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The Corporation as Client: Problems, Perspectives, and Partial Solutions

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Corporations have long been an extremely important type of client for American attorneys. However common the corporation as client may be, application of traditional professional responsibility concepts to the relationship between a client corporation and its attorney is often an awkward endeavor. The difficulty exists because a corporation remains an abstraction, even to those who labor in its behalf, while the professional responsibility norms are designed to regulate the provision of legal services to concrete individuals.

The sophisticated complaints of Ralph Jonas, which appear in the preceding pages,1 are similar to reservations undoubtedly voiced by many practitioners and scholars over the years. Mr. Jonas focuses his remarks on the corporate client-attorney relationship during an unfriendly takeover attempt upon the corporation. An unfriendly takeover attempt naturally sharpens instincts for managerial self-preservation. This understandable consequence of the takeover tends to raise, in bold relief, the question of the obligations of a lawyer employed by a corporation (a corporation lawyer) when there is antagonism between the interests of various collective or individual components, or “constituencies,” of the corporation.2 Although usually less dramatic than in hostile takeover situations, actual or potential constituent antagonism and possible
confusion over the professional loyalty of the corporation's lawyer are constants of corporate law practice.

Such antagonisms arise most frequently in the situation in which an executive commits a negligent or intentionally wrongful act while carrying out his or her duties—in general terms, an act of "constituent misconduct." If the executive seeks to keep the misconduct secret from his or her superiors, including the corporation's board of directors, the executive's interest in such secrecy is antagonistic to the interests of other managers, the board of directors, and the shareholders. While the rules of professional loyalty provided by courts and other arbiters of professional ethics are not wholly satisfactory in a hostile takeover situation, those rules are nonetheless as satisfactory when a takeover is in prospect as they are at any other time in the life of a corporation.

Mr. Jonas makes a number of points that, for the most part, are beyond dispute. First, the proposition that a corporation lawyer owes professional allegiance solely to the corporation as an abstract entity, rather than to the officers and directors who select, pay, and determine the lawyer's retention or to the shareholders who own the corporation is psychologically awkward. Second, in a hostile takeover situation, when the board and management seek advice and scrivener's work on any number of self-protective devices such as staggered terms, "golden parachutes," and "poison pills," the corporation attorney will have

3. It would, perhaps, be less awkward to refer to a "conflict" between the interests of the executive and those of the board and the shareholders. I have chosen, however, to use "antagonism," for the reason that a "conflict" of interests in the law of professional responsibility is traditionally associated with a difference in the interests between two clients of one attorney. See, e.g., Model Rules, supra note 2, Rule 1.7; Model Code of Professional Responsibility DR 5-105 (1969) [hereinafter Model Code]. A basic point in the law of professional responsibility relating to the obligations of a corporate lawyer is that the corporation is the lawyer's sole and exclusive client. Thus, in most instances, there is no traditional conflict of interests present in the constituent antagonism situation and to use the term "conflict" might raise confusing implications.

4. Jonas, supra note 1, at 617.

5. The "staggered terms" device refers to changing the terms of office of the target corporation's board of directors so that the terms overlap, rather than having all of the terms of the board members begin and end at the same time. After the terms are staggered, only a portion of the terms of the target corporation's board will become open for reelection in a given year. Thus, this anti-takeover device increases the amount of time required before the takeover company can complete a turnover in management. 2 W. Fletcher, Cyclopedia of the Law of Private Corporations § 334.1 (perm. ed. 1982); T. Hazen, The Law of Securities Regulation § 11.20, at 380 (1985).

6. A "golden parachute" is a contract entered into between the corporation and a corporate officer under which the officer, upon retirement or dismissal in the event of a takeover, receives a large severance bonus. Technically such contracts are less a method of deterring a hostile takeover, than a last ditch attempt to provide a very easy exit, after the takeover is completed, for the old management. See D. Block, N. Barton & S. Radin, The Business
very good cause to wonder if he or she is serving best the interests of the corporation or those of the corporation’s officers. Third, since the corporation’s board of directors has a heavy fiduciary obligation to act only for the best interests of the corporation, as long as the board fulfills its duty, an attorney should owe his or her loyalty to the board without thinking of the corporate entity as the “client.”

In response to these points, it could be said that the concept of the corporation entity as client is far from the only counter-intuitive abstraction found in the law, that attorneys in many contexts have to appraise self-seeking acts to determine if those acts violate the legal rights of their clients, and that, as a practical matter, the professional standards of conduct do allow corporation lawyers to look to a corporation’s board of directors as an effective surrogate for the “client.” A more useful response, however, is to consider whether there is a better principle than that of the entity as client to guide attorneys in constituent antagonism situations. Once the best principle for attorney loyalty is established, it is a separate question whether the available standards for proper professional conduct adequately translate the principle into workable guidelines for practitioners. While it appears to be the consensus view that the entity as client principle should control a corporation lawyer’s professional loyalty, the most recently promulgated rules of professional conduct are partially inconsistent with the entity as client concept, and apparently follow the idea advanced by Mr. Jonas that a corporation lawyer should consider the board of directors as his or her client.

