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Second Circuit Reverses Order Disqualifying Defense Counsel In Suit Over Demutualization Of Insurance Company

In [*Murray v. Metropolitan Life Ins. Co.*](#), No. 09-3716-CV, 2009 WL 3080462 (2d Cir. Sept. 29, 2009), the [United States Court of Appeals for the Second Circuit](#) reversed an order by the district court disqualifying defense counsel for a life insurance company in an action alleging fraud in connection with the demutualization of defendant life insurance company. The Court held that the law firm did not have an attorney-client relationship with the policyholders (plaintiffs) by reason of counsel's representation of the insurance company in the demutualization process several years earlier. The Second Circuit's decision provides clear guidance as to whether constituents of a mutual company have a direct attorney-client relationship with counsel for the company, slamming shut the door opened by the district court in this case.

Murray is a class action suit brought by policyholders of [Metropolitan Life Insurance Company](#) ("MetLife") following the demutualization of MetLife in 2000. "Demutualization" is a process by which a customer owned mutual organization, changes form to a corporation. Plaintiffs alleged that they were defrauded by MetLife in connection with the demutualization.

During discovery in the case, MetLife invoked the attorney-client privilege in an attempt to prevent plaintiffs from discovering certain materials containing communications between MetLife and outside counsel. The district court held that prior to demutualization, "MetLife's policyholders were the clients of MetLife's in-house and outside counsel, because they were MetLife's beneficiaries and the beneficiaries of MetLife counsel's advice," and denied a protective order. See *In re MetLife Demutualization Litig.*, 495 F. Supp. 2d 310, 314 (E.D.N.Y. 2007).

Nine years after the action was commenced, and only five weeks before trial was scheduled to begin, plaintiffs moved to disqualify MetLife's defense counsel. Relying upon the district court's reasoning in its protective order ruling from 2007, plaintiffs argued that counsel's representation of MetLife during the demutualization process amounted to representation of the plaintiffs in their capacity as beneficiaries (policyholders) of MetLife. Thus, plaintiffs argued, they had a right as clients of MetLife's counsel to object to defense counsel's continued representation of their adversary, MetLife. Plaintiffs also argued that the witness-advocate rule required disqualification of defense counsel because the attorneys at the firm who worked on the demutualization transaction would likely give testimony adverse to MetLife at trial.

The district court granted plaintiffs' motion for disqualification. The court explained that "the problem . . . is [defense counsel] represented the policyholders up until the date on the closing [of the demutualization] when they walked over across the aisle and started representing the stockholders, if you will, and . . . the corporation more exactly."

The Second Circuit reversed the disqualification decision on two grounds. First, the Court held that under New York law policyholders of a mutual insurance company are *not* the clients of the insurance company's outside counsel. By relying on "well-settled law" that "outside counsel to a corporation represents the corporation, not its shareholder or other constituents," the Court reasoned that the same principles apply to a mutual insurance company and that the district court's 2007 decision did not distinguish a mutual insurance company from any other corporation.

Second, the Second Circuit rejected plaintiffs' argument that the witness advocate rule barred representation. Under Rule 3.7(a) of the New York Rules of Professional Conduct "[a] lawyer shall not act as an advocate before a tribunal in a matter in which the lawyer is likely to be a witness on a significant issues of fact." Subsection (b) reads "A lawyer may not act as an advocate before a tribunal in a matter if . . . another lawyer in the lawyer's firm is likely to be called as a witness on a significant issue other than on behalf of the client, and it is apparent that the testimony may be prejudicial to the client."

Plaintiffs argued that four attorneys at the law firm were likely to testify. Because three were transactional attorneys and none was acting as advocates before the jury, the Court found that plaintiffs failed to establish by clear and convincing evidence the requisite prejudice to justify the extreme remedy of disqualification by imputation. Moreover, the Court took into consideration the time and money that would need to be spent to bring in new counsel at the eve of trial, the nine-year delay before plaintiffs sought disqualification and MetLife's overall desire to retain outside counsel of its choice.

In reaching its decision, the Second Circuit applied well settled law regarding the distinction between limited liability business entities (e.g., corporations) and their constituents (e.g., shareholders). This decision extends that body of law to mutual companies. To the extent the district court's rulings created controversy in this area, the Second Circuit's decision resolves that controversy with clarity.

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