When Does a Representation Against a Subsidiary of a Current Client Constitute a Conflicted Representation?

By Elizabeth L. Bradley

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Does the representation of a client against a subsidiary of a current client constitute a conflicted representation? Not surprisingly, the answer to this question is … it depends. As with so many ethics questions, there is no bright line rule.

Duty of Loyalty is Paramount in Concurrent Representations

"A lawyer shall not, without informed written consent from each client … represent a client if the representation is directly adverse to another client in the same or a separate matter," even where the two matters are entirely unrelated.[i] "The primary value at stake in cases of simultaneous or dual representation is the attorney's duty—and the client's legitimate expectation—of *loyalty*, rather than confidentiality."[ii] The test for disqualification due to simultaneous representation is stringent.[iii] A client who learns that their lawyer is also representing a litigation adversary, even in a wholly unrelated matter, cannot be expected to sustain the level of confidence and trust in counsel that is one of the foundations of the professional relationship.[iv]

Where a lawyer represents an organization, the client is the organization itself, acting through its duly authorized directors, officers, employees, members, shareholders, etc.[v] The prevailing view is that the mere fact of corporate affiliation does not create a conflict. Under certain circumstances, however, an adverse representation against an affiliate or subsidiary of a current client may constitute a conflicted representation. Both the State Bar of California and the American Bar Association have issued formal ethics opinions concluding that a lawyer who represents a corporate client is not by that fact alone barred from a representation that is adverse to a corporate affiliate of that client in an unrelated matter; both opinions recognize that a disqualifying conflict could arise in particular circumstances. [vi] Whether a client's subsidiary should be treated as a client for conflict purposes is therefore a highly factual analysis, to be decided on a case-by-case basis.

"[A] parent corporation and its subsidiary, even if wholly owned, are generally regarded as separate entities for conflicts purposes, *unless an exception applies*—where the relationship between the entities are such they have a 'unity of interests' so as to deserve being treated as one."[vii] The State Bar opinion identifies two exceptions. "When a corporation is the alter ego of another entity or has a sufficient unity of interests, they should be treated as the same entity for conflict purposes."[viii] Also, "if the attorney has

obtained confidential information directly from the nonclient subsidiary under circumstances where the subsidiary could reasonably expect that the attorney had a duty to keep such information confidential, the attorney might be precluded from acting adversely to the subsidiary in matters related to the subject on which the attorney had obtained such confidential information."[ix]

Successive v. Concurrent Representations

In *Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft*,[x] the conflict question involved a successive representation in the context of monitoring counsel.[xi] The court applied four factors to ascertain whether a parent corporation and its subsidiary should be regarded as separate entities for conflict purposes: (1) Whether the firm received confidential information from the parent substantially related to the claim against the subsidiary; (2) Whether the parent controlled the legal affairs of the subsidiary;[xii] (3) Whether the parent and subsidiary shared operations and management, such as overlapping functions and personnel; and (4) Whether the parent and subsidiary shared a unity of interest.[xiii]

The *Morrison* court equated this analysis as the "unity of interests" analysis referred to in the State Bar Opinion, and recognized it as distinct from and something less than an alter ego analysis. The court's approach has been referred to as a "pragmatic, totality of the circumstances approach."[xiv] It concluded that the principal focus should be the practical consequences of the attorney's relationship with the corporate family. If that relationship may give the attorney a practical advantage in a case against an affiliate, then the attorney can be disqualified from taking the case. While an alter ego test is one possible basis for equating affiliates in conflicts cases, an alter ego finding is not required.[xv] Because confidentiality was the primary concern in the successive representation context in *Morrison*, the court primarily focused on whether the lawyer acquired confidential information from the parent that would give the lawyer an advantage and could be used against the subsidiary.[xvi]

In *Certain Underwriters*, however, the concern in the concurrent representation context was not confidential information or any other practical litigation advantage obtained against an affiliate, but the duty of undivided loyalty owed to the affiliate.[xvii] Applying the *Morrison* unity of interest test in the context of a concurrent representation, the *Certain Underwriters* court concluded that the question is whether there is a sufficient unity of interest between parent and subsidiary such that the firm's representation of the parent's adversary in the matter reasonably diminished the 'level of confidence and trust in counsel' held by the subsidiary.[xviii] Two factors militate in favor of finding a reasonable basis for a diminution of such trust and confidence: The financial impact of the instant litigation on the subsidiary, and "the management operations and the legal affairs" were "essentially identical" for both the parent and subsidiary.[xix]

Courts have also looked to whether the lawyer advised the parent on strategic decisions in matters impacting the entire corporate family. In one case, a unity of interest was found to exist even where the law firm never agreed to represent the parent's subsidiaries, and

the fee agreement stated that the firm did not represent subsidiaries or affiliates, where the parent considered the firm to be its and its subsidiaries' top strategic firm, and both entities shared the same legal department. The two adverse litigations were unrelated in purpose, and the firm ensured that no lawyer individually represented both entities, yet the ethical wall erected by the law firm did not cure the concurrent conflict. [xx]

