Corporation purchased ASI and its assets, including ASI stock, which were foreclosed on later that year by one of Dalrada's lenders. The Sebias -- who had carved out employment agreements during the acquisition -- were also fired."; "The Sebias sued McNees Wallace for legal malpractice, but the appeals court affirmed the trial court's decision, saying the firm had only represented ASI and not the Sebias."; "The appeals court said that <u>ASI -- not the Sebias -- signed an engagement letter with McNees Wallace, which explicitly identified the firm's client as the corporation, not an individual shareholder. According to the court, the firm had included the following line in the letter: 'We always recommend that individual owners consider obtaining separate legal counsel. We do so here as well.'</u>" (emphasis added); "Judge Jenkins wrote in the opinion that the <u>Sebias never had face-to-face meetings with the firm, never received bills from it, never paid the firm's bills or</u>

complained about its services. The Sebias did not ask the firm to perform due diligence during the Dalrada transaction, invite the firm to meetings with ASI's accountants or ask the firm for its opinion about the original or revised stock purchase agreements with Dalrada, according to the appeals court." (emphasis added)).

- Kurre v. Greenbaum Rowe Smith Ravin Davis & Himmel, LLP, Dkt. No. A-5323-07T1, 2010 N.J. Super. Unpub. LEXIS 832, at *2-3, *8-9 (N.J. Super. Ct. App. Div. Apr. 16, 2010) (holding that a shareholder could not file a derivative action against a closely-held corporation's lawyer; "On August 3, 2001, Labriola Motors retained Greenbaum to represent it in connection with a proposed sale to Pine Belt Automotive, Inc. The retainer letter stated that Greenbaum would act as 'counsel to the Company' and expressly advised plaintiffs and Joseph, with whom Greenbaum had a prior relationship, that because each of their 'interests and concerns as shareholders of the Company differ in connection with the proposed transaction,' each 'should retain independent legal counsel and/or accounting or financial advisors to represent [them] in connection with [their] review, negotiation and execution of the contract documents.' Plaintiffs signed the retainer agreement and acknowledged 'that (i) this firm will represent only the Company in connection with the proposed transaction, and (ii) this firm has advised you of your right to obtain independent legal counsel.'" (emphasis added); "The record as a whole precludes consideration of a legitimate factual dispute concerning Greenbaum's representation of plaintiff's personally at any relevant time, or of any duty owed to them with respect to issues concerning the dealership. . . . Nor can they reasonably contend that they legitimately believed that Greenbaum represented them personally in the dealership's dealings with Nissan.").

- Bovee v. Gravel, 811 A.2d 137, 141 (Vt. 2002) (holding that a shareholder cannot directly sue the corporation's lawyer for malpractice; "Courts have generally refused . . . to recognize an exception to the privity requirement for shareholders' claims against a corporate attorney."; "Although a few courts have evinced a willingness to recognize an attorney's duty of care to the shareholders of a closely-held corporation, these decisions are generally based on circumstances demonstrating a relationship between the attorney and a small number of shareholders approaching that of privity." (emphasis added); "Many courts, however, have refused to recognize a duty to nonclient shareholders even in such closely-held corporations. See Skarbrevik v. Cohen, England & Whitfield, 231 Cal. App. 3d 692, 282 Cal. Rptr. 627, 634-36 (Ct. App. 1991) (counsel for close corporations owed no duty to nonclient shareholder); Brennan v. Ruffner, 640 So. 2d 143, 145-46 (Fla. Dist. Ct. App. 1994) ('where an attorney represents a closely-held corporation, the attorney is not in privity with and therefore owes no separate duty of diligence and care to an individual shareholder'); Felty v. Hartweg, 169 Ill. App. 3d 406, 523

N.E.2d 555, 557, 119 Ill. Dec. 799 (Ill. App. Ct. 1988) (declining to recognize corporate attorney's duty to shareholders, court observed that 'even in closely-held corporations, minority shareholders often have conflicting interests with the corporation.')." (emphasis added)).

- Brennan v. Ruffner, 640 So. 2d 143, 145-46, 146 (Fla. Dist. Ct. App. 1994) (holding that a shareholder controlling one-third of a company's stock cannot directly sue the company's lawyer; "Dr. Brennan argues that a separate duty to him as a shareholder arose by virtue of the lawyer's representation of the closely-held corporation. Although never squarely decided in this state, we hold that where an attorney represents a closely-held corporation, the attorney is not in privity with and therefore owes no separate duty of diligence and care to an individual shareholder absent special circumstances or an agreement to also represent the shareholder individually. While there is no specific ethical prohibition in Florida against dual representation of the corporation and the shareholder if the attorney is convinced that a conflict does not exist, an attorney representing a corporation does not become the attorney for the individual stockholders merely because the attorney's actions on behalf of the corporation may also benefit the stockholders. The duty of an attorney for the corporation is first and foremost to the corporation, even though legal advice rendered to the corporation may affect the shareholders. Cases in other jurisdictions have similarly held." (footnote omitted) (emphasis added); "[T]here are no facts to support Dr. Brennan's assertion that the primary intent of the corporation in hiring the attorney to draft the shareholder's agreement was to directly benefit Dr. Brennan individually. Dr. Brennan admits that there was an inherent conflict of interest between the rights of the individual shareholder and the corporation. This alone expressly undercuts a third party beneficiary claim. . . . A third party beneficiary theory of recovery has been rejected in other jurisdictions in similar circumstances on the basis that the individual shareholder cannot be an intended third party beneficiary of a shareholder's agreement because the interests of the corporation and the minority shareholder are potentially in opposition.").

- Skarbrevik v. Cohen, England & Whitfield, 282 Cal. Rptr. 627, 634-35, 636, 637 (Cal. Ct. App. 1991) (holding that plaintiff officer, director, and 25 percent shareholder cannot directly sue the company's lawyer; "An attorney representing a corporation does not become the representative of its stockholders merely because the attorney's actions on behalf of the corporation also benefit the stockholders; as attorney for the corporation, counsel's first duty is to the corporation. . . . Corporate counsel should, of course, refrain from taking part in any controversies or factional differences among shareholders as to control of the corporation, so that he or she can advise the corporation without bias or prejudice. . . . Even where counsel for a closely-held corporation treats the interests of the majority shareholders and the corporation interchangeably, it is the attorney-client relationship with the

> corporation that is paramount for purposes of upholding the attorney-client privilege against a minority shareholder's challenge. . . . These cases make clear that corporate counsel's direct duty is to the client corporation, not to the shareholders individually, even though the legal advice rendered to the corporation may affect the shareholders." (emphases added); "Plaintiff in this case did not have close interaction, or any interaction at all, with defendant attorneys during the time period in which the legal services sued upon were rendered. The evidence at trial was that after the July 13, 1983, meeting, plaintiff was told by the other shareholders that defendant Comis would prepare the documents to effect the buy out of his shares, and that in August 1983, when plaintiff asked Erlich [one of the other three 25% shareholders] if the papers were ready, Erlich told plaintiff that because of their attorney's advice, he and the two other shareholders had decided not to pay him for his shares, and that no contract would be forthcoming."; "There was no contact between plaintiff and defendant Comis regarding the proposed buy out; the initial instructions regarding the drafting of buy out documents were given to Comis by Erlich. Nor was there any basis for plaintiff to place faith, confidence or trust in Comis to protect his interests in regard to this rift among the shareholders, particularly after he was told that it was on the basis of their attorney's advice that the other three shareholders had decided not to pay him for his shares. All the wrongful acts complained of were subsequent to the date he received that information, and he was completely unaware of any of those acts until after he brought this action."; "Applying these principles to the case before us, we conclude that plaintiff had no attorney-client relationship with defendant attorneys, he was not an intended beneficiary of the attorney-client relationship, and certainly had no reason to believe he was intended to be benefited by that relationship, particularly after he was told by Erlich that based on 'their attorney's counsel,' the majority shareholders would not pay him for his shares. The evidence at trial demonstrates that plaintiff was at that time a potential adverse party whose interests could not be, and were not, represented by his adversaries' chosen counsel, whose duty of loyalty was to his own clients. . . . The fact that defendant Comis could have foreseen the adverse consequences of his advice and its impact on plaintiff is not sufficient justification for fixing liability on him to a nonclient shareholder under these circumstances." (emphasis added); "Defendants owed no professional duty of care to plaintiff, and in the absence of duty, could not be held liable for professional negligence.").

Lawyers' file ownership usually follows from attorney-client relationships. A 2009 Western District of New York case applied the general "default" rule in denying a closely-held company's owners access to the company lawyer's files.

- MacKenzie-Childs LLC v. MacKenzie-Childs, 262 F.R.D. 241, 246, 248, 249, 250, 251, 252, 252-53, 253. 254, 255 (W.D.N.Y. 2009) (addressing privilege issues in a trademark case; explaining that a lawyer had represented a closely-held business, which had eventually declared bankruptcy, with the assets sold to a number of successors; analyzing the ability of the former sole owners of the company to obtain privileged documents from the lawyer -- thus raising the issue of whether the lawyer had represented them individually or their closely-held company; explaining the co-owners' position that the lawyer represented them; "Victoria and Richard argue that Salai [lawyer] 'act[ed] as their personal attorney and not as attorney for their wholly owned company.'. . . Because they were fifty percent shareholders of a closely-held corporation, they continue, they had 'every right' to assume that Salai was acting as their personal attorney when he provided trademark and copyright advice. . . . In support of their position, they also offer copies of nearly thirty supplementary copyright registrations that Salai submitted on January 16, 1997, correcting earlier registrations for works previously identified as works for hire. . . . Salai signed each of the filings and certified that he was the 'duly authorized agent of Victoria and Richard [co-owners] MacKenzie-Childs.'" (internal citation omitted); explaining the basic rule involving an asset sale; "Where one corporation merely sells its assets to another, however, the privilege does not pass to the acquiring corporation unless (1) the asset transfer was also accompanied by a transfer of control of the business and (2) management of the acquiring corporation continues the business of the selling of the corporation."; also explaining how the joint representation and common interest doctrine apply in a corporate setting; "The concept of joint representation and the related common interest doctrine are particularly complex in the corporate setting. . . . Under this rule, courts presume that the corporation owns the privilege -- rather than the individual corporate representatives, or the individuals and the corporation jointly -- and the individuals bear the burden of rebutting the presumption."; "Despite this 'default' rule, courts have been willing to recognize that an individual corporate representative may assert an individual attorney-client privilege in communications with corporate counsel provided that certain requirements are met. . . . Some courts, such as the First, Third and Tenth Circuits, apply the following five-part test enunciated in Bevill to determine whether an individual has demonstrated a personal privilege in communications with corporate counsel."; "Thus, although this authority permits an individual to assert a personal privilege in certain communications with corporate counsel, it does not stand for the proposition that an individual and a corporation may enjoy a joint privilege in the same, non-segregable communication with counsel by a corporate representative in both his representative and individual capacity."; "Although the Second Circuit has acknowledged the Bevill test, it has not clearly adopted it. . . . It has made it clear, however, that whether Bevill is or is not applied, a prerequisite to assertion of a personal privilege by a corporate representative is proof that the employee 'ma[de] it clear to corporate counsel that he [sought] legal advice on personal matters.'" (citation omitted); noting the lawyer's testimony; "He testified that he always believed that he was acting as counsel to the corporation, and not as counsel to Richard and Victoria, individually. . . . He further testified that he never spoke to either of them about any matters, but instead communicated with other corporate employees, some of whom he identified in his testimony. . . . Invoices for his services were paid by the corporation, and not by Victoria and Richard personally. . . . On this record, defendants' contention that Salai never provided legal advice or services to the corporation strains credulity and cannot be accepted."; holding that the privilege passed with the assets sole to various successors; "I find that MacKenzie-Childs II purchased substantially all of the assets then-owned and the business then-operated by MacKenzie-Childs I and thereafter continued the business in which MacKenzie-Childs I had been engaged. . . . Thus, I conclude that the attorney-client privilege passed from MacKenzie-Childs I to MacKenzie Childs II."; "I likewise conclude that the privilege passed again in 2008, this time from MacKenzie-Childs II to MacKenzie-Childs III. The record demonstrates that MacKenzie-Childs III purchased substantially all of the assets of MacKenzie-Childs II, including its intellectual property, and has continued the business of MacKenzie-Childs II and III. . . . Considering these facts, plaintiffs have the authority to assert -- as they did in Salai's deposition -- the attorney-client privilege to protect confidential communications made between representatives of MacKenzie-Childs I and Salai, as counsel to the corporation."; rejecting the co-owners' argument that they reasonably believe they were the lawyer's client; "<u>[T]he fact that an attorney represents a corporation does not make that attorney counsel to the corporation's officers, directors, employees or shareholders.</u>" (emphasis added); "<u>[W]hether Richard and Victoria believed that Salai was acting as their individual attorney and whether that belief was reasonable are simply irrelevant to the pending privilege doctrine.</u>" (emphasis added); "<u>Rather, whether Richard and Victoria may establish a personal privilege in communications with Salai depends on proof that they sought legal advice from Salai about personal matters and that they made it clear to him that they were seeking advice in their individual, not representative, capacities.</u>" (emphasis added); "<u>First, it does not allege that Victoria or Richard ever actually communicated directly with Salai, as opposed to communicating through other corporate representatives. Defendants have cited no authority, and the Court is unaware of any, to support the novel proposition that a privileged relationship may be created between an individual and a corporate attorney with whom the individual has never spoken nor directly communicated.</u>" (emphasis added); "Moreover, [there is] the dearth of any evidence showing that Victoria or Richard ever personally paid for Salai's legal advice."; "In sum, defendants' reliance on their 'reasonable belief' that Salai represented them personally because they were the sole shareholders and ultimate decisionmakers of a closely-held corporation is insufficient to establish a personal attorney-client privilege.

Because they cannot even establish that they ever communicated directly with Salai, let alone that they made clear to him that they were seeking legal advice in their individual capacities, their contention that they possess a privilege capable of being waived must be rejected."; also finding that the lawyer must honor the current privilege owner's direction about documents; "Consistent with my determination that any attorney-client privilege belongs to the companies, and not to Victoria and Richard personally or jointly with the companies, Salai and HSE [lawyer's present firm] must respect plaintiffs' assertion of privilege concerning the requested documents.").

In some situations, corporations' shareholders can rely on what is called the "fiduciary exception" to access otherwise privileged communications between management and the corporations' lawyer.

Minority Approach: Lawyers Representing Closely-held Corporations Cannot Represent the Corporation Against Minority Owners

Some jurisdictions take a different approach.

For instance, a District of Columbia ethics rule comment explains that

> if the organization client is a corporation that is wholly owned by a single individual, in most cases for purposes of applying this rule, that client should be deemed to be the alter ego of its sole stockholder.

District of Columbia Rule 1.7 cmt. [23].

Courts taking what can be fairly described as the minority position generally point to two district court decisions articulating closely-held corporation's lawyers' duty to corporate constituents.

- Rosman v. ZVI Shapiro, 653 F. Supp. 1441, 1445 (S.D.N.Y. 1987) (finding that the half-owner of a corporation could reasonably have thought that the same lawyer representing the company also represented him, and therefore disqualifying that lawyer from representing the company and the company's other owner; "Rosman and Shapiro jointly consulted Y&Y [Law firm] for legal advice concerning Filtomat's [defendant] contractual relationship with Filtration [defendant]. Moreover, it is clear that Y&Y now represents Shapiro against Rosman in two actions before the Court and that both actions focus on the identical issues discussed during the prior consultations. Based on these facts, Rosman seeks to disqualify Y&Y pursuant to Canons 4 and 9 of ABA Code of Professional Responsibility."; "It is clear that Rosman reasonably believed that Zisman [Y&Y lawyer] was representing him. Although, in the ordinary corporate situation, corporate counsel does not necessarily become counsel for the corporation's shareholders and directors . . ., where, as here, the corporation is a close corporation consisting of only two shareholders with equal interests in the corporation, it is indeed reasonable for each shareholder to believe that the corporate counsel is in effect his own individual attorney." (emphasis added); "This is especially true in this case because both Rosman's uncontradicted affidavit . . . and the shareholder agreement creating Filtomat . . ., demonstrate that both Rosman and Shapiro treated Filtomat as if it were a partnership rather than a corporation. In short, it would exalt form over substance to conclude that Y&Y only represented Filtomat, solely because Rosman and Shapiro chose to deal with Filtration through a corporate entity.").

- United States v. Edwards, 39 F. Supp. 2d 716, 731-32 (M.D. La. 1999) ("As a general rule, an attorney for a corporation represents the corporation, and not its shareholders. The issue of attorney-client relationship becomes more complicated in the case of a small closely-held corporation with only a few shareholders or directors. In such cases, the line between individual and corporate representation can become blurred. The determination whether the attorney represented the individual of the small closely-held corporation is fact-intensive and must be considered on a case-by-case basis. The court in Rosman v. Shapiro [653 F. Supp. 1441, 1445 (S.D.N.Y. 1987)] noted that although corporate counsel does not ordinarily become counsel for the shareholders and directors, in a closely-held corporation consisting of only two shareholders, 'it is indeed reasonable for each shareholder to believe that the corporate counsel is in effect his own individual attorney.' The court in Sackley v. Southeast Energy Group, Ltd. [No. 83 C 4615, 1987 U.S. Dist. LEXIS 10279, at *9-10 (N.D. Ill. June 19, 1987)] set forth a number of factors which could be considered: (1) 'whether the attorney ever represented the shareholder in individual matters'; (2) whether the attorneys' services were billed to and paid by the corporation'; (3) 'whether the shareholders treat the corporation as a corporation or as a partnership'; and (4) 'whether the shareholder could reasonably have believed that the attorney was acting as his individual attorney rather than as the corporation's attorney.'" (footnotes omitted) (emphasis added)).

A number of cases following this line essentially equate lawyers' representation of a closely-held corporation with that of its owners, or warn lawyers of that risk.

- Ontiveros v. Constable, 199 Cal. Rptr. 3d 837, 844, 845, 846 (Cal. Ct. App. 2016) (holding that the same lawyer could not represent the company and a sixty-percent shareholder of the company in an action brought by the minority shareholder; "Defendants contend the trial court erred by disqualifying Counsel as to Omega [company]. We disagree because Counsel concurrently represented defendants in the same action where an actual conflict existed between them, and Kent alone did not have authority to consent to the conflicting representation on Omega's behalf."; "Omega's and the Constables' [sixty-percent owner] respective interests were clearly adverse to one another. Although Ontiveros's [Minority owner suing the company and the majority shareholder] complaint nominally named Omega a defendant, Omega 'is the real plaintiff' on those claims against the Constables. . . . 'Current case law clearly forbids dual representation of a corporation and directors in a shareholder derivative suit, at least where, as here, the directors are alleged to have committed fraud.'" (citation omitted); "The nature of Ontiveros's derivative claims, which sound in fraud, demonstrates that an actual conflict of interest existed. Omega's interests were adverse to the Constables' with regard to, at a minimum, ownership of the property and Omega's payment of rent to the Constables."; "Defendants contend the trial court erred because rule 3-600 allows an attorney to concurrently represent an organization and its shareholders, provided they all knowingly consent to the joint representation."; "[W]e conclude that because Ontiveros's derivative claims render the Constables' and Omega's interests adverse, Kent's [Constable] attempt to consent to Counsel's concurrent representation of Omega over Ontiveros's objection was ineffective. Therefore, the trial court did not err in disqualifying Counsel as to Omega."; "Nor are persuaded by defendants' argument that 'there exists a split in authorities regarding joint representation in derivative actions.' (Capitalization omitted.) The argument relies entirely on foreign authority. The California authorities we have discussed clearly and uniformly address the issue and support the trial court's ruling as to Omega.").

- <u>Eternal Pres. Assocs., LLC v. Accidental Mummies Touring Co.</u>, 759 F. Supp. 2d 887, 888-89, 893-94, 894 (E.D. Mich. 2011) (denying a motion to disqualify Clark Hill from representing both an LLC and an entity that controls the LLC's managing member; explaining that the LLC sued its half-owner, and that Clark Hill represented both the LLC and the other half-owner; "The Court finds that a conflict certainly exists; but the conflict is between Wolf [half owner of the LLC represented by Clark Hill] and DSC [entity controlling the managing member of the LLC] over who should control the litigation against AMTC [LLC represented by Clark Hill, and plaintiff in suing half-owner Wolf]. Disqualifying Clark Hill would do little to resolve that conflict, and the Court finds it unnecessary to do so under the Michigan Rules of Professional Conduct. Clark Hill's loyalties are not divided, since the firm is doing the bidding of AMTC's managing member. That is not to say, however, that Clark Hill may not have a fiduciary duty to Wolf as an equal member of AMTC. For now, however, the Court concludes that Clark Hill may continue to represent AMTC in this litigation, albeit at its peril. The motion to disqualify, therefore, will be denied."; "[A]s long as DSC controls AMTC, Clark Hill will not face that conflict. Clark Hill must follow the instruction of its client, and it must give advice unfettered by conflicting loyalty to another client. But it is unlikely that AMTC would consider the possibility of a suit against DSC while an entity controlled by DSC determines AMTC's litigation decisions. As long as DSC-controlled interests are in a position to decide what is in AMTC's best interests, Clark Hill's simultaneous representation of both AMTC and DSC will not violate Michigan Rule of Professional Conduct 1.7." (emphasis added); "It is important to note that Wolf's claim of conflict of interest is not based on Clark Hill's possession of confidential information . . . . Instead, it is based on the idea that Clark Hill, taking instruction from the managing member of AMTC, Marcon Eekstein (which is manages [sic] by Eekstein's Workshop, L.L.C., in turn wholly owned by DSC), will not pursue a litigation strategy that Wolf would like and DSC may not. That cannot constitute a violation of Michigan Rule of Professional Conduct 1.7(b); if it did, no lawyer could represent AMTC in the present litigation, regardless of which of the fifty percent members controlled AMTC. Disputes between constituent members over control of an entity should not be resolved under the guise of an attorney conflict of interest." (emphasis added); "That is not to say that Wolf may not have recourse against Clark Hill directly. An attorney who represents a closely-held corporation and a controlling shareholder may also have a fiduciary [duty] to the other shareholder(s)." (emphasis added)).

- Classic Ink, Inc. v. Tampa Bay Rowdies, Civ. A. No. 3:09-CV-784-L, 2010 U.S. Dist. LEXIS 75220, at *6-7, *7-8 (N.D. Tex. July 23, 2010) (disqualifying a lawyer from adversity to an individual, based on the lawyer's previous representation of the entity solely owned by the individual; "Anderson was the sole shareholder, employee, and president of the Entity when it was formed. The Entity never grew significantly in size and eventually came to include a three-person Board of Directors, consisting of Anderson, his wife Carolyn Anderson, and fellow shareholder Mark Scott. At all times, the Entity fit the profile classification of a closely-held corporation, and it [sic] status as a closely-held corporation is undisputed by the parties." (footnote omitted); "The record and hearing testimony make clear that Anderson sought Hemingway [lawyer] because he knew Hemingway, trusted him, and needed legal assistance to help carry on his Internet sales activities. Although Anderson ultimately gave Hemingway approval to incorporate the Entity, it is apparent that incorporating the Entity was Hemingway's legal opinion and advice, which Anderson admittedly accepted and authorized, but not originally Anderson's idea. Hemingway testified that all of the legal work he performed was at the behest of his 'client,' referring to Anderson. That Hemingway, on the one hand, would call Anderson his client and, on the other hand, maintain the position that he never had an attorney-client relationship with Anderson does not square. As it is uncontroverted that the Entity did not exist at the time Anderson first met with and retained Hemingway, the court determines that, at best, Hemingway has demonstrated that he jointly represented Anderson and the Entity. Moreover, given their prior acquaintanceship and the absence of any documentation or contract narrowing Hemingway's representation solely to the Entity, it was reasonable for Anderson -- as well as an objective third-party observer -- to assume that Hemingway represented him and not just the Entity. Accordingly, the court concludes that Anderson has satisfied the first element of the 'substantial relationship' test. An actual attorney-client relationship existed between Anderson and Hemingway." (emphases added)).

Several ethics opinions have warned lawyers who represent closely-held corporations that they must remain neutral in the owners' fight over control of the corporation. That reticence might be expected from bars' legal ethics opinions. Those tend to be very cautious.

- Alaska LEO 2012-3 (10/26/12) ("When conflict issues arise in the context of a small closely-held business entity, for a number of reasons they can be very difficult to resolve. In a small, closely-held organization, unlike a larger organization, each of the owners may have a direct and intimate responsibility for the operation of the business. The attorney for the organization may have dealt directly with each owner on a regular basis on many matters, or even with respect to the particular legal matter at issue. The constituent may have used the legal services of the attorney on unrelated matters or in circumstances in which it was reasonable for the constituent to conclude that the attorney was acting as the constituent's attorney. When owners in a small closely-held organization clash, there is a high likelihood that the attorney will previously have received information or given advice to all concerned that is relevant to the dispute. Finally, when the owners have equal or nearly equal ownership rights and responsibilities, and where each may have been directly involved in giving instructions to the attorney in the past, the attorney may find that it is hard to know who speaks for the business entity and thus who gives direction on behalf of the 'client.' Although ARPC 1.13(g) allows dual representation if the organization consents, it may be impossible to find an 'appropriate individual' or shareholder who is genuinely disinterested and who can thus approval dual representation." (footnote omitted) (emphasis added); "First, when an owner of a closely-held organization, acting in a capacity as a representative or 'constituent' of the organization, consults with the organization's attorney, receives legal advice or provides confidential information no attorney client relationship is formed with the constituent. No conflict of interest arises if the interests of the constituent and the organization later diverge."; "Second, and conversely, advice given by counsel to a constituent regarding the constituent's individual legal issues (including, for example, legal advice regarding the constituent's rights or claims against the organization) may create either an actual or an implied attorney client relationship that gives rise to an impermissible conflict that precludes the attorney from representing the corporation on an issue adverse to the constituent's interests. Finally, to the extent that it is not possible to reconcile the conflict under the Rules of Professional Conduct, or it is not possible to determine who can make decisions on behalf of the client, the attorney must withdraw, rather than express a preference for one client over another." (footnote omitted); "<u>The attorney for a closely-held business entity can and should make clear that the attorney represents the organization, and not the individual owners. The attorney can and should make the implications of this clear as well. Any communications from one owner to the attorney regarding the affairs of the business are not likely to be protected from the other owner. The attorney may not favor the interests of one owner over another during the course of representing the business. If a conflict should arise among the owners the attorney may be required to withdraw from representing any party if the owners cannot agree on a waiver or some method of resolving the conflict.</u>" (footnotes omitted) (emphasis added)).

- Vermont LEO 2009-4 (2009) (holding that a law firm could represent a client adverse to the principal of a corporation which the law firm had previously represented, although the law firm could not use information obtained from the principal; explaining the situation: "The requesting attorney's firm represents A and has done so for a number of years. One matter handled by the requesting attorney was A's purchase of a parcel of land that adjoins lands owned by a corporation in which B is a principal. The firm has never represented the landowner corporation but has formed an LLC for B and has performed collection work for a different corporation in which B is also a principal. Both files are now closed. There are no open files in which either B or any of his business entities are represented by the firm."; "Recently, on A's behalf, the firm sent a letter to the landowner corporation disputing the landowner corporation's claimed right of access onto A's adjoining property. In response to that letter, B has claimed a conflict of interest and requested that the firm refrain from representing A in connection with the dispute."; "In B's claim of conflict he asserts that the requesting attorney's firm's representation of A 'creates at least the appearance of conflict'. He also expresses a concern that his interest may have been compromised by dual loyalties. He goes on to claim that the firm is privy to financial and legal concerns that would compromise him in his negotiations with A. The firm has no active case files for B, and no retainer arrangement exists."; noting that the principal was never the law firm's client; "In the matter at hand, <u>the firm has never actually represented the corporation which is the landowner. Rather, it has represented one of the principals of the landowner corporation in the formation of an LLC and it has performed collection work for an entirely</u>

different corporation. On these facts, we do not believe that the landowner corporation is even a former client. While this may seem an overly technical conclusion, clients should understand that they have separate legal identities from the entities they create so long as those entities have been properly formed and maintained." (emphasis added); warning the law firm that it could not use information obtained from the principal; "Having reached that conclusion, however[,] does not mean that the firm may use information obtained in the course of its work for B and B's other corporation in a manner which is adverse to B's interests. The firm has a continuing duty under Rule 1.9(c) to maintain the confidentiality of information obtained and not to use any information that it may have against B or B's interests." (emphasis added); "It is noted that Rule 1.9(c) does not preclude representation of A. Rather it prohibits the requesting attorney from using or revealing information relating to the former representation of B against B. Even if we (1) assume that the requesting attorney's firm has confidential or secret information obtained during the prior representations of B or B's other corporation; and (2) infer that the requesting attorney has access to all of the firm's files, Rule 1.9(c) does not preclude the requesting attorney from representing A. Rather it precludes the use of confidential or secret information to B's disadvantage.").

- California LEO 1999-153 (1999) (holding that a lawyer who had not previously represented a corporation or any of its executives may represent the company and one of its owners in an action brought by the other owner, as long as both of the lawyer's clients consent; articulating the issue as follows: "May a lawyer, who is not currently and has not previously represented a close corporation as to the subject of a dispute, be retained to represent the corporation and Shareholder A, who is authorized to retain and oversee counsel for the corporation, in a lawsuit brought by Shareholder B, the only other shareholder of the corporation, against both the corporation and Shareholder A?"; offering the following as a digest: "Under the particular facts presented, and subject to any limitations created by any fiduciary duties of Shareholder A, a lawyer may ethically represent both the corporation and Shareholder A in the lawsuit. To the extent a potential conflict of interest exists between Shareholder A and the corporation, the lawyer must obtain the informed written consent of both the corporation and Shareholder A before commencing the representation under rule 3-310(C)(1) of the California Rules of Professional Conduct. Under the facts presented, the corporation's consent to the joint representation may be obtained from Shareholder A. Consistent with rule 3-310(C)(1), this joint representation is permissible only for so long as the corporation and A do not have opposing interests in the lawsuit which the attorney would have a duty to advance simultaneously for each. Additionally, the lawyer must fulfill those duties to the corporation described in rule 3-600."; noting that "[a]t the time of the engagement, Attorney is not currently and has not previously represented Corporation as to the subject matter of the dispute. In addition, Attorney has not previously represented Corporation in any matter." (emphasis added); explaining California law on this issue; "California law has long recognized that when a lawyer acts as corporate counsel, the lawyer's first duty is to the corporation. (Meehan v. Hopps, supra, 144 Cal. App. 2d at p. 293.) As a result, courts have held that corporate counsel should retain from taking part in any controversies or factual differences among shareholders as to control of the corporation so that he or she can advise the corporation without prejudice or bias. (Metro-Goldwyn-Mayer, Inc. v. Tracinda Corp. (1995) 36 Cal. App. 4th 1832, 1842 [43 Cal. Rptr. 2d 327]; Skarbrevik v. Cohen, England & Whitfield, supra, 221 Cal. App. 3d at p. 704; Goldstein v. Lees (1975) 46 Cal. App. 3d 614, 622 [120 Cal. Rptr. 253].) This rule generally applies when a lawyer who has been representing a corporation is asked to represent one shareholder against another shareholder in a dispute over control of the corporation. (Woods v. Superior Court (1983) 149 Cal. App. 3d 931 [197 Cal. Rptr. 185] (lawyer who for years represented corporation owned by husband and wife could not represent one shareholder against the other in a marital dissolution action when the corporation was the primary focus of the dispute); Goldstein v. Lees, supra, 46 Cal. App. 3d 614 [former corporate counsel who had material confidential information could not represent one shareholder in a proxy fight for control of the corporation].)" (emphases added); "On the other hand, a lawyer is not prohibited from taking actions on behalf of the corporation that negatively impact the interests of a shareholder or other constituents. (See Skarbrevik v. Cohen, England & Whitfield, supra, 231 Cal. App. 3d 692 [holding that a lawyer for a corporation may render advice and draft documentation for the corporation that results in a dilution of a minority shareholder's interest in the company]; Meehan v. Hopps, supra, 144 Cal. App. 2d 284 [corporation's lawyer may bring an action on behalf of the corporation's receiver against a majority shareholder who had previously dominated the corporation].)"; noting that the analysis might change if the adverse half-owner gains control of the company or obtains access to confidential communications; "To the extent that B, or another person such as a receiver, obtains the ability to control the affairs of Corporation, an actual conflict of interest could arise. In that situation, Attorney could receive conflicting instructions from Corporation and A. Attorney could be called on to advance inconsistent positions or to pursue a claim by Corporation against A, or vice versa. Attorney could be required to disclose confidential communications with A in the course of the joint representation which A would not want disclosed. Both clients could make a demand on Attorney for the original file."; "Even if a change of control does not occur, a conflict of interest could arise if B, as a constituent of Corporation, has or obtains a right to learn the substance of confidential communications Attorney has with A in the course of the joint representation, which A does not want disclosed to B. These concerns exist not only during the representation, but after the representation as well. While B or some other person might not have the ability to learn the substance of A's confidential information while the joint representation of A or Corporation is pending, in some cases they may attain a position in the Corporation in the future that would entitle them to obtain such information from Attorney."; explaining that the individual half-owner represented by the lawyer may consent on behalf of the company; "Attorney may obtain Corporation's consent to the joint representation from A under the second of the two approaches set forth in the rule. Under the facts presented, A may consent to the joint representation for the Corporation because (1) A is the only other shareholder, and (2) as president of Corporation, A is authorized to retain counsel for the Corporation and oversee the representation of the Corporation by that counsel. These two facts taken together allow Attorney to ethically represent Corporation and A jointly with A's consent for both."; noting that "<u>this opinion does not address a situation in which the lawyer seeking to represent Corporation and A has previously represented Corporation and in so doing has obtained confidential information that is material to the current dispute.</u>" (emphasis added); also noting that the lawyer may not assist the clients in violations of law that may harm the corporation).

- District of Columbia LEO 216 (1/15/91) ("The principle that a lawyer representing a corporation represents the entity and not its individual shareholders or other constituents applies even when the shareholders come into conflict with the entity. <u>Courts have generally held, therefore, that a corporation's lawyer is not disqualified from representing the corporation in litigation against its constituents. . . . A different result may sometimes be required where the shareholders of a closely-held corporation reasonably might have believed they had a personal lawyer-client relationship with the corporation's lawyer.</u>" (emphasis added); "[T]he corporation's lawyer may continue to take direction from A until the dispute over control of the corporation is resolved by the courts or the parties. If, however, the lawyer should become convinced that A's decisions are clearly in violation of A's own fiduciary duties to the corporation, the lawyer may be forced to seek guidance from the courts as to who is in control of the corporation, there being no higher authority within the corporation to whom the lawyer can turn. <u>Throughout the representation, the lawyer must continue to recognize that the interests of the corporation must be paramount and that he must take care to remain neutral with respect to the disputes between the present shareholders, B and U, and between A and U.</u>" (emphasis added)).

Lawyers would be wise to heed such warnings.

As explained above, lawyers representing a closely-held corporation owe what might be called a derivative duty to its minority owners - even in the absence of an attorney-client relationship with them. That might not explicitly prohibit such lawyers from representing the closely-held corporation and its majority owners against its minority owners, but the duty certainly raises the stakes of counterclaims against the corporation (and perhaps even a malpractice claim or ethics charge against the lawyers.

In the classic fight for control of a closely-held corporation, the corporation itself may not need much legal advice or an intensively involved lawyer to represent it. For this reason, it usually seems wise for a lawyer representing a majority owner or owners to select some other lawyer to represent the corporate entity. Even though the majority controls the entity and therefore may direct the entity's lawyer in such a dispute, the majority owner's lawyer is not burdened by any arguable duty to the minority shareholders who are now litigation adversaries.

Such an approach carries another benefit. If a court ultimately finds that the minority shareholders do, or should in the future, control the corporation, the lawyers who have represented the corporation normally must turn over their files to the corporation -- now in the hands of the former adversary. And majority shareholders who have not been warned by their lawyers could even settle a dispute with the minority owners by turning over control of the corporation to them - perhaps in return for some benefit in a related or even unrelated dispute.

The majority owners may not recognize the significance of such a settlement. But just as when a court grants a closely-held corporation's control to an adversary, such a settlement hands over control of the lawyers' corporate client to a former adversary -- who may now access the lawyers' files. This could be an enormous problem for the lawyers, because they presumably had jointly represented the corporation and the owner or owners who at that time controlled the corporation. Because joint clients normally have joint ownership of the lawyers files generated during the joint representation, the former joint client corporation -- now in the hands of former adversaries -- probably can access the lawyer's entire file from the joint representation. This file includes communications and documents relating to the lawyer's representation of the corporation. But more importantly, it includes all of the communications between the lawyer and the owner or owners who formerly controlled the corporation.

<u>Derivative Cases</u>

As in so many other areas, derivative cases present different and usually more complicated issues.

An ABA Model Rules Comment explains that

> Under generally prevailing law, the shareholders or members of a corporation may bring suit to compel the directors to perform their legal obligations in the supervision of the organization. Members of unincorporated associations have essentially the same right. Such an action may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization.
>
> The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.

ABA Model Rule 1.13 cmt. [13] and [14].

Lawyers who represent derivative case corporate defendants and other defendants sometimes regret such a joint representation -- if the corporation declares bankruptcy or otherwise becomes an adversary.

- In re Equaphor Inc., Ch. 7 Case No. 10 20490 BFK, 2012 Bankr. LEXIS 2129, at *9-10 (Bankr. E.D. Va. May 11, 2012) (analyzing the ramifications of a law firm jointly representing a company and two of its executives in a derivative case; noting that the company later declared bankruptcy, and that the bankruptcy trustee moved to compel the turnover of documents the law firm created during the joint representation; inexplicably confusing the joint defense/common interest doctrine and the joint representation situation; ordering the law firm to produce the documents; "WTP and the Individual Defendants place great reliance on the fact that the corporation is named as a 'nominal defendant' in the shareholders' Complaint. In doing so, WTP and the Individual Defendants imply that the interests of the Individual Defendants are entitled to greater weight than those of the Debtor (and now, its creditors). However, while the Debtor may have been named as a nominal defendant, there is no such thing as a nominal client of a law firm. Further, there is no support in the case law for a 'nominal defendant exception' to the principle that all clients are entitled to an attorney's files. The corporation's status as a nominal defendant is of no consequence in considering the common interest privilege of the parties."; "But this is not a discovery dispute in the ordinary sense of the term. It is a motion to compel the turnover of the law firm's files under 11 U.S.C. § 542(e) to the party who now stands in the shoes of the former client, the Debtor. Under these circumstances, the courts have been uniform in holding that the work product doctrine does not prevent the turnover of the files." (emphasis added)).

In 2015, the Southern District of New York addressed a complicated issue involving in lawyers representing corporations and others in a derivative setting.

