Justinian Capital SPC v WestLB AG
2011 NY Slip Op 34075(U)
May 18, 2011
Sup Ct, New York County
Docket Number: 600975/2010
Judge: Shirley Werner Kornreich

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. SHIRLEY W. KORNREICH Justice PART 3

JUSTINIAN CAPITAL

- v -

WESTLB A.G

INDEX NO. 600975/10

MOTION DATE 3/17/11

MOTION SEQ. NO. 001

MOTION CAL. NO.

The following papers, numbered 1 to 4, 5, 8, 13-19 were read on this motion to/for cross motion to dismiss

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	PAPERS NUMBERED 1-4, 5, 8
Answering Affidavits — Exhibits	13, 14
Replying Affidavits	15 — 19

and transcript of 3/3/11 argument

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DISPOSED OF IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 5/18/11

JUSTICE SHIRLEY WERNER KORNREICH J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/JUDG. ☐ SETTLE ORDER

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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JUSTINIAN CAPITAL SPC, for and on behalf of BLUE HERON SEGREGATED PORTFOLIO,

Plaintiffs,

-against-

WESTLB AG, NEW YORK BRANCH, WESTLB ASSET MANAGEMENT (US) LLC, and BRIGHTWATER CAPITAL MANAGEMENT LLC,

Defendants.

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Index No.: 600975/2010

DECISION and ORDER

KORNREICH, SHIRLEY WERNER, J.:

This action arises from the collapse of special purpose companies (SPCs) that were sponsored and managed by defendants WestLB AG, New York Branch, WestLB Asset Management (US) LLC (collectively "WestLB"), and Brightwater Capital Management LLC (Brightwater). Plaintiff Justinian Capital SPC (Justinian), a Cayman Islands, segregated portfolio company, is acting for and on behalf of holders of subordinated notes in Blue Heron Segregated Portfolio (Blue Heron). Blue Heron is comprised of unincorporated entities wholly owned by Justinian.

WestLB and Brightwater move to disqualify plaintiffs' law firm, ReedSmith LLP, from representing plaintiffs in this action (mot. seq. 001). Justinian opposes.

I. Background

By Decision and Order dated August 19, 2010, the court disqualified ReedSmith from representing the plaintiffs, including Justinian, in the case of *Bank Hapoalim B.M., et al v*

WestLB AG, et al, Index No. 603458/09 (Justinian I). In that case Justinian was acting for and on behalf of its wholly owned "Harrier"segregated portfolios, holders of "Harrier and Kestrel" income notes. Two weeks after being disqualified, ReedSmith filed Justinian's complaint in this action against other WestLB entities. The court's order of disqualification in Justinian I was affirmed by the Appellate Division, First Department, on March 3, 2011. *Bank Hapoalim B.M. v WestLB AG*, ___ AD3d ___, 2011 NY Slip Op 1586 (1st Dept 2011).

Defendant WestLB is the New York branch office of WestLB AG, a German banking institution. Defendant WestLB Asset Management is a subsidiary of WestLB AG, and has its principal place of business in New York. Defendant Brightwater is a division of WestLB Asset Management. Brightwater managed approximately 14 investment vehicles during 2007. Mauhs Reply Affirm., ¶ 2. These vehicles included the Harrier and Kestrel portfolios involved in Justinian I and the Blue Heron VI and VII portfolios involved in this case (Justinian II). *Id.* Mauhs attests that, "all of [these investment vehicles] invested in similar mortgage and other asset-backed securities, and all of which, as a result of the subprime mortgage and resulting liquidity and credit crisis that began in mid-2007, suffered significant losses." *Id.*

In its marketing materials (Ex. 1, Motion), Justinian describes itself as a "unique asset management business which offers a strategy to asset owners which releases value from their failing investments using specialist financial and legal expertise." That strategy includes the "[u]se of external lawyers for intervention" who will "act on contingency." Ex. 1. A "typical scenario" is described as Justinian "[u]sing experience of running contentious disputes of this kind to control and manage external lawyers acting collectively or, where necessary, [Justinian]

will itself instruct and manage external lawyers." *Id.* Justinian identifies ReedSmith as one of its three "litigation partners." *Id.*

