

WHEN BUSINESS DECISIONS OF A CLIENT CREATE A CURRENT CLIENT CONFLICT OF INTEREST: IMPLICATIONS IN A COMPLEX ETHICAL LANDSCAPE

Abstract: Lawyers have an ethical duty to be loyal to their clients. Conflict of interest questions involving loyalty are increasingly at issue in the modern climate of mergers and acquisitions. When there is a traditional client conflict the courts favor disqualification, finding the risk to loyalty values too extreme. Yet, when there is a corporate affiliate situation, or when the conflict is created by client business decisions and not the law firm, the balance may and should be shifted. This Note argues that courts should follow the flexible, practical, balancing of facts and circumstances approach instead of a strict per se rule. This balancing of facts and circumstances must consider all facts that implicate loyalty, including the law firm's fault in creating the conflict. This Note concludes that a more flexible balancing approach, which includes whether the law firm is at fault in creating the conflict, adequately protects loyalty values while preventing the misuse of disqualification motions as a litigation tactic.

INTRODUCTION

In 1985, Gould, Inc. filed a lawsuit against Pechiney and Tremfimetaux ("Pechiney").¹ In the lawsuit, *Gould, Inc. v. Mitsui Mining & Smelting Co.*, Gould was represented by the law firm of Jones, Day, Reavis & Pogue ("Jones, Day").² Jones, Day also represented IG Technologies, Inc. in various contractual matters.³ Unfortunately, in 1989, Pechiney acquired IG Technologies, putting Jones, Day in the position of suing the subsidiary of a current client.⁴

Lawyers have an ethical duty to be loyal to their clients.⁵ One component of the duty of loyalty is that a lawyer cannot be directly

¹ *Gould, Inc. v. Mitsui Mining & Smelting Co.*, 738 F. Supp. 1121, 1122 (N.D. Ohio 1990).

² *Id.* at 1122.

³ *Id.* at 1123.

⁴ *Id.*

⁵ Ronald D. Rotunda, *Conflicts Problems When Representing Members of Corporate Families*, 72 NOTRE DAME L. REV. 655, 662 (1997) (explaining that attorneys are clients' agents and owe fiduciary duties including loyalty).

adverse or materially adverse to the interest of a current client, such as the position in which Jones, Day found itself.⁶ This duty of loyalty is the basis for the attorney-client relationship, a relationship in which clients reveal their most intimate confidences.⁷ A law firm's undivided and uncompromising loyalty to its clients is fundamental to the integrity of legal representation.⁸ Just as important, it is vital to the layman's perception of justice.⁹ Four general policies, therefore, drive the duty of loyalty and the conflict of interest rules that accompany this duty: (1) maintaining professional judgment and thereby effective representation; (2) maintaining confidentiality; (3) protecting the client's expectations; and (4) "furthering broader societal objectives."¹⁰

Conflict of interest and loyalty issues can occur in a variety of situations. A traditional current client conflict can arise if a law firm that represents two clients, A and B, sues Client B on behalf of Client A.¹¹ Even if the suit on behalf of A against B is unrelated to the law firm's representation of B, the basic ethical rule is that adversity is prohibited as a breach of loyalty to a current client.¹² Traditionally, jurisdictions have used either a per se rule of disqualification or a prima facie rule to prohibit such representation.¹³ Yet, as the legal

⁶ See Nora Pisman, *The Conflict of "Conflict of Interest": The Michigan Example*, 1995 DET. C. L. REV. 133, 133 (1995); see also Gould, 738 F. Supp. at 1123.

⁷ E.g., Pisman, *supra* note 6, at 133 (describing loyalty as the basis of the attorney-client relationship).

⁸ See Lara E. Romansic, *Conflict of Interest: Stand by Your Client?: Opinion 95-390 and Conflicts of Interest in Corporate Families*, 11 GEO. J. LEGAL ETHICS 307, 315 (1998).

⁹ See ABA Comm. on Prof'l Ethics and Prof'l Responsibility, Formal Op. 390 (1995) [hereinafter Formal Op. 390] (Fox, dissenting) (arguing "[t]he last thing our profession needs is another black eye caused by jettisoned client loyalty in the name of economic expediency"); Pisman, *supra* note 6, at 159, (quoting G.A.C. Commercial Corp. v. Mahoney Typographers, Inc., 238 N.W.2d 575, 577-78 (Mich. Ct. App. 1975)) (noting that if attorney's conduct appears unethical, regardless of actual ethical violation, that respect and trust in profession is weakened such that ethical questions should be resolved on side of caution).

¹⁰ Michael Sacksteder, *Formal Opinion 95-390 of the ABA's Ethics Committee: Corporate Clients, Conflicts of Interest, and Keeping the Lid on Pandora's Box*, 91 NW. U. L. REV. 741, 748-49 (1997).

¹¹ See Rotunda, *supra* note 5, at 661-62.

¹² *Id.* (noting that representation is generally prohibited even if unrelated); see also Thomas D. Morgan, *Suing a Current Client*, 1 J. INST. STUD. LEGAL ETHICS 87, 97 (1996) (quoting Grievance Comm. v. Rottner, 203 A.2d 82, 184 (Conn. 1964)) (arguing if a client is sued and loses something valuable, like his home, all feeling of loyalty is destroyed regardless of whether the representations are related).

¹³ See Morgan, *supra* note 12, at 88; Rotunda, *supra* note 5, at 687-88.

environment has shifted in the last twenty years, these strict rules are increasingly challenged as out of date and unduly formalistic.¹⁴

Conflict of interest questions are increasingly at issue in the modern climate of mergers and acquisitions, as in the case of *Gould*.¹⁵ In this situation, courts must decide what rules apply when a law firm suddenly finds itself adverse to a client's affiliate because of a business action of a client, such as a merger or an acquisition.¹⁶ There is a breach of loyalty when a law firm is adverse to a current client, even when there is no relationship between the two representations, but, of course, there is no loyalty issue when a law firm is adverse to a non-client.¹⁷ Therefore, the key question when a law firm is adverse to a corporate affiliate of a client, known as a corporate family conflict, is whether the affiliate should be treated as a client or non-client for conflict of interest purposes.¹⁸ Various courts and commentators have advocated approaches ranging from per se treatment of an affiliate of a client as an actual client to considering corporate family members as completely separate entities.¹⁹

State and federal ethical codes ultimately define and regulate the attorney's duty of loyalty and attempt to address these questions.²⁰ The American Bar Association's ("ABA") *Model Code of Professional Responsibility* and its replacement, the *Model Rules of Professional Conduct*, both address conflicts of interest by emphasizing loyalty to the cli-

¹⁴ See, e.g., Andrew Drucker, *Explanations, Suggestions, and Solutions to Conflict Tracking and Prevention in Response to the Growth and Expansion of the Larger Law Firm*, 24 DEL. J. CORP. L. 529, 530-31 (1999) (noting law firm growth increases number of conflict situations and Model Rules are increasingly incapable of dealing with new and unique conflicts in the modern legal world); Morgan, *supra* note 12, at 88 (noting that law firms have specialized, and grown and clients hire many different firms such that ignoring new structure of law firms may place too many restrictions on the activities of both clients and lawyers). But see Pisman, *supra* note 6, at 166 (criticizing courts for increasingly allowing representations that they previously would have prevented and weakening enforcement of conflict rules despite voicing strict messages condemning such representation).

¹⁵ See Romansic, *supra* note 7, at 307 (noting that corporate families often change through mergers and acquisitions and that as this happens the potential for current conflicts increases).

¹⁶ See, e.g., *Colorpix Sys. of Am. v. Broan Mfg. Co.*, 131 F. Supp. 2d 331 (D. Conn. 2001).

¹⁷ Rotunda, *supra* note 5, at 662-63.

¹⁸ See *id.* at 676.

¹⁹ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS: CONFLICTS OF INTEREST § 121 Reporter's Note cmt. d (2000) [hereinafter RESTATEMENT].

²⁰ See, e.g., Pisman, *supra* note 6, at 134.

ent.²¹ Additionally, there has been substantial development of the duty of loyalty in both case law and ethics opinions.²²

This Note addresses the duty of loyalty, and the prohibition against suing or otherwise acting adversely to your own client, in the context of mergers and acquisitions.²³ Furthermore, it examines what rules should govern given the complex interaction of three paradigms: current conflicts between traditional clients, conflict with a former client, and the hot potato rule, which prohibits a law firm from dropping one client to undertake representation of another client.²⁴ Part I of this Note addresses the current state of the *Model Code of Professional Responsibility* ("Model Code"), *Model Rules of Professional Conduct* ("Model Rules"), *Restatement (Third) of the Law Governing Lawyers* ("Restatement"), and ethical opinions in resolving current client and corporate affiliate conflicts.²⁵ Part II discusses the general case history and the differences between the per se rule and the facts and circumstances test.²⁶ Part III addresses how a conflict caused by the actions of the client should be addressed in the context of the per se rule and the facts and circumstances test.²⁷ Part IV argues for a practical approach that looks for real, instead of imaginary, conflicts.²⁸

I. THE BASIC ETHICAL DOCTRINE

The American Bar Association's ("ABA") *Model Rules of Professional Conduct* ("Model Rules") and *Model Code of Professional Responsibility* ("Model Code") embody the basic doctrine on conflicts of interest.²⁹ Although the *Model Rules* and the *Model Code* have formed the basis for state ethics rules, both of these documents were meant to have force

²¹ See MODEL RULES OF PROF'L CONDUCT R. 1.7 (1999); MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105 (1983); Sacksteder, *supra* note 9, at 745-48.

²² See Rotunda, *supra* note 5, at 665-66 (noting that discrepancies between district courts is now "standard operating procedure" because of a 1981 Supreme Court case, *Firestone Tire & Rubber Co. v. Risjord*, 449 U.S. 368 (1981), that rejected appeals to denials of disqualification motions and the ensuing development of this holding by federal and state courts).

²³ See *infra* notes 29-326 and accompanying text.

²⁴ See *infra* notes 29-326 and accompanying text.

²⁵ See *infra* notes 29-84 and accompanying text.

²⁶ See *infra* notes 86-161 and accompanying text.

²⁷ See *infra* notes 162-278 and accompanying text.

²⁸ See *infra* notes 279-326 and accompanying text.

