

IN THE SUPREME COURT OF TEXAS

=====
No. 96-1131
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IN RE EPIC HOLDINGS, INC., EPIC HEALTHCARE GROUP, INC.,
AND EPIC HEALTHCARE MANAGEMENT CO., RELATORS

- consolidated with -

=====
No. 96-1133
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IN RE KENNETH GEORGE, RELATOR

=====
ON PETITIONS FOR WRIT OF MANDAMUS
=====

Argued on October 9, 1997

JUSTICE HECHT delivered the opinion of the Court, in which CHIEF JUSTICE PHILLIPS, JUSTICE OWEN, JUSTICE ABBOTT, JUSTICE DAVIS,¹ and JUSTICE ABLES² join.

JUSTICE BAKER filed a dissenting opinion in which JUSTICE GONZALEZ and JUSTICE SPECTOR join.

JUSTICE ENOCH and JUSTICE HANKINSON did not participate in the decision.

Three corporations and their former chief executive officer, defendants in certain pending litigation, contend in these two original mandamus proceedings that the lawyers representing plaintiff

¹ Hon. Rex D. Davis, Chief Justice, Court of Appeals for the Tenth Court of Appeals District, sitting by commission of Hon. George W. Bush, Governor of Texas, pursuant to Section 22.005 of the Texas Government Code.

² Hon. Stephen B. Ables, District Judge, 216th Judicial District, and Presiding Judge, Sixth Administrative Judicial Region, sitting by commission of Hon. George W. Bush, Governor of Texas, pursuant to Section 22.005 of the Texas Government Code.

should be disqualified from doing so because they have violated Rule 1.09 of the Texas Disciplinary Rules of Professional Conduct, which provides in pertinent part:

(a) Without prior consent, a lawyer who personally has formerly represented a client in a matter shall not thereafter represent another person in a matter adverse to the former client:

(1) in which such other person questions the validity of the lawyer's services or work product for the former client; [or]

* * *

(3) if it is the same or a substantially related matter.

(b) [W]hen lawyers are or have become members of or associated with a firm, none of them shall knowingly represent a client if any one of them practicing alone would be prohibited from doing so by paragraph (a).

(c) When the association of a lawyer with a firm has terminated, the lawyers who were then associated with that lawyer shall not knowingly represent a client if the lawyer whose association with that firm has terminated would be prohibited from doing so by paragraph (a)(1)³

After hearing evidence from relators, the district court denied their motions to disqualify plaintiff's counsel. We conclude that plaintiff's counsel must be disqualified, and that the district court's refusal to grant relators' motions was a clear abuse of discretion for which relators have no adequate appellate remedy.

I

In the litigation out of which these original mandamus proceedings arise, plaintiff Vicki Anderson alleges that Kenneth George, while chief executive officer of EPIC Holdings, Inc., and two other directors of that corporation breached their fiduciary duties by exorbitantly compensating

³T EX. DISCIPLINARY R. PROF.'L. CONDUCT 1.09, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. A (1998) (TEX. STATE BAR R. art. X, § 9).

themselves and other executives in connection with the acquisition of EPIC Holdings' by HealthTrust, Inc.-The Hospital Company. Anderson also alleges that HealthTrust conspired to assist the directors in their self-dealing in order to gain their approval of the acquisition.

George has moved to disqualify Anderson's legal counsel under Rule 1.09, contending that the pending case is substantially related to matters in which their former law firm, Johnson & Gibbs, represented George and an EPIC Holdings' subsidiary, EPIC Healthcare Group, Inc., and that Anderson's counsel are questioning the work Johnson & Gibbs did for George and EPIC Healthcare. These two EPIC companies and another EPIC Holdings' subsidiary, EPIC Healthcare Management Company, none of which is presently named as a defendant in Anderson's lawsuit, have intervened in that suit to move to disqualify Anderson's counsel for the same reasons urged by George. Anderson denies that her lawyers have violated Rule 1.09 and counters that relators have waived their disqualification claims. Following the district court's denial of the motions to disqualify, George and the three EPIC companies initiated the mandamus proceedings now before us. Before we set out in more detail the parties' contentions here, we recount, first, the events that led to the pending litigation and the issues raised by the motions to disqualify, and then the proceedings in the courts below.

A

In 1988, American Medical International, a for-profit hospital company, decided to divest itself of more than thirty of its lower revenue-producing hospitals and offered Kenn George, a senior vice president, the opportunity to become chief executive officer of the new corporation formed to acquire the hospitals. George accepted the offer and recruited two other AMI vice presidents, Marliese E. Mooney and Thomas T. Schleck, to go with him. The new company was to be owned

largely by its several thousand employees through common stock allocated to their retirement income accounts as permitted by the federal Employee Retirement Income Security Act.⁴ Vesting ownership in its employees afforded the new company favorable treatment under federal tax laws, strong incentives for employee industry and loyalty, and good publicity.

