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Attorney Conflicts of Interest in Corporate Disputes

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Issues concerning attorney conflicts of interest in shareholder disputes have traditionally been a fertile ground for litigation. It has generally been thought that counsel for the corporate entity is prohibited from also representing individual shareholders and/or officers in any action adverse to other shareholders of the same corporation. [FN1] In a number of recent decisions in Nassau and Suffolk counties, however, the courts have scrutinized the actual matters upon which counsel has represented the various parties to determine whether a conflict actually exists or whether confidences are likely to be revealed. This apparent trend has resulted in fewer attorney disqualifications in corporate disputes.

Second Department Rulings

The Second Department has enunciated broad pronouncements in the area of attorney disqualification in shareholder disputes, unequivocally holding that a lawyer is prohibited from representing any of the shareholders against other shareholders where that same attorney represented the corporate entity. In the recent decision of *Morris v. Morris*, 306 A.D.2d 449, 763 N.Y.S.2d 622 (2d Dept. 2003), for example, a minority shareholder asserted individual and derivative claims against the majority shareholder, alleging misappropriation of corporate

funds and diversion of corporate assets and business opportunities.

The Second Department reversed the trial court's denial of the minority shareholder's motion to disqualify defendants' counsel, who had appeared for both the corporation and the majority shareholder. The Second Department ruled: "'One who has served as attorney for a corporation may not represent an individual shareholder in a case in which his interests are adverse to other shareholders.'" *Morris*, 306 A.D.2d at 452; 763 N.Y.S.2d at 624-25 (quoting *Matter of Greenberg*, 206 A.D.2d 963, 965, 614 N.Y.S.2d 825, 827 (4th Dept. 1994)).

The Second Department in *Morris* also relied upon its earlier decision in *Schmidt v. Magnetic Head Corp.*, 101 A.D.2d 268, 476 N.Y.S.2d 151 (2d Dept. 1984), in which the court reversed Special Term's refusal to disqualify the same law firm from representing the corporate defendant and the individual shareholders/directors in a shareholder derivative action where the interests of the individual defendants were in potential conflict with the corporation.

The Second Department in *Schmidt* distinguished the situation before it from those cases where the corporation in a derivative action is only "a passive litigant," finding that where "the relief sought may require an appearance and answer by the corporate defendant," such appearance "must be by an inde-

pendent counsel whose interests will not conflict with those of the individual defendants." *Schmidt*, 101 A.D.2d at 278-79, 476 N.Y.S.2d at 157 (quoting *Russo v. Zaharko*, 53 A.D.2d 663, 666, 385 N.Y.S.2d 105 (2d Dept. 1976)).

Similarly, on the flip side of the fact pattern, the Second Department has sustained the lower court's refusal to allow counsel who had represented the corporation also to represent the plaintiff minority shareholders in a derivative action seeking to recover allegedly misappropriated corporate funds from the majority shareholders. *Bianchi v. Mille*, 266 A.D.2d 419, 698 N.Y.S.2d 454 (2d Dept. 1999).

Nassau and Suffolk Counties

The Second Department case law thus appears to indicate a rather rigid approach to addressing the attempted joint representation of shareholders and corporations, leaning in the direction of disqualification. In a number of recent decisions in Nassau and Suffolk counties, however, the Supreme Court has looked past the blanket pronouncements of the Second Department to scrutinize the factual basis of the motion to disqualify. Rather than rely upon the broader language in the appellate decisions, the courts have focused on whether conflicts existed or confidences were involved in the prior representation.

In *Landa v. Bleier*, 1 Misc.3d 902(A), 2003 WL 22928561 (Nassau Sup. Nov. 19, 2003) (Austin, J.), for example, the respective shareholders and members of

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a corporation and limited liability company instituted individual and derivative claims against another shareholder and owner of the limited liability company, alleging, among other things, breach of fiduciary duty. The defendant shareholder moved to disqualify plaintiff's counsel, arguing that a conflict of interest existed because the law firm was on retainer to both the corporation and the limited liability company.

The court began by explaining that "[i]n deciding whether a conflict requiring disqualification exists, the Court must consider if the lawyer or firm has previously represented the party or entity which is seeking to disqualify that attorney and/or if the attorney has obtained in the course of that representation confidential information which would be disclosed or could be used against the former client in the current litigation."

