LAWYERING AND ETHICS FOR THE BUSINESS ATTORNEY

Third Edition

Marc I. Steinberg

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I dedicate this book with all my love to my beautiful wife Laurie and my wonderful children Alexandra (Alex), Avram (Avi) and Phillip (Bear).

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Scenario I

WHO'S THE CLIENT?

When an individual visits a lawyer's office and asks to be represented in a particular matter, the attorney normally has little difficulty identifying who is the client. Entity representation, however, renders the attorney's client-identification process more complex. The importance of ascertaining the identity of the client is underscored by the American Bar Association's (ABA) Model Rules of Professional Conduct. These Rules impose certain obligations that run from the attorney to the client.[1] For example, Model Rule 1.7 focuses on the loyalty owed by the attorney to each client.[2] Similarly, Model Rule 1.6, with certain exceptions, requires the attorney to maintain confidentiality with respect to information relating to the representation of a client.[3] This confidentiality is premised on two separate, but related, legal doctrines.[4]

The principle of confidentiality under the Model Rules is based first on the attorney-client privilege and the work product doctrine.[5] The second principle premised on lawyer-client confidentiality is found in the

1. *See, e.g.,* ABA Model Rules of Prof. Conduct, Rules 1.3–1.8.

2. As comment 1 to Model Rule 1.7 states: "Loyalty and independent judgment are essential elements in the lawyer's relationship to a client."

3. *See* Rule 1.6 of the Model Rules.

4. *Id.* Rule 1.6 cmt. 3.

5. *Id. See Upjohn Co. v. United States*, 449 U.S. 383 (1981).

Model Rules themselves.[6] Lawyer-client confidentiality is more encompassing than the attorney-client privilege: Regardless whether the information is protected from disclosure under the attorney-client privilege, Rule 1.6 mandates (with certain exceptions) that all information relating to the representation of that client, regardless of its source, be kept confidential.[7]

Both the privilege and the attorney's confidentiality obligation contain certain exceptions. For example, when the client gives informed consent to the disclosure of the otherwise protected information, such information is no longer within the scope of Rule 1.6.[8] As a second example, "lawyers within the same firm are generally deemed to have implied authorization to share client information with each other, to the extent necessary to carry out the representation."[9] As a last example, a lawyer under the Model Rules may reveal client information to the extent necessary "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services."[10]

Model Rule 1.6's obligations encompass communications between an attorney and a client.[11] An entity, such as a corporation, clearly cannot speak for itself; rather, it must rely on and speak through its representatives. Under the Model Rules, these corporate representatives are defined as constituents.[12] Constituents include directors, officers, employees, members, and sharehold-

6. *See* Model Rule 1.6.

7. *Id.* Rule 1.6 cmt. 3.

8. *Id.* Rule 1.6(a).

9. *Id.* Rule 1.6 cmt. 5.

10. Rule 1.6(b)(2). A lawyer also may reveal client information to the extent necessary to establish a claim or defense on behalf of the lawyer in the event a controversy arises between the client and the lawyer. Rule 1.6(b)(5). For other exceptions to the principle of confidentiality, see Rule 1.6(b)(1), (3), (4), (6), Rule 1.13(c) & cmt. 6.

11. *Id.* Rule 1.6(a).

12. *Id.* Rule 1.13.

ers.[13] The communications between the attorney and a constituent of the organization relating to the giving of legal advice to the organization are within the scope of Rule 1.6, so long as the communications relate to the constituent's role or position within the organization.[14]

In a situation where the organization's attorney becomes aware of a constituent's contemplated course of action that is a violation of law that reasonably may be imputed to the organization, the Model Rules provide a series of procedures that the attorney should follow, depending on the severity of the potential harm.[15] In the most extreme situation, the attorney may find it necessary to refer the matter to the organization's highest authority.[16] This issue is addressed in later Scenarios of this text. In the event that the organization's highest authority insists upon conduct that violates the law and that likely will result in substantial harm to the organization, the attorney may be obligated to withdraw from the representation and may reveal information concerning the representation to the extent the attorney reasonably views is necessary in order to prevent substantial harm to the organization.[17]

Closely held corporations (such as family corporations) may present complex scenarios. The attorney for such an enterprise often has significant contact with many, if not all, of the constituents.[18] As a result, some of the constituents may think that the attorney is representing them as individuals, in addition to the business enterprise.[19] Indeed, some sources argue that due to the

13. *Id.* Rule 1.13(f).

14. *Id.* Rule 1.13 cmt. 2.

15. *Id.* Rule 1.13(b) & cmt. 4.

16. *Id.* Rule 1.13(b)(3) & cmt. 5.

17. *Id.* Rules 1.13(c), (d), 1.16(a), (b). *See* C. Wolfram, *Modern Legal Ethics* § 13.7 (1986).