- Obeid v. La Mack, No. 14 cv 6498 (LTS) (MHD), 2015 U.S. Dist. LEXIS 154546, at *2-3, *3, *4 n.3, *4, *6, *7-8, *8 n.6, *8, *11, *12-13, *15-16, *16-17 (S.D.N.Y. Nov. 9, 2015) (denying a motion to disqualify the law firm McGuireWoods from representing a corporation and two of its owners in a derivative action filed by the third owner; noting that the firm had withdrawn from representing the corporation, and had not represented the third owner in matters substantially related to the current dispute among the owners; finding unpersuasive an affidavit filed by Plaintiff's expert professor Bruce Green; noting New York law's reluctance to disqualify law firms; "We start by emphasizing the cautions that the Second Circuit has advised district courts to observe when addressing disqualification motions. Such motions 'are generally viewed with disfavor' . . . since (1) they interfere with a party's ability to select its own counsel, (2) are often invoked for tactical reasons, and (3) almost invariably cause delays. . . . Thus, a party moving for disqualification must bear 'a heavy burden' . . . even though 'in the disqualification situation any doubt is to be resolved in favor of disqualification.'" . . . (citation omitted); "'The Second Circuit has directed that courts faced with disqualification motions take a "restrained approach that focuses primarily on preserving the integrity of the trial process."'" . . . (citations omitted); "Thus, '[d]isqualification is only warranted in the rare circumstance where an attorney's conduct "poses a significant risk of trial taint."'" (citation omitted); "In addressing disqualification motions, courts look to the American Bar Association Model Rules of Professional Conduct and to state rules governing attorney conduct, but these sources serve only as guides, since the court is exercising its inherent supervisory authority."; "There is some case law suggesting that the mere assertion of derivative claims -- at least theoretically on behalf of the company and against some of its officers or directors -- should preclude joint representation of the defendant officers or directors and of the company, which has the status of a nominal defendant in such a case. . . . Such routine disqualification appears to be inconsistent with the cautions emphasized by the Second Circuit when addressing motions to disqualify the opposing attorney. The better reasoned decisions in such cases have declined to apply such a rubber stamp and have indeed delayed acting on such a basis absent clear evidence of a colorable or stronger basis to infer potential merit to a purported derivative claim."; "Moreover, the New York courts have observed that representation of a company sued derivatively as a nominal defendant does not ordinarily trigger a need for separate representation."; "Apart from these general concerns, <u>when the company in question is closely-held, as in this case, additional practical considerations suggest caution in approaching a disqualification motion."; "This case presents the paradigm for these practical concerns. Gemini is owned and controlled by its three principals -- plaintiff Obeid and defendants La Mack and Massaro -- and each is entitled to one vote, with decisions mandated to be made by majority vote. Unavoidably, then, any replacement attorney would be chosen by Messrs. La Mack and Massaro, and would be subject to their direction. Since a mandated change of counsel would not improve matters, and since there is no demonstrated meaningful threat to the integrity of the trial from the challenged joint representation, we would be strongly inclined to allow McGuire Woods to continue as counsel to Gemini as well as to La Mack and Massaro, were such a decision necessary</u>. In any event, however, during the pendency of this motion, new counsel has been substituted to represent the nominal defendants, and that step leaves no basis to disqualify McGuire Woods from representing the other, active defendants on a conflict-of-interest theory"; "These concerns were highlighted at oral argument when the court inquired of plaintiff's counsel how a substitute attorney for Gemini would make any practical difference and specifically how that lawyer would be selected other than by La Mack and Massaro. Counsel responded with the obviously illusory assumption that plaintiff would join in making the selection, which would have to be unanimous, a scenario that collides with the rules of governance for Gemini, which impose majority rule, with the result that La Mack and Massaro would make the decision. . . . Counsel's only other suggestion was that in the case of a deadlock, the court should somehow solve the conundrum."; "Plaintiff's alternative ground for disqualification, based on the assertion that McGuire Woods previously represented plaintiff, fares no better. The motion plainly fails to satisfy the requirements for triggering disqualification on this basis"; "In substance, Obeid argues that in the past McGuire Woods represented him as a client as well as representing Gemini. He further seems to suggest, albeit in general terms, that the services provided by the law firm involved matters substantially related to the issues in this case. He fails, however, to make a persuasive showing on the essentials of this rule"; "In view of the stated concerns of the Second Circuit as to the disruptive effect of motions to disqualify, the potential for their use as tactical devices, and the desirability of honoring a litigant's choice of attorney, the requirement that there be 'a substantial relationship between the subject matter of the counsel's prior representation of the moving party and the issues in the present lawsuit' is strictly enforced. Thus the Circuit has observed that disqualification will be granted -- assuming the other Evans [Evans v. Artek Sys. Corp., 715 F.2d 788 (2d Cir. 1983)] criteria are met – 'only when the issues [in the two matters are] "identical" or "essentially the same,"' and only if the moving party makes that substantial relationship "patently clear.' . . . Moreover, the congruence must involve an identity of factual issues and not merely an overlap of areas of law."; "There is no obvious linkage -- much less identity -- between legal work that the firm did in altering the Gemini operating agreement to allow Jariwala's [former minority member of Gemini] participation as a minority member of Gemini and the issues in this lawsuit. Although Jariwala may at some point have been a member of Gemini, he had left by the time of the events that gave rise to this lawsuit, and in any event the drafting of documents and the rendition of any advice to Gemini members about their rights vis-a-vis each other and their responsibilities to each other at that earlier time do not mirror the claims or defenses, or any identified legal or factual issues, currently in the case."; "Similarly, the law firm's work on various investment transactions, and some potential transactions, in locations other than New York does not involve factual issues substantially related to the current litigation. Equally irrelevant is any advice that the firm may have given to Obeid (or indeed to the other members of Gemini) about their potential exposure on guarantees that they executed when purchasing or refinancing some properties (none apparently at issue here). Finally, neither the apparent effort by Mr. Harmon [McGuireWoods lawyer] in 2013 and 2014 to drum up some business from Gemini (for which the law firm had last worked in 2009) nor Obeid's asserted disclosure to Harmon of his 'vision' for

> the company amounts to performance by the firm on matters substantially related to the lawsuit before us." (emphasis added)).

Conclusion

As in all contexts, lawyers working with closely-held corporations should carefully define the "client" or "clients" they represent. Of course, lawyers must also deal with ethics and legal principles that might burden them with duties to non-clients. But they can minimize avoidable risks by making sure everyone who owns or manages a closely-held corporation knows the client's or clients' identity.

Even lawyers carefully documenting the clients' identity must avoid other missteps that can occur in a closely-held corporate context.

Among other things, for example, lawyers disclaiming an attorney-client relationship with one or more of the corporation's owners might unwittingly make some filing or prepare an opinion letter or other document on behalf of that owner. Monitoring paralegals' or other nonlawyers' filings and correspondence might minimize this risk. Lawyers should also carefully check any "off-the-shelf" forms that they or their staff might use in such settings.

Lawyers must also remember that a corporate client must avoid oppressing any minority owners. The corporation's lawyers may not assist a corporate client in such wrongful action. This duty to minority owners does not rest on the corporate lawyers' attorney-client relationship with them. The corporation is still the only client. But that client has duties to its minority owners that the corporation's lawyer may not assist the corporation in skirting or violating.

Even though the majority "default" rule generally allows lawyers to represent a closely-held corporation and one of its owners against another owner, careful lawyers often avoid such an arrangement. Among other things, a court judgment or even a settlement might hand control of the corporation over to the adverse co-owner. Lawyers obviously would face termination at that point, but they might not realize that the new owner now controls the lawyer's former joint client (the corporation). This normally would allow the corporation (now in the hands of a former adversary) to access the lawyer's entire file. This could be bad enough for the lawyer if the file includes communications between the lawyer and the corporate decision makers who were then in power but who have now lost control of the corporation. It could be even worse if the lawyer jointly represented the corporation and the other owner -- because most courts would give the corporate joint client access to communications between the lawyer and the other then-joint client (the owner).

All in all, lawyers should keep in mind ethics and legal principles that could cause them problems both in the short term and in the long term.

<u>Best Answer</u>

The best answer to this hypothetical is **MAYBE**. B 8/16

Identifying the Client Within a Corporate Family: Outside Lawyers' Issues

<u>Hypothetical 4</u>

You have been asked to bring a lawsuit against a Dallas-based corporation. Although your law firm's computerized conflicts search does not reveal any problems, one of your partners just called to tell you that she is handling a small amount of labor work for one of the proposed defendant's sister corporations. Your law firm does not represent the parent. The sister corporations are in different businesses, but both rely on the parent's law department for legal advice.

May you represent your client in the lawsuit against the Dallas-based corporation (without its consent)?

<u>MAYBE</u>

<u>Analysis</u>

When representing a corporation, the entity is the client.[1] However, it is unclear whether all members of the corporate "family" are also clients for conflicts purposes.[2]

<u>ABA Model Rules</u>

The ABA Model Rules generally seem to allow a lawyer representing one member of a corporate family to take matters adverse to another member of that family. However, the Rules also mention circumstances in which such representation will be impermissible -- thus depriving lawyers of certainty.

> A lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary. See Rule 1.13(a). Thus, the lawyer for

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1 ABA Model Rule 1.13(a).

2 When this issue arises in the context of the attorney-client privilege, most courts have held that <u>all</u> members of the corporate family are within the scope of the privilege. <u>See, e.g.</u>, <u>Admiral Ins. Co. v. United States Dist. Court</u>, 881 F.2d 1486, 1493 n.6 (9th Cir. 1989); <u>United States v. AT&T</u>, 86 F.R.D. 603, 616-17 (D.D.C. 1979); <u>Weil Ceramics & Glass, Inc. v. Work</u>, 110 F.R.D. 500, 503 (E.D.N.Y. 1986).

> an organization is not barred from accepting representation adverse to an affiliate in an unrelated matter, unless the circumstances are such that the affiliate should also be considered a client of the lawyer, there is an understanding between the lawyer and the organizational client that the lawyer will avoid representation adverse to the client's affiliates, or the lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client.

ABA Model Rule 1.7 cmt. [34] (emphasis added).

The ABA has also issued a legal ethics opinion discussing this issue.[3] In ABA LEO 390 (1/25/95) the ABA rejected a per se determination that representation of one corporate affiliate and adversity to another automatically creates a conflict. The ABA indicated that the existence of a conflict depends on: the lawyer's and client's understanding of which corporate entities are clients; the client's expectations about an attorney-client relationship with the affiliated corporation; the facts of the representation (such as whether the lawyer actually performs work for a corporate affiliate, reports to the general counsel of a parent when working for a subsidiary, etc.); the nature of the corporate affiliation (such as any alter ego relationships among corporate affiliates); and whether the lawyer has acquired any confidential information from the corporate affiliate. The ABA indicated that adversity to a corporation generally amounts only to "indirect" adversity to an affiliated corporation, because the adversity only derivatively affects the affiliate.

[3] ABA LEO 390 (1/25/95) ("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. However, a lawyer may not accept such a representation without consent of the corporate client if the circumstances are such that the affiliate should also be considered a client of the lawyer; or if there is an understanding between the lawyer and the corporate client that the lawyer will avoid representations adverse to the client's corporate affiliates; or if the lawyer's obligations to either the corporate client or the new, adverse client, will materially limit the lawyer's representation of the other client. Even if the circumstances are such that client consent is not ethically required, as a matter of

prudence and good practice a lawyer who contemplates undertaking a representation adverse to a corporate affiliate of a client will be well advised to discuss the matter with the client before undertaking the representation."; explaining that "[c]learly, 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 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"; noting that "considerations of client relations will ordinarily dictate the lawyer's course of conduct" without addressing ethics issues; noting that "circumstance of only partial ownership . . . is a variable that might affect the result in a particular case," but does not fundamentally change the analysis; holding that "in the absence of a clear understanding otherwise, the better course is for a lawyer to obtain the corporate client's consent before the lawyer undertakes a representation adverse to its affiliate"; also noting that lawyers must follow whatever retainer contract they enter into with clients, but that "a client that has such an expectation [that its lawyer will not be adverse to its affiliate] has an obligation to keep the lawyer apprised of changes in the composition of the corporate family"; addressing various factors in determining the propriety of a lawyer taking matters adverse to the affiliate of a corporate client; "[T]he nature of the lawyer's dealings with affiliates of the corporate client may be such that they have become clients as well. This may be the case, for example, where the lawyer's work for the corporate parent -- say, on a stock issue or bank financing -- is intended to benefit all subsidiaries, and involves collecting confidential information from all of them. Even if the subject matter of the lawyer's representation of the corporate client does not involve the affiliate at all, however, the lawyer's relationship with the corporate affiliate may lead the affiliate reasonably to believe that it is a client of the lawyer. For example, the fact that a lawyer for a subsidiary was engaged by and reports to an officer or general counsel for its parent may support the inference that the corporate parent reasonably expects to be treated as a client. . . . A client-lawyer relationship with the affiliate may also arise because the affiliate imparted confidential information to the lawyer with the expectation that the lawyer would use it in representing the affiliate. . . . Additionally, even if the affiliate confiding information does not expect that the lawyer will be representing the affiliate, there may well be a reasonable view on the part of the client that the information was imparted in furtherance of the representation, creating an ethically binding obligation that the lawyer will not use the information against the interests of any member of the corporate family. Finally, the relationship of the corporate client to its affiliate may be such that the lawyer is required to regard the affiliate as his client. This would clearly be true where one corporation is the alter ego of the other. It is not necessary, however, for one corporation to be the alter ego of the other as a matter of law in order for both to be considered clients. A disregard of corporate formalities and/or a complete identity of managements and boards of directors could call for treating the two corporations as one. . . . The fact that the corporate client wholly owns, or is wholly owned by, its affiliate does not in itself make them alter egos. However, whole ownership may well entail not merely a shared legal department but a management so intertwined that all members of the corporate family effectively operate as a single entity; and in those circumstances representing one member of the family may effectively mean representing all others as well. Conversely, where two corporations are related only through stock ownership, the ownership is less than a controlling interest and the lawyer has had no dealing whatever with the affiliate, there will rarely be any reason to conclude that the affiliate is the lawyer's client"; also distinguishing between direct and indirect adversity; "The paradigm situation here is presented by a lawyer's bringing a lawsuit, unrelated in substance to the lawyer's representation of a corporate client, seeking substantial money damages against a wholly owned subsidiary of the client: if the suit is successful, this will affect adversely not only the subsidiary but the parent as well, in the sense that one of its assets is the equity in the subsidiary, and its consolidated financial statements may (unless the subsidiary has applicable insurance coverage) reflect the impact of material adverse judgments against the subsidiary"; explaining that a lawyer's representation that involves "attacking the conduct or credibility of the second client or seeking to compel resisted discovery from the client" is directly adverse, but that positional adversity is not directly adverse; including that financial impact on another member of a corporate family is only indirect adversity; nevertheless finding that even such an indirect adversity might be a "material limitation" under Model Rule 1.7(b) ultimately shifting the burden of proof on the lawyers seeking to undertake the representation; "[I]n any instance where the lawyer concludes that no client consent is required, under either paragraph of Rule 1.7, the lawyer should be prepared to show how he

Finally, the ABA explained that even in the absence of a conflict lawyers might be prohibited from taking positions adverse to a corporate client's affiliate if their diligence or judgment on behalf of the corporate client might be adversely affected (if, for instance, the corporate client would "resent" the lawyer undertaking the representation).

As might be expected, the ABA advised lawyers to resolve any doubts in favor of withdrawal, and suggested that a lawyer should discuss matters with the existing client even if consent is not required.

Restatement

The Restatement takes the same basic approach.

> For purposes of identifying conflicts of interest, a lawyer's client is ordinarily the person or entity that consents to the formation of the client-lawyer relationship, see § 14. For example, when a lawyer is retained by Corporation A, Corporation A is ordinarily the lawyer's client; neither individual officers of Corporation A nor other corporations in which Corporation A has an ownership interest, that hold an ownership interest in Corporation A, or in which a major shareholder in Corporation A has an ownership interest, are thereby considered to be the lawyer's client.

Restatement (Third) of Law Governing Lawyers § 121 cmt. d (2000).

The Restatement includes two illustrations (Illustrations 6 and 7) which distinguish between: (1) a lawyer taking a litigation matter against a client's wholly owned subsidiary, when the lawsuit might materially affect the client's value;[4] and (2) a

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was able to make the various determinations required without contacting the client for information or consent -- particularly determinations (a) that the client does not have an expectation that the corporate affiliate will be treated as a client, and (b) that the proposed representation adverse to the affiliate will not have a material adverse effect on the representation of the client.").

4 Restatement (Third) of Law Governing Lawyers § 121 cmt. d, illus. 6 (2000) ("Lawyer represents Corporation A in local real-estate transactions. Lawyer has been asked to represent Plaintiff in a products-liability action against Corporation B claiming substantial damages. Corporation B is a wholly owned subsidiary of Corporation A; any judgment obtained against Corporation B will have a material

lawyer taking a litigation matter against a company that is 60% owned by the client's parent, in a matter that will not materially affect either the defendant's or the parent's financial position[5] -- the former is unacceptable, while the latter is acceptable.

State Ethics Rules

Most states follow the ABA Model Rules approach to this issue, which is discussed above. As explained in that discussion, the ABA Model Rules do not provide any certainty, and therefore give little comfort to lawyers tempted to take a matter adverse to a corporate client's affiliate if they would not otherwise be deterred from doing so by business concerns.

Several jurisdictions have specific ethics rules that seem to go further toward allowing such representations adverse to a corporate client's affiliates. However, none of them provide 100% certainty.

A Washington, D.C., ethics rule takes the most expansive approach, providing numerous comments on the issue and offering language that would seem to permit such representations in more circumstances than allowed in the ABA Model Rules.

One comment provides a general explanation of D.C. Rule 1.13:

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adverse impact on the value of Corporation B's assets and on the value of the assets of Corporation A. Just as Lawyer could not file suit against Corporation A on behalf of another client, even in a matter unrelated to the subject of Lawyer's representation of Corporation A . . . , Lawyer may not represent Plaintiff in the suit against Corporation B without the consent of both Plaintiff and Corporation A under the limitations and conditions provided in § 122.").

5 Restatement (Third) of Law Governing Lawyers § 121 cmt. d, illus. 7 (2000) ("The same facts as in Illustration 6, except that Corporation B is not a subsidiary of Corporation A. Instead, 51 percent of the stock of Corporation A and 60 percent of the stock of Corporation B are owned by X Corporation. The remainder of the stock in both Corporation A and Corporation B is held by the public. Lawyer does not represent X Corporation. The circumstances are such that an adverse judgment against Corporation B will have no material adverse impact on the financial position of Corporation A. No conflict of interest is presented; Lawyer may represent Plaintiff in the suit against Corporation B.").

> As is provided in Rule 1.13, the lawyer who represents a corporation, partnership, trade association or other organization-type client is deemed to represent that specific entity, and not its shareholders, owners, partners, members or "other constituents." Thus, for purposes of interpreting this rule, the specific entity represented by the lawyer is the "client." Ordinarily that client's affiliates (parents and subsidiaries), other stockholders and owners, partners, members, etc., are not considered to be clients of the lawyer. Generally, the lawyer for a corporation is not prohibited by legal ethics principles from representing the corporation in a matter in which the corporation's stockholders or other constituents are adverse to the corporation. <u>See</u> D.C. Bar Legal Ethics Committee Opinion No. 216. A fortiori, and <u>consistent with the principle reflected in Rule 1.13, the lawyer for an organization normally should not be precluded from representing an unrelated client whose interests are adverse to the interests of an affiliate</u> (<u>e.g.</u>, parent or subsidiary), stockholders and owners, partners, members, etc., of that organization in a matter that is separate from and not substantially related to the matter on which the lawyer represents the organization.

D.C. Rule 1.7 cmt. [21] (emphasis added).

However, the next two comments list the circumstances in which a lawyer representing one member of a corporate family generally <u>cannot</u> take a matter adverse to one of a corporate client's affiliates. The first situation involves the lawyer's acquisition of confidential information from the client that it could use against the client's affiliate.

> However, there may be cases in which a lawyer is deemed to represent a constituent of an organization client. Such de facto representation has been found where a lawyer has <u>received confidences from a constituent during the course of representing an organization client in circumstances in which the constituent reasonably believed that the lawyer was acting as the constituent's lawyer as well as the lawyer for the organization client</u>." <u>See generally</u> ABA Formal Opinion 92-365. In general, representation may be implied where on the facts there is a <u>reasonable belief by the constituent that</u>

> there is individual as well as collective representation. Id. The propriety of representation adverse to an affiliate or constituent of the organization client, therefore, must first be tested by determining whether a constituent is in fact a client of the lawyer. If it is, representation adverse to the constituent requires compliance with Rule 1.7. See ABA Opinion 92-365. The propriety of representation must also be tested by reference to the lawyer's obligation under Rule 1.6 to preserve confidences and secrets and to the obligations imposed by paragraphs (b)(2) through (d)(4) of this rule. Thus, absent informed consent under Rule 1.7(c), such adverse representation ordinarily would be improper if:
>
> (a) the adverse matter is the same as, or substantially related to, the matter on which the lawyer represents the organization client,
>
> (b) during the course of representation of the organization client the lawyer has in fact acquired confidences or secrets (as defined in Rule 1.6(b)) of the organization client or an affiliate or constituent that could be used to the disadvantage of any of the organization client or its affiliate or constituents, or
>
> (c) such representation seeks a result that is likely to have a material adverse effect on the financial condition of the organization client.

D.C. Rule 1.7 cmt. [22] (emphases added).

The next comment addresses another scenario in which the lawyer's representation would generally be improper -- if the lawyer's client and the adversary are considered "alter egos" of each other.

> In addition, the propriety of representation adverse to an affiliate or constituent of the organization client must be tested by attempting to determine whether the adverse party is in substance the "alter ego" of the organization client. The alter ego case is one in which there is likely to be a reasonable expectation by the constituents or affiliates of an organization that each has an individual as well as a collective client-lawyer relationship with the lawyer, a likelihood that a result adverse to the constituent would also be adverse to the existing organization client, and a risk that both the new and the old representation would be so

> adversely affected that the conflict would not be "consentable." Although the alter ego criterion necessarily involves some imprecision, it may be usefully applied in a parent-subsidiary context, for example, by analyzing the following relevant factors: whether (i) the parent directly or indirectly owns all or substantially all of the voting stock of the subsidiary, (ii) the two companies have common directors, officers, office premises, or business activities, or (iii) a single legal department retains, supervises and pays outside lawyers for both the parent and the subsidiary. If all or most of those factors are present, for conflict of interest purposes those two entities normally would be considered alter egos of one another and the lawyer for one of them should refrain from engaging in representation adverse to the other, even on a matter where clauses (a), (b) and (c) of the preceding paragraph [22] are not applicable. Similarly, if the organization client is a corporation that is wholly owned by a single individual, in most cases for purposes of applying this rule, that client should be deemed to be the alter ego of its sole stockholder. Therefore, the corporation's lawyer should refrain from engaging in representation adverse to the sole stockholder, even on a matter where clauses (a), (b) and (c) of the preceding paragraph [22] are not applicable.

D.C. Rule 1.7 cmt. [23] (emphases added).

Similarly, a comment to the Florida ethics rules regarding representation of related organizations provides that

> a lawyer or law firm who represents or has represented a corporation (or other organization) ordinarily is not presumed to also represent, solely by virtue of representing or having represented the client, an organization (such as a corporate parent or subsidiary) that is affiliated with the client. There are exceptions to this general proposition, such as, for example, when an affiliate actually is the alter ego of the organizational client or when the client has revealed confidential information to an attorney with the reasonable expectation that the information would not be used adversely to the client's affiliate(s). Absent such an exception, an attorney or law firm is not ethically precluded from undertaking representations adverse to affiliates of an existing or former client.

Florida Rule 4-1.13 cmt. (emphasis added). Thus, Florida also recognizes exceptions to the general rule if (1) the lawyer has learned confidences from the corporate client that could be used against the affiliates, and (2) the two corporate family members are considered "alter egos" of each other.

Although Washington, D.C.'s, and Florida's ethics rules clearly decrease the uncertainty about whether lawyers can undertake such representations adverse to corporate clients' affiliates, neither rule reduces the uncertainty to zero. The presence of <u>any</u> uncertainty usually deters lawyers from undertaking such representations.

Not surprisingly, New York's new ethics rules effective April 1, 2009 deal with this issue. One of the comments to New York Rule 1.7 essentially follows the ABA approach -- without coming to a definitive conclusion.

> A lawyer who represents a corporation or other organization does not, simply by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary. <u>See</u> Rule 1.13(a). Although a desire to preserve good relationships with clients may strongly suggest that the lawyer should always seek informed consent of the client organization before undertaking any representation that is adverse to its affiliates, Rule 1.7 does not require the lawyer to obtain such consent unless: (i) the lawyer has an understanding with the organizational client that the lawyer will avoid representation adverse to the client's affiliates, (ii) the lawyer's obligations to either the organizational client or the new client are likely to adversely affect the lawyer's exercise of professional judgment on behalf of the other client, or (iii) the circumstances are such that the affiliate should also be considered a client of the lawyer. Whether the affiliate should be considered a client will depend on the nature of the lawyer's relationship with the affiliate or on the nature of the relationship between the client and its affiliate. For example, the lawyer's work for the client organization may be intended to benefit its affiliates. The overlap or identity of the officers and boards of directors, and the

> client's overall mode of doing business, may be so extensive that the entities would be viewed as "alter egos." Under such circumstances, the lawyer may conclude that the affiliate is the lawyer's client despite the lack of any formal agreement to represent the affiliate.

New York Rule 1.7 cmt. [34]. The New York Bar adopted two other comments not found in the ABA Model Rules. The first provides helpful guidance to lawyers attempting to analyze the conflict of interest situation (although without providing absolute certainty), and the second reminds lawyers of the economic impact of their analysis.

> Whether the affiliate should be considered a client of the lawyer may also depend on: (i) whether the affiliate has imparted confidential information to the lawyer in furtherance of the representation, (ii) whether the affiliated entities share a legal department and general counsel, and (iii) other factors relating to the legitimate expectations of the client as to whether the lawyer also represents the affiliate. Where the entities are related only through stock ownership, the ownership is less than a controlling interest, and the lawyer has had no significant dealings with the affiliate or access to its confidences, the lawyer may reasonably conclude that the affiliate is not the lawyer's client.

New York Rule 1.7 cmt. [34A].

> Finally, 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 a magnitude that it would materially limit the lawyer's ability to represent the client opposing the affiliate. In 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.

New York Rule 1.7 cmt. [34B].

<u>State Bar Opinions</u>

State bars also take differing approaches.

Predictably, the New York City Bar has frequently analyzed this issue. Unfortunately, the New York City Bar's most recent analysis adopts the sort of fact-intensive standard that lacks predictability.

- New York City LEO 2005-05 (6/2005) (addressing what are called "thrust upon" conflicts; among other factors, analyzing the ethics rules governing a lawyer's adversity to a corporate client; "Previous opinions have articulated the circumstances under which an apparent conflict involving a member of a current client's corporate family will be considered an actual conflict of interest requiring consent to continue representing both parties. This determination is based on several factors, including the relationship between the two corporate entities, and the relationship between the work the law firm is doing for the current client and the work the law firm wishes to undertake in opposition to the client's corporate family member. <u>See</u> <u>Eastman Kodak Co. v. Sony Corp.</u>, 2004 WL 2984297 at *3 (W.D.N.Y. Dec. 27, 2004) ('[t]he relevant inquiry centers on whether the corporate relationship between the two corporate family members is 'so close as to deem them a single entity for conflict of interest purposes'"); <u>Discotrade Ltd v. Wyeth-Ayerst Int'l, Inc.</u>, 200 F.Supp.2d 355, 358-59 (S.D.N.Y. 2002) (concluding that a corporate affiliate was also a client for conflict purposes because, among other things, the affiliate was an operating unit or division of an entity that shared the same board of directors and several senior officers and used the same computer network, e-mail system, travel department and health benefit plan as the client); <u>J.P. Morgan Chase Bank v. Liberty Mutual Insurance Co.</u>, 189 F.Supp.2d 20, 21 (S.D.N.Y. 2002) (concluding that a subsidiary of a corporate client is also a client for conflicts purposes because 'the relationship [between the two] is extremely close and interdependent, both financial and in terms of direction'; among other things they operated from the same headquarters, shared the same board of directors, and the general counsel (and senior vice president) of the parent was also the general counsel (and senior vice president) of the subsidiary). <u>See also</u> N.Y. City Eth. Op. 2003-03 (whether a corporate affiliate is a client for conflicts purposes 'will depend on many factors, including the relationship between the two corporations and the relationship between the work the law firm is doing for the current client and the work the law firm wishes to undertake in opposition to the client's corporate family member'); <u>[s]ee also</u> ABA Formal Op. No. 95-390 (1995) (factors as to whether a corporate affiliate of a client is also considered a client include whether the subject matter of the representation involves the affiliate; whether affiliate reasonably believes that it is a client of the lawyer;

whether the affiliate imparted confidential information to the lawyer in expectation of representation; and whether the lawyer may be required to regard the affiliate as a client due to the relationship between the client and affiliate); N.Y. County Eth. Op 684 (1991) (factors as to whether representation of parent company extends to subsidiary include whether either the parent or subsidiary reasonably believes that an attorney-client relationship exists; whether counsel to the parent is privy to confidential information about subsidiary that could be detrimental to the subsidiary's interests; and whether the parent's interests would be materially adversely affected by an action against its subsidiary).").

The Illinois Bar has taken essentially the same fact-laden approach.

- Illinois LEO 95-15 (5/1996) (addressing the ability of a lawyer representing a corporation to take matters adverse to one of the client's wholly owned subsidiaries; "The Committee therefore concludes that a corporate affiliation, including a majority or even sole ownership of a subsidiary, without more, does not make a client corporation's affiliate an additional client of the lawyer. Because a corporate client's affiliate is not deemed to be a client of the corporation's lawyer merely because of the affiliation, then a representation adverse to the affiliate will not be directly adverse to 'another client' within the meaning of Rule 1.7(a)."; "The Committee notes, as do the ABA and the California Bar, that there may well be particular circumstances that would require the lawyer to consider a subsidiary or other constituent of a corporate client to be a client of the lawyer as well. Such instances could include, for example, situations where the lawyer's work for a corporate parent involves direct contact with its subsidiaries and the receipt of information concerning the subsidiaries protected by Rule 1.6 or situations where the client corporation and the subsidiary in question have the same management group. Another situation that would require the lawyer to treat a corporate affiliate as a client is where one entity could be considered the alter ego of the other. In these kinds of circumstances, the lawyer would be required to seek the corporate client's consent, with appropriate disclosure, before accepting a representation adverse to the affiliate."; "In conclusion, the Committee believes that the Rules of Professional Conduct generally permit a lawyer to accept a proposed representation adverse to a subsidiary or other affiliate of an existing corporate client entity. As also noted above, however, this general proposition may be altered by the specific facts and circumstances of any particular situation. As noted above, the better solution to the issue addressed in this opinion is the agreement of lawyers and corporate clients, in defining the scope of an engagement, as to those affiliates that will be included in the corporate client group.").

In California LEO 1989-113, the California Bar concluded that

> [a] parent corporation, even one which owns 100 percent of the stock of a subsidiary, is still, for purposes of rule 3-600, a shareholder and constituent of the corporation. Rule 3-600 makes clear that in the representation of corporations, it is the corporate entity actually represented, rather than any affiliated corporation, which is the client.

California LEO 1989-113 (1989). Furthermore, "[t]he fact of total ownership does not change the parent corporation's status as a constituent of the subsidiary." The parent corporation argued that a successful action against its subsidiary would adversely affect its finances. The Bar rejected this argument:

> [H]ere, the parent is not a party to the suit against the subsidiary, and there is no prospect that it will be made a party. The representation against the subsidiary can therefore have no direct consequences on the parent; the only adversity can be that indirect adversity which might result from the diminution in the value of the parent's stock in the subsidiary if the attorney's suit against the subsidiary is ultimately successful. This possible indirect impact is insufficient to give rise to a breach of the duty of loyalty owed to the parent.

Id. The California Bar recognized only one exception to this rule -- if corporate form is disregarded and a parent is considered its subsidiary's "alter ego."

Case Law

Courts also take differing positions. Some courts hold that the representation of one member of the corporate family makes other members "clients" for conflicts purposes.[6]

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[6] Bd. of Managers v. Wabash Loftominium, L.L.C., 876 N.E.2d 65, 74 (Ill. App. Ct. 2007); Avocent Redmond Corp. v. Rose Elecs., 491 F. Supp. 2d 1000 (W.D. Wash. 2007); UCAR Int'l, Inc. v. Union Carbide Corp., No. 00 Civ. 1338 (GBD), 2002 U.S. Dist. LEXIS 21766 (S.D.N.Y. Nov. 7, 2002); Travelers Indem. Co. v. Gerling Global Reinsurance Corp., No. 99 Civ. 4413 (LMM), 2000 U.S. Dist. LEXIS 11639 (S.D.N.Y. Aug. 14, 2000); Discotrade Ltd. v. Wyeth-Ayerst Int'l, Inc., 200 F. Supp. 2d 355 (S.D.N.Y. 2002); Stratagem Dev. Corp. v. Heron Int'l N.V., 756 F. Supp. 789 (S.D.N.Y. 1991); In re Blinder,

Other courts flatly state that the representation of one member of a corporate family does not have that effect.[7]

In 2012, the Northern District of Ohio flatly held that a law firm representing a parent corporation did not automatically represent its subsidiary.

- FDIC v. Commonwealth Land Title Ins. Co., Case No. 1:08CV2390, 2012 U.S. Dist. LEXIS 127247, at *13, *13-14, *14, *15 (N.D. Ohio Sept. 7, 2012) (finding that a law firm's representation of a parent company did not make one of the parent's subsidiaries a law firm client; "Defendant is not a client of Thompson Hine just by virtue of the fact that it is wholly owned by Chicago Title."; "Moreover, 'parent and subsidiary corporations are separate and distinct legal entities, "even if the parent owns all of the outstanding shares of the subsidiary."'. . . The attorney-client relationship is a contractual one, and a contract cannot bind parties that are not included in the contract."; "During the Brown and Moore matters, Defendant could not have had a reasonable belief that Thompson Hine was their counsel because Defendant was represented by their own attorneys. . . . Defendant was not a party to Chicago Title's Brown or Moore matters. Chicago Title and Defendant appear to have separate legal departments; otherwise this potential conflict would have been brought to the attention of the parties sooner. Chicago Title's indirect interest in its subsidiary (i.e., Defendant) succeeding in the litigation against the FDIC is solely insufficient to create a situation of direct adversity."; "The Court finds that Thompson Hine and Defendant did not have an attorney-client relationship." (emphasis added)).

The case law generally looks at the same factors as the legal ethics opinions.

In 2010, the Second Circuit adopted what it called the "operationally integrated" standard.

- GSI Commerce Solutions, Inc. v. Babycenter, L.L.C., 618 F.3d 204, 211, 213, 210, 210-11, 211, 211-12, 212 n.3 (2nd Cir. 2010) (disqualifying the law firm of Blank Rome from handling a matter adverse to BabyCenter, a wholly owned subsidiary of Blank Rome's client Johnson & Johnson; ultimately adopting a "operationally integrated" standard for determining what a law

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Robinson & Co., 123 B.R. 900, 909-10 (Bankr. D. Colo. 1991); Teradyne, Inc. v. Hewlett-Packard Co., No. C-91-0344 MHP ENE, 1991 U.S. Dist. LEXIS 8363 (N.D. Cal. June 6, 1991).

[7] Whiting Corp. v. White Mach. Corp., 567 F.2d 713 (7th Cir. 1977); Brooklyn Navy Yard Cogeneration Partners, L.P. v. Superior Court, 70 Cal. Rptr. 2d 419 (Cal. Ct. App. 1997); Pennwalt Corp. v. Plough, Inc., 85 F.R.D. 264 (D. Del. 1980).

firm's corporate client's affiliate should be regarded as a law firm "client" for conflict purposes; noting that the Blank Rome retainer letter contained the following provision: "'Unless otherwise agreed to in writing or we specifically undertake such additional representation at your request, we represent only the client named in the engagement letter and not its affiliates, subsidiaries, partners, joint venturers, employees, directors, officers, shareholders, members, owners, agencies, departments or divisions.'"; noting that Johnson & Johnson complained about Blank Rome's role only after the mediation failed; "Although the American Bar Association ('ABA') and state disciplinary codes provide valuable guidance, a violation of those rules may not warrant disqualification. . . . Instead, disqualification is warranted only if 'an attorney's conduct tends to taint the underlying trial.'" (citation omitted); "The factors relevant to whether a corporate affiliate conflict exists are of a general nature. Courts have generally focused on: (i) the degree of operational commonality between affiliated entities, and (ii) the extent to which one depends financially on the other. As to operational commonality, courts have considered the extent to which entities rely on a common infrastructure. . . . Courts have also focused on the extent to which the affiliated entities rely on or otherwise share common personnel such as managers, officers, and directors."; "This focus on shared or dependent control over legal and management issues reflects the view that neither management nor in-house legal counsel should, without their consent, have to place their trust in outside counsel in one matter while opposing the same counsel in another."; "<u>[W]e agree with the ABA that affiliates should not be considered a single entity for conflicts purposes based solely on the fact that one entity is a wholly-owned subsidiary of the other, at least when the subsidiary is not otherwise operationally integrated with the parent company.</u>" (emphasis added); "First, Babycenter substantially relies on J&J for accounting, audit, cash management, employee benefits, finance, human resources, information technology, insurance, payroll, and travel services and systems. Second, both entities rely on the same in-house legal department to handle their legal affairs. The member of J&J's in-house legal department who serves as 'board lawyer' for BabyCenter helped to negotiate the E-Commerce Agreement between BabyCenter and GSI that is the subject of the present dispute. Moreover, J&J's legal department has been involved in the dispute between GSI and BabyCenter since it first arose, participating in mediation efforts and securing outside counsel for BabyCenter. Finally, BabyCenter is a wholly-owned subsidiary of J&J, and there is at least some overlap in management control."; "GSI argues that BabyCenter and J&J have forfeited any right to contest Blank Rome's representation. It focuses on the fact that J&J and BabyCenter waited several months before objecting to Blank Rome as counsel. We reject GSI's argument because a party's delay in raising a conflict-of-interest objection does not prohibit a court from deciding whether a conflict of interest exists."; ultimately holding that Blank & Rome's retainer letter was insufficient to allow the law firm to represent a party adverse to the Johnson & Johnson affiliate; noting among other things that the retainer letter purported to allow Blank Rome to sue even departments and divisions of Johnson & Johnson, which would clearly be unethical. (emphasis added)).

Courts applying this approach have sometimes disqualified law firms.

