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Second Circuit Adopts Factors for Assessing Corporate Affiliate Conflict of Interest

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Lawyers for the Profession® Alert

GSI Commerce Solutions, Inc. v. Babycenter, LLC, ___ F.3d___, 2010 WL 3239436 (2d Cir. 2010)

Brief Summary
In a matter of first impression for the U.S. Court of Appeals for the Second Circuit, the court addressed whether representation of a parent corporation in other matters warranted disqualification of a law firm engaged in litigation against a wholly-owned subsidiary of the parent company. In determining whether the parent company and its subsidiary effectively are one entity for conflict-of-interest purposes, the court will look at the entities' financial interdependence and operational commonality.

Complete Summary
The Second Circuit upheld the disqualification of a law firm based on the firm's simultaneous general representation of a parent company, Johnson & Johnson, and a party adverse to one of the parent company's wholly-owned subsidiaries in litigation on a matter unrelated to the representation of the parent company. The appellate court held that the district court did not abuse its discretion in granting the disqualification motion filed by the subsidiary because the operational relationship between the two companies was close and thus the representation reasonably could diminish "the level of confidence and trust in counsel" held by the parent company.

The Second Circuit had not previously addressed a so-called affiliate conflict. In determining whether the representation here constituted a conflict warranting disqualification, the court focused on rules from other courts, as well as commentary to ABA Model Rule 1.7 and ABA Formal Opinion 95-390. The court based its decision on two factors: the extent to which one entity depends financially on the other, and the degree of operational commonality between the companies.

Regarding financial interdependence, the court found little of that here and rejected a rule suggested in other jurisdictions' case law that such interdependence automatically exists, requiring disqualification in a matter involving a wholly-owned subsidiary. The court focused instead on operational commonality across multiple departments (e.g., accounting, human resources, some overlap in operational control). The court particularly emphasized the fact

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that the entities shared in-house counsel, who had been involved in the underlying dispute since it first arose, including mediation efforts and obtaining outside counsel for the subsidiary. The court held that the combination of these factors appropriately called for disqualification of the firm.

Finally, the court rejected the position that the parent company prospectively had waived this conflict in its engagement agreement with the firm. The court assumed *arguendo* that this was a waivable conflict but held that the specific waivers in the engagement letter did not encompass the particular conflict at issue in this case. The court also discounted the fact that the subsidiary had waited several months before making its motion to disqualify the firm.

Significance of Opinion
This opinion marks the Second Circuit's first foray into the area of affiliate conflicts. The law in this area is relatively new, but there appears to be some consensus emerging around the type of inquiry engaged in by the Second Circuit in this case. Notably, the court did not address any issues with respect to "blanket" advance waivers by a parent company, since no such waiver was at issue here.

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