18. *See* Mitchell, *Professional Responsibility and the Close Corporation: Toward a Realistic Ethic*, 74 Cornell L. Rev. 466 (1989); Comment, *Once You Enter This Family There's No Getting Out: Ethical Considerations of Representing Family–Owned Businesses*, 75 UMKC L. Rev. 1085 (2007).

19. *See* Haynsworth, *Competent Counseling of Small Busi-*

close nature of these corporations, the attorney's actions have a direct effect on each constituent and consequently, the attorney's obligations should run not only to the organization, but to each constituent as well.[20] In a family corporation, for example, the constituents are generally the employees, shareholders, officers and directors of the enterprise.[21] In addition, the business operations of a closely held corporation are oftentimes the sole source of livelihood for its shareholders. In such a situation, the corporation's success takes on paramount importance to each shareholder; if things go sour, such shareholders have no viable escape from their investment.[22] These problems are exacerbated when individual shareholders have different personal interests, and each attempts to implement his/her individual goals within the company's policies and corporate framework.

It should be noted that in the partnership context, some courts have found that the attorney representing the organization also represents the individual partners.[23] As one court explained: "In the context of the

ness Clients, 13 U.C. Davis L. Rev. 401 (1980); Mitchell, note 18 *supra*.

20. Mitchell, *supra* note 18, at 506. *See In re Brownstein*, 602 P.2d 655 (Or. 1979). *But see Skarbrevik v. Cohen, England & Whitfield*, 282 Cal.Rptr. 627 (Ct. App. 1991).

21. *See, e.g., Galler v. Galler*, 203 N.E.2d 577 (Ill. 1964); *Triggs v. Triggs*, 385 N.E.2d 1254 (N.Y. 1978).

22. *See* D. Branson, J. Heminway, M. Loewenstein, M. Steinberg & M. Warren, *Business Enterprises: Legal Structures, Governance and Policy* 309–380 (2008); Gross, *What Duties Does Corporate Counsel Owe to Minority Shareholders in a Closely Held Corporation,* 35 Ohio N.U. L. Rev. 987 (2009); Hendon, *Combatting Legal Theft: Arguments For Shareholder/Employees Terminated From Close Corporations*, 77 Or. L. Rev. 735, 737 (1998); Moll, *Shareholder Oppression v. Employment At Will in the Close Corporation: The Investment Model Solution,* 1999 U. Ill. L. Rev. 517 (1999); Siegel, *Corporate Inversions: The Interplay of Tax, Corporate, and Economic Implications,* 29 Del. J. Corp. L. 377 (2004).

23. *See, e.g., Metropolitan Life Insurance Company v. The Guardian Life Insurance Company of America,* 2009 WL 1439717 (N.D. Ill. 2009); *Adell v. Sommers, Schwartz, Silver and Schwartz*, 428 N.W.2d 26 (Mich. Ct. App. 1988).

representation of a partnership, the attorney for the partnership represents all the partners as to matters of partnership business."[24] Under this approach, an individual partner (even under privity principles) may bring a malpractice suit against the organization's attorney. For example, in one such case, the court allowed a limited partner to file a malpractice claim against the attorney that had been retained on behalf of the limited partnership.[25] Other courts, however, have adhered to the entity theory of representation in the partnership setting.[26] Consequently, depending on the jurisdiction and the underlying circumstances, it may be uncertain whether an attorney for a partnership represents only the enterprise, or, absent an agreement otherwise, is deemed to represent the individuals as well.

An attorney for a newly forming or formed corporation should discuss potentially significant issues and conflicts before they arise. When representing a closely held corporation, the attorney should monitor the situations in which significant adverse interests may arise. The need for caution results from the fact that in close

24. *Wortham & Van Liew v. Superior Court*, 233 Cal.Rptr. 725, 728 (Ct. App. 1987). *See also, Law v. Harvey*, 2007 WL 1280585, at *5 (N.D. Cal. 2007) (holding that attorney was representing the partnership and the partners in their individual capacity).

25. *Adell v. Sommers, Schwartz, Silver and Schwartz*, 428 N.W.2d 26, 30 (Mich. Ct. App. 1988).

Note that, depending on the circumstances, nonclients may bring negligence claims against the subject attorney. *See, e.g., McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787 (Tex. 1999) (negligent misrepresentation claim based on issuance of defective opinion letter to nonclient); *Hines v. Data Line Systems Inc.*, 114 Wash.2d 127, 787 P.2d 8 (1990) (negligent preparation of private placement memorandum to investors in securities offering); American Law Institute, *Restatement (Second) of Torts* § 552 (1977); Michels, *Third-Party Negligence Claims Against Counsel: A Proposed Unified Liability Standard*, 22 Geo. J. Leg. Eth. 143 (2009).

