Journal of the Institute for the Study of Legal Ethics

Volume 2 Article 26

1-1-1999

Conflicts in the Corporate Family: Professor Wolfram Has It Almost Right

Lawrence J. Fox

CONFLICTS IN THE CORPORATE FAMILY: PROFESSOR WOLFRAM HAS IT ALMOST RIGHT

*Lawrence J. Fox**

Chuck Wolfram was far too modest in telling the story about the Chuck & Larry Show. We have, in fact, had the privilege of debating each other most recently on the Today Show where the question was whether Vince Foster's lawyer should be forced to turn over the notes of his last interview with his now famous, now deceased client. After the show I received a telephone call from my mother. She told me, in obligatory motherly fashion, both how handsome and how articulate I was. But in the end she told me she agreed with Professor Wolfram entirely because she really wanted to know what was in those notes. I guess I didn't win that debate. Maybe today, without my mother in the audience, I can win this debate on conflicts of interest.

The truth is Professor Wolfram and I have much less to debate this time. Indeed, I was, by and large, very happy to read Professor Wolfram's paper. Nobody has done a better job of putting a stake in the heart of the reasoning behind the majority opinion issued by the ABA Standing Committee on Ethics and Professional Responsibility with respect to conflicts in the corporate family, Formal Opinion 95-390. There is so much to celebrate in his paper that, as I describe the places where he and I differ, I hope he will keep in mind the many issues on which we agree. What I hope to do today is persuade Professor Wolfram that now that he is almost all the way there, he actually wants to go the last mile and embrace the dissenting opinion, which I continue to maintain got it quite right.

Before doing so, let me digress and say as a practicing lawyer and sometime observer of this ethical scene, I think this discussion of conflicts in the corporate family is quite depressing. That is so because it reflects a much broader picture of what I think of as the brave new world of ethics, particularly in the area of conflicts of interest. The modern law firm is engaged, not in a discussion of what it should do to demonstrate

* Partner, Drinker Biddle & Reath LLP; B.A. U. of Pa 1965; LLB, U. of Pa. 1968.

loyalty to its clients, but rather how its lawyers can get around the annoying impediments that are often created by Model Rule 1.7 to accomplish its real goal: to represent as many clients as possible, with little regard to whether those clients' interests are adverse to the interests of present or former clients. What we end up with are a lot of sophisticated arguments, fueled by a lot of our friends in academia, that at bottom add credibility to the notion that we can tear asunder the rules governing conflicts of interest and let firms "ethically" take this niggardly approach toward client loyalty.

I am not unmindful that these firms seek to justify their conduct by pointing to the conduct of client corporations who go around the legal world conflicting out as many firms as they can by spreading small assignments here, there, and everywhere. These firms argue that their approach to conflicts of interest is justified by the disloyal attitude of the clients. This is a proposition I reject out of hand. No matter how badly our clients behave, there is no excuse for us to pursue this guerilla warfare. We, as lawyers, are guided by different rules, and therefore, have to adhere to our standards even in the face of client provocation. I would hope that as we engage in a continuing dialogue on the rules governing how loyal lawyers should be to their clients, we will ignore the fact that clients are not always loyal to their lawyers.

Professor Wolfram states the key hypothetical as one in which the lawyer represents a parent corporation and that lawyer seeks to sue the client corporation's wholly-owned subsidiary. While I agree that that is the factual situation we must address, there is a little gloss I would like to place on those spare facts to translate the situation into the real world.

Caldwell & Moore, that venerable Philadelphia institution, represents Colossus Corporation. It is suddenly presented with an opportunity to sue Mini Corporation, a wholly-owned subsidiary of Colossus.

When I describe this situation you are probably assuming that the firm is proceeding as if Colossus Corporation is going to find out about the suit against Mini. The dismal truth, however, is that today a lot of law firms are taking advantage of the size and vast operations of the Colossus Corporations of this world by simply taking on the representation against Mini in the hope that Colossus will never figure it out. That is not our hypothetical; that is not what we are discussing today.

Here Caldwell & Moore assumes Colossus Corporation will know what the firm is up to but, nonetheless, the firm wants to take this position directly adverse to Mini. As a result, the following little dialogue goes on in the law firm. Someone asks whether Colossus is going to be upset. The answer is, of course, they are going to be upset. The discussion that follows turns to the really critical question which is whether the law firm can afford to get Colossus upset. Somebody gets out a computer sheet and notes that the law firm only received $23,000 last year from Colossus Corporation. Next someone asks how big is this new representation. The answer is the suit against Mini might yield a million dollars in fees. Then Caldwell & Moore's partners ask whether the firm can sue a subsidiary of its client, knowing full well that Colossus is going to be very upset and may even fire Caldwell & Moore. Caldwell & Moore concludes it is perfectly happy to accept that consequence. That is the key hypothetical in full context.

