

## A House Divided: Who's the Client?

*Lawyers, inside and outside, face ethical dilemmas when an internal corporate feud forces them to take sides.*

Internal battles and power struggles within corporations, partnerships, and other entities are not unusual and can become unpleasant. Emotions are high, loyalties are tested, and the pressure to choose sides is strong. This is particularly true when there is a deadlock between factions within the organization and lawful control is in dispute.

A lawyer in this situation must make sure he or she avoids get-

ting caught in the cross fire. As in other tricky ethical predicaments, it's not good enough to simply "trust your instincts."

### Ethics

In a recent California case, an outside lawyer for a company was suspended for two years when he sided with the corporate president and against the majority of the board of directors in taking positions for the corporation.

While it is normally appropriate for an outside lawyer to follow the legitimate dictates of a duly authorized corporate executive, the court found that here, the attorney failed to consider the limitations on the powers of the president in the corporation's organizational documents, and the authority of the board of directors. (The board did not have authority, however, to replace the president until his term expired.)

The court stated: "Faced with a dispute over who was authorized to speak for [the company], respondent should have first looked to the corporation's organizational documents and other pertinent agreements."

The California court further stated that given the authority of the board, the lawyer should have sought the board's consent in representing the company—and if he had tried and failed to obtain that consent, he should have withdrawn as counsel to the corporation. The court cautioned lawyers against "taking part in controversies among the corporation's directors and shareholders" or choosing among "conflicting interests."

The principal authority in the District regarding intra-entity conflicts is *Griva v. Davison*, 637 A.2d 830 (D.C. 1994). In that case, the D.C. Court of Appeals held that under D.C. Rule 1.7(a), assum-

ing that there is actual adversity of interest, there may be an absolute prohibition on a lawyer simultaneously representing both the entity as a whole and a faction of it.

The court further held that even if there was not the actual adversity necessary for an absolute prohibition, the attorney had the burden of demonstrating informed consent from both factions to cure any potential conflict.

D.C. Bar Ethics Opinion 216 notes that in this situation, "the lawyer must normally follow the direction of those duly appointed or elected to act on behalf of the corporation."

The D.C. Bar Ethics Committee cautioned, however, that the organization's attorney should consider the interests of the entity to be paramount. The committee stated, therefore, that if "the lawyer should become convinced that [the corporate president's] decisions are clearly in violation of [the president's] own fiduciary duties to the corporation, the lawyer may be forced to seek guidance from the courts as to who is in control of the corporation, there being no higher authority within the corporation to whom the lawyer can turn."

There are limits, however, on what a court can do.

In *Tydings v. Berk Enterprises*, 565 A.2d 390 (Ct. Sp. App. Md. 1989), a suit by a minority shareholder alleging corporate looting by the majority, the Maryland Court of Special Appeals agreed with a trial court that an outside lawyer could not represent both the corporation and the individual defendants. The appellate court nevertheless held that the trial court had no authority to select or appoint separate outside counsel for the corporation, even under a procedure giving both sides an opportunity to agree on counsel, and absent an agreement, giving both sides an opportunity to propose counsel to the court.

The appeals court held that the majority of the board had the power and duty to select independent corporate counsel, and that the counsel selected would have an ethical duty to consider the interests of the corporation as an entity. The court did not address whether this attorney, once selected, would be bound by instructions from the board. The possibility therefore remains that at some point, the chosen counsel might have to withdraw if the board gives instructions that the lawyer believes are contrary to the interests of the corporation.

## GUIDELINES

The basic lessons are as follows. First, a lawyer often cannot represent both the entity and one faction of it, and can never do so without informed consent. Second, those persons who, under the entity's organizational documents, have the legal authority to retain counsel for the corporation should do so. Third, a lawyer representing an entity must be loyal to the interests of the entity and retain independent judgment in carrying out that obligation.

According to Susan Hackett, senior vice president and general counsel of the American Corporate Counsel Association, the ethical considerations that apply to outside counsel apply equally to in-house counsel.

Hackett says that in-house counsel normally should view the board, rather than individual shareholders, as the client. She says that if a minority shareholder challenges a policy of management that is neither illegal nor fraudulent and is reasonably calculated to be in the best interests of the company, the in-house counsel should assist management in defending the challenge.

Hackett adds that if the policy is "legal but stupid," the in-house lawyer will likely advise the managers of his or her perspective with the full knowledge that it may or may not influence the actions of management.

On the other hand, Hackett says, if management acts improperly and persists in doing so despite appeals up the ladder to the board, the in-house counsel may ultimately have a duty to "withdraw" by resigning his or her position in the company. A lawyer in that situation would need to consult the applicable jurisdiction's confidentiality rules to determine whether there may be permissive or mandatory disclosure to third parties of client confidences. Finally, Hackett adds, in a state that permits disclosures, in-house counsel can normally persuade management to rectify their actions before a disclosure actually needs to be made.

With all this said, one problem remains unanswered. When the organizational documents allow for a deadlock, such as where unanimity of all principals is required, the deadlock can prevent the selection of counsel who has authority to act for the entity. This contingency should be provided for in the drafting of such documents.

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