- Atl. Specialty Ins. Co. v. Premera Blue Cross, No. 2:15-cv-01927-TSZ, 2016 U.S. Dist. LEXIS 54333, at *34-35, *35, *38-39 (disqualifying a law firm from representing defendant, because the law firm's earlier representation of the plaintiff's affiliate created a conflict; "[T]he question is whether ASIC [plaintiff] and Homeland's [insurance company] common management, reinsurance agreement, and shared Legal Claims Unit require them to be treated as a single entity for conflicts purposes. As noted above, Lane Powell contends that these entities are 'distinct corporations,' with each maintaining its own financial reporting, and the firm represented Homeland (and not OneBeacon) in the AAM matter and has always been adverse to ASIC."; "The most helpful cases on point, although they are largely from other districts, have considered the question of when a corporate parent and its wholly-owned subsidiary should be considered the same entity for conflicts purposes. Although this matter, of course, involves the slightly different question of whether two corporate affiliates should be considered the same entity for conflicts purpose, the analysis is, for all intents and purposes, the same."; "Based upon this precedent, the Court concludes that ASIC and Homeland must be considered a single entity for purposes of the conflicts analysis. ASIC has provided substantial evidence showing that ASIC and Homeland's operations are sufficiently intertwined to reflect a unity of interest. As wholly-owned subsidiaries of OneBeacon, ASIC and Homeland conduct unified operations. . . . All OneBeacon member companies share the same mailing address and principal place of business. . . . Perhaps most significantly, however, these entities' operations are structured so that all claims-handling services for all OneBeacon companies are handled by the same internal Claims Unit personnel, who are employees of ASIC, with the claim leadership located in Plymouth, Minnesota. . . . The same Claims Legal Unit handles all insurance coverage litigation commenced by or against the OneBeacon companies, including ASIC and Homeland. . . . This is further exemplified by the fact that Homeland, Lane Powell's client in the AAM coverage dispute, has no employees, and the same claims attorney, Ms. Lindley, was involved in both the AAM and Premera matters. . . . In hiring Lane Powell and obtaining legal advice in the AAM matter, Ms. Lindley was an ASIC employee fulfilling ASIC's contractual obligations to its affiliate, Homeland.").

- Honeywell Int'l, Inc. v. Philips Lumileds Lighting Co., Case No. 2:07-CV-463-CE, 2009 U.S. Dist. LEXIS 12496, at *4, *4-5, *6, *7-8, *8 (E.D. Tex. Jan. 6, 2013) (disqualifying Paul Hastings under the simultaneous concurrent representation standard; "Philips Lumileds claims that much of the work conducted by PHJW [Paul Hastings] on behalf of Philips is funneled through a wholly-owned Philips Division, Philips IP&S. Philips IP&S directs intellectual property legal strategy in the United States and abroad for Philips divisions and subsidiaries, including Philips Consumer Electronics, Philips Healthcare, and Philips Lumileds. Similar to other Philips subsidiaries, Philips Lumileds, the defendant in this case, receives legal direction from Philips IP&S. Neither Philips, nor any of its subsidiaries has consented to PHJW's handling this infringement case against Philips Lumileds."; "Honeywell, to the contrary, contends that Philips Lumileds is not a client of PHJW. Honeywell concedes that PHJW represents PENCA [sic] in a number of governmental matters. Honeywell, however, asserts that Philips Lumileds and PENAC [Philips Elecs., N. Am. Corp] do not share a parent-subsidiary relationship, but are attenuated affiliates of one another. Honeywell also denies the fact that PHJW has represented any of the above asserted Philips entities, including Philips IP&S."; "The first issue is whether Philips Lumileds is a current client of PHJW. Here, the issue centers on whether a corporate affiliation creates a concurrent client-lawyer relationship. The issue of whether a corporate affiliation 'ipso facto creates a client-lawyer relationship with every member of a corporate family when one of its members is formally represented by the lawyer' is not addressed in the ABA Model Rules themselves."; "Here, it is undisputed that (1) Philips Lumileds and the other Philips affiliates share a common legal department, Philips IP&S; (2) Philips and Philips Lumileds share common management, computer networks, and marketing designs; and (3) PHJW currently represents PENAC. As indicated above, Philips IP&S directs intellectual property litigation and licensing strategy for Philips subsidiaries worldwide, including Philips Lumileds. Additionally, while it is generally disputed, PHJW has had broad access to confidential information of various Philips entities, based on its representation of various Philips entities. In fact, Lawrence R. Sidman, a partner at PHJW, stated in his declaration that he had received confidential information concerning PENAC, Philips Consumer Electronics, Philips Healthcare, and Philips IP&S. . . . Although it is not clear whether PHJW's representation of PENAC will directly benefit Philips Lumileds, this fact is not dispositive."; "In addition, some courts have pointed to manifestations to the public as a factor relevant to disqualification."; "<u>Here, both the Philips Lumileds' website and marketing materials feature the Philips logo. The PENAC website also features the Philips logo.</u> Considering all the facts, the Court is persuaded that Philips Lumileds should be considered a current client of PHJW." (emphases added)).

- <u>Cascades Branding Innovation, LLC v. Walgreen Co.</u>, Case No. 11 C 2519, 2012 U.S. Dist. LEXIS 61750, at *17, *21, *22, *23-24 (N.D. Ill. May 3, 2012) (disqualifying the law firm of Robins Kaplan from adversity to the subsidiary of a parent company which had interviewed but not hired Robins Kaplan; noting that "[i]t is also clear that the parent company, Cascades Ventures, is directing the current litigation. <u>See GSI</u>, <u>infra</u>. Cascades Ventures and

Plaintiff are managed by the same personnel, are part of the same corporate family and are closely aligned in purpose."; "It also appears that Cascades Ventures routinely operates its litigation through subsidiaries created for that purpose. In fact, the litigation which Brown sought to entice Robins Kaplan into filing was eventually filed through a subsidiary, Cascades Computer Innovation, LLC."; "[I]t is apparent that Cascades Ventures (the party that had the prospective-client relationship with Robins Kaplan) is effectively the same party as Cascades Branding for the purpose of conflict-of-interest analysis. This conclusion is based on the fact that Cascades Ventures is the sole owner of Cascades Branding, and due to the fact that Cascades Ventures appears responsible for acquiring and managing the legal representation of its subsidiaries. It is further based on the unique business model of Cascades Ventures, a non-practicing entity ('NPE') seeking to enforce patents through subsidiaries."; pointing to the parent's disclosure of material confidences to Robins Kaplan; "The August 25, 2010 communication reflects a distinct litigation strategy with regards to the Elbrus portfolio, and it further reflects that Schultz (e-mailing from an airport) was able to recall this information off the top of his head without the benefit of a file."; "The Court believes the e-mail at issue not only reflects strategy specific to one target in the Elbrus matter, but is illuminating as to Cascades Ventures' core litigation, licensing, reasonable royalty and business model strategies. . . . what sort of return Cascades Ventures would accept, what sort of settlements would make litigation profitable, and what sort of royalty and licensing agreements Cascades was looking for.").

- Bd. of Managers v. Wabash Loftominium, L.L.C., 876 N.E.2d 65, 74 (Ill. App. Ct. 2007) (assessing the conflict of interests involved in litigation brought by a lawyer who moved from the Chicago law firm of Michael Best & Friedrich to the firm of Arnstein & Lehr, which was then representing related corporations; describing the connection between the defendants and the law firm's clients, most of which involved indirect ownership through LLCs; upholding the trial court's reliance on Illinois LEO 95-15, which points to related corporations' "same management group" as a factor demonstrating that the related companies should be considered as the same client for conflicts purposes; "The particular circumstances of this case indicate Arnstein [law firm] was engaged by and reports to a management group that runs parent, subsidiary, and affiliated corporations that own, manage, and develop residential condominium properties in Chicago. The particular circumstances of this case would lead the management group and the Ambelos corporations [the holding company which developed residential condominium projects in Chicago] to reasonably believe they were Arnstein's existing clients."; noting that the law firm had represented "this management group" on sixty different matters between 1999 and 2005; explaining that any the doubt about the existence of a lawyer-client relationship be clarified by the lawyer; "Significantly, there is no indication that Arnstein took any affirmative action to inform the Ambelos management group that it was ending their long-term attorney-client relationship regarding the ownership, management, and development of residential condominium properties in Chicago."; also rejecting the law firm's effort to avoid disqualification by imposing an internal screen; disagreeing with the law firm that the clients had waived their right to complain about the conflict by not raising it for six or seven months after learning that the lawyer had moved to the new law firm).

More infrequently, courts decline to disqualify law firms under this fact-intensive standard.

- <u>Skanska USA Bldg. Inc. v. Atl. Yards B2 Owner, LLC</u>, 40 N.Y.S.3d 46, 54, 55 (N.Y. App. Div. 2016) (declining to disqualify Troutman Sanders from presenting a defendant despite the firm's representation of plaintiff's corporate affiliates in unrelated matters; "Skanska USA Civil Inc. (Skanska Civil) is a wholly owned subsidiary of Skanska USA Inc. Plaintiff is likewise a wholly owned subsidiary of Skanska USA. Skanska Civil holds entities which work in various regions of the United States, including Skanska USA Southeast Inc. (Skanska Southeast). Neither Skanska Southeast's Virginia litigation nor its Florida and Maryland transactional matters have any relationship to, or involve any of the same adverse parties as, the instant action. Nor does plaintiff allege that any of Troutman's Forest City litigation team members possesses any of plaintiff's confidential information, or that the ethical screen that Troutman has set up between its Forest City and Skanska attorneys is in any other way inadequate."; "The motion court therefore providently exercised its discretion in denying plaintiff's motion to disqualify the law firm. Plaintiff has not shown that, standing alone, Troutman's representation of corporate affiliates of plaintiff and adversity to one of the directors of one of plaintiff's affiliates creates a conflict of interest (see Rules of Professional Conduct [22 NYCRR 1200.0] rules 1.7[a], 1.13[a]).").

<u>Ability to Define the "Client" in Retainer Agreements</u>

Clients and lawyers can try to define the "client" as a matter of contract in their retainer agreements.

- <u>Avocent Redmond Corp. v. Rose Elecs.</u>, 491 F. Supp. 2d 1000, 1004, 1004 n.2, 1007-08, 1010, 1011 (W.D. Wash. 2007) (disqualifying Heller Ehrman from adversity to a corporate affiliate of a corporate client; noting that the retainer letter with its client specifically indicates that the law firm will represent its corporate client "and its affiliates"; "<u>Had Heller Ehrman wanted to limit the scope of its representation, it could have done so by expressly limiting the OSA affiliates that it was agreeing to represent rather than broadly</u>

agreeing to represent all of them. As one scholar cited by defendant's expert states, 'The lack of a per se disqualification rule does not mean that the corporate family would be unable to impose such a rule. The law firm and client, in the initial engagement letter, could always agree to treat some or all members of the corporate family as a single entity, or as separate entities'). Ronald D. Rotunda, Conflicts Problems When Representing Members of Corporate Families, 72 Notre Dame L. Rev. 655, 687-88 (1997); see Dkt. # 68 at P8. Furthermore, the conflict at issue here could have been discovered earlier if Heller Ehrman had listed 'OSA . . . and its affiliates' as the client in its electronically-maintained conflicts database." (emphasis added); also noting that during the scope if its representation of the corporate client Heller Ehrman would have dealt with licenses in the same "patent family" as the patents at issue in the current adversity -- meaning that the law firm's previous representation of the corporate client was "substantially related" to the current adversity; also noting that Heller Ehrman retained its former client's files -- meaning that Heller Ehrman's current adversary would have to ask the law firm for its files; "This puts Heller Ehrman in the troublesome position of having to review and produce documents from its own files relating to the representation of a former client because a current litigation client has requested the documents in discovery."; "Should any issue regarding attorney-client privilege or work product doctrine arise, Heller Ehrman lawyers would be both asserting privilege or work-product on behalf of Redmond as an OSA affiliate, and representing defendants in contesting any claim of privilege.").

In some cases, law firms have been able to avoid disqualification by relying on a retainer agreement that explicitly limited the firm's representation to one corporate entity –– thus implicitly allowing the law firm to represent other clients adverse to its corporate affiliates.

- e2Interactive, Inc. v. Blackhawk Network, Inc., No. 09-cv-629-slc, 2010 U.S. Dist. LEXIS 48333, at *4-5, *6, *12, *13-14, *14-15, *15, *16-17, *17, *17-18 (W.D. Wis. May 17, 2010) (refusing to disqualify Alston & Bird from handling a matter adverse to a Safeway subsidiary while simultaneously representing Safeway itself in another matter; also finding that Alston's past representation of a trade association that included Safeway's subsidiary did not warrant disqualification because the representation was not related to the matter Alston was handling adverse to the subsidiary; explaining that Safeway's in-house lawyer refused to sign Alston's retainer letter that limited the firm's representation to Safeway and excluded affiliates, but then signed a letter with the same provision on a later occasion two years later; "In September 2007, Safeway retained William Baker of Alston & Bird to represent Safeway in the Ware litigation. Ann Erickson, senior corporate counsel for Safeway, refused to sign Alston's initial proposed retainer agreement and specifically objected to an advance waiver of conflicts provision and a 'one client' provision limiting Alston's representation to the Safeway parent entity and not its subsidiaries. The first provision, entitled 'Waiver of Future Conflicts,' stated that Safeway waived any future conflicts so long as the subject matter was not substantially related to Alston's work for Safeway. The second provision, entitled 'Limitation of Client Relationship to One Entity, Not Affiliates,' provided that Alston's 'representation of Safeway, Inc., does not give rise to an attorney-client relationship between the Firm and . . . any . . . subsidiary or affiliated entity . . . .'"; "In summer 2009, Baker sent Erickson a new retainer letter to change the hourly fee arrangement for the Ware litigation, to a fixed monthly fee arrangement. The 2009 retainer letter contained the provisions titled 'Waiver of Future Conflicts' and 'Limitation of Client Relationship to One Entity, Not Affiliates,' that were identical to the provisions Erickson had struck in the October 2007 retainer letter. Erickson struck the 'Waiver of Future Conflicts' provision in the new retainer letter and Alston inserted a notice provision instead; however, she signed the revised retainer letter on or about September 1, 2009 without striking the 'Limitation of Client Relationship' provision." (emphases added); holding that "[t]he attorney-client relationship may be informal and implied from the words and actions of the parties. . . . Whether and when an attorney client relationship exists depends on the contractual intent and conduct of the parties."; finding that there was no "Conflict by Agreement"; "Safeway struck these provisions, stating its position that by representing Safeway, Alston was representing Safeway's subsidiaries and that Safeway would not argue to allow Alston to sue its subsidiaries. However, Safeway never put these statements into the amended retainer, so it is not clear whether Alston actually agreed with Safeway's position or simply agreed to delete the contrary language from the retainer agreement."; "That retainer was replaced with a 2009 retainer in which defendant agreed that Alston's representation of Safeway did not give rise to an attorney-client relationship between Alston and defendant's subsidiaries. In other words, any 'understanding' was erased on September 1, 2009 by agreement. Because there is no evidence that Alston had started representing plaintiffs by that date, the 2007 agreement created no conflict."; "Not so fast, argues defendant: Safeway should not be held to the terms of the 2009 agreement because it was not expecting the conflict terms to change from the previous agreement. This is not going to get defendant very far: a person signing a document has a duty to read it and know the contents of the writing." (emphasis added); "Defendant tries to shift the onus to Alston, by contending that the law firm was its 'fiduciary' who therefore was required to alert Safeway to every change made to the agreement rather than expect Safeway to read it. . . . If Alston sneaked in a change (or just forgot to include Safeway's redactions in the new version of the agreement), that's either a sharp practice or sloppy work, but neither is enough to conclude that a large corporation with sophisticated in-house lawyers should not be held to the terms of an agreement it signed." (emphasis added); also finding that there was no "conflict by creation of [an] attorney-client relationship," because even if the subsidiary was to be treated as a client for conflicts purposes pursuant to the 2007 letter, it did not create a full attorney-client relationship; "An agreement to treat a subsidiary as a client in this setting 'does not in itself establish a full fledged client-lawyer relationship with the affiliates,' ABA Comm. On Ethics and Prof'l Responsibility, Formal Op. 95-390 (1995), so no current or former client status arises out of such an agreement.")).

Although one might expect courts to honor such explicit arrangements (especially with sophisticated corporate clients), not all of them do.

In 2014, the Southern District of New York acknowledged that Gibson Dunn had disclaimed any representation of a corporate parent's subsidiaries, but nevertheless found that the subsidiaries were Gibson Dunn's clients for conflicts purposes (presumably by operation of law, applying the fact-specific standard discussed above). Fortunately for Gibson Dunn, the court nevertheless declined to disqualify the law firm.

- HLP Props., LLC v. Consol. Edison Co. of N.Y., No. 14 Civ. 01383 (LGS), 2014 U.S. Dist. LEXIS 147416, at *9-10, *10-11, *12, *13-14, *14, *16 (S.D.N.Y. Oct. 16, 2014) (refusing to disqualify the law firm of Gibson Dunn from adversity to the subsidiary of a parent that the firm represents in unrelated matters; noting that Gibson Dunn's retainer letter with the parent excluded its subsidiaries from any attorney-client relationship, although the parent and the subsidiary shared law the same law department; also noting that Gibson Dunn asked the parent for consent to be adverse to the subsidiary after the parent complained, and was turned down; "CECONY [subsidiary] argues two theories upon which Gibson Dunn should be disqualified, both premised on Gibson Dunn's alleged concurrent representation of adverse clients. First, CECONY asserts that Gibson Dunn has served both CECONY and CEI [parent] directly as clients. Because the evidence in the record does not establish that Gibson Dunn provided any legal services directly to CECONY, this argument is rejected. Second, CECONY asserts that, even if Gibson Dunn provided services only to CEI, CECONY and CEI must be considered the same client for purposes of disqualification. This contention is correct, and accordingly the burden is on Gibson Dunn to demonstrate that 'there will be no actual or apparent conflict in loyalties or diminution in the vigor of his representation.' . . . Because

Gibson Dunn has met its burden, and because other factors counsel against disqualification, the motion is denied." (citation omitted); "CECONY's argument that it was a client of Gibson Dunn is not supported by the evidence. First, the engagement letter in the CEI matter explicitly states that Gibson Dunn is not undertaking the representation of any of CEI's subsidiaries absent express agreement. The parties agree that there was no such agreement. Second, Olson denies having performed work in any capacity for CECONY. Third, the two instances in which Gibson Dunn allegedly rendered services to CECONY -- Gibson Dunn's review of CEI's proxy statements and Gibson Dunn's advice to CEI in respect to a third party audit relating to issues at both CEI and CECONY -- were not rendered to CECONY or with the express purpose of assisting CECONY, although they may have indirectly benefitted CECONY. On this record, no attorney-client relationship existed between Gibson Dunn and CECONY. See generally Merck Eprova AG v. ProThera, Inc., 670 F. Supp. 2d 201, 210 (S.D.N.Y. 2009) (citing six-factor test for determining existence of attorney-client relationship)."; "The same operational commonalities exist here [as in GSI Commerce Solutions, Inc. v. Babycenter LLC, 618 F.3d 204, 209 (2d Cir. 2010)] -- namely, CEI and CECONY share corporate headquartesr, a computer system, a payroll system, a human resources department, benefits plans and their law department. Further, the two companies share management -- all of the CEI's six officers are also officers of CECONY. Finally, there is substantial financial dependence between the two companies -- CECONY is CEI's principal subsidiary and represents 85% of its operating revenues, 96% of its net income and 89% of its assets. Accordingly, CEI and CECONY are the same corporate entity for conflicts purposes."; "While Gibson Dunn engaged in troubling conduct in failing to obtain a waiver from CEI and Plaintiffs when it undertook to represent CEI, that conduct does not warrant disqualification. First, the record provides no indication of an actual or apparent conflict in loyalties or diminished vigor in Gibson Dunn's representation. Plaintiffs have attested to their confidence in Gibson Dunn's continuing as their litigation counsel and Gibson Dunn has already represented Plaintiffs for fifteen years without complaint from either Plaintiffs or CEI."; "Second, the record contains no evidence that there is any risk of trial taint, and Defendant does not suggest otherwise. Gibson Dunn's dual representations involve unrelated subjects, different attorneys, different Gibson Dunn departments (transactional versus litigation), different offices, and different legal entities -- a parent and a subsidiary."; "The final consideration is whether Plaintiffs will suffer significant prejudice if Gibson Dunn is disqualified. Were it not for this consideration, the outcome of this motion might well have been different, but the issue of prejudice given the duration of the parties' dispute -- 15 years -- is critical and weighs heavily against disqualification. Gibson Dunn has represented Plaintiffs in connection with the Site since 1999. The case involves complex environmental and regulatory matters. It is doubtful, to say the least, that new counsel could acquire the knowledge accumulated over the years by Gibson Dunn in the time it will take for this case to run its course." (emphases added)).

On the other hand, courts have disqualified law firms based on engagement letters (or, more frequently, outside counsel guidelines) defining the law firms' "clients" as all corporations affiliated with the corporation to whom the law firm will provide legal advice.

- Dr. Falk Pharma GmbH v. Generico, LLC, 916 F.3d 975, 982, 982-83, 983, 984, 984-85, 985, 986 (Fed. Cir. 2019) (disqualifying law firm of Katten Muchin from representing its client Mylan in trademark litigation against Bausch & Lomb, relying on the engagement letter Katten had earlier signed with Bausch & Lomb's parent Valeant, which recognized all Valeant affiliates as Katten Muchin clients; explaining that two Alston & Bird lawyers moved to Katten and brought Mylan as a client with them, which was then a defendant in a case brought by Valeant; "Circumstances in which an affiliate is considered a client of a lawyer can arise by express agreement or when affiliates are so interrelated that representation of one constitutes representation of all."; "Katten's representation of Mylan adverse to Valeant-CA and Salix in Valeant II and its ongoing representation of Bausch & Lomb, an affiliate of movants, presents a concurrent conflict of interest in violation of Rule 1.7. This is true even though movants are affiliates of Bausch & Lomb because the terms of the engagement letter and movants' demonstration of interrelatedness between the various Valeant affiliates presents circumstances such that movants should also be considered a client of Katten."; "Because the engagement letter creates an ongoing attorney-client relationship between the law firm, Katten, and its organizational clients, Valeant-CA and Salix, Katten's representation of Mylan adverse to movants in Valeant II gives rise to a concurrent conflict of interest under Rule 1.7. The express terms of the engagement letter and accompanying OC Guidelines indicate that Katten formed such a relationship with the movants when it signed the engagement letter for the Bausch & Lomb trademark litigation. Specifically, the engagement letter states that it 'represents the general terms of engagement governing the overall relationship between [Katten] and Valeant Pharmaceuticals International, Inc.' . . . This sentence, on its face, demonstrates that Katten's relationship extends beyond just Bausch & Lomb to at least Valeant-CA." (first alteration in original); "The OC Guidelines, which are expressly incorporated into the engagement letter, further extend the relationship to include any Valeant entity."; also relying on case law to come to the same conclusion; "Even if there were any plausible ambiguity in the engagement letter, Mylan's arguments would still fail because Valeant-CA, Salix, and Bausch & Lomb have demonstrated that the three entities are sufficiently interrelated to give rise to a corporate affiliate conflict. The relevant regional circuits have not previously set out factors governing corporate interrelatedness in this context."; pointing to the frequently cited "operational commonality" standard articulated in GSI Commerce Solutions, Inc. v. BabyCenter, L.L.C., 618 F.3d 204, 210-11 (2d Cir. 2010); "In the absence of evidence to the contrary, we conclude that the relevant regional circuits would likely find the Second Circuit's reasoning persuasive and would therefore adopt its factors here. In particular, we find that they would agree that shared or dependent control over operational and legal matters between the affiliates is significant to the inquiry. Accordingly, we apply the Second Circuit's interrelatedness test to the facts in this case, and find that Valeant-CA, Salix, and Bausch & Lomb all share a high degree of operational commonality and are financially interdependent. Gorman Suppl. Decl. at ¶¶ 5, 6, 7, 10, 11, 12."; "The two also 'share the same in-house Valeant legal department.'" (internal citation omitted); recognizing that some courts adopt a per se disqualification standard for ethics violations, while others look at total circumstances, but that Katten would be disqualified under either standard; "Mylan contends that, even if Katten has violated Rule 1.7, disqualification is not warranted under the circumstances. Some district courts have held that disqualification is mandatory for violation of Rule 1.7. See, e.g., Manoir-Electroalloys Corp. v. Amalloy Corp., 711 F. Supp. 188, 195 (D.N.J. 1989) (finding that disqualification should be mandatory for violation of Rule 1.7). But other district courts have considered whether the totality of the circumstances—including the impact, nature, and degree of a conflict, the prejudice or hardship to either party, and which party was responsible for creating the conflict—warrants disqualification. Wyeth v. Abbott Labs., 692 F. Supp. 2d 453, 457-59 (D.N.J. 2010) (citing Boston Sci. Corp. v. Johnson & Johnson, Inc., 647 F. Supp. 2d 369, 374 (D. Del. 2009); Elonex I.P. Holdings, Ltd. v. Apple Computer, Inc., 142 F. Supp. 2d 579, 583-84 (D. Del. 2001) (balancing factors to find disqualification unwarranted). We have previously disqualified counsel without consideration of any factor, other than the fact of the ethical violation, but did so in a nonprecedential decision. Freedom Wireless, 2006 U.S. App. LEXIS 32797, 2006 WL 8071423, at *3 ('Having concluded that a conflict of interest exists, we further conclude that disqualification . . . is warranted.'). Here, we need not decide which approach is preferable because we find that, even if additional considerations were necessary, they all weigh in favor of disqualification." (alteration in original); "Finally, we conclude that Katten's erection of an ethical wall is insufficient to resolve its violation of Rule 1.7. Katten claims that this wall cordons off Mukerjee and Soderstrom from Katten attorneys who have worked on matters for Bausch & Lomb, Valeant-CA, or affiliates in the 18 months preceding May 7, 2018. But this wall does nothing to address the concerns stemming from Katten's violation because it was created after Mukerjee and Soderstrom joined Katten, it applies only partially to work conducted within 18 months before May 7, 2018, and Katten

> never previously informed movants of any potential conflict." (emphases added)).

Although uncertainty might aid the client or the lawyer if some dispute arises, in most situations it is better for both to know the exact identities of all of the lawyer's clients.

Conclusion

There is no clear answer to this hypothetical. Under some courts' and bars' approaches, you might be barred from representing one subsidiary and being adverse to another. On the other hand, the sister-subsidiary relationship is even more attenuated than the parent-subsidiary connection, and the ABA Model Rules emphasize that the lawyer's client is the entity and not any of its constituents.

Under the logical fact-intensive approach, you would need more facts to decide whether you could represent your client in the lawsuit without the defendant's consent.

Best Answer

The best answer to this hypothetical is **MAYBE**. B 8/16

Identifying the Client Within a Corporate Family: In-House Lawyers' Issues

Hypothetical 5

After about three years of practice, you decided to move in-house with your largest client. From your work with that client, you know that it has several wholly owned subsidiaries and several partially owned subsidiaries.

As an in-house lawyer, will you be jointly representing the parent corporation (which employs you) and all of its subsidiaries?

MAYBE

Analysis

Lawyers representing corporations owe their duty to the corporation as an entity, not to any of its constituents. ABA Model Rule 1.13(a). This basic rule seems easy to understand in the abstract, but can result in enormously difficult ethics situations for in-house and outside lawyers representing corporations.

The ABA Model Rules explain that

> [w]ith respect to the law department of an organization, including the government, there is ordinarily no question that the members of the department constitute a firm within the meaning of the Rules of Professional Conduct. There can be uncertainty, however, as to the identity of the client. For example, it may not be clear whether the law department of a corporation represents a subsidiary or an affiliated corporation, as well as the corporation by which the members of the department are directly employed.

ABA Model Rule 1.0 cmt. [3] (emphasis added).

In the disqualification context, the stakes of improperly identifying the client (or in recognizing the attorney-client relationship) can involve very high stakes.

The ABA Model Rules include law departments within their definition of law firms.

> "Firm" or "law firm" denotes a lawyer or lawyers in a law partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization or the legal department of a corporation or other organization."

ABA Model Rule 1.0(c). (emphasis added).

This seemingly innocuous definition imputes to an entire law department an individual in-house lawyer's disqualification under ABA Model Rule 1.10 (absent some other ABA Model Rules provision). Thus, each in-house lawyer must guard against his or her own individual disqualification -- to avoid an imputed disqualification. The risk of each lawyer's disqualification in turn depends on the identity of that lawyer's current and former clients.

The Restatement similarly recognizes that the existence of an attorney-client relationship within a single corporation or a corporate family depends on the circumstances.

> Whether a lawyer represents affiliated organizations as clients is a question of fact . . . . When a lawyer represents two or more organizations with some common ownership or membership, whether a conflict exists is determined primarily on the basis of formal organizational distinctions. If a single business corporation has established two divisions within a corporate structure, for example, conflicting interests or objectives of those divisions do not create a conflict of interest for a lawyer representing the corporation. Differences within the organization are to be resolved through the organization's decisionmaking procedure.
>
> If an enterprise consists of two or more organizations and ownership of the organizations is identical, the lawyer's obligation is ordinarily to respond according to the decisionmaking procedures of the enterprise, subject to any special limitations that might be validly imposed by regulatory regimes such as those governing financial institutions and insurance companies.

> On the other hand, when ownership or membership of two or more organizations is not identical, the lawyer must respect the organizational boundaries of each and analyze possible conflicts of interest on the basis that the organizations are separate entities. That is true even when a single individual or organization has sufficient ownership or influence to exercise working control of the organizations.

Restatement (Third) of Law Governing Lawyers § 131 cmt. d (2000). An illustration describes the complication triggered by other owners' stake in a subsidiary controlled by the lawyer's client/employer.

> A Corporation owns 60 percent of the stock of B Corporation. Lawyer has been asked by the President of A Corporation to act as attorney for B in causing B to make a proposed transfer of certain real property to A at a price whose fairness cannot readily be determined by reference to the general real estate market. Lawyer may do so only with effective informed consent of the management of B (as well as that of A). The ownership of A and B is not identical and their interests materially differ in the proposed transaction.

Restatement (Third) of Law Governing Lawyers § 131 illus. 2 (2000).

As in the ABA Model Rules, the Restatement generally imputes an individual in-house lawyer's disqualification to the entire law department.

> Questions concerning the proper scope of imputation can also arise because of inter-organizational relationships. For example, if one corporation owns all of the stock of another, it is ordinarily appropriate to consider lawyers employed by each corporation as part of a single legal office for purposes of imputed prohibition. Likewise, if one corporation exercises substantial control over the actions of another corporation or if such control is exercised by a group of shareholders of two or more corporations, principles of imputed prohibition similarly should be applied to corporate counsel. However, imputation between the legal offices might be inappropriate where, despite common management in other respects, the legal offices of the affiliated organizations are separately operated.").

Restatement (Third) of Law Governing Lawyers § 123 cmt. d(i) (2000).

In 2008, the New York City Bar took the same basic approach.

- New York City LEO 2008-02 (2/1/08) ("In analyzing the conflicts facing inside counsel who 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. 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). 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.";"It is inevitable that on occasion parents and subsidiaries will see their interests diverge, particularly in spin-off, sale, and insolvency 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."; "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. 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 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)."; "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)."; "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."; "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."; "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."; "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."; "Alternatively, inside counsel can limit the representation of one or more affiliates to avoid conflicts."; "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.").

In 2017, the Illinois Bar issued a legal ethics opinion suggesting that in-house lawyers always treat their employer's affiliates as if they were separate clients - for both loyalty and confidentiality purposes.

- Illinois LEO 17-05 (5/2017) (analyzing the loyalty (conflicts) and confidentiality implications of parent company's in-house lawyer's dealings with corporate subsidiaries of the lawyer's client/employer; recommending: (1) that lawyer treat subsidiaries as separate clients for loyalty/conflicts purposes, including even obtaining consents or prospective consents in the event of any "competing interests"; and (2) also treat subsidiaries as separate clients for confidentiality purposes, including even analyzing how confidential information will be shared among the corporate affiliates; "<u>For the in-house lawyer, there is no one size fits all test for identifying the client. It may change depending on the circumstances of the representation</u>. Is it the single corporate parent (whose interests may be considered to preempt the interests of any subsidiary, or in any case, be able to provide informed consent to any conflict waiver or disclosure of confidential information)? Or is it the legally distinct individual subsidiaries? Recognizing subsidiaries as separate clients seems to be acknowledged in the IRPC noted above, particularly IRPC 1.13. For practical purposes, <u>treating subsidiaries as distinct clients would seem the better practice if for no other purpose than to focus the in-house lawyer's attention on identifying and addressing problematic legal and ethical issues</u>."; "With respect to conflicts of interests, when an in-house lawyers is called upon to provide legal services to a related corporate entity that is not the lawyer's direct employer, the lawyer must be careful to recognize the potential for competing interests. . . . As with any representation, the in-house lawyer must consider and, if applicable, apply IRPC 1.7. Although impacted by client identification, the interests of intra-family corporate entities may or may not be considered aligned. <u>If the interests are determined to conflict, an in-house lawyer can consider a number of actions to address and resolve the conflict. First and foremost is to obtain, if possible, the subsidiary's and parent's consent to the representation as permitted by IRPC 1.7(b). Counsel may also consider obtaining advance conflict waivers</u>, limiting the scope of the representation to eliminate the potential conflict, or retaining outside counsel."; "<u>Perhaps even thornier issues than conflicts arise with respect to confidentiality under IRPC Rule 1.6</u>. Virginia State Bar Opinion 1838 provides that an in-house lawyer must maintain a subsidiary's confidences unless the subsidiary consents to disclosure. In most corporate contexts, maintaining this confidentiality from the corporate parent, and perhaps other subsidiaries, is likely unworkable and doesn't reflect the work of an in-house legal department. . . . Attempting to maintain confidentiality between related corporate entities, but particularly between a subsidiary and a parent, tends to disregard corporate ownership and hierarchy. . . . In these situations, as with conflicts of interest, a prudent course for the in-house lawyer may be to memorialize in writing how confidential information will be treated, obtain advance consent for disclosure, or retain outside counsel.") (emphases added).

It seems seems unlikely that many in -house lawyers would take these steps, but Illinois LEO 17-05 (5/2017) certainly serves to "focus the in-house lawyer's attention on identifying and addressing problematic legal and ethical issues."

Thus, for conflicts purposes, corporate parents and their wholly owned subsidiaries generally are treated as a single client or joint clients, but partially owned subsidiaries may not be. This highlights the wisdom of in-house lawyers defining their "clients" for ethics purposes.

For purposes of privilege, most courts protect as privileged communications between a parent's lawyer and wholly owned or controlled subsidiaries' employees.

- SCR-Tech LLC v. Evonik Energy Servs. LLC, 2013 NCBC 42, at ¶ 18, ¶¶ 15, 26 (N.C. Super. Ct. Aug. 13, 2013) (reviewing the very sparse case law on privilege protection for communications with partially owned subsidiaries; dealing with communications to and from plaintiff SCR-Tech (1) when the company was partially owned by Ebinger; (2) when the company was then sold to, and wholly owned by, Catalytica, and (3) when the company later entered into a "common interest agreement" with Ebinger, because both faced similar litigation; applying a sort of sliding scale, considering both the percentage of ownership and any "shared legal interest."; concluding that the privilege protected communications during all three situations, because (1) SCR-Tech's shared legal interest with Ebinger meant that the court did not have to determine whether Ebinger's 37.5% ownership (which gave it control) was "too limited" to assure privilege protection by itself; (2) Catalytica's 100% ownership of, and shared legal interest with, SCR-Tech assured privilege protection; (3) the "common interest" doctrine could protect communications between SCR-Tech and its former controlling shareholder Ebinger even in the absence of any corporate affiliation at that time.).

- Glidden Co. v. Jandernoa, 173 F.R.D. 459, 472-73 (W.D. Mich. 1997) ("The universal rule of law, expressed in a variety of contexts, is that the parent and subsidiary share a community of interest, such that the parent (as well as the subsidiary) is the 'client' for purposes of the attorney-client privilege. See Crabb v. KFC Nat'l Man. Co., 1992 U.S. App. LEXIS 38268, 1992 WL 1321 (6th Cir. 1992) ('The cases clearly hold that a corporate 'client' includes not only the corporation by whom the attorney is employed or retained, but also parent, subsidiary and affiliate corporations.') (quoting United States v. AT&T, 86 F.R.D. 603, 616 (D.D.C. 1979)). Consequently, disclosure of legal advice to a parent or affiliated corporation does not work a waiver of the confidentiality of the document, because of the complete community of interest between parent and subsidiary. Id. at *2. Numerous courts have recognized that, for purposes of the attorney-client privilege, the subsidiary and the parent are joint clients, each of whom has an interest in the privileged communications. See, e.g., Polycast Tech. Corp. v. Uniroyal, Inc., 125 F.R.D. 47, 49 (S.D.N.Y. 1989); Medcom Holding Co. v. Baxter Travenol Lab., 689 F. Supp. 841, 842 (N.D. Ill. 1988). Simply put, a sole shareholder has a right to complete disclosure about the legal affairs of its wholly owned subsidiary.").

Some courts insist that corporate affiliates demonstrate a common legal interest before protecting their communications as privileged.

- Au New Haven, LLC v. YKK Corp., No. 15-CV-03411 (GHW)(SN), 2016 U.S. Dist. LEXIS 160602, at *10, *20 (S.D.N.Y. Nov. 18, 2016) (rejecting defendants' argument that "entities under common ownership sharing privileged information are always considered to be a single entity for the purpose of attorney-client privilege" protection; instead holding that "[e]ntities that are under common ownership must still demonstrate that [the common interest doctrine] applies, such as by making a showing that a common attorney was representing both corporate entities or that they otherwise shared a common legal interest"; ultimately finding the privilege applicable).

The required commonality is axiomatic in the case of wholly owned subsidiaries. And presumably the type of communications that would otherwise deserve privilege protection would normally be based on a common legal interest even if there was no totally identical ownership.

In-house lawyers can essentially assure privilege protection by jointly representing their client/employer and any wholly or partially owned subsidiaries. However, that can create conflicts issues if adversity develops, and perhaps more serious file ownership issues if such adversity develops.

Best Answer

The best answer to this hypothetical is **MAYBE**. B 8/16

Ownership of the Attorney-Client Relationship after Corporate Transactions

Hypothetical 6

As the most experienced transactional lawyer in your law department, you generally take responsibility for large corporate transactions. Your client has been trying to dramatically downsize as it struggles to avoid bankruptcy, and you have several questions about the effect of transactions on the attorney-client relationship (including the privilege).

(a) The current crisis began when one of your clients wholly - owned subsidiaries declared bankruptcy after a disastrous transaction. Who now owns the attorney-client relationship and privilege for that subsidiary ?

(A) Your client?

(B) The bankruptcy trustee?

(B) THE BANKRUPTCY TRUSTEE

(b) If your client sells the stock of a subsidiary to another company, who will own the attorney-client relationship and privilege?

(A) Your client?

(B) The former subsidiary?

(B) THE FORMER SUBSIDIARY

(c) If your client sells substantially all the assets of a subsidiary to another corporation, who will own the relationship and privilege?

(A) Your client?

(B) The former subsidiary?

(B) YOUR CLIENT (PROBABLY)

(d) Can you affect the relationship's and the privilege's ownership in the transactional documents?

(A) YES (PROBABLY)

Analysis

Although starting with the common-sense notion that in-house and outside lawyers represent the institutional client and not any constituent of the institutional client, any analysis involving corporate stock and asset transactions can create remarkably complicated and even frightening implications.

(a) As a corporate asset, the attorney-client relationship and privilege normally passes to corporate successors (who can assert or waive the privilege) -- including bankruptcy trustees. Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 349 (1985); United States v. Campbell, 73 F.3d 44, 47 (5th Cir. 1996).

