CONFLICTS OF INTEREST IN DERIVATIVE LITIGATION INVOLVING CLOSELY HELD CORPORATIONS: AN ALL OR NOTHING APPROACH TO THE REQUIREMENT OF "INDEPENDENT" CORPORATE COUNSEL

While the Model Rules of Professional Conduct is arguably a marked improvement over its predecessors, "[n]o code of ethics could establish unalterable rules governing all possible eventualities."[1] The problem with a one-size-fits-all approach is aptly demonstrated by the difficulty judges and attorneys have encountered when trying to apply the ethical standards governing conflicts of interests to the unique features of derivative litigation. An attorney attempting to represent both the corporation itself, as well as the individual directors and/or officers accused of harming the corporation, will find that "[t]he dilemma of dual representation in stockholder's derivative suits . . . arises from the unclear role in the action of the business entity."[2] It has been stated that "[t]he interest of the corporate client is paramount and should not be influenced by any interest of the individual corporate officials."[3] But what happens when the "corporate officials" in question are also the majority shareholders of the corporation? This is the situation faced in derivative litigation involving closely held corporations.[4] Specifically, does a closely held corporate entity really need to be represented by an "independent" attorney apart from its directors? If so, how should such an attorney be selected and to whom should he answer?

In the context of closely held corporations, the corporation should not be required to retain independent counsel because the danger the adversarial process will not adequately represent the interests of the shareholders

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1. Cannon v. U.S. Acoustics Corp., 398 F. Supp. 209, 215 (N.D. Ill. 1975), *aff'd in relevant part per curiam*, 532 F.2d 1118 (7th Cir. 1976).

2. Schwartz v. Guterman, 441 N.Y.S.2d 597, 598 (Sup. Ct. 1981), *aff'd*, 448 N.Y.S.2d 650 (App. Div. 1982).

3. *Cannon*, 398 F. Supp. at 216.

4. A "closely held corporation" is generally defined as "[a] corporation whose stock is not freely traded and is held by only a few shareholders (often within the same family)." BLACK'S LAW DICTIONARY 365 (8th ed. 2004). Furthermore, many states have statutorily defined what constitutes a closely held corporation, such as Delaware, which requires that, *inter alia*, "[a]ll of the corporation's issued stock . . . shall be held of record by not more than a specified number of persons, not exceeding 30." DEL. CODE ANN. tit. 8, § 342 (2001). *See also* ARIZ. REV. STAT. ANN. § 10-1803(A)(3) (2004) (limiting the number of original investors to ten).

and the corporate entity as a "going concern"[5] is minimal to non-existent. If in a particular case, however, it is determined that such dangers do exist, a court-appointed attorney akin to a guardian ad litem appears to be the only way to assure that the attorney is truly "independent" and not subject to manipulation.

I. DERIVATIVE LITIGATION UNDER THE MODEL RULES

A derivative lawsuit involves shareholders of a corporation bringing claims against third parties on the corporation's behalf, where the corporation's board of directors, or those otherwise in charge of the corporation, refuse to assert such claims.[6] Thus, in a derivative suit, the corporation is both a defendant and plaintiff. It is a defendant because a derivative action is, essentially, a suit by the shareholders to compel the corporation to sue. At the same time, the corporation is a plaintiff because the shareholders are asserting claims on the corporation's behalf against those liable to it.[7] The corporation, however, "is merely a 'nominal' defendant, and in fact stands to receive a substantial benefit if the plaintiffs/shareholders are successful,"[8] since any recovery derived from the litigation does not go to the shareholders that brought the suit, but rather goes directly to the corporation itself.[9] As a result of these unique procedural characteristics, corporate attorneys may often find themselves at odds with applicable legal ethics rules as they relate to conflicts of interest.[10]

The potential for a conflict of interest arises in derivative litigation when an attorney attempts to represent the corporation and the individual directors, officers, and/or shareholders who are also named as defen-

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5. "Going concern" is defined as "[a] commercial enterprise actively engaging in business with the expectation of indefinite continuance." BLACK'S LAW DICTIONARY 712 (8th ed. 2004).

6. Gregory P. Williams & Evan O. Williford, *Derivative Litigation: Fundamental Concepts and Recent Developments*, *in* ANN. REV. OF DEV. IN BUS. & CORP. LITIG. 515, 519 (2005 ed.).

7. *Id.*; Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); *see also* Musheno v. Gensemer, 897 F. Supp. 833, 835 (M.D. Pa. 1995) (observing that in a derivative action "the corporation is in the anomalous position of being both a plaintiff and a defendant"); Otis & Co. v. Pennsylvania R.R. Co., 57 F. Supp. 680, 683 (E.D. Pa. 1944) (stating that in a derivative action, "there are two causes of action combined, one by the stockholder against the corporation for refusing to act, the other by the stockholder as representative of the corporation against the individual defendants").

8. *Musheno*, 897 F. Supp. at 835.

9. Williams & Williford, *supra* note 6, at 519-20 ("Any recovery in the action belongs to the corporation, and derivative plaintiffs 'secure nothing to themselves as individuals.'"); *see also* Rogers v. Virgin Land, Inc., No. 1996-13M, 1996 WL 493174, at *2 (Dist. Ct. V.I. May 13, 1996) (observing that while the corporation is actually a defendant, it is merely a "nominal defendant" because "any recovery by the shareholder inures to the corporation's benefit"); Schwartz v. Guterman, 441 N.Y.S.2d 597, 598 (Sup. Ct. 1981) ("Traditionally, the corporation is named a party defendant. Yet conceptually, in a derivative action, the corporation is a party plaintiff in the sense that it will benefit from successful prosecution of the suit." (citation omitted)), *aff'd*, 448 N.Y.S.2d 650 (App. Div. 1982).

10. This Comment is based on the ABA's Model Rules of Professional Conduct ("Model Rules") unless otherwise specified.

dants.[11] The problem arises because a corporate attorney technically represents the intangible corporate entity, and not the individual directors, officers, employees and/or shareholders.[12] Although dual representation is specifically allowed by the Model Rules, its permissibility is subject to Model Rule 1.7, which deals with concurrent conflicts of interest.[13] The comments to Model Rule 1.13 directly address dual representation in the context of derivative litigation, and state:

> Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.[14]

Furthermore, Model Rule 1.7 allows clients to waive conflicts of interest in certain situations,[15] and Model Rule 1.13 specifically allows such a waiver even when an attorney is representing both a corporation and one or more of its constituents.[16] Unfortunately, in regards to the possible conflicts of interests created by dual representation, references to the applicable Model Rules do not solve many of the underlying problems inher-

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11. Williams & Williford, *supra* note 6, at 571; *see also Rogers,* 1996 WL 493174, at *2 (observing that the interests of the corporate entity and the individual wrongdoers are potentially adverse in a meritorious suit); Rosenfield v. Metals Selling Corp., 643 A.2d 1253, 1264 (Conn. 1994) ("In a derivative suit, the role of counsel for the corporation who is also counsel for the defendant directors can, under certain circumstances, be hampered by a conflict of interest."); Tydings v. Berk Enterprises, 565 A.2d 390, 394 (Md. Ct. Spec. App. 1989) ("When, in a suit against a corporation and its directors, an attorney undertakes to represent both the corporation and any of its directors, individually, a possible conflict of interest immediately arises.").

