Joint Representation and Disqualification in Disputes Over Entity Control

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Joint representation of an entity along with one or more of its constituents in litigation brings with it unique ethical considerations that cannot always be resolved with informed consent. Where control of an organization is disputed, sometimes the organization will be unable to provide informed consent to representation because the owners or managers cannot reach agreement.

An entity speaks only through its authorized agents or representatives. Rule 1.13 of the Rules of Professional Conduct (relating to "Organization as Client") requires that a lawyer employed by an organization shall conform his or her representation to the concept that the client is the organization itself, acting through its duly authorized directors, officers, employees, members, shareholders or other constituents who oversee the particular engagement. It is not uncommon that an organization will be controlled by two equal managing members or 50/50 shareholders. Problems may arise when control of the organization is evenly divided and the constituents cannot agree.

In litigation, a lawyer who undertakes the joint representation of one of the constituents and the entity may be disqualified unless informed consent has been obtained. Under Rule 1.7, written disclosure of the relevant circumstances and the reasonably foreseeable adverse consequences is required when there is a significant risk that the representation of one client will be materially limited by the lawyer's responsibilities to another client. Obtaining informed consent to joint representation requires such written disclosure before the consent may be obtained. (Rule 1.7(b), Rule 1.0.1(e) and (e-1)). Subdivision (g) of Rule 1.13 permits the lawyer to represent both the organization and any of its constituents but this is explicitly subject to the lawyer's compliance with Rule 1.7.

Joint representation may not be undertaken without informed written consent from *each* affected client, but who is allowed to provide consent on behalf of the organization when its constituents are in dispute over its management and cannot agree? This difficult question was addressed under the former rules in Formal Opinion 1999-153 issued by The State Bar of California's Standing Committee on Professional Responsibility and Conduct. Under the current rules, Rule 1.13(g) mandates that the organization's consent to dual representation "*shall be given* by an appropriate official, constituent, or body of the organization *other than* the individual who is to be represented, or by the shareholders." (Emphasis added). The consent given only by the represented constituent will not be sufficient. Thus, it is possible that informed consent is unobtainable unless there is another constituent who will provide informed consent on behalf of the organization. The

organization is likely to be deadlocked if the constituents cannot agree, and this is almost a certainty where there is litigation among the constituents over the question of control.

The resolution of such a conflict is not expressly found in the rules, but rather, in case law. "[A]n attorney for a corporation's first duty is to the corporate entity." (*M'Guinness v. Johnson*, 243 Cal. App. 4th 602, 622 (2015).) In a control dispute, in the absence of informed written consent from an authorized constituent, it is well established in California that an attorney for an entity may not take sides when representing concurrently a corporation and one of the factions in the control dispute. (*See, e.g., id.*; *Metro-Goldwyn-Mayer, Inc. v. Tracinda Corp.*, 36 Cal. App. 4th 1832, 1842 (1995).) "In acting as the corporation's legal advisor [the attorney] must refrain from taking part in any controversies or factional differences which may exist among shareholders as to its control. When his [or her] opinion is sought by those entitled to it, or when it becomes his duty to voice it, he [or she] must be in a position to give it without bias or prejudice and to have it recognized as being so given. Unless he [or she] is in that position his [or her] usefulness to [the] client is impaired." (*Goldstein v. Lees*, 46 Cal. App. 3d 614, 622 (1975). *See also, Woods v. Superior Court*, 149 Cal. App. 3d 931, 936 (1983) (long-time corporate counsel disqualified from jointly representing a family-owned business and husband in marital dissolution against the wife and equal owner); *Gong v. RFG Oil, Inc.*, 166 Cal. App. 4th 209, 214 (2008) (disqualifying counsel jointly representing corporation and majority shareholder in dissolution action by minority shareholder).) In *Goldstein*, the court held that an attorney who formerly represented a corporation could not later represent a minority shareholder in a proxy fight over control of the corporation. The court explained that corporate counsel's obligation to "act without bias or prejudice" survived his discharge as counsel for the corporation. (*Goldstein*, 46 Cal. App. 3d at 622.)

In shareholder derivative actions, there may be an exception to this rule of automatic disqualification that allows the attorney to continue representing the individual despite disqualification from representing the organization. For example, in *Forrest v. Baeza*, 58 Cal. App. 4th 65, 76 (1997), an attorney simultaneously representing the organization and two shareholders accused in a derivative claim of embezzling from closely held family-run corporations was disqualified from representing the corporations, but not from continuing to represent the two accused shareholders. This unusual outcome was justified as an exception to strict application of a rule of automatic disqualification, even though the interests of the formerly represented corporations would be directly adverse to the interests of the shareholders the lawyer continued to represent. The Court of Appeal justified that result because the functioning of the corporations had been so intertwined with the individual defendants that a distinction between them was fictional, and there would in effect be no confidential information learned on behalf of the former corporate clients that would not also be known to the lawyer's other clients. Thus, the court concluded that application of the "former client" rule, under then existing Rule 3-310(E) (and presumably, also applicable today under current rule 1.9, involving duties to former clients) would be meaningless.

Caution is dictated whenever a lawyer jointly represents an organization and one or more of its constituents. Due consideration must be given to the problem of obtaining and maintaining informed consent whenever there is a dispute over management and control.