In contrast to this universally-accepted result in the context of a corporate bankruptcy, the issue is more complicated when an individual declares bankruptcy.

Lawyers representing corporations which are teetering on the edge of bankruptcy should keep this rule in mind. Bankruptcy trustees might ultimately control the privilege that would otherwise protect from public view desperate pre-bankruptcy communications between management and the lawyer.

This universally-accepted principle can lead to some counter-intuitive results.

For instance, in 2015 the SEC asked a corporation to waive its privilege and produce documents during its investigation. SEC v. Present, Civ. No. 14-14692-LTS, 2015 U.S. Dist. LEXIS 170245 (D. Mass. Dec. 21, 2015). The company refused to do so. When the company went bankrupt, the SEC started to focus on its former CEO.

The CEO sought documents from the now-bankrupt company he once led -- claiming that he needed them to support his advice of counsel defense. The bankruptcy trustee now running the company refused to waive the privilege, -- and the court upheld that refusal.

- SEC v. Present, Civ. No. 14-14692-LTS, 2015 U.S. Dist. LEXIS 170245, at *2-3, *3, *9-10 (D. Mass. Dec. 21, 2015) (concluding that a former CEO could not obtain documents from a bankrupt company he founded and ran in order to use the documents to defend himself from an SEC action by asserting advice of counsel; "In 2013, the Securities and Exchange Commission ('SEC') commenced an investigation into both F-Squared and Present. . . . In August 2014, during the course of this investigation, F-Squared, with Present as CEO, refused the SEC's request to waive its attorneyclient [sic] privilege . . . . In November 2014, Present left F-Squared . . . and thereafter F-Squared admitted liability for making materially false statements . . . and paid a $35 million fine. . . . F-Squared has now filed for bankruptcy protection, where it faces a variety of creditor claims, including a potential class action lawsuit."; "On the day the SEC settled with F-Squared, the SEC sued Present for various violations of the Advisers Act . . . and associated SEC regulations."; "Among other affirmative defenses, Present asserted in his Answer that he 'reasonably relied upon the work, advice, professional judgment, and opinion of others, including but not limited to legal and compliance professionals."; "Both as the CEO and a sophisticated businessman, he necessarily understood that F-Squared, rather than he, personally held the keys to attorney-client privilege. At that time, as the CEO of F-Squared, Present was in the position either to waive the privilege or to obtain in his personal capacity the right to be able to waive the privilege in the future. He chose not to do so. These circumstances mitigate the fairness considerations advanced by Present. Finally, ordering disclosure, even under a protective order, necessarily divests F-Squared from control over its privileged information and exposes it to the SEC and, ultimately, at trial to a variety of others contrary to the fundamental purposes of the privilege.").

Even more interesting issues can arise when a company buys assets out of bankruptcy, and therefore essentially stands in the shoes of the bankrupt entity (as explained below, this bankruptcy setting was the birthplace of the "practical consequences" standard).

In 2018, a New York court dealt with a fascinating situation – the winner in a litigated case that drove the loser in bankruptcy purchased the loser's assets out of bankruptcy, and then sued the loser's law firm for malpractice in the case the winner had just won.

- Utilisave, LLC v. Fox Horan & Camerini, LLP, No. 652318/2014, 2018 NY Slip Op 33320(U), at *2, *3,*11, *8-9, *10-11, *15 (N.Y. Sup. Ct. Dec. 17, 2018) (addressing a situation in which h one of Utilisave's two managing members (MHS, which was owned by Michael Steifman) had earlier successfully "pursued both direct and derivative claims against Utilisave and its then-CEO"; noting that after Utilisave declared bankruptcy, MHS and Steifman: (1) purchased Utilisave's assets from a liquidation trustee, (2) caused Utilisave to file a malpractice case against Utilisave's law firm that had lost the earlier action, and (3) sought access to communications between that law firm and Utilisave's then-CEO; explaining that the law firm argued that "Utilisave is not entitled to any privileged communications because the company was purchased by Steifman, who was adverse to Utilisave in the Prior Action"; acknowledging that "had Steifman or MHS sought privileged communications during the pendency of that [earlier] action, defendants' documents would have been prohibited from disclosure"; concluding that now that MHS and Steifman owned Utilisave, they could rely on what is called the "practical consequences" standard to assert ownership of Utilisave's attorney-client privilege and its former law firm's files; ordering Utilisave's former law firm to describe the files in its possession so some could be produced; inexplicably holding in contrast "that [Utilisave] has not advanced any argument that it is entitled to [its former law firm's] work product").

More recently, a court was less generous to a plaintiff who purchased a now-bankrupt defendant's assets out of bankruptcy. The court held that some of the bankrupt defendant's executives' personal emails were not owned by the defendant (despite being housed on its server). This meant that the bankruptcy trustee did not acquire them, so it could not convey them to the plaintiff who purchased the defendant's assets out of bankruptcy.

- In re Ahlan Industries, Inc., Ch. 7 Case No. BG 18-04650, 2020 Bankr. LEXIS 1746, at *27-28, *46-47 (Bankr. W.D. Mich. July 2, 2020) (addressing a situation in which GRE sued several corporate defendants, individual owners and managers; noting that when one defendant corporation declared bankruptcy, GRE purchased from a Chapter 7 trustee all of the corporation's assets, and that GRE claimed that it now owned 60,000 emails on the corporation's servers; further noting that the individual defendants argued that 424 of the emails were their communications with their personal lawyers, which the trustee did not own and therefore could not sell to GRE; agreeing with the individual defendants; applying the generally accepted standard for ownership of such personal emails on company servers (In re Asia Global Crossing, Ltd., 322 B.R. 247 (Bankr. S.D.N.Y. 2005)); pointing to the company's "lack of policies concerning email usage or monitoring, the password protection of the accounts, and the fact that the company had never taken any steps to invade the confidentiality of the accounts"; holding that even if the company (now under the trustee's control) could waive its privilege, the individuals could veto that waiver as the privilege's co-owners).

(b) Outside the bankruptcy setting, the purchaser of a corporation's stock generally steps into the shoes of the previous owner, and may assert or waive the privilege.

This approach is consistent with corporate law, and common sense -- when applied to the privileged communications created during and related to the corporation's day-to-day operations. After all, the corporation remains exactly the same incorporeal entity -- but a different set of directors has become the decision-makers.

Not surprisingly, numerous courts have applied this almost-axiomatic principle.

- Polycast Tech. Corp. v. Uniroyal, Inc., 125 F.R.D. 47, 50-51 (S.D.N.Y. 1989) ("Polycast acquired this authority to waive the joint privilege when it purchased the stock of Plastics. The power to waive the corporation's attorney-client privilege rests with corporate management, who must exercise this power consistent with their fiduciary duty to act in the best interest of the corporation. Just as Plastics' new management has an obligation to waive or preserve the corporation's privileges in a manner consistent with their fiduciary duty to protect corporate interests, Polycast, as parent and sole shareholder, has the power to determine those interests. Because there are ample grounds for a finding that the privilege is held jointly by Polycast and Uniroyal, and because Polycast acquired control over Plastics' privilege rights when it purchased the company, Polycast and Plastics' new management may now waive the privilege at their discretion." (citations omitted); finding that the purchaser of a subsidiary of Uniroyal was entitled to obtain copies of notes of the subsidiary's vice president that he prepared before the transaction).

- McCaugherty v. Siffermann, 132 F.R.D. 234, 245 (N.D. Cal. 1990) ("the purchaser of a corporate entity buys not only its material assets but also its privileges. . . . Since the attorney-client privilege over a corporation belongs to the inanimate entity and not to individual directors or officers, control over privilege should pass with control of the corporation, regardless of whether or not the new corporate officials were privy to the communications in issue.").

- In re Grand Jury Subpoenas 89-3 & 89-4, John Doe 89-129, 902 F.2d 244, 248 (4th Cir. 1990) (finding that the new management of a subsidiary created by divestiture could waive the privilege).

- Rayman v. Am. Charter Fed. Sav. & Loan Ass'n, 148 F.R.D. 647, 652 (D. Neb. 1993) ("a surviving corporation following a merger possesses all of the privileges of the pre-merger companies").

- Chase Manhattan Mortg. Corp. v. Advanta Corp., Civ. A. No. 01-507 (KAJ), 2004 U.S. Dist. LEXIS 7378, at *6-7 (D. Del. Apr. 23, 2004).

- M-I LLC v. Stelly, Civ. A. No. 4:09-cv-1552, 2010 U.S. Dist. LEXIS 52736, at *11 (S.D. Tex. May 26, 2010) (holding that the company acquiring another company in a merger became the owner of the acquired company's privilege; explaining that the new owner's "management stood in the shoes of prior management and controlled GCS's attorney client privilege as it related to the company's operations.").

- Girl Scouts-Western Okla., Inc. v. Barringer-Thomson, 252 P.3d 844, 847, 849 (Okla. 2011) (holding that a successor after a merger owned the entities' attorney-client privilege; "Western [plaintiff] alleged ownership of all of Sooner's documents and materials based on the merger. In support of its counter-motion for summary judgment, Western attached the merger agreement, annual meeting minutes of Sooner and Red Lands adopting the merger agreement, the Certificate of Merger submitted to the Secretary of State and the Certificate of Merger issued by the Secretary of State. The merger agreement provides that all of the assets, properties, rights, privileges, immunities, powers and franchises of Sooner shall vest in the surviving entity. Likewise, under the merger agreement, all debts, liabilities and duties of Sooner shall become the debts, liabilities and duties of the surviving entity. Thus, under the merger agreement, what belonged to Sooner now belongs to Western. Western recognizes that matters that were confidential in the hands of Sooner must remain confidential in the hands of Western."; explaining that "[i]f the client is a corporation, the privilege may be claimed by the successor, trustee, or similar representative."; implying that the companies could have altered this general rule in the agreement; "Sooner did not exempt or exclude confidential or any other materials from the merger agreement; it adopted a merger agreement that transferred all assets, properties and privileges to the surviving corporation. Ownership of Sooner's assets, as well as its attorney-client privilege, has now transferred to Western by operation of law as a result of the merger. To allow Attorney to assert Sooner's attorney-client post-merger would be in derogation of the merger agreement transferring ownership to Western.").

Not surprisingly, when a company sells or spins off a subsidiary, it must immediately treat the now - independent former subsidiary as a separate company. As awkward as it might be to take this approach when dealing with those who were colleagues the day before, failure to do so can causes damaging consequences - as Boeing discovered.

In 2010, the District of Kansas dealt with a transaction in which a portion of Boeing became a separate corporation named Spirit.[1] In that case, several labor unions sued Boeing in connection with its sale of a Wichita, Kansas, facility to buyer Spirit. Boeing and Spirit sought the return of protected emails that they claimed to have inadvertently produced to the unions.

The court refused to order the documents' return, finding that they did not deserve any protection, because Boeing had waived any attorney-client privilege protection during the sale to Spirit. As the court explained it, to "facilitate a smooth transition" after the sale of the Wichita facility, Boeing allowed 8,000 former Boeing employees (now working for Spirit) to continue using the Boeing email system.[2] Boeing argued that this disclosure of pre-transaction privileged documents in its email system

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1 Soc'y of Prof'l Eng'g Emps. in Aerospace v. Boeing Co., Case Nos. 05-1251- & 07-1043-MLB, 2010 U.S. Dist. LEXIS 27093 (D. Kan. Mar. 22, 2010).

2 Id. at *12.

to another company's employees did not waive the privilege, because there were "unique circumstances" resulting from "the need for Spirit employees to have access to the Boeing e-mail messages in order to continue their work at the Wichita facility."[3] The court rejected Boeing's argument, concluding that Boeing had made "an educated business decision" to allow employees who no longer worked for Boeing to have access to Boeing electronic records.[4] Although the court acknowledged that the 8,000 Spirit employees with access to the Boeing records had themselves been Boeing employees, it nevertheless found a waiver.

> Unquestionably, Boeing was presented with a dilemma in how to handle e-mail files when negotiating with Spirit. Boeing made an educated business decision that it would not pre-screen the electronic files in order to preserve the confidentiality of attorney-client communications. However, Boeing presents no persuasive authority to support its contention that 'unique circumstances' excuse the intentional disclosure of attorney-client privileged communications to a third party. At best, Boeing proposes a 'business decision' exception to the general rule that disclosure of privileged materials to a third party waives the privilege. In the absence of persuasive authority, the court is unwilling to recognize a 'business decision' exception to the general rule. Accordingly, Boeing and Spirit's motion for a protective order and return or destruction of the e-mail messages shall be denied.

Soc'y of Prof'l Eng'g Emps. in Aerospace v. Boeing Co., Case Nos. 05-1251- & 07-1043-MLB, 2010 U.S. Dist. LEXIS 27093, at *21-22 (D. Kan. Mar. 22, 2010) (footnotes omitted)).

This result is somewhat surprising. Disclosing pre-existing privileged communications to a former employee would not automatically waive the corporation's

[3] Id. at *18.

[4] Id. at *21.

privilege. One would have thought that the court's holding that there had been a waiver would focus on emails created after the transaction rather than before the transaction. Still, the District of Kansas's analysis points out the necessity of remembering that post-transaction corporations must be treated as separate legal entities.

But despite such occasional snafus, it makes sense to include operational - related privileged communications in a stock transaction.

But that general principle's application to a company's day-to -day operations - related privileged communications seems inapt in the context of a tiny but key subset of the company's privileged communications - those relating to the sale transaction itself. If ownership of those communications also passes to the stock purchaser, new management could immediately see what the selling management and their lawyers were saying to each other up until the moment of closing. In other words, the new management could see the selling management's negotiation strategy, bottom line figure, and even what the selling management and their lawyers thought of the purchasing group and its lawyers.

In 1996, New York's highest court distinguished between these communications and the ordinary business - related privileged communications. The court essentially held that by operation of law (rather than through negotiation), the transaction - related privilege documents did not pass to the buyer in a stock transaction.

- Tekni-Plex, Inc. v. Meyner & Landis, 674 N.E.2d 663, 668, 669, 670, 670-71, 671, 671-72, 672 (N.Y. 1996) (applying the "practical consequences" test in connection with a corporate acquisition; noting the general rule that "[w]hen ownership of a corporation changes hands, whether the attorney-client relationship transfers as well to the new owners turns on the practical consequences rather than the formalities of the particular transaction."; including the purchasing control of pre-merger privileged communications;

"That Acquisition, rather than old Tekni-Plex, was designated the surviving corporation, however, is not dispositive. Acquisition was a mere shell corporation, created solely for the purpose of acquiring old Tekni-Plex. Following the merger, the business of old Tekni-Plex, remained unchanged, with the same products, clients, suppliers and non-managerial personnel. Indeed, under the Merger Agreement, new Tekni-Plex possessed all of the rights, privileges liabilities and obligations of old Tekni-Plex, in addition to its assets. Certainly, new Tekni-Plex is entitled to access to any relevant pre-merger legal advice rendered to old Tekni-Plex that it might need to defend against these liabilities or pursue any of these rights."; addressing the buyer's motion to disqualify the seller's law firm in a dispute between the buyer and the seller; noting that the seller's law firm would be able to represent the seller if the dispute related to the merger "as opposed to corporate operations" of the seller before the merger; explaining that the dispute at issue before the court related to the seller's corporate operations, so that the seller's law firm could not represent the seller in a dispute with the buyer; "The dispute here, however, unlike <u>Flanzer</u> [<u>Int'l Elecs. Corp. v. Flanzer</u>, 527 F2d 1288 (2d Cir. 1975)], goes beyond the merger negotiations. It also involves issues relating to the law firm's longstanding representation of the acquired corporation on matters arising out of the company's business operations -- namely, M&L's [seller's law firm] separate representation of old Tekni-Plex [Seller] prior to the merger on environmental compliance matters. Any environmental violations will negatively affect not only the purchasers but also the business interests of the merged corporation. In this regard, the interests of M&L's current client Tang [seller's sole shareholder at the time of the merger] are adverse to the interests that new Tekni-Plex [Buyer] assumed from old Tekni-Plex."; "M&L's earlier representation of old Tekni-Plex provided the firm with access to confidential information conveyed by old Tekni-Plex concerning the very environmental compliance matters at issue in the arbitration. M&L's duty of confidentiality with respect to these communications passed to new Tekni-Plex; yet its current representation of Tang creates the potential for the law firm to use these confidences against new Tekni-Plex in the arbitration."; "[N]ew Tekni-Plex now has the authority to assert the attorney-client privilege to preclude M&L from disclosing the contents of these confidential communications to Tang. Likewise, <u>ownership of the law firm's files regarding its pre-merger representation of old Tekni-Plex on environmental compliance matters passed to the management of new Tekni-Plex</u>."; rejecting the seller's argument that the law firm jointly represented the seller and seller's sole shareholder; "Appellants urge that because Tang and old Tekni-Plex were co-clients of M&L, none of the communications made by corporate actors to the law firm are confidential from Tang. Generally, where the same lawyer jointly represents two clients with respect to the same matter, the clients have no expectation that their confidences concerning the joint matter will remain secret from each other, and those confidential communications are not within the privilege in subsequent adverse proceedings between the co-clients . . . .

While M&L jointly represented Tang and old Tekni-Plex during the acquisition, with respect to the environmental compliance matters the record before us establishes only M&L's representation of the corporation."; concluding that the buyer did not acquire ownership of privileged communications between the seller and the seller's lawyer; "To allow new Tekni-Plex access to the confidences conveyed by the seller company to its counsel during the negotiations would, in the circumstances presented, be the equivalent of turning over to the buyer all of the privileged communications of the seller concerning the very transaction at issue. The parties here, moreover, recognized the community between the selling shareholder and his corporation and expressly provided that it be preserved in any subsequent dispute regarding the acquisition."; "[C]orporate actors should not have to worry that their privileged communications with counsel concerning the negotiations might be available to the buyer for use against the sold corporation in any ensuing litigation. Such concern would significantly chill attorney-client communication during the transaction."; "In light of the facts of this particular transaction and the structure of the underlying agreement, new Tekni-Plex is without authority to assert the attorney-client privilege to preclude M&L from revealing to Tang the contents of communications conveyed by old Tekni-Plex concerning the merger transaction. Similarly, new Tekni-Plex does not control M&L's files relating to its prior representation of old Tekni-Plex during the acquisition. Of course, nothing in our decision today prevents new Tekni-Plex from obtaining through the normal course of discovery any non-confidential documents, or confidential documents for which the privilege has been waived, to which it is entitled." (emphases added)).

In 2011, the Eastern District of New York explained the rationale for what became known as the Tekni-Plex approach.

- Safeco Ins. Co. of Am. v. M.E.S., Inc., 289 F.R.D. 41, 53 (E.D.N.Y. 2011) ("[E]ven in those circumstances where the successor company is deemed to have acquired the predecessor's privilege, New York courts have carved out an exception for confidential communications related to the acquisition itself. . . . Otherwise, the successor company would have access to the confidential information of its direct adversary in the recently concluded negotiations. . . . Such a scenario, the courts reason, 'would significantly chill attorney client communication during such transactions.' . . . Moreover, the court is reluctant to imply such a provision into the parties' agreements when the parties could have provided it expressly." (emphases added)).

New York courts continue to follow this approach.

- Askari v. McDermott, Will & Emery, LLP, 114 N.Y.S.3d 412, 415, 415-16, 429, 430, 432, 432-33 (N.Y. App. Div. 2019) (confirming and applying the Tekni-Plek doctrine under which the Seller in a stock sale transaction retains the transaction documents' privilege protection essentially by operation of law; "On this appeal we are asked to address a conflict between New York and Delaware law relating to which law applies, and implicating who or which entity may assert the attorney-client privilege, in the context of the merger and restructuring of businesses, the sale of membership interests, and related transactions which occurred in connection with those events."; "Upon concluding that, under Delaware law, the right of the plaintiffs, Kevin Askari and Sina Drug Corp. (hereinafter Sina), as sellers, to transactional documents contained in the file of the defendant law firm McDermott, Will & Emery, LLP (hereinafter McDermott), relating to the reorganization, merger, and sale of Sina, was transferred to the new entity/buyer, the defendant Oncomed Specialty, LLC (hereinafter Specialty), post- merger/reorganization, the Supreme Court denied the plaintiffs' motion for summary judgment on the complaint and granted the defendants' separate cross motions for summary judgment dismissing the complaint insofar as asserted against each of them. We reverse the order appealed from for the reasons set forth herein."; "Under New York law, the attorney-client privilege regarding pre-merger communications between an attorney and his or her client which are related to a business/corporate merger does not fully pass to the new or surviving company/buyer, but remains with the former shareholders of the prior company/seller (see Tekni-Plex, Inc. v Meyner & Landis, 89 NY2d at 130). In Tekni-Plex, the Court of Appeals determined that the buyer in a corporate acquisition controlled the attorney-client privilege as to some, but not all, of the pre-merger communications (see id. at 127)."; "Thus, the Court of Appeals made a clear distinction between confidential communications regarding a company's ongoing operations and those related to its acquisition (see id. at 136). The Court noted that, during the acquisition negotiation process, the predecessor company and its shareholders were in an adversarial relationship with the successor company (see id. at 138-139). Therefore, the original Tekni-Plex continued to control the attorney-client privilege with respect to confidential communications concerning the acquisition, and was entitled to refuse to disclose such communications to the new Tekni-Plex (see id. at 138-139; Fochetta v Schlackman, 257 AD2d 546, 546, 685 N.Y.S.2d 22 ["Given the extent of plaintiff's ownership interest and managerial involvement in defendant corporations prior to the disputed stock surrender, the motion court properly determined that the attorney-client privilege was not properly invoked by defendants to deny plaintiff access to otherwise privileged pre-surrender materials essential to the proof of his claims"]; see also Orbit One Communications, Inc. v Numerex Corp., 255 FRD 98, 104, 106-107 [SD NY] ["Allowing Numerex to control Old Orbit One's privilege would lead to a fundamentally unfair result. . . . Numerex cannot both pursue the rights of the buyer and simultaneously assume the attorney-client rights of the buyer's

> adversary, Old Orbit One. Old Orbit One retained ownership of, and continues to control, the attorney-client privilege as to confidential communications with [the law firm which represented it throughout the acquisition negotiations] concerning the acquisition transaction" [citation omitted]).” (alterations in original); “In a situation where documents are sought, New York will apply the law of the forum where the evidence will be introduced at trial or the location of the proceeding seeking discovery of those documents (see People v Greenberg, 50 AD3d 195, 198-199, 851 N.Y.S.2d 196). Here, the privileged communications being sought by the plaintiffs in this New York replevin action were made in New York between New York-based attorneys at McDermott and Sina, a New York corporation, involving its then-majority shareholder and president, Askari, a New York resident. The sole nexus that Delaware has to this action is that Specialty is a limited liability company formed under the laws of that state. Consequently, New York law applies in this action sounding in replevin seeking the disclosure of McDermott's files (see id. at 199).”; “It would indeed be incongruous to enforce a law which effectively forecloses New York corporations merging with foreign corporations from having the ability to pursue their claims against their counsel or the newly formed, post-merger entities based on the post-merger entities' control of the documents needed by the former entities to prosecute potential claims. Here, Delaware law gives the new corporation, a putative defendant, sole access to and control of the merger-related documents by the exercise of the attorney-client privilege. This is contrary to New York public policy as enunciated in Tekni-Plex.”)

Although this Tekni-Plex approach undoubtedly provided some comfort to selling companies' management and their lawyers, it seems oddly paternalistic for perhaps the world's greatest and most sophisticated commercial center. After all, the management of companies whose stock is being sold presumably could exclude from that sale such privileged transaction-related communications. Sophisticated management and lawyers may not deserve to be protected from failure to do so by some operation-of-law doctrine.

In 2013, a Delaware Chancery Court caused quite a stir by implicitly rejecting the operation-of-law Tekni-Plex approach, and instead treating transaction – related privileged communications as a negotiable item in a stock transaction.

In Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A.3d 155 (Del. Ch. 2013),[5] Chancellor Strine dealt with this ownership issue in connection with the buyer's allegation that selling shareholders defrauded it.

The court explained the factual context.

> After the Buyer brought this suit in September 2012 -- a full year after the merger -- it notified the Seller that, among the files on the Plimus computer systems that the Buyer acquired in the merger, it had discovered certain communications between the Seller and Plimus's then-legal counsel at Perkins Coie regarding the transaction. During that year, the Seller had done nothing to get these computer records back, and there is no evidence that the Seller took any steps to segregate these communications before the merger or excise them from the Plimus computer systems, the control over which was passing to the Buyer in the merger. It is also undisputed that the merger agreement lacked any provision excluding pre-merger attorney-client communications from the assets of Plimus that were transferred to the Buyer as a matter of law in the merger, and the merger was intended to have the effects set forth in the Delaware General Corporation Law ('DGCL'). Nonetheless, when the Seller was notified that the Buyer

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[5] Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A.3d 155, 156, 160, 161 n.27, 161 (Del. Ch. 2013) (addressing a situation in which the buyer of a company's stock claimed that the seller shareholders had defrauded it in the purchase transaction; noting that the buyer discovered privileged communications between the seller and its outside counsel Perkins Coie in the company's computer system because the seller had not removed those documents from its computer system before the closing, and had "done nothing to get these computer records back" since the closing a year earlier; explaining that the seller claimed that the attorney-client privilege nevertheless protected those communications "on the ground that it, and not the surviving corporation [buyer], retained control of the attorney-client privilege," rejecting the seller's privilege claim – relying on the Delaware General Corporation Law's clear statement that after a merger the surviving company (the buyer here) owns "'all'" property, privileges, etc.; concluding that the buyer could read and use the intimate privileged communication between the seller's executives and Perkins Coie about the transaction; noting that sellers can "negotiate[] special contractual agreements to protect themselves and prevent certain aspects of the privilege from transferring to the surviving corporation in the merger"; noting that pointing to a 2008 Delaware decision approving a purchase transaction provision specifically excluding from such a sale "'all rights of the Sellers under this Agreement and all agreements and other documentation relating to the transactions contemplated hereby.'" (citing Postorivo v. AG Paintball Holdings, Inc., Consol. Civ. A. Nos. 2911- & 3111-VCP, 2008 Del. Ch. LEXIS 17, at *6 n.5 (Del. Ch. Feb. 7, 2008) (unpublished opinion)); reiterating that "the answer to any parties worried about facing this predicament in the future" is to "exclude from the transferred assets the attorney-client communications they wish to retain as their own." (emphasis added)).

> had found pre-merger communications on the Plimus computer system, the Seller asserted the attorney-client privilege over those communications on the ground that it, and not the surviving corporation, retained control of the attorney-client privilege that belonged to Plimus for communications regarding the negotiation of the merger agreement. Before the court is a motion by the Buyer seeking to resolve this privilege dispute and determine, among other things, that the surviving corporation owns and controls any pre-merger privilege of Plimus or, alternatively, that the Seller has waived any privilege otherwise attaching to those pre-merger communications.

Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A.3d 155, 156 (Del. Ch. 2013) (footnote omitted).

The court pointed to the buyer's merger into the purchased corporation, which by Delaware statute transferred all privileges to the merged entity -- including privileged communications about the purchase transaction. The court emphasized the Delaware statute's clear terms.

> The Buyer contends that under the plain terms of § 259 of the DGCL, the attorney-client privilege -- like all other privileges -- passes to the surviving corporation in the merger as a matter of law. Thus, the Buyer argues, this court must enforce the statute. The court agrees. If the General Assembly had intended to exclude the attorney-client privilege, it could easily have said so. Instead, the statute uses the broadest possible language to set a clear and unambiguous default rule: all privileges of the constituent corporations pass to the surviving corporation in a merger.

Id. at 159 (footnotes omitted).

The court noted that the selling shareholders could have negotiated the post-closing ownership of such privileged communications.

> Of course, parties in commerce can -- and have -- negotiated special contractual agreements to protect

> themselves and prevent certain aspects of the privilege from transferring to the surviving corporation in the merger.

Id. at 160. The court even pointed to language from an earlier Delaware chancery court case (applying New York law) that carved out such privileged communications from that sale.

> 'Section 1.2(h) [of the asset purchase agreement] provides that "'Excluded Assets" from the sale include "all rights of the Sellers under this Agreement and all agreements and other documentation relating to the transactions contemplated hereby."''

Id. at 161 n.27 (quoting Postorivo v. AG Paintball Holdings, Inc., Consol. Civ. A. Nos. 2991- & 3111-VCP, 2008 Del. Ch. LEXIS 17, at *19 n.25 (Del. Ch. Feb. 7, 2008)).

Thus, after articulating a frightening scenario, the court prescribed a fairly simple remedy.

> Thus, the answer to any parties worried about facing this predicament in the future is to use their contractual freedom in the manner shown in prior deals to exclude from the transferred assets the attorney-client communications they wish to retain as their own.

Id. at 161.

Other courts have reached the same conclusion.

- Newspring Mezzanine Capital II, L.P. v. Hayes, Civ. A. No. 14-1706, 2014 U.S. Dist. LEXIS 169900, at *6-7, *8, *10-11, *11 (E.D. Pa. Dec. 9, 2014) (holding that a company sold the privilege when it sold the stock of a company, because the law firm assisting the company did not represent the individual selling shareholders as personal clients; "The Baxter Parties insist that they retain the right to assert attorney-client privilege over communications with Wishart Norris pre-merger because they were the sellers of a controlling interest in Old Utilipath. In support of this position, they analogize the current situation to Tekni-Plex v. Meyner and Landis, 89 N.Y.2d 123, 674 N.E.2d 663, 651 N.Y.S.2d 954 (Ct. Ap. N.Y. 1996)."; "The most useful point of departure is the contract of representation whereby Wishart Norris was retained. The retention letter stated that it related to 'this Firm's

> representation of Utilipath, LLC ('the Company').' The letter also cautioned, 'The advice and communications which we render on the Company's behalf are not intended to be disseminated to or relied upon by any other parties without our written consent' (emphasis added). The signature line identified Utilipath LLC and identified Jarrod Hayes as a 'manager.' Jarrod Hayes did not separately sign as an individual, and neither did his father, Baxter Hayes, Jr., or brother, Baxter Hayes, III."; "I also find nothing in Wishart Norris' actions that indicate it was representing any of the Baxter Parties as individuals in addition to representing the corporations. Further supporting my conclusion is the fact that Baxter, Jarrod, and Lindon Hayes had retained their own personal counsel."; "In contrast, in the situation before me, Wishart Norris was explicitly retained by Old Utilipath to carry out the Utilipath transaction, and other lawyers were retained to personally represent the parties in the transaction. Under Bevill [In re Bevill, Bresler & Schulman Asset Mgmt. Corp., 805 F.2d 120 (3d Cir. 1986)], the individuals asserting the privilege have a specific burden, which they have failed to meet."; "Because Wishart Norris represented the corporation, the corporation's post-merger owners took control of the corporation's attorney-client privilege.").

The Great Hill approach (and even the Tekni-Plex approach) work in the abstract, but do not address a practical issue. It is one thing to exclude (either by operation of law or by negotiation) privileged negotiation - related documents from a stock sale. It is quite another thing to remove them from the servers that physically pass to the purchaser. It presumably is impossible to delete those documents from every nook and cranny in which they exist. Under Tekni-Plex, perhaps the seller could rely on the new management's reluctance to search for documents that by operation of law they do not own. Under Great Hill, presumably the best that selling management could do is to negotiate it an agreement barring new management from searching for or using those transaction - related privileged communications.

In 2019, the Delaware Chancery Court resolved this dilemma under its Great Hill approach - barring new management from "using or relying on" such communications left on the server (or in some other spot).

- Shareholder Representative Services LLC v. RSI Holdco, LLC, C.A. No. 2018-0517-KSJM, 2019 Del. Ch. LEXIS 196, at *3, *4-5, *10,*11-12 (Del. Ch. May 29, 2019) (addressing a situation in which the sellers negotiated a merger agreement provision: (1) recognizing continued privilege protection after the closing for their privileged transactional communications with their law firm Seyfarth Shaw; and (2) prohibiting the buyer from "us[ing] or rely[ing] on any of the Privileged Communications in any action or claim against or involving any of the parties hereto after the Closing"; noting that the buyer nevertheless sought to use them in a post-closing dispute – arguing that "[b]ecause the sellers did not excise or segregate the privileged communications from the computers and email servers transferred to the surviving company," sellers waived their privilege and "the buyer may thus use the communications in this litigation"; rejecting buyer's argument, finding that it would "undermine the guidance of Great Hill [Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A.3d 155 (Del. Ch. 2013)] – which cautioned parties to negotiate for contractual protections"; holding that the sellers could "assert that privilege in this litigation," and that buyer was "barred from using or relying on the Emails in this litigation").

This approach makes great sense, given the impracticability or even impossibility of assuring deletion of all such transaction -related privileged documents.

(c) Asset sale transactions in the corporate context are inherently different from stock sale transactions. With the latter, the incorporeal entity continues just as it was - but now takes direction from a different set of elected directors. With the former, a different incorporeal entity begins to use the assets. The old entity might still exist, but is now shorn of all or some of its assets.

Before turning to some of the key issues, it is first worth noting the application of the normal privilege "waiver" doctrine in an asset sale context.

The attorney-client privilege protection is so fragile that owners have waived that protection even by disclosing privileged communications to their own family members (as Martha Stewart did by sharing a privileged email with her own daughter). The work product doctrine is much more robust - Martha Stewart did not wave that separate protection that also covered the email she shared with her daughter.

And under standard waiver doctrine, disclosing a privileged communication to an outsider waives the privilege protection as to everyone else and for all time – entitling anyone to access the same formerly privileged communication.

With a stock transaction, there is no waiver - because there is no disclosure to an outsider. The privileged communications stay where there are - in the possession of the same entity, albeit now under the control of different directors. But if the stock transaction is preceded by disclosure during due diligence, etc., there might well (and probably will) be a waiver. The good news in that context that is the communications disclosed during the due diligence or negotiation process most frequently focus on litigation or anticipated litigation – meaning that the disclosed communications presumably also deserve the more robust work product protection that survives such a disclosure.

In negotiations over an asset transaction, such due diligence has the same waiver implications as in a stock transaction (and the same presumably predominant sharing of work product - protected communications).

To be sure, in an asset transaction closing, privileged communications may be among the assets that convey from the current owner to the new owner. At first blush, that might seem to involve a waiver. But properly considered, it does not. At closing, the privileged communications pass to someone who has also purchased the protection. If that caused a waiver, a client would waive her privilege by replacing her lawyer with another lawyer, a lawyer would waive his clients' protection by permissibly selling his law practice to another lawyer, etc.

So the cases that label such sale or asset transaction conveyances as a "waiver" presumably do not really mean what they say.

- Solis v. Bruister, Civ. A. No. 4:10-cv-77-DPT-FEB, 2013 U.S. Dist. LEXIS 29108, at *4-5, *8-9 (S.D. Miss. Jan. 22, 2013) (concluding that transfer of privileged communications as part of a stock sale of a company waived the seller's attorney-client privilege; analyzing the following situation: "Plaintiff's Motion to Compel seeks an order compelling the production of documents subpoenaed by Plaintiff from DirecTV [nonparty], the purchaser of Southeastern Ventures, Inc. f/k/a Bruister & Associates, Inc. These documents were stored on Defendant Amy Smith's Bruister & Associates computer, which DirecTV acquired in the purchase. . . . The instant motion seeks production of the DirecTV documents withheld by Defendants. DirecTV asserts no objection to the production of the documents at issue in Plaintiff's Motion."; "Plaintiff has argued that because all the documents at issue were provided to a third party, DirecTV, the privilege, if any ever existed, was waived on that basis. See Alldread v. City of Grenada, 988 F.2d 1425, 1434 (5th Cir. 1993) ('Patently, a voluntary disclosure of information which is inconsistent with the confidential nature of the attorney-client relationship waives the privilege.'). Along those lines, other federal district courts have held that a sale and transfer of assets, including allegedly privileged information, waives the attorney-client and work product privileges. See Robbins & Myers, Inc. v. J.M. Huber Corp., 2003 U.S. Dist. LEXIS 10001, 2003 WL 21384304, *3 (W.D.N.Y. May 9, 2003); and In re In-Store Adver. Secs. Litig., 163 F.R.D. 452, 458 (S.D.N.Y. 1995). Defendants have not convinced the Court that any privileges were not waived when Amy Smith's computer was turned over to DirecTV."; inexplicably failing to address DirecTV's ownership of the documents contained on the computer it purchased, and DirecTV's acquiescence to their production; not addressing the other possible impact of a "waiver" -- such as the availability of other third parties to assess the documents; also finding a waiver based on defendant's inadequate log and on the fiduciary exception. (emphasis added)).

- Robbins & Myers, Inc. v. J.M. Huber Corp., No. 01-CV-0201E(F), 2003 U.S. Dist. LEXIS 10001, at *3-4, *16 (W.D.N.Y. May 9, 2003) (analyzing the waiver impact of the sale of a subsidiary's stock to a buyer, in connection with the buyer's later lawsuit against the selling parent for fraud; finding a waiver; describing the factual setting as follows: "Robbins & Myers, Inc. ('R&M') bought the stock of Flow Control Equipment, Inc. ('FCE') from J.M. Huber Corporation ('Huber') pursuant to a stock purchase agreement ('the

> Agreement') dated November 20, 1997. . . . Subsequently, R&M brought this suit for various claims of fraud based on its contention that Huber had induced R&M to buy FCE by misrepresenting the scope of the off-specification closure liability. R&M contends that Huber had represented that the liability was limited to 194 units whereas the liability now appears to be for several thousand units."; among other things, finding a waiver; "[D]efendants have waived any attorney-client privilege or work-product protection that otherwise might have attached to any documents that were left in the possession of FCE after November 20, 1997. See In re Grand Jury Subpoenas, 734 F. Supp. 1207, 1213 (E.D. Va. [1990]) (holding that parent waived attorney-client privilege with respect to documents left in subsidiary's possession after sale of the subsidiary), rev'd on other grounds, 902 F.2d 244 (4th Cir. 1990). Accordingly, defendants may not claim the attorney-client privilege or work product protection with respect to any documents that were left in FCE's possession after it had been purchased by R&M." (footnote omitted); inexplicably failing to address the buyer's possible ownership of the privileged documents belonging to the subsidiary that it had purchased it from the defendant parent corporation; similarly not addressing the possible implications of the waiver analysis, such as third parties' possible right to access the same documents if there had been a waiver. (emphases added)).

In 2015, the Northern District of California dealt with this privilege ownership issue after an asset sale.