What we are talking about here, from an ethical perspective, is the situation where the law firm is making a conscious decision to antagonize the client to take on another client. If that were not the case, then the entire situation could be taken care of by Caldwell & Moore's desire to preserve its relationship with Colossus. In that case the firm calls up Colossus and asks whether Colossus will consent to the representation against Mini. Does the client object to the course of conduct Caldwell & Moore proposes? I recognize the answer to this question is that clients are often not cooperative these days. They don't readily grant consents to such representations. To which I answer, "that is their prerogative, and it nonetheless is too bad for us. It is just the cost of lawyers' doing business." But that is the correct answer to the question and, from a public policy perspective, that should be the answer to the question. In the present discussion, however, we are getting past the issue of seeking consent. We are dealing with whether there should be a situation in which Caldwell & Moore can say to Colossus, "Screw you. We don't care if you fire us. We are happy to lose your business because the suit against Mini is so big, so lucrative and so advantageous to our law firm that we wish to take it on without your consent."

Professor Wolfram systematically answers the major contentions of those who would argue that it is ethical for Caldwell & Moore to sue Mini. First, Professor Wolfram's paper presents his devastating response to the argument, that because the client has chosen to do business through subsidiaries, it is OK to sue those subsidiaries. The law firm that offers this argument may well be the same law firm that told the corporation this was the way it should order its affairs. This may well be the same law firm that informed the client that in order to hold a French patent it must continue to be owned by the corporation's French subsidiary. This may well be the same law firm that told the client to set up a subsidiary in order to limit the parent's liability for the subsidiary's risky business plan. Having set up these subsidiaries for the benefit of the corporation, these lawyers are now turning around and saying they can sue those subsidiaries for that very reason.

When I hear this argument I often get confused. These lawyers are talking about their own clients, but they sound as if they are talking about the enemy, as if there were something nefarious, if not illegal, in doing business through subsidiaries, as if these corporations earned the right to be sued by their own lawyers because they have established an elaborate corporate structure for regulatory, historic or liability limiting reasons. "We'll teach them! These corporations will get their just deserts," seems to be the lawyers' attitude toward their clients' perfectly legitimate, natural, and well-advised corporate arrangements.

Second, Professor Wolfram gives the alter ego theory all the dignity it deserves. Under this argument it is said that the only time you are barred from suing your own client's subsidiary is when the subsidiary is the alter ego of the parent. In other contexts, we all recognize how devastating an alter ego finding will be. It is a status we lawyers resist on behalf of our corporate clients because, if one corporation is treated as the alter ego of another, it means the integrity of the corporate form will not be respected and the parent may be held liable for the debts of the subsidiary or vice versa.

The topsy turvy nature of this argument gives new definition to the overused word—"irony." When the corporate client is most upset because it has an alter ego problem, the client is asked to take some solace, if you will, from the fact that this is the one time when the corporation's lawyers are not allowed to sue the client's subsidiaries. But if the client parent corporation conducts its subsidiary operations properly in a way that maintains its separate identity then, this "good" client gets punished by being in a position in which its subsidiary may be sued by its own lawyer! Something is wrong with this picture.

Professor Wolfram next lays waste to the entity theory argument. This argument looks to Model Rule 1.13, observes that it tells the lawyer the entity is the client and not any of its constituents—officers, directors, shareholders—and, therefore, the lawyer only represents the entity. The entity theory, as Professor Wolfram points out, simply is not helpful. It doesn't work, because the entity theory was designed to solve the situation where there is a conflict between the constituents of the entity. The CEO tells the lawyer she should do X; the Board tells the lawyer she should do Y. Since the lawyer represents the entity, the lawyer looks to the highest authority of the entity—in this case the Board—and follows its direction. The rule was designed to protect lawyers from conflict of interest situations caused by the fact that you have a corporate client that can only act through individuals. The entity theory has no place, no role whatsoever, in the situation of a wholly-owned subsidiary of a parent corporation. By definition, there can be no conflict between them.

I might add, as my own argument, that the majority opinion in 95-390 exalts form over substance. Take, for example, Columbia HCA which has hundreds of separate subsidiaries. What is the business of the parent? Owning hospitals, hundreds of subsidiaries. If these subsidiaries were called divisions, everyone at this conference, everybody in the majority in Opinion 95-390, would agree you can't sue any of them. But because they are subsidiaries, the majority says you can. What difference does that make? In real terms, it makes no difference. As Professor Wolfram says, corporations can organize themselves into 1,000 ways. But in the one hundred percent ownership model, it is all one economic entity; to say a division is one thing and a subsidiary is another makes no sense at all. Just ask the Ford Motor Company. Does Ford care whether it loses $100,000,000 in the Mercury Division or in the Jaguar subsidiary; at the end of the day either result is just as devastating to Ford's bottom line.