This Article will discuss the development of the entity as client concept, the consistency of that concept with the principles of corporations and agency law, and the soundness of the concept as a matter of public

JUDGMENT RULE 170-72 (1987). Of course the size of the severance bonuses which the takeover bidder will have to honor upon assuming control of the corporation may serve to deter the bid.

7. A “poison pill” is a conditional stock right that, if triggered by a partially completed takeover, gives a shareholder in the target corporation the option to purchase newly issued stock at a very large discount from market price. This will greatly increase both the number of shares that must be purchased and the total price that must be paid by the person or entity seeking to complete the takeover by means of purchasing a controlling percentage of the stock of the target corporation. P. Richter, CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE at xix (1987).


9. Id. at 621-22.

10. While the first two responses, pointing out that abstractions and appraisals of legality are a lawyer’s bread and butter and no cause to eliminate the entity as client notion are self evident, the third response is given the elaboration it requires infra text accompanying notes 53-54.

11. See infra text accompanying notes 48-54.
policy. This Article then asserts that the solution for corporation lawyer loyalty questions lies in a proposed, but unadopted, provision of the final draft of the Model Rules of Professional Conduct. That provision would reduce significantly the restrictions currently obstructing attorneys from acting in the best interests of client corporations.

**Development of the Entity as Client Concept**

The corporation concept is poorly suited for the application of many legal principles developed to order a society composed of flesh and blood individuals. Writing fifty years ago, a Minnesota Supreme Court Justice put it well:

A corporation is not a person, but has a legal and real individuality. Neither is it artificial, save as it is a generation of law rather than nature. It is in simple fact a legal unit—a very real one—endowed by its creator with many of the rights and attributes of persons. It is so much *sui generis* that to attempt to define it, rather than to describe or enumerate its peculiar features, in terms of the law of persons, tends to obstruct rather than facilitate comprehension.\(^\text{12}\)

While rigidly adopting the fiction that corporations are "persons" may produce some confusion, the basic structure of English and American law was designed for regulating persons' activities. It is thus inevitable that the law will view corporations, to the greatest possible degree, as if these abstract entities were individuals. Noting this tension, Justice Rutledge identified the basic cause of the difficulty in fixing attorney loyalty duties in situations of corporate-constituent antagonism:

The process of translating group or institutional relations in terms of individual ones, and so keeping them distinct from the non-group relations of the people whose group rights are thus integrated, is perennial, not only because the law's norm is so much the individual man, but also because the continuing evolution of institutions more and more compels fitting them into individualistically conceived legal patterns.\(^\text{13}\)

Given the difficulty of accommodating the corporation concept into the framework of a legal system premised upon individual action, it is not surprising that the rules governing lawyers, the technicians of the legal system, have been unclear on the subject of an attorneys' obligations to corporate clients. On at least four occasions, large national attorneys' organizations have written codes of ethics for the profession. The more recent codes were promulgated with the hope that the states, which license and control the practice of law within their borders, would adopt

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12. *In re Clarke's Will*, 204 Minn. 574, 578, 284 N.W. 876, 878 (1939) (Stone, J.).
the organization's proposal in much the same manner as the Commission on Uniform State Laws has adopted model acts with the largely realized expectation of adoption by individual states.

Three of these model code efforts were made by the largest voluntary organization of lawyers, the American Bar Association (ABA) and each of the three received wide adoption within a few years after promulgation. The American Trial Lawyers Association (ATLA), a much younger professional group than the ABA, produced the fourth code, which no state has yet adopted.

The first ABA drafted code, the Canons of Professional Ethics (Canons), appeared in 1908. Thirty-one state bar associations adopted the Canons from 1908 to 1914. The Canons made no reference to corporations or to any particular difficulties that attorneys might encounter in performing legal services for such clients. Accordingly, this section does not undertake a detailed analysis of the Canons. This section focuses on the later ABA codes, the Model Code of Professional Responsibility and the Model Rules of Professional Conduct, and briefly discusses the ATLA code, The American Lawyer's Code of Conduct.

A. The ABA Model Code of Professional Responsibility

The second ABA code, the Model Code of Professional Responsibility (Code), was officially adopted in 1970. The Code specifically recognized corporations and embraced the entity as client concept to guide a corporation lawyer's professional loyalty.

The Code's discussion of the corporation as client is limited to one paragraph in a document of over fifty pages. More importantly, the discussion is included in an Ethical Consideration (EC), a nonbinding and aspirational statement, as opposed to the Code's mandatory "Disciplinary Rules" (DR). Specifically, EC 5-18 states that an attorney retained by a "corporation or similar entity owes his allegiance to the entity" and not to any constituent of the corporation. The Code advises that, when rendering legal services to the corporation, the corporation attorney should keep the corporation's interest paramount and should avoid being influenced by any constituent's desires. While EC 5-18 authorizes a corporation lawyer also to represent individual corporate constituents, such as an officer or shareholder, such additional representation can only be undertaken or maintained "if the lawyer is convinced

15. See MODEL CODE, supra note 3, EC 5-18.
16. Id. Preliminary Statement.
17. Id. EC 5-18.
that differing interests are not present."\textsuperscript{18}

In explicitly embracing the entity concept to determine the identity of the client to whom a corporation's lawyer owes loyalty, the Code was consistent with the well-developed substantive corporation law principle that corporations are separate juristic persons for many purposes, including entering into contracts with employees, customers, and suppliers.\textsuperscript{19} Since the separate corporate entity employs the lawyer, it was at least a consistent step to establish that an attorney's obligation of loyalty ran toward the corporation, his or her employer.