²⁹ See MODEL RULES OF PROF'L CONDUCT R. 1.7 (1999); MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105 (1983).

only within the membership of the ABA.³⁰ An increasing number of states have adopted the *Model Rules* with various modifications, although a significant minority have adopted modified *Model Codes*.³¹ The state rules of professional conduct are followed by the state courts.³² Meanwhile, the federal courts try to apply a national standard of ethics by relying on the state ethics codes, as well as the *Model Code* and the *Model Rules*.³³

A. The Model Code of Professional Responsibility

The *Model Code* is made up of Canons, Ethical Considerations ("EC") and Disciplinary Rules ("DR").³⁴ Canons are general directives, while Ethical Considerations are more specific guidelines that are not binding.³⁵ In contrast, Disciplinary Rules are binding on legal professionals.³⁶ Canons 4, 5 and 9 apply generally to concurrent representation, although Disciplinary Rule 5-105 is the controlling provision.³⁷

Embedded in the *Model Code* is a preoccupation with maintaining public confidence in attorneys and upholding the legal profession's integrity.³⁸ Canon 4, for instance, addresses the former by preserving the confidences of clients, thus encouraging clients to speak freely to their lawyers without fear of disclosure.³⁹ Canon 5 addresses the latter by imposing a duty to exercise independent professional judgment on behalf of a client.⁴⁰ EC 5-1 further states that the professional judgment of a lawyer should be exercised solely for the benefit of his cli-

³⁰ PROFESSIONAL RESPONSIBILITY STANDARDS, RULES & STATUTES 2 (John S. Dzienkowski ed., abr. ed. 2000-2001) [hereinafter PROF'L RESPONSIBILITY STANDARDS].

³¹ *Id.* at 145 (noting that, in 2000, 39 states had replaced ethics codes based on Model Code with that from Model Rules and every one of these states has in some way modified the Model Rules provisions).

³² See, e.g., *Ex parte AmSouth Bank, N.A.*, 589 So. 2d 715, 717 (Ala. 1991) (applying the Alabama Rules of Professional Conduct).

³³ See PROF'L RESPONSIBILITY STANDARDS, *supra* note 26, at 6.

³⁴ *Id.* at 388.

³⁵ *Id.* at 389.

³⁶ *Id.*

³⁷ MODEL CODE OF PROF'L RESPONSIBILITY Canon 4, 5, 9, DR 5-105.

³⁸ *Id.* Canon 1. Canon 1, for example, is entitled "A Lawyer Should Assist in Maintaining the Integrity and Competence of the Legal Profession." *Id.* Furthermore, the Preamble places the role of the attorney in the lofty context of "lawyers as guardians of the law [playing] a vital role in the preservation of society." *Id.* at Preamble.

³⁹ *Id.* Canon 4.

⁴⁰ *Id.* Canon 5.

ent, and the interests of other clients should not "be permitted to dilute his loyalty to his client."⁴¹

Within this framework, Disciplinary Rule 5-105 specifically mandates that lawyers may not accept or continue employment if their independent professional judgment is likely to be adversely affected or if it would likely involve them in representing differing interests.⁴² There is an exception if it is obvious that a lawyer could adequately represent the interest of each client and if both consent.⁴³ The consent provision is important because occasionally a client will not consent to the adverse representation, but the law firm or the opposing party will believe that consent should not be necessary because there is no real conflict.⁴⁴ Furthermore, Canon 9 of the *Model Code* embodies a concept courts liberally use to reject representation adverse to a current client: "a lawyer should avoid even the appearance of impropriety."⁴⁵ This concept is increasingly rejected by *Model Rules* jurisdictions.⁴⁶

B. The Model Rules of Professional Conduct

The *Model Rules* deal with adverse representation against a current client or its affiliate through Model Rule 1.7.⁴⁷ Rule 1.7 states:

A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:

⁴¹ *Id.* EC 5-1.

⁴² MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105.

⁴³ *Id.*

⁴⁴ See, e.g., Morgan, *supra* note 12, at 93, 94 (agreeing that obtaining consent is "good client relations" but that a problem "typically arises because the client threatened with suit refuses to grant consent, often solely out of a desire to make life difficult for the opponent").

⁴⁵ MODEL RULES OF PROF'L CONDUCT R. 1.9 cmt. 5; MODEL CODE OF PROF'L RESPONSIBILITY Canon 9; see, e.g., Pisman, *supra* note 6, at 158-59 (quoting G.A.C. Commercial Corp. v. Mahoney Typographers, Inc., 238 N.W.2d 575 (Mich. Ct. App. 1975)) (noting that appearance of impropriety standard is used to disqualify even though no ethical canons are actually violated to maintain highest standards of professional conduct and public respect). But see Rotunda, *supra* note 5, at 668 (noting that vague rule where lawyers are reluctant to soil their reputations by risking disqualification motion favors "less ethical" lawyers who are willing to "play the lower court lottery").

⁴⁶ See MODEL RULES OF PROF'L CONDUCT R. 1.9 cmt. 5. But see Drucker, *supra* note 14, at 540-41 (noting that "broad language" of Model Rules still prohibits representations that do not threaten loyalty and instead limit development of the legal profession).

⁴⁷ MODEL RULES OF PROF'L CONDUCT R. 1.7.

the lawyer reasonably believes that representation will not adversely affect the relationship with the other client; and each client consents after consultation.

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

the lawyer reasonably believes the representation will not be adversely affected; and

the client consents after consultation⁴⁸

The rule emphasizes that representation "directly adverse" to another client is prohibited unless the lawyer reasonably believes that the representation will not be adversely affected and each client consents.⁴⁹ The comment to Rule 1.7 states that "a lawyer ordinarily may not act as advocate against a person the lawyer represents in some other matter, even if it is wholly unrelated."⁵⁰ On the other hand, simultaneous representation, in unrelated matters, of clients whose interests are only generally adverse instead of directly adverse, such as competing economic enterprises, "does not require consent of the respective clients."⁵¹ The *Rules*, therefore, distinguish between impermissible and permissible representation according to the degree of adverse impact, emphasizing the difference between specific and generalized, and direct and indirect adversity.⁵² Although the *Model Code's* more general principles of loyalty and public confidence are also embodied in the *Model Rules*, the *Rules'* specific guidelines allow more leeway than the standard of the *Code*.⁵³ Unlike the *Model Code's* "appearance of impropriety" standard, where "disqualification would become little more than a question of subjective judgment," the *Rules* approach considers whether loyalty has been compromised realistically and objectively.⁵⁴

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* R. 1.7 cmt. 3.

⁵¹ *Id.*

⁵² See MODEL RULES OF PROF'L CONDUCT R. 1.7(a), R. 1.7 cmt. 3. Unfortunately, the Model Rules do not define what is meant by "direct" or "indirect," leading to subsequent attempts to define the terms. See Rotunda, *supra* note 5, at 677.

⁵³ See MODEL RULES OF PROF'L CONDUCT R. 1.9 cmt.

⁵⁴ *Id.* R. 1.9 cmt. 5.

Model Rule 1.9 is also relevant to current conflicts because it requires a lawyer to maintain confidentiality.⁵⁵ Although Rule 1.7's approach to current client conflicts is based on concerns of loyalty, Rule 1.9's approach to conflicts is more practical.⁵⁶ Instead of concern with direct adversity, Rule 1.9 addresses the lawyer's duty to maintain confidentiality both with current and former clients.⁵⁷ Therefore, even if Rule 1.7 is not applicable because there is no conflict or the representation is not current, the more relaxed "substantial relationship" test of Rule 1.9 must still be met before the representation is ethical.⁵⁸ The test under Rule 1.9 is whether the current representation is substantially related to the representation of the former client such that client confidences are likely to be compromised.⁵⁹

In addition, Rule 1.13 is important in that it defines who an attorney's client is in the case of an organization.⁶⁰ Specifically, Rule 1.13(a) provides that: "A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."⁶¹ Therefore, its "[o]fficers, directors, employees, and shareholders" are not considered individual clients.⁶²

Although both the *Model Code* and *Model Rules* prohibit adversity to current clients, and to a lesser extent former clients, neither the *Model Code* nor the *Model Rules* explicitly answer how representation against the corporate affiliate of a current client should be treated.⁶³ Furthermore, they do not address the more specific question of how to deal with a conflict caused by the business actions of the client and not by any transgression of the law firm.⁶⁴ The *Restatement (Third) of the*

⁵⁵ *Id.* R. 1.9.

⁵⁶ *See id.* R. 1.7, R. 1.7 cmt. 3, R. 1.9.

⁵⁷ *See id.* R. 1.9; Drucker, *supra* note 14, at 542.

⁵⁸ *See* Drucker, *supra* note 14, at 542, 543 (describing the substantial relationship test as essentially consistent in result but that there are different approaches).

⁵⁹ *Id.* at 542-43 (noting that Rule 1.9 not only prevents further representation when confidences have been compromised but also does so when the attorney has been placed in a position where confidences could be compromised); *see* MODEL RULES OF PROF'L CONDUCT R. 1.9; Dan S. Boyd, *Current Trends in Conflict of Interest Law*, 53 BAYLOR L. REV. 1, 3 (2001) (explaining that "virtually all of the litigation involving attempted disqualifications under . . . [the former client] doctrine in Texas and elsewhere in the United States involve analysis solely or mainly of the substantial relationship test").

⁶⁰ *See* MODEL RULES OF PROF'L CONDUCT R. 1.13.

⁶¹ *Id.* R. 1.13(a).

⁶² *Id.* R. 1.13 cmt. 2.

⁶³ *See id.* R. 1.7; MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105 (1983).

⁶⁴ *See* MODEL RULES OF PROF'L CONDUCT R. 1.7; MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105.

Law Governing Lawyers ("Restatement"), however, provides another tool in determining a law firm's duties in such a situation.⁶⁵

C. The *Restatement (Third) of the Law Governing Lawyers*

The general concern of the *Restatement* is that the relationship and trust between the lawyer and the client, and the justified expectation of the client that the lawyer will be on her side, will be impacted by allowing lawyers to be adverse in any significant way to their client's interests.⁶⁶ Consequently, the *Restatement* prohibits suits brought by an attorney against a present client.⁶⁷ Additionally, this prohibition may extend to "situations, not involving litigation, in which significant impairment of a client's expectation of the lawyer's loyalty would be [likely]."⁶⁸ Such situations are likely to impair expectations of loyalty because, although they do not involve litigation, they involve "contentious" or emotional dealings.⁶⁹ This may include charges of bad faith or transactions that involve a large part of the client's financial worth.⁷⁰

The *Restatement*, like the *Model Rules*, prohibits direct adversity but more specifically identifies what meets this standard.⁷¹ It emphasizes that adversity relates not to the end result of a given case but to the "quality of representation."⁷² The *Restatement* also concludes that general adversity between clients is not enough; instead, the important test is whether the relationship between the lawyer and the client is likely to be compromised.⁷³

In addition, the *Restatement* goes further than the *Model Rules* and provides a test to determine whether the financial and personal relationship between a client and its corporate affiliates are strong enough that the affiliate should be treated as the client for conflict purposes.⁷⁴ These factors include: (1) whether financial loss or benefit to the non-client corporate affiliate will have a direct, adverse

⁶⁵ See RESTATEMENT, *supra* note 19, § 132 cmt. j.