In HunterHeart Inc. v. Bio-Reference Laboratories, Inc., the founder of Hunter Laboratories and his wife sold Hunter's "clinical testing laboratory and the bulk of its assets" -- excluding from the sale various tests and protocols that the founder continued to operate under the name HunterHeart. Case No. 5:14-cv-04078-LHK, 2015 U.S. Dist. LEXIS 123921, at *2 (N.D. Cal. Sept. 16, 2015).[6]

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[6] HunterHeart Inc. v. Bio-Reference Laboratories, Inc., Case No. 5:14-cv-04078-LHK, 2015 U.S. Dist. LEXIS 123921, at *2, *5, *6, *7 (N.D. Cal. Sept. 16, 2015) (addressing a situation in which Hunter Laboratories sold "the bulk of its assets" to defendant; noting that the asset purchase agreement explicitly identified the transferred assets as including Hunter's "computer equipment," software, e-mail addresses and "other records, data and communications . . . in the cloud." (alteration in original) (internal citation omitted); explaining that Hunter's owner used the company email system both before and after the asset sale; further explaining that Hunter's remaining business (now called HunterHeart) later sued defendant, and sought a protective order preventing defendant from using privileged communications on the servers and other systems the defendant had purchased; denying the protective order, finding that as for the pre-transaction privileged communications: (1) Hunter waived its privilege "when it agreed to hand over all of its servers, files and communications"; and, if not, (2) the "[privilege] passed from Hunter to [Defendant]

The court quoted portions of the Asset Purchase Agreement ("APA") which specifically identified some of the assets that Hunter sold to the buyer BRLI.

> [A]ll of "Hunter's computer equipment"; "all electronic files, codes, and software stored on said computer equipment"; Hunter's "e-mail addresses" and "other records, data and communications . . . in the cloud." The APA enumerated the email addresses that BRLI had purchased, one of which was Chris Riedel's [HunterHeart CEO] Hunter email address, "criedel@hunterlabs.com." The agreement permitted Riedel "to have access" to this email address for one year after the closing date.

Id. (footnotes omitted).

The court noted that the founder used his Hunter email address "to communicate with counsel before the sale" and even after the sale. Id. at *3.

About one year after the sale, HunterHeart sued BRLI. In preparing to respond to HunterHeart's discovery, defendant BRLI discovered on its email system pre-closing and post-closing communications between Hunter's founder and the company's lawyers. BRLI notified HunterHeart, which claimed privilege protection for those communications.

The court rejected HunterHeart's privilege claim. In addressing the pre-closing communications, the court found that Hunter waived any privilege by explicitly transferring the privileged communications to BRLI.

> Hunter waived that privilege, however, when it agreed to hand over all of its servers, files and communications. HunterHeart argues that California law, which applies in this diversity case, defines waiver as an "intentional relinquishment of a known right." But that is exactly what

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by virtue of the [asset purchase agreement]'s transfer of the other company assets"; *holding* that post-transaction communications never deserved privilege protection, because Hunter's owner who continued to use the email system "could not have expected these emails to remain confidential").

> Hunter did when it executed the APA -- it intentionally relinquished its ownership right over all of its communications, and it received consideration in exchange. It is immaterial whether Riedel subjectively anticipated the disclosure of privileged emails. He and Hunter were sophisticated entities who negotiated the APA over the course of several months, and they came to an express agreement to hand over all the communications relevant here. And not until two years after the sale did HunterHeart or Riedel try to remove or retrieve these purportedly privileged communications.

Id. at *5 (footnotes omitted).

As explained above, this analysis seems incorrect -- although it resulted in probably the right outcome. If Hunter waived its privilege protection in the sale, under general waiver principles that would have made the privileged communications available to other third parties.

Instead, the proper analysis should focus on ownership of the communications -- which the HunterHeart decision articulated as an alternative.

> Even if Hunter had not waived its privilege in the APA by express transfer of the disputed communications, it passed from Hunter to BRLI by virtue of the APA's transfer of the other company assets. BRLI cites the instructive case City of Rialto v. U.S. Dep't of Def. [492 F. Supp. 2d (C.D. Cal. 2007)], where the court held that a purchaser acquiring "substantially all" of a company's assets also acquired the company's attorney-client privilege. Unlike the purchaser in City of Rialto, BRLI did not purchase literally all of Hunter's assets -- HunterHeart reserved a portion of the business in the form of the HunterHeart program. But the burden of preserving the privilege lies with HunterHeart, and HunterHeart offers insufficient evidence that its sale of all of its tangible assets and nearly all of its intangible ones constituted less than a sale of substantially all of them.

Id. at *6 (footnote omitted).

This seems to be the correct analysis. It gave BRLI ownership of the privileged communications, but without forfeiting BRLI's right to assert protection if some third party sought access to those communications. Thus, this approach makes more sense than the waiver analysis.

In addressing the post-closing communications, the court held that Hunter's founder could not have expected those to remain confidential once the email system belonged to the buyer BRLI.

> HunterHeart has failed to show that the attorney-client privilege protects Riedel's communications with counsel after the APA was executed. The privilege never applied in the first instance because Riedel [Hunter's founder] could not have expected these emails to remain confidential. The APA expressly had transferred ownership of Riedel's email account [sic] and the server where its contents were stored, and he could continue to use the account only because the APA permitted it. Riedel was aware that BRLI controlled his email acco[un]t, as evidenced by the fact that he contacted BRLI to restore his access. Also, as above, HunterHeart waived any privilege that may have applied when it agreed to the APA. Like the pre-APA emails, these communications were stored on BRLI servers, and neither Riedel nor HunterHeart ever showed any intention of moving them from that non-confidential location until now.

Id. at *6-7.

The court's analysis highlights the continuing trend toward court's use of what is called the "practical consequences" test when determining privilege ownership in an asset sale. The court's task was presumably made easier by the explicit transfer of electronic communications.

Although the HunterHeart court ultimately did not rely on a waiver concept (instead finding that the asset transaction conveyed the privileged communications), even the court's consideration of that theory is troubling.

Turning now to the relationship and privilege ownership implications of an asset transaction, traditionally the purchasers of a corporation's assets did not acquire the corporation'a attorney client-privileged communications or rights.

- In re In-Store Adver. Sec. Litig., 163 F.R.D. 452, 455, 455-56, 458 (S.D.N.Y. 1995) (addressing the waiver implications of a company's purchase of another corporation's assets; addressing the following factual context; "[P]laintiffs request the production of documents held by Peat Marwick as stakeholder for Emarc, Inc. . . ., the successor to In-Store. . . . Peat Marwick is holding documents produced to it by Emarc because Kirkland & Ellis, attorneys for the Director Defendants, and Baer Marks & Upham . . . , former counsel for In-Store, have asserted that the documents are attorney-client privileged, or are protected from discovery by the work product doctrine."; "At issue are roughly 250 documents (the 'Emarc Documents') in the possession of Peat Marwick which were produced to it, pursuant to a subpoena relating to this litigation. The Emarc Documents were produced by Valassis Communications, Inc. ('Valassis'), which received them as part of a transfer of assets from Emarc, the successor to In-Store."; finding a waiver; "[A] change in management or a change in control of the corporation does not effect a disclosure such that the privileged is waived. . . . However, '[a] transfer of assets, without more, is not sufficient to effect a transfer of the privileges; control of the entity possessing the privileges must also pass for the privileges to pass.' In re Grand Jury Subpoenas 89-3 and 89-4, 734 F. Supp. [1207,] 1211 n.3 [(E.D. Va. 1990)]. Therefore, where confidential attorney-client communications are transferred from a corporation selling assets to the corporation buying the assets, the privilege is waived as to those communications."; "Baer Marks represented In-Store in this action until 1993 when O'Sullivan was substituted as counsel for In-Store. . . . In-Store was reorganized in bankruptcy proceedings and was succeeded by Emarc. The attorney-client privilege was controlled at this point by Emarc . . ., and Emarc therefore had the power to assert or waive the privilege . . . . When those communications were transferred to Valassis in connection with a sale of the assets by Emarc to Valassis, Emarc thereby waived any privilege still in effect as to those communications. See In re Grand Jury Subpoenas 89-3 and 89-4, 734 F. Supp. at 1211 n. 3. The former attorney of In-Store, Baer Marks, cannot claim the privilege that has been waived by the successor to its former client."; not finding a subject matter waiver). However, starting several years ago, some courts began to look at the "practical consequences" of a corporate transaction rather than recognizing a strict dichotomy between stock and asset purchases.

- Bass Pub. Ltd. v. Promus Cos., No. 92 Civ. 0969 (SWK), 1994 U.S. Dist. LEXIS 5474, at *6-7 (S.D.N.Y. Apr. 25, 1994) ("Had Promus [parent] wished, it could have sold only Holiday Inn's [subsidiary's] physical assets, which would have avoided the consequences [of allowing new management of the subsidiary to waive the privilege].").

Most courts formerly followed what is called a "bright-line" test -- holding that the privileged commnications never accompanied assets sold to a third party.

- In re In-Store Adver. Sec. Litig., 163 F.R.D. 452, 455, 455-56, 458 (S.D.N.Y. 1995) (addressing the waiver implications of a company's purchase of another corporation's assets; addressing the following factual context; "[P]laintiffs request the production of documents held by Peat Marwick as stakeholder for Emarc, Inc. . . ., the successor to In-Store. . . . Peat Marwick is holding documents produced to it by Emarc because Kirkland & Ellis, attorneys for the Director Defendants, and Baer Marks & Upham . . . , former counsel for In-Store, have asserted that the documents are attorney-client privileged, or are protected from discovery by the work product doctrine."; "At issue are roughly 250 documents (the 'Emarc Documents') in the possession of Peat Marwick which were produced to it, pursuant to a subpoena relating to this litigation. The Emarc Documents were produced by Valassis Communications, Inc. ('Valassis'), which received them as part of a transfer of assets from Emarc, the successor to In-Store."; finding a waiver; "[A] change in management or a change in control of the corporation does not effect a disclosure such that the privileged is waived. . . . However, '[a] transfer of assets, without more, is not sufficient to effect a transfer of the privileges; control of the entity possessing the privileges must also pass for the privileges to pass.' In re Grand Jury Subpoenas 89-3 and 89-4, 734 F. Supp. [1207,] 1211 n.3 [(E.D. Va. 1990)]. Therefore, where confidential attorney-client communications are transferred from a corporation selling assets to the corporation buying the assets, the privilege is waived as to those communications."; "Baer Marks represented In-Store in this action until 1993 when O'Sullivan was substituted as counsel for In-Store. . . . In-Store was reorganized in bankruptcy proceedings and was succeeded by Emarc. The attorney-client privilege was controlled at this point by Emarc . . ., and Emarc therefore had the power to assert or waive the privilege . . . . When those communications were transferred to Valassis in connection with a sale of the assets by Emarc to Valassis, Emarc thereby waived any privilege still in effect as to those communications. See In re Grand Jury Subpoenas 89-3 and 89-4, 734 F. Supp. at 1211 n. 3. The former attorney of In-Store, Baer Marks, cannot claim the privilege that has been waived by the successor to its former client."; not finding a subject matter waiver). However, starting several years ago, some courts began to look at the "practical consequences" of a corporate transaction rather than recognizing a strict dichotomy between stock and asset purchases.

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This "practical-consequences" test picked up steam when bankrupt corporations sold essentially all of their assets to another company, who then continued the bankrupt company's operations.

- Coffin v. Bowater, Inc., No. 03-277-P-C, 2005 U.S. Dist. LEXIS 9395, at *9 (D. Me. May 13, 2005) (rejecting a bankruptcy trustee's attempt to waive a bankrupt company 's privilege; rejecting a "bright-line rule" that only a stock sale conveyed the privilege; finding that privilege now belonged to the purchaser of the company's assets (including all the company's "tangible and intangible rights"); explaining that because the "practical consequences" of the asset purchase "was to transfer virtually all control and continuation of the [company's] business to [the new owner]," the new owner -- not the company's bankruptcy trustee - had the right to waive or assert the privilege.).

A 2010 decision articulated how the "practical consequences" test applies in a bankruptcy setting.

- Schleicher v. Wendt, No. 1:02-cv-1332-WTL-TAB, 2010 U.S. Dist. LEXIS 48084, at *3-7 (S.D. Ind. May 14, 2010) ("[t]he parties agree on the applicable legal standard: the power to assert or waive a corporation's attorney client privilege is an incident of control of the corporation. . . . Whether control of a corporation transfers from 'old' to 'new' depends on the practical consequences of the transaction at issue. . . . The Defendants and Conseco assert that 'New Conseco is essentially the same business enterprise' as Old Conseco because of all the assets, sources of revenue and expense, and management of New Conseco are the same as that of Old Conseco just prior to the bankruptcy confirmation. . . . Because New Conseco acquired substantially all of Old Conseco's business operations, it also acquired Old Conseco's right to assert the attorney client privilege.

Courts eventually began to reject the traditional "bright-line" test, and instead use the "practical consequences" test outside the bankruptcy setting." One court declined to follow the "bright-line test" when determining whether the privilege passed with assets rather than stock, and ultimately concluded that the transfer of assets also transferred the privilege.[7] Another court held in the context of a disqualification motion that the "practical consequences" standard applied in determining ownership of the attorney-client privilege after a corporate transaction (ultimately holding that the attorney-client privilege passed with a father's transfer of stock to his sons).[8]

In 2012, the Northern District of Texas dealt with a disqualification motion which focused on whether an asset sale conveyed the elements of an attorney-client relationship.[9] The court asked for more evidence, but noted that applying the "practical consequences" test involves

> such factors as the extent of the assets acquired, including whether stock was sold, and whether the purchasing entity continues to sell the same product or service, whether the old customers and employees are retained, and whether the same patents and trademarks are used.

John Crane Prod. Solutions, Inc. v. R2R & D, LLC, Civ. A. No. 3:11-CV-3237-D, 2012 U.S. Dist. LEXIS 67457, at *5 (N.D. Tex. May 15, 2012).

Just as the "practical consequences" test moved from the bankruptcy setting to other contexts, it has also been moving from settings where a company buys substantially all the assets of another company to settings where only a portion of a

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7 Parus Holdings, Inc. v. Banner & Witcoff, Ltd., 585 F. Supp. 2d 995, 1002-03 (N.D. Ill. 2008).

8 Goodrich v. Goodrich, 960 A.2d 1275 (N.H. 2008).

9 John Crane Prod. Solutions, Inc. v. R2R & D, LLC, Civ. A. No. 3:11-CV-3237-D, 2012 U.S. Dist. LEXIS 67457 (N.D. Tex. May 15, 2012).

company's assets pass to the new owner. Thus, several courts have essentially divided up the privilege's ownership after a partial asset sale.

In 2008, a Delaware state court held that the purchaser of a company's assets acquired the privileged communications relating to the company's operations, but not relating to the acquisition that was the subject of later litigation.[10] Another Delaware court engaged in an even more subtle analysis. The court addressed a transaction in which a company sold some assets to a buyer, but retained other assets. The court ultimately held that (1) the purchaser owned the privilege covering the seller's "ordinary course of business" communications occurring before the transaction; (2) the seller owned the privilege covering communications relating to the transaction; and (3) the seller owned the privilege relating to the assets it retained.[11]

All of this matters because disputes frequently arise between the seller of a subsidiary's stock or assets and the buyer of that stock or those assets. Thus, a number of cases have dealt with adversity between a parent and a former subsidiary (or its new owner), with differing results.

Two 2018 decisions typify the common sense application of the "practical consequences" test.

- Utilisave, LLC v. Fox Horan & Camerini, LLP, No. 652318/2014, 2018 NY Slip Op 33320(U), at *2, *3,*11, *8-9, *10-11, *15 (N.Y. Sup. Ct. Dec. 17, 2018) (addressing a situation in which one of Utilisave's two managing members (MHS, which was owned by Michael Steifman) had earlier successfully "pursued both direct and derivative claims against Utilisave and its then-CEO"; noting that after Utilisave declared bankruptcy, MHS and Steifman: (1) purchased Utilisave's assets from a liquidation trustee, (2) caused Utilisave to

[10] Orbit One Commc'ns, Inc. v. Numerex Corp., 255 F.R.D. 98 (S.D.N.Y. 2008).

[11] Postorivo v. AG Paintball Holdings, Inc., Cons. Civ. A. No. 2991-VCP, 2008 Del. Ch. LEXIS 17 (Del. Ch. Feb. 7, 2008) (unpublished opinion).

file a malpractice case against Utilisave's law firm that had lost the earlier action, and (3) sought access to communications between that law firm and Utilisave's then-CEO; explaining that the law firm argued that "Utilisave is not entitled to any privileged communications because the company was purchased by Steifman, who was adverse to Utilisave in the Prior Action"; acknowledging that "had Steifman or MHS sought privileged communications during the pendency of that [earlier] action, defendants' documents would have been prohibited from disclosure"; concluding that now that MHS and Steifman owned Utilisave, they could rely on what is called the "practical consequences" standard to assert ownership of Utilisave's attorney-client privilege and its former law firm's files; ordering Utilisave's former law firm to describe the files in its possession so some could be produced; inexplicably holding in contrast "that [Utilisave] has not advanced any argument that it is entitled to [its former law firm's] work product").

- United States v. Adams, Case No. 0:17-CR-00064-DWF-KMM, 2018 U.S. Dist. LEXIS 41165, at *3, *5, *8-9, *10, *11, *14 (D. Minn. Mar. 12, 2018) (assessing a situation in which the government seized emails between defendant (also a lawyer) Adams and his former clients ("Apollo"); noting that many of the emails deserved privilege protection, but the government argued that the privilege belonged to Scio, a company which earlier had purchased (in the words of the asset purchase agreement) "certain of [Apollo's] property, assets, rights and privileges."; explaining that the government noted that Scio was willing to waive its privilege; further explaining that Adams argued that although defunct, Apollo "retained the authority to waive," and could therefore assert, the privilege; court applying the "practical consequence[s]" test, and thus focusing on the "practical realities of the Apollo-Scio transactions"; emphasizing that: (1) Apollo had sold Scio "all of its intellectual property"; (2) the transactional parties' contemporaneous communications "support the conclusion that [the transactions] effectively constituted the sale of a business that transferred control of the privilege as well"; and (3) there was no evidence that after the transactions "Apollo continued operating in any meaningful way"*;* concluding that Scio owned and could therefore waive the privilege – even though Apollo continued to exist as a corporate entity).

In 2020, a Delaware Chancery Court decision articulated the diametrically different privilege ownership implications of a stock and an asset sale: (1) in a stock transaction, under Great Hill the negotiation - related privileged communications go to the stock purchaser - unless there is some agreement to the contrary; (2) in an asset transaction, the negotiation - related privileged communications stay with the seller – unless there is some agreement to the contrary.

- DLO Enterprises, Inc. v. Innovative Chemical Products Group, LLC, C.A. No. 2019-0276-MTZ, 2020 Del. Ch. LEXIS 202, at *9, *10, *11 (Del. Ch. June 1, 2020) (not released for publication) (pointing to earlier Delaware case law indicating that by statute the purchaser of a corporation's stock acquires the corporation's privileged transactional documents -- unless the seller explicitly excludes them; explaining that the situation before the court instead involved an asset sale; explaining that "we must look to the Purchase Agreement, not a statute, to determine if Buyers purchased certain assets and privileges"; further explaining that because the Agreement listed "this litigation [as] an Excluded Liability," "the privilege for this litigation remains with [the assets'] Sellers"; noting that asset sales involve a "baseline rule governing pre-closing privilege" that differs from a stock sale context, meaning that "the seller will retain pre-closing privilege regarding the agreement and negotiations unless the buyer clearly bargains for waiver"; emphasizing that "[h]ere, Buyers failed to explicitly secure pre-closing privilege waiver rights relating to the negotiation of the Purchase Agreement").

Not surprisingly, just as the parties in a stock transaction must immediately protect the fragile privilege in light of the transaction, the parties to an asset transaction must similarly follow through on the asset agreement's provision - and safeguard the privilege protection of any privileged communications they retain.

As explained above, Boeing paid the price for not doing so after a stock transaction. More recently, Textron lost its privilege protection because of unfortunate steps after an asset transaction.

- Cooper v. Meritor, Inc., Civ. A. Nos. 4:16-cv-052 to -056-DMB-JMV, 2017 U.S. Dist. LEXIS 4727, at *43, *44, *45-46, *46, *47, *47-48 (N.D. Miss. Jan. 12, 2017) (analyzing the waiver impact of fifteen documents Textron created when it owned a Mississippi facility from 1989 to 1996; explaining that Textron sold assets of the company in 1999; disagreeing with Textron's assertion that the asset purchase agreement excluded the privileged environmental documents; noting that Textron left the documents at the facility without any restrictions on access, and did not object when the asset purchaser went bankrupt in 2004 and all of its assets were sold to another company out of bankruptcy; finding that Textron waived privilege protection for the fifteen documents, even though Textron claims to have forgotten that the documents were left at the facility; "In the instant case, Textron asserts a privilege over fifteen (15) documents created from 1989 to 1996 during a period of time it owned and operated a wheel cover manufacturing facility in Grenada, Mississippi. In 1999, Textron entered and subsequently consummated an asset sale agreement with Grenada Manufacturing, LLC (hereinafter sometimes 'the APA'). According to Textron, it did not transfer ownership of documents related to environmental matters, including the subject 15 documents, to Grenada Manufacturing, LLC as part of that sale. It is Textron's positon that it retains ownership of all such documents and any affiliated privilege with respect thereto."; "According to an affidavit supplied by Textron, boxes of these environmental documents, together with other business records of Textron's operations prior to the 1999 sale, were left by Textron at the Grenada facility after the sale. Indeed, Textron contracted for a right to access the documents for a period of time following the sale. APA 14.1. In the court's view, Textron's claim of retained ownership of the documents, even if it were convincing, does not satisfactorily answer whether its treatment of those assets waived any privilege that might be claimed with regard to any of them."; "Textron is faced with the fact that it intentionally left documents that it must acknowledge (because it is material to its claim of retained ownership of the documents in the first instance) it knew concerned environmental matters related to releases from the business prior to 1999. These documents were intentionally left unattended and unrestricted in the hands of yet another party -- this time, Ice Industries, Inc. Though Textron was given notice of the asset transfer to Ice Industries, Inc., it made no effort to retrieve the environmental documents or to even review them for privilege."; "In other words, Textron plainly waived any privilege that would have otherwise been retained if the documents had, in fact, been excluded from the purchase and asset sale."; "Textron argues that unless it realized that the documents concerning environmental matters that it freely gave possession of to others for decades did in fact contain privileged documents, that disclosure could not waive any privilege attendant to the document(s)."; "The court is unpersuaded."; "[T]here is nothing about the 'practical consequences doctrine' that dictates a different outcome. The practical outcome of leaving -- for decades -- documents a company contends it owns in possession of another, with no provision for protection of any privileged communications therein, not to mention permitting the subsequent transfer of possession to others on additional occasions, all without any effort to retrieve them prior to the instant litigation, or to otherwise review them to remove privileged materials has the obvious practical and legal consequence of waiver of any associated privileges.") (emphases added).

(d) Lawyers involved in corporate transactions might consider steps that could shape the privilege's later ownership, but a trend has deprived any certainty about another traditional step.

First, lawyers can avoid a joint representation of multiple clients involved in the transaction. This prevents one of the clients (now independent, or controlled by an entity or person who might become adverse to the remaining client) from claiming joint ownership of the privilege, or seeking discovery from the remaining client if adversity develops.

This step generally would prevent one of the other participants in the transaction from claiming some ownership of the privilege, but might make many possibly sensitive communications vulnerable to a third party's discovery. For example, a lawyer representing a corporate parent in the sale of a subsidiary could assure privilege protection for communications with the parent during the transaction by arranging for another lawyer to represent the subsidiary. However, explicitly disclaiming an attorney-client relationship with a subsidiary means that the lawyer normally could not claim privilege protection for any communications with the subsidiary's employees related to the transaction.[12] Third parties attacking the transaction would thus have a much easier time gaining access to those communications.[13]

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12 The parent and the lawyer might argue that the parent and the subsidiary had entered into a "common interest" agreement that avoided waiver of any privilege during the transaction, but this would be a difficult argument to win.

13 Furthermore, the work product doctrine presumably would not provide an alternative protection for these communications. It would be difficult for the parent or the subsidiary to claim that they anticipated litigation involving the transaction. Even if they could do that, the communications at issue presumably would have been created even in the absence of such anticipation.

Second, and somewhat ironically, lawyers might explicitly arrange for a joint representation in an effort to shape the privilege's ownership. One court even permitted the same lawyer to represent the buyer and the seller in a corporate transaction who were attempting to resolve one's claim against the other. The joint representation allowed them to protect communications relating to the claim's resolution from a third party's effort to discover those communications.

Thus, unlike the first technique discussed above, this approach protects the communications from third parties. However, it normally would not protect communications from one of the jointly represented clients should adversity develop between them. This approach would also essentially doom any chance that the lawyer jointly representing the clients in the transaction could represent either one if such adversity developed.

Traditionally, clients and their lawyers might have been able to affect the privilege's ownership by choosing an asset rather than a stock sale. However, it is no longer safe to assume that corporations could retain control of their privilege by selling assets rather than stock (although one court suggested that such a step might work).[14] This is because the "practical consequences" standard does not itself provide any certainty about whether the sale of assets will or will not transfer control of the privilege.

Several courts have explained (or at least hinted) that participants in corporate transactions might have some power to affect the privilege's ownership.

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[14] <u>Bass Pub. Ltd. Co. v. Promus Cos.</u>, No. 92 Civ. 0969 (SWK), 1994 U.S. Dist. LEXIS 5474, at *6-7 (S.D.N.Y. Apr. 25, 1994) ("Had Promus [parent] wished, it could have sold only Holiday Inn's [subsidiary's] physical assets, which would have avoided the consequences [of allowing new management of the subsidiary to waive the privilege].").

In 1988, the Northern District of Illinois bluntly stated that corporate clients and their lawyers can shape the privilege's control in corporate transactions.

> It is reasonable then to treat the parties to a subsidiary divestiture by sale of stock as having contracted on the assumption that after the sale management of the divested corporation will control its attorney-client privilege. The parties are free to vary this rule by agreement. For example, if the selling parent will have a continuing interest after the sale in contracts, assets or liabilities of the subsidiary the parent can negotiate for special access or control to protect that interest. Similarly, if the attorneys who represent a corporate parent also represent its subsidiary in the sale of the subsidiary's stock they run the resulting risk that after the acquisition subsidiary management will waive the privilege with respect to <u>its</u> communications with those attorneys. A seller who wishes to avoid that result can do so by agreement with the purchaser or by employing separate counsel for the subsidiary and limiting to the parent's own attorneys those communications which the parent wishes to protect.

<u>Medcom Holding Co. v. Baxter Travenol Labs., Inc.</u>, 120 F.R.D. 66, 70 (N.D. Ill. 1988). The court ultimately concluded that the new owners of a corporate subsidiary could waive the attorney-client privilege relating to pre-transaction communications, but explained that parties to the transaction could have arranged for a different result.

Since that 1988 decision, other courts have suggested similar steps.

- One court implied that parties to a corporate transaction could articulate in the merger agreement whether the privilege was part of the transaction.[15]

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[15] <u>Girl Scouts-Western Okla., Inc. v. Barringer-Thomson</u>, 252 P.3d 844, 847, 849 (Okla. 2011) (holding that a successor after a merger owned the entities' attorney-client privilege; "Western [plaintiff] alleged ownership of all of Sooner's documents and materials based on the merger. In support of its counter-motion for summary judgment, Western attached the merger agreement, annual meeting minutes of Sooner and Red Lands adopting the merger agreement, the Certificate of Merger submitted to the Secretary of State and the Certificate of Merger issued by the Secretary of State. The merger agreement provides that all of the assets, properties, rights, privileges, immunities, powers and franchises of Sooner shall vest in the surviving entity. Likewise, under the merger agreement, all debts, liabilities and duties of Sooner shall become the debts, liabilities and duties of the surviving entity. Thus, under the merger agreement, what belonged to Sooner now belongs to Western. Western recognizes that matters that

- One court suggested that a parent spinning off a subsidiary should contractually retain access rights to documents the spun company acquires in the spin.[16]

- One court suggested that a parent may retain the right to veto a newly spun subsidiary's waiver of the attorney-client privilege.[17]

As explained above, in 2013 a Delaware Chancery Court not only explained that lawyers negotiating a stock sale could affect the ownership, it even recommended language that would carve out from the sale all privileged communications between the seller and the seller's lawyer about the transaction. Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A.3d 155, 161 (Del. Ch. 2013).

Unfortunately, these steps do not provide any real certainty. For instance, a parent arranging for its subsidiary's relinquishment of the privilege would undoubtedly be vulnerable to the former subsidiary's argument that it was compelled to forfeit its privilege rights and therefore should not be bound by any such agreement.

Significantly, very little case law deals with such agreements, which probably means that very few companies enter into such agreements during corporate transactions. In one of the very few decisions dealing with this issue, the District of

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were confidential in the hands of Sooner must remain confidential in the hands of Western."; explaining that "[i]f the client is a corporation, the privilege may be claimed by the successor, trustee, or similar representative."; implying that the companies could have altered this general rule in the agreement; "Sooner did not exempt or exclude confidential or any other materials from the merger agreement; it adopted a merger agreement that transferred all assets, properties and privileges to the surviving corporation. Ownership of Sooner's assets, as well as its attorney-client privilege, has now transferred to Western by operation of law as a result of the merger. To allow Attorney to assert Sooner's attorney-client post-merger would be in derogation of the merger agreement transferring ownership to Western.").

16 Bass Pub. Ltd. v. Promus Cos., No. 92 Civ. 0969 (SWK), 1994 U.S. Dist. LEXIS 5474, at *6-7 (S.D.N.Y. Apr. 25, 1994).

17 In re Grand Jury Subpoenas, 734 F. Supp. 1207 (E.D. Va.), aff'd in part, vacated in part, 902 F.2d 244 (4th Cir. 1990).

Delaware noted that the buyer and seller of corporate assets disagreed about the meaning and effect of an agreement that purported to shape the privilege's ownership.

> The express retention of attorney-client privilege rights, to the extent effective, was reserved for the non-related information that might end up in Chase hands because of the transfer of employees to Chase as part of the transaction. . . . That result is, of course, what one would expect, since it would be strange indeed for reasonable business people to negotiate a transaction in which material information concerning the object of the purchase and sale was somehow retained as the property of the seller, with the buyer left as a warehouseman. Advanta has done nothing to demonstrate the documents at issue are, or any particular document is, unrelated to the business. Advanta having failed to carry the burden of establishing that the documents are privileged, the in limine application is denied.

Chase Manhattan Mortg. Corp. v. Advanta Corp., Civ. A. No. 01-507 (KAJ), 2004 U.S. Dist. LEXIS 7378, at *6-7 (D. Del. Apr. 23, 2004) (footnote omitted).

One of the other cases to deal with this situation refused to enforce an agreement that the subsidiary had entered into after it became independent. In that case the court rejected the applicability of a "protocol" entered into by a corporate parent and a former subsidiary which authorized their joint lawyers to keep confidential from one of the clients' information they had obtained from the other client.[18] The court noted that the subsidiary's in-house counsel had ratified the "Protocol" one year after the divestiture, but that the general counsel "had ties to [the parent] and [the law firm which had jointly represented the parent and the subsidiary in the spin-off of the subsidiary]" and therefore had "an interest in maintaining the validity of the transactions

[18] In re Mirant Corp., 326 B.R. 646 (Bankr. N.D. Tex. 2005).

involved in the divestiture."[19] Thus, even an agreement entered into by a subsidiary after its independence might not have the desired effect.

In 2012, the Northern District of Illinois seemed to reject the notion that parties to a corporate transaction transferring assets could affect the privilege's ownership.

> [N]othing in the assigning documents for the '550 application between the various parties explicitly states that any attorney-client privileged documents were part of the conveyance. That omission is significant. Courts in this district have held that a transfer of assets from one corporation to another is not sufficient for transfer of the privilege, unless there is also a transfer of overall control; 'the right to assert or waive a corporation's attorney-client privilege is an incident of control of the corporation.' . . . Indeed, even when the parties sign a specific agreement to transfer the privilege along with certain assets, a court may nonetheless find that the privilege did not transfer.

Trading Techs. Int'l, Inc. v. GL Consultants, Inc., Civ. A. Nos. 05-4120 & -5164, 2012 U.S. Dist. LEXIS 34489, at *19 (N.D. Ill. Mar. 14, 2012).

The court seemed to indicate that parties to such a transaction could avoid a waiver only if they met the exacting standards of the common interest doctrine.

> Taken to its logical extreme, plaintiff's argument would imply that the attorney-client privilege attaches to any item conveyed from one party to another so long as the transferring party once spoke to an attorney about the item. Other courts have held that it is not error for a district court to find a lack of common interest and common attorney-client privilege when the sale of a patent is not executed as 'part of a joint legal claim or defense.' . . . This Court sees no reason to hold otherwise.

Id. at *20-21.

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19 Id. at 652.

For lawyers hoping that they can control their client's privilege after such a transaction, this is a worrisome result. It shows that even lawyers with the foresight to suggest such agreements cannot assure their intended effect.

Given the case law's uncertainty, it is unfortunately unclear whether lawyers representing negotiating parties in a stock or asset sale can define the ownership. This is not to say that lawyers should not consider the privilege's ownership in corporate transactions, and perhaps even try to affect that ownership. As long as they realize the uncertainty, it seems beneficial to at least consider the ownership and make an effort (even if unsuccessful) to retain, convey or share the attorney-client privilege. The judicial analysis of the privilege's ownership in the case of joint representations and asset sales generally does not describe any effort by the transactional parties to affect the privilege's ownership. Courts might be receptive to at least consider (if not enforce) the party's expectations. Although such expectations clearly cannot trump the legal principles governing the privilege, they might color a court's analysis.

Best Answer

The best answer to **(a)** is **(B) THE BANKRUPTCY TRUSTEE**; the best answer to **(b)** is **(B) THE FORMER SUBSIDIARY**; the best answer to **(c)** is **(A) YOUR CLIENT (PROBABLY)**; the best answer to **(d) YES (PROBABLY)**.

B 8/16

Effect of a Joint Representation in Corporate Transactions

<u>Hypothetical 7</u>

Last year, you represented your firm's largest corporate client in spinning off one of its subsidiaries to become an independent company. The timing could not have been any worse, and the newly-independent former subsidiary declared bankruptcy. This morning you received a call from the lawyer representing the recently-appointed bankruptcy trustee. The lawyer demanded all of your law firm's files created during your work on the transaction, claiming that you had jointly represented the parent and the then-subsidiary in the spin. Given that lawyer's threatening tone, you have been trying to remember what damaging documents might exist in the file -- while considering the trustee's lawyer's legal position.

If you had jointly represented the parent and the then-subsidiary in the spin transaction, does the bankruptcy trustee have the right to your law firm's file?

(A) <u>YES (PROBABLY)</u>

<u>Analysis</u>

In many transactions in which one member of a corporate "family" becomes an independent company through either a stock or asset sale, the same lawyers represent both entities in the transaction. Lawyers representing the entire corporate family in such transactions can include in-house and outside lawyers.

Before turning to joint representations' implications during corporate transactions, it is worth noting the general rule that former joint clients normally may access their joint lawyer's files, and communications with the other jointly represented clients.

- <u>Hall CA-NV, LLC v. Ladera Development, LLC</u>, No. 3:18-cv-00124-RCJ-CBC, 2018 U.S. Dist. LEXIS 203257, at *11-12, *25 (D. Nev. Nov. 30, 2018) (addressing a situation in which two jointly represented clients ended up in litigation against each other; noting that when one sought their joint law firm's file, the other former joint client and the law firm objected on privilege and work product grounds -- withholding communications between the law firm and one client "that did not include [the other client] or its representatives"; rejecting the privilege and work product claims, because "it is widely recognized that the joint representation exception [allowing all now-adverse jointly represented clients to access their lawyer's file] applies to all communications made by a co-client to the joint attorney – regardless of whether both parties are present when the communications occur").

- Estate of Jackson v. General Electric Capital Corp, (In re Fundamental Long Term Care, Inc.), 515 B.R. 874 (Bankr. M.D. Fla. 2014) (addressing a situation in which Kirkland & Ellis represented several corporate affiliates on various matters, including a corporate transaction and Ohio litigation; noting that a state receiver took over one of Kirkland's former clients, and other affiliates in the corporate family declared bankruptcy (and thus had a trustee now calling the shots); carefully scrutinizing Kirkland & Ellis's work for the related corporations when the corporations became litigation adversaries; concluding that Kirkland had not jointly represented two of the affiliated corporations in the transaction – which meant that the trustee (standing in the shoes of the bankrupt joint client) could not obtain the other corporation's responsive but privileged documents about the transaction; holding in contrast that Kirkland had jointly represented two of the affiliated corporations in the Ohio litigation, allowing the trustee to rely on what the court called the "co-client exception" to obtain privileged documents relating to that litigation).

- In re Equaphor Inc., Ch. 7 Case No. 10-20490-BFK, 2012 Bankr. LEXIS 2129, at *9-10, *15 (Bankr. E.D. Va. May 11, 2012) (analyzing the ramifications of a law firm jointly representing a company and two of its executives in a derivative case; noting that the company later declared bankruptcy, and that the bankruptcy trustee moved to compel the turnover of documents the law firm created during the joint representation; inexplicably confusing the joint defense/common interest doctrine and the joint representation situation; ordering the law firm to produce the documents; "WTP and the Individual Defendants place great reliance on the fact that the corporation is named as a 'nominal defendant' in the shareholders' Complaint. In doing so, WTP and the Individual Defendants imply that the interests of the Individual Defendants are entitled to greater weight than those of the Debtor (and now, its creditors). However, while the Debtor may have been named as a nominal defendant, there is no such thing as a nominal client of a law firm. Further, there is no support in the case law for a 'nominal defendant exception' to the principle that all clients are entitled to an attorney's files. The corporation's status as a nominal defendant is of no consequence in considering the common interest privilege of the parties."; "But this is not a discovery dispute in the ordinary sense of the term. It is a motion to compel the turnover of the law firm's files under 11 U.S.C. § 542(e) to the party who now stands in the shoes of the former client, the Debtor. Under these circumstances, the courts have been uniform in holding that the work product doctrine does not prevent the turnover of the files." (emphasis added)).

Thus, one key implication of a joint representation as that if adversity develops any jointly representing client normally can obtain access to all of the joint clients' communications with the lawyer who represented them all. Of course, a joint client already possesses the communications in which she participated. So the real significance of this universally-applied principle is that a joint client can access communications between the other joint clients and their joint lawyer in which the joint client had not participated.

Some lawyers (even one in - house lawyer) have been forced to turn over communications with their lawyer to a third party who almost certainly was not really a joint client.

- DePuy Orthopaedics, Inc. v. Orthopaedic Hospital, Cause No. 3:12-cv-299-JVB-MGG, 2016 U.S. Dist. LEXIS 166537, at *12-13, *13 (N.D. Ind. Dec. 1, 2016) (addressing a situation in which plaintiff DePuy and defendant Hospital had worked together on patent prosecutions – but later become litigation adversaries; noting that DePuy resisted the Hospital's attempt to discover communications to and from DePuy's in-house counsel, which was based on the Hospital's contention that DePuy's in-house lawyer jointly represented her employer/client DuPuy and the Hospital; further noting that DuPuy's in-house counsel claimed that DePuy and the Hospital had only entered into a common interest agreement – noting that O'Melveny & Myers had acted as patent "prosecution counsel" on behalf of both companies; reciting facts that could have proven either a common interest agreement or a joint representation: DePuy and the Hospital shared confidential information and cooperated on a common legal strategy; DePuy's in-house counsel communicated with and gave direction to O'Melveny, etc.; ultimately concluding that DePuy's in-house counsel had jointly represented DePuy and the Hospital – rather than represented just DePuy in a common interest arrangement with the separately represented Hospital; emphasizing that "the evidence does not show that DePuy's in-house counsel . . . provided any kind of disclaimer about representation when answering the Hospital's questions with legal information or consequence regarding the patent prosecution" (emphasis added); delivering the punchline impact -- because DePuy's in-house counsel had jointly represented DePuy and the Hospital, the former joint client Hospital could discover "DePuy's internal communications related to the [patent] prosecution").