12. MODEL RULES OF PROF'L CONDUCT R. 1.13(a) (2004) ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.").

13. MODEL RULES OF PROF'L CONDUCT R. 1.13(g) (2004) ("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."); *see also infra* note 15.

14. MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. 14 (2004).

15. "Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
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> (2) the representation is not prohibited by law;
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> (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
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> (4) each affected client gives informed consent, confirmed in writing."

MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (2004).

16. MODEL RULES OF PROF'L CONDUCT R. 1.13(g) (2004) ("If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.").

ent in derivative litigation, and this is especially true when closely held corporations are involved.

An attorney agreeing to the dual representation of both the corporate defendant and the individual directors and/or officers of the corporation, will be forced to walk a fine line between the corporation's rights and the attorney's ethical responsibilities.[17] Although often undertaken,[18] such dual representation is generally considered to be improper,[19] even though courts disagree as to why it is improper.[20] Even so, at least one state that has specifically addressed the issue has determined that dual representation is acceptable,[21] in spite of the current trend to ban the practice.[22] Louisi-

17. Forrest v. Baeza, 67 Cal. Rptr. 2d 857, 862 (Cal. Ct. App. 1997) ("The issue of disqualification 'ultimately involves a conflict between the clients' right to counsel of their choice and the need to maintain ethical standards of professional responsibility.'") (quoting Metro-Goldwyn-Mayer, Inc. v. Tracinda Corp., 43 Cal. Rptr. 2d 327, 331 (Cal. Ct. App. 1995)); *see also* Cannon v. U.S. Acoustics Corp., 398 F. Supp. 209, 213 (N.D. Ill. 1975) (stating that dual representation in a shareholder derivative suit "raises fundamental questions of legal ethics and the extent to which a court should interfere with the right of any litigant to be represented by counsel of his own choosing"), *aff'd in relevant part per curiam*, 532 F.2d 1118 (7th Cir. 1976).

18. Note, *Independent Representation for Corporate Defendants in Derivative Suits*, 74 YALE L.J. 524, 524 & n.2 (1965) [hereinafter Note, *Independent Representation*].

19. *Forrest*, 67 Cal. Rptr. 2d at 863 ("Current case law clearly forbids dual representation of a corporation and directors in a shareholder derivative suit."); *see also* Rogers v. Virgin Land, Inc., No. 1996-13M, 1996 WL 493174, at *2 (D. V.I. May 13, 1996) ("Dual representation is improper, because the interests of the corporate entity and the individual wrongdoers are potentially adverse in a meritorious suit."); *In re* Oracle Sec. Litig., 829 F. Supp. 1176, 1188-89 (N.D. Cal. 1993) (stating "[d]ual representation is impermissible, particularly at the settlement stage," because of the insufficient protection afforded the corporation, as well as the "appearance of impropriety which casts a shadow over the entire proceeding"); Lower v. Lanark Mut. Fire Ins. Co., 448 N.E.2d 940, 946 (Ill. App. Ct. 1983) ("Even if no conflicts currently exist, the potential conflict cannot be ignored, and . . . [thus] the corporation must obtain independent counsel."); Garlen v. Green Mansions, Inc., 193 N.Y.S.2d 116, 117 (App. Div. 1995) (stating that where an "appearance and answer by [the] corporation [is required,] such appearance must be by independent counsel whose interests will not conflict with those of the individual defendants").

20. While courts seem to be most wary of the prospect that the corporation will be forced to act to the detriment of the non-defendant shareholders and the corporation as a going concern, *see generally* Note, *Independent Representation*, *supra* note 18, at 524, some courts feel that "public interest requires . . . a context which is as free as possible from the appearance of any potential for conflict of interest," Yablonski v. United Mine Workers, 448 F.2d 1175, 1180 (D.C. Cir. 1971), and still others cite the risk "that confidences obtained from one client could be used to the detriment of the other [client]." Musheno v. Gensemer, 897 F. Supp. 833, 838 (M.D. Pa. 1995). *But see* Forrest v. Baeza, 67 Cal. Rptr. 2d 857, 868 (Cal. Ct. App. 1997) (finding improper use of confidential information not an issue because "the functioning of the corporation has been so intertwined with the individual defendants that any distinction between them is entirely fictional, and the sole repositories of corporate information to which the attorney has had access are the individual clients").

21. *See infra* note 23.

22. *Developments in the Law*—Conflicts of Interest in the Legal Profession, 94 HARV. L. REV. 1244, 1340 (1981) [hereinafter *Conflicts of Interest*] ("[T]he emerging rule is against dual representation."); *see also Musheno*, 897 F. Supp. at 835 ("Early decisions adopted the position that, at least in the absence of a breach of trust, joint representation was permissible. However, more recent decisions, . . . have identified numerous problems with dual representation.") (citations omitted); *Cannon*, 398 F. Supp. at 217 ("The older cases have refused to disqualify counsel, while the more recent trend is to require the corporation to obtain independent counsel."). *Compare* Jacuzzi v. Jacuzzi Bros., 52 Cal. Rptr. 147, 171 (Cal. Dist. Ct. App. 1966) ("In general, . . . prior to an adjudication that the corporation is entitled to relief against its officers, or directors, the same attorney may represent both."), *and*

ana currently allows an attorney to represent both the corporation and the individual defendants, reasoning that because the corporation is only a nominal defendant and "its true interest lies with the plaintiff shareholder . . . there is no conflict of interest because there are really no adverse interests being represented."[23]

II. EXCEPTIONS TO THE GENERAL RULE AGAINST DUAL REPRESENTATION

Like many rules of law, the prohibition against dual representation is generally not absolute, as there are exceptions to the rule even in states that normally consider the practice to be inappropriate. The court in *Campellone v. Cragan* summarized the three main exceptions that would allow for dual representation, stating that "disqualification of corporate counsel from representing individual defendants may be avoided if the derivative action is patently frivolous, the degree of participation of the corporation in defending the action is very low, or if the allegations against the individual defendants involve mismanagement rather than fraud, intentional misconduct or self-dealing."[24]

Regarding the first exception, patently frivolous cases do not pose the same problems as meritorious cases because both the corporation and the individual defendants would benefit from having such cases dismissed.[25] Under the second exception, "cases and ethics opinions differ on whether there must be separate representation from the outset or merely from the

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Otis & Co. v. Pa. R.R. Co., 57 F. Supp. 680, 684 (E.D. Pa. 1944) (holding dual representation permissible based on the corporation's right to the select any counsel it so chooses), *with* Forrest v. Baeza, 67 Cal. Rptr. 2d 857 (Cal. Ct. App. 1997) (declining to follow *Jacuzzi*), *and* Bell Atl. Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993) (declining to follow *Otis & Co.*).