This motion, as was the Justinian I motion, is based on a November 5, 2007, hour-long meeting during which WestLB's general counsel (Mauhs) met with three attorneys from the Anderson Kill law firm about defending WestLB in anticipated litigation involving the collapse of Harrier and Kestrel Structured Investment Vehicles (SIVs) supervised and managed by WestLB and Brightwater. The anticipated litigation became a reality when ReedSmith, on behalf of Justinian, et al, filed a complaint against WestLB and Brightwater (Justinian I). The lead ReedSmith attorney on the case, Jordan Siev, had previously represented WestLB in the Enron litigation while working at another law firm, Anderson Kill & Olick, P.C. He was one of the lawyers who met with WestLB's general counsel on November 5, 2009 about the then likely Justinian I litigation After that meeting, Siev and the other two attorneys who met with WestLB's general counsel, left Anderson Kill and joined ReedSmith, which represented Justinian in Justinian I and represents Justinian in Justinian II. Since the parties to this case were also parties to Justinian I, the court assumes their familiarity with the evidence submitted in that case and the facts found by the court in its August 19, 2010 decision and order.

The complaint in this case was filed on September 7, 2010, less than three weeks after the court's decision relieving ReedSmith from representing the plaintiffs in Justinian I. ReedSmith counsel David A. Kochman, who signed the complaint, also was named on the Justinian I complaint with Siev as counsel for the plaintiffs in that case. He had worked with Siev at the Anderson Kill law firm before moving to ReedSmith.

WestLB and Brightwater claim that the "substantial relationship" between the two Justinian actions warrants disqualification. ReedSmith, on the other hand, claims that disqualification is not warranted because the two actions involve different issues, the Blue Heron entities were not discussed at the November 5, 2007 meeting, and defendants have failed to identify any confidence that was shared at that meeting. For the reasons discussed below, the court grants the motion and disqualifies ReedSmith as counsel for Justinian in this case.

II. Discussion

As a preliminary matter, the court must determine whether the issue of disqualification is governed by the Code of Professional Responsibility or the Rules of Professional Conduct, which took effect on April 1, 2009. In Justinian I, the court found that the former applied because the disqualification issue arose before April 2009. That decision was based on: the November 5, 2007 meeting between WestLB's general counsel and Jordan Siev; ReedSmith's 2008 hiring of Siev and the other two attorneys at the November 5th meeting; and the retention of ReedSmith by the plaintiffs in Justinian I, including Justinian, some time in 2008. The Appellate Division affirmed, holding: "[C]ounsel's conduct in taking on the conflicting representation is governed by the Code of Professional Responsibility, which was in effect at the time of the conduct, rather than by the Rules of Professional Conduct, which were in effect when the motion to disqualify was brought." *Bank Hapoalim B.M.*, 2011 NY Slip Op 1586.

Although the complaint in this action was filed on September 7, 2010, well after the Rules of Professional Conduct took effect on April 9, 2009, the alleged confidences at the root of the current claim for disqualification, were divulged in 2007 at the November 5th meeting with

Mauhs, WestLB's generl counsel. The court has not been made aware of when ReedSmith and Justinian began discussions and preparations to file the complaint in this action, but ReedSmith's representation of Justinian in the Justinian I action began prior to April 9, 2009. Since any doubts as to the existence of a conflict of interest must be resolved in favor of disqualification [*see The Rose Ocko Foundation, Inc. v Liebovitz*, 155 AD2d 426 (2d Dept 1989)], the court concludes that ReedSmith took on the "conflicting representation" for the purpose of the pending motion, before April 9, 2009. *Id.* The Code of Professional Responsibility, therefore, applies.

