A REVIEW OF *HF MANAGEMENT SERVICES LLC V. PISTONE:* DOES AN UNDERWRITER'S DUE DILIGENCE COUNSEL HAVE A FIDUCIARY DUTY TO AN ISSUER?

I. **Summary**

Whether an underwriter's due diligence counsel has a fiduciary obligation to the issuer of a security, and in turn, whether such obligation warrants disqualification of counsel in a later action against the issuer, are matters of unsettled law in New York State. The differences of opinion on these issues are brought to a head in *HF Management Services LLC v. Pistone*, No. 7513, 602832/04818, 818 N.Y.S.2d 40 (1st Dep't June 27, 2006) ("*HF Management Services*"), a recent decision handed down by the New York State Supreme Court, Appellate Division, First Department. The majority in *HF Management Services* reversed the lower court's order disqualifying plaintiff's litigation counsel, on the ground that no fiduciary obligation existed between an underwriter and an issuer, and thus, none can be imputed to underwriter's counsel. The dissent, on the other hand, found that a fiduciary obligation did arise when underwriter's counsel obtained confidential information regarding the issuer, that it would not have been privy to, but for its role as counsel to underwriter.

This report first sets forth a summary of the majority and dissenting opinions in *HF Management Services,* with a focus on identifying the primary basis for each opinion. The report then analyzes the issues and case law crucial to the positions taken by both the majority and the dissent, and analyzes the strengths and weaknesses of those positions. Finally, consideration is taken of several policy concerns including: 1) the potential for countless conflicts to arise if it is found that underwriter's due diligence counsel owes a fiduciary duty to an issuer; 2) the additional burden placed upon law firms and attorneys to assess such potential conflicts; 3) the additional limitations placed on clients in selecting the counsel of their choice; 4) that by expanding the fiduciary

obligation of counsel to non-clients, law firms and attorneys face the risk of additional liability; and 5) that faith in the legal profession could be lost if clients are allowed to seek and retain counsel who possess confidential information concerning a particular adversary.

II. ***HF Management Services LLC v. Pistone***

A. Case Overview and the Motion Court's Finding

HF Management Services, an action premised upon breach of employee non-solicitation agreements and unfair competition, presents issues of ethical concern that could greatly impact the landscape of attorney conflict and disqualification. Plaintiff, HF Management, appealed from the lower court's disqualification of its counsel on the ground that a fiduciary relationship exists between an underwriter and an issuer of securities, and that such relationship is imputed to that underwriter's due diligence counsel. *HF Management Services LLC v. Pistone*, Index No. 602832/2004 (Sup. Ct. N.Y. County Feb. 16, 2005) (Ira Gammerman, J.H.O.).

Specifically, plaintiff HF Management alleged that two employees of WellCare Health Plans, Inc. ("WellCare"), who had previously been employed by HF Management, breached their non-solicitation agreements. *HF Management Services*, 818 N.Y.S.2d at 41. In addition, plaintiff alleged that WellCare engaged in unfair competition by raiding plaintiff's sales force. *Id.* Significantly, the law firm representing plaintiff HF Management in the action, Epstein, Becker & Green ("EBG"), had previously served as due diligence counsel to WellCare's underwriter, Morgan Stanley, in connection with the recent initial public offering ("IPO") of WellCare stock. *Id.* In its role as counsel to Morgan Stanley, EBG: 1) spent several hundreds of hours reviewing files and interviewing WellCare personnel; 2) reviewed business plans, strategic and market analyses, employee policies, and recruitment and retention documents; and 3) discussed pending litigations and related litigation strategies with WellCare's head of litigation and general counsel. *Id.*

Based upon the foregoing, defendants moved to disqualify EBG as HF Management's counsel on the grounds that, in the course of the IPO due diligence investigation, EBG had acquired confidential information, and that such information would prejudice the defense. Granting defendants' motion, the lower court reasoned that the lack of a formal attorney-client relationship was not dispositive, and that "the crux of disqualification is not the attorney-client relationship itself, but the fiduciary relationship that results from it." *Id.* In so holding, the Court found that: 1) Morgan Stanley in its role as an underwriter owed a fiduciary duty to WellCare, and 2) EBG as Morgan Stanley's agent in the IPO shared the underwriter's fiduciary duty to WellCare. *Id.*

B. The Majority

The majority agreed with the lower court that even "where no formal attorney-client relationship exists," a fiduciary obligation may be sufficient grounds for attorney disqualification. However, the majority held that because "no fiduciary relationship existed between Morgan Stanley and WellCare, … none may be imputed to EBG as Morgan Stanley's agent." *Id.* at 41.