The new corporation, EPIC Healthcare Group, Inc., acquired the hospitals from AMI in exchange for cash, notes, preferred stock, and assumption of debt. EPIC Healthcare's common stock was issued to an employee stock ownership plan — an “ESOP” — for cash borrowed from various lenders. The ESOP's stock was pledged to secure these loans. Each year EPIC Healthcare contributed retirement benefits to the ESOP that were equal to the principal and interest payments on the loans. As the ESOP used the contributions to pay down the debt, the stock was released and allocated to individual employees' retirement accounts. Some of AMI's preferred stock was convertible to common stock, and EPIC Healthcare could issue common stock for other purposes. But even when the ESOP's interest was fully diluted, it would remain the majority owner of EPIC Healthcare.

The ESOP stock was voted by a trustee. Employees to whose accounts stock was allocated were entitled to direct the trustee's vote of that stock — a right referred to as “pass-through voting” — but only on certain fundamental matters such as mergers and liquidations, not on election of directors. In voting for directors, and in voting the stock that remained pledged as security, the trustee was subject to direction by the committee overseeing the plan. The members of the ESOP Committee, as well as the trustee, were named by EPIC Healthcare's board of directors, which was always dominated by George and his management team. The directors' control of the ESOP trustee

⁴ 29 U.S.C. §§ 1001-1461 (1994).

through the ESOP Committee gave them complete control of the corporation, even though they owned no stock themselves. In 1991, employees' pass-through voting rights were enlarged to include election of EPIC Healthcare's directors, and in later years the preferred stock AMI held was converted to common stock and EPIC Healthcare issued common stock to others besides the ESOP. Even with these changes, however, there could be no serious threat to the directors' effective control of the corporation until almost all the ESOP's stock was allocated to individual employees' retirement accounts, thereby giving the employees the right to vote a majority of EPIC Healthcare's outstanding stock.

George and his senior management were employed by EPIC Healthcare Management Company, a wholly owned subsidiary of EPIC Healthcare. Incentive compensation, mostly to senior executives, was provided in the form of stock appreciation rights — "SARs" — convertible to cash or stock under certain conditions. SARs minimized the tax consequences of the incentive compensation to George and the other executives. The SAR plan was administered by a committee appointed by EPIC's board and thus controlled by George.

We have described only those basic elements of EPIC Healthcare's structure necessary to place in perspective the issues before us. Our brief summary belies the complexity of the transaction. The formation of EPIC Healthcare necessitated the assistance of sophisticated legal counsel experienced in many different areas of law: corporate, tax, securities, banking, ERISA, labor, real estate, and health law. George interviewed several Dallas law firms and selected Johnson & Swanson, later named Johnson & Gibbs and still later, Johnson & Wortley. Like the parties, for simplicity we refer to the firm in all its incarnations as Johnson & Gibbs.

To work on the transaction, the firm assigned more than twenty attorneys coordinated by Jim Watson, a firm shareholder. Watson and Michael G. Frankel, another shareholder, advised George on his employment agreement. Frankel also worked on the SAR plan. William B. McClure, Jr., also a shareholder, drafted the ESOP documents, including the trust agreement and the loan documents, and advised George on how the ESOP was to be administered. Associate attorney Jakes Jordaan spent 785 hours on the matter, mostly devoted to writing, revising, and issuing EPIC Healthcare's registration statement. Another associate, Jeffrey Carter, worked on Medicare issues, although his exact role is unclear. Johnson & Gibbs also advised George on the selection of the ESOP trustee, counseling him not to choose the person AMI nominated but to look for someone more independent. Johnson & Gibbs approved George's ultimate selection. The firm also assisted in preparing the handbook providing employees with a summary description of the ESOP, something required by ERISA. Johnson & Gibbs billed over \$2.2 million for four months' work in setting up EPIC Healthcare, and an additional \$2.3 for handling other matters for the company over the next three years. According to Frankel, EPIC was probably Johnson & Gibbs's largest client in 1988 and a substantial client thereafter. Johnson & Gibbs continued to represent EPIC until it was acquired by HealthTrust in 1994.

Jordaan left Johnson & Gibbs in 1990 and formed his own firm, Jordaan, Howard & Pennington. The next year Mike McKool, Jr., who had been on Johnson & Gibbs's board of directors for nearly a decade, also left to form his own firm, McKool Smith. Four other Johnson & Gibbs lawyers accompanied McKool: Charles W. Cunningham, Gary J. Cruciani, Jeffrey Carter, and Michael Piazza.

In 1992, EPIC Holdings, Inc. was formed to acquire EPIC Healthcare as a wholly owned subsidiary, to purchase some of AMI's preferred stock, and to facilitate conversion of other EPIC Healthcare preferred stock to common stock. In the transaction an AMI representative, Alan J. Chamison, became a director of EPIC. The ESOP received the same proportion of EPIC Holdings' common stock as it held in EPIC Healthcare's common stock. Because the parties do not distinguish, for purposes of this proceeding, between the EPIC company relators — EPIC Holdings, EPIC Healthcare, and EPIC Management — we hereafter refer to them together simply as EPIC.

