American Bar Association

Forum on the Construction Industry

WHO'S YOUR CLIENT – DUAL REPRESENTATION OF AN ORGANIZATION AND ITS SHAREHOLDERS/DIRECTORS/ OFFICERS/EMPLOYEES

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Any business organization such as a corporation or limited liability company is a unique legal entity. Unlike an individual, a corporation cannot think for itself. Decision making in a corporation is facilitated through its officers and directors. Accordingly, legal representation of these discrete entities can be difficult because an attorney is subject to the decisions and direction of people who may have separate and distinct interests from those of the represented organization.

I. Who Speaks for the Corporation?

The American Bar Association's ("ABA") Model Rules of Professional Conduct provide guidance for lawyers who represent corporations. For example, Rule 1.13(a) states, "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."[1] The question becomes, who are the organization's duly authorized constituents? In other words, who gets to tell you what to do?

In a 2003 California case, the Review Department of the State Bar was faced with this very issue.[2] James Davis, a corporate attorney, was approached by an individual seeking legal advice regarding the impending dissolution of a corporation. The individual, who, by the way, opposed the dissolution, was the president, board member, and 50% shareholder of the corporation.[3] Davis advised the President that the best course of action would be for the corporation to file for Chapter 11 bankruptcy.[4] The president subsequently retained Davis to do just that.[5] Unfortunately for Davis, the president was not authorized to unilaterally hire counsel for the corporation. Nor was he authorized to unilaterally authorize the filing of a bankruptcy petition on the corporation's behalf.[6]

Davis reviewed the corporation's Articles of Incorporation, Bylaws, Shareholder Agreements, and Minutes of directors' meetings and knew of the limitations that were placed

upon the president to take such an arbitrary action.[7] Davis, however, determined that the other three directors were "hopelessly conflicted" and, therefore, the president, as the least conflicted director, had the authority to speak on the corporation's behalf.[8]

The court determined that Davis had breached his duty of loyalty to his client, the corporation. The court stated:

> As corporate counsel to [the Corporation], respondent's professional obligations were to the entity and not to its officers, directors, or shareholders in their representative or individual capacities . . . a corporation is a statutory person that can speak only through its constituent officers, directors, shareholders and agents. Faced with a dispute over who was authorized to speak for [the Corporation], respondent should have first looked to the corporation's organizational documents and other pertinent agreements.[9]

Attorneys who are engaged to represent a corporation or other business entity should read and understand the entity's organizational documents in order to understand the decision making authority of its officers, owners and other management bodies, such as a board or directors. Attorneys representing business entities should strictly follow whatever is outlined and avoid involvement in disputes between the entity and its management or owners.

II. What if the Decisions are Legally Wrong?

Despite the requirement that an attorney yield to the individual(s) who are given authority under corporate documents, there are, according to the ABA Model Rules, times where such direction is to be questioned and even ignored. Rule 1.13(b) states:

> If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization or a violation of law that reasonably might be imputed to the organization and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best

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> interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.

Rule 1.13(c) even allows (but does not require) an attorney to reveal unlawful behavior as necessary to prevent substantial injury to the organization, regardless of the duty of confidentiality placed upon an attorney through Rule 1.6,[10] if the highest corporate authority fails or refuses to remedy the unlawful behavior and the lawyer is reasonably certain that substantial injury to the organization is bound to occur.[11]

The distinction in these rules is between decisions that a lawyer merely finds imprudent versus those decisions that the lawyer finds unlawful. According to the ABA commentary to Rule 1.13(b), decisions made by corporate officers or directors within the limits of their granted authority must be adhered to by the lawyer, "even if their utility or prudence is doubtful."

Once a lawyer determines "that an officer, employee or other person associated with the organization"[12] is acting or intends to act unlawfully instead of just imprudently, the commentary suggests that the lawyer consider "the seriousness of the violation and its consequences, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations."[13] The purpose of such consideration is to determine whether a mere request that the person reconsider their anticipated course will suffice or whether such conduct must be reported to higher authorities within the organization.[14]

Naturally, attorneys often are hesitant to report unlawful conduct of an officer or employee to such individual's supervisors for fear of retaliation in employment. For example, general counsel for a corporation may be forced to report a CEO or president's planned course of action or prior conduct to the board of directors. Such a report could, ultimately, lead to the

general counsel being disciplined or his or her employment terminated. However, according to Rule 1.13(e), such is not to be considered when determining the proper course of action and the lawyer "must proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal."[15]

Given this rule, it is plain to see how a genuine conflict of interest can arise almost instantaneously for an attorney who represents a corporation and one or more of its officers. For example, if an attorney who represents ABC Corporation and also represents ABC President in his or her individual capacity discovers through a communication with ABC President that ABC President intends to misappropriate ABC Corporation's information and form a competing corporation or engage in some other unlawful activity or activity adverse to the corporation's interests, what is the attorney to do? Disclosure would violate Rule 1.6 as to the attorney's representation of ABC President but failure to disclose would violate Rule 1.13 as to ABC Corporation.