Having first found that New York law does not recognize the existence of a fiduciary obligation "based solely on the [typical] relationship between an underwriter and issuer," the majority held that "nothing in the record even remotely suggests that the relationship between Morgan Stanley and WellCare rose above the typical contractual relationship of an underwriting agreement between a buyer and a seller." *Id.* at 42-43. The majority specifically noted that "[b]oth parties were separately counseled," and that "there is no indication or suggestion that Morgan and WellCare enjoyed any type of pre-existing relationship, or that Morgan acted as an 'expert advisor on market conditions' to WellCare." *Id.* at 43.

The majority did find, however, that even though the "typical relationship between an underwriter and issuer based upon an underwriting agreement… does not create any fiduciary

obligations," where a "pre-existing relationship created independently and apart from the contractual one" exists, a fiduciary obligation may arise. *Id.* at 42. However, the majority in *HF Management Services* found that a pre-existing and independent relationship did not exist between Morgan Stanley and WellCare.

C. The Dissent

The dissent, rather than focusing upon the fiduciary obligation between an underwriter and an issuer, emphasized that "confidential information obtained by plaintiff's counsel Epstein Becker & Green, P.C. (EBG) from defendant WellCare Health Plans, Inc. in the course of its prior due diligence work for Morgan Stanley may be reasonably perceived as placing such confidences in jeopardy of disclosure to plaintiff." *Id.* at 44-45.

The dissent found that EBG had obtained information in the due diligence process within the context of a fiduciary relationship, and that such information is reasonably related to the issues presented in the present action.[1] *Id.* at 45. The dissent stated that a fiduciary relationship did exist between Morgan Stanley and WellCare, "at least to the extent that Morgan Stanley was bound to preserve from adverse use against WellCare in other contexts confidential information elicited from it to facilitate the underwriter's due diligence." *Id.* Further, the dissent agreed with the lower court that this fiduciary obligation would be imputed to Morgan Stanley's counsel, EBG. *Id.*

Specifically, the dissent, in agreement with the motion court, found that "the crux of disqualification is not the attorney-client relationship itself, but the fiduciary relationship that results from it." *Id.* at 45. The heart of the dissent's opinion was that EBG, acting as Morgan Stanley's agent, obtained "secret" information from WellCare within the meaning of Code of Professional Responsibility DR 4-101 (22 NYCRR 1200.19), to which it would not otherwise have been privy. *Id.*

[1] The dissent specifically noted that the confidential information turned over by WellCare to EBG in the course of Morgan Stanley's due diligence work was "directly relevant to the unfair competition claims now brought by plaintiff against WellCare." *Id.* at 46.

at 45. Having obtained such information, EBG then owed "WellCare a fiduciary or special obligation not to disclose to anyone other than Morgan Stanley the 'secret' information obtained by it in the course of rendering professional services to Morgan Stanley, so that Morgan Stanley could use it for the purposes for which EBG was retained." *Id.* at 45-46. In effect, the dissent acknowledges the existence of a fiduciary or special obligation between EBG, underwriter's counsel, and WellCare, the issuer, primarily on the basis that having obtained confidential information to facilitate its due diligence, Morgan Stanley brought upon itself a fiduciary duty not to use such information adversely against WellCare in other situations.

Thus, both the majority and the dissent in *HF Management Services* acknowledge that under certain circumstances, even where no formal attorney-client relationship exists, a fiduciary obligation may be sufficient grounds for attorney disqualification. The dissent however, unlike the majority, finds the existence of a special obligation between underwriter's counsel and a third party, *i.e.*, the issuer, solely on the basis that underwriter's counsel acquired confidential information. What the dissent failed to address, however, is that the information provided by WellCare to Morgan Stanley was not provided with an expectation of confidentiality.

III. **An Analysis of Relevant Legal Issues and Case Law**

A. Attorney Disqualification

The disqualification of an attorney is a matter that rests within the sound discretion of the court. *Flores v. Willard J. Price Assocs.*, 20 A.D.3d 343, 344 (1st Dep't 2005). *See also Nationwide Assoc. v Targee St. Internal Medicine Group*, 303 A.D.2d 728 (2d Dep't 2003). "Attorneys owe fiduciary duties of both confidentiality and loyalty to their clients." *Tekni-Plex, Inc. v Meyner & Landis*, 89 N.Y.2d 123, 130 (1996). Thus, attorneys have continuing obligations to protect their clients' confidences. *Flores*, 20 A.D.3d at 344. Moreover, an attorney "must avoid not only the fact, but

even the appearance, of representing conflicting interests." *Cardinale v Golinello*, 43 N.Y.2d 288, 296 (1977).