⁶⁶ See *id.* § 121 cmt. b.

⁶⁷ *Id.* § 128(2).

⁶⁸ *Id.* § 121 cmt. b.

⁶⁹ *Id.*

⁷⁰ RESTATEMENT, *supra* note 19, § 121 cmt. b.

⁷¹ Compare *id.* § 121 cmt. c(i), with MODEL RULES OF PROF'L CONDUCT R. 1.7.

⁷² RESTATEMENT, *supra* note 19, § 121 cmt c(i).

⁷³ *Id.* § 121 cmt. c(iii).

⁷⁴ See *id.* § 121 cmt. d.

impact on the client;⁷⁵ (2) whether the lawyer's relationship to one client is such that another client's interests would be materially adversely affected;⁷⁶ (3) whether the client enjoys significant control of the non-client affiliate;⁷⁷ and (4) whether specific obligations such as confidentiality are compromised.⁷⁸ The *Restatement* notes that various courts have used all, some or none of these considerations in determining whether representation without consent is permissible.⁷⁹

Finally, unlike the *Model Code* and *Model Rules*, the *Restatement* directly addresses the underlying issue of fault in concurrent adverse representation.⁸⁰ Under the *Restatement*, conflicts of interest arising from a client merger should trigger an exception to the so called "hot potato" rule.⁸¹ The hot potato rule prohibits a law firm from withdrawing from representation of one client when the purpose is to undertake representation of a new client adverse to it.⁸² The concern is that law firms prohibited from undertaking a new or lucrative representation by concurrent representation rules may try to drop a less lucrative client like a "hot potato."⁸³ By converting the current client to a former client they would try to avoid disqualification under the current client analysis and instead fall under the less strenuous former-client substantive relationship test.⁸⁴ This doctrine is relevant to the conflict of interest question because some courts have addressed corporate family conflicts by crafting an exception to the hot potato

⁷⁵ See *id.* § 121 cmt. d, illus. 6. A lawyer cannot undertake representation adverse to wholly owned subsidiary of client if it would have substantial material impact felt by client. *Id.* If, however, the representation is adverse to a corporation that is less than wholly owned subsidiary of client that representation may be able to continue. *Id.* § 121 cmt. d, illus. 7.

⁷⁶ *Id.* § 121 cmt. d, illus. 8 (showing this would be the case if attorney relied heavily on one client for business).

⁷⁷ See *RESTATEMENT*, *supra* note 19, § 121 cmt. d, illus. 9 (explaining that if an affiliate elects a majority the directors of its family member, approves its key officers, regularly supervises decisions or regularly advises it on decisions that there is significant control).

⁷⁸ *Id.* § 121 cmt. d., cmt. d, illus. 10.

⁷⁹ See *id.* § 121 Reporter's Note cmt. d.

⁸⁰ Compare *MODEL RULES OF PROF'L CONDUCT* R. 1.7, and *MODEL CODE OF PROF'L RESPONSIBILITY* DR 5-105, with *RESTATEMENT*, *supra* note 19, § 121 cmt. e(v) (citing *RESTATEMENT*, *supra* note 19, § 132 cmt. j).

⁸¹ See *RESTATEMENT*, *supra* note 19, § 132 cmt. j.

⁸² GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, *THE LAW OF LAWYERING* § 1.16:302 (2d ed. supp. 1998).

⁸³ See Rotunda, *supra* note 5, at 663-64 (noting that because there is a duty of loyalty limiting representation to current but not to former clients, lawyers seek to avoid the ethical problem by converting the least lucrative client into a former client).

⁸⁴ See HAZARD, *supra* note 82, § 1.16:302.

rule, allowing selective withdrawal and application of the substantive relationship test.⁸⁵

II. DEVELOPMENT OF THE CASE LAW

A. *The Per Se Disqualification Rule*

In 1991, in *Stratagem Development Corp. v. Heron International N.V. & Heron Properties, Inc.*, the United States District Court for the Southern District of New York held that representation adverse to the corporate affiliate of a client is per se improper.⁸⁶ *Stratagem* involved a motion to remove plaintiff's counsel because of a conflict of interest in a breach of a real estate joint venture agreement case.⁸⁷ The plaintiff, Stratagem Development Corporation ("Stratagem"), was represented in the action by Epstein, Becker & Green ("Epstein Becker").⁸⁸ The defendant, Heron Properties ("Heron"), moved to disqualify Epstein Becker because the firm also represented Fidelity Services Corporation ("FSC"), a wholly-owned subsidiary of Heron, in an unrelated labor lawsuit and arbitration.⁸⁹ Epstein Becker responded to Heron's complaints that it was violating the New York Code of Professional Responsibility by withdrawing from its representation of FSC but continuing to represent Stratagem in its dealings with Heron.⁹⁰

To determine whether Epstein Becker's representation of Stratagem against Heron was prohibited, the court looked to *Cinema 5, Ltd. v. Cinerama, Inc.* for the proposition that where there is adversity to a current client, "the conduct '... must be measured not so much against the similarities in litigation, as against the duty of undivided loyalty which an attorney owes to each of his clients.'"⁹¹ The court further stated that this duty is equally applicable where the client is a subsidiary of the entity being sued.⁹² The court found this especially true in the present case where, as a wholly owned subsidiary, damages against the subsidiary corporation "directly affect[ed] the bottom line

⁸⁵ See Charles Wolfram, *Legal Ethics: Corporate-Family Conflicts*, 2 J. INST. STUD. LEGAL ETHICS 295, 362-63 (1999).

⁸⁶ See 756 F. Supp. 789, 792 (S.D.N.Y. 1991); RESTATEMENT, *supra* note 19, § 121 Reporter's Note cmt. d; Rotunda, *supra* note 5, at 658-59.

⁸⁷ *Stratagem*, 756 F. Supp. at 790-91.

⁸⁸ *Id.* at 789-90.

⁸⁹ *Id.* at 790.

⁹⁰ *Id.* at 791.

⁹¹ *Id.* at 792 (citing 528 F.2d 1384, 1386 (2d Cir. 1976)).

⁹² *Stratagem*, 756 F. Supp. at 793 (citing *Glueck v. Jonathan Logan, Inc.*, 512 F. Supp. 223, 227 (S.D.N.Y. 1981), *aff'd* 653 F.2d 746 (2d Cir. 1981)).

of the corporate parent.⁹³ As a result, Epstein Becker's attempt to end the representation of FSC and avoid disqualification was ineffective.⁹⁴

In 1994, in *Cincinnati Bell, Inc. v. Anixter Bros., Inc.* the United States District Court for the Southern District of Ohio also followed a per se rule that prohibited adversity against the corporate affiliate of a current client.⁹⁵ In *Cincinnati Bell*, Anixter Brothers, Inc. ("Anixter"), the defendant, moved to disqualify Frost & Jacobs as counsel for the plaintiff, Cincinnati Bell, due to a conflict of interest.⁹⁶ Frost & Jacobs first represented Cincinnati Bell in a partnership agreement with Anixter, which was subsequently purchased by Itel, the parent of Itel Rail Corp. ("Itel Rail").⁹⁷ Itel Rail then engaged Frost & Jacobs in unrelated litigation without either Frost & Jacobs or Itel Rail realizing the potential for a conflict of interest with Itel Rail's sister corporation, Anixter.⁹⁸ Frost & Jacobs subsequently instituted a suit on behalf of Cincinnati Bell against Anixter as a result of the prior representation on the partnership agreement, still not realizing that Anixter was the sister company of its client Itel Rail.⁹⁹ In the meantime, Itel Rail was winding up its business and being integrated into the parent company Itel.¹⁰⁰

Interestingly, even though the conflict arose because Frost & Jacobs failed to discover a potential conflict in its representation of Itel Rail, and the conflict arguably could have been prevented by an adequate conflicts check, the court characterized the conflict as one caused by the client's business actions.¹⁰¹ The court further concluded that because neither party realized the conflict, the conflict arose in-

⁹³ *Id.* at 792. *But see* Rotunda, *supra* note 5, at 660 (criticizing *Stratagem* test as having "enormous implications" because "[a] law firm could have trouble suing a corporation (such as General Motors) if any one of the law firm's clients owned any stock in General Motors because the liabilities (and even the potential liabilities) of General Motors affect its bottom line").

⁹⁴ *Stratagem*, 756 F. Supp. at 793.

⁹⁵ *See Cincinnati Bell, Inc. v. Anixter Bros.*, No. C-1-93-0871, 1994 U.S. Dist. LEXIS 21012, at *9 (S.D. Ohio Jun. 24, 1994).

⁹⁶ *Id.* at *4-5.

⁹⁷ *Id.* at *7-8.

⁹⁸ *Id.* at *8.

⁹⁹ *Id.*

¹⁰⁰ *Cincinnati Bell*, 1994 U.S. Dist. LEXIS 21012, at *8.

¹⁰¹ *See id.* at *7.

nocently.¹⁰² But in actuality, *Cincinnati Bell* is factually distinct from true no-fault conflict cases.¹⁰³

Despite finding the law firm to be without fault, the court went on to condemn the conflict with strong words.¹⁰⁴ The court stated, "We cannot imagine how an attorney can maintain a duty of undivided loyalty to a client, while at the same time zealously attempting to exact millions of dollars of damages from a sister corporation."¹⁰⁵ *Cincinnati Bell* therefore exemplifies a per se prohibition of adversity to a current client because of the "direct effects upon the financial well-being" of the parent company and the resulting financial impact on the sister company.¹⁰⁶ The court justified this result by interpreting Canon 5 of the *Model Code* to mean that the "very threat of divided loyalty is a basis for disqualification."¹⁰⁷

B. Widespread Rejection of the Per Se Rule

The per se disqualification rule of *Stratagem* and *Cincinnati Bell* has had followers, but the majority of courts have instead adopted a more flexible test to determine whether a law firm can undertake representation adverse to the corporate family member of a current client without consent.¹⁰⁸ In fact, most cases citing *Stratagem* do not apply the per se rule of disqualification but instead adopt a more pragmatic balancing test.¹⁰⁹ In addition, the cases on which *Stratagem* relies only weakly support a per se rule in corporate family conflicts.¹¹⁰

The American Bar Association Committee on Ethics and Professional Responsibility ("Committee") directly addressed the question

¹⁰² See *id.* at *8.