In January 1994, EPIC's directors agreed to a plan of merger with another hospital holding company, HealthTrust, Inc.-The Hospital Company, as a result of which EPIC would become a wholly owned subsidiary of HealthTrust. EPIC shareholders, including employee retirement accounts, would be paid for their stock, and the ESOP would be extinguished. HealthTrust agreed to pay some \$277 million to acquire EPIC's stock, and to assume EPIC's indebtedness of some \$727 million. Thus, HealthTrust and EPIC announced that the transaction involved more than \$1 billion.

By this time, the ESOP owned about sixty percent of EPIC's outstanding shares, and a majority of the ESOP's shares had been allocated to employees' retirement accounts. The stock that remained pledged, plus AMI's stock, constituted a majority of the outstanding shares. In the merger negotiations with HealthTrust, the ESOP trustee took the position that he was both entitled and obliged to evaluate the benefits to the shareholders without direction from either the ESOP Committee or the individual employees that had received stock allocations. Before voting with AMI and other EPIC shareholders to approve the transaction with HealthTrust, the trustee insisted on and obtained various terms.

One condition of the transaction was that George and twelve other EPIC executives resign their employment. For release of their contractual rights, including severance and SAR payments, HealthTrust paid the executives over \$42 million, a little more than half of which went to George. HealthTrust also agreed to indemnify the executives from any excise tax liability for the payments, up to \$6 million.

B

On April 29, 1994, a few days before the transaction was to close, Vicki Anderson, an employee to whose retirement account the ESOP had allocated stock, sued EPIC, its five directors, and HealthTrust, to enjoin the merger and recover damages.⁵ Anderson's core complaint is that George and other executives, at the expense of EPIC shareholders, obtained payments for their severance rights and SARs far in excess of anything to which they were entitled. HealthTrust went along with the payments, Anderson alleges, to "bribe" George and the other directors to sell EPIC for much less than it was worth, and the ESOP trustee voted for the transaction because George and other EPIC directors threatened and intimidated him. Anderson complains that employees were never told of the 1991 change in their pass-through voting rights, and that the 1994 proxy materials soliciting shareholder approval of the merger did not disclose the self-dealing of EPIC's directors, misrepresented the ESOP trustee's role in the transaction, failed to state that AMI had sued to stop an earlier proposed merger of EPIC and HealthTrust, and did not explain the merger's true impact on EPIC's employees.

⁵ Defendants contend that Anderson lacks standing to sue individually and that her claims are preempted by ERISA and outside the jurisdiction of the state courts. We express no opinion on these issues.

A little over an hour after suit was filed, the district court issued a temporary restraining order prohibiting consummation of the merger. A few days later defendants removed the case to federal court. To obtain Anderson's withdrawal of her opposition to closing the transaction, HealthTrust agreed that it would assign her, or cause EPIC to assign her, whatever claims EPIC had against its directors and HealthTrust arising out of the actions and events described by Anderson in her original petition. The merger transaction then closed. Anderson later amended her petition to include claims on behalf of EPIC and to drop EPIC as a defendant.

Anderson's suit was filed by attorney James E. Pennington, a member of the law firm of Jordaan, Howard & Pennington. Johnson & Gibbs lawyers representing EPIC in the merger knew of the connection between Pennington and Jordaan, but the lawyer representing EPIC and its former directors in the lawsuit, Jerry R. Selinger, did not, and therefore he did not realize at first that Pennington might be disqualified from representing Anderson. Over the next four months, while little activity occurred in the case, Pennington's firm and McKool Smith agreed to represent Anderson jointly, sharing equally in the work and in any fees awarded. On September 2, 1994, Charles W. Cunningham, a shareholder at McKool Smith who had been a Johnson & Gibbs shareholder when EPIC was formed, entered an appearance on Anderson's behalf. Selinger immediately recognized the connection between the McKool firm and Johnson & Gibbs, and raised the issue of whether Anderson's counsel were disqualified.

Over the next several months the parties exchanged correspondence on the disqualification issues, each requesting information from the other on the subject. In essence, EPIC and its former directors argued: that Johnson & Gibbs had represented both EPIC and George; that attorneys Jordaan and Carter had even worked on the formation of EPIC themselves; that the formation of

EPIC was substantially related to Anderson's claims; that Anderson's suit was adverse to EPIC and George; that Anderson's counsel could not represent her without revealing confidential information acquired through the representation of EPIC and George; and that Anderson could not prosecute her claims in the lawsuit without questioning the validity of Johnson & Gibbs's services or work product for EPIC and George. Anderson took the position: that Johnson & Gibbs had represented only AMI, not EPIC or George, in the formation of EPIC; that Jordann had worked only on EPIC's registration statement after EPIC was formed; that Carter could not be shown to have worked on EPIC's formation; that Anderson's claims were unrelated to the work done to form EPIC; that there was no reasonable probability that Anderson's counsel would divulge confidential information obtained through forming EPIC; and that while Anderson would explore Johnson & Gibbs's work in forming EPIC, she intended to rely on, not question, that work and to complain only of events after 1992. On October 20, 1994, Anderson's counsel wrote to EPIC's counsel: "We don't see any allegations in the petition that reasonably can be construed as a challenge to the 1988 creation of EPIC, the SAR Plan, or the employment contracts."