23. Robinson v. Snell's Limbs and Braces, 538 So. 2d 1045, 1048-49 (La. Ct. App. 1989). Additionally, a U.S. District Court in Ohio held dual representation is not improper "when there is no conflict of interest and no breach of confidence or trust." Selama-Dindings Plantations, Ltd. v. Durham, 216 F. Supp. 104, 115 (S.D. Ohio 1963). Unfortunately, as the court in *Cannon v. U.S. Acoustics Corp.* pointed out, "[t]he [*Durham*] court did not discuss why there was no conflict of interest," and "the court of appeals did not discuss the dual representation issue in its affirmance." *Cannon*, 398 F. Supp. 209, 218 & n.18 (N.D. Ill. 1975), *aff'd in relevant part per curiam*, 532 F.2d 1118 (7th Cir. 1976).

24. Campellone v. Cragan, 910 So. 2d 363, 365 (Fla. Dist. Ct. App. 2005); *see also* ABA/BNA LAW. MANUAL PROF. CONDUCT § 91: 2608 (2000). Note that the last exception listed by the *Campellone* court, regarding the type of allegations levied against the directors, is often discussed as the distinction between a breach of the duty of care versus a breach of the duty of loyalty, the former being a less serious charge that would allow for dual representation. *E.g.*, Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1315-17 (3d Cir. 1993).

25. Rogers v. Virgin Land, Inc., No. 1996-13M, 1996 WL 493174, at *3 (D. V.I. May 13, 1996) ("When the suit is patently frivolous, there is no conflict of interest because both the individual defendants and the corporation would have the same interest in seeking dismissal of the suit."); *see also* Rowen v. LeMars Mut. Ins. Co., 230 N.W.2d 905, 915 (Iowa 1975) ("If the action is without merit, the expense of independent counsel for the corporation is unjustified."); Note, *Independent Representation*, *supra* note 18, at 530 ("[W]henever the action is without merit . . . the burdensome procedure of retaining independent counsel will accomplish little and merely adds another weapon to the arsenal of the strike suitor.").

time the corporation seeks to take an active role."[26] Thus, while some courts have allowed dual representation of a passive corporate litigant, at least until any motions to dismiss have been overruled,[27] others prohibit the practice by reasoning that the very decision of whether "to pursue an active or passive stance in the litigation . . . may have already been tainted by conflict."[28] Finally, absent allegations of a breach of loyalty, the directors are presumably continuing to manage the corporation in good faith; therefore, the corporation's need for independent representation should not arise.[29] Accordingly, where there are no "serious charges of wrongdoing," the Model Rules seem to consider derivative lawsuits to be a "normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit."[30]

Needless to say, not all states are in agreement as to what, if any, exceptions to the rule should be made.[31] Interestingly, the one potential exception to the rule that seems to be regularly rejected is also one mentioned in the Model Rules.[32] As one court has succinctly stated, "commentators and case law alike have concluded that reliance on consent is ill founded in the context of derivative litigation."[33] This is because such consent would likely be illusory, since a corporation, as an intangible entity, must act through its directors. As defendants, the directors would be the very people who would stand to gain from allowing the dual representation, while, at the same time, possibly harming the corporation.[34]

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26. *Conflicts of Interest*, *supra* note 22, at 1340-41.

27. Clark v. Lomas & Nettleton Fin. Corp., 79 F.R.D. 658, 661 (N.D. Tex. 1978) (allowing dual representation for the initial motion to dismiss so long as the law firm "does not otherwise participate in the lawsuit," and it terminates the dual representation "when either the motions to dismiss are overruled or when it becomes necessary to actively participate").

28. Messing v. FDI, Inc., 439 F. Supp. 776, 782 (D. N.J. 1977).

29. *See Bell Atl.*, 2 F.3d at 1315-17. *Contra* Lower v. Lanark Mut. Fire Ins. Co., 448 N.E.2d 940, 946 (Ill. App. Ct. 1983) (finding arguments "that the directors . . . did not achieve personal gain from their alleged wrongdoing . . . unpersuasive, since that fact does not in any way affect the adverse nature of their interest vis-a-vis that of the corporation").

30. MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. 14 (2004).

31. *See supra* note 29; *Messing*, 439 F. Supp. at 782 (allowing none of the general exceptions to the need for independent corporate counsel).

32. *See supra* notes 15 & 16 and accompanying text.

33. Forrest v. Baeza, 67 Cal. Rptr. 2d 857, 864 (Cal. Ct. App. 1997).

34. *In re* Oracle Sec. Litig., 829 F. Supp. 1176, 1189 (N.D. Cal. 1993) ("[A]n inanimate corporate entity, which is run by directors who are themselves defendants in the derivative litigation, cannot effectively waive a conflict of interest . . . ."); *see also* Note, *Independent Representation*, *supra* note 18, at 528 ("[I]t would be meaningless in derivative litigation to allow the consent of the parties defendant to exculpate the practice of dual representation, for most often it would be the defendant directors and officers who would force the corporation's consent.").

III. RE-EVALUATING THE EFFECTIVENESS OF DUAL REPRESENTATION FOR CLOSELY HELD CORPORATIONS

Opponents of dual representation claim it may result in a breakdown of the adversarial process.[35] Although this may be true when public corporations are involved, it is at this point that the distinctions between a closely held corporation and a public corporation become apparent.[36] While courts have yet to differentiate their holdings based on the type of corporation, such distinctions do make a difference and can change the analysis enough to warrant a re-consideration of the ban on dual representation. Accordingly, in the context of a closely held corporation, should the court disqualify the corporation's attorney where the plaintiff has a vested interest in obtaining the maximum recovery for the corporation, while at the same time the individual defendants are also the majority shareholders of the corporation, control the board of directors, and, thus, have virtually complete control over the actions taken by the corporation?

A closely held corporation and a public corporation may be similar in form, but they vary significantly in substance. The characteristics of a closely held corporation typically include the following:

> (1) the shareholders are few in number, often only two or three; (2) they usually live in the same geographical area, know each other, and are well acquainted with each other's business skills; (3) all or most of the shareholders are active in the business, usually serving as directors or officers or as key participants in some managerial capacity; and (4) there is no established market for the corporate stock.[37]

Consequently, when a lack of marketable shares is combined with an "owner-controlled"[38] board of directors,[39] the result is a corporation that lacks "the disciplinary effects of the capital market and other market

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35. Note, *Independent Representation*, *supra* note 18, at 531.