- Naturalock Sols., LLC v. Baxter Healthcare Corp., No. 14-cv-10113, 2016 U.S. Dist. LEXIS 66982, at *4, *6, *6 n,1, *7-8, *9, *9-10 (N.D. Ill. May 20, 2016) (analyzing a product inventor's efforts to obtain the files of K&L Gates, which were obtained by Baxter, but which also assisted the inventor in prosecuting a patent; ultimately concluding that K&L Gates jointly represented Baxter and the inventor, which meant that the inventor could obtain the law firm's files in connection with its later dispute with Baxter; "The parties have submitted numerous exhibits that they claim support their respective positions as to whether Naturalock was a client of K&L Gates." (emphasis added); "Given the extensive nature of Baxter's involvement in the patent prosecution, this Court does not find persuasive Naturalock's attempt to cast itself as K&L Gates's sole client. Thus, the question is whether Naturalock was a joint client along with Baxter." (emphasis added); "Baxter asserts that Delaware, not federal, law applies to this privilege dispute. Baxter does not, however, show that the privilege analysis would be different under Delaware and federal law. . . . In fact, Baxter itself cites federal law in support of its arguments."; "Here, based on the record before the Court, it is clear that K&L Gates provided legal advice and services to Naturalock and acted at the direction of Naturalock in addition to Baxter. This is not a situation where there is no evidence of the nature of communications between the licensor and licensee's counsel. . . . It does not matter what K&L Gates or Baxter perceived the relationship to be." (emphasis added); "Baxter focuses on the facts that Naturalock had separate counsel and that all of the parties involved referred to K&L Gates as Baxter's counsel. But those facts do not lead to the conclusion that K&L Gates's representation of Baxter was to the exclusion of Naturalock. Furthermore, Baxter does not contend that Naturalock was ever explicitly informed that K&L Gates represented only Baxter. To the contrary, the record makes clear that K&L Gates had a professional relationship with both Naturalock and Baxter, and that both Naturalock and Baxter manifested an intention to seek professional legal advice from K&L." (second emphasis added); "In sum, it appears that Naturalock and Baxter were joint clients of K&L Gates, and thus there is no basis for Baxter to assert the attorney-client privilege to deny Naturalock discovery regarding correspondence regarding the prosecution of patents for Naturalock's technology. This is true even if Naturalock is correct that Baxter, unbeknownst to Naturalock at the time, was actually acting in a manner that was adverse to Naturalock's interests and even if K&L Gates was complicit in Baxter's scheming." (emphasis added)).

It is not difficult to see how this basic principle can cause great mischief in a corporate transactional context. When a parent company sells or spins off a subsidiary, the same in -house or outside lawyer frequently represents both the parent and the subsidiary in that transaction. If the parent and the now - independent subsidiary become adversaries about some pre- closing or post - closing dispute, the now-independent subsidiary's management can cause it to demand access to communications between the subsidiary (when it was owned by the parent) and the lawyer who had jointly represented the parent and the then - subsidiary. As mentioned above, the now - adverse subsidiary's owner will be most interested in accessing communications between the lawyer and the jointly represented parent in which the then - subsidiary's management had not participated. If the subsidiary's purchaser thinks it had been defrauded in the transaction, those communications are an obvious target.

If the now – independent subsidiary has declared bankruptcy, the risk to the former parent is even greater. The bankruptcy trustee will be looking for deep pockets - often pursuing a theory that the parent knowingly spun off the subsidiary with insufficient assets, or otherwise acted improperly during the sale or spin.

In the 1980's and 1990's, several courts applied this basic joint representation principle in such settings.

- <u>Fogel v. Zell (In re Madison Mgmt. Grp. Inc.)</u>, 212 B.R. 894 (Bankr. N.D. Ill. 1997) (the same lawyers represented a parent and a subsidiary; when the subsidiary went bankrupt, the trustee for the subsidiary sought to give to a third party (a creditor) documents created during the time of the joint representation; the court distinguished the situation from that in <u>Santa Fe</u> (in which the former subsidiary wanted to obtain documents for itself), and held that the parent could block the trustee for the former subsidiary from providing privileged documents to the third party creditor (although the parent and the former subsidiary were now adverse to one another)), <u>rev'd on other grounds</u>, 221 F.3d 955 (7th Cir. 2000).

- <u>Glidden Co. v. Jandernoa,</u> 173 F.R.D. 459 (W.D. Mich. 1997) (Glidden (now called Grow) sold its subsidiary (Perrigo) to the subsidiary's management; Grow then sued its old subsidiary and the subsidiary's management; the court ordered the former subsidiary to produce all of the requested documents to the former parent; the court also rejected the argument that the former subsidiary's management could assert their own privilege).

- Bass Pub. Ltd. Co. v. Promus Cos., No. 92 Civ. 0969 (SWK), 1994 U.S. Dist. LEXIS 5474 (S.D.N.Y. Apr. 25, 1994) (Latham & Watkins represented both the parent (Promus) and a subsidiary (Holiday Inn), which was sold to Bass; the former subsidiary (which was merged into Bass) sought documents from Latham & Watkins dating from the time of the joint representation; although the court found that the documents were not created as part of a joint litigation defense effort, it ordered Latham & Watkins to produce the documents, finding that the jointly-represented subsidiary was entitled to them).

- In re Santa Fe Trail Transp. Co., 121 B.R. 794 (Bankr. N.D. Ill. 1990) (in-house lawyers represented both a parent and a subsidiary; the former subsidiary went bankrupt, and its trustee sought documents from the former parent; although the court found that the situation did not involve a joint litigation defense arrangement (but instead was a joint representation), the court held that the former subsidiary could obtain documents from the parent that were created before the closing of the spin (and certain document created after that date)).

- In re Grand Jury Subpoenas 89-3 & 89-4 & 89-129, 734 F. Supp. 1207 (E.D. Va.) (a parent waives any attorney-client privilege applicable to documents by leaving those documents with the spun subsidiary), aff'd in part, vacated in part, 902 F.2d 244 (4th Cir. 1990).

- Polycast Tech. Corp. v. Uniroyal, Inc., 125 F.R.D. 47 (S.D.N.Y. 1989) (Uniroyal sold its subsidiary (Plastics) to a company called Polycast; Polycast sued Uniroyal for fraud; the court found that communications among the lawyers who jointly represented Uniroyal and its then-subsidiary Plastics did not involve a joint litigation defense, meaning that the new management of Plastics (now owned by Polycast) could obtain the documents).

- Medcom Holding Co. v. Baxter Travenol Labs, Inc.,120 F.R.D. 66 (N.D. Ill. 1988) (the parent (Baxter) sold all of the stock of its subsidiary Medcom to Medcom Holding; Medcom Holding later sued Baxter for securities fraud; the court found that the same lawyers represented Baxter and Medcom during the relevant time; the court held that Medcom's new management had the power to waive the privilege as to some of the documents; however, the court held that documents created during an earlier litigation when Baxter and its subsidiary were jointly represented could not be obtained by the subsidiary's new parent unless Baxter itself consented, even though adversity had developed between Baxter and the new owners of its former subsidiary).

Starting in 2005, several high profile cases and ethics opinions highlighted the frightening implications of such recurring scenarios.

Mirant. In In re Mirant Corp., 326 B.R. 646, 649 (Bankr. N.D. Tex. 2005), the Troutman Sanders law firm was required to produce files it generated while jointly representing the firm's long-time client The Southern Company and the subsidiary which became known as Mirant when it became an independent company and later declared bankruptcy. The court rejected Troutman Sanders' argument that Mirant's bankruptcy trustee was not entitled to communications between Troutman Sanders and The Southern Company created during the joint representation and noted that "[i]t is well established that, in a case of a joint representation of two clients by an attorney, one client may not invoke the privilege against the other client in litigation between them arising from the matter in which they were jointly represented."

Teleglobe. In Teleglobe Communications Corp. v. BCE Inc. (In re Teleglobe Communications Corp.), 493 F.3d 345 (3d Cir. 2007), the Third Circuit analyzed the nature of an in-house lawyer's representation of her employer and its corporate affiliates.

In Teleglobe, Canada's largest broadcaster (BCE) had a wholly owned Canadian subsidiary (Teleglobe), which in turn had several wholly owned second-tier U.S. subsidiaries. Teleglobe and its U.S. subsidiaries were developing a global fiber optic network. Not surprisingly, by late 2001 BCE started to reassess the project, exploring such options as restructuring, maintaining its funding or cutting off funding for Teleglobe and its subsidiaries. After this intensive reassessment involving in-house and outside lawyers (and undoubtedly generating troublesome documents), BCE decided to cut off funding.

Within just a few weeks, Teleglobe declared bankruptcy in Canada, and the second-tier subsidiaries declared bankruptcy in the United States. The bankrupt second-tier subsidiaries (now controlled by hostile creditors) sued BCE for cutting off their funding. They sought documents from BCE's law department and various outside law firms which had represented BCE, Teleglobe and its subsidiaries. The second-tier subsidiaries claimed that they had been jointly represented by BCE's in-house lawyers and their outside law firms.

The District of Delaware agreed with this argument, and gave the bankrupt subsidiaries access to all otherwise privileged documents shared with BCE's law department. BCE appealed the district court's decision rather than turn over the documents.

In Teleglobe, the Third Circuit reversed and remanded. It agreed with the district court's analysis of both the ethics and privilege effects of a joint representation: (1) absent an agreement to the contrary, there can be no secrets among jointly represented clients; (2) former jointly represented clients generally can have access to their joint lawyer's files; (3) litigation adversity among jointly represented clients causes the privilege to evaporate, thus allowing any of them to use otherwise privileged communications in the litigation.

Although the Third Circuit's opinion started with a quote from the Righteous Brothers' song "You've Lost That Lovin' Feelin'," the opinion includes a serious analysis of several issues. Id. at 352 & n.1. Significantly, the Third Circuit specifically rejected arguments presented by amicus Association of Corporate Counsel.

Among other things, the Third Circuit rejected what in essence was the district court's automatic presumption that all lawyers representing BCE also jointly represented Teleglobe and its now bankrupt subsidiaries. The court remanded so the district court could assess with more care the nature of BCE's in-house and outside lawyers' representation of Teleglobe and its subsidiaries.

After the Third Circuit described the adverse consequences of a joint representation, it offered a roadmap for how in-house lawyers can avoid those consequences.

Most importantly, the court explained that in-house lawyers can limit the scope of their representation of corporate affiliates. The court provided the example of a corporate parent's gathering of information from subsidiaries in order to make public filings -- which does not necessarily "involve jointly representing the various corporations on the substance of everything that underlies those filings." Id. at 373. The court also acknowledged that "in some of these circumstances in-house counsel may not need to represent the subsidiaries at all," because the parent company's lawyer can have privileged communications with subsidiaries' employees without representing the subsidiary. Id. at 373 n.27.

In discussing situations where a parent's and a subsidiary's interests might later diverge ("particularly in spin-off, sale and insolvency situations"), the court advised that "it is wise for the parent to secure for the subsidiary outside representation." Id. at 373. The court emphasized that this "does not mean that the parent's in-house counsel must cease representing the subsidiary on all other matters." Id. The court assured in-house lawyers that

> [b]y taking care not to begin joint representations except when necessary, to limit the scope of joint representations, and seasonably to [hire] separate counsel on matters in which subsidiaries are adverse to the parent, in-house counsel can maintain sufficient control over the parent's privileged communications.

Id. at 374. If in-house lawyers take this step, "they can leave themselves free to counsel a parent alone on the substance and ramifications of important transactions without risking giving up the privilege in subsequent adverse litigation [between a parent and a former subsidiary]." Id. at 383 (emphasis in original).

On remand, the Bankruptcy Court for the District of Delaware ultimately found that there had not been a joint representation.[1]

625 Milwaukee. Significantly, the same approach has been applied in the case of a parent's sale of a subsidiary in the ordinary course of its business, rather than in a bankruptcy setting.

In 625 Milwaukee, LLC v. Switch & Data Facilities Co., Case No. 06-C-0727, 2008 U.S. Dist. LEXIS 19943 (E.D. Wis. Feb. 29, 2008), law firms Blank Rome and Quarles & Brady represented a parent and its fully owned subsidiary in a transaction involving the subsidiary's sale to a new owner. The subsidiary later sued its former parent, and sought the law firms' files. The court ordered production of the files despite the law firms' argument that they never represented the subsidiary in the transaction. The court noted that the parent had presented "no evidence indicating that it ever hired

[1] Teleglobe USA, Inc. v. BCE Inc. (In re Teleglobe Commc'ns Corp.), Ch. 11 Case No. 02-11518 (MFW), Adv. No. A-04-53733 (MFW), 2008 Bankr. LEXIS 2130 (Bankr. D. Del. Aug. 7, 2008).

separate counsel for [the subsidiary] before the date it was sold to [buyer]," so "the only attorneys who could have been representing [the subsidiary] at the moment the Lease Term Sheet was signed were Blank Rome and Quarles & Brady." Id. at *12. The court even ordered the production of a post-transaction document -- Blank Rome's invoice which referred to the firm's pre-transaction work. Accord Brownsville General Hosp., Inc. v. Brownsville Prop. Corp. (In re Brownsville General Hosp., Inc.), 380 B.R. 385 (Bankr. W.D. Pa. 2008).

New York City LEO 2008-2. A 2008 New York City legal ethics opinion thoroughly analyzed this issue, and also warned in-house lawyers of the risk they run by jointly representing corporate affiliates.[2] The New York City Bar suggested that an in-house lawyer in this situation could obtain a prospective consent.

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2 New York City LEO 2008-2 (9/08) (addressing an in-house lawyer's representation of corporate affiliate in the face of conflicts of interest; explaining that "[i]t is inevitable that on occasion parents and subsidiaries will see their interests diverge, particularly in spin-off, sale, and insolvency 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."; first analyzing an in-house lawyer's representation of a parent and one or more wholly owned affiliates; explaining that in their 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"; also analyzing an in-house lawyer's representation of a parent and an affiliate that is only partially owned by the parent, or several affiliates controlled by, but not wholly owned by, a common parent; explaining that in that situation "inside counsel must act on the basis that the parent and each of its represented affiliates is a separate entity with separate interests"; concluding that in the second scenario in-house lawyers must analyze whether they can jointly represent affiliates with conflicting interests; "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."; also saluting the "disinterested lawyer" test, which determines if an objective lawyer would believe that he or she could adequately represent multiple affiliate corporations in the joint representation; noting that the in-house lawyer might consider obtaining prospective consents from the various clients; "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

> 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: [i]dentify for the clients the potential or existing conflicts with as much specificity as possible; [m]ake clear to the clients that the confidences and secrets of the affiliate will be shared with the parent; and [o]btain 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.

New York City LEO 2008-2 (9/08). Not surprisingly, the New York City Bar also reminded in-house lawyers that anyone signing such a prospective consent on the corporation's behalf "must have the degree of independence from the parent, or from other affected affiliates, required by applicable corporate law." Id.

Echoing the Third Circuit's warning in Teleglobe (discussed above), the New York City Bar also suggested that in-house lawyers might want to avoid representing corporate affiliates in certain circumstances.

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affiliate, the advance waiver should: [i]dentify for the clients the potential or existing conflicts with as much specificity as possible; [m]ake clear to the clients that the confidences and secrets of the affiliate will be shared with the parent; and [o]btain 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."; explaining that in some circumstances the in-house lawyer might conclude that separate lawyers should represent the affiliates; also noting that "[i]t 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"; also noting that an in-house lawyer might alternatively limit the representation to one or more affiliates in order to avoid conflicts; "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."; warning that "[s]ensitivity to conflicts between represented affiliates will help forestall judicial criticism and avoid unnecessary curtailment of inside counsel's continued functioning in their expected capacity").

> 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.

Id.

Crescent Resources. In In re Crescent Resources, LLC, 457 B.R. 506 (Bankr. W.D. Tex. 2011), the Litigation Trust for bankrupt Crescent Resources sought the files of the Robinson, Bradshaw & Hinson law firm.

The Litigation Trust claimed that Robinson, Bradshaw had jointly represented Crescent and its parent Duke Ventures, LLC -- in a transaction that allegedly left Crescent insolvent after a transfer of over $1 billion to Duke. If there had been a joint representation, universally recognized principles would entitle either of the jointly represented clients to the law firm's files. As the undeniable successor to Crescent Resources, the Litigation Trust would therefore be entitled to the law firm's files -- including all communications between the law firm and Duke about the transaction, even if no Crescent representative participated in or received a copy of those communications.

The court succinctly stated the issue.

> The major issue before the Court is whether the Trust is to be considered a joint or sole client, or no client at all, of RBH [Robinson, Bradshaw & Hinson] with respect to the Project Galaxy files.

Id. at 516.

The court also teed up the parties' positions.

> The Trust argues that RBH did represent Crescent Resources, while Duke would have the Court believe that RBH jointly represented Crescent Resources before the 2006 Duke Transaction and after the 2006 Duke Transaction, but not <u>during</u> the 2006 Duke Transaction. Duke further alleges that Crescent Resources was not represented by counsel <u>at all</u> during the 2006 Duke Transaction. Duke is arguing, essentially, that for the purposes of the 2006 Duke Transaction only, RBH did not represent Crescent Resources. So the issue to be resolved is whether RBH represented Crescent Resources with respect to the 2006 Duke Transaction.

<u>Id.</u>

Duke and Robinson, Bradshaw staked out a firm position, and both

> provided sworn testimony that Duke was RBH's sole client for Project Galaxy. Mr. Torning ["Duke's in-house attorney responsible for Project Galaxy and attorney in charge of outside counsel for Duke for Project Galaxy"] testified that it was his understanding "that at all times during Project Galaxy, RBH represented Duke, not Crescent."

<u>Id.</u> at 520. Thus, both Duke and Robinson, Bradshaw stated <u>under oath</u> that the law firm represented only Duke -- and did not represent Crescent.

The court looked at all the obvious places in assessing whether Robinson, Bradshaw solely represented Duke in the transaction, or jointly represented Duke and Crescent in the transaction.

First, the court found that a 2004 Robinson, Bradshaw retainer letter was somewhat ambiguous.

> "The Firm is retained to represent Duke Energy (<u>or any of its subsidiaries or affiliates</u>) and to render legal advice or representation as directed and specified by a Duke Energy attorney . . . with respect to a given matter . . . However, the Duke Energy Office of General Counsel has the ultimate responsibility and authority for handling all decisions in connection with the Services."

Id. at 519. A Robinson, Bradshaw lawyer testified that the firm "was unable to locate any engagement letter . . . in which Crescent Resources was a signatory." Id. Thus, there was no specific retainer letter for the pertinent transaction, but the earlier general retainer letter was not inconsistent with Robinson, Bradshaw's joint representation of Crescent in the transaction.

Second, the court pointed to Duke's payment of Robinson, Bradshaw's invoices. Id. at 520. The court explained that Duke's payment of Robinson, Bradshaw's legal fees did not necessarily preclude the firm's joint representation of Duke and Crescent.

> The evidence shows that Duke, not Crescent, paid for the legal services provided in connection with Project Galaxy. However, that is not dispositive, as there can still be an implied attorney-client relationship independent of the payment of a fee.

Id. at 522.

Third, the court noted Duke's argument that Robinson, Bradshaw "took direction from, reported to, and provided legal services to Duke." Id. at 520. In analyzing the direction issue, the court pointed to a Robinson, Bradshaw lawyer's testimony.

> Mr. Buck testified that neither he nor any RBH attorneys represented Crescent in the Project Galaxy transaction. . . . Mr. Buck additionally testified that he did not report to Crescent nor take direction from Crescent during Project Galaxy.

Id. at 521. Of course, the Robinson, Bradshaw lawyers had interacted with Crescent employees in connection with the transaction.

> Duke acknowledged that RBH worked with Crescent Resources on Project Galaxy, but downplayed that by stating that "of course [RBH interacted with Crescent], because they're representing Duke in the sale of . . . its 49 percent shareholder interest in Crescent. And of course,

> when you're providing information to the buyer—the prospective buyer—you're going to work with the company in which you're selling a portion of your shares." . . . . Duke argues that this contact between RBH and Crescent Resources is not the same as RBH representing Crescent Resources with respect to Project Galaxy.

Id. at 519.

Thus, Duke and Robinson, Bradshaw argued that the firm had not jointly represented Duke and Crescent in the transaction, relying on sworn statements to that effect from both Duke and the law firm; the lack of a specific retainer letter with Crescent; Duke's payment of the legal bills; and Duke's direction to the law firm in connection with the transaction.

The court then turned to contrary evidence presented by the Litigation Trust.

First, the court pointed to evidence clearly establishing that Robinson, Bradshaw had represented Crescent before the transaction. Id. at 518. The court also noted the firm's failure to run conflicts when undeniably representing Crescent in a number of matters before the transaction.

Ironically, the court also pointed to Crescent's own application to retain Robinson, Bradshaw as its law firm in the bankruptcy -- which described the law firm's long-standing representation of Crescent.

> The Trust presented the Application to Employ RBH submitted to this Court on June 11, 2009 (the "Application") . . . . That document details RBH's pre-petition relationship with the Debtors. "RB&H has been representing Crescent and many of its debtor and non-debtor subsidiaries since 1986 and has served as Crescent's primary corporate counsel for several years." . . . . The Application states that "RB&H represented Crescent in connection with the formation, in 2006, of its current parent holding company, incident to a change in Crescent's historical ownership

> structure as a wholly-owned, indirect subsidiary of Duke Energy Corporation." . . . . The Application also contains the Declaration of Robert C. Sink in Support of Application to Employ (the "Sink Declaration") . . . . Mr. Sink is a shareholder with RBH and the declaration was made on RBH's behalf. In the Sink Declaration, Mr. Sink echoes the Application and states that "RB&H has represented Crescent Resources and many of its debtor and non-debtor subsidiaries in various matters since 1986 and has served as Crescent's primary corporate counsel for several years."

Id. at 517-18 (emphasis added). The court concluded that

> RBH represented both Crescent and Duke prior to Project Galaxy. There was no end to the attorney-client relationship and RBH attorneys were going through Crescent files in performing the due diligence for Project Galaxy. It is reasonable that a current client would believe that an attorney was representing them if the attorney showed up to that current client's office and started going through files.

Id. at 522 (emphasis added).

The court also noted Robinson, Bradshaw's representation of Crescent after the transaction.

> Duke provided no evidence which would have given RBH cause to terminate their relationship with Crescent, nor did Duke provide any evidence that RBH gave notice to Crescent that RBH was terminating their relationship. Further, Duke acknowledges that RBH and Crescent continued to maintain an attorney-client relationship post Project Galaxy, which would negate any potential argument by Duke that RBH and Crescent's relationship may have terminated by implication.

Id. at 523.

Second, the court noted that Crescent did not have any other law firms represent it in connection with the transaction.

> RBH had a long-term relationship with Crescent before Project Galaxy. Additionally, there was no other representation of Crescent during Project Galaxy.

Id. at 521 (emphasis added).

Third, the court pointed to several Robinson, Bradshaw lawyers' website bios boasting that they had represented Crescent in the transaction.

> The Trust also discussed statements made by various RBH lawyers on RBH's website. Stephan J. Willen's page, under "Representative Experience" includes "Representing a real estate developer, as borrower, in connection with a $1.5 billion revolving and term loan letter of credit facility used to recapitalize the developer." The Trust stated that this represents the 2006 Duke Transaction and shows Mr. Willen's understanding that Crescent Resources was RBH's client with respect to the 2006 Duke Transaction. Additionally, William K. Packard's page, under "Representative Experience" states "Representation of Crescent Resources, as borrower, in connection with a $1.5 billion revolving and term loan letter of credit facility."

Id. at 518 (emphases added).

After examining both side's arguments, the court turned to the legal standard.

The court pointed to the Third Circuit's extensive analysis of this very issue in In re Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007).[3] The court noted that

> Teleglobe, relied on by both parties, reads almost as an instructional manual to in-house counsel on how to avoid

[3] Id. at 516 ("The various cases cited by both the Trust and Duke involve cases where a parent corporation and subsidiary were represented by the same attorney during a spin-off, sale, or divestiture. See e.g. In re Teleglobe Commc'ns Corp., 493 F.3d 345 (3rd Cir. 2007) (in-house counsel of the parent corporation represented both the subsidiary and parent companies); Polycast Tech. Corp. v. Uniroyal, Inc., 125 F.R.D. 47 (S.D.N.Y. 1989) (in-house counsel of the parent corporation represented both the subsidiary and parent in the sale of the subsidiary); Medcom Holding Co. v. Baxter Travenol Labs., Inc., 689 F. Supp. 841 (N.D.Ill. 1988); In re Mirant Corp.[,] 326 B.R. 646 (Bankr. N.D.Tex. 2005) (same law firm representing both parent and subsidiary in a public stock offering of the subsidiary). In those cases, the courts determined the parties were joint clients. The issue remaining before this Court is whether RBH represented Crescent Resources with respect to the 2006 Duke Transaction.").

> tangled joint-client issues. Teleglobe instructs that a court should consider the testimony from the parties and their attorneys on the areas of contention.

Id. at 524. The court also pointedly noted that

> RBH and in-house counsel for Duke should have heeded the warnings in Teleglobe and taken greater care to have in place an information shielding agreement or ensured that Crescent was represented by outside counsel.

Id.

The court ultimately concluded that Robinson, Bradshaw had jointly represented Duke and Crescent in the transaction. The court therefore held that the Litigation Trust was entitled to Robinson, Bradshaw's files generated during the firm's joint representation of Duke and Crescent in the transaction.[4]

In looking ahead to litigation between Litigation Trust and Duke, the court also held found that

> Duke cannot invoke an attorney-client privilege to stop the Trust from using the joint-client files in adversary proceedings between Duke and the Trust.

Id. at 528. In contrast, the court held that

> the Trust may not unilaterally waive the joint-client privilege and use jointly privileged information in proceedings involving third parties, absent a waiver from Duke.

Id. at 530.[5] The court's conclusions follow the majority rule when joint clients become adversaries. The law generally allows either joint client access to their common law

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[4] Id. at 524.

[5] Id. at 529-30 ("The Restatement [Restatement (Third) of Law Governing Lawyers § 75 cmt. e (2000)] says co-client communication is not privileged as between the co-clients. The Trust's reading of the Restatement appears to state that if co-client communication is then used in an adversary [sic] between the former co-clients, it would then waive the privilege as to third parties. This would effectively make the privilege superfluous. Protections can be placed on any future hearings between Duke and the

firm's files, and permits either joint client to use any of those documents in litigation with another joint client.

Since this highly-publicized case, another court reached the same conclusion in a similar setting.

- Newsome v. Lawson, 286 F. Supp. 3d 657, 664-65, 665 (D. Del. 2017) (applying the Teleglobe standard, and finding that a liquidating trustee could obtain privileged documents from a lawyer that jointly represented the bankrupt company and its parent; also finding that the Eureka case did not change that result; also finding that the "breach of duty exception" allowed the lawyer for a joint client to obtain privileged communications between either of the joint client and their lawyer; "Several courts have relied on the breach of duty exception to compel disclosure of privileged communications in a lawsuit between a joint client and the joint attorney. . . . The breach of duty exception provides that, '[i]n a lawsuit between an attorney and a client based on an alleged breach of a duty arising from the attorney-client relationship, attorney-client communications relevant to the breach are not protected by the attorney-client privilege.' . . . Delaware has adopted a breach of duty exception in substantially the same form. See Del. R. Evid. 502(d)(3) (stating that there is no privilege '[a]s to a communication relevant to an issue of breach of duty by the lawyer to the client or by the client to the lawyer.'" (alterations in original); "[T]he court finds that the magistrate judge erred in concluding that the breach of duty exception does not apply to cases involving a joint representation.").

Best Answer

The best answer to this hypothetical is **(A) YES (PROBABLY)**.

B 8/16

[n—12/15/20]

Trust, and any co-client privileged information can remain privileged as to third parties even if used in a future adversary proceeding between Duke and the Trust.").

Intentional Joint Representation of Corporate Employees

Hypothetical 8

As the only in-house lawyer for a privately-held company, you are occasionally asked to represent company employees (often distant relatives of the primary owner). You want to make sure that such representations do not run afoul of any rules, or jeopardize your main job as the company's lawyer.

(a) May you intentionally represent a company employee in a company-related matter?

(A) YES

(b) May you intentionally represent a company employee in a non-company-related matter?

MAYBE

Analysis

Introduction

Although it certainly raises conflicts of interest issues and privilege ownership issues, there is nothing inherently unethical about a lawyer representing both a corporation and one or more of the corporation's employees. In fact, ABA Model Rule 1.13 specifically acknowledges such joint representations.

> A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

ABA Model Rule 1.13(g).

Unauthorized Practice of Law/Multijurisdictional Practice Issues

However, the issue becomes much more complicated in the case of in-house lawyers.

This situation is governed by unauthorized practice of law ("UPL") regulations in each state. States take differing approaches to the permissibility of in-house lawyers representing individual constituents (officers, directors, employees) of their corporate client-employers. The stakes can be surprisingly high -- an in-house lawyer representing such an individual in a state that does not permit such representations would be engaging in the unauthorized practice of law. Most states prohibit the unauthorized practice of law in their criminal statutes.

Even in-house lawyers <u>fully licensed</u> in the state where they practice must examine their state's unauthorized practice of law rules. In-house lawyers represent somewhat of an anomaly in the law -- because they ultimately report to a nonlawyer (the company's board of directors). Because of this unique role, in-house lawyers must assess with whom they can establish an attorney-client relationship. At the extreme, an in-house lawyer working for a large retailer could not set up a table near the store's front door and begin representing customers who might want a will drafted for them. This would essentially make the corporation a law firm owned by shareholders -- which no state permits. On the other hand, some states allow in-house lawyers to represent their corporation's employees (subject to the conflicts rules). Other states are more liberal, and allow in-house lawyers to represent their corporation's former employees, and in some situations even their corporation's customers. However, each state takes a slightly different approach, and in-house lawyers would be wise to check the applicable rules.

States' somewhat hostile attitude toward in-house lawyers' representation of such third parties creates a special dilemma for in-house lawyers hoping to engage in pro bono work. As indicated above, no in-house lawyer could begin to represent thousands of company customers. Technically, pro bono clients stand in the same shoes as those customers -- they are strangers to the corporation. Many states have wrestled with this issue, and most find a way to turn a blind eye toward any technical violation of the unauthorized practice of law rules that might occur if an in-house lawyer engages in pro bono work.

These issues become even more complicated for in-house lawyers who are not full members of the bar in the state where they are practicing. Traditionally, most states often did not require in-house lawyers to join the bar or even register with the bar in some way. However, most states now require in-house lawyers to either take the full step of joining the bar where they practice, or at least register in some way.

Cynics would argue that states are as much interested in the dues money as in their desire to police in-house lawyers' conduct. It is easy to see why states normally do not have much of an interest in regulating in-house lawyers. Because in-house lawyers generally cannot represent entities or people outside their corporate employer (as discussed above), there normally is no great danger that in-house lawyers will harm the public. And to the extent that they harm their corporation or its employees, the corporation itself generally can take care of such misdeeds.

The ethics rules contain provisions dealing with what in-house lawyers may do when practicing in states in which they are not licensed.

This issue (called the "multijurisdictional practice" (or MJP) issue) is governed by ABA Model Rule 5.5 and the parallel rules in states adopting the ABA approach.

Under ABA Model Rule 5.5, all lawyers (including in-house lawyers) may practice law in other states as long as they do not hold themselves out as being admitted in that state, and as long as they provide legal services in that other state only on a "temporary basis." In addition, the lawyer practicing in another state must either associate with a lawyer from that state, comply with whatever pro hac vice rules apply to appear before a tribunal, or engage in representations that "arise out of or are reasonably related to" the lawyer's practice in a state where the lawyer is admitted. ABA Model Rule 5.5(c).

Of special interest to in-house lawyers, ABA Model Rule 5.5(d) allows an in-house lawyer to represent the lawyer's "employer or its organizational affiliates" in a state where the lawyer is not licensed, even as part of a "systematic and continuous presence" in the other state. ABA Model Rule 5.5(d).

A comment explores this "safe harbor" -- which does <u>not</u> allow the in-house lawyer to represent individual constituents of the client-employer in the other state.

> Paragraph (d)(1) applies to a lawyer who is employed by a client to provide legal services to the client or its organizational affiliates, i.e., entities that control, are controlled by, or are under common control with the employer. <u>This paragraph does not authorize the provision of personal legal services to the employer's officers or employees.</u> The paragraph applies to in-house corporate lawyers, government lawyers and others who are employed to render legal services to the employer. The lawyer's ability to represent the employer outside the jurisdiction in which the lawyer is licensed generally serves the interests of the

> employer and does not create an unreasonable risk to the client and others because the employer is well situated to assess the lawyer's qualifications and the quality of the lawyer's work.

ABA Model Rule 5.5 cmt. [16] (emphasis added).

Thus, in-house lawyers moving to a state that follows the ABA Model Rules and not wishing to join that state's bar may represent the corporation's "organizational affiliates" -- but <u>not</u> any individual corporate constituents.

<u>Conflicts Issues</u>

Lawyers who represent corporations sometimes intentionally create a separate representation of a corporate employee. Such a joint representation does not have any dramatic effect on either the corporation's or the employee's attorney-client privilege. The lawyer must maintain the privilege protecting communications with the employee on such a separate matter, and must of course do likewise for any communications relating to the lawyer's representation of the corporation.

Such separate representations clearly carry ethics implications. A lawyer representing an employee on a traffic ticket matter has an attorney-client relationship with the employee, which precludes the lawyer from adversity to the employee even on unrelated matters (absent consent). This is one reason why wise lawyers try to avoid representing the employees of companies they also represent, even on unrelated matters. For instance, a lawyer representing a corporate vice president in buying a house cannot (absent consent) advise the company's board about its right to fire that vice president. Consent would normally be unavailable as a practical matter, because the board would not permit the lawyer to make the sort of disclosure necessary to obtain a valid consent. A lawyer might find it awkward to arrange for a prospective consent when beginning to represent the employee in his or her house purchase, because it might send an unfortunate signal that such adversity might develop, or be a "turn off" to the lawyer's important contact and business generator in the corporate hierarchy.

When a law firm explicitly represents both the company and an employee, it might be necessary to determine if the representations are joint or separate. A lawyer who jointly represents a corporation and a corporate employee must consider all of the normal ramifications of such a joint representation on the same matter. First, the lawyer might not be able to keep secrets from either of the jointly represented clients. Second, a joint representation gives the employee equal ownership of and power over the attorney-client privilege. This means that the employee might have later access to the lawyer's file and communications between the lawyer and the corporation. It also means that absent some degree of adversity between the corporation and the employee, the corporation and the employee would have to unanimously vote to reveal any of their privileged communications to outsiders. Third, the development of any adversity between the jointly represented clients almost inevitably requires the withdrawal from representation of both clients. To make matters worse, the imputed disqualification rules applicable to law firms also generally apply to law departments, which means that an in-house lawyer's disqualification from a joint representation of the corporation and an individual employee normally would require the entire law department's disqualification.[1]

1 ABA Model Rule 1.0(c).

Lawyers might be able to mitigate some of the risks by arranging for a prospective consent from the employee, attempting to allow the lawyer to withdraw from representing the employee if adversity develops between her and the corporation, while continuing to represent the corporation.[2] The efficacy of such prospective consents is outside the scope of this hypothetical, but it is worth noting that courts and bars examine prospective consents both when the lawyers arrange for them <u>and</u> when the lawyers attempt to rely on them. Thus, there is never a guarantee that such a prospective consent will allow the lawyer to continue representing the corporation on the same matter if that would include adversity to the employee who is now the lawyer's former client. Lawyers therefore can never assure their corporate clients with confidence that they can completely mitigate the risks of a joint representation should adversity develop.

Despite these risks, lawyers representing corporations frequently enter into such intentional joint representations.

Trying to avoid a joint representation might be easy, if the law firm represents the executive in some non-corporate matters such as a traffic ticket or a house purchase. However, law firms might try to "thread the needle" by claiming that they represented a company and an executive on a company-related matter, but that their representations were separate rather than joint. This is nearly an impossible argument to successfully make, absent very clear retainer letters.

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[2] For instance, one court refused to disqualify a firm from representing a company in litigation adverse to a former company executive whom the firm had also represented -- finding that the firm had adequately described its role and obtained a valid prospective consent from the executive. <u>Laborers Local 1298 Annuity Fund v. Grass (In re Rite Aid Corp. Sec. Litig.)</u>, 139 F. Supp. 2d 649, 660 (E.D. Pa. 2001).

A 2009 decision highlights the risks that a lawyer runs when intentionally entering into separate representations of both a company and one of its employees, who was under investigation for wrongdoing. In that case, the well-known California law firm of Irell & Manella undertook what the court called "three separate, but inextricably related, representations" of Broadcom and its CFO.[3] The law firm represented Broadcom in connection with the company's internal investigation of stock option issues, and the CFO in two lawsuits brought by shareholders alleging wrongdoing in connection with stock options. The law firm interviewed the CFO, and then disclosed information it learned during the interview to the U.S. Attorney's Office, the SEC, and Broadcom's auditor. When the government pursued criminal charges against the CFO, he sought to suppress the statements he had made to the law firm during the interview, and the trial court granted his motion. Among other things, the court noted that the law firm had not advised the CFO before the interview that the firm was wearing only its "Broadcom" hat during the interview, and that it might disclose to third parties what it learned from the CFO. The court explained that "whether an Upjohn [Upjohn Co. v. United States, 449 U.S. 383 (1981)] warning was or was not given is irrelevant" -- because the firm clearly represented the CFO.[4] As the court put it, "[a]n oral warning to a current client that no attorney-client relationship exists is nonsensical at best -- and unethical at worst."[5] In addition to suppressing the evidence, the court referred the law firm to the State Bar for

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[3] United States v. Nicholas, 606 F. Supp. 2d 1109, 1111 (C.D. Cal. 2009), rev'd and remanded sub nom. United States v. Ruehle, 583 F.3d 600 (9th Cir. 2009).

[4] Id. at 1117.

[5] Id.

"appropriate discipline," based on the firm's ethical misconduct that "[t]he Court simply cannot overlook."[6]

The Ninth Circuit reversed the district court's holding, but lawyers should not breathe easy.[7] The Ninth Circuit (i) found that the law firm had represented both Broadcom and its former CFO Ruehle in connection with possible option backdating; (ii) agreed with Ruehle that the law firm had not provided the proper Upjohn warning to Ruehle, despite the lawyers' contrary claims (pointedly noting that the [law firm] lawyers "took no notes nor memorialized their conversation on this issue in writing";[8] (iii) held that the district court had improperly applied California law rather than federal law to the privilege question (meaning that the district court might have been upheld if it had made the same findings under the federal standard); (iv) noted that Ruehle "was no ordinary Broadcom employee" because he knew that the law firm was sharing information with Broadcom's auditor Ernst & Young (a fact that will not be present in most situations involving law firms representing both corporations and executives);[9] (v) labeled as "troubling" the law firm's "allegedly unprofessional conduct";[10] and (vi) emphasized that "our holding today should not be interpreted as carte blanche approval" of the law firm lawyers' testimony about their communications with Ruehle (implying that the law firm's proffer to the FBI might have included impermissible disclosures).[11]

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6 Id. at 1112.