At first, EPIC and its former directors did not insist on disqualification, nor did Anderson's counsel absolutely reject the possibility that disqualification might be required. Rather, both sides explored the subject at length and in good faith before solidifying their positions. George's counsel later stated that EPIC and its former directors realized by December 1994 that Anderson's counsel would not withdraw, although EPIC and George now say that Anderson's counsel did not unequivocally refuse to withdraw until March 1995, after attempting to undertake discovery. In any event, EPIC filed a motion to disqualify Anderson's counsel on March 31, 1995, and George and the other defendant directors filed a similar motion on April 3. Days later, the federal court remanded

the case to state court without ruling on the motions. On April 27, EPIC and its former directors filed in state district court a joint motion to disqualify Anderson's counsel, and Anderson filed a second amended petition which, as already noted, did not name EPIC as a defendant. George and others then filed an amended motion to disqualify. EPIC, no longer a party, did not join in the amended motion and abandoned its own motion. In June 1995 the district court heard the movants' evidence and, without hearing Anderson's evidence, denied the motion to disqualify.

Trial began on June 3, 1996. As Anderson's case began to unfold, its cast was distinctly critical of Johnson & Gibbs's work in forming EPIC, as we explain below. On June 17, the tenth day of trial, George and the other defendant directors renewed their motion to disqualify Anderson's counsel, based on the way they had conducted her case. Without ruling on the motion, and apparently for reasons unrelated to it, the district judge granted defendants' motion for a mistrial and recused herself from the case. The case was transferred to another court. On July 12, EPIC intervened in the case for the purpose of moving to disqualify Anderson's counsel.

The district court heard the motions to disqualify on October 29, 1996. After hearing argument for all parties, but before hearing evidence, the court denied the motions, indicating that it believed that the grounds asserted for disqualification either had been raised previously and ruled on, or had not been timely raised and were waived. However, after allowing the movants to make bills of exception, the court admitted the evidence and denied the motions on their merits. Anderson presented some evidence at the hearing, but she understandably desisted when the court announced that it would rule in her favor.

George and EPIC separately sought review by mandamus, first unsuccessfully in the court of appeals, and then in this Court. We granted the petitions on June 12, 1997, with JUSTICE ENOCH

recusing himself.⁶ The Court heard argument on October 9, 1997, and a few days later, before the case could be decided, JUSTICE CORNYN resigned his office and JUSTICE HANKINSON was appointed to the Court in his place. JUSTICE HANKINSON also recused herself from participating in the decision of the case. The CHIEF JUSTICE certified the fact of the recusals to the Governor, who thereupon commissioned the Honorable Rex D. Davis, Chief Justice of the Court of Appeals for the Tenth District of Texas at Waco, and the Honorable Stephen B. Ables, Judge of the 216th District Court in Kerrville and Presiding Judge of the Sixth Administrative Judicial Region of Texas, to hear and decide the case.⁷

II

We have repeatedly observed that “[t]he Texas Disciplinary Rules of Professional Conduct do not determine whether counsel is disqualified in litigation, but they do provide guidelines and suggest the relevant considerations.”⁸ George makes an argument apart from the disciplinary rules that what he calls Anderson’s counsel’s “side-switching” creates an appearance of impropriety. But as we said at the beginning, George and EPIC focus their arguments on Rule 1.09, and we think George’s more general argument is fairly comprehended by the considerations supplied by that rule. Consequently, we analyze the elements of the rule and then consider whether disqualification of any or all of Anderson’s legal team is required.

⁶ 40 TEX. SUP. CT. J. 628 (June 12, 1997).

⁷ TEX. GOV’T CODE § 22.005.

⁸ *National Medical Enterprises, Inc. v. Godbey*, 924 S.W.2d 123, 132 (Tex. 1996) (citing *Henderson v. Floyd*, 891 S.W.2d 252, 254 (Tex. 1995) (per curiam); *Spears v. Fourth Court of Appeals*, 797 S.W.2d 654, 656 (Tex. 1990); and *Ayres v. Canales*, 790 S.W.2d 554, 556 n.2 (Tex. 1990)).