36. For purposes of this Comment, the term "public corporation" will be used to refer to any corporation other than a "closely held corporation" as defined *supra*, note 4.

37. O'NEAL & THOMPSON, O'NEAL'S CLOSE CORPORATIONS AND LLCS § 1:9 1-35 (rev. 3d ed. 2004); *see also* WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE 107 (8th ed. 2002) ("The principal distinguishing feature of the closely held corporation is a small number of shareholders, though in all likelihood the firm will also be one of relatively modest economic scope . . . , and generally (though by no means always) the people owning a substantial portion of the total shares will occupy the top managerial positions or will be involved in a meaningful way in [their] selection . . . as well as in the formulation of corporate strategies and policies.").

38. *See* KLEIN & COFFEE, *supra* note 37, at 110.

39. *Id.* at 129 ("In closely held corporations, directors are usually controlling shareholders or people selected by, and responsive to the wishes of, these shareholders.").

mechanisms."[40] It follows that since these shareholders are frequently friends, family members, or have some other personal connection to each other,[41] derivative lawsuits filed in the context of closely held corporations often "involve situations where these informal bonds have broken down as a result of death, divorce [or] retirement of the patriarch,"[42] or where the family or personal relationships or both have otherwise deteriorated.

A public corporation, on the other hand, possesses characteristics virtually opposite to those of a closely held corporation.[43] Its shareholders are typically passive investors, large in number, geographically dispersed, and unknown to each other.[44] Additionally, public corporations are much more likely to have "outside" or "independent" directors that make up at least some, if not a majority, of its board of directors.[45]

When all these factors are taken into consideration, the minority shareholder of a closely held corporation is in a much different position than his or her counterpart in a public corporation. A derivative lawsuit highlights just how different these positions can be by drawing attention to the disparity in what each shareholder has at stake in the litigation. In the context of a public corporation, although "the action is brought by an aggrieved shareholder[,] in reality, it is typically brought by a plaintiff's attorney who finds a shareholder, who may own only a few shares, to serve as the nominal plaintiff."[46] Furthermore, in addition to generally having only a relatively small investment in the company, the aggrieved shareholder will also have little invested in the litigation itself. This is because the attorney will normally bear the financial burden of the litigation if the lawsuit fails,[47] while the corporation will normally bear the burden if the lawsuit is successful.[48] Accordingly, decisions made by such

40. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 243 (1991).

41. *Id.* at 229 ("Participants in closely held corporations frequently have familial or other personal relations in addition to their business dealings.").

42. *Id.* at 229-30.

43. *See generally* KLEIN & COFFEE, *supra* note 37, at 107-11 (describing a publicly held corporation as being "[a]t the other end of the spectrum").

44. *See* KLEIN & COFFEE, *supra* note 37.

45. *Id.* at 131 ("Available data shows a marked trend over the last decade toward boards with a majority of independent directors, at least in the case of corporations listed on major stock exchanges."). The term "outside" or "independent" director generally refers to those directors who are neither officers nor employees of the company, and who do not otherwise have any operational responsibilities or significant relationships with the company's management. *Id.*

46. *Id.* at 199.

47. KLEIN & COFFEE, *supra* note 37, at 199 ("If the action is unsuccessful, it will probably be the attorney and not the shareholder who bears the costs.").

48. Williams & Williford, *supra* note 6, at 576 ("Where a derivative action results in a benefit to the corporation, courts typically approve payment to the plaintiff, from the corporation, of the plaintiff's attorneys' fees.").

shareholders during the litigation are likely to be reflective of how little they have at stake financially.[49]

In sharp contrast, the shareholder/plaintiff of derivative litigation involving a closely held corporation has a great deal at stake. Such shareholders often "have large percentages of their wealth tied up in [this] one firm and lack access to capital markets."[50] Consequently, whether the shareholders win or lose is paramount in terms of both recovery and cost.[51] These differences are highly relevant when evaluating the effectiveness, and thus the desirability, of disqualifying the corporation's original attorney and yet still allowing the corporation's directors, independent or not, to exercise their control over the newly selected "independent" attorney.

In light of these differences, an evaluation of the practical arguments made in opposition to the acceptability of dual representation can be made.[52] While each argument has merit when applied to public corporations, none seem to hold up when applied to the very different situation encountered in closely held derivative litigation. First, because the corporation is entitled to take an active role in the litigation, such as "aid[ing] the plaintiff shareholder by assisting in the prosecution" or "set[ting] up certain procedural defenses," it is argued that independent counsel is needed "to advise the corporation regarding its proper stance in the controversy."[53] However, in a closely held corporation, "it is often members of the majority position who commit the wrong, and it is very unlikely that they will vote to have the corporation bring a lawsuit against themselves."[54] It seems equally unlikely that they will change their minds after discussing the matter with a new "independent" attorney. This is not to say that the directors of a public corporation would be willing to sue themselves; rather, the issues here are about ownership, control, and accountability. In a public corporation, the defendant directors are unlikely to have control of the board through ownership,[55] and the board itself is more likely to have "independent" directors that can make impartial judgments

49. EASTERBROOK & FISCHEL, *supra* note 40, at 101 ("A dominating characteristic of the derivative action is the lack of any link between stake and reward . . . . Shareholders with tiny holdings can bring derivative actions. Holders of small stakes have little incentive to consider the effect of the action on other shareholders . . . who ultimately bear the costs.").

50. EASTERBROOK & FISCHEL, *supra* note 40, at 229.

51. MICHAEL DIAMOND, MANAGING AND OPERATING A CLOSELY HELD CORPORATION 112 (1991). "They benefit, if they prevail, by having the injury to the corporation rectified, generally by a cash award paid to the corporation by the wrongdoer. This payment will increase the value of the corporation and, therefore, the value of the stock held by the shareholders." *Id.*

52. Note, *Independent Representation*, *supra* note 18, at 529 (observing that although the corporation is technically both a plaintiff and a defendant, "a finding of impropriety based on this inherent conflict of interest fails to take into account the realities of derivative litigation").

53. *Id.* at 530-31.

54. DIAMOND, *supra* note 51, at 111.

55. *See* KLEIN & COFFEE, *supra* note 37, at 107.

in light of their responsibility and accountability to the shareholders.[56] Contrast that situation with the defendant directors of a closely held corporation, who are not accountable to anyone but themselves, as they are likely to be the majority shareholders and have control of the board, or at least enough control to veto any notions of allowing the company to side with the plaintiff.[57] Therefore, as unlikely as it may be for a public corporation to take an active stance against its directors, it is far more unlikely, if not inconceivable, for a closely held corporation to do so.[58]

The next argument in opposition of dual representation is that "the adversary process is most likely to break down . . . at the crucial stage of settlement, where a major portion of derivative actions [are] concluded."[59] It is thought that because the plaintiff's attorney's fee will max out and then level off after the settlement terms have reached a certain monetary value, once that point is reached both sides will have a common interest in accepting the terms and ending the litigation, regardless of whether or not the recovery is commensurate with the harm.[60] Such acquiescence to potentially inadequate settlement terms is the result of having so little at stake because, regardless of the size of the recovery, the plaintiff/shareholder is unlikely to receive any tangible benefit.[61] Furthermore, the plaintiff is not only indifferent to the size of the total recovery, but also as to the portion of the recovery that the attorney will receive.[62] In this respect, the defendant directors may also be indifferent to the amount of fees awarded to plaintiff's counsel, since they too are likely to have only a minority position in the corporation and will be unaffected by the settlement or the attorney's fees.