DR5-108(A)(1) of the Code of Professional Responsibility prohibits a lawyer from representing a party against a former client in the same or a substantially related matter, "without the consent of the former client after full disclosure." The rule also proscribes the use of the former client's confidences or secrets. DR5-108(A)(2). Confidences are defined as information covered by the attorney-client privilege, and secrets are defined as other information disclosed in the professional relationship, unless the information is generally known. DR4-101; *see Jamaica Pub. Serv. Co., Ltd. v AIU Ins. Co.*, 92 NY2d 631, 637 (1998) (attorney may divulge generally known information about former client). When seeking disqualification pursuant to DR5-108, movant must prove an attorney client relationship, that the matter was the same or substantially related and that the interests of the attorney's present client and former client are adverse. *Solow v W.R..Grace & Co.*, 83 NY2d 303,308 (1994); *accord id.* at 636; *Tekni-Plex, Inc. v Meyner and Landis*, 89 NY2d 123, 130 (1996). These criteria, when met, "give rise to an irrebuttable presumption of disqualification." *Jamaica Public Serv., id.*; *Tekni-Plex, id.*

Moreover, the duty to protect a former client's confidences under DR5-108 is broader than the attorney client privilege. *Pelligrino*, 49 AD3d 99. A "reasonable probability of

disclosure" is sufficient to meet a moving party's burden for disqualification. *Jamaica Pub. Serv.*, 92 NY2d 637; *Id.* In making this showing, the movant need not specify the secrets and confidences at issue, but must "provide the court with information sufficient to determine whether there exists a reasonable probability that DR5-108(A)(2) would be violated." *Jamaica Pub. Serv.*, *id.* at 638.

First, the doctrine of *collateral estoppel* bars Justinian from re-litigating the issues determined by the court's August 19, 2010 order. The two requirements of collateral estoppel are, "'that an issue in the present proceeding be identical to that necessarily decided in a prior proceeding, and that in the prior proceeding the party against whom preclusion is sought was accorded a full and fair opportunity to contest the issue' (*Allied Chem. v Niagara Mohawk Power Corp.*, 72 NY2d 271, 276)." *Safchik v Board of Educ.*, 158 AD2d 277, 278 (1st Dept 1990) (parties estopped to contest any issue in arbitration award). (Citation included.)

The issues decided by the court in its prior disqualification order in Justinian I, and affirmed on appeal, that are identical to the issues to be decided here in Justinian II are: the preliminary consultation between ReedSmith and WestLB encompassed an attorney-client relationship; confidences were revealed during the preliminary consultation, establishing a fiduciary duty of loyalty as to those communications; and there is a reasonable probability that ReedSmith might disclose WestLB's confidences to Justinian.

ReedSmith and Justinian do not dispute that they had a full and fair opportunity to litigate these issues in Justinian I, or that Justinian and WestLB/Brightwater are adverse parties in this case. They claim only that collateral estoppel does not apply because no confidences regarding

the Blue Heron action were revealed during the November 5, 2007 meeting. However, to grant disqualification, the court does not have to find that Blue Heron in particular was discussed at the meeting, only that the attorney is representing a party against that attorney's former client in a matter substantially related to the matter giving rise to the former representation. DR5-108(A)(1). Justinian I and II are "substantially related."

The parties are the same, Justinian and WestLB/Brightwater. Additionally, Justinian's claims in both actions are nearly identical. For example, Justinian alleges in both actions that: it is acting "for and on behalf of" its wholly owned "Segregated Portfolios" containing junior, subordinated notes in investment vehicles that invested in mortgage and other asset-backed securities; the note holders in both cases had the same place on the loss ladder; the investment vehicles in both actions were managed by WestLB's Brightwater division; WestLB defendants allegedly mismanaged the investment vehicles and defrauded the junior note holders during the 2007 credit crisis; and, allegedly, in an effort to avoid harm to themselves, WestLB and Brightwater breached their duties to note holders represented by Justinian. Exh. 2, ¶¶ 4, 17, 20, 24, 28, 30, 82, 85-86, 99-102, 129, 135-137; Exh. 3, ¶¶ 8, 17, 20, 26, 28, 51, 79-83, 86-87, 147, 260. ReedSmith was Justinian's "litigation partner" in its business endeavor to capitalize "on confrontational opportunities arising from the growing number of failing investment vehicles" (Exh. 1, motion), including Harrier (Justinian I) and Blue Heron (this action).