Courts in New York State "recognize that the importance of preserving client confidences and secrets requires that all doubts be resolved in favor of attorney disqualification. *First Hudson Fin. Group, Inc. v. Martinos*, 812 N.Y.S.2d 767, 770 (Sup. Ct. N.Y. County 2005). Courts, however, are also cognizant both that disqualification interferes with a party's right to retain counsel of his choice, and, in the current reality of litigation, disqualification motions are often utilized as a tactical tool. *Id.* Therefore, motions to disqualify an attorney are subject to a high burden of proof. *Hickman v. Burlington Bio-Medical Corp.*, 371 F. Supp. 2d 225 (E.D.N.Y. 2005). Moreover, the appearance of impropriety, without more, is insufficient to grant a motion to disqualify. *In re Stephanie X*, 6 A.D.3d 778, 773 N.Y.S.2d 766 (3d Dep't 2004).

B. A Fiduciary Obligation Has Been Sufficient Grounds for Attorney Disqualification Despite The Absence of a Formal Attorney Client Relationship

As an initial matter, both the majority and dissent, in reliance upon *Greene v. Greene*, 47 N.Y.2d 447, 418 N.Y.S.2d 379, 391 N.E.2d 1355 (1979), acknowledge that a fiduciary obligation is sufficient ground for attorney disqualification, notwithstanding the lack of a formal attorney-client relationship. In *Greene*, plaintiff alleged that the law firm she used in connection with the creation and management of an *inter vivos* trust, and one of its partners at the time, committed breaches of fiduciary duty, fraud and other wrongs. Two third party defendants, former members of defendant law firm, became members of the law firm retained by plaintiff against defendant law firm. Determining that disqualification of plaintiff's retained law firm was appropriate, the Court of Appeals of New York held that since the members of the law firm currently representing plaintiff had been members of the defendant law firm, they were liable for all conduct occurring during their employment at that firm, and thus, had a financial interest in the present lawsuit. Further, the Court

found that an attorney may not act on behalf of a client in an action where the attorney has a direct interest of the subject matter of the suit.

Specifically, the Court of Appeals held that:

> An attorney traditionally has been prohibited from representing a party in a lawsuit where an opposing party is the lawyer's former client…. Underlying this rule is the notion that an attorney, as part of his fiduciary obligation, owes a continuing duty to a former client—broader in scope than the attorney-client evidentiary privilege—not to reveal confidences learned in the course of the professional relationship…. As former partners in defendant law firm, Grutman and Bjork owe a fiduciary obligation similar to that owed by an attorney to his client…. In view of these allegations, we cannot discount the possibility that ***information obtained by Grutman and Bjork in their role as fiduciaries*** will be used in the pending lawsuit.

Greene, 47 N.Y.2d at 453 (emphasis added).

In essence, the *Greene* court found that attorney disqualification is warranted, despite the absence of a formal attorney-client relationship, where a retained law firm or members of that firm hold an independent fiduciary obligation, at odds with their current representation. In *Greene*, this obligation manifested itself in the form of a fiduciary duty that two former partners owed to the defendant law firm. Thus, under *Greene*, the acquisition of confidential information alone, absent a conflicting fiduciary obligation or former attorney-client relationship, does not appear to necessitate attorney disqualification.[2]

C. The Fiduciary Relationship Between an Underwriter and an Issuer

1. The Fiduciary Relationship

A fiduciary relationship "exists between two persons when one of them is ***under a duty to act for or to give advice for the benefit of another*** upon matters within the scope of the

[2] Significantly, as discussed in greater detail below, *Greene* is distinguishable from *HF Management Services* in that in *Greene* the conflicted attorneys were actually fiduciaries of their former law firm, and thus, had a pre-existing fiduciary obligation at odds with their current representation. In *HF Management Services*, on the other hand, the existence of a fiduciary relationship between underwriter's counsel and issuer arose, if at all, solely upon Morgan Stanley's receipt of confidential information necessary to complete its due diligence in connection with the issuance of WellCare securities.

relation." Restatement [Second] of Torts § 874, Comment *a* (emphasis added). *See also HF Management Services,* 818 N.Y.S.2d at 42; *EBC I Inc. v. Goldman, Sachs & Co.*, 5 N.Y.3d 11, 19, 799 N.Y.S.2d 170, 175, 832 N.E.2d 28, 31 (2005).

Moreover, a fiduciary relationship generally does not arise between parties that are involved in arm's length transactions. *See Northeast Gen. Corp. v. Wellington Adv.*, 82 N.Y.2d 158, 162 (1993) ("'many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties…. If the parties find themselves or place themselves in the milieu of the "workaday" mundane marketplace, and if they do not create their own relationship of higher trust, courts should not ordinarily transport them to the higher realm of relationship and fashion the stricter duty for them."); *EBC I*, 5 N.Y.3d at 19 (a fiduciary relationship, "necessarily fact specific, is grounded in a higher level of trust than normally present in the marketplace between those involved in arm's length business transactions").