Another conflict of interest can arise when a corporation's attorney is asked to represent an employee in litigation arising from the employee's employment. For example, if suit is brought against a corporation and also against an officer/employee of that organization for an alleged tort of that officer/employee and the corporation's attorney is engaged in the joint representation of the corporation and the officer/employee, the parties' interests could quickly become adverse. An attorney may be faced with showing the officer/employee acted beyond the scope of his or her employment to further the corporation's interests. Such a strategy could, however, be against the officer's/employee's interests. A conflict might also arise if one client has a strong desire to settle but it is in the best interests of the other client to litigate.

Shareholder derivative suits create a third area where conflicts often arise. A shareholder derivative suit involves a situation where the corporation is both a plaintiff and a defendant. Attorneys may be forced to defend the board of directors' decisions. However, a conflict can arise when the derivative litigation involves a claim of wrongdoing by those in control of the corporation.[16]

III. When and How Can a Lawyer Enter Into a Dual Representation Relationship?

According to Rule 1.13(g), "[a] lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents subject to the provisions of Rule 1.7." Rule 1.7 governs concurrent conflicts of interest, including when one client's interests are directly adverse to another client as well as situations where there is a "significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client . . . ."[17] Most dual representations of a corporation or organization and its officer(s), director(s), or shareholder(s) pose a "significant risk" of conflict and should be considered as a concurrent conflict of interest requiring compliance with part (b) of the rule.

Rule 1.7(b) allows for the existence of concurrent conflicts of interest if:

> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.[18]

Regarding the requirement of informed consent, Rule 1.13(g) requires that an organization's informed consent come from the "appropriate officials," excepting the person to be represented in his or her individual capacity.[19] This hearkens back to the discussion above, concerning who has authority to speak for an organization.

Given these requirements, there may be situations where dual representation is forbidden. For example, as previously noted, unlawful conduct by an officer of a corporation would be an absolute bar to dual representation, even assuming proper informed consent was obtained from both the officer and the corporation, because such representation would "involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding . . . ."[20]

The District of Columbia has modified ABA Model Rule 1.7 to further elaborate as to the categories into which dual representation might fit.[21] The District of Columbia rule divides potential conflicts into three kinds: "(1) cases in which representation is absolutely forbidden, (2) cases in which dual representation is permissible after informed consent of all affected clients is obtained, and (3) cases in which dual representation is permitted without client consent."[22] This elaboration is not intended to change the ABA Model Rule but merely to further explain the Rule.[23]

According to the comment on Rule 1.7 of the District of Columbia Rules of Professional Conduct, the first situation, absolute prohibition on representation, involves representation of adverse positions for different clients in the same matter.[24] The second situation, dual representation with informed client consent, encompasses representation that could reasonably have the appearance of an adverse affect.[25] It also applies "if there is any reason to doubt the lawyer's ability to provide wholehearted and zealous representation of a client . . . ."[26] All other

dual representation situations do not require informed consent and are considered proper both under the District of Columbia Rules of Professional Conduct as well as under the ABA Model Rules.[27] However, as has previously been noted and as referenced in the comment on Rule 1.7 of the District of Columbia Rules of Professional Conduct, the safest approach to dual representation is informed consent in all situations.[28]

In *Griva v. Davison*, Griva, a minority partner in a family partnership sought disqualification of the attorneys for Defendants, Griva's other two partners, as a result of the attorneys' dual representation of the partners and the partnership.[29] Additionally, Griva sought the production of files related to the attorneys' representation of the partnership.[30] In applying Rule 1.7 of District of Columbia Rules of Professional Conduct discussed above, the court found that the conflict was not the first type, an outright prohibition on representation, simply based on the fact that Griva had never argued as such.[31]

However, the court did find that this dual representation was the type requiring informed consent of the parties and concluded that the attorneys had not obtained Griva's informed consent to engage in the dual representation.[32] The court found that the attorneys had not met their burden of "approach[ing] both clients with an affirmative disclosure so that each [could] evaluate the potential conflict and decide whether or not to consent to continued dual employment."[33]

Additionally, the court, in dicta, stated that even if informed consent had been obtained by the attorneys, Griva was free to revoke such consent at any time, including when an actual conflict between the partnership and the individual partners arose.[34] Without the informed consent of both parties, dual representation would be impermissible under the Rules of Professional Conduct.