¹⁰³ Compare *id.*, with *Gould, Inc. v. Mitsui Mining Co.*, 738 F. Supp. 1121, 1127 (N.D. Ohio 1990) (noting that the conflict was created by a client acquisition of another corporation after the law suit had begun).

¹⁰⁴ *Cincinnati Bell*, 1994 U.S. Dist. LEXIS 21012, at *9.

¹⁰⁵ See *id.*

¹⁰⁶ See *id.*

¹⁰⁷ *Id.* at *9-10 (quoting *Pennwalt Corp. v. Plough Inc.*, 85 F.R.D. 264, 271 (D. Del. 1980)).

¹⁰⁸ See, e.g., RESTATEMENT, *supra* note 19, at § 121 Reporter's Note cmt. d (commenting that most cases and Restatement reject per se rule and look at direct impact of the adversity on representation); Sacksteder, *supra* note 9, at 749 (noting that per se rule prohibiting representation against the corporate affiliate of a client has followers but majority approach is more flexible one that looks at the facts and circumstances); see also Rotunda, *supra* note 5, at 669 (criticizing the *Stratagem* line of cases).

¹⁰⁹ See, e.g., *Colorpix Sys. of Am. v. Broan Mfg. Co.*, 131 F. Supp. 2d 331, 336 (D. Conn. 2001).

¹¹⁰ See Rotunda, *supra* note 5, at 667.

of whether a lawyer who represents a corporate client may represent another client adverse to the affiliate of that corporate client in an unrelated manner.¹¹¹ Their Opinion rejected the application of a *per se* rule in a corporate affiliate conflict situation, regardless of whether the affiliate is wholly-owned or has a more tenuous ownership connection with the original client.¹¹² The test is not affiliation itself, but whether the circumstances of the client-lawyer relationship are such that the client has a reasonable expectation, known to the law firm, that its affiliate will be treated as a client for conflicts purposes.¹¹³

Moreover, the Opinion clarifies that Model Rule 1.7(a) applies only if two conditions are met.¹¹⁴ First, the corporate affiliate must be considered a client.¹¹⁵ Second, the representation must be directly adverse.¹¹⁶ If both conditions are met, the representation is prohibited unless the lawyer reasonably believes that the representation will not be adversely affected and both clients consent.¹¹⁷

If the corporate affiliate is not considered a client, then Rule 1.7(b) is applicable.¹¹⁸ Under Rule 1.7(b), if a lawyer's representation of a client may be materially limited by the lawyer's duties to another person or entity, such as an affiliate of another client, the lawyer is prohibited from accepting the representation.¹¹⁹ An exception is allowed if the attorney obtains consent from the client whose representation may be materially limited and the lawyer reasonably believes that the representation will not be adversely affected.¹²⁰

To determine whether the corporate affiliate is also a client, the Committee stated that although the *Model Rules* could be interpreted otherwise, Rule 1.13 includes a presumption that an organization is considered separate from its constituents for conflict of interest purposes.¹²¹ Whether the affiliate is considered a client thus depends on the particular circumstances of the relationship, and is a matter of implied or express contract.¹²² If, however, the client has an expecta-

¹¹¹ Formal Op. 390, *supra* note 8.

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *See id.*

¹¹⁵ *Id.*

¹¹⁶ Formal Op. 390, *supra* note 8.

¹¹⁷ *See id.*

¹¹⁸ *Id.*; *see* MODEL RULES OF PROF'L CONDUCT R. 1.7(b).

¹¹⁹ Formal Op. 390, *supra* note 8.

¹²⁰ MODEL RULES OF PROF'L CONDUCT R. 1.7(b).

¹²¹ Formal Op. 390, *supra* note 8.

¹²² *See id.* An agreement could be in the form of an explicit letter of engagement, or could come about as a result of reasonable expectations on the part of the client and the

tion that corporate affiliates will be protected as clients from adverse representation, the Committee believes that lawyers who perform only a limited role for the client should not be expected to be current on all corporate affiliations and that the burden is on the client to keep the lawyer informed.¹²³ Therefore, the Committee stated that a lawyer who has no reason to know of the conflict will not necessarily violate the ethics rules by accepting new representation without client consent.¹²⁴

To determine whether the particular circumstances indicate a client relationship with the affiliate, the Committee examined whether the nature of the lawyer's dealings was intended to benefit all subsidiaries and involved obtaining confidential information from these subsidiaries.¹²⁵ Adverse representation against a corporate affiliate may be particularly problematic when the lawyer has had access to confidential information through her previous work for the corporate client that could be used against the affiliate.¹²⁶ In addition, if the relationship is more attenuated, the affiliate could still be considered a client if the lawyer-client relationship is such that the affiliate reasonably believes that it is a client.¹²⁷ This is exemplified where the legal teams of the affiliate and the corporate client are closely linked.¹²⁸ Finally, a lawyer may be required to consider a client's affiliate as a client when the two corporations are alter-egos.¹²⁹ An alter-ego is characterized by a disregard of corporate formalities or a complete overlap of management and board of directors.¹³⁰

Significantly, a mere economic impact on the affiliate that results in an economic impact on the corporate client, does not warrant disqualification.¹³¹ While it directly impacts a non-client, the affiliate, the

subsequent actions of the lawyer in failing to dispel or disagree with such expectations. *Id.* The committee relies heavily on a tentative draft of the *Restatement (Third) of the Law Governing Lawyers*, which provides that a lawyer-client relationship is created when a person indicates that they require legal services and the lawyer somehow indicates consent to provide those services or fails to indicate lack of consent when he knows or should know that the prospective client reasonably expects such services. *See id.*

¹²³ *Id.*

¹²⁴ *Id.* (citing *Pennwalt Corp. v. Plough, Inc.*, 85 F.R.D. 264, 266 (D. Del. 1980)).

¹²⁵ *See id.*

¹²⁶ *See* Formal Op. 390, *supra* note 8.

¹²⁷ *See id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.* Note that this formulation of the alter-ego analysis is often broader than that used in corporate law. *See* Wolfram, *supra* note 85, at 347-48.

¹³¹ Formal Op. 390, *supra* note 8.

representation is only indirectly adverse to the client.¹³² Finally, the Committee noted Rule 1.7(b) limits the lawyer's representation where a lawyer cannot recommend or carry out an appropriate course of action because of other responsibilities or loyalties.¹³³ Here the Committee worries that the attorney's concern for pleasing one client might compromise his professional judgment in advising another client.¹³⁴

The Opinion also advises a law firm to clarify which of its clients' corporate affiliates are to be considered its clients for conflicts of interest purposes from the onset of the representation.¹³⁵ This understanding is not, however, mandatory.¹³⁶

The dissents to the Opinion are concerned that the majority departed from the traditional interpretation of the *Model Rules* and shifted the burden of protection from the lawyer to the client in requiring it to bargain for protection of its affiliates.¹³⁷ Furthermore, the dissenters believe that considering economic impact as merely indirect conflict is an inaccurate portrayal of the business world.¹³⁸ Indeed, the dissent states that outside the Fortune 500, most companies would find a suit that imposed economic harm as a clear conflict of interest.¹³⁹

In 2001, in *Colorpix Systems v. Broan Manufacturing Co.*, the United States District Court for the District of Connecticut, consistent with the ABA Ethics Opinion, as well as the dominant approach in the United States Court of Appeals for the Second Circuit, rejected the per se rule.¹⁴⁰ Defendant Broan Manufacturing Co. ("Broan") moved to disqualify the law firm of Robinson & Cole ("R&C") from representing the plaintiff, Travelers Casualty and Surety Company of Illi-

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ Formal Op. 390, *supra* note 8.

¹³⁷ See *id.* (Amster, dissenting). But see Romansic, *supra* note 7, at 311 (claiming that corporations have no choice but to bargain for firms to recognize their affiliates as clients and firms can respond with higher fees representing lost opportunities).

¹³⁸ Formal Op. 390, *supra* note 8 (Fox, dissenting).

¹³⁹ *Id.* (Amster, dissenting). The dissents feel that distinguishing subsidiaries, particularly wholly owned subsidiaries, from divisions, for example, ignores the legal and other requirements that may force such a distinction. *Id.* They feel that the majority puts the responsibility of protection on the client, sacrificing smaller business that may not be as savvy as Fortune 500 companies that can clearly negotiate the scope of every representation. *Id.*

¹⁴⁰ *Colorpix Sys. v. Broan Mfg. Co.*, 131 F. Supp. 2d 331, 336 (D. Conn. 2001).

nois ("Travelers"), because R&C represented Broan's parent company, Nortek, Inc., in a prior suit.¹⁴¹ The *Colorpix* case, unlike *Stratagem*, involved a former client relationship, but the issue of whether Broan was a client of R&C for conflicts of interest purposes still arose.¹⁴² The court noted that Broan was a wholly-owned subsidiary of Nortek and that a significant share of Nortek's business was comprised of Broan and Nordyne, Inc., another wholly-owned subsidiary.¹⁴³ In addition, Broan and Nordyne shared a legal department, management personnel and business strategy.¹⁴⁴ The court stated that whether there is a former or current client relationship, and whether the client is traditional or attenuated, is immaterial for purposes of the conflicts of interest standard.¹⁴⁵ To determine whether Broan was a client of R&C, the court asked whether there were "sufficient aspects" of a traditional client relationship to trigger protection, not whether there was actually such a relationship.¹⁴⁶

The *Colorpix* court did not interpret *Stratagem* to require a per se test.¹⁴⁷ Instead, it cited *Stratagem* for the proposition that financial impact "weighs in favor of finding a conflict of interest."¹⁴⁸ According to *Colorpix*, elements of the "facts and circumstances" test include the level of control over the subsidiaries' litigation, coordinated business strategy, and whether the entities are alter-egos of one another because they share management and legal departments.¹⁴⁹ The court concluded that because Broan was a wholly-owned subsidiary of Nor-

¹⁴¹ *Id.* at 333.