2. New York Has Long Recognized the Non-Fiduciary Nature of the Underwriter - Issuer Relationship

Generally, New York courts have recognized that "an underwriting contract does not create a fiduciary duty between the underwriter and the issuer." *Blue Grass Partners v. Bruns, Nordeman, Ra & Co.*, 75 A.D.2d 791, 791, 428 N.Y.S.2d 254, 255 (1st Dep't 1980) (court noted the lower court's finding that "an underwriter, in a best efforts underwriting, owes no fiduciary duty to an issuer" with respect to the sale of assets it acquired from the issuer to the public).

Other jurisdictions applying New York law have also recognized that an underwriting contract does not generally give rise to a fiduciary relationship between underwriter and issuer. For instance, in *Breakaway Solutions v. Morgan Stanley & Co.*, 2004 Del. Ch. LEXIS 125, *51 (2004), the court found that "[a] fiduciary duty is an example of a duty which 'must be separate and beyond any contractual duties. A fiduciary relationship may exist where one party reposes

confidence in another and reasonably relies on the other's superior expertise or knowledge, but an arms-length business relationship does not give rise to a fiduciary obligation.'" (citation omitted). The *Breakaway Solutions* court found that to allege a fiduciary obligation between underwriter and issuer a complaint must set forth "allegations showing a pre-existing relationship between plaintiff and defendant that justified the alleged trust the former placed in the latter in setting the price of its shares." *Id.* at *53.

3. The Pre-Existing Relationship Exception

The New York Court of Appeals has recently emphasized the non-fiduciary nature of the relationship between an underwriter and an issuer. In *EBC I*, the court described the relationship between an underwriter and an issuer, in connection with an initial public offering, as essentially one between a buyer and a seller "whereby the 'issuer' – or company seeking to issue the security – sells an entire allotment of shares to an investment firm who purchases the shares with a view to sell them to the public." *EBC I,* 5 N.Y.3d at 16. The court found that this contractual relationship alone does not give rise to any fiduciary obligations. *Id.* at 20.

However, the *EBC I* court did find that in limited situations, where a pre-existing relationship created independent of the underwriting contract is alleged, an underwriter may have a fiduciary obligation to an issuer. For example, in *EBC I* the issuer had hired Goldman Sachs, its lead managing underwriter with respect to an initial public offering, for its "knowledge and expertise to advise it as to a fair IPO price… with [the issuer's] best interest in mind." *Id.* at 20. Focusing exclusively upon these specific and independently agreed upon terms, the court found that under these circumstances the "parties are alleged to have created their own relationship of higher trust beyond that which arises from the underwriting agreement alone…." *Id.* at 22.

Highlighting that the typical underwriter - issuer relationship does not give rise to a fiduciary obligation, the Court of Appeals stated, "[w]e stress, however, that the fiduciary duty we recognize is limited to the underwriter's role as advisor. We do not suggest that underwriters are fiduciaries when they are engaged in activities other than rendering expert advice." *Id.* at 21-22.

4. Federal Securities Laws

Statutorily imposed duties of an underwriter to an issuer's investors, under the Federal securities laws, further support the non-fiduciary nature of the underwriter - issuer relationship. Specifically, pursuant to the Securities Act of 1933, 15 U.S.C. §§ 77 *et seq.*, an underwriter bears the responsibility to prepare a registration statement that provides full and adequate information to investors with respect to the issuer of a particular security and the distribution of those securities. *See* 15 U.S.C. § 77g (stating, in relevant part, that any registration statement shall contain information and documents "necessary or appropriate in the public interest or for the protection of investors.") Thus, as stated by the majority in *HF Management Services*, "not only is a fiduciary aspect absent from the majority of underwriting relationships, such relationships are better characterized as adversarial since the statutorily-imposed duty of underwriters is to investors." *HF Management Services,* 818 N.Y.S.2d at 43.[3]

5. An Underwriter May Not Profit From Corporate Information Gained in Its Capacity as Underwriter

As noted by the majority in *HF Management Services*, "the motion court established Morgan Stanley's fiduciary obligation as arising from the principle that an underwriter 'may not profit from corporate information gained in its capacity as underwriter.' In so doing, [the motion

