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When Business Decisions of a Clients Create a Current Client Conflict of Interest: Implications in a Complex Ethical Landscape

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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

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[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

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[6] *See* Nora Pasman, *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.*, Pasman, *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"); Pasman, *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-

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[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* Pasman, *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.*, Pasman, *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

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[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-

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[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:

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[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.*, Pasman, *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.
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> 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:
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> the lawyer reasonably believes the representation will not be adversely affected; and
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> the client consents after consultation . . . .[48]

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]

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[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*

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[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

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[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

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[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

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[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-

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[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

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[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-

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[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

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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-

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[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-

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[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-

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[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

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[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

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[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

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[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

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[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

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[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

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[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-

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[229] *See id.* at *21–30.
[230] *Id.* at *27.
[231] *Id.* at *21–30.
[232] *Univ. 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

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[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

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[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*

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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

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[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

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[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); Pasman, *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-

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[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

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[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

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[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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