These adversarial problems are not likely to occur in a closely held corporation, however, because of the large stake each party has in the litigation.[63] In this situation, the plaintiff/shareholder has every incentive to maximize the corporation's recovery and minimize the attorney's fees,[64] because he, unlike his counterpart in a public corporation, is likely to see a significant monetary benefit based directly on the settlement amount.[65]

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56. *Id.*
57. *Id.*
58. EASTERBROOK, *supra* note 40, at 106 ("Undoubtedly directors named as defendants in derivative suits do not exercise impartial judgment in deciding whether to sue themselves.").
59. Note, *Independent Representations*, *supra* note 18, at 531.
60. *Id.* at 531-32.
61. *See supra* notes 46-49 and accompanying text.
62. *See supra* notes 46-49 and accompanying text.
63. *See supra* notes 50-51 and accompanying text.
64. *See supra* notes 50-51 and accompanying text.
65. *See supra* notes 50-51 and accompanying text.

As a result, his interests are inextricably intertwined with those of the corporation.[66]

On the other side of the litigation, the defendant directors of a closely held corporation are also in a different situation than those in a public corporation. Because the defendant directors are likely to be majority shareholders, even if they lose the lawsuit in a way they still win because the recovery will go to the corporation of which they are the biggest residual claimants.[67] Alternatively, because of the defendants' simultaneous positions of director and shareholder,[68] a circular recovery could result by simply declaring a dividend. This would allow them to pull the recovery out of the company, deduct the minority plaintiff's share, and place it back into their pockets. If, on the other hand, the board is "deadlocked,"[69] then the corporation is unlikely to survive the litigation even if it wins the lawsuit; thus, the same result would occur upon winding up the corporation's affairs.[70] Consequently, these defendant directors have every incentive to limit their attorney's fee since it essentially comes directly out of their pockets.[71] Therefore, although there may be legitimate issues with public corporations' settlement agreements, the adversarial process is likely to remain intact in the context of a closely held corporation.

A final concern over allowing dual representation involves the payment of the corporation's attorney's fees. The argument is that dual representation renders it "difficult to segregate legal services performed for the corporation from those performed on behalf of the insiders. Thus the corporation may readily finance the insiders' defense by paying a proportionately larger share of the legal expenses than is merited by its role in the litigation."[72]

This argument, however, does not involve issues unique to derivative litigation or the parties involved in the litigation, but rather it is more directly related to the ethical integrity of the attorney involved in the dual

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66. At least one court has recognized that a plaintiff's motivation turns on the distinction between a public corporation and a closely held corporation:

> In fact, in the context of the large publicly traded corporation, because the benefit to any individual shareholder in securing a recovery for the corporation may be correspondingly small, the party with the more significant interest on the plaintiff's side in a derivative suit often may be the plaintiff's counsel, who may stand to reap hefty fees in connection with a recovery or settlement. In this case, however, [plaintiff], whose immediate family controlled 50 percent of the stock of [the corporations], had a real interest in securing a recovery for the corporations.

Rosenfield v. Metals Selling Corp., 643 A.2d 1253, 1264 n.24 (Conn. 1994).

67. *See supra* notes 37-39, 50-51 and accompanying text.

68. *See supra* notes 37-39 and accompanying text.

69. The term "deadlock" is defined as "[t]he blocking of corporate action by one or more factions of shareholders or directors who disagree about a significant aspect of corporate policy." BLACK'S LAW DICTIONARY 426 (8th ed. 2004).

70. *See supra* notes 37-39, 50-51 and accompanying text.

71. *See supra* notes 37-39, 50-51 and accompanying text.

72. Note, *Independent Representation*, *supra* note 18, at 533.

representation. Model Rule 1.5 states that "[a] lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses."[73] Thus, employing any type of "fee shifting" from the individual defendants to the corporation will necessarily result in charging the corporate client an "unreasonable fee" in violation of Model Rule 1.5, over and above any ethical implications that may arise from the dual representation itself.

By allowing dual representation in some circumstances,[74] the Model Rules implicitly support the notion that, although difficult, segregating the attorney's fees for services rendered to the corporation and the corporate insiders is not impossible and indeed must be done. Thus, it should not be automatically presumed that an attorney will fail to adhere to the ethical obligation of charging a reasonable fee simply because they are acting as the attorney for two clients at the same time, especially where the Model Rules have contemplated that such engagements are within an attorney's ethical boundaries.[75] Furthermore, if it were presumed that the corporation's attorney would act unethically in this situation, it must also be presumed the attorney will act unethically in other situations. Therefore, forcing the corporation to retain separate counsel will not necessarily solve the problem. Even if the attorney is disqualified from representing the corporation in the derivative lawsuit, the attorney may continue his representation of the individual defendants[76] and concurrently represent the corporation in other unrelated matters.[77] Therefore, he could still accomplish this "fee shifting" by inflating the fees charged to the corporation for other services while simultaneously reducing the fees charged to the individual directors. Hence, disciplinary action instead of disqualification may be the proper solution.

IV. THE NEW PROBLEMS OF SELECTION AND CONTROL WHEN INDEPENDENT REPRESENTATION IS REQUIRED

In determining whether dual representation should be permissible, the proposed solution must also be evaluated to determine whether it actually solves the problem or simply creates new ones. Thus, assuming the lawsuit is not governed by Louisiana law, and none of the exceptions to the

73. MODEL RULES OF PROF'L CONDUCT R. 1.5(a) (2004).

74. MODEL RULES OF PROF'L CONDUCT R. 1.13(e) (2004) ("A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents . . . ."); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. 11 (2004) ("Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit.").

75. *See id.*

76. *See infra* note 78 and accompanying text.

77. *See* MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (2004).

general ban on dual representation apply, how then is the conflict resolved? In general, courts will disqualify corporate attorneys from representing the corporation, but allow them to continue their representation of the individual defendants.[78] The issue then turns to who selects the new attorney for the corporation, and what role the new attorney will play in the litigation. It is at this juncture where legal theory and corporate reality begin to diverge, and it will be the focus of the remainder of this Comment.