Professor Wolfram correctly points out that the majority opinion unfairly places the burden on the client to act. If the corporation wants to protect its subsidiaries, it must send its lawyers a letter telling them that treating the subsidiaries as clients is a condition of the representation. But since when does the client have to act to protect his interests? It's the other way around. The lawyers are supposed to protect the client's interests. If the majority in 95-390 has correctly stated the rule, then lawyers should send a letter to the client. The letter would say, "Dear Client, we can sue all your subsidiaries unless you tell us by return mail that we can't." It's not a laughing matter because the sophisticated client, like General Electric has already taken care of this. If you take on a representation for GE, the company will send you a disc, with all of its subsidiaries on it. It is the small corporation that doesn't have an in-house counsel, that may also have a number of subsidiaries, and that doesn't know better, to whom we are going to say "Gotcha, you did not protect yourself, and now we can sue your subs."

One of my favorite arguments made by those who would sue their client's subsidiaries is that modern corporations' structures are so complex and elaborate that we poor lawyers can't figure it out. Professor Wolfram devastatingly destroys this argument. First, the complexity and the chaos is partly of the lawyers' doing. We told these corporations that this is the way that they should organize. Second, if it really is so complex, how come it's not complex when law firms want to figure it out for their own benefit? When the client development committee of Caldwell & Moore is looking to do business with a new corporation, it can figure out the corporate structure in 13 seconds. There is even software that law firms can buy from Dun & Bradstreet that costs a few thousand dollars and that gets updated every month, and that will tell them every subsidiary and division of every major corporation.

Finally, there is the argument about the indirect effect. This calls to mind the argument that the person who places the poison into a capital defendant's arm doesn't really execute him because all he does is inject some liquid. The liquid travels all of the way through the system until it gets to the heart and stops its beating. So it wasn't the injection; it was the circulatory system that did him in. In the same way these lawyers seek to avoid responsibility for their conduct because, when they sue Jaguar, resulting in a 100 million pound adverse judgment against that subsidiary, two accounting entries and a currency conversion must be made before the loss shows up as dollars on Ford's income statement and balance sheet, before it gets reported in some consolidated statement, and before it gets filed with the SEC as part of a Report on Form 10-K. Does it make any difference? Not a one, as Professor Wolfram recognizes.

In the end, the only thing Professor Wolfram and I disagree about is what is the nature of the "effect" that triggers a conflict. And by the way, he mischaracterizes my view. I do not believe that when I represent Ford that I represent every one of its subsidiaries. I don't believe that for one minute. What I believe is that I must analyze, for conflict of interest purposes, the effect on my client of any action I do undertake. The only issue is what will the effect of my proposed representation be on my client, Ford? And Professor Wolfram agrees that is the correct analysis.

Our only difference, then, is whether we are going to apply a different standard of adverse effect when I'm suing my client's subsidiary from that which is applied when I'm suing my client. We all agree I cannot take a position that is directly adverse to my client, no matter how insubstantial its effect. But Professor Wolfram argues that I can take a position directly adverse to my client's wholly owned-subsidiary when there is no substantial effect on the parent. I don't know what "no substantial effect" means or how it is to be determined. But it is clearly Professor Wolfram's intent to apply a different standard in the situation where I sue my client's subsidiary from that used when I sue the client itself.

I don't believe that makes any logical sense. We should have one standard for conflicts of interest. Either we ought to change the standard to say that I can take a position adverse to my present client unless it has a substantial effect, a proposition I would reject. Or we ought to maintain the identical standard for a position adverse to a wholly-owned subsidiary as for a position taken directly against the parent, a proposition I support. When you are talking about loyalty, what we certainly do not need is two different standards.

The major problem with employing a substantial effect test is that it leaves the judgment of when you can sue a client's subsidiary with the lawyer. And if we hearken back to the beginning of this speech, you will recall we have this eager lawyer who says he doesn't give a damn anymore about Colossus, his own client. He's prepared to lose that client because he wants to take on a suit against Mini. Should this be the person who makes that judgment? I think not. What we should continue is the system we have now in which the client makes that judgment. Our ethical obligation should be to call the client on the phone and ask, "Do you consent to the suit against Mini?" It is the client, not the lawyer, who should have the autonomy to decide, one way or the other.

For that reason I reject the DC rule which Professor Wolfram endorses. It's mischievous, it puts too much discretion in the hands of lawyers, and lawyers don't have enough information to make the decision. If the lawyer thinks the adverse representation is minor, let us permit the general counsel, the client, to decide if it is, in fact, minor—if the lawyer is, in fact, correct. I seek consent every single day in my law firm. When I don't get consents, I am sorely disappointed, but that rejection of my request reflects a decision by my client that no matter how unimportant I thought the proposed representation was, the client thought it was important enough to withhold consent. The client insists on some measure of loyalty and rejecting my request is the client's way of securing that commitment.

In conclusion, it is my view that if you can't do it to the parent, you can't do it to the wholly-owned subsidiary. And you can't do it to sister corporations. I'm sure that Professor Wolfram now recognizes how close he has come to upholding our professional values, solving the conflict of interest problem, and interring Formal Opinion 95-390 with a respectful burial. Now if I can only convince him to drop his support for this D.C. double standard . . . .