26. *See, e.g., Hopper v. Frank*, 16 F.3d 92 (5th Cir. 1994) (applying Mississippi law); *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 910 N.E.2d 976, 883 N.Y.S.2d 147 (Ct. App. 2009).

corporations the interests and rights of the organization and the constituents who control the organization often start off as consistent with one another.[27] Perhaps because of this alignment of interests, at least some courts take the position that, unless the parties agree otherwise, the attorney represents the constituents in their individual capacities as well as the organization.[28] This approach, however, is contrary to the generally accepted "entity" rule, according to which the entity (or the organization) is the client, and not the individual shareholders.[29]

Under the entity rule, "where a lawyer represents a corporation, the client is the corporation, not the corporation's shareholders."[30] As explained by one court:

> "[W]here an attorney represents a closely held corporation, the attorney [normally] . . . owes no separate duty of diligence and care to an individual shareholder. . . . [A]n attorney representing a corporation does not become the attorney for the individual stockholders merely because the attorney's actions on behalf of the corporation may also benefit the stockholders. The duty of an attorney for a corporation is first and foremost to the corporation, even though the legal advice rendered to the corporation may affect the shareholders."[31]

27. *See, e.g., Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976).

28. *See, e.g., In re Brownstein*, 602 P.2d 655 (Or. 1979), *citing, In re Banks*, 584 P.2d 284 (Or. 1978).

29. *See, e.g., Skarbrevik v. Cohen, England & Whitfield*, 282 Cal.Rptr. 627 (Ct. App. 1991); *Egan v. McNamara*, 467 A.2d 733 (D.C. 1983); *Jesse v. Danforth*, 485 N.W.2d 63 (Wis. 1992); *Canegie Associates Ltd. v. Miller*, 2008 WL 4106907 (N.Y. Sup. Ct. 2008).

30. *McKinney v. McMeans*, 147 F. Supp. 2d 898, 901 (M.D. Tenn. 2001). *See also,* Model Rule 1.13(a) ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.").

31. *Brennan v. Ruffner*, 640 So.2d 143, 145–146 (Fla. Dist. Ct. App. 1994). *See SEC v. Credit Bancorp, Ltd.*, 96 F. Supp. 2d 357 (S.D.N.Y. 2000).

Contrary to the "entity" theory of representation,[32] some courts take the position that counsel represents individual shareholders in addition to the organization, based on that individual's reasonable expectation of being separately represented.[33] As one court explained: "Although, in the ordinary corporate situation, corporate counsel does not necessarily become counsel for the corporation's shareholders . . . where, as here, the corporation is a close corporation consisting of only two shareholders with equal interests in the corporation, it is indeed reasonable for each shareholder to believe that the corporate counsel is in effect his own individual attorney."[34] To hold otherwise reasoned the court would "exalt form over substance."[35]

Ascertaining whether such a reasonable expectation exists may hinge on the frequency and quality of encounters between the attorney and the individual. Elements that have been deemed relevant in this determination include: "[T]he extent and nature of the attorney's representation of the constituent in individual matters, the attorney's representation of entity clients with interests that diverge from those of the constituent, any oral or written representations made by the attorney regarding the representation, the person to whom the attorney's services were billed and who in return paid these bills, and the presence of independent counsel for the constituent."[36]

32. *See* cases cited *supra* notes 29–31.

33. *See e.g.,* Comment, *An Expectations Approach to Client Identity*, 106 Harv. L. Rev. 687 (1993).

34. *Rosman v. Shapiro*, 653 F.Supp. 1441, 1445 (S.D.N.Y. 1987), *citing, Westinghouse Electric Corp. v. Kerr–McGee Corp.*, 580 F.2d 1311 (7th Cir. 1978), *Glover v. Libman*, 578 F.Supp. 748 (N.D. Ga. 1983), *Bobbitt v. Victorian House, Inc.*, 545 F.Supp. 1124 (N.D. Ill. 1982).

35. 653 F.Supp. at 1445. *See* Gross, *supra* note 22, 35 Ohio N.U. L. Rev. at 1005 (stating that in the small closely-held corporation setting, "if a lawyer leads an individual to [reasonably] believe she represents him, then the lawyer would owe him traditional obligations, including a duty of confidentiality").