Beginning with the issue of attorney selection, as with the many other facets of conflicts of interest in derivative litigation, there is no uniform approach as to how such selections should be accomplished. But courts should be mindful of the method ultimately used in selecting the new attorney, as it is important for two reasons. First, it impacts the corporation's acknowledged right to be represented by an attorney of its own choosing,[79] and second, it may place the new attorney in no better position to protect the interests of the corporation than the old attorney.[80]

Some courts have concluded that allowing the corporation's board of directors to select the corporation's new "independent" counsel does not pose any insurmountable problems, even where the entire board is made up of defendant directors.[81] Others have held that the decision should be made by disinterested members of the board of directors.[82] Still others

78. Forrest v. Baeza, 67 Cal. Rptr. 2d 857, 867 (Cal. Ct. App. 1997) (holding that "while dual representation of a corporation and its directors is impermissible . . . the attorney who formerly represented both clients may continue to represent the individual ones" consistent with federal authority); *see also* Note, *Independent Representation*, *supra* note 18, at 534 (stating that the "decision to have the corporation secure new counsel seems the sounder alternative"); *Conflicts of Interest*, *supra* note 22, at 1341 ("The better rule is to require that outside counsel represent the corporation, while the corporate attorney represents the insider defendant.").

79. *E.g.*, *Forrest*, 67 Cal. Rptr. 2d at 862 (discussing attorney disqualification in light of the "recognized and important right to counsel of one's choosing").

80. Note, *Independent Representation*, *supra* note 18, at 534 ("Despite the optimism of the court, it seems likely that in many instances the corporate counsel chosen will be the mere pawn of the insider defendants.").

81. Lewis v. Shaffer Stores Co., 218 F. Supp. 238, 240 (S.D.N.Y. 1963) ("The fact that the selection of such independent counsel will necessarily be made by officers and directors who are defendants does not seem to me to present any insuperable difficulty."). *See* Tydings v. Berk Enterprises, 565 A.2d 390, 395-96 (Md. Ct. Spec. App. 1989); Cannon v. U.S. Acoustics Corp., 398 F. Supp. 209, 220 (N.D. Ill. 1975), *aff'd in relevant part per curiam*, 532 F.2d 1118 (7th Cir. 1976). *See also* Lower v. Lanark Mut. Fire Ins. Co., 448 N.E.2d 940, 946 (Ill. App. Ct. 1983) ("The defendant corporation may select its own counsel even though some or all of the defendant directors may make the selection.").

82. Messing v. FDI, Inc., 439 F. Supp. 776, 783 (D.N.J. 1977) (directing that "the corporation resolve [the] problem as it would any other issue as to which the existence of interested directors renders the usual corporate decision-making process unavailable"); *see also* Musheno v. Gensemer, 897 F. Supp. 833, 839 (M.D. Pa. 1995) (stating the corporation "should select independent counsel in the manner it would act in any other circumstance where a conflict of interest exists"); *In re* Oracle Sec. Litig., 829 F. Supp. 1176, 1190 (N.D. Cal. 1993) (electing not to appoint the new corporate counsel but to instead "defer to the independent directors on the selection").

have either not addressed the issue,[83] or simply failed to give any advice regarding methods the court would deem appropriate.[84] Finally, there are at least two cases where a court decided to make the selection itself and actually appointed an attorney to represent the corporation.[85] Although appointment by the court is admittedly the exception,[86] courts should be wary of leaving a corporation to its own devices if a truly "independent" attorney is desired.

Even if the court does choose an attorney to represent the corporation, however, it still must deal with the fundamental issue of control. In a statement that seems to convey the general consensus, one court held that "the organization is entitled to an evaluation and representation of its institutional interests by independent counsel, unencumbered by potentially conflicting obligations to any defendant officer."[87] The term "independent," as defined in Black's Law Dictionary, means "[n]ot subject to the control or influence of another,"[88] and accordingly, it is the issue of control and influence that is at the center of this ethical dilemma.

For example, if consent to dual representation is generally considered illusory because of the control individual defendants have over the decisions of the company,[89] then why is the selection of, and control over, a supposedly "independent" attorney by those very same individual defendants not illusory as well?[90] Most courts have rationalized their decisions by relying, not on the corporate directors to uphold their legal duties to act in the best interest of the corporation, but, instead, on the ethical integrity of the newly selected "independent" counsel to represent the interests of the corporate entity and not the individual defendants.[91] While it may be

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83. *E.g.*, Campellone v. Cragan, 910 So. 2d 363, 365 (Fla. Dist. Ct. App. 2005); Forrest v. Baeza, 67 Cal. Rptr. 2d 857, 862 (Cal. Ct. App. 1997); Dukas v. Davis Aircraft Prods. Co., 494 N.Y.S.2d 632 (Sup. Ct. 1985).

84. Rogers v. Virgin Land, Inc., No. 1996-13M, 1996 WL 493174, at *2 (Dist. Ct. V.I. May 13, 1996).

85. Rowen v. LeMars Mut. Ins. Co., 230 N.W.2d 905 (Iowa 1975); Niedermeyer v. Niedermeyer, No. 70-492, 1973 WL 419, at *13 (D. Or. 1973).

86. Most courts that have addressed the issue have refused to make such appointments. Tydings v. Berk Enterprises, 565 A.2d 390, 395-96 (Md. Ct. Spec. App. 1989); Musheno v. Gensemer, 897 F. Supp. 833, 839 (M.D. Pa. 1995); Lewis v. Shaffer Stores Co., 218 F. Supp. 238, 240 (S.D.N.Y. 1963); Rogers v. Virgin Land, Inc., No. 1996-13M, 1996 WL 493174, at *2 (Dist. Ct. V.I. May 13, 1996); Cannon v. U.S. Acoustics Corp., 398 F. Supp. 209, 220 (N.D. Ill. 1975), *aff'd in relevant part per curiam*, 532 F.2d 1118 (7th Cir. 1976); Messing v. FDI, Inc., 439 F. Supp. 776, 783 (D. N.J. 1977).

87. *In re Oracle*, 829 F. Supp. at 1189 (quoting International Brotherhood of Teamsters v. Hoffa, 242 F. Supp. 246 (D.D.C. 1965)).

88. BLACK'S LAW DICTIONARY 785 (8th ed. 2004).

89. *See supra* note 34 and accompanying text.

90. Schwartz v. Guterman, 441 N.Y.S.2d 597, 598 (Sup. Ct. 1981) (disqualifying a partnership's attorney in an analogous situation despite the court's acknowledgment that "since the managing partner or insider defendants will hire the attorney for the business entity, independent representation may be illusory"), *aff'd*, 448 N.Y.S.2d 650 (App. Div. 1982).