¹⁴² *Id.* at 336 n.1. Interestingly, the court analyzes the conflict of interest question under the more lenient former client standard even though R&C represented Nortek while at the same time suing Broan in the *Colorpix* case. *See id.* The court concludes that the former client standard is warranted, perhaps because R&C did not impermissibly drop a client like a "hot potato" but because the Nortek representation ended naturally when the opposing party withdrew its complaint. *See id.*

¹⁴³ *Id.* at 337.

¹⁴⁴ *Id.*

¹⁴⁵ *See Colorpix*, 131 F. Supp. 2d at 336.

¹⁴⁶ *Id.*

¹⁴⁷ *See id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 336-38. *Colorpix* relies heavily on *Ramada Franchise Sys., Inc. v. Hotel of Gainesville Assoc.* *See id.* at 336, 337, 338. The court in *Ramada* recognized differing approaches as to whether an affiliated entity is protected, but looked to a pragmatic line of cases that focused not on "labels" but instead on the "facts and circumstances" involved. 988 F. Supp. 1460, 1464 (N.D.Ga. 1991). The court found that because the three companies involved, all had "substantially similar management" personnel, shared the same headquarters, and had the same corporate philosophies and shared a single legal department, there was sufficient "identity of interest" among them to consider there to be a conflict of interest. *Id.* at 1465.

tek and comprised a substantial share of Nortek's business, any claim against Broan would directly and adversely affect Nortek's "bottom line."¹⁵⁰ Furthermore, the connection between the legal departments and sharing of corporate management personnel and business philosophy meant Broan had a sufficient attorney-client relationship with R&C to create a potential conflict.¹⁵¹

In 1989, in *Hartford Accident & Indemnity Co. v. RJR Nabisco, Inc.*, the United States District Court for the Southern District of New York again applied the facts and circumstances test developed in the Second Circuit.¹⁵² To determine whether there was a traditional client relationship requiring disqualification, the *Hartford* court considered whether the parent and subsidiary were distinct and separate entities for the purposes of legal representation.¹⁵³ In *Hartford*, the court concluded there was a traditional relationship because the general counsel of the parent retained a supervisory role over the subsidiary.¹⁵⁴ The court, however, also found that the relationship was not a continuing one, such that the less stringent substantial relationship test could be applied to determine disqualification.¹⁵⁵ The court also found an exception to the "hot-potato" doctrine, which prohibits applying the less stringent former-client conflict test when a law firm drops a client, was warranted in *Hartford* because the law firm did not drop its client.¹⁵⁶ Instead, the client's long-time lawyer merely left the firm with the client in tow.¹⁵⁷ Therefore, the less stringent test was applied by the court and disqualification was ultimately unnecessary.¹⁵⁸

As shown, the preferred approach of most courts to a corporate family conflict is a balancing of the facts and circumstances.¹⁵⁹ In these cases, presumption of loyalty to a client's affiliate is rejected and adversity to the corporate affiliate of a client is treated as merely indi-

¹⁵⁰ *Colorpix*, 131 F. Supp.2d at 337.

¹⁵¹ *Id.* (noting Broan and Nortek shared the same vice president, secretary and general counsel).

¹⁵² 721 F. Supp. 534, 538 (S.D.N.Y. 1989).

¹⁵³ *Id.* at 539-40.

¹⁵⁴ *Hartford Accident & Indem.*, 721 F. Supp. at 539-40.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 540-41.

¹⁵⁷ *Id.* The client, R.J. Reynolds Tobacco Company (Reynolds) left the firm of Murphy & Mitchell, P.C. for LeBoeuf when attorney Donald J. Wood changed firms. *Hartford Accident & Indemnity*, 721 F. Supp. at 536. When Wood left LeBoeuf Reynolds also left. *Id.* at 541.

¹⁵⁸ *Id.* at 541-42.

¹⁵⁹ See *supra* notes 108-158 and accompanying text.

rect.¹⁶⁰ Instead, the courts look to the relationship between the client and the law firm, and the client and its affiliate, to determine if there are enough similarities to a traditional client relationship that the same loyalty concerns are raised and the same strict duties should be imposed.¹⁶¹

III. CONFLICTS CAUSED BY THE CLIENT

Within the complex framework of current conflicts of interest, some cases address a conflict that arises through the actions of the client and not through those of the law firm.¹⁶² There is, however, considerable disagreement as to how this element should work into the basic framework of either the per se or the balancing tests.¹⁶³ There are three basic approaches to the problem.¹⁶⁴ The first two approaches developed in the case law, one following from the per se framework of *Stratagem Development Corp. v. Heron International N.V. & Heron Properties, Inc.*,¹⁶⁵ the second from the cases that reject a per se conflict rule in the corporate family situation.¹⁶⁶ The third approach has no case support and originates from a strict reading of the *Restatement*.¹⁶⁷ All three approaches, even the per se test, address the fault issue by incorporating a balancing test, but differ in how this test is applied.

A. Gould: A Per Se Approach with a Balancing Test Exception

The first approach seen in the case law deals with the problem of a no-fault conflict that arises when the court uses the per se conflict rule seen in *Stratagem*.¹⁶⁸ This approach was used by the United States District Court for the Northern District of Ohio in 1990 in *Gould, Inc. v. Mitsui Mining & Smelting Co.*¹⁶⁹ *Gould* has been widely cited to support an exception to the hot potato rule when a current conflict is

¹⁶⁰ See *supra* notes 108–158 and accompanying text.

¹⁶¹ See *supra* notes 108–158 and accompanying text.

¹⁶² See *infra* notes 168–278 and accompanying text.

¹⁶³ See *infra* notes 168–278 and accompanying text.

¹⁶⁴ See *infra* notes 168–278 and accompanying text.

¹⁶⁵ See *infra* notes 168–192 and accompanying text.

¹⁶⁶ See *infra* notes 193–267 and accompanying text.

¹⁶⁷ See *infra* notes 268–278 and accompanying text.

¹⁶⁸ See *Gould, Inc. v. Mitsui Mining & Smelting Co.*, 738 F. Supp. 1121, 1125 (N.D. Ohio 1990).

¹⁶⁹ See *id.*

caused by client action.¹⁷⁰ The per se rule is applied and disqualification is presumed, but a second step mitigates this strict rule by allowing withdrawal if the facts and circumstances warrant.¹⁷¹ In other words, a conflict is presumed but the law firm has the option to drop either client at its own discretion if it was not at fault.¹⁷² Once the law firm is allowed to convert the problem client into a former client the conflict is then analyzed under the more permissive standard for former client conflicts.¹⁷³

In *Gould*, the plaintiff, Gould, Inc., was represented by the law firm Jones, Day, Reavis & Pogue ("Jones, Day") against multiple defendants including Pechiney and Trefimetaux ("Pechiney").¹⁷⁴ Pechiney moved to disqualify Jones, Day as Gould's counsel because of two conflicts of interest created by a complex sequence of events including a law firm merger and a client acquisition.¹⁷⁵ In 1985, Gould filed suit against Pechiney with Jones, Day as local counsel.¹⁷⁶ In 1987, Pechiney, which had been represented by McDougall, Hersh & Scott in patent matters wholly unrelated to the suit at hand, became a client of Jones, Day as a result of the merger of the law firms of McDougall, Hersh & Scott and Jones, Day.¹⁷⁷ In addition, in 1989 Pechiney acquired IG Technologies Inc. ("IGT"), which Jones, Day represented in numerous matters unrelated to the suit against Pechiney.¹⁷⁸ Thus, after the acquisition, Jones, Day was put in the position of suing Pechiney, the parent company of its client IGT.¹⁷⁹ Pechiney claimed that Jones, Day should be disqualified because of the conflicts.¹⁸⁰

In approaching the issue, the *Gould* court considered two questions.¹⁸¹ First, whether Jones, Day violated Canon 5 of the *Model Code*, and, second, if such a violation occurred, whether disqualification was necessary.¹⁸² The court, applying a per se approach, stated that suing

¹⁷⁰ See RESTATEMENT, *supra* note 19, § 132 Reporter's Note cmt. j; HAZARD, *supra* note 82, § 1.7:207.

¹⁷¹ *Gould*, 738 F. Supp. at 1127.

¹⁷² *Id.*

¹⁷³ See generally *id.* at 1128.

¹⁷⁴ *Id.* at 1122.

¹⁷⁵ *Id.* at 1123-24.

¹⁷⁶ *Gould*, 738 F. Supp. at 1122-23.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 1123.

¹⁷⁹ *Id.* at 1123-24.

¹⁸⁰ *Id.*

¹⁸¹ *Gould*, 738 F. Supp. at 1124-25.

¹⁸² *Id.*

a client's corporate affiliate was the same as suing the client itself.¹⁸³ The court then concluded that consent to the conflict was required not only by Gould but also by Pechiney, the non-client and parent of the client IGT.¹⁸⁴

Yet, while it applied a per se rule, the court also recognized the conflict was caused by the client not the law firm.¹⁸⁵ The court therefore created a second step in the analysis, asking whether there should actually be disqualification, or whether the remedy of selective withdrawal (an exception to the hot potato rule) would be appropriate.¹⁸⁶ The court advocated a balancing approach to take into account the changing corporate environment and increasing merger activity.¹⁸⁷ In applying this balancing test, the *Gould* court found that judicial integrity was not threatened because, among other factors, no information or confidences were compromised and Pechiney created the conflict by acquiring IGT after the suit had commenced.¹⁸⁸ Therefore, while the first prong of the test in *Gould* is a per se disqualification rule, it is softened by allowing an exception under the second prong: a balancing of the facts and circumstances, including the law firm's fault.¹⁸⁹

Although *Gould* has spurred a line of cases applying some version of an exception to the hot potato rule, most cases do not actually seem to use a two step test.¹⁹⁰ Instead, they skip the per se analysis and use a facts and circumstances test that considers the fault of the law firm as one element.¹⁹¹ This is consistent with the widespread rejection of a per se approach discussed earlier.¹⁹²

B. Facts and Circumstances Test

The United States Courts of Appeals for the Second, Third, and Ninth Circuits all favor some type of a balancing test over a per se standard to determine whether corporate family members should be

¹⁸³ *Id.* at 1125.

¹⁸⁴ *Id.* at 1126.

¹⁸⁵ *Id.* at 1127.

¹⁸⁶ *Gould*, 738 F. Supp. at 1124-25.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 1126-27.

¹⁸⁹ *Id.*

¹⁹⁰ See *infra* notes 193-267 and accompanying text.

¹⁹¹ See *infra* notes 193-267 and accompanying text.