A

Anderson concedes that Jakes Jordaan, Jeffrey Carter, and other Johnson & Gibbs lawyers personally represented EPIC in 1988, but she argues that none of the lawyers in that firm represented George in that time period. Anderson points out that no 1988 documents identify George as a client of any attorney at the firm, that firm documents show “Newco” — the firm’s name for EPIC Healthcare — as the client at that time, that a former Johnson & Gibbs shareholder, Winston Walp, testified that EPIC was the firm’s client in 1988, and that AMI paid the bills for the work done to form EPIC. These facts are direct evidence that Johnson & Gibbs represented EPIC and AMI, but they say nothing about whether the firm *also* represented George individually. The fact that AMI paid the firm’s bills does not suggest that EPIC was not also a client; indeed, Anderson’s own direct evidence is to the contrary. Neither does AMI’s responsibility for paying Johnson & Gibbs’s fees suggest that George was not also represented by the firm. Nor does Walp’s testimony that EPIC was the client, as shown in firm records, suggest that AMI, who paid the bills, was not, or that George was not. The evidence to which Anderson points neither proves, nor supports an inference, that Johnson & Gibbs attorneys did not personally represent George in 1988.

Anderson does not argue that a conflict of interest would have prevented Johnson & Gibbs from representing George individually as well as AMI and EPIC, and there is no evidence that any such conflict, if one existed, was not waived. AMI’s and EPIC’s interests in 1988 were similar but they were not congruent. Disagreement arose, for example, over who should be the ESOP trustee and how independent he should be from AMI’s influence. Nothing in the record we have indicates that AMI or EPIC considered any disagreements they had to pose a conflict preventing their

representation by the same firm, or that Johnson & Gibbs was precluded from also representing George personally.

The only evidence in the record before us — some of it adduced by Anderson herself — is that the firm did represent George individually in setting up EPIC. At trial, attorney Cunningham asked attorney Watson, testifying as an adverse witness, whether he had “represented Kenn George personally in connection with the formation of EPIC” in 1988, to which Watson answer, “That’s correct.” Later, attorney McKool examined George as follows:

Q And when EPIC was being set up, that’s when you hired the corporate lawyers from the firm of Johnson & Gibbs; is that right?

A Correct.

Q And I’m not going to go back into the details, but the lead lawyer for that group was the Mr. James Watson that we saw here for several days this week; is that not right?

A Correct.

Q And it’s true, isn’t it, that those lawyers helped you structure every line, sentence, and paragraph of your employment contract?

A Those lawyers drafted every line, sentence, and paragraph in the contract, correct.

Q And when they did it, they were representing you personally, weren’t they?

A That’s what I thought.

Attorney McKool even told the jury in his opening statement that “[t]he evidence will be that every word of Kenn George’s employment agreement was drafted by this personal lawyer, representing both him personally and the company.” Attorney McClure testified at the October 1996 hearing on the motions to disqualify that he advised George in negotiating the ESOP documents.

We think that when an attorney performs legal services benefitting a person individually who is regarded by both the attorney and the person as a client, the existence of an attorney-client relationship cannot be challenged by a third party. To allow one member of a law firm to dispute the existence of an attorney-client relationship acknowledged by another member of the same firm would put a client at a serious disadvantage in dealing with the firm. Members of a law firm cannot disavow access to confidential information of any one attorney's client.

There is, in effect, an irrebuttable presumption that an attorney in a law firm has access to the confidences of the clients and former clients of other attorneys in the firm. One reason for this presumption is that it would always be virtually impossible for a former client to prove that attorneys in the same firm had not shared confidences. Another reason for the presumption is that it helps clients feel more secure. Also, the presumption helps guard the integrity of the legal practice by removing undue suspicion that clients' interests are not being fully protected.⁹

To allow members of a firm to dispute another member's assertion of an attorney-client relationship with a person would open an avenue for circumventing the presumption protecting client confidences. Even though access to confidential information could not be denied, existence of the protected relationship could be.

Here, not only is the evidence uncontradicted that Johnson & Gibbs attorneys personally represented George as well as EPIC in 1988, Anderson herself took that position at trial. At the October 1996 hearing McKool explained that his statement to the jury of what the evidence would show about Johnson & Gibbs's personal representation of George was merely a recitation of the testimony he expected, not an endorsement of it. But this is not the fair import of his statement to the jury or his examination of George. McKool undertook to prove his former firm's personal representation of George, not to dispute it. The firm's representation of George was not limited to

⁹ *National Medical Enterprises*, 924 S.W.2d at 131 (citations omitted).

drafting his employment agreement and the SAR plan. George was the person most intimately involved in every aspect of forming EPIC, from choosing legal counsel to choosing the ESOP trustee. Defining management's role was crucial to EPIC's entire operation and an inseparable part of the legal work done to set up the corporation. We thus conclude that the Johnson & Gibbs lawyers who served on the legal team to form EPIC in 1988 personally represented not only EPIC but George.