91. Cannon v. U.S. Acoustics Corp., 398 F. Supp. 209, 220 (N.D. Ill. 1975) (allowing the corporation to select its new counsel by reasoning that although the individual defendants were still serving on

true that this new "independent" attorney does not have a direct attorney/client relationship with any of the directors personally, there is still one fundamental flaw in this reasoning: The Model Rules state that the attorney is to act through the corporation's constituents,[92] the very same constituents who caused the original attorney to be disqualified in the first place.[93] In fact, not only are the defendants the corporation's decision-makers, but the comments to the Model Rules specifically state that "[w]hen constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province."[94]

With this in mind, the underlying problem in representing a corporation whose board of directors has been accused of serious wrongdoing becomes readily apparent. While it may be technically correct to disqualify an attorney from representing both the corporation and the individual defendant directors,[95] having the corporation retain new independent counsel may not have any practical effect on whether or not the best interests of the corporation do in fact get represented.[96] Just as courts have deter-

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the company's board of directors, "[c]ertainly new counsel [would] recognize their duty to represent solely the interests of the corporate entities"), *aff'd in relevant part per curiam*, 532 F.2d 1118 (7th Cir. 1976); Tydings v. Berk Enterprises, 565 A.2d 390, 395-96 (Md. Ct. Spec. App. 1989) ("There is no reason for us to believe that counsel for the corporation will represent anyone other than the corporate entity."); *see also In re* Oracle Sec. Litig., 829 F. Supp. 1176 (N.D. Cal. 1993); Lower v. Lanark Mut. Fire Ins. Co., 448 N.E.2d 940 (Ill. App. Ct. 1983); Yablonski v. United Mine Workers, 448 F.2d 1175, 1180 (D.C. Cir. 1971).

92. MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. 1 (2004) ("An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client.").

93. *See* Glenn G. Morris, *Shareholder Derivative Suits: Louisiana Law*, 56 LA. L. REV. 583, 637 (1996) (observing that simply telling the attorney to represent the corporation does not solve the problem when he is still receiving his instructions from the corporation's board of directors which is made up of the same defendants he is supposed to be "independent" from).

94. MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. 3 (2004). Arguably, the word "ordinarily" leaves open the possibility that there are situations in which the lawyer does not have to accept the decisions of the corporation's constituents. Those situations would seem to be limited to those falling within Model Rule 1.13(b). This rule holds that an attorney "shall proceed as is reasonably necessary in the best interest of the organization" when the attorney knows of a corporate constituent that 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 . . . likely to result in substantial injury to the organization." MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2004). However, this does not appear to be particularly helpful in this situation because it is unclear exactly what actions the lawyer could actually take in light of Model Rule 1.13(d), which does not allow the lawyer to reveal any confidential information relating to the representation if he is specifically hired, as he would be here, "to investigate an alleged violation of law, or to defend the organization . . . against a claim arising out of an alleged violation of law." MODEL RULES OF PROF'L CONDUCT R. 1.13(d) (2004).

95. *See supra* note 19.

96. "Since the officers and directors generally conduct the corporate entity, there is always a danger that a corporation will be directed to act in a manner which fails to protect its best interests. This . . . would naturally affect both the selection and performance of an independent corporate counsel." Note, *Independent Representation*, *supra* note 18, at 534.

mined the old attorney cannot be relied on to represent the best interest of the corporation due to a direct conflict with the directors,[97] it seems equally unlikely the new "independent" attorney will be allowed to pursue any action on the corporation's behalf that is detrimental to those same directors given that they are in complete control over any and all actions taken by the new attorney on behalf of the corporation.[98] Therefore, in a situation where the new "independent" attorney is instructed to take a course of action that may be, in his view, detrimental to the corporation's best interest, simply informing the new attorney he is to represent the corporation's best interests and not those of the individual defendants is insufficient at best, as it "will put the lawyer in the untenable position of choosing either to follow or to reject the instructions of the corporation's normal representatives, the very directors whose self-interest in the suit were thought to make the appointment of independent counsel necessary to begin with."[99]

Thus, as even critics of dual representation have recognized, "a conceptualization of the corporation as a separate entity capable of treatment as an ordinary client ignores [the complexity of corporate interrelationships] and consequently results in too simplistic a resolution of the ethical issue of dual representation."[100]

In an attempt to solve this dilemma, some courts have relied on the independent directors to assure that the selection of counsel and the positions taken by the corporation in the litigation are actually in its best interest.[101] But reliance on these directors may sometimes be misplaced, since "[i]ndependence is not established by the fact that directors are not defendants in the derivative action," as they "are often beholden to the defendant directors who appointed them."[102] This is especially true in the context of closely held corporations, where there are often strong personal or familial relationships among the corporation's board of directors that may

97. *See supra* note 19.

98. *See supra* note 92 and accompanying text.

99. Morris, *supra* note 93, at 637.

100. Note, *Independent Representation*, *supra* note 18, at 528. Without considering the distinctions between public corporations and closely held corporations, the author concluded that, in general, "the strictures against dual representation . . . are justified by both the theory and reality of derivative litigation." *Id.* at 533.

101. Messing v. FDI, Inc., 439 F. Supp. 776, 783 (D. N.J. 1977) (stating that in appointing new counsel "[i]t is the duty of the directors, in this as in other matters, to act in the corporation's best interest"); Musheno v. Gensemer, 897 F. Supp. 833, 839 (M.D. Pa. 1995) (citing the court's reasoning in *Messing*).

102. *In re* Oracle Sec. Litig., 829 F. Supp. 1176, 1187 (N.D. Cal. 1993). The court in *Oracle* also observed that it "must be mindful that directors are passing judgment on fellow directors in the same corporation and . . . [those] who designated them to serve both as directors and committee members." *Id.* However, the court then relied on independent counsel to "provide[] one of the few safeguards to ensure the legitimacy of [the independent directors'] acts." *Id.* But again, this "safeguard" may be more illusory than safe in light of the directors' power over the attorney. *See supra* note 34 and accompanying text.

negate any possibility for objectivity.[103] Furthermore, what if there are no independent directors,[104] as will likely be the case in most closely held corporations?

V. SOLVING THE FALLACY OF "INDEPENDENT" CORPORATE COUNSEL

Based on the arguments presented thus far, where closely held corporations are involved in derivative lawsuits, solving the ethical dilemma of dual representation in any practical way requires choosing one of two alternatives: (1) allow the original corporate attorney to continue his representation of both the corporation and the individual defendants, or (2) have the court appoint a guardian ad litem for the corporation, or something equivalent thereto, who advises and reports directly to the court. This conclusion is based on the crucial distinctions that must be made between a closely held corporation and a public corporation.[105] First, the structure of the former will allow the adversarial process to remain intact, and second, corporate reality dictates that even if a corporation retains an "independent" attorney, the nature of the attorney's relationship with the corporate entity will not allow the "independence" necessary for a lawyer to operate outside the control and influence of the individual defendants.