¹⁹² See *supra* notes 108-158 and accompanying text.

considered the same client for current conflict purposes.¹⁹³ In practice, per se jurisdictions treat corporate affiliates as the same client, and therefore automatically remedy a conflict through disqualification or withdrawal.¹⁹⁴ To determine whether disqualification or withdrawal is appropriate, courts implement a balancing test.¹⁹⁵ In contrast, in jurisdictions that favor the second "facts and circumstances" approach, the test has only one step.¹⁹⁶ This step is a balancing test where the law firm's lack of fault is merely one factor to consider in determining whether the law firm should be disqualified, forced to withdraw, or whether representation can continue.¹⁹⁷

In 1980, the United States District Court for the District of Delaware decided *Pennwalt Corp. v. Plough*.¹⁹⁸ Plaintiff Pennwalt Corporation's ("Pennwalt") counsel, Dechert, Price & Rhoads ("Dechert") also currently represented the defendant's sister corporation, Scholl, Inc., in an unrelated suit.¹⁹⁹ Dechert continuously represented Pennwalt in litigation matters starting in 1956.²⁰⁰ In 1977, Pennwalt began considering a law suit against Plough.²⁰¹ In 1978, Dechert became the defense counsel for Scholl in an unrelated anti-trust case.²⁰² In 1979, Schering-Plough, the parent company of Plough, acquired Scholl as a wholly-owned subsidiary.²⁰³ Approximately one month later, Dechert instituted the lawsuit against Plough on behalf of Pennwalt, and only later became aware of the corporate relationship.²⁰⁴

Dechert was allowed to withdraw from representing Scholl, leaving the court to consider Plough's attempt to disqualify it from representing Pennwalt.²⁰⁵ Plough urged a per se rule of disqualification because any action against it would necessarily harm its affiliate

¹⁹³ See, e.g., *Teradyne, Inc. v. Hewlett-Packard Co.*, No. C-91-0344 MHP ENE, 1991 U.S. Dist. LEXIS 8363, *10, 15 (Jun. 6, 1991); *Hartford Accident & Indem. Co. v. RJR Nabisco, Inc.*, 721 F. Supp. 534, 538 (S.D.N.Y. 1989); *Pennwalt Corp. v. Plough*, 85 F.R.D. 264, 272(D. Del. 1980); *Brooklyn Navy Yard Cogeneration Partners v. Superior Court*, 60 Cal. App. 4th 248, 253 (1997).

¹⁹⁴ See, e.g., *Gould*, 738 F. Supp. at 1127.

¹⁹⁵ See *id.* at 1126-27.

¹⁹⁶ *Pennwalt*, 85 F.R.D. at 269.

¹⁹⁷ See *id.* at 269, 272.

¹⁹⁸ *Id.* at 264.

¹⁹⁹ *Id.* at 266.

²⁰⁰ *Id.* at 265.

²⁰¹ *Pennwalt*, 85 F.R.D. at 265.

²⁰² *Id.*

²⁰³ *Id.* at 266.

²⁰⁴ *Id.* Note once Dechert was aware of the conflict it failed to inform its clients. *Id.*

²⁰⁵ *Id.* at 267.

Scholl.²⁰⁶ In contrast, Dechert argued that because it never represented either Plough or Schering-Plough there was no ethical duty implicated in being adverse to them.²⁰⁷ Furthermore, Dechert argued that the conflict was the fault of Schering-Plough because it was created by its purchase of Scholl.²⁰⁸

The court analyzed the issues under a *Model Code* framework and rejected the positions of both parties.²⁰⁹ The court rejected the per se rule because neither Schering-Plough nor Plough were clients of Dechert and all the companies were distinct legal entities.²¹⁰ Instead, the court used the facts and circumstances test to determine if the ultimate objectives of the *Code*, undivided loyalty and confidentiality, were violated.²¹¹ To determine whether there is a threat to loyalty, a court following *Pennwalt* should consider the relationship between the sister corporations to determine to what degree the representation of one client may be influenced by a regard for the other client.²¹² The *Pennwalt* court concluded that there was no threat of disloyalty because the conflict arose significantly after the actions began.²¹³ Although Scholl and Plough were in the process of merging their personnel and operations, including their legal departments, these changes had not yet taken place at the time of Dechert's withdrawal from representing Scholl.²¹⁴ Therefore, under the formula in *Pennwalt*, the integration of the legal departments and a close structural relationship between the sister companies could implicate loyalty.²¹⁵ More interestingly, it was important to the court's analysis that the conflict arose through the actions of one of the clients and not the law firm.²¹⁶ The court ultimately concluded that there was no threat to loyalty and no conflict, such that Dechert's withdrawal never implicated the hot potato rule.²¹⁷ Importantly, Dechert had to withdraw because of the impending conflict created as the legal departments of Scholl and Schering-Plough merged.²¹⁸ Implicitly, if there had been

²⁰⁶ *Pennwalt*, 85 F.R.D. at 268.

²⁰⁷ *Id.*

²⁰⁸ *Id.*

²⁰⁹ *Id.*

²¹⁰ *Id.* at 268-69.

²¹¹ *Pennwalt*, 85 F.R.D. at 269.

²¹² *Id.* at 271-72.

²¹³ *Id.*

²¹⁴ *Id.*

²¹⁵ *See id.* at 272.

²¹⁶ *Pennwalt*, 85 F.R.D. at 272.

²¹⁷ *Id.* at 272-73.

²¹⁸ *See id.* at 272.

no such operational integration then withdrawal might not have been necessary.²¹⁹

The Second Circuit has a well-defined approach that uses a similar balancing test for the current conflict of interest question.²²⁰ If the law firm is adverse to a "traditional client," or if the legal relationship is a continuing one, a strict prima facie rule against representation is applied.²²¹ If the client is neither traditional nor continuing then it can be treated as a former client and the more permissive substantial relationship test is applied.²²² Most courts then look at factors such as links between the affiliates in terms of management and legal decision-making to determine if they are separate entities or should be considered one traditional client.²²³ Courts consider whether the law firm was at fault as relevant to whether the relationship is continuing.²²⁴ Therefore, like in *Pennwalt* and the second step of *Gould*, although it is normally unacceptable to terminate a client relationship after a conflict arises and then use a more lenient conflicts test, courts will allow this exception to the hot potato rule where the facts and circumstances warrant it.²²⁵ Namely, an exception to the hot potato doctrine is allowed when the client and its affiliate are not so closely connected that they should be treated as one client, and where the conflict is not the fault of the law firm.²²⁶

This approach was followed in 2000, in *University of Rochester v. G.D. Searle & Co.*, where the United States District Court for the Western District of New York balanced the facts and circumstances and determined that disqualification was not warranted.²²⁷ In this case, a law firm represented the University of Rochester against the subsidiary of its client Pharmacia because of Pharmacia's subsequent merger with Upjohn and Monsanto, to whom Searle previously was related.²²⁸ The court used a balancing test, considering several factors including the unexpected nature of the merger that caused the conflict, and that substantial work had been done by the firm prior to the

²¹⁹ See *id.*

²²⁰ See, e.g., *Hartford Accident & Indem.*, 721 F. Supp. at 538.

²²¹ See *id.*

²²² See *id.* at 539.

²²³ See, e.g., *id.* at 540; *Pennwalt*, 85 F.R.D. at 272.

²²⁴ See, e.g., *Univ. of Rochester v. G.D. Searle & Co.*, 00-CV-6161L(B), 2000 U.S. Dist. LEXIS 19030, *26-27 (W.D.N.Y. Dec. 11, 2000).

²²⁵ See, e.g., *Gould*, 738 F. Supp. at 1127; *Pennwalt*, 85 F.R.D. at 272.

²²⁶ See, e.g., *Gould*, 738 F. Supp. at 1127; *Pennwalt*, 85 F.R.D. at 272.

²²⁷ See 2000 U.S. Dist. LEXIS 19030, at *22, 25.

²²⁸ *Id.* at *9, 10.

merger.²²⁹ Attempting to avoid the hot potato rule, the law firm withdrew from the prior representation for the merged company and claimed that this cured its conflict.²³⁰ The court agreed that an exception was warranted, citing several factors in support of withdrawal.²³¹ These factors included the conflict created by a client business decision, and the law firm's prompt reaction to the conflict once it was discovered.²³²

This approach can also be seen in *In re Wingspread Corp.*, where the trustee of Wingspread Corporation and its subsidiaries sought to retain Hahn & Hessen as its counsel against NCNB National Bank of North Carolina ("NCNB").²³³ The parent of NCNB, NationsBank Corporation ("NationsBank"), sought to disqualify Hahn & Hessen because Hahn & Hessen was counsel for Citizens, a NationsBank subsidiary, in unrelated matters.²³⁴ The conflict was created by a merger that made NationsBank the parent company of both NCNB and Citizens.²³⁵ Due to the merger, Hahn & Hessen was representing one sister company of the NationsBank family while suing another.²³⁶ The court first asked whether the relationship between Hahn & Hessen and NationsBank was attenuated and vicarious or a traditional client relationship.²³⁷ The court considered that Hahn & Hessen never represented NationsBank or any other subsidiaries before the merger, and after the merger continued to represent only Citizens as a separate entity from NationsBank.²³⁸ Furthermore, NationsBank's extended corporate structure sufficiently distanced NationsBank from Hahn & Hessen.²³⁹ The court also looked to whether the representation was current, and found that there was minimal work, only approximately eight hours, done for Citizens since the dismissal of the last case.²⁴⁰ The court noted that withdrawal is usually not allowed to cure a current conflict.²⁴¹ In this case, however, the more lenient sub-

²²⁹ See *id.* at *21-30.

²³⁰ *Id.* at *27.

²³¹ *Id.* at *21-30.

²³² *Uniu. of Rochester*, 2000 U.S. Dist. LEXIS 19030, at *29.

²³³ 152 B.R. 861, 862 (Bankr. S.D.N.Y. 1993).

²³⁴ *Id.* at 862.

²³⁵ *Id.* at 862-63.

²³⁶ *Id.*

²³⁷ *Id.* at 863-64.

²³⁸ *In re Wingspread*, 152 B.R. at 864.

²³⁹ *Id.*

²⁴⁰ *Id.* at 865.