B

Unquestionably, EPIC and George have not consented to the participation of Anderson's counsel in the pending litigation, and the litigation is adverse to George. But Anderson argues that the litigation cannot be adverse to EPIC because she is suing in part on claims EPIC assigned her. EPIC counters that it has contracted to indemnify George and the other directors against liability for claims against them arising out of their management roles, and to pay a portion of the legal fees incurred in defending such claims. Anderson responds that the defendant directors may not be entitled to enforce their contractual indemnification rights if they are found liable for the self-dealing she alleges in her pleadings. Assuming Anderson is correct, the directors would nevertheless be entitled to payment of legal fees as provided in the indemnification agreements if Anderson should not prevail. This liability is not merely hypothetical. The unchallenged evidence in the record is that EPIC has already become indebted for part of the substantial legal fees defendants have incurred in this litigation. Anderson argues that responsibility for the fees is really HealthTrust's because it assumed EPIC's indemnification obligations. But HealthTrust's responsibility is clearly in addition to, not in lieu of, EPIC's; the directors have never released EPIC from the indemnification agreements.

“Adversity,” we have explained, “is a product of the likelihood of the risk [that a lawsuit poses to a person’s interests] and the seriousness of its consequences.”¹⁰ Anderson’s lawsuit poses the almost certain risk to EPIC of either being liable for a part of the defendants’ legal fees, already a substantial sum, or incurring its own legal expense in an effort to avoid such liability, or both. Accordingly, we conclude that Anderson’s lawsuit is adverse to EPIC as well as George.

C

EPIC and George contend that Anderson’s claims in her lawsuit are substantially related to matters involved in EPIC’s formation, and that Anderson has questioned the validity of Johnson & Gibbs’s services and work product in those matters. Anderson argues in response that her claims focus on events occurring after 1992 and unrelated to the legal work done in 1988. She does not question the validity of that work, she says, but on the contrary, affirms it as setting the corporate context for the defendant directors’ misconduct.

A claim that a corporate officer has breached his fiduciary duty to the corporation is not, in and of itself, related to legal work done to form the corporation, and does not necessitate a challenge to that work. Indeed, corporate counsel may be best suited to prosecute such a claim. But there is more to Anderson’s claim than this. Anderson contends that in forming EPIC, a “circle of power” was created that allowed George and other directors to perpetuate their control of the corporation despite the fact that they owned no stock. EPIC’s directors named the ESOP Committee, which directed the ESOP trustee in voting the stock not yet allocated to employee retirement accounts and, until 1991, even directed the ESOP trustee in voting the allocated stock in the election of directors. EPIC’s directors also named the ESOP trustee. Only when the ESOP’s allocated stock and the stock

¹⁰ *National Medical Enterprises*, 924 S.W.2d at 132.

issued to others constituted a majority of the outstanding shares could the directors' control of the corporation be challenged. Anderson claims that George and the other directors misused and abused this control to cause themselves to be paid more than EPIC owed them in connection with the merger with HealthTrust. Defendants contend that George and the other directors were paid only what they were due.

Anderson's claims are thus related to Johnson & Gibbs's work in 1988. They pose a basic issue of whether George and the other directors acted as it was contemplated they would when EPIC was formed or whether, instead, they abused their power. Whether the relationship between Anderson's claims and Johnson & Gibbs's work is substantial enough to invoke Rule 1.09 concerns, or whether the validity of the work done in forming EPIC is put in question, cannot be determined from Anderson's pleadings or pretrial discovery alone. Thus, the district court correctly rejected the argument in EPIC's former directors' original motions for disqualification — an argument made by EPIC in its original motion, too, before Anderson dismissed it from the suit — that Rule 1.09 problems were unavoidable. George himself now concedes that “[i]t may well be that, before trial, Anderson's counsel had every intent of trying a case that never would have questioned the 1988 Johnson & Gibbs work — just as they represented at all times prior to trial.” But the fact that Anderson *could* prosecute her claims without Rule 1.09 implications does not mean that she *would* do so, or that she could do so effectively.

As trial began, the approach of Anderson's counsel was clearly critical of matters prior to 1993. In his opening statement, McKool was critical not only of what George and others were paid in connection with the HealthTrust transaction, but of the amount of George's compensation throughout EPIC's existence. George's compensation before the merger was “not what we're

complaining about here”, McKool told the jury, but was nevertheless, in his words, “relevant and very telling to the issues in this case”. During voir dire attorney Cunningham addressed the venire as follows:

[A]s this lawsuit unfolds, you’re going to see that we’re going to have to challenge pretty strongly Mr. Watson and some of the things that went on that we take issue with. Have any of you been involved in having to confront or challenge people that you’ve worked with before that you think have been involved in something that is not right?

When a member of the venire expressed difficulty with the idea that a lawyer could criticize work done by his partner while they were partners, Cunningham assured her that Anderson’s claims related only to events in 1994. Anderson herself later testified on direct examination that she had no complaint about the way EPIC was structured in 1988. But mere disavowals cannot contradict what actually happened. Cunningham stated in voir dire that attorney Watson, who headed the Johnson & Gibbs team that formed EPIC, would be “a central feature of this lawsuit”. What that meant, as Cunningham’s lengthy, grueling, and sometimes heated cross-examination of attorney Watson revealed, was that Anderson contended that Watson was the architect of a structure that allowed George to abuse EPIC’s employees.