After finding that the law firm had never represented the individual defendant and there was no evidence demonstrating that counsel obtained any confidential information regarding defendant, the court turned to plaintiffs' counsel's present and prior representation of the entities. The court denied disqualification, relying upon the fact that counsel's prior and current representation of the entities was limited to collections and regulatory matters that appeared "to be wholly unrelated to the corporate issues presented here."

The court explicitly distinguished the Second Department's recent decision in *Morris*, discussed above, finding that the attorney in *Morris* was disqualified because he had not only been general counsel to the corporation, but had represented the corporation in connection with the transactions which were at issue in the action, factors that the court found were not present in the case before it. Thus, the court allowed counsel who had represented and continued to represent the corporation also to represent an individual shareholder against another shareholder.

In *Pantelis v. Stewart Ave. Holding Corp.*, Nassau Co., Index No. 7662/02, (Oct. 4, 2002, entered Oct. 24, 2002), Justice Geoffrey J. O'Connell also denied plaintiff's motion to disqualify defendants' counsel. *Pantelis* was a shareholder derivative action in

which the same counsel represented both the individual shareholder defendant and the corporate defendant, as well as the corporation in other actions and transactions. Plaintiff argued that the defendants' law firm should be disqualified because it "previously represented plaintiff with respect to [the corporation's] corporate actions in the past."

After finding that there was "no demonstration of a confidence or other secret of the plaintiff which was relayed to the [defendants' counsel's] firm which would warrant disqualification," the court also found that there was no conflict of interest between representing the corporation in another action and representing the corporation and the majority shareholder in the derivative action. The court even noted that "the other action may be related to the allegations alleged against the individual defendant in this matter," but would not accept what it viewed as plaintiff's "conclusory allegations of prejudice," which might result therefrom.

Similarly, in *Philmus v. Hank*, Nassau Co., Index No. 3593/03 (Aug. 24, 2003, entered Aug. 21, 2003), Justice Ira B. Warshawsky denied plaintiff's motion to disqualify counsel from representing an individual shareholder and the corporation in a shareholder derivative action. Relying upon language from the Second Department's *Schmidt* decision noted above, the court found that while in certain shareholder derivative actions a corporation may have an interest adverse to the individual shareholders or directors, the record before it did "not show that the conduct of the defendant shareholder ... has created adverse effects upon the corporate defendant beyond the adverse effects allegedly sustained by plaintiff, minority shareholder." Thus, the court found that "the conclusion may be safely drawn that there are only two interested parties in this lawsuit and that the corporation is a nominal defendant and no disqualification on the basis of conflict of interest is necessary."

In *Franzese v. Darress*, Suffolk Co., Index No. 14064/03 (Oct. 27, 2003), Justice Elizabeth H. Emerson also denied defendant's motion to disqualify plaintiffs' counsel in a shareholder derivative

action. Plaintiffs were a shareholder and the two corporations in which the individual plaintiff and defendant were each 50 percent owners. Defendant claimed that plaintiffs' counsel had a conflict of interest because it "represented the business enterprises in which plaintiff and defendant have been involved during the past 15 years." Defendant also argued that as a result of the representation, "confidences were disclosed."

Focusing on the "former client" basis of disqualification, the court found that defendant "must prove that there was an attorney-client relationship between the moving party and opposing counsel, that the matters involved in both representations are substantially related, and that the interests of the present client and former client are materially adverse." The court concluded that "defendant failed to set forth the nature of the confidential information allegedly obtained from him by plaintiffs' [law] firm, or show that there is a reasonable probability that such information will be disclosed during the course of this litigation." Thus, the court found no basis to disqualify plaintiffs' counsel.

Conclusion

This recent line of decisions in Nassau and Suffolk counties indicates that motions to disqualify corporate counsel in shareholder litigation are likely to be scrutinized, notwithstanding what some might have interpreted to be broad, general pronouncements of the Second Department. The courts appear to be more than willing to examine the factual basis of the claimed conflict of interest and to allow counsel of choice where the court believes the interests of the parties are adequately protected.

Endnotes

FN1. *Morris v. Morris*, 306 A.D.2d 449, 452, 763 N.Y.S.2d 622, 624-25 (2d Dept. 2003) ('One who has served as attorney for a corporation may not represent an individual shareholder in a case in which his interest are adverse to other shareholders.')