²⁴¹ *Id.* at 864.

stantial relationship test was appropriate because the conflict was created by a client action after representation commenced.²⁴²

In *Teradyne, Inc. v. Hewlett-Packard Co.*, a 1991 case decided by the United States District Court for the Northern District of California, the court used an "alter-ego" test to determine whether corporate affiliates were to be treated as the same client for conflicts purposes.²⁴³ The alter-ego approach in *Teradyne* has significant similarities to the balancing approach.²⁴⁴ The court found that the intimate connection between the two affiliates made them alter-egos.²⁴⁵ The connections between the two affiliates included supervision of legal work for the subsidiary by the parent's legal department, regular instructions to the subsidiary's law firm by the parent corporation's management, the direction of correspondence and billing by the subsidiary's law firm to the parent, and the full integration of most of the subsidiary's employees and business to the parent company.²⁴⁶ The court found this significant identity of legal interest key in finding the companies to be alter-egos of one another for conflicts purposes.²⁴⁷

In 1991, in *Ex parte AmSouth Bank, N.A.*, the Supreme Court of Alabama addressed the issue of concurrent adverse representation not created by the law firm.²⁴⁸ The plaintiff, AmSouth, attempted to disqualify counsel for defendant, Drummond Company, Inc.²⁴⁹ In 1990, AmSouth approached Arnold & Porter to represent it in some transactional undertakings.²⁵⁰ Three months later, Arnold & Porter was retained by Drummond in regards to a suit by a minority stockholder of ABC who complained of a merger process.²⁵¹ AmSouth was trustee for a number of trusts that held ABC stock, and sued Drummond two months later.²⁵² Arnold & Porter decided to withdraw from its representation of AmSouth but continued to represent Drummond.²⁵³ The parties stipulated that Arnold & Porter's work for

²⁴² *Id.* at 865.

²⁴³ *Teradyne*, 1991 U.S. Dist. LEXIS 8363, *10-11.

²⁴⁴ See *supra* notes 193-267 and accompanying text.

²⁴⁵ *Teradyne*, 1991 U.S. Dist. LEXIS 8363, at *14-16.

²⁴⁶ *Id.* at *10-12.

²⁴⁷ See *id.* at *14-15. But see Wolfram, *supra* note 85, at 346 (criticizing alter-ego formula because in "[w]renching the alter ego notion out of the fraud-prevention context for purposes of determining whether a client-lawyer conflict exists risks serious distortion").

²⁴⁸ *Ex parte AmSouth Bank, N.A.*, 589 So. 2d 715, 719 (Ala. 1991).

²⁴⁹ *Id.* at 716

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² *Id.* at 716-17.

²⁵³ *AmSouth Bank*, 589 So. 2d at 717.

Drummond in the case was unrelated to its prior transactional work for AmSouth.²⁵⁴ The court then found that there was no threat to confidentiality.²⁵⁵

Although this case did not involve corporate family conflicts, but rather the more stringent rules of a traditional conflict, the court gives an enlightening consideration of a conflict caused by the subsequent actions of the clients and not the law firm.²⁵⁶ The court found that although lawyers ordinarily cannot shift from a Rule 1.7 (current client) to a Rule 1.9 (former client) test by dropping a client as Arnold & Porter did, the conflict was caused by AmSouth's suit, not by the law firm.²⁵⁷ The court acknowledged the hot potato rule but distinguished it from the facts of the case, holding that Arnold & Porter could permissibly drop one of its clients because the conflict was not its fault and disqualification would be unfair.²⁵⁸ The court also noted that Arnold & Porter sought a waiver as soon as the conflict became apparent, and that the decision to withdraw from one client and not the other was made after careful consideration of its duty of loyalty to both clients.²⁵⁹

In conclusion, the elements of the facts and circumstances test have varied when applied by different courts.²⁶⁰ However, the most common elements include: prejudice to one of the parties from losing its chosen representation;²⁶¹ financial impact on the traditional client;²⁶² the importance the traditional client affiliate places on the litigation including supervision of the litigation;²⁶³ "identity of interest" between the corporate affiliates including sharing personnel, management, and legal departments;²⁶⁴ whether the law firm was at

²⁵⁴ *Id.*

²⁵⁵ *See id.* at 718.

²⁵⁶ *See id.* at 719.

²⁵⁷ *Id.*

²⁵⁸ *See AmSouth Bank*, 589 So. 2d at 719–20.

²⁵⁹ *Id.* at 719.

²⁶⁰ *See supra* notes 193–267 and accompanying text.

²⁶¹ *See Rotunda, supra* note 5, at 685–86 (noting that in *Gould*, although the law firm acted inappropriately in failing to either obtain consent or notify its clients of the conflict, disqualification was not warranted because of the balance of time and money and lack of fault).

²⁶² *See Wolfram, supra* note 85, at 358.

²⁶³ *See Rotunda, supra* note 5, at 685 (noting that if "the same people act for both [entities] in retaining and actively supervising the outside lawyer" it is "an important factor to consider in determining" whether corporate formalities should be ignored).

²⁶⁴ *See id.* at 684–85 (suggesting "it may be appropriate to pierce the corporate veil" in an ethics issue "when the parent corporation has an integrated legal department with similar personnel"); Wolfram, *supra* note 85, at 358–59 (emphasizing the operational issues

fault in creating the conflict;²⁶⁵ and whether the law firm reacted promptly and appropriately upon discovering the conflict.²⁶⁶ These elements all directly address loyalty concerns, and ensure that the balancing test appropriately considers all factors that weigh towards disqualification, withdrawal, or continued representation in a corporate affiliate conflict situation.²⁶⁷

C. The *Restatement (Third) of the Law Governing Lawyers*

In comparison to the two case law approaches towards no-fault conflicts, the *Restatement* approach, read literally, is less flexible in its treatment of fault.²⁶⁸ The *Restatement* is valuable in that it explicitly spells out a balancing test to determine whether two affiliates should be treated as the same client such that there is a conflict.²⁶⁹ The balancing test involves considering four factors: (1) whether financial loss or benefit to the non-client corporate affiliate will have a direct, adverse impact on the client;²⁷⁰ (2) whether the lawyer's relationship to one client is such that another client's interests would be adversely affected;²⁷¹ (3) whether the client enjoys significant control of the non-client affiliate;²⁷² and (4) whether specific obligations such as confidentiality are compromised.²⁷³ This approach is similar to the facts and circumstances test developed in the case law and to the balancing test that is the second step of *Gould*.²⁷⁴ The fault element of the test does not, however, seem to be part of this balancing test.²⁷⁵ The comment to Section 132 instead seems to indicate that if the conflict was not the fault of the law firm then there is an automatic exception to the finding of a conflict under the balancing test.²⁷⁶ Indeed, this is the interpretation of the court in *University of Rochester*

involved when there is shared management but questioning the importance of shared legal departments).

²⁶⁵ See Rotunda, *supra* note 5, at 686.

²⁶⁶ See *id.*

²⁶⁷ See *Gould*, 738 F. Supp. at 1126.

²⁶⁸ Compare *Gould*, 738 F. Supp. at 1127, and *Univ. of Rochester*, 2000 U.S. Dist. LEXIS 19030, at *27-30, with *RESTATEMENT*, *supra* note 19, § 132 cmt. j.

²⁶⁹ See *RESTATEMENT*, *supra* note 19, § 121 cmt. d.

²⁷⁰ See *id.* § 121 cmt. d, illus. 6.

²⁷¹ *Id.* § 121 cmt. d, illus. 8.

²⁷² *Id.* § 121 cmt. d, illus. 9.

²⁷³ *Id.*

²⁷⁴ Compare *RESTATEMENT*, *supra* note 19, § 121 cmt. d, with *Gould*, 738 F. Supp. at 1127-28, and *Pennwalt*, 85 F.R.D. at 271-72.

²⁷⁵ See *RESTATEMENT*, *supra* note 19, § 121 cmt. d.

²⁷⁶ *Id.* § 132 cmt. j.

where the court looked to the *Restatement* but explicitly rejected its implication that there is an automatic exception.²⁷⁷ Instead, the court chose to use the no-fault element as merely one element of the balancing test.²⁷⁸

IV. ANALYSIS

A. *The Per Se Rule or the Balancing Test*

The preferred approach in addressing corporate family conflicts is one that looks at the facts and circumstances involved and determines whether ethical concerns are actually implicated.²⁷⁹ This method is superior to a per se approach because it is practical instead of theoretical.²⁸⁰ A flexible approach that looks at the facts and circumstances instead of automatically treating corporate affiliates as one client is more consistent with corporate formalities.²⁸¹ It also appropriately considers loyalty concerns by imposing disqualification, a harsh burden on the client's resources and right to counsel, only when there is an actual, not an imagined, threat to the integrity of the profession.²⁸² Finally, using a balancing of the facts and circumstances that includes the fault of the law firm, instead of the per se approach or the *Restatement* approach, renders an appropriate result that reflects actual loyalty concerns.²⁸³

A per se rule ignores corporate legal norms by treating corporate affiliates of a client as the same entity as the client itself.²⁸⁴ The per se rule allows a corporation to acquire a subsidiary, retain the protection of limited liability created by the corporate form, but at the same time

²⁷⁷ *Univ. of Rochester*, 2000 U.S. Dist. LEXIS 19030, at *29-30.

²⁷⁸ *Id.*

²⁷⁹ See Sacksteder, *supra* note 9, at 764 (arguing that per se rule inappropriately uses too broad a view of loyalty for the modern legal profession because it incorporates "more thorough-going loyalty as a person" versus "loyalty in the performance of a role").

²⁸⁰ See *supra* notes 168-267 and accompanying text.

²⁸¹ See *supra* notes 284-290 and accompanying text.

²⁸² See *infra* notes 291-301 and accompanying text.

²⁸³ See *infra* notes 302-326 and accompanying text.

²⁸⁴ Rotunda, *supra* note 5, at 655-56 (noting that under corporate law each member of a corporate family is treated separately except in the extremely rare case of veil piercing but this is opposite conflict of interest rules which routinely ignore corporate formalities). But see Wolfram, *supra* note 85, at 348-49 (asking why business decisions about corporate form having nothing to do with the retention of lawyers should control the scope of loyalty).

ignore any disadvantages in the realm of legal ethics.²⁸⁵ Notably, if the affiliate had chosen not to take advantage of a corporate family structure and had simply treated the acquisition as a new department, for instance, it would receive the full protection of client loyalty.²⁸⁶ Furthermore, in a conflict between the client and the affiliate the law firm's duty of loyalty would clearly be with the client.²⁸⁷ The per se rule is therefore inconsistent with standard treatment of corporate affiliates as separate entities.²⁸⁸ Additionally, corporate affiliate conflicts arise in regards to sophisticated clients with complex legal structures.²⁸⁹ A strict per se rule ignores the ability of large corporations with extensive affiliate structures to protect themselves by negotiating representation for their affiliates.²⁹⁰

Over-zealous disqualification, which can come from a per se rule, also ignores a number of important values.²⁹¹ This can lead to an unduly formalistic result, out of touch with reality, and ultimately undermining public confidence in the legal profession.²⁹² A per se rule undervalues the client's right to representation of its choice.²⁹³ In contrast, a more flexible approach correctly recognizes that disqualification is a serious remedy and a hardship on the party whose attorney is being disqualified.²⁹⁴ This is true in terms of both time

²⁸⁵ Rotunda, *supra* note 5, at 670 (criticizing rule which allows large corporations to create separate subsidiaries when it suits their purposes as well as to retain the benefits of being a single entity for disqualifying opposing counsel).