[3] The court in *HF Management Services* also notes that "the creation of a fiduciary duty from underwriter's counsel to the issuer of securities makes no sense under the federal securities laws," since the due diligence defense afforded to an underwriter, pursuant to Section 11 of the Securities Act, against liability for material misstatements in the registration statement, is not available to the issuer of the securities. *HF Management Services,* 818 N.Y.S.2d at 44. "Consequently…, there is 'no conceivable basis for any conclusion that the due diligence is being performed for the issuer's benefit.'" *Id.*

court] mistakenly relied on case law like *Frigitemp Corp. v. Fin. Dynamics Fund, Inc.*, 524 F.2d 275, 279 (1975), that allow a characterization of underwriters as fiduciaries of corporations ***primarily in situations involving confidential, insider information used for profit or benefit prior to an IPO.***" *HF Management Services,* 818 N.Y.S.2d at 43 n.1. (emphasis added). *See Dirks v. Sec. Exch. Comm.*, 463 U.S. 646, 655 n.14 (1983) ("[u]nder certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to the information solely for corporate purposes…. When such a person breaches his fiduciary relationship, he may be treated more as a tipper than a tippee").

While the majority in *HF Management Services* rejects the motion court's reliance on case law such as *Frigitemp* and *Dirks*, the dissent appears to embrace these cases in finding that an independent fiduciary obligation arises upon receipt of confidential information by an underwriter. Specifically, the dissent, in agreement with the motion court, explains that a fiduciary "relationship did exist between Morgan Stanley and WellCare, at least to the extent that Morgan Stanley was bound to preserve from adverse use against WellCare in other contexts confidential information elicited from it to facilitate the underwriter's due diligence." *HF Management Services,* 818 N.Y.S.2d at 45.

D. Attorney Disclosure of Confidences and Secrets

1. Code of Professional Responsibility DR 4-101 (22 NYCRR 1200.19)

Canon 4 of The Lawyer's Code of Professional Responsibility generally prohibits a lawyer from revealing a client's confidences and secrets. Similarly, Code of Professional Responsibility DR 4-101 (22 NYCRR 1200.19) states in relevant part:

> (a) Confidence refers to information protected by the attorney-client privilege under applicable law, and secret refers to other information gained in the professional relationship ***that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.***
>
> (b) Except when permitted under section 1200.19(c) of this Part, a lawyer shall not knowingly:
>
> > (1) reveal a confidence or secret ***of a client***;
> > (2) use a confidence or secret ***of a client*** to the disadvantage of the client; and
> > (3) use a confidence or secret ***of a client*** for the advantage of the lawyer or of a third person, unless the client consents after full disclosure.
>
> (c) A lawyer may reveal:
>
> > (1) Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.
> > (2) ***Confidences or secrets when permitted under disciplinary rules or required by law or court order****….*
>
> (d) A lawyer shall exercise reasonable care to prevent his or her employees, associates, and others whose services are utilized by the lawyer from disclosing or using confidences or secrets of a client, except that a lawyer may reveal the information allowed by subdivision (c) of this section through an employee.
>
> (emphasis added).

As demonstrated by the emphasized portions of the text above, DR 4-101 (22 NYCRR 1200.19) is intended to protect the confidences and secrets of a client, not those of a third party. This distinction is significant to the *HF Management Services* action in that EBG was hired specifically as Morgan Stanley's counsel, and not as counsel to WellCare. Thus, based upon the text of DR 4-101 (22 NYCRR 1200.19), EBG would be under no obligation to refrain from revealing confidential information provided by WellCare to Morgan Stanley, and in turn to EBG.

2. A Confidentiality Obligation May Not Attach to Information Provided for the Purpose of Preparing Public Documents in Connection With a Security Issuance

Even if it is assumed that underwriter's counsel owed a fiduciary obligation to an issuer, a confidentiality obligation would likely not attach to the information obtained in the due diligence process, as such information is generally provided in order to prepare public documents which are not intended to be confidential, including the registration statement and the prospectus.

For instance, in *John Doe Corp. v. United States*, 675 F.2d 482 (2nd Cir. 1982), defendant argued that the prior disclosure of a particular document to its underwriter's counsel should not waive defendant's attorney-client privilege with respect to the document. Rejecting defendant's argument, the court held that the privilege of confidentiality was lost after selective disclosure to underwriter's counsel for a beneficial purpose, *i.e.,* a securities offering, and not for the purpose of legal advice. Specifically, the Second Circuit held that "[o]nce materials are utilized in that disclosure, they become representations to third parties by the corporation. The fact that they were originally compiled by attorneys is irrelevant because they are serving a purpose other than the seeking and rendering of legal advice." *Id.* at 489.

Moreover, information provided by an issuer to underwriter's counsel is generally not exchanged under circumstances that give the issuer a right to believe counsel would respect its confidences, since among other reasons, an underwriter bears the responsibility to prepare a registration statement that provides full and adequate information to investors with respect to the issuer. *See Cutner & Assocs. P.C. v. Kanbar*, 300 A.D.2d 157, 751 N.Y.S.2d 733 (1st Dep't 2002) (motion for disqualification of defendant's counsel was properly denied, where among other factors, law firm did not receive confidential information under circumstances in which client had the right to believe that the law firm would respect such confidences).