The preferable solution would be to create another exception to the general ban, and allow the practice of dual representation in the context of derivative litigation involving closely held corporations. As previously mentioned, the permissibility of dual representation is not without precedent.[106] As one court specifically pointed out, "[a]fter trial, dual representation is usually found to have been harmless."[107]

However, if in a particular situation the court is still uncomfortable in allowing dual representation based on the particular facts of the case, appointment of an attorney who reports directly to the court seems to be the only alternative. This too is not without precedent or support. As one commentator has observed:

> If the lawyer follows the instructions of the corporation's normal representatives, its defendant-directors, then not much will

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103. *See supra* note 41.

104. "Without independent *managerial* representation for the corporation, the independent lawyer's role will be confusing at best . . . . For an independent lawyer to do his job properly, his appointment must be tied to the naming of some independent manager or management group . . . to act as his client contact." Morris, *supra* note 93, at 638.

105. "When dealing with ethical principles, . . . we cannot paint with broad strokes. The lines are fine and must be so marked." United States v. Standard Oil Co., 136 F. Supp. 345, 367 (S.D.N.Y. 1955).

106. *See supra* note 23 and accompanying text.

107. Schwartz v. Guterman, 441 N.Y.S.2d 597, 598 (Sup. Ct. 1981), *aff'd*, 448 N.Y.S.2d 650 (App. Div. 1982).

> have been accomplished through the appointment of independent counsel; the "independent" corporate lawyer will end up following the same instructions as the defendants' personal lawyers. But if the independent counsel actually asserts his independence, if he refuses to follow the instructions of his client's human representatives in the ordinary way, then the lawyer will have stepped out of his normal role as counselor and advocate, and will have taken on a troublesome new dual role as combined corporate counselor and guardian ad litem.
>
> The first situation is merely wasteful; the second undercuts all the normal rules of corporate management. If a court believes that it has the power, and appropriate grounds, for the appointment of a special-purpose receiver or guardian ad litem for the corporation, then it should make those appointments.[108]

Specifically addressing this issue, the Supreme Court of Iowa in *Rowen v. LeMars Mutual Insurance Co.* agreed with this reasoning and held that although allowing the corporation to choose its own attorney "would respect corporate autonomy and remove the outward appearance of dual representation, it would not eliminate the substance of the problem sought to be avoided. Counsel for the corporation would be subject to the control of those accused of wrongdoing."[109]

Of course, this position is not without its critics. The dissent in *Rowen* argued that "[t]he majority order for trial court appointment of counsel . . . ignores the safeguards of the adversary process."[110] If the "safeguards of the adversary process" were in place, however, there would be no need for the corporation to retain independent counsel in the first place. Further, the retention of a new attorney who follows orders given by the exact same people as the old attorney does nothing to ensure or enhance the legitimacy of the adversarial process, as would be the case if the corporation used a court-appointed attorney instead.

The Court of Special Appeals in Maryland is likewise critical of court appointments. In *Tydings v. Berk Enterprises*, the court sided with the dissent in *Rowen* and refused to appoint an attorney for the corporation.[111] Unfortunately, the court's analysis of the issue was superficial at best,

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108. Morris, *supra* note 93, at 637-38.

109. 230 N.W.2d 905, 916 (Iowa 1975); *see also* Niedermeyer v. Niedermeyer, No. 70-492, 1973 WL 419, at *13 (D. Or. 1973) (stating that because "[i]t now appears that there is a substantial conflict and that the interests of [the corporation] may not have been properly represented . . . . I intend to appoint an independent attorney to represent the interest of [the corporation] in this case").

110. Rowen v. LeMars Mut. Ins. Co., 230 N.W.2d 905, 918 (Iowa 1975) (Moore, C.J., dissenting).

111. 565 A.2d 390 (Md. Ct. Spec. App. 1989).

when it failed to see how an attorney could "be 'independent' and, simultaneously, dependent upon and subject to the control of the wrong doer."[112] Instead, the court declared that "[o]ne is independent or not, but never independent and dependent at the same time."[113] This reasoning, however, confuses the two very different contexts in which the term "independent" can apply. An attorney who has no previous connection with the corporation or any of its directors at the outset of the representation, and thus "independent" of the corporation, is not the same thing as being "independent" from, and therefore not subject to the control of, those that control the organization–the board of directors–during the representation. If an attorney was in fact "independent" in both ways at the same time, it would essentially mean the attorney either answers to no one but himself, or else he would have to answer to the court, in which case the court would have needed to come to the opposite result than was decided in the case.

Furthermore, the court in *Tydings* demonstrated all too clearly the erroneous outcomes that can result from the reification of the corporation[114] when it equated the need for court appointment with unethical behavior on the part of attorneys. This was evident when the court presumptuously reasoned that by allowing court appointment, "the majority in *Rowen* impugn[ed] the integrity of the Bar in general and of Iowa in particular."[115] Evidently, attorneys in Maryland do not have to act through, or answer to, the constituents of the corporation so long as they act through, and answer to, the intangible "legal abstraction known as the corporation."[116] In reality, however, the attorneys involved will not be dealing with an abstraction; rather, it is "human beings to whom the lawyer is supposed to be giving advice, and from whom the lawyer is supposed to be receiving his instructions."[117] Accordingly, the preservation of an attorney's ethical integrity is precisely what court appointments can accomplish, as the attorney will not be placed "in the untenable position of choosing either to follow or to reject the instructions of the corporation's normal representatives."[118]

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112. *Id.* at 395.
113. *Id.*
114. KLEIN & COFFEE, *supra* note 37, at 110 ("In general, the corporation is reified."). The author then goes on to point out that "reification is a device for making something that is in fact complex seem simple, and that can be dangerous. In reality, only individuals enjoy the benefits, or bear the burdens and the responsibilities, of actions affecting other individuals." *Id.* at 111.
115. Tydings v. Berk Enters., 565 A.2d 390, 395 (Md. Ct. Spec. App. 1989).
116. Morris, *supra* note 93, at 638.
117. *Id.* at 637.
118. *Id.*

VI. CONCLUSION

The reification of the corporation has led to inconsistent approaches taken by the courts in trying to solve the problems encountered with dual representation. But "[b]ecause of the inadequacies of the concept of the corporation as an entity, an inquiry into the propriety of dual representation must 'pierce the corporate veil' and determine the real nature of the confidences and interests of the corporate client."[119] In the absence of such an analysis, the court "should not presume that it is really resolving an ethical problem for the lawyers in the case by appointing an 'independent' lawyer to represent the legal abstraction known as the corporation."[120] Thus, a reevaluation of dual representation in the context of closely held corporations, based on corporate reality as opposed to corporate theory, will reveal that an all-or-nothing approach to the issue is preferable to the middle ground of having the corporation retain "independent" counsel that remains under the defendant directors' control. As demonstrated, such arrangements are either unnecessary or inadequate solutions.

Robert J. Riccio

119. Note, *Independent Representation*, *supra* note 18, at 528.
120. Morris, *supra* note 93, at 638.