²⁸⁶ See *id.*

²⁸⁷ *Id.* (noting "for every purpose (except, apparently, for purposes of the law of conflicts) the law treats parents, subsidiaries, and sister corporations as separate and distinct legal entities").

²⁸⁸ See *id.*

²⁸⁹ See *id.* at 672.

²⁹⁰ See Rotunda, *supra* note 5, at 672-73. But see Wolfram, *supra* note 85, at 349-50 (criticizing rule that relies on agreements to protect clients because it may shift responsibility for addressing conflicts from the attorney to the client).

²⁹¹ See Boyd, *supra* note 59, at 23.

²⁹² See, e.g., *Panduit Corp. v. All States Plastic Mfg. Co.*, 744 F.2d 1564, 1576-77 (Fed. Cir. 1984) (noting over disqualification encourages "vexatious tactics and increased cynicism by the public").

²⁹³ See *Univ. of Rochester v. G.D. Searle & Co.*, 2000 U.S. Dist. LEXIS 19030, at *15 (W.D.N.Y. Dec. 11, 2000) (noting that disqualification is disfavored because it harms a client by separating him from his chosen counsel); Pasinan, *supra* note 6, at 173 (noting that each attorney-client relationship is unique and that the "bond of trust that develops between them should not be severed lightly"); Wolfram, *supra* note 85, at 327 (commenting on the importance of "long-standing counsel who know . . . [the clients] affairs expertly and who can quickly and efficiently focus on the client's particular legal needs").

²⁹⁴ See Wolfram, *supra* note 85, at 363 (praising exception to the hot potato rule because of burden of changing counsel after the representation had begun and the importance of attorney choice).

considerations as well as the financial expense of retaining and orienting new representation on a case that may be complicated or technical.²⁹⁵ Furthermore, a client could consider its long time counsel's rejection of representation as much a betrayal as undertaking conflicting representation.²⁹⁶ Finally, the attorney's right to practice is also a value ignored by the per se rule; one that has increasing implications as the opportunities for conflict situations grow.²⁹⁷

In contrast, a test that balances the facts and circumstances allows for a more practical and less formalistic approach to identifying conflicts of interest, and disregards the corporate form only when public policy reasons demand it.²⁹⁸ Such a practical approach, focusing on real and concrete threats to loyalty, protects loyalty and judicial integrity while refusing to undermine other values equally important to the integrity of the profession under the guise of protecting it.²⁹⁹ It is true that allowing conflicts of interest to continue unchecked will harm the integrity of the legal profession and foster negative perceptions by the public.³⁰⁰ However, a formalistic rule that imposes the burdens of disqualification on parties when the motion stems from litigation tactics not ethical concerns will likewise harm the integrity of the profession.³⁰¹

B. *The Role Of Fault in Conflicts of Interest*

Whether a law firm is at fault in creating a current conflict, or whether it was created by business actions of a client, should always be an element in determining disqualification.³⁰² The fault of the law firm should be considered because it is directly related to concerns of loyalty.³⁰³ After all, if there is no fault on the part of the law firm then there is no ethical misconduct, no action to sanction, and no poten-

²⁹⁵ *Id.*

²⁹⁶ See Susan Shapiro, *Symposium Case Studies in Legal Ethics: Everests of the Mundane: Conflicts of Interest in Real-World Legal Practice*, 69 *FORDHAM L. REV.* 1139, 1143 (2000) (noting that long-standing clients may see the refusal to take on representation as breach of loyalty).

²⁹⁷ See Drucker, *supra* note 14, at 535.

²⁹⁸ See Rotunda, *supra* note 5, at 683-84.

²⁹⁹ See Drucker, *supra* note 14, at 557-58.

³⁰⁰ See, e.g., Formal Op. 390, *supra* note 8 (Fox, dissenting); Romansic, *supra* note 7, at 315.

³⁰¹ See, e.g., *Panduit*, 744 F.2d at 1576-77.

³⁰² See *Gould, Inc. v. Mitsui Mining & Smelting Co.*, 738 F. Supp. 1121, 1126 (N.D. Ohio 1990) (arguing increased merger activity and resulting increase in conflicts requires courts to take "less mechanical approach" to disqualification).

³⁰³ See *id.* at 1127.

tial for deterrence.³⁰⁴ Some courts, such as *Gould, Inc. v. Mitsui Mining & Smelting Co.*, recognize the importance of the fault element in any loyalty analysis, but cling to a per se rule.³⁰⁵ They try to incorporate fault by implementing a balancing test as a second step after a per se conflict rule.³⁰⁶ This approach is correct in incorporating the valuable factual element of fault, but is theoretically flawed in using a per se approach when the conflict is against a client's family member because, as already seen, a per se rule is unduly formalistic and inconsistent with corporate norms.³⁰⁷ Furthermore, a *Gould* approach attempts to take into account fault, but fails to fully recognize its implications in terms of remedies.³⁰⁸ For example, because the *Gould* analysis is based on a per se rule, there is a presumptive conflict that must be addressed by the court.³⁰⁹ There are therefore only two results to the balancing test step in *Gould*: disqualification or withdrawal.³¹⁰ Such an approach ignores that when a law firm is not at fault, and the conflict is with a current client's affiliate, that there may be no conflict at all.³¹¹ A better approach recognizes that, like the other elements of the balancing test, the no-fault element goes directly to whether there is actually any conflict of interest present.³¹² These elements, therefore, may not just weigh in favor of allowing withdrawal over disqualification, but could also show that in a corporate family context withdrawal may not be necessary either.³¹³

Equally important to including the no-fault element in any consideration of current client conflicts in the corporate family situation, or even the traditional client conflict situation, is not overvaluing its importance.³¹⁴ It is vitally important in any balancing test not to look blindly at each factor in the test, but to consider each in light of the underlying concern: preserving the value of loyalty.³¹⁵ An example of overvaluing fault and ignoring the underlying ethical concerns can be

³⁰⁴ See *supra* notes 162-278.

³⁰⁵ See *Gould*, 738 F. Supp. at 1126-27.

³⁰⁶ See *id.*

³⁰⁷ See *supra* notes 108-158.

³⁰⁸ See *Gould*, 738 F. Supp. at 1127; see also *supra* notes 325-326.

³⁰⁹ See *Gould*, 738 F. Supp. at 1127.

³¹⁰ See *id.* (noting that because there was a conflict of interest that representation of one of the clients must be discontinued).

³¹¹ See Rotunda, *supra* note 5, at 664.

³¹² See *id.*

³¹³ See *supra* notes 237-238.

³¹⁴ See *Univ. of Rochester*, 2000 U.S. Dist LEXIS 19030, at *27-30.

³¹⁵ See *id.*

seen in a literal reading of the *Restatement* approach.³¹⁶ In the *Restatement* a balancing test is applied to determine if there is a conflict.³¹⁷ Fault is not, however, a factor in this test.³¹⁸ Instead, the fault element is treated as an exception to the determination of a conflict under the balancing test.³¹⁹ Presumably, then, the law firm's lack of fault overrides the determination of whether there is a conflict under the balancing test.³²⁰ The court in *University of Rochester v. G.D. Searle & Co.* explicitly cites the *Restatement* approach and rejects an automatic exception based on the law firm's lack of fault.³²¹ Instead, the court praises the case law approach that uses the fault element as only one factor in the balancing test.³²² The *Restatement* approach is inferior to the case-law approach because it ignores why fault is important: because it has loyalty implications.³²³ In allowing an automatic exception based on fault, the *Restatement* ignores other actions by the law firm that may shift the balance in favor of withdrawal or disqualification.³²⁴ For instance, a law firm could be innocent of creating the conflict, but act inappropriately in addressing that conflict.³²⁵ It could fail to adequately inform the clients of the conflict when it is discovered, delay in addressing the problem, or otherwise act in a way that compromises loyalty and warrants disqualification.³²⁶

CONCLUSION

Disqualification motions in current client conflicts raise many competing values, the most basic of which are maintenance of judicial integrity versus the right of parties to choose their own representation. When there is a traditional client conflict the courts favor disqualification, finding the risk to loyalty values too extreme. Yet, when there is a corporate affiliate situation, or when the conflict is created

³¹⁶ See *RESTATEMENT*, *supra* note 19, § 132 cmt. j.

³¹⁷ See *id.* § 121 cmt. d.

³¹⁸ See *id.*

³¹⁹ See *id.* § 132 cmt. j.

³²⁰ See *id.*

³²¹ *Univ. of Rochester*, 2000 U.S. Dist. LEXIS 19030, at *29-30 (noting that courts have adopted the no-fault factor as one factor to be considered in balancing facts and circumstances, not as a "cure" as in the *Restatement*).

³²² See *id.*

³²³ See *id.*

³²⁴ See *id.*

³²⁵ See *id.*; *Gould*, 738 F. Supp. at 1127 (noting that the law firm was unethically slow in responding to the conflict and that this is a serious breach of ethics).

³²⁶ See *Univ. of Rochester*, 2000 U.S. Dist. LEXIS 19030, at *29-30.

by client business decisions and not the law firm, the balance may and should be shifted. The courts should follow the flexible, practical, balancing of facts and circumstances approach instead of a strict *per se* rule. Such an approach rejects labels and formalistic rules and looks to determine if loyalty is really at risk. It protects the integrity of the profession by disqualifying law firms that have compromised loyalty, but refuses to undermine the profession by allowing disqualification to be used as a litigation tactic.

A balancing of the facts and circumstances must consider all facts that implicate loyalty, including the law firm's fault in creating the conflict. Whether the actions of the law firm were inappropriate is directly relevant to loyalty and to the justified expectations of that client. Additionally, when a law firm is not at fault disqualification serves no sanctioning or preventative value. The balance of the facts and circumstances may therefore lean towards withdrawal or continued representation when the law firm's lack of fault is taken into account.

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