IV. **EBG's Fiduciary Obligation to WellCare and the Resulting Need For Disqualification**

A. Majority's Focus – The Existence of An Independent Fiduciary Relationship Prior to the Exchange of Confidential Information Between Issuer and Underwriter's Counsel

As the majority in *HF Management Services* notes and as the case law above demonstrates, "New York law … essentially does not recognize the existence of a fiduciary obligation that is based solely on the relationship between an underwriter and issuer." *HF Management Services*, 818 N.Y.S.2d at 42. Therefore, as an initial matter, the majority appears to have appropriately determined that Morgan Stanley, as WellCare's underwriter, did not owe a fiduciary duty to WellCare solely based upon the underwriting agreement between the parties. In turn, the absence of any fiduciary obligation between Morgan Stanley and WellCare, based exclusively on the traditional underwriting agreement entered into by the parties, relieves EBG of any fiduciary obligation to the issuer.

However, as recognized in *EBC I*, a fiduciary obligation may arise between issuer and underwriter where there is a pre-existing relationship created independently and apart from the contractual one. *EBC I*, 5 N.Y.3d at 20. An example of such a pre-existing relationship can be taken from the *EBC I* case itself, in which the issuer had hired Goldman Sachs, the lead managing underwriter, to specifically "advise it as to a fair IPO price… with eToys' best interest in mind." *Id.* In *HF Management Services*, the record does not suggest that the relationship between Morgan Stanley and WellCare was anything other than the typical contractual relationship dictated by a traditional underwriting agreement. In fact, not only were both parties counseled separately, but the underwriting agreement specifically set forth that EBG's role was as "special regulatory counsel for the underwriters." Thus, as the majority aptly found "there is no indication or suggestion that Morgan and WellCare enjoyed any type of pre-existing relationship, or that Morgan acted as an

"expert advisor on market conditions." *HF Management Services*, 818 N.Y.S.2d at 43. Further, unlike the dissent, as discussed below, the majority did not find that a fiduciary obligation arose between EBG and WellCare at the point in time that confidential information was made available to Morgan Stanley in order to complete its due diligence.

B. Dissent's Focus - Fiduciary Relationship Arising From The Receipt of Confidential Information Itself

As noted above, the dissent focuses almost exclusively upon the lower court's finding that "the crux of disqualification is not the attorney-client relationship itself, but the fiduciary relationship that results from it." *Id.* at 45. In so doing, the dissent pays little attention to the fact that case law and federal statutes explicitly rebut the existence of a fiduciary relationship between underwriter and issuer, absent certain exceptions that do not appear to exist in *HF Management Services*. In fact, the dissent specifically asserts that "[w]hether or not Morgan Stanley, as underwriter, was a fiduciary in the limited sense that Goldman Sachs was found to be in *EBC I*," should not be determinative of the fiduciary duty owed by Morgan Stanley to WellCare. *Id.* Rather, the dissent finds that a fiduciary relationship arises not out of an existing relationship between Morgan Stanley and WellCare, but due to the fact that "EBG obtained 'secret' information from WellCare within the meaning of Code of Professional Responsibility DR 4-101 (22 NYCRR 1200.19), to which it would not otherwise have been privy." *Id.* at 45-46. However, this view tends to conflict with the specific authorities the dissent relies upon.

First, in reliance on *Greene*, the dissent asserts that "EBG's disqualification was proper since it obtained confidential information in the due diligence process within the context of a fiduciary relationship," notwithstanding the lack of a formal attorney-client relationship. As noted above, the majority in *HF Management Services* also recognized that disqualification may be appropriate despite the absence of an attorney-client relationship. *Id.* at 45. However, in

determining that a fiduciary relationship did not exist between Morgan Stanley and WellCare, the majority found that disqualification was not appropriate in the *HF Management Services* action. The dissent, in finding that disqualification is appropriate, does not focus on the relationship between Morgan Stanley and WellCare, but rather on the fiduciary relationship that arose strictly based upon the receipt of confidential information by Morgan Stanley and EBG from WellCare. However, the *Greene* decision does not appear to support disqualification on this basis.