Practical Challenges Applying the Unity of Interests Analysis

The facts required to perform a unity of interest analysis may pose practical challenges to a lawyer's attempt to ascertain whether they are precluded from accepting a representation adverse to an affiliate or subsidiary of a current client. Depending on the specific nature of the matter or matters on which the lawyer represents the corporate client, the lawyer's knowledge of the inner workings of the corporate client, its legal department, and the corporate family may be limited. The lawyer may not know how the client subjectively views the nature of its relationship with the lawyer, as related to the subsidiary or the corporate family. It is entirely plausible that where the lawyer is not privy to the inner workings of the corporate family, the lawyer may not learn all relevant facts necessary to the determination of the conflict issue until faced with a disqualification motion.

As the *Morrison* court concluded, even if the lawyer has reasonable ground for believing that they do not have a conflict of interest, a lawyer takes a chance by venturing into a gray area. A court, thoughtfully reviewing all of the evidence, may reasonably conclude that they had a conflict.[xxi] Serious consideration should be given to the lawyer's duties of disclosure to the existing client under rules 1.4 and 1.7 prior to undertaking a potentially conflicting representation. If the analysis lands in a gray area or the conclusion depends on information outside the lawyer's knowledge, it would be prudent to consider disclosing the potential representation to the existing client before undertaking the representation (to the extent authorized under the Rules of Professional Conduct), in an attempt to ascertain whether that client will challenge the new representation.[xxii]

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[i] Cal. R. of Prof. Conduct, R 1.7; *Flatt v. Superior Court*, 9 Cal.4th 275, 284 (1994) ("*Flatt*").
[ii] *Flatt*, at 284.
[iii] Id.
[iv] Id. at 285.
[v] Cal. R. of Prof. Conduct, R. 1.13(a) and former R. 3-600(A).
[vi] ABA/BNA Lawyers Manual on Professional Conduct, Formal Ethics Opn. 95-390 (Jan. 25, 1995) p. 1001:258 (ABA Formal Ethics Opn. 95-390); State Bar Com. on Prof. Responsibility, Formal Opn. No.1989-113 (1989) (Opn. No.1989-113, the "State Bar Opinion") [limiting discussion to potential representation adverse to the parent of a current corporate client, a wholly owned subsidiary; applying former Cal. R. of Prof. Conduct, R 3-310(B), 3-600(D).) Both opinions recognize that a disqualifying conflict might arise in particular circumstances. While the ABA opinion describes the exceptions in broad terms, the California opinion identifies two specific exceptions. (Opn. No.1989-

113.) Though not binding, the ABA Model Rules of Professional Conduct can be looked to as persuasive authority. (State Bar Formal Opinion No. 1983-71.)

[vii] *Certain Underwriters at Lloyd's, London, Highlands Insurance Company (UK) Ltd., et al. v. Argonaut Insurance Company,* 264 F.Supp.2d 914, 920-921 (N.D. Cal. 2003) ("*Certain Underwriters*"), applying California law, emphasis added; *Michail v. Fluor Mining & Metals, Inc.*, 180 Cal.App.3d 284, 286 (1986) [federal court decisions applying California law have persuasive value].

[viii] Opn. No. 1989-113. "In determining whether there is a sufficient unity of interests to require an attorney to disregard separate corporate entities for conflict purposes, the attorney should evaluate the separateness of the entities involved, whether corporate formalities are observed, the extent to which each entity has distinct and independent managements and board of directors, and whether, for legal purposes, one entity could be considered the alter ego of the other."

[ix] Id.

[x] *Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft,* 69 Cal.App.4th 223 (1999) ("*Morrison*").

[xi] "Where the potential conflict is one that arises from the *successive* representation of clients with potentially adverse interests, the courts have recognized that the chief fiduciary value jeopardized is that of client *confidentiality*." *Flatt, supra,* at 283.

[xii] See also, *Teradyne, Inc. v. Hewlett-Packard Co.* 2 U.S.P.Q. 2d 1143 (N.D.Cal. 1991).

[xiii] *Morrison*, at 245-248.

[xiv] *Demery v. Hartford Underwriters Ins. Co.*, Not Reported in Cal.Rptr.3d (2008).

[xv] *Morrison*, at 253.

[xvi] See also, *Baxter Diagnostics, Inc. v. AVL Scientific Corp.*, 798 F.Supp. 612, 615-616 [challenged attorneys had provided legal advice to a corporate predecessor of the opposing party on the very subject matter of the current litigation].

[xvii] *Certain Underwriters, supra,* 264 F.Supp.2d at 922.

[xviii] Id. at 922.

[xix] Id. at 923-924.

[xx] *Lennar Mare Island, LLC v. Steadfast Ins. Co.,* 105 F.Supp.3d 1100 (2015).

[xxi] *Morrison*, at 253.

[xxii] Opn. No. 1989-113