We have held that two matters are “substantially related” within the meaning of Rule 1.09 when a genuine threat exists that a lawyer may divulge in one matter confidential information obtained in the other because the facts and issues involved in both are so similar.¹¹ Such a threat exists here, when information Johnson & Gibbs lawyers obtained from George and EPIC in 1988

¹¹*Texaco, Inc. v. Garcia*, 891 S.W.2d 255, 256-257 (Tex. 1995) (per curiam) (citing *NCNB Texas Nat’l Bank v. Coker*, 765 S.W.2d 398, 400 (Tex. 1989)); *Metropolitan Life Ins. Co. v. Syntek Finance Corp.*, 881 S.W.2d 319, 320-321 (Tex. 1994) (per curiam); see also TEX. DISCIPLINARY R. PROF’L CONDUCT 1.09, cmt. 4B, reprinted in TEX. GOV’T CODE ANN., tit. 2, subtit. G app. A (1998) (TEX. STATE BAR R. art. X, § 9).

may be relevant in the prosecution of Anderson's claims. An actual disclosure of confidences need not be proven; the issue is the existence of a genuine threat of disclosure because of the similarity of the matters.¹²

At the October 1996 hearing on the disqualification motions, EPIC and its former directors offered the opinions of two experts on legal ethics that Anderson's counsel should be disqualified under Rule 1.09. We need not consider this expert testimony, however, because the record of the trial proceedings determines whether Anderson questioned the validity of Johnson & Gibbs's services and work product in 1988, thereby making her claims substantially related to those matters involved in forming EPIC. The issue is a legal one. Having reviewed the trial record, we have determined that Anderson's counsel did question the work their former firm performed when they were still members of it, and that the relationship between that work and Anderson's claims as her counsel has chosen to prosecute them is substantial.

D

We therefore conclude that Jordaan and Carter, who personally represented EPIC and George while at Johnson & Gibbs in 1988, are prohibited by Rule 1.09(a) from representing Anderson in her lawsuit against George and others because her claims are adverse to George and EPIC, are substantially related to matters on which they worked in 1988, and question the validity of Johnson & Gibbs's services and work product. Rule 1.09(b) prohibits all the lawyers in a firm from representing a client that any one of them could not represent because of Rule 1.09(a). Thus, Rule 1.09(b) would prohibit any member of Jordaan, Howard & Pennington and McKool Smith from

¹² *Texaco*, 891 S.W.2d at 257.

representing Anderson.¹³ Moreover, Rule 1.09(c) would prohibit any lawyer who was a member of the Johnson & Gibbs firm in 1988 from representing Anderson.

The question remains whether Anderson's counsel should be disqualified because their representation of Anderson is prohibited by Rule 1.09. We disqualified counsel based on this rule in *National Medical Enterprises, Inc. v. Godbey*,¹⁴ and we believe the concerns embodied in the rule require the same result here. The legal system's image is ill-served by lawyers criticizing the work of their former associates with whom they shared in the fees paid for the work. Also, it is most unfair for a client to be forced to defend the work of the former associates of his opponent's counsel. One member of the venire at the trial proceedings voiced this reaction to Anderson's counsel's characterization of how the case would be conducted. The provisions of Rule 1.09 serve not only to set standards for attorney conduct but to protect the integrity of legal proceedings. We conclude that Anderson's counsel should be disqualified.

III

Anderson makes two procedural arguments against disqualification. One is that EPIC and George have waived the grounds they assert for disqualification by failing to assert them earlier. The other is that Anderson was not given an opportunity to present evidence against disqualification. We address each in turn.

¹³ *National Medical Enterprises*, 924 S.W.2d at 131; *Henderson*, 891 S.W.2d at 254.

¹⁴ 924 S.W.2d 123 (Tex. 1996).

A

As a rule, “[a] party who fails to file its motion to disqualify opposing counsel in a timely manner waives the complaint.”¹⁵ Anderson argues that EPIC and George waived disqualification of her counsel by waiting over four months after suit was filed to raise the issue and seven more months to file their motions. We think EPIC and George have satisfactorily explained these delays. For four months after Anderson filed suit defendants’ counsel was unaware of the connection between attorney Pennington’s firm and Johnson & Gibbs. Johnson & Gibbs, who was representing EPIC in the HealthTrust merger, recognized the connection but did not communicate it to defendants’ litigation counsel. Anderson concedes that during the last four months of 1994 the parties were exchanging information and correspondence in an effort to identify and resolve disqualification issues but argues that defendants should have filed their motions at least three months before they did. From the record it appears to us, however, that the parties persisted in their efforts to resolve the issues they could before discovery commenced, at which point defendants immediately filed their motions. It is of some importance that in the eleven months before the motions to disqualify were filed almost no discovery was conducted except on disqualification issues. The delay in filing the motions did not prejudice Anderson’s prosecution of her claims.