Rather, the majority's holding in *Greene* tends to support the position that absent an existing fiduciary relationship or obligation ***at the time confidences were obtained***, disqualification would not be appropriate. In fact, crucial to the opinion in *Greene* was the court's finding that "[a]s former partners in defendant law firm, Grutman and Bjork ***owe a fiduciary obligation similar to that owed by an attorney to his client***.... In view of these allegations, we cannot discount the possibility that ***information obtained by Grutman and Bjork in their role as fiduciaries*** will be used in the pending lawsuit." *Greene*, 47 N.Y.2d at 453 (emphasis added). What appears to be missing in *HF Management Services* is a fiduciary obligation that existed independent of the fact that Morgan Stanley and EBG obtained confidential information in the due diligence process, that they would not have otherwise been privy to. In *Greene*, for example, the existing obligation arose from the fiduciary duty that two former partners owed to their former law firm. Thus, under *Greene*, the acquisition of confidential information alone, absent an independent and existing fiduciary obligation or formal attorney-client relationship, does not appear to necessitate attorney disqualification.

Additionally, the dissent relies upon Code of Professional Responsibility DR 4-101 (22 NYCRR 1200.19), in finding that "even if it was not a fiduciary as found in the context of *EBC I*, at the very least, EBG owed WellCare a fiduciary or special obligation not to disclose to anyone other than Morgan Stanley the "secret" information obtained by it in the course of rendering

professional services to Morgan Stanley, so that Morgan Stanley could use it for the purposes for which EBG was retained." However, as noted above, DR 4-101 (22 NYCRR 1200.19) explicitly pertains only to *client* "confidences" and "secrets," and thus, the dissent seems to stretch the scope of the rule by including under its reach, information obtained from third parties or non-clients.[4]

Moreover, there is no expectation of confidentiality in an IPO setting. As discussed above, the expectation is that an underwriter will publicly disclose, by way of a registration statement and prospectus, the information the underwriter and its counsel obtain in performing their due diligence.

The preceding analysis demonstrates that the dissent's position is not sufficiently supported by case law and legal authority, and thus, this report adopts the majority's position. Additionally, an analysis of the policy considerations set forth below also weighs in favor of adopting the majority opinion. However, as discussed in detail below, there is at least one policy consideration that tends to support the dissent's view.

V. **Policy Considerations**

The *HF Management Services* action presents for resolution "the potentially difficult problem of balancing the interests of a client [*i.e.*, HF Management Services] desirous of retaining an attorney of [its] personal choice and preference against the interests of the opposing litigant to be free from the risks of opposition by a lawyer once privy to that litigant's confidences." *Greene*, 47 N.Y.2d at 454. The following policy considerations are factors that assist in balancing these interests.

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[4] Further, the dissent does not address the motion court's misplaced reliance on case law such as *Frigitemp* and *Dirks*. As discussed above, those cases deem an underwriter to be a fiduciary in the limited sense that the receipt of confidential insider information may not be used by the underwriter *for profit or benefit prior to an IPO*. However, *HF Management Services* presents no facts demonstrating that EBG used the confidential information it obtained in the due diligence process to improperly benefit from trading in EBG securities.

A. Policy Considerations that Militate Against Disqualification and the Finding of a Fiduciary Obligation Between Underwriter's Counsel and Issuer

If the *HF Management Services* court were to find that an underwriter's due diligence counsel owed a fiduciary duty to an issuer, who in essence is a non-client, law firms would likely be faced with a significant rise in attorney conflicts, which in turn, would lead to a rise in attorney disqualifications. The direct consequence of an increase in disqualifying events would be the additional limitations placed on a client's freedom to select the law firm of his, her or its choice. Another negative effect of this trend would be to place an additional burden upon attorneys and law firms to monitor traditional conflicts with respect to their actual clients, as well as potential conflicts with respect to all third party and non-client entities from whom the law firm had obtained "confidential" or "secret" information. In the IPO context, this policy concern is bolstered by the fact that an issuer has no expectation of confidentiality when providing documentation to underwriter's due diligence counsel. Additionally, by expanding the fiduciary obligation of counsel to non-clients, law firms and attorneys will be faced with the very real and potentially significant risk of additional liability.

Finally, because security offerings and the related due diligence process around such offerings involve arm's length transactions between highly sophisticated parties, as noted in the case law above, an issuer should be expected to protect itself through limited confidentiality agreements in the event concerns arise that confidences obtained (in the due diligence process) may be used against it at a later point in time.

B. Policy Considerations Supporting Disqualification

While legal authority generally supports the position that underwriter's due diligence counsel does not owe a fiduciary duty to an issuer, and thus, disqualification is not warranted on that ground alone, there is at least one policy consideration that would support a different result. Putting

aside the issues of fiduciary obligation and the disclosure of client "confidences" and "secrets," it is important to consider that in the context of a security offering, an issuer, in order to facilitate the issuance of its securities, openly provides underwriter's counsel with nearly unfettered access to confidential corporate information, which would not have been accessible, but for the due diligence process. If courts then allow "advantaged" law firms to use the confidences and secrets as weapons against an issuer, who openly provided the information in the first place, clients will actively and deliberately seek and retain those law firms privy to the confidential information. This phenomenon, while not necessarily illegal, tends to foster an unethical attorney selection process which could ultimately give rise to a loss of faith in the legal profession.