Disqualification is necessary to avoid the probability that ReedSmith will disclose its attorney's discussion with WestLB's counsel, which it has already been finally determined was confidential. The prohibition against revealing a client's confidences is contained in subsection (A)(2) of DR5-108. WestLB's confidences divulged and discussed during the meeting did not

have to specifically concern this action. A movant's allegations of "disclosure of the type of information that could, even inadvertently, provide a strategic advantage to [plaintiffs]" supports disqualification. *Rose Ocko*, 155 AD2d at 427. The information discussed at the preliminary consultation, if disclosed to Justinian, could provide it with a strategic advantage over WestLB in this action.[1] As the court wrote in its August 19, 2010 order in Justinian I, Justinian's counsel (Siev and two other soon-to-become ReedSmith attorneys) and WestLB's general counsel discussed, *inter alia*: litigation strategy regarding allegations that WestLB/Brightwater made management and investment decisions in their own, and not the plaintiff note holders' interests, "possible strategies for restructuring [the investment vehicles] in the face of the note holders' claims" (Mauhs Reply Affid., ¶ 7); "WestLB's legal and other obligations to support [the investment vehicles]" (*Id.*); the background to Brightwater and WestLB's problems (Mauhs Reply Affid., ¶ 8); and the "confidential" October 29, 2007 letter from note holders threatening litigation.

The court has already determined, and the Appellate Division has affirmed, that the discussion, if disclosed, could provide a strategic advantage to Justinian and ReedSmith's other

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[1] Disqualification would be required as well under the Rules of Professional Conduct now in effect. Rule 1.18(a) defines a prospective client as one with whom the lawyer discussed forming an attorney-client relationship. Section (b) of the Rule prohibits the lawyer from revealing information learned during the consultation, except as Rule 1.9 of the Code would permit regarding a former client, even if not retained. And, section (c) enjoins the lawyer from representing "a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer received information from the prospective client that *could be significantly harmful* to that person in the matter." [emphasis added]. Disclosure of WestLB's litigation strategy to Justinian could be significantly harmful to WestLB in this litigation, as well as in any other actions Justinian might bring against it on behalf of note holders in investment vehicles that were managed by Brightwater during the same period.

clients in Justinian I. The court now finds that the same discussion could provide Justinian with a strategic advantage in Justinian II. As Mauhs attests, "[m]y department and I were aware that other investment vehicles managed by Brightwater might be suffering similar problems. Hence, the concerns and issues I discussed with Siev and his colleagues on November 5, 2007 applied to all these vehicles." *Id.*

Any doubts as to the existence of a conflict must be resolved in WestLB's favor even if only to avoid the appearance of impropriety. *See Burton v Burton*, 139 AD2d 554 (2d Dept 1988) (no evidentiary hearing required where disqualification necessary to avoid appearance of impropriety); *see also Rose Ocko*, 155 AD2d at 427; *Seeley v Seeley*, 129 AD2d 625, 626-627 (2d Dept 1987). As the Court of Appeals has said: "[A]ttorneys historically have been strictly forbidden from placing themselves in a position where they must advance, or even appear to advance, conflicting interests * * *. This prohibition was designed to safeguard against not only violation of the duty of loyalty owed the client, but also against abuse of the adversary system and resulting harm to the public at large." *Greene v Greene*, 47 NY2d 447, 451 (1979). Accordingly, it is hereby

ORDERED that the motion of WestLB AG, New York Branch, WestLB Asset Management (US) LLC, and Brightwater Capital Management LLC, to disqualify Reed Smith LLP as counsel for plaintiffs in this action, is granted; and it is further

ORDERED that this action is stayed for 60 days for plaintiffs to retain new counsel in this action; and it is further

ORDERED that the parties are to appear in Part 54, 60 Centre St., rm. 228, for a status conference on July 14, 2011 at 11:00 a.m.

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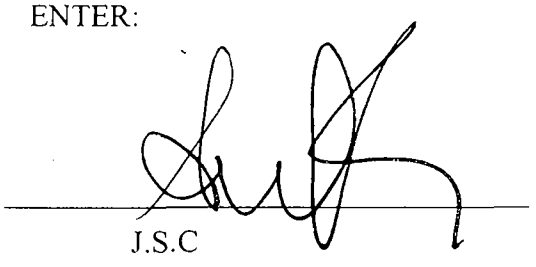

Date: May 18, 2011

J.S.C