7 United States v. Ruehle, 583 F.3d 600 (9th Cir. 2009).

8 Id. at 604 n.3.

9 Id. at 610.

10 Id. at 613.

11 Id. at 613 n.10.

In 2007, another lawyer avoided disqualification in a similar setting.

- United States v. White Buck Coal Co., Crim A. No. 2:06-00114, 2007 U.S. Dist. LEXIS 3163, at *29, *39, *41, *42-43 (S.D. W. Va. Jan. 16, 2007) (declining to disqualify a lawyer who formerly represented Massey Energy as an in-house lawyer, and jointly representing Massey's subsidiary White Buck and an individual employee accused of mine safety violations; explaining that the lawyer eventually withdrew from representing the individual employee, but continued to represent White Buck after joining the Spilman Thomas law firm; finding a conflict of interest, but declining to disqualify the lawyer or Spilman; "Heath represented Wine and White Buck during the investigation of the citation, an inquiry that has now blossomed into the criminal prosecution of both Wine and White Buck. Additionally, Wine will be the key witness against White Buck in this criminal action. The two entities have held fast to diametrically opposed positions since the day following the citation. Specifically, Wine has insisted since the morning of June 28, 2002, that his White Buck supervisors instructed him to conduct his pre-shift duties in an unlawful manner. Since that same time, White Buck has engaged in determined efforts to pin all fault upon Wine for the violation. When the case is called for trial, one of the most significant challenges for White Buck will be the utter decimation of Wine's credibility. The architect charged with assembling the strategem designed to achieve that end is none other than the Spilman firm, with which Heath is now associated. The conflict of interest could not be clearer."; "[O]ne can readily discern the two subjects for inquiry under Wheat [Wheat v. United States, 486 U.S. 153 (1988)] when the court is presented, as here, with an actual conflict of interest. First, the court must ascertain whether the conflict will interfere with the proper functioning of the adversarial process, namely, whether counsel's ethical dilemma robs the client of a constitutionally effective advocate. Second, the court must ascertain whether allowing conflicted counsel to proceed will cause observers to question the fairness or integrity of the proceeding."; noting that the individual former client could not point to any privileged or confidential information that the lawyer possessed; "White Buck has offered Robert Luskin, counsel of record from a different law firm, to conduct the Wine cross examination. The government has not challenged White Buck's observations concerning this proposal, which provide as follows: 'First, Mr. Luskin has had minimal contact with Mr. Heath, and possesses no knowledge of confidential communications that could be used in the cross-examination of Mr. Wine. Second, Mr. Luskin will not hesitate to conduct a rigorous cross-examination of Mr. Wine, and cannot possibly fear breaching a confidential relationship because none ever existed. Third, Mr. Luskin does not anticipate that Mr. Wine will ever be his client and, thus, is not encumbered by the speculative conflict that might arise from the loss of future business.'"; "Additionally, our courts of appeals has tacitly approved such arrangements. See [United States v.]Williams, 81 F.3d 1321, 1325 (4th Cir. 1996). ('While allowing . . . [auxiliary counsel under similar circumstances] might have been within the court's discretion, declining to use it cannot be held an abuse of that discretion.')"; "[I]t is important to note that Wine has never moved to disqualify Heath. Also, Wine has waived any remaining privilege on the apparent subject matter involved in this action. Finally, his former counsel's present firm will be barred from confronting him on cross examination."; explaining a lawyer from another firm would cross-examine the former client).

In 2017, a court declined to disqualify Covington & Burling in this setting, but labeled as "troubling"!that prestigious firm's lack of disclosure to its deposition - related client.

- Adkisson v. Jacobs Eng'g Grp., Inc., No. 3:13-CV-505-TAV-HBG, 2016 WL 6534273, at *2, *4, *5 (E.D. Tenn Nov. 1, 2017) (declining to disqualify Covington & Burling from representing the defendant company and several employees, but criticizing the firm for not having adequately made disclosures to the employees/clients and obtaining their consent; "Covington informed the witnesses of their options for representation at the deposition: to be unrepresented, to be represented by government counsel, or to be represented by Covington free of charge. . . . Each witness chose to have Covington represent them during their depositions."; "During the September 23, 2016, hearing, Kurt Hamrock from Covington represented to the Court that the nonparty-witness clients did not provide oral informed consent and did not sign any consent forms, conflict waivers, potential conflict waivers, or representation agreements. He also informed the Court that no one at Covington explained to these clients what would happen if a conflict arose during the course of the depositions and no one discussed any joint representation confidentiality issues with the clients."; "Plaintiffs argue that Covington should be disqualified from representing any party in these cases for violating several of the Tennessee Rules of Professional Conduct ('TRPC') through its representation of the nonparty witnesses during depositions. . . . In response, Jacobs contends that Covington did not violate any of the TRPC and that there is no legal basis to justify the drastic remedy of disqualification."; "The Court finds that the same concerns about the court raised in Mid-State [Mid-State Aftermarket Body Parts, Inc. v. MQVP, Inc., No. 4:03CV00733, 2009 WL 1211440 (E.D. Ark. May 4, 2009)] also apply here. Many of those concerns, however, could be alleviated if certain precautions are taken. In its response to the motion to disqualify, Jacobs states: 'Plaintiffs ignore much more recent guidance on this subject, however, which has concluded that attorneys are 'ethically permitted' to represent nonparty witnesses at depositions in a litigation where the attorney also represents named party.'"; "During the depositions, while the nonparty witnesses provided information that supports Jacob's defenses, they also provided information to support plaintiffs' position. Specifically, counsel for plaintiffs posed several hypothetical[s] regarding whether Jacobs would be in violation of its contract if it engaged in certain actions. In response to these hypotheticals, the nonparty witnesses replied that such actions would be improper and/or would not be permissible under Jacobs's contract."; "Although Covington's actions do not rise to the level requiring attorney disqualification, the Court emphasizes that it finds Covington's actions troubling and that such actions are inconsistent with the practices in this district. Covington's decision to undertake representation of these nonparty witnesses without first engaging in the barest minimum of precautions to prevent or prepare for conflicts is a practice that is fraught with ethical peril."; "In light of this, the Court ADMONISHES Covington and ORDERS that if any counsel in these actions undertakes the representation of nonparty witnesses in the future, the attorney SHALL first secure informed consent, execute a written waiver of potential or actual conflict, and execute a representation agreement that clearly describes the dual representation and dual loyalty between the party and the nonparty witness as set forth in this opinion.").

Although some lawyers jointly representing companies and their employees dodge the bullet, a Union Pacific in-house lawyer was not so lucky.

- Yanez v. Plummer, 164 Cal. Rptr. 3d 309, 310, 311, 313, 313-14, 314, 315 (Cal. Ct. App. 2013) (holding that a Union Pacific in-house lawyer could be sued by a Union Pacific employee for malpractice; explaining that their lawyer jointly represented Union Pacific and the employee in the employee's deposition as a witness in litigation involving a fellow employee's injury, and that the lawyer did not protect the client/witness -- who was later fired for inconsistency in his testimony and earlier version of the accident; "Union Pacific fired Yanez [Employee] for dishonesty, citing a discrepancy between a witness statement that Yanez wrote and a deposition answer he gave concerning a coemployee's on-the-job injury (the deposition answer occurred in the coemployee's lawsuit against Union Pacific under the Federal Employers Liability Act . . . . At the deposition, Plummer [Union Pacific in-house lawyer] represented both Union Pacific and Yanez. Yanez claims the alleged dishonesty was a simple miswording in his witness statement that Plummer, during the deposition, manufactured into something sinister for Union Pacific's benefit."; "Yanez expressed concern about his job because his deposition testimony was likely to be unfavorable to Union Pacific, and asked Plummer who would 'protect' him at the deposition. Plummer responded that Yanez was a Union Pacific employee and Plummer was his attorney for the deposition; as long as Yanez told the truth in the deposition, Yanez's job would not be affected. Plummer never told Yanez about any conflict of interest involving Plummer representing Union Pacific and Yanez at the deposition."; "Yanez and Union Pacific occupied adverse positions regarding

Garcia's FELA lawsuit against Union Pacific. Yanez -- working with Garcia when Garcia was injured, and the only percipient witnesses to Garcia's accident -- was aware of several unsafe work conditions that may have contributed to Garcia's injury."; "Despite these conflicting interests, Union Pacific's in-house counsel, Plummer, represented both Union Pacific and Yanez at Yanez's deposition in Garcia's lawsuit. Prior to being deposed, Yanez expressed to Plummer his concern about how this state of affairs would affect his job, and Yanez asked Plummer who would 'protect' him at the deposition. Plummer responded that Yanez was a Union Pacific employee and Plummer was Yanez's attorney for the deposition, and stated that if Yanez told the truth at the deposition, his job would not be affected."; "Yanez presented evidence in his summary judgment papers that Plummer neither informed him about conflicts with Union Pacific nor obtained his written consent to represent him despite such conflicts."; "As for Plummer's conduct, it is true Yanez wrote in his second statement that he 'saw' Garcia slip and fall, and it is true Yanez first admitted to Garcia's counsel in the deposition that he did not 'witness' Garcia's 'accident.' But it was Plummer who highlighted Yanez's deposition testimony that he did not 'see' Garcia slip; it was Plummer who presented the second statement at the deposition; it was Plummer who got Yanez, <u>under oath at the deposition</u>, to effectively admit that his deposition testimony conflicted with the second statement; it was Plummer who did not offer Yanez a chance to explain this discrepancy; and it was Plummer who failed to present the first statement as an exhibit at Yanez's deposition."; "Yanez has presented a triable issue of material fact that but for Plummer's alleged malpractice, breach of fiduciary duty and fraud, Yanez would not have been terminated.").

There is a slight bit of good news for lawyers who would like to represent company executives in a very limited way. In a somewhat surprising approach that helps corporations, several courts and one bar have disagreed with the California court's analysis of <u>Yanez</u> (discussed above), and instead held that a company's lawyer's representation of a company executive during depositions or other testimony did not create a joint attorney-client relationship.

- <u>Springs v. First Student, Inc.</u>, Case No. 4:11CV00240 BSM, slip op. at 2-3 (E.D. Ark. Nov. 30, 2011) (declining to disqualify Jackson Lewis from representing its client First Student in an action brought by several plaintiffs, on the grounds that the law firm represented the plaintiffs in their role as deponents in an earlier related case; "It appears that Munger's and Barnes's [Jackson Lewis lawyers] representation of plaintiffs was fairly limited and nothing in the record indicates that plaintiffs provided Munger and Barnes with 'confidential factual information' when plaintiffs gave their depositions in the Douglas case. Indeed, Springs did not meet with Munger prior to giving her deposition. . . . Further, while Burnley states that he told Munger that he made an internal FLSA-based complaint to First Student, . . . nothing indicates that Munger received any relevant information regarding that complaint or that Munger advised Burnley regarding that complaint. . . . Finally, nothing indicates that plaintiffs have given Munger and Barnes the type of information that would materially advance First Student's position in this case.").

- Perez v. PetSmart, Inc., No. CV 10-5339 (LDW) (ETB), 2011 U.S. Dist. LEXIS, at *18-19 102229 (E.D.N.Y. Sept. 12, 2011) (finding that a former PetSmart employee could not disqualify the law firm of Littler Mendelson on the grounds that the law firm represented him rather than the company; "[P]laintiff did not form a de facto attorney-client relationship with any Littler Mendelson attorneys he may have spoken to. . . . Rather, plaintiff allegedly revealed confidences to Littler Mendelson attorneys in the context of the firm's defense of PetSmart against allegations of wrongful termination in another action. . . . Knowing that Littler Mendelson represented PetSmart, plaintiff could not have reasonably believed that information he provided to the firm in the course of that representation would be kept confidential and not shared with the corporation.").

- Gary Friedrich Enters., LLC v. Marvel Enters., Inc., No. 08 Civ. 1533 (BSJ) (JCF), 2011 U.S. Dist. LEXIS 54154, at *11-12 (S.D.N.Y. May 20, 2011) ("In situations such as this where a former employee is represented by counsel for a defendant corporation for the purpose of testifying at a deposition at no cost to him, courts have not treated the former employee as having an independent right to the privilege, even where that employee believes that he is being represented by that counsel.").

- Wisconsin LEO E-07-01 (7/1/07) ("Lawyers for organizations may appear on behalf of the organization when a constituent is deposed, but that does not mean that the lawyer represents that constituent as an individual. This practice is common, but the mere fact that a lawyer accompanies a constituent to a deposition and consults with that constituent does not transform that constituent into a client. . . . The lawyer's client remains the organization and the lawyer is obligated to protect the interests of the organization first. In such a situation, the lawyer should take care to ensure that the constituent does not misunderstand the lawyer's role . . . .").

This forgiving attitude can have two significant implications. First, the lack of a joint attorney-client relationship means the company has the sole power to waive the privilege protecting the communications between the lawyer and the executive. Second, as an ethics matter, the lack of a joint representation allows the company lawyer to later represent the company adverse to the executive whom the lawyer had represented in such a limited way.

Not surprisingly, other courts disagree with this approach.

- <u>Advanced Mfg. Techs., Inc. v. Motorola, Inc.</u>, No. CIV 99-01219 PHX-MHM (LOA), 2002 U.S. Dist. LEXIS 12055, at *17-19 (D. Ariz. July 2, 2002) (addressing a motion by a former Motorola employee (Corley) to disqualify the law firm of Lewis & Roca from representing Motorola in taking any action (such as depositions) of the former employee; explaining that a Lewis & Roca lawyer (Irish) had appeared for Motorola at an earlier deposition of the retired Motorola employee; rejecting Irish's argument that he never represented the former Motorola employee -- noting that Corley had testified at the deposition that Irish represented him as well as Motorola, and that Irish had not spoken up at the deposition to indicate otherwise; "Regardless of whether Corley's personal belief that Irish represented him was reasonable prior to the September 20, 2001 deposition, <u>the irrefutable expressed belief by Corley that Irish represented him in his deposition coupled with Irish's silent acquiescence to that representation established an attorney-client relationship ab initio</u>. Irish's failure to timely object to, or otherwise contest, Corley's explicit belief, whether reasonable or not, that Corley was being represented by Irish in his deposition manifested Irish's implied consent to an attorney-client relationship between them. Moreover, at a minimum, Irish should have known that his silence to Corley's expressed belief in the deposition that Irish represented him would cause confirmation and further reliance by Corley to the belief that Irish represented him. An attorney can not [sic] have it both ways: on the one hand to sit by silently at the public expression by a possible client of the existence of their attorney-client relationship, that would preclude adverse counsel from properly inquiring into the nature and substance of their prior communications protected by the attorney-client privilege, and then, at a later date, to permit that silent attorney to disavow and deny that such a relationship existed when the interests of the former employer and employee unexpectedly became adverse. Therefore, <u>on and after this deposition date until expressly told otherwise, Corley's belief that Irish represented both Motorola and him was reasonable</u>." (emphases added, footnote omitted); declining to disqualify Lewis & Roca because the firm had not yet filed a lawsuit against Corley after discovering he had engaged in alleged wrongdoing adverse to Motorola, but noting that the court would entertain a mechanism by which Corley's interests would be protected if Lewis & Roca remained on the case for Motorola.)

In 2016, New York City Bar issued a lengthy and instructive legal ethics opinion providing useful guidance for lawyers seeking to represent a non-party deposition witness while simultaneously representing a party (presumably the witness's current or former employer, in most cases).

> An attorney is ethically permitted to represent a non-party witness at a deposition in a proceeding where that same attorney also represents a party, subject to the following limitations. First, such a representation may constitute a limited scope representation under Rule 1.2(c). If so, the attorney must ensure that any limitations on the scope of representation are reasonable under the circumstances and must secure informed consent from the witness-client. Second, the attorney must evaluate whether representing the witness-client creates a conflict of interest with the party-client. If so, the attorney must determine whether the conflict is waivable and secure written conflict waivers before proceeding with the representation. The attorney also must continue to monitor the representation to ensure that appropriate steps are taken if a conflict of interest arises later in the proceeding. Third, the attorney must explain that both clients in a joint representation are entitled to receive information that is material to the representation. Thus, if one of the joint clients discloses confidential information to the lawyer that is material to the representation of the other joint client, the lawyer is obligated to share that information with the other client, unless an exception applies or the clients agree to a different arrangement. Fourth, when communicating with the deposition witness about the prospective representation, the attorney must comply with the ethical rules governing solicitation of clients.

New York City LEO 2016-2 (7/2016). The New York City Bar helpfully offered detailed separate advice on the issues of loyalty and information flow.

> In the context of limited scope representations, informed consent requires, at a minimum: (i) adequate disclosure of the limitations of the scope of engagement and matters excluded; and (ii) disclosure of the reasonably foreseeable consequences of the limitations, including the complications of having to retain separate counsel later if

> services outside the scope of the representation become necessary."; "To meet Rule 1.2(c)'s requirements when representing a witness solely for the purposes of a deposition, an attorney should, at a minimum, disclose the following information: What services are included in the representation (see supra at Part I.A discussing the services that may be involved in representing non-party deposition witnesses); What services are excluded from the representation (see id.); The implications of excluding certain services from the representation, such as the possible need to retain separate counsel to advise on those matters and the risk that the witness may face liability or other consequences if she does not secure legal advice with respect to an exclude service; Who will be responsible for paying the lawyer's fees; The identity of the attorneys' other client(s) in the matter; Whether there are any conflicts of interest between the witness and the lawyer's other client(s) and the implications of those conflicts of interest; What will happen if a conflict of interest arises in the future, including who the attorney will continue to represent (see id.); How confidential information will be treated in connection with the joint representation; That the witness is not required to accept the limited scope representation and is free to retain separate counsel.

Id. Fortunately for lawyers seeking guidance on the equally important but often overlooked information flow issue, the New York City LEO provided detailed guidelines.

> Among joint clients, there is a presumption that confidential information that is material to the joint representation will be shared among the joint clients unless some exception applies."; "Importantly, this presumption of shared confidences applies only to confidential information received from one joint client that is material to the other joint client's representation. Therefore, in our scenario, the lawyer is not necessarily obligated to share all confidential information he receives from the party-client with the witness-client. He is only obligated to share information that is material to the lawyer's representation of the witness-client for the purposes of her deposition. Confidential information that relates generally to the litigation, but is not material to the deponent's representation, is not subject to the presumption of shared confidences and need not be shared with the witness-client."; "Although the presumption of

> shared confidences is the default rule, that rule may be modified by agreement with the clients, under certain circumstances. R. 1.17, Cmt. [31]. Thus, the clients may agree that the attorney will not share confidential communications between the two joint clients, provided this limitation on shared confidentiality does not preclude the attorney from providing competent and diligent representation to both clients. . . . Lawyers who choose to represent deposition witnesses would be wise to avail themselves of this contractual option, by obtaining the witness's informed consent not to receive confidential communications that the party-client shares with the attorney about the case. If the attorney is unable to secure the witness's informed consent to this limitation, he should seriously consider declining the representation. Otherwise, the lawyer could find himself in a situation where the party-client instructs him not to share confidential information that the lawyer believes is material to the witness-client. If that occurs, the lawyer may be forced to withdraw from both representations."; "A thornier issue is whether the attorney should agree not to share confidential information that he receives from the witness-client with the party-client. One of the risks of such an arrangement is that the witness may disclose confidential information to the attorney that would have a significant adverse effect on the party-client or on the case itself. Under those circumstances, the attorney would be prohibited from disclosing that information to the party-client and may be forced to withdraw from one or both of the representations. In light of this potential harm to the party client, a lawyer should agree to withhold confidential information from the party-client only in rare circumstances, and only after the lawyer has explained to the party-client the significant risks of such an arrangement.

Id.

In 2014, a New York City legal ethics opinion analyzed an issue that many lawyers may not even have considered – whether offering to represent a company employee violated the anti-solicitation rule. The New York City LEO eventually determined that it did not.

- New York Cnty. LEO 747 (6/9/14) (holding that a corporation's lawyer does not act unethically if the lawyer offers to also represent corporate employees, because the purpose of the meeting between the lawyer and the employee does not generate business for the lawyer; "Under Rule 7.3(b), the question of whether the lawyer properly may offer in-person (rather than in writing) to represent the corporation's employee following the conclusion of the interview depends on whether the 'primary purpose' of the lawyer's 'private communication' with the employee 'is the retention of the lawyer or law firm, and a significant motive for [the communication] is pecuniary gain.' We conclude that conveying the corporation's offer, and following up if the employee expresses interest, would not constitute a 'solicitation' for several reasons." (footnote omitted); "First, the primary purpose of the in-person meeting at its inception is not to offer the lawyer's services to the employee, but to interview the employee as a potential witness. Indeed, in many cases, that may turn out to be the exclusive purpose of the meeting, if the lawyer concludes that the employee does not require legal representation or that the lawyer cannot provide it. Second, when the lawyer initially offers to represent the employee, the lawyer is acting on behalf of the corporation, as its lawyer and agent, primarily for purposes of conveying the corporation's offer to secure legal representation for an employee in need of legal assistance. The corporation could, of course, have one of its non-lawyer officers or its in-house counsel extend the offer on behalf of the corporation. But, as the corporation's lawyer and agent, the lawyer may be in a better position to do so, because the lawyer may be better qualified to answer questions and provide information about the implications of the representation. Moreover, in conveying the corporation's offer and, if the employee is interested, following up by offering representation, the lawyer's 'primary purpose' is not to secure legal fees from a new client but to render competent representation to a current corporate client by enabling it to fulfill its objective (and, in some cases, its statutory or contractual obligation or internal policy) of making legal assistance available to an employee who may need counsel." (footnote omitted); "When a corporation's lawyer conveys in person or by telephone an offer to represent a corporate employee in connection with a lawsuit, the application of the solicitation rule, Rule 7.3(a), depends on the factual context and the lawyer's motivation. Under <u>Rivera</u> [<u>Rivera v. Lutheran Med. Ctr.</u>, 866 N.Y.S.2d 520 (N.Y. Sup. Ct. 2008)], the communication would be improper if the lawyer's motivation was exclusively 'to gain a tactical advantage in th[e] litigation by insulating [witnesses] from any informal contact with plaintiff's counsel.' However, we conclude that an offer of representation at the corporation's request would be proper where the lawyer initially interviews the employee as a non-client witness in order to learn relevant information and subsequently determines that the individual is in need of legal services as a party or potential testifying witness and that the concurrent representation would be permissible.").

An earlier New York state court case took a frighteningly different approach.

- Rivera v. Lutheran Med. Ctr., 866 N.Y.S.2d 520, 525, 526 (N.Y. Sup. Ct. 2008) (in an opinion by Supreme Court of New York, Kings County, Judge Michael A. Ambrosio, analyzing defendant hospital's law firm Morgan Lewis's conduct in soliciting as separate clients of the firm: two executives of the defendant hospital; one current lower level employee who was involved in the alleged sexual harassment; two other current lower level hospital employees, apparently not involved in the incident; two former hospital supervisory employees; recognizing that the first three individuals would be considered "parties" under New York's ex parte communications rule, and therefore not "subject to informal interviews by plaintiff's counsel"; explaining that the last four witnesses would have been fair game for ex parte communications from the plaintiff's lawyer; "These [four] witnesses are not parties to the litigation in any sense and there is no chance that they will be subject to any liability. They were clearly solicited by Morgan Lewis on behalf of LMC to gain a tactical advantage in this litigation by insulating them from any informal contact with plaintiff's counsel. This is particularly egregious since Morgan Lewis, by violating the Code in soliciting these witnesses as clients, effectively did an end run around the laudable policy consideration of Niesig in promoting the importance of informal discovery practices in litigation, in particular, private interviews of fact witnesses. This impropriety clearly affects the public view of the judicial system and the integrity of the court."; ultimately disqualifying Morgan Lewis from representing the four witnesses, because of the firm's improper solicitation of the witnesses, and reporting Morgan Lewis to the bar's Disciplinary Committee).

Conclusion

(a) Unless a conflict of interest would prevent it, an in-house lawyer fully licensed in a state can represent a company employee in a company matter.

(b) Unless a conflict of interest would prevent it, a fully licensed company lawyer may also represent a company employee in a non-company matter -- although in-house lawyers frequently seek to avoid such representations. An in-house lawyer who is not fully licensed in the state where he or she practices probably could not undertake such a representation.

Best Answer

The best answer to **(a)** is **(A) YES**; the best answer to **(b)** is **MAYBE**.

B 8/16

Accidental Creation of a Joint Representation of a Corporate Employee

Hypothetical 9

As your company's in-house lawyer primarily responsible for litigation matters, you recently worked with outside counsel during an investigation of possible wrongdoing by three executives. You prepared notes of your interview sessions. Your notes reflect that you and your outside colleague made the following statements to the three executives:

- "We represent the company but we could represent you as well, as long as no conflict appeared."
- "We can represent you until such time as there appears to be a conflict of interest."
- "We represent the company, and can represent you too if there is not a conflict."

As it turned out, the executives had indeed engaged in wrongdoing -- and the company fired them. The federal government began to investigate the wrongdoing, and asked for your interview notes. The former employees' new lawyers claim that you and outside counsel jointly represented the company and the employees, which gives them a "veto power" over your waiver of the privilege. The federal government is becoming increasingly insistent that you hand over the notes.

May you waive the privilege covering your interview of the then-employees, over their objection?

MAYBE

Analysis

The real danger in the corporate context is that a lawyer representing the corporation will accidentally create a joint representation with a corporate employee.

Theoretically this should never happen. As a matter of ethics, lawyers dealing with company executives who might misunderstand the lawyer's role must "explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing."[1] The standard Upjohn warning includes essentially the same disclosure.

On the other hand, it is easy to see how lawyers who are not scrupulous in following their ethics duties and the Upjohn standard might generate a reasonable belief in corporate employees that the lawyer is representing them as well as the corporation in a corporate-related matter. This is because lawyers can engage in privileged communications with employees in their role as employees, without separately representing them. This is not the case with third parties. Neither the lawyer nor the third party in that non-corporate setting is likely to think that an attorney-client relationship exists. In contrast, a corporation's lawyer generally knows that the privilege applies to communications with the employees even if the lawyer does not represent them. The corporate employee in that setting knows that he or she is talking with a lawyer. Given this setting, it is no wonder that there can some confusion.

The key point here is not the existence of the privilege, but who owns it. The corporate lawyer following Upjohn and protecting a corporate client will ensure that the corporate client owns the privilege. This means that the corporation can assert the privilege and, most importantly, can waive the privilege. A corporate employee usually claims a joint representation when the corporation wants to waive the privilege otherwise covering communications between the corporate lawyer and the employee, and the employee wants to prevent such a waiver. This situation often arises when the government or another third party seeks disclosure of those communications. The corporation might want to cooperate with the government by disclosing them, while the

[1] ABA Model Rule 1.13(f).

employee who is often the subject of government inquiry wants to keep those communications secret.

Given the high stakes involved, one would think that company lawyers would always explicitly indicate whether they jointly represent employees with whom they are dealing. In other words, they would either explicitly disclaim an attorney-client relationship with the employees, or in very unusual circumstances explicitly articulate a joint representation. As the Southern District of New York explained,

> [t]his problem could be avoided if counsel in these situations routinely made clear to employees that they represent the employer alone and that the employee has no attorney-client privilege with respect to his or her communications with employer retained counsel. Indeed, the Second Circuit advised that they do so years before the communications here in question. But there is no evidence that the attorneys who spoke to Ms. Warley followed that course.

United States v. Stein, 463 F. Supp. 2d 459, 460 (S.D.N.Y. 2006) (footnote omitted).

An earlier example highlighted the dangers of ambiguity. In that case,[2] a court criticized (but ultimately found effective) what it called a "watered down 'Upjohn warning[]'" that a company's in house lawyers and outside lawyers gave to executives they were interviewing. The lawyers had made the following statements to the three executives that they interviewed:

- "[T]hey represented [the company] but that they 'could' represent him as well, 'as long as no conflict appeared.'"
- "We can represent [you] until such time as there appears to be a conflict of interest."

[2] Under Seal v. United States (In re Grand Jury Subpoena: Under Seal), 415 F.3d 333, 340 (4th Cir. 2005).

- "We represent [the company], and can represent [you] too if there is not a conflict."[3]

The employees had claimed joint ownership of the privilege covering the interview to block the company's disclosure of the interview notes to the government. The company ultimately won sole ownership of the privilege, but had to fight the now-former employees up to the circuit court level.

The law had to develop a test for determining whether a corporate employee's argument about a joint representation would succeed or would not.

Some lawyers who represent corporations also intentionally establish either separate or joint representations of corporate employees. In other situations, lawyers explicitly disclaim an attorney-client relationship with a corporate employee, following their ethics duty to disclose their role and the Upjohn warning's provision explicitly denying that the lawyer represent the employee either separately or jointly with the corporate client.

However, in the absence of such an intentional representation or explicit disclaimer of a representation, courts developed a standard for determining whether an attorney-client relationship exists between a corporation's lawyer and a corporate employee.

Thus, the test essentially amounts to a "default" standard in the absence of some explicit memorialization of a relationship or the lack of a relationship. Careful lawyers have already taken care of this issue, and therefore do not need a "default" standard.

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3 Id. at 336.

However, the large number of cases dealing with such a "default" situation highlights many lawyers' inattention to this important issue.

A 1986 Third Circuit case articulated the most widely recognized standard -- the Bevill standard.[4] Under the Bevill standard, a corporate employee seeking to prove an attorney-client relationship with a corporation's lawyer (thus carrying both privilege and other ethics implications) must establish that:

- The employee approached the corporation's attorney for legal advice;
- The employee made it clear that the request had to do with matters that arose in his or her individual capacity;
- The attorney understood this request and advised on the matter even though there was a potential for conflict;
- These communications were confidential;
- The subject matter of the communication did not concern a more general corporate matter.

The critical element is the last one: The communication usually may not relate to the employee's duties on behalf of the corporation.[5]

Most courts now adopt the Bevill standard. For instance, in 2010, the Ninth Circuit explicitly adopted the Bevill standard.[6] Other courts have adopted variations of the Bevill standard, but with essentially the same bottom line.[7]

Most courts applying the Bevill standard refuse to recognize an attorney-client relationship between a corporation's lawyer and individual corporate constituents.[8] For

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[4] In re Bevill, Bresler & Schulman Asset Mgmt. Corp., 805 F.2d 120 (3d Cir. 1986).

[5] In re Grand Jury Subpoena, 274 F.3d 563, 573-74 (1st Cir. 2001).

[6] United States v. Graf, 610 F.3d 1148 (9th Cir. 2010) (the court ultimately determined that a company consultant did not meet that standard).

[7] United States v. Stein, 463 F. Supp. 2d 459 (S.D.N.Y. 2006).

instance, a 2010 Eastern District of Pennsylvania decision analyzed the issue, ultimately concluding that the corporation's lawyer did not also represent an executive.

> [A]t no time did Keany [company lawyer] think that he was representing [executive] individually. In fact, at some point during Keany's representation of [company], he advised [executive] that he should retain separate counsel. . . . [T]he conversations between [executive] and Keany only involved matters within [company] or the business affairs of [company]. At the hearing, [executive] failed to adduce any conversation with Keany which was confidential or which dealt with [executive's] personal liability or criminal exposure as opposed to [company's]. . . . Under these circumstances, Defendant can claim no attorney client privilege which would bar Keany's testimony at trial or which would trump [company's] waiver of the attorney-client privilege.

United States v. Norris, 722 F. Supp. 2d 632, 639-40 (E.D. Pa. 2010).

Many courts take this approach.[9]

- United States v. Blumberg, Crim. A. No. 14-458 (JLL), 2017 U.S. Dist. LEXIS 47298, at *7, *12, *13, *14, *14-*15 (D.N.J. Mar. 27, 2017) (addressing a situation in which defendant Blumberg claimed that the Bracewell law firm represented both his employer and him individually – meaning that he co-owned the privilege protecting his communications with Bracewell lawyers; noting competing affidavits about whether Bracewell lawyers gave an Upjohn

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[8] United States v. Norris, 753 F. Supp. 2d 492 (E.D. Pa. 2010), aff'd 419 F. App'x 190 (3d Cir. 2011); Grunstein v. Silva, 2010 Del. Ch. LEXIS 68 (Del. Ch. Apr. 13, 2010); In re Paul W. Abbott Co., Inc., 767 N.W.2d 14 (Minn. 2009).

[9] Kennedy v. Gulf Coast Cancer & Diagnostic Center at Se., Inc., 326 S.W.3d 352, 358 (Tex. Ct. App. 2010) (in a TRO proceeding, ordering a former in-house lawyer to return privileged documents that he had taken with him when he left the client's employment; holding that the company rather than any individual executives or directors own the privilege; "Kennedy's subjective intent notwithstanding, no evidence objectively manifests that EBGWH [Epstein Becker Law Firm, who represented the in-house lawyer even before he left the client's employment] secured the parties' consent or undertook any of the other steps that Texas law requires for dual representation of Gulf Coast and either the officers and directors or Kennedy individually. . . . We therefore hold that the trial court did not abuse its discretion in determining that Gulf Coast alone holds the attorney-client privilege applicable to the memo."); In re Grand Jury Proceedings, 469 F.3d 24 (1st Cir. 2006); United States ex rel. Magid v. Barry Wilderman, M.D., P.C., Civ. A. No. 96-CV-4346, 2006 U.S. Dist. LEXIS 56116 (E.D. Pa. Aug. 10, 2006); Applied Tech. Int'l, Ltd. v. Goldstein, Civ. A. No. 03-848, 2005 U.S. Dist. LEXIS 1818, at *11-12 (E.D. Pa. Feb. 7, 2005); In re Grand Jury Subpoena, 274 F.3d 563, 573 (1st Cir. 2001); United States v. Int'l Bhd. of Teamsters, 119 F.3d 210, 215 (2d Cir. 1997); United States v. Aramony, 88 F.3d 1369, 1390 (4th Cir. 1996).

warning; applying "the five-factor Bevill analysis"; explaining that the Bevill doctrine requires employees seeking to claim personal privilege protection for communications with the company's lawyer to prove on a communication-by-communication basis that: (1) they sought legal advice from the lawyer; (2) if so, they "'made it clear that they were seeking legal advice in their individual rather than in their representative capacities'"; (3) the company lawyer agreed to provide such individual advice regardless of possible conflicts; (4) such communications were confidential; and (5) the communications' substance "'did not concern matters within the company or the general affairs of the company'"; in assessing the fifth factor, acknowledging Blumberg's claim that he and Bracewell lawyers discussed his "'potential for criminal exposure,'" and that the lawyers said that employee was a "'fact witness'"; concluding that this one possible exchange did not allow Blumberg to assert a blanket claim of "privilege over all statements made during the Bracewell Meetings"; ultimately holding that the company rather than Blumberg owned the privilege covering his communications with the Bracewell lawyers, and thus could waive it (presumably over his objection)).

- United States v. Drake, Nos. 1:16CR205-2 to -4, 2018 U.S. Dist. LEXIS 63798, at *25-26 (M.D.N.C. Apr. 16, 2018) (finding that Smith Moore represented a bank and not an individual executive, so the bank could disclose the documents to the government; "[T]his court finds that in September 2012, no attorney-client relationship was established between Earnest, individually, and Smith Moore. This court first finds that Earnest did not seek to become a client; instead, Earnest engaged Smith Moore to represent the Bank, of which he was President. Based upon Earnest's statements to the Bank's board of directors, this court finds Earnest understood and believed that he engaged Smith Moore to represent the Bank and was consulting with Smith Moore on behalf of the Bank in his capacity as an officer of the Bank. . . . Any suggestion by Earnest now that he believed Smith Moore was engaged to represent him individually in September 2012 or that he held such an understanding . . . is not credible and is, at a minimum, subjectively unreasonable.").

However, some courts permit those relationships and therefore recognize the privilege in limited circumstances.[10] Perhaps more importantly, a court finding that the law firm had established an attorney-client relationship with an employee might

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[10] Intervenor v. United States (In re Grand Jury Subpoenas), 144 F.3d 653, 659 (10th Cir.), cert. denied, 525 U.S. 966 (1998).

disqualify the firm from representing the company if adversity develops between it and the employee.[11]

Even high-profile in-house lawyers might find themselves dealing with the ramifications of having accidentally created an attorney-client relationship with corporate employees.

Starting in 2012, Penn State's former General Counsel and former Pennsylvania Supreme Court Justice Cynthia Baldwin found herself embroiled in a high-profile question about whether she had simultaneously represented the University and two high-level officials appearing before a grand jury.

- Catherine Dunn, Court Weighs Admissibility of Ex-Penn State General Counsel Testimony in Criminal Cases, Corporate Counsel, Nov. 27, 2012 ("Can Cynthia Baldwin, the former general counsel of Penn State University (PSU), testify against two former Penn State officials in upcoming criminal proceedings?"; "That's the question before a Dauphin County, Pennsylvania, judge as former PSU senior vice president Gary Schultz and athletic director Tim Curley, who's on leave from the university, prepare their defense against charges stemming from the Jerry Sandusky sexual abuse scandal."; "Last week, attorneys for Curley and Schultz filed their second motion in a month related to Baldwin's counsel and the cases being brought against them by the Pennsylvania Attorney General. This latest filing seeks to bar Baldwin's testimony from a preliminary hearing scheduled for next month on new charges of conspiracy, endangering the welfare of children, and obstruction of justice."; "Curley and Schultz have also faced charges of perjury and failure to report suspected child abuse since November 2011. They are scheduled for trial in January."; "In the latest set of papers, filed last Tuesday, defense attorneys argue that testimony by Baldwin would violate Curley and Schultz's attorney-client privilege with the ex-general counsel, who left Penn State in June, having established the school's first in-house legal department in 2010."; "Curley and Schultz's lawyers argue that Baldwin acted as their attorney during a grand jury investigation into allegations that Sandusky molested children on Penn State's campus."; "Though just what role Baldwin

[11] Home Care Indus., Inc. v. Murray, 154 F. Supp. 2d 861, 869 (D.N.J. 2001) (disqualifying Skadden, Arps from representing a company in an action against its former CEO; agreeing with the CEO that, because the lawyers created an environment in which he comfortably confided in them, his "belief that the [law] firm represented him personally was reasonable.").

played in the grand jury investigation has itself been an ongoing source of controversy -- particularly since the release of a Penn State internal investigation last summer."; "According to the Patriot News, which cited grand jury transcripts, both Curley and Schultz identified Baldwin as their legal counsel during their grand jury appearances in January 2011. But according to the Freeh Report, Baldwin has maintained that she represented the university during those appearances -- and not Curley or Schultz."; "Baldwin told the Special Investigative Counsel that she went to the Grand Jury appearances as the attorney for Penn State, and that she told both Curley and Schultz that she represented the University and that they could hire their own counsel if they wished,' the report states."; "The defense teams for Curley and Schultz have taken a different view. In a motion to dismiss the charges against the two men filed earlier this month, defense attorneys argued that Baldwin's counsel to Curley and Schultz constituted a conflict of interest, and that they were deprived of their right to counsel."; "Prosecutors countered in a November 14 filing, arguing that 'at the time that Attorney Baldwin represented the Defendants, there was no actual conflict of interest,' according to court papers. 'Based on their interviews prior to testifying, it appeared that the Defendants intended to cooperate with the investigation. Such an action would not conflict with the interests of the other witnesses represented by attorney Baldwin, who also were cooperating.'").