More importantly, the information available to defendants at any time prior to trial did not establish that Anderson’s counsel should be disqualified under Rule 1.09. As we have already explained, the pleadings and discovery prior to trial did not establish that Anderson’s claims were so substantially related to the work done in 1988 to form EPIC as to raise Rule 1.09 concerns, or that prosecution of those claims would question the validity of that work. Only at trial did it become apparent that Anderson’s approach would be critical of Johnson & Gibbs’s work in 1988. George

¹⁵ *Vaughan v. Walther*, 875 S.W.2d 690, 690 (Tex. 1994) (per curiam).

and the other defendant directors filed their motion during trial, and EPIC intervened and filed its motion a few days later. Both motions were based on the events at trial, and both were timely.

The district court refused to find that EPIC or George waived grounds for disqualification, and in this we conclude that court was correct.

B

After hearing arguments on the motions to disqualify, the district court indicated that defendants' contentions were not sufficiently different from those George had raised unsuccessfully a year earlier to warrant reconsideration of the matter. The court therefore denied the motions without hearing evidence. It properly permitted defendants to adduce evidence in a bill of exceptions, and defendants did so. Anderson was, of course, not obliged to examine the witnesses defendants called as part of their bill, and she did not do so. When the bill was completed, the district court changed course, admitted the evidence, and denied the motions on their merits. Anderson did offer a few exhibits before the court's ruling, but she understandably did not insist on a full evidentiary presentation to a court that had evidenced a definite intention to rule in her favor. Now before us Anderson argues that her counsel should not be disqualified before she has had a full opportunity to present her evidence.

Anderson's argument would be compelling except that as we have resolved the issues, no further evidence is necessary. We have held that Watson's unequivocal and repeated acknowledgment that George was his client cannot be impeached by a third party, including his former partners and associates, when his work undisputedly benefitted George individually and George himself testified that he was Watson's client. Moreover, Anderson herself took the position at trial that Johnson & Gibbs represented George in 1988. Our conclusion that Anderson's action

is adverse to EPIC is based on indemnification agreements in the record. Anderson does not contend that these agreements are for some reason wholly invalid or unenforceable; she argues only that George and the other directors may not be entitled to indemnification for self-dealing. But as we have shown, the mere possibility that EPIC may eventually escape liability does not alleviate the present adversity of Anderson's action. Our determination that Anderson's claims raise Rule 1.09 problems requiring disqualification is a legal one, not a factual one, based entirely on the trial record. Likewise, our conclusion that George and EPIC did not waive the grounds they assert for disqualification is based entirely on the written record of the proceedings below and does not involve factual disputes. In sum, further evidence could not affect resolution of these issues.

IV

We need respond to the dissent only briefly.

The dissent would hold that EPIC waived the grounds asserted in its July 1996 motion for disqualification because it raised essentially the same issues in its March 1995 motion, which it abandoned before the hearing. If nothing had changed in the intervening period, we might agree, but as we have explained, Rule 1.09 concerns were not necessarily raised by Anderson's pleadings and discovery and did not become critical until Anderson began to present her case at trial. We do not understand how EPIC's failure to urge a motion that should have been denied can prohibit it from later reurging the motion when it should have been granted.

The dissent also argues that factual disputes prevent us from determining whether George was Johnson & Gibbs's client in 1988, and whether at trial Anderson questioned the validity of Johnson & Gibbs's work. But Anderson conceded that Johnson & Gibbs represented George personally, removing any possible factual dispute on the issue. Moreover, there is evidence that

Johnson & Gibbs represented AMI and EPIC, and evidence that Johnson & Gibbs represented George individually, but there is no evidence that the firm did not represent George individually. The fact that AMI and EPIC were firm clients does not mean that George was not. Whether Anderson questioned the validity of Johnson & Gibbs's work must be determined from the trial record. It says what it says, and its assessment is thus a legal question.

V

Mandamus relief is available to correct a clear abuse of discretion for which there is no adequate remedy at law. Anderson's counsel should have been disqualified, and the district court's denial of EPIC's and George's motions was a clear abuse of discretion. We held in *National Medical Enterprises v. Godbey*¹⁶ that appeal of the denial of attorney disqualification does not adequately remedy the injury to the parties in having to defend the litigation involving Rule 1.09 concerns, or the injury to the legal profession. The same is true in the present case.

* * * * *

For the reasons we have explained, we conclude that Jordaan, Howard & Pennington and McKool Smith must be disqualified in the pending action. We are confident that the district court will promptly comply, and our writ of mandamus will issue only if that confidence proves misplaced.

Nathan L. Hecht
Justice

Opinion delivered: December 31, 1998

¹⁶ 924 S.W.2d at 133.