36. Comment, *supra* note 33, 106 Harv. L. Rev. at 691.

One of the corporate lawyer's tasks during the incorporation process is to draft the pertinent documents. These documents may include, for example, the articles of incorporation, by-laws, stock transfer restrictions, employment agreements, and shareholder agreement. While documents such as the articles of incorporation and corporate bylaws may not give rise to an individual's reasonable expectation of being separately represented by the drafting attorney, the situation may become more problematic where the lawyer drafts documents that set forth the rights and interests of individual shareholders. Such documents may include buy-sell agreements, voting agreements, and employment contracts. Presumably, the attorney drafts such documents with the corporation's best interests in mind. One may ponder, however, whether the individuals, especially those who have had prior significant interactions with the attorney, have a reasonable expectation that the attorney is simultaneously protecting their personal best interests.[37]

If deemed to be concurrently representing the organization as well as an individual constituent, the attorney may be in a precarious position. As clients, each is owed the duties of loyalty and confidentiality.[38] If the attorney in fact is representing each of these common clients, then that attorney evidently is further bound by the obligations relating to intermediaries. For example, in a situation where an attorney is rendering legal advice to two clients who are organizing a business enterprise, the attorney is likely to be serving as an intermediary.[39]

37. *Id.* at 691–704. *See Minion v. Nagin,* 394 F.3d 1062, 1069 (8th Cir. 2005) (concluding that, as set forth in the complaint, attorney-client relationship existed between counsel for the corporation and individual shareholder-employee when counsel drafted key documents and rendered legal advice that focused on such shareholder-employee's personal interests, including his employment agreement with the corporation).

38. *See* Model Rules 1.6, 1.7.

39. Former Model Rule 2.2.

Former ABA Model Rule 2.2 set forth obligations assumed by an attorney serving as an intermediary.[40] These obligations today generally are set forth in Model Rule 1.7 and comments thereto. Accordingly, in this setting, the attorney must consult "with each client concerning the implications of the common representation" and procure "each client's consent to the common representation."[41] This consultation requires the attorney to present to each client the advantages, disadvantages, and risks involved, including the effect on the attorney-client privilege.[42] As an intermediary, the attorney must consult with each client regarding decisions to be made, so that each client is able to make adequately informed decisions.[43] Moreover, in the event that litigation eventuates between the clients, communications between these common clients and the attorney-intermediary generally will not be shielded from discovery by the attorney-client privilege.[44] Nonetheless, the attorney's obligation of confidentiality remains intact. Thus, confidences communicated to counsel by one common client may not be revealed (absent that client's consent) to any of the other common clients. As a result, the attorney must strike a delicate balance between keeping each client adequately informed and maintaining the requisite confidentiality.[45]

40. *Id.* Former Model Rule 2.2(a)(1). Note that the 2002 amendments to the Model Rules, implementing the Ethics 2000 Commission's position, deleted Rule 2.2. Revised Rule 1.7 presumably encompasses the lawyer as intermediary dilemma. *See* Model Rule 1.7 cmt. 28. Scenario III herein addresses in greater depth the lawyer as intermediary.

41. *Id.* Former Model Rule 2.2(a)(1).

42. *Id.*

43. *Id.* Former Model Rule 2.2(b).

44. *Id.* Former Model Rule 2.2 cmt. 6.

45. Model Rule 1.7 cmts. 28–33; former Model Rule 2.2 cmt. 6. *See AVR, Inc. v. Cemstone Products, Co.,* 1993 WL 104933, at *7 (D. Minn. 1993); *Hansen, Jones & Leta, P.C. v. Segal,* 220 B.R. 434 (D. Utah 1998); Rollock, *Professional Responsibility and Organization of the Family Business: The Lawyer as Intermediary,* 73 Ind. L.J. 567 (1998).

What steps an attorney representing a forming or just-formed closely held corporation should take to minimize potential conflicts of interest, liability exposure, and violation of the ethical rules at times are illusive.[46] One approach would be for the attorney to attempt to have all the parties involved agree that the attorney is representing only the organization, rather than the individuals. If such an agreement is reached, it should be evidenced in writing. Thus, perhaps the safest way for the attorney to avoid potential liability resulting from multiple representation is to have each constituent seek independent counsel. For example, language incorporated into a shareholder agreement for a closely held corporation may provide:

> "The Shareholders acknowledge that this Shareholder Agreement contains significant restrictions on their respective interests, and that they have been advised to seek their own legal counsel for themselves (and for the spouse, if any, of each individual Shareholder) and they represent and warrant that they are not represented by and are not relying on the Corporation's legal counsel for any legal advice concerning the meaning, interpretation, or legal effect of this Agreement."

However, retention of separate counsel for each shareholder is likely to make the process of organizing a business far more expensive. The constituent shareholders may well view these costs as prohibitive. Indeed, vigorous representation by separately retained counsel may "nix" the venture before it ever commences.

The following Scenario highlights some of the significant ethical issues and dilemmas an attorney faces when attempting to represent a closely held enterprise.

SCENARIO

Ashley and Alan Beasley are first cousins. A few years back, they started a small internet dating service.

46. *See* Mitchell, *supra* note 18, 74 Cornell L. Rev. 466 (1989).