Canon 9 of the Code of Professional Responsibility supports this view. Specifically, Ethical Consideration 9-1 provides that "Continuation of the American concept that we are to be governed by rules of law requires that the people have faith that justice can be obtained though our legal system. A lawyer should promote public confidence in our system and in the legal profession." Moreover, Ethical Consideration 9-6 states that:

> Every lawyer owes a solemn duty to uphold the integrity and honor of his profession: to encourage respect for the law and for the courts and the judges thereof; to observe the Code of Professional Responsibility; to act as a member of a learned profession, one dedicated to public service; to cooperate with his brother lawyers in supporting the organized bar through the devoting of his time, efforts, and financial support as his professional standing and ability reasonably permit; to conduct himself so as to reflect credit on the legal profession and to inspire the confidence, respect, and trust of his clients and of the public; and to strive to avoid not only professional impropriety but also the appearance of impropriety.

Interestingly, the concurrence in *Greene* embraced similar considerations in finding that attorney disqualification was appropriate in that case. *Greene*, 47 N.Y.2d at 454. In fact, the *Greene* concurrence specifically noted that it reached its conclusion "without reliance on obligations which attach when there is an attorney-client relationship." *Id.* Specifically, the *Greene* concurrence explained, in relevant part, that

> The focus…, must be on the right of defendants in the lawsuit brought against them by Mrs. Greene not to have her represented by a law firm which includes, or until very recently did include, two lawyers who were members of the defendant law firm and allegedly privy to its affairs at the time of the transactions which form the basis of Mrs. Greene's claims…. To permit another law firm with which Grutman and Bjork subsequently became affiliated to represent Mrs. Greene in her lawsuit against their former firm ***would be inappropriate***, at least when there is tendered no special reason why Mrs. Greene selected the Eaton, Van Winkle firm over others to represent her. The information and any documents and records which Bjork and Grutman might have acquired while in the inner councils of defendants' affairs should not be made available to Mrs. Greene other than by discovery or on trial in the action. From the perspective of defendants they are entitled to be protected from having their adversary represented by an attorney who was directly or indirectly an inside participant on their side of the transactions on which the lawsuit is based.
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> From the opposing point of view of Mrs. Greene, the client, it may surely be said that, absent any countervailing considerations, she should be entitled to an attorney or law firm of her preferential choice. In this instance, however, the substantive rights of defendants do countervail and must be held sufficient to require Mrs. Greene to seek legal representation elsewhere. Conceivably the result might be different with recourse had to other means adequately to protect the legitimate rights of defendants not to have one of their former members sit in the councils of the enemy if there were special reasons, such as prior association, personal confidence or relationship, or singular experience and competence, supporting the client's initial desire to be represented by the particular law firm or lawyer.

Id. at 454-55.

In *HF Management Services*, as in *Greene*, defendant is faced with the predicament of having openly provided "confidential" information to an attorney, which is now at risk of being used against the defendant in a separate legal proceeding. Notwithstanding that the attorney in *HF Management Services*, EBG, likely did not owe a fiduciary duty to WellCare, disqualification may nonetheless be warranted considering that: 1) EBG was privy to confidential information regarding WellCare that would not have been available to HF Management other than through eventual discovery, and 2) there is no "special reason" why HF Management selected EBG over others to represent it in an action against WellCare.

VI. **Conclusion**

Case law and legal authority support the majority's position that a fiduciary obligation does not arise between an issuer and an underwriter solely based upon the traditional underwriting agreement. Focusing strictly on the absence of this fiduciary obligation, it is appropriate to conclude that underwriter's counsel has no fiduciary duty to an issuer with respect to confidences obtained during the due diligence process. Thus, disqualification on fiduciary obligation grounds alone would not be appropriate. This conclusion is supported by policy considerations including, among others: 1) the limitations that would be placed upon a client's freedom in selecting counsel, 2) the additional burden placed upon attorneys in monitoring conflicts with respect to "non-clients," and 3) the fact that in the IPO context an issuer does not provide information to underwriter's counsel with an expectation of confidentiality.

However, although this report adopts the opinion of the majority, at least one policy consideration supports a different conclusion. Specifically, if law firms and attorneys were allowed to use purported confidences obtained from an issuer in the due diligence process, as weapons against that issuer at a later point in time, future litigants would be motivated to seek and retain those law firms privy to the confidential information. While not necessarily illegal, this practice fosters an unethical attorney selection process which could ultimately give rise to a loss of faith in the legal profession.