- Ben Present, Schultz Could Sue Ex-Penn State General Counsel, Legal Intelligencer, Dec. 13, 2012 ("A former Penn State administrator facing criminal charges related to the Jerry Sandusky sex-abuse scandal has filed a praecipe for writ of summons against the university's former general counsel, Cynthia Baldwin, indicating he intends to sue her for legal malpractice."; "Gary Schultz, represented by a team of Sprague & Sprague attorneys led by Richard A. Sprague, filed papers that were docketed Wednesday in the Centre County Court of Common Pleas. Schultz faces charges of perjury, endangering the welfare of children, failure to report child abuse and other criminal charges related to allegations he engaged in a conspiracy to conceal allegations against Sandusky, the school's former defense coordinator and convicted serial child molester."; "In court papers, Schultz has pled Baldwin allowed him to 'believe she was his unencumbered, conflict-free lawyer,' telling him before is grand jury appearance that she would represent him at the proceeding."; "Former Penn State athletic director Tim Curley also moved to dismiss his case, or suppress his grand jury testimony in the alternative, arguing in court papers that Baldwin told him she could represent him before the grand jury."; "When the two men testified before the grand jury, both said they were being represented by Baldwin."; "Baldwin, however, has claimed she was present before the grand jury to represent the university -- not Schultz or Curley, both of whom have testified she was their lawyer." (emphasis added); "As previously reported by The Legal Intelligencer, Baldwin has labeled the whole thing a misunderstanding."; "Washington, D.C., attorney Lanny Davis, who Baldwin has previously authorized to speak on her behalf, told the Harrisburg Patriot-News and The Legal Intelligencer that, when Baldwin told supervising Judge Barry Feudale and representatives from the Office of the Attorney General in Feudale's chambers that she represented the university, nobody objected to her listening to the administrators' testimony."; "Then, Davis told The Legal Intelligencer, when the administrators testified that Baldwin was their attorney, she did not think it was 'appropriate' to interrupt the proceedings and clarify." (emphases added)).

- Dan Packel, Sandusky Defendants Say State Knew Of Attorney Conduct, Law360, Jan. 8, 2013 ("Two former Pennsylvania State University administrators charged with covering up sexual abuse committed by former assistant football coach Jerry Sandusky argued Friday that the state knew that because of a conflict of interest, they were deprived of their right to counsel prior to going before a grand jury. Former Penn State Vice President Gary Schultz and former Athletic Director Tim Curley allege the prosecution conceded that Penn State's former general counsel Cynthia Baldwin represented both the university as well as the administrators, leading to a conflict of interest. They seek to suppress their grand jury testimony prior to their upcoming criminal trial. They contended in separate filings that Pennsylvania's Office of the Attorney General (OAG) was also aware of the conflict of interest. The circumstances in this case lead to the unavoidable conclusion that although aware of Ms. Baldwin's conflict, the OAG chose to ignore it in order to hear the testimony of her clients,' Curley said. 'Bluntly put, Ms. Baldwin and the OAG put their own interests before the interest[s] of the witnesses they were meant to protect.'"; "They contended that Baldwin, in her role for the university, was obligated to work to minimize its civil and criminal liability, and that as a consequence she was incapable of representing them as well since the parties had differing interests. In October motions, Schultz and Curley argued that Penn State's interests were best served by cooperation, while their own interests would have been better served by invoking their own Fifth Amendment rights. In Friday's filings, Curley and Schultz allege that in its response to their motions, the state conceded that while both defendants had the right to counsel before testifying, Baldwin did not consider herself to be their counsel, even though she represented herself as such to the judge and the defendants.").

- Matt Fair, Sandusky Defendants Can't Nix Ex-Penn State Attorney Testimony, Law360, Apr. 10, 2013 ("A state judge ruled Tuesday that he did not have authority to quash testimony from a former Pennsylvania State University attorney included in a grand jury presentment indicting a trio of school administrators for allegedly covering up the crimes of convicted child molester Jerry Sandusky.;" "While ousted Penn State president Graham Spanier and two other high-ranking administrators charged in the alleged conspiracy had sought to have testimony from former university attorney Cynthia Baldwin stricken from the presentment on grounds that she'd violated their attorney-client privilege, Judge Barry Feudale said that he lacked the authority to do so as the grand jury's supervising judge.;" "'The singular issue before this court involves the absence of jurisdictional authority for the grand jury supervising judge to quash a presentment after steps were properly taken to issue the presentment and adhere to statutory procedure.' Judge Feudale said. 'It is not within the supervising judge's jurisdiction to entertain the joint motion to quash presentments put before this court.'").

- Ama Sarfo, Ex-Penn State Execs Lose 2nd Atty Privilege Appeal, Law 360, June 19, 2013 ("The Pennsylvania Superior Court on Tuesday squashed a second appeal by two former Pennsylvania State University administrators who said a grand jury presentment relied on privileged attorney-client information and was defective, as they face charges for conspiring to cover up Jerry Sandusky's child abuse. Earlier this month, the state's Supreme Court denied petitions for review filed by former Penn State vice president Gary Schultz and former athletic director Tim Curley, saying they can raise their issue in their underlying criminal prosecution. The Superior Court on Tuesday declined to weigh in on the matter, saying that issues surrounding grand jury investigations can only be addressed by the state Supreme Court."; "In filings and a brief, Schultz, Curley and ousted Penn State President Graham Spanier argued that the conflict created by Baldwin's dual roles as their attorney and as attorney for the school effectively deprived them of their right to counsel. They also argued that Baldwin's testimony against them violated attorney-client and work-product privileges. However, Judge Feudale said his review of Baldwin's testimony left him inclined to disagree. 'My review of the testimony of attorney Baldwin before the grand jury persuaded me . . . that her testimony was circumspect and circumscribed,' he said. 'It was not a violation of the attorney-client privilege but rather was related to her belated awareness of the commission of alleged criminal acts and was in accordance with her responsibilities as an officer of the court. Finally, attorney Baldwin testified as approved by her then client, [Penn State,] the organization for which she was employed.'").

In January 2015, the trial court declined to dismiss criminal charges based on Penn State's General Counsel's alleged improper action and resulting confusion about the existence of an attorney-client relationship with the three former Penn State executives.

- Commonwealth v. Curley, Nos. 5164- & 5165 CR 2011 & 3614-, 3615-, & 3616 CR 2013, slip op. at 27, 30, 34, 34-35, 35, 39 (Pa. C.P. Dauphin Jan.

18, 2015) (in a Memorandum Opinion and Order, refusing to dismiss criminal charges against three Penn State officials, despite Penn State's general counsel's alleged improper activity; noting that Penn State general counsel Cynthia Baldwin attended Grand Jury testimony from defendants Curley and Schultz on January 12, 2011, and herself appeared before the Grand Jury on October 26, 2012, to give testimony adverse to them; rejecting defendants' argument that Baldwin represented them personally, and therefore had acted improperly by testifying herself before the Grand Jury; "Central to disposition of Defendants' claims and theories for relief is determination of the scope of the attorney-client privilege asserted by each Defendant. We must determine whether the record demonstrates the existence of an individual attorney-client privilege between each Defendant personally and Ms. Baldwin."; "We find that, in all matters related to their appearances before the grand jury, including preparation for such appearances, Ms. Baldwin represented each Defendant in his capacity as an agent of the University conducting University business, not in an individual, personal capacity. Thus, in their roles as agents of the University, the Defendants received representation and no denial of counsel occurred."; "We further find that the University, as the holder of the privilege, waived its attorney-client privilege, and that any disclosure of information related to the ongoing investigation of Sandusky fell within the terms of the waiver. Therefore, no violations of the attorney-client privilege occurred."; "Defendants assert, however, that Ms. Baldwin represented each Defendant individually and, because of alleged failures of or conflicts in representation, they were deprived of the right to counsel throughout the proceedings, which failures or conflicts entitle them to relief."; relying on the Bevill case (In the Matter of Bevill, Bresler & Schulman Asset Mgmt. Corp., 805 F.2d 120, 124 (3d Cir. 1988)); "Defendants presented no evidence that they sought representation in their individual rather than their organizational capacities."; "Defendants chose to proceed with Ms. Baldwin as their counsel, aware of her role as University counsel and made no request that she represent them individually."; "[T]here exists no evidence that Ms. Baldwin communicated with the officials in their individual capacities, knowing that a conflict could arise. We cannot conclude that Ms. Baldwin was aware of the facts which raised a conflict between the interests of the University and the Defendants personally; that is, potential personal exposure to criminal charges. In response to Ms. Baldwin's request to gather information required by the subpoena duces tecum directed to the University, Defendants responded that they had none. If Defendants possessed personal knowledge which created either personal criminal exposure or a conflict of interest, we have no evidence upon which we could conclude that Ms. Baldwin was or should have been aware of such information and communicated with them in their individual capacities in spite of such knowledge."; "Defendants have not alleged that conversations occurred with Ms. Baldwin which related to private individual matters outside of their roles as University officials."; "We find that the interests of the University and the individuals appeared aligned at the time the Defendants met with Ms. Baldwin and testified before the grand jury, that is, the interests in providing truthful information within their knowledge, as agents of the University, regarding the apparent target of the investigation, Sandusky."; "We disagree with the assertion that Ms. Baldwin knew or should have known that the interests of the individual Defendants would diverge from the interests of the University, such that an inevitable conflict existed, which denied Defendants of representation.").

Almost exactly one year later, the appellate court reversed -- and dismissed several criminal counts against the three former Penn State executives based upon the General Counsel's conduct.

- Commonwealth v. Spanier, 132 A.3d 481, 485, 487, 496, 497, 498 (Pa. Super Ct. 2016) (dismissing charges against Penn State's former president, because they were based on grand jury testimony during which he reasonably believed that he was being personally represented by Penn State's general counsel Cynthia Baldwin; "Subsequently, after discussions regarding compliance with the Subpoena 1179 were coming to a close, Judge Feudale inquired, 'Cindy, [Ms. Baldwin] just for the record, who do you represent? . . . Outside the presence of Spanier, and for the first time on the record, Ms. Baldwin responded, 'The university.' . . . Judge Feudale followed up, 'The university solely?' Ms. Baldwin answered, 'Yes, I represent the university solely.'" (internal citation omitted); "Upon entering the grand jury room, the OAG queried, 'Sir, you're represented by counsel today?' . . . Spanier responded, 'Yes.' The OAG then asked, 'Could you just identify counsel?' . . . Spanier answered, 'Cynthia Baldwin setting behind me.'" (internal citations omitted); "After entering the courtroom, Ms. Baldwin indicated that she was present with and accompanied by two attorneys. Those attorneys were representing her personally. Despite the foregoing representations by Mr. Fina, a significant number of the Commonwealth's questions to Ms. Baldwin before the grand jury implicated potential confidential communications.'"; "Consistent with our decision in Schultz [Commonwealth v. Schultz, No. 280 MDA 2015, 2016 Pa. Super. LEXIS 30 (Pa. Jan. 22, 2016)], we find that Ms. Baldwin did not adequately explain to Spanier that her representation of him was solely as an agent of Penn State and that she did not represent his individual interests. Although Spanier knew Ms. Baldwin was general counsel for Penn State, this knowledge does not ipso facto result in Spanier understanding that she represented him solely in an agency capacity before the grand jury. Spanier was not aware that Ms. Baldwin was not appearing with him in order to protect his interests and therefore unable to provide advice concerning whether he should answer potentially incriminating questions or invoke his right against self-incrimination. In line with our holdings in Schultz and Curley [Commonwealth

v. Curley, No. 299 MDA 2015, 2016 Pa. Super. LEXIS 31 (Pa. Jan. 22, 2016)], we conclude that Ms. Baldwin was incompetent to testify at the grand jury hearing as to communications between her and Spanier."; "As we discussed in both Schultz and Curley, communications between a corporate attorney and an employee of a corporation may be personally privileged. It simply does not follow that, if Ms. Baldwin represented Spanier as an agent of Penn State, none of his communications with her were privileged."; "Instantly, Spanier met with Ms. Baldwin to discuss subpoenas served on Curley, Schultz, Paterno, the University, and later himself. His meetings with Ms. Baldwin relative to his own subpoenas did not pertain to a subpoena for the University. He consulted Ms. Baldwin for the purpose of securing legal advice. The issues discussed between Ms. Baldwin and Spanier were not general business matters related to the operation of the University, but concerned the criminal investigation into Jerry Sandusky and Spanier's own response to learning of certain information in 1998 and 2001."; "[W]e agree that an attorney-client relationship existed between Spanier and Ms. Baldwin before and during his grand jury testimony, thereby giving rise to an attorney-client privilege. Ms. Baldwin's grand jury testimony regarding communications with Spanier constituted a violation of the attorney-client privilege, rendering her incompetent to testify. Accordingly, and in light of our holdings in Schultz and Curley , we quash the challenged charges of perjury, obstruction of justice, and conspiracy to commit those crimes.").

- Commonwealth v. Schultz, 133 A.3d 294, 301, 303, 321 n.22, 323, 324, 325, 326, 326-17, 328 (Pa. Super. Ct. 2016) (dismissing charges against Penn State's former senior vice president for finance and business, because they were based on grand jury testimony during which he reasonably believed that he was being personally represented by Penn State's general counsel Cynthia Baldwin; "Ms. Baldwin did not advise Schultz regarding his Fifth Amendment right against self-incrimination. Ms. Baldwin also did not explain the difference between her representation of Schultz in his individual capacity or as an agent of his former employer, Penn State. Nonetheless, she did inform Schultz that any information he told her was not confidential insofar as she could relay it to the University Board of Trustees."; citing Ms. Baldwin's statement; "'I told him that as long as there was no conflict, that I could go in with him.'" (internal citation omitted); "Schultz then entered the courtroom with Ms. Baldwin, who was seated beside him during his testimony. At the outset, a deputy attorney general asked Schultz, 'You are accompanied today by counsel, Cynthia Baldwin, is that correct?' . . . Schultz answered, 'That is correct.' . . . Ms. Baldwin did not indicate at that time that she represented Schultz solely in an agency capacity due to his prior employment at Penn State or that she was not representing him in a personal capacity."; "Both the Tenth Circuit Court of Appeals and the First Circuit of Appeals have explained the fifth aspect of Bevill [In re Bevill, Bresler & Schulman Asset Mgmt. Corp., 805 F.2d 120 (3d Cir. 1988)] as follows, 'The fifth prong of In the Matter of

Bevill, properly interpreted, only precludes an officer from asserting an individual attorney client privilege when the communication concerns the corporation's rights and responsibilities. However, if the communication between a corporate officer and corporate counsel specifically focuses upon the individual officer's personal rights and liabilities, then the fifth prong of In the Matter of Bevill can be satisfied even though the general subject matter of the conversation pertains to matters within the general affairs of the company. In re Grand Jury Subpoena, 274 F.3d 563, 572 (1st Cir. 2001) (citing Grand Jury Proceedings v. United States, 156 F.3d 1038, 1041 (10th Cir. 1998))."; "Ms. Baldwin also communicated with Schultz and expressed her belief that no conflict prevented her from representing Schultz and Curley. Thus, ostensibly, Ms. Baldwin was aware of the potential for a conflict of interest between Schultz and other individuals. The communication between Schultz and Ms. Baldwin occurred one-on-one and she did not reveal those communications to the Board of Trustees of Penn State, outside of possibly Spanier. The communications concerned the rights and responsibilities of Schultz relative to appearing before a criminal investigating grand jury and not Penn State's corporate rights." (footnote omitted); "Moreover, Ms. Baldwin did not adequately explain to Schultz that her representation of him was solely as an agent of Penn State and that she did not represent his individual interests. Although Schultz was certainly aware that Ms. Baldwin was general counsel for Penn State, it is unreasonable to conclude that this awareness by a lay person ipso facto results in Schultz knowing that she represented him solely in an agency capacity."; "Ms. Baldwin's after-the-fact justifications for her own testimony were not expressed on the record prior to Schultz's testimony, nor is there sufficient evidence that she properly advised Schultz of the limits of her representation. Simply stating that she could reveal communications to the Penn State Board of Trustees and was general counsel to the University was decidedly inadequate."; "Insofar as Ms. Baldwin has repeatedly maintained that she did not represent Schultz's individual interests, absent an adequate colloquy or other evidence reflecting acquiescence to such limited representation for purposes of her presence during his grand jury testimony, we find that Schultz's statutory right to counsel during his grand jury testimony was infringed. Indeed, we agree that Ms. Baldwin's acknowledged agency representation of Schultz during his grand jury testimony, without proper and adequate explanation and informed consent to allow limited representation, left Schultz constructively without personal counsel for purposes of his grand jury appearance."; "As Schultz consulted with Ms. Baldwin for purposes of preparing for his grand jury testimony relative to a criminal investigation into Jerry Sandusky, and reasonably believed she represented him, and Ms. Baldwin neglected to adequately explain the distinction between personal representation and agency representation, and give appropriate warnings to Schultz, we conclude that all the communications between Schultz and Ms. Baldwin were protected by the attorney-client privilege. Consequently, Ms. Baldwin breached that privilege by testifying before the grand jury with respect to such communications."; "[W]e preclude Ms. Baldwin from testifying in future proceedings regarding privileged communications between her and Schultz, absent a waiver by Schultz."; "Since Schultz was constructively without counsel during his grand jury testimony, and he did not provide informed consent as to limited representation, we agree that his right against self-incrimination was not protected by Ms. Baldwin's agency representation, and the appropriate remedy is to quash the perjury charge arising from the first grand jury presentment."; "The charges of perjury, obstruction of justice, and conspiracy are hereby quashed.").

- Commonwealth v. Curley, 131 A.3d 994, 998, 1006-07, 1007 (Pa. Super Ct. 2016) (dismissing charges against Penn State's former athletic director, because they were based on grand jury testimony during which he reasonably believed that he was being personally represented by Penn State's general counsel Cynthia Baldwin; "Curley entered the courtroom with Ms. Baldwin, who was seated beside him during his testimony. At the outset, a deputy attorney general asked Curley, 'You have counsel with you?' . . . 'Yes, I do.' . . . The prosecutor then asked, 'Would you introduce her, please?' . . . Curley responded, 'My counsel is Cynthia Baldwin.' . . . Ms. Baldwin did not indicate at that time that she represented Curley solely in an agency capacity or that she was not representing him in a personal capacity."; "In the present case, Curley met with Ms. Baldwin to discuss the subpoena served on him to testify before a criminal grand jury investigating Jerry Sandusky. The subpoena was not for the University. This meeting was for the purpose of securing legal advice. The trial court itself found that Curley sought legal advice from Ms. Baldwin related to appearing before the grand jury investigation into Jerry Sandusky."; "Moreover, Ms. Baldwin did not adequately explain to Curley that her representation of him was solely as an agent of Penn State and that she did not represent his individual interests. Although Curley was certainly aware that Ms. Baldwin was general counsel for Penn State, this awareness did not result in Curley knowing that she represented him solely in an agency capacity. Indeed, it is illogical to conclude that Curley was aware of this critical distinction when there is no evidence to suggest that at the relevant time, the OAG and the supervising grand jury judge, experts in the law, were able to distinguish Ms. Baldwin's representation of Curley as being so limited."; "Curley's final issue, that Ms. Baldwin violated his attorney-client privilege by testifying at a grand jury hearing regarding communications between him and her, flows from his prior positions. For the reasons already outlined, we agreed that Ms. Baldwin's grand jury testimony was improper. Ms. Baldwin was not competent to testify. Accordingly, and in light of our holding and discussion in Schultz [Commonwealth v. Schultz, 133 A.3d 294 (Pa. Super Ct. 2016)], we quash the obstruction of justice and related conspiracy charge and find that Ms. Baldwin is precluded from disclosing privileged communications between herself and Curley.").

In April 2016, the Pennsylvania Attorney General (who then was not able to practice law, because she had been suspended) determined not to appeal these rulings.

- Dan Packel, Pa. To Drop Appeals In Penn State Sex Abuse Cover-Up Case, Law360, Apr. 29, 2016 ("Pennsylvania Attorney General Kathleen G. Kane announced Friday that the state would not appeal rulings that slashed the charges faced by three former Pennsylvania State University administrators accused of interfering with the investigation into assistant football coach Jerry Sandusky's sexual abuse."; "Kane pointed to a legal opinion from recently appointed state Solicitor General Bruce Castor, who acknowledged concerns about how the trio were represented when they testified in front of a grand jury."; "The state's Superior Court in January found fault with the conduct of university general counsel Cynthia Baldwin, concluding that she should not have been permitted to testify against former Penn State President Graham Spanier, former Athletic Director Tim Curley and former Senior Vice President Gary Schultz, as their communications with her were protected by attorney-client privilege."; "The court also found that Schultz and Spanier were not properly represented during their testimony before a grand jury, as Baldwin had advised them that she was serving as their counsel when she had a stronger duty to the university."; "'Attorney General Kane recognizes the efforts of members of her office to get the cases to this point, but now directs her staff shall proceed in accordance with the opinions of the Superior Court, and prepare the cases for trial,' she said in a release."; "The state had initially asked the Superior Court for an en banc rehearing, but the court denied the request at the end of March. As a result of the decision not to appeal the rulings to the state's Supreme Court, Spanier and Schultz will no longer face perjury, obstruction of justice and conspiracy charges. Curley will no longer face obstruction of justice and conspiracy charges."; "The three men still face charges of failure to report suspected abuse and endangering the welfare of children, and Curley also faces a perjury charge. The state's decision not to appeal paves the way for a trial on these remaining charges, which had originally been anticipated for the spring of 2014, before the questions surrounding the grand jury testimony halted the process.").

This eight year long saga did not end well for the former Penn State General Counsel and former Pennsylvania Supreme Court Justice. The Court on which she formerly served publicly publicly admonished her for undertaking the joint representation of Penn State (her institutional client/employer) and the three executives.

- Office of Disciplinary Counsel v. Baldwin, 225 A.3d 817, 832, 840-41, 849 (Pa. 2020) (publicly reprimanding former Penn State General Counsel and Pennsylvania Supreme Court Justice Cynthia Baldwin for improperly representing Penn State and three Penn State executives accused of covering up the Sandusky sex abuse scandal; "Based upon the entirety of the evidence or record, we agree with the conclusions of both the Hearing Committee and the Disciplinary Board that Respondent represented Curley, Schultz and Spanier in their personal capacities at the time of their grand jury testimony."; "By agreeing to undertake the concurrent representation of Penn State, Curley, Schultz and Spanier, Respondent committed multiple violations of Pa.R.P.C. 1.7. Rule 1.7 requires attorneys to avoid conflicts of interest in the representation of multiple clients. A conflict of interest exists under Rule 1.7(a)(1) when the representation of one client is materially adverse to the interests of another client or where there is a 'significant risk' that the representation of one client will be materially limited by the lawyer's responsibilities to another client as proscribed by Pa.R.P.C. 1.7(a)(2). A client may waive a conflict of interest, but only upon providing informed consent. Pa.R.P.C. 1.7(a)(2). In the present circumstance, the Disciplinary Board properly concluded that Respondent's concurrent representation of Penn State and Curley, Schultz and Spanier 'undoubtedly created a significant risk that her ability to consider, recommend or carry out an appropriate course of action for each client could be materially limited by her representation of Penn State.'"; "Respondent asserts a number of defenses to ODC's claims of violations of Rule 1.6(a). As an overarching defense, Respondent relies on the concept of waiver applicable to the attorney-client privilege. In this regard, we note that Respondent offers no legal analysis to explain the alleged interplay between the attorney-client privilege, an evidentiary privilege, and the duty of confidentiality embodied in the Rules of Professional Conduct, specifically Rule 1.6(a). Pertinently, Respondent does not explain how the waiver of an evidentiary privilege can be the basis of an ex post facto defense to a disciplinary claim when the client, the holder of the claim, was not heard in the evidentiary proceedings before the allegedly waived communication is discussed.").

Penn State General Counsel's experience highlights the wisdom of carefully defining the "client" in a corporate setting and -- especially -- avoiding the accidental creation of attorney-client relationships.

Best Answer

The best answer to this hypothetical is **MAYBE**.

B 8/16

Fiduciary Exception: The Garner Rule

Hypothetical 10

You are the General Counsel of a company owned by approximately 500 shareholders. You just learned that about 75 of the shareholders have filed a derivative case targeting several company executives who the shareholders claim to have engaged in wrongdoing. The lawyers filing the derivative case also notified you that they will be seeking access to your communications with your corporate client's upper management as part of their expedited discovery.

Will the shareholders successfully gain access to your communications with your corporate client's management?

MAYBE

Analysis

The "default" position is that a corporation's lawyer represents the institution rather than any of its constituents or employees. Because shareholders own the corporation, should they be seen as the ultimate client?

At first blush, the answer would seem to clearly be no. Surely one shareholder out of a million shareholders would not be able to gain access to highly confidential privileged communications between a corporation's management and the corporation's lawyers.

On the other hand, in certain limited circumstances it makes sense to consider the shareholders as the real "client." Starting in the somewhat unusual context of shareholder derivative lawsuits, this concept has expanded to include several counter-intuitive situations. In fact, this concept now exists outside of the corporate shareholder context, and has a much broader name -- the "fiduciary exception."

If there was any situation in which a corporation's shareholders might be seen as the corporation's lawyer's "clients," it would be in a shareholder derivative lawsuit.

In such a lawsuit, shareholders bring a claim on behalf of the corporation against some third party. They allege that the corporation's management has been delinquent in failing to pursue the claim, and the shareholders must step in to benefit the corporation. Starting in 1971, one court recognized that in that narrow context shareholders could be seen as the true "client," and could sometimes be given access to communications between a corporation's management and its lawyers.

In Garner v. Wolfinbarger,[1] the Fifth Circuit held that to obtain access to such privileged communications, the shareholders must demonstrate "good cause" by satisfying several factors. The court listed the following indicia that might be used in this evaluation:

- The number of shareholders;
- The percentage of stock they own;
- Their bona fides;
- The nature of their claim;
- The necessity or desirability of shareholders receiving the information;
- The availability of the information from other sources;
- Whether any alleged wrongdoing is illegal, criminal, or of doubtful legality;
- Whether the alleged wrongdoing relates to past or prospective actions;
- Whether the communication sought concerns the litigation itself;

[1] 430 F.2d 1093 (5th Cir. 1970), cert. denied, 401 U.S. 974 (1971).

- The extent to which the information requested is identified and not just a "fishing expedition";

- The risk of revealing trade secrets or other information that is independently confidential.[2]

Most courts now follow this approach.[3]

The Garner rule has not been universally adopted, and a number of courts have explicitly rejected it. The commentators that question Garner do so because it is effectively an exception to the rule established by the United States Supreme Court in Upjohn that management exercises exclusive control over the privilege. Another concern is that the shareholders may not truly represent a legitimate interest if, as litigants, they are essentially just protecting their own investments.[4]

Another well-respected court criticized the Garner approach, although ultimately finding it applicable.[5]

Courts adoptings the Garner doctrine disagree about whether the doctrine applies to plaintiffs who were not shareholders at the time the privileged

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2 Id. at 1104.

3 Ryskamp v. Looney, Civ. A. No. 10-cv-00842-WJM-KLM, 2011 U.S. Dist. LEXIS 98644 (D. Colo. Sept. 1, 2011) (finding that the Garner doctrine did not apply because a small number of shareholders had filed a lawsuit and could not establish good cause); Kosachuk v. Harper, C.A. No. 17928, 2000 Del. Ch. LEXIS 176, at *3 (Del. Ch. Dec. 9, 2000); Weiser v. Grace, 683 N.Y.S.2d 781, 786 (N.Y. Sup. Ct. 1998) (assessing plaintiff shareholders' efforts to obtain documents from the special litigation committee of defendant company; "The court recognizes that some of the documents sought may contain privileged matter which may be immune from discovery, notwithstanding their relevance to issues of good faith and the reasonableness of the investigation. Thus, an in camera review is the appropriate procedural vehicle to ensure that those privileges are not violated, while permitting plaintiffs to obtain the discovery necessary to challenge the SLC's [Special Litigation Committee] good faith. However, the court notes that the application of the attorney-client privilege is problematic. The SLC's counsel represents both the SLC and the corporation as a whole (e.g., the plaintiff shareholders). Under such circumstances, the attorney-client privilege would not bar discovery of all communications between counsel and the SLC."; noting that the Garner doctrine might entitle plaintiffs to review the documents, and ordering an in camera review to assist in that determination).

4 Milroy v. Hanson, 875 F. Supp. 646, 651-52 (D. Neb. 1995).

5 Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 244 F.R.D. 412 (N.D. Ill. 2006).

communications took place. Some courts require the shareholders to have been owners at that point,[6] while others take the position that later acquisition of the stock is sufficient.[7]

Because the traditional Garner analysis includes transitory factors, such as the shareholders' ability to obtain the necessary information elsewhere, courts adopting the Garner doctrine sometimes find that shareholders who have not satisfied the Garner test are able to try again later in the litigation.[8]

The theory underlying the Garner doctrine is that the shareholders are the actual "client" because they are suing derivatively, stepping into the shoes of corporate management to take some action that management refused to undertake on the corporation's behalf. In the derivative situation, this makes sense. But courts eventually began to expand the doctrine beyond this context.

The theory remained essentially the same -- that the shareholders were the real "client." However, the rationale for applying the Garner doctrine shifted a bit. Even if the shareholders were no longer suing derivatively (and therefore stepping into the shoes of management), corporate management's fiduciary duties to the shareholders essentially made the shareholders the real "client." This affected the analysis of the shareholders' right to access communications between the corporate management whom the shareholders elected and the corporate lawyers that the shareholders essentially pay.

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6 In re Kidder Peabody Sec. Litig., 168 F.R.D. 459, 475 (S.D.N.Y. 1996).

7 Monfardini v. Quinlan, No. 02 C 4284, 2004 U.S. Dist. LEXIS 4054, at *18-19 (N.D. Ill. Mar. 11, 2004); Bairnco Corp. Sec. Litig. V. Keene Corp., 148 F.R.D. 91 (S.D.N.Y. 1993).

8 In re Fuqua Indus. S'holder Litig., Consol. Civ. A. No. 11974, 2002 Del. Ch. LEXIS 52 (Del. Ch. May 2, 2002).

Some courts have applied the Garner doctrine beyond the derivative context. For instance, in late 2006, the Northern District of Illinois applied the Garner doctrine to a non-derivative securities fraud case shareholders had filed against a corporation.[9]

However, other courts have criticized the expansion.[10] Just eight months later, another Northern District of Illinois judge disagreed with that expansion, explaining that

> [t]he fiduciary exception is most clearly applicable in a derivative suit. The rationale that supports the fiduciary exception -- that the directors and officers being suited in a derivative suit owe the plaintiffs fiduciary duties -- is strained in a non-derivative suit, where the plaintiff is suing on behalf of herself, not on behalf of the company.

Blau v. Harrison (In re JP Morgan Chase & Co. Sec. Litig.), MDL No. 1783, Master Dkt. No. 06 C 4674, 2007 U.S. Dist. LEXIS 60095, at *27-28 (N.D. Ill. Aug. 13, 2007).

About six months earlier, the Southern District of New York also questioned whether the Garner doctrine "should apply routinely in a securities-fraud lawsuit":[11]

> We question whether the fiduciary exception should apply routinely in a securities-fraud lawsuit. First, the plaintiffs in such a case are seeking personal benefit and are not seeking to benefit the company, which is the intended beneficiary of fiduciary obligations owed by corporate management. Second, plaintiffs are complaining of alleged misconduct injurious to them as members of the investing public rather than injurious to the corporation and its shareholders at the time of the misconduct. Third, in the typical class-action suit for securities fraud, there is no reason to assume that the class members will have been

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9 Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 244 F.R.D. 412 (N.D. Ill. 2006).

10 Weil v. Investment/Indicators, Research & Mgmt., Inc., 647 F.2d 18, 23 (9th Cir. 1981) ("Without passing on the merits of Garner, we find it inapposite to the case before us. Weil is not currently a shareholder of the Fund, and her action is not a derivative suit. The Garner plaintiffs sought damages from other defendants in behalf of the corporation, whereas Weil seeks to recover damages from the corporation for herself and the members of her proposed class. Garner's holding and policy rationale simply do not apply here.").

11 In re Omnicom Grp. Inc., Sec. Litig., 233 F.R.D. 400, 412 (S.D.N.Y. 2006).

> shareholders at the time of the targeted communications, and if not, they may not be in a position to claim any relevant fiduciary obligation on the part of corporate management in any event.

In re Omnicom Grp. Inc., Sec. Litig., 233 F.R.D. 400, 412 (S.D.N.Y. 2006).

Thus, courts have debated the Garner doctrine's expansion beyond derivative lawsuits; however, a number of courts have recognized the expansion, albeit reluctantly.[12]

In 2014, the Delaware Supreme Court explicitly recognized the Garner doctrine, and held that unions who owned Walmart stock could access otherwise privileged communictions relating to Walmart's investigation into alleged corruption in Mexico.

- Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund IBEW, 95 A.3d 1264, 1278 (Del. 2014) (applying the Garner doctrine (Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970)) in a Delaware § 220 action, in which union shareholders sought privileged documents about Wal-Mart's alleged Mexican corruption investigation; "[T]he Garner doctrine fiduciary exception to the attorney-client privilege is narrow, exacting, and intended to be very difficult to satisfy. It achieves a proper balance between legitimate competing interests."; "We hold that the Garner doctrine should be applied in plenary stockholder/corporation proceedings. We also hold that the Garner doctrine is applicable in a Section 220 action. However, in a Section 220 proceeding, the necessary and essential inquiry must precede any privilege inquiry because the necessary and essential inquiry is dispositive of the threshold question -- the scope of document production to which the plaintiff is entitled under Section 220." (footnote omitted)).

One year later, a New York Supreme Court also recognized the Garner doctrine.

- NAMA Holdings, LLC v. Greenberg Traurig LLP, 18 N.Y.S.3d 1, 7, 7-8, 8, 9, 9-10, 10, 10-11 (N.Y. App. Div. 2015) (applying the fiduciary exception; holding that an investor which owned seventy percent of an LLC did not automatically deserve access to the LLC's privileged documents, and

[12] Monfardini v. Quinlan, No. 02 C 4284, 2004 U.S. Dist. LEXIS 4054, at *16, *18 (N.D. Ill. Mar. 11, 2004; Fausek v. White, 965 F.2d 126 (6th Cir.), cert. denied, 506 U.S. 1034 (1992); Sandberg v. Va. Bankshares, Inc., 979 F.2d 332 (4th Cir. 1992), vacated on settlement, No. 91-1873, 1993 U.S. App. LEXIS 32286 (4th Cir. Apr. 7, 1993); Deutsch v. Cogan, 580 A.2d 100, 106, 108 (Del. Ch. 1990).

remanding for an in camera review; "In the corporate context, where a shareholder (or, as here, an investor in a company) brings suit against corporate management for breach of fiduciary duty or similar wrongdoing, courts have carved out a 'fiduciary exception' to the privilege that otherwise attaches to communications between management and corporate counsel. This Court has not previously defined the parameters of the exception, so we take the opportunity to do so here."; "The fiduciary exception has its origins in English trust law, which long ago recognized that the fiduciary nature of the relationship between a trustee and a beneficiary of a trust provides an exception to the privilege with respect to communications between the trustee and the trust's attorney . . . . The theory is that when a trustee seeks legal advice in executing his or her fiduciary duties, he or she is acting ultimately on behalf of the beneficiaries of the trust and, accordingly, cannot cloak his or her actions from them, the attorney's 'real clients.'" (citation omitted); "In 1970, the U.S. Court of Appeals for the Fifth Circuit extended the fiduciary exception to the corporate environment in Garner v Wolfinbarger (430 F2d 1093 [5th Cir 1970], cert denied 401 U.S. 974, 91 S. Ct. 1191, 28 L. Ed. 2d 323 [1971])."; "Despite its critics,[4] the fiduciary exception has been widely accepted throughout most of the United States in trustee-beneficiary and corporation-shareholder cases." (footnote omitted); "Several New York courts have also recognized the fiduciary exception -- both in corporation-shareholder and trustee-beneficiary cases -- and we are not aware of any that have rejected it outright."; "In extending the fiduciary exception to the corporate sphere, the Garner court set forth a non-exhaustive list of factors that should be considered to determine whether a party has shown good cause for applying the exception in a given case."; "The Garner test remains viable, and it strikes the appropriate balance between respect for the privilege and the need for disclosure; therefore, we adopt it here."; "Here, the motion court determined that NAMA demonstrated good cause to apply the fiduciary exception to the withheld communications without considering the factors set forth in either Garner or Hoopes [Hoopes v. Carota (531 N.Y.S.2d 407 [N.Y. App. Div. 1988])]. . . . For example, we do not know whether the approximately 3,000 communications on the Privilege Log pertain to past or prospective actions, whether the information sought is available from other sources, or whether any of the communications concern advice regarding the instant litigation."; "Thus, although defendants do not take issue with the motion court's finding of good cause -- they focus on the determination that there never was an adversarial relationship between NAMA and Alliance -- we conclude that the case must be remanded for the court to conduct a comprehensive good-cause analysis."; "While some factors in the Garner test are relevant to a determination of adversity, Garner did not create a categorical adversity limitation. Thus, adversity is not a threshold inquiry but a component of the broader good-cause inquiry. Moreover, of the Garner factors that pertain to adversity, some will indicate whether the parties are generally adverse, while others will require a review of the communications in

> dispute; the relevant factors may weigh against finding good cause to apply the fiduciary exception with respect to those communications that reveal adversity. Accordingly, a court may find that the party seeking disclosure has shown good cause to be given access to some communications but not others."; "That NAMA is a 70% majority investor in Alliance and is suing the managers derivatively suggests that it is not, in this action, generally adverse to Alliance. However, while the derivative nature of a shareholder's claim tends to support a finding of good cause, it is not dispositive.").

Presumably every court would agree that the Garner doctrine does not apply in certain obvious circumstances. For instance, in 2007 the Eastern District of Louisiana rejected efforts by two members of a hospital management committee to obtain access to the management committee's communications with the lawyer defending it from the two members' lawsuit.[13] The court confirmed that "[n]othing in Garner suggests that plaintiff-shareholders who are actively involved in litigation against the corporation are entitled to access opposing counsel's litigation file."[14] Even if Garner could theoretically apply to such a situation, shareholders in that situation clearly would fall short of satisfying the Garner factors. Thus, as a practical matter, they would never be given access to privileged communications.

Best Answer

The best answer to this hypothetical is **MAYBE**.

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13 Sigma Delta, LLC v. George, Civ. A. No.: 07-5427 SECTION: "A" (5), 2007 U.S. Dist. LEXIS 94213 (E.D. La. Dec. 20, 2007).

14 Id. at *9.