IV. What is the Proper Way to Conduct an Internal Investigation so as to Avoid a Potential Conflict of Interest?

Rule 1.13(f) of the ABA's Model Rules states, "[i]n dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing."[35] Officers and employees of a corporation who have worked closely with outside counsel or general counsel of a corporation may have a mistaken belief that conversations with the corporation's attorney are subject to confidentiality. Essentially, these officers and employees may erroneously believe that the corporation's attorney is also their attorney. In order to avoid inadvertent conflicts of interest, attorneys for a corporation should be extra vigilant in disclaiming representation of any individual. This so-called "corporate miranda" warning is intended to prevent inadvertent conflicts of interest.

As counsel for a corporation, you are under a duty of confidentiality,[36] and the corporation, as a client, can claim attorney client privilege for communications between shareholders/directors/officers/employees of the corporation and its attorney. However, because this privilege belongs to the corporation, it can be waived at the corporation's discretion and information revealed to an attorney can be disclosed.

Accordingly, lawyers should advise corporate constituents that they represent the corporation and not any individual constituent. This warning should inform the constituent that any attorney client privilege is between the attorney and the corporation and that the corporation can authorize the disclosure of any information revealed to the attorney by the constituent at that time. In other words, any damaging information revealed by the constituent to the attorney may be used against them.

If adequate warnings are not given, attorneys run the risk of having an attorney client relationship between the constituent and the attorney imputed. If such is imputed, an attorney is exposed to disqualification from representing the corporation, malpractice actions by the constituent, and discipline from the attorney's state bar.

V. Conclusion

Because business entities cannot think for themselves, representation of them is a path riddled with ethical traps. Attorneys representing business entities must ensure that they are following the directions of those with the proper authority to give directions while continually being mindful of their right to disclose unlawful conduct that can cause substantial harm. Attorneys should always gain informed consent of the parties before entering into dual representation, and, when interacting with constituents of a business entity, should overtly disclose their representation of the entity and the entity's ability to waive privilege as to the constituents' communications.

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[1] ABA MODEL RULE 1.13(a).

[2] *In re* Davis, No. 96-O-04662, 2003 WL 21904732 (Cal. Bar Ct., Aug. 6, 2003).

[3] *Id*. at *2.

[4] *Id*.

[5] *Id*. at *3.

[6] *Id*.

[7] *Id*.

[8] *Id*.

[9] *Id*. at *14.

[10] ABA Model Rule of Prof'l Conduct 1.6 provides that:

> (a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).
>
> (b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:
>
> (1) to prevent reasonably certain death or substantial bodily harm;

(2) 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;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) to comply with other law or a court order.

ABA MODEL RULE 1.13(a).

[11] There is an exception to this permission, found in Rule 1.13(d), placed upon lawyers who are hired to "investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law," in an effort to provide adequate counsel to corporations. *Id.* R. 1.13(d).

[12] ABA MODEL RULE 1.13(b)

[13] *Id*. R. 1.13 cmt.

[14] *See id*.

[15] ABA MODEL RULE 1.13(e).

[16] *See* i*d*. R. 1.13 cmt.

[17] ABA MODEL RULE 1.7(a).

[18] *Id*. R. 1.7(b).

[19] *Id.* R. 1.13(g).

[20] *Id*. R. 1.7(b)(3).

[21] *See* Griva v. Davison, 637 A.2d 830, 842–43 (D.C. 1994).

[22] *Id*. at 842.

[23] *See id*. at 843.

[24] *See* D.C. RULES OF PROF'L CONDUCT R. 1.7 cmt. (2006), available at http://www.dcbar.org /new_rules/rules.cfm.

[25] *See id*.

[26] *Id*.

[27] *See id*.; ABA MODEL RULE 1.7 cmt..

[28] *See* D.C. RULES OF PROF'L CONDUCT R. 1.7 cmt. (2006).

[29] *Griva*, 637 A.2d at 832–836.

[30] *Id*. at 832.

[31] *Id*. at 844.

[32] *Id*. at 845.

[33] *Id*.

[34] Griva was free to revoke the consent on behalf of the partnership as a result of a unanimous consent provision in the partnership agreement. *See id*. at 833. Accordingly, the partnership is not authorized to consent to dual representation unless Griva consents to the dual representation.

[35] ABA MODEL RULE 1.13(f).

[36] *See* ABA MODEL RULE 1.6.