Within the first five years after the promulgation of the Code, forty-nine states approved the Code as a replacement for the Canons.\textsuperscript{20} Notwithstanding this rapid acceptance, the ABA appointed a commission to evaluate the Code in 1977. The commission, noting technical and substantive deficiencies in the Code, recommended the drafting of a new body of professional standards to propose to the states. One area in which the commission found the Code deficient was the subject of an attorney's loyalty to an organizational client.\textsuperscript{21}

B. The ABA Model Rules

After several years of drafting, discussion, and revision, the commission submitted its Proposed Final Draft of the Model Rules of Professional Conduct (Final Draft) to the ABA House of Delegates in 1981. The Model Rules of Professional Conduct (Rules) adopted by the House of Delegates two years later differ in several pertinent respects from the Final Draft. Because the portions of the commission's proposal on the professional responsibilities of a corporation lawyer that were rejected by the House of Delegates were well thought out, as well as intensely con-

\textsuperscript{18} \textit{Id.}

\textsuperscript{19} The right to enter into contracts as a legal entity to the same extent as a natural person, along with perpetual succession and the rights to participate in law suits, hold title to lands, and make by-laws, was recognized in Blackstone's Commentaries in 1765. I W. BLACKSTONE COMMENTARIES *275-76. The right to contract has been a constant feature of corporate existence to the present day. H. HENN \& J. ALEXANDER, LAWS OF CORPORATION § 79, at 148 (3d ed. 1983); REVISED MODEL BUSINESS CORP. ACT § 3.02(7) (1984). It is somewhat surprising that limited liability, which is today virtually synonymous with the corporate entity concept, was not a certain legal consequence of the corporate business form until the mid-nineteenth century in England and the United States. H. HENN \& J. ALEXANDER, supra § 79, at 148 n.2.

\textsuperscript{20} C. WOLFRAM, supra note 14, § 2.6.3, at 56-57, 57 n.46. California was the one state that chose not to adopt the substantive provisions of the Code, although eight other states chose to adopt only the Canons and Disciplinary Rules from the Code without the Ethical Considerations. \textit{MODEL RULES OF PROFESSIONAL CONDUCT} Chairman's Introduction at v (Proposed Final Draft 1981) [hereinafter FINAL DRAFT].

\textsuperscript{21} \textit{FINAL DRAFT}, supra note 20, Chairman's Introduction at V.
troversial, this Article will review the Final Draft provisions on the subject.

The Final Draft, like the eventually adopted Rules, contained mandatory Model Rules and comments, which contain explanations and amplifications of the prohibitions and duties set out in the Model Rules.\(^2\) In both the Final Draft and the Rules, rule 1.13, entitled “Organization as the Client,” dealt with the specific topic of the loyalty of an attorney employed by a corporation. The Model Rule 1.13 consists of five subparts, (a) through (e). The language of each of the five subparts of Final Draft rule 1.13 was changed in the Rules version, but only subpart (c) was changed in a truly significant manner.\(^3\)

As previously established by EC 5-18 of the Code, subpart (a) re-

\(^2\) The Final Draft also contained elaborate drafter's Notes containing Code comparisons and discussion of relevant case law. The ABA House of Delegates decided to delete the Final Draft Notes from the Rules which it approved.

\(^3\) In order to assist the reader in following the analysis in the text, the provisions, in their entirety are set forth, with the differences noted in italics.

The Final Draft provided:

(a) A lawyer employed or retained to represent an organization represents the organization as distinct from its directors, officers, employees, members, shareholders or other constituents.

(b) 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, and is likely to result in material injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, 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. The measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:

(1) asking reconsideration of the matter;

(2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and

(3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

(c) When a matter has been referred to the organization's highest authority in accordance with paragraph (b), and that authority insists upon action, or refuses to take action, that is clearly a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer may take further remedial action that the lawyer reasonably believes to be in the best interest of the organization. Such action may include revealing information relating to the representation of the organization only if the lawyer reasonably believes that:

(1) the highest authority in the organization has acted to further the personal or
states the principle that a lawyer employed by an organization, such as a
corporation, owes his or her duty of loyalty to the organization and not

financial interests of members of that authority which are in conflict with the interests
of the organization, and

(2) revealing the information is necessary in the best interest of the organization.

d) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client
when necessary to avoid misunderstandings on their part.

e) 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. 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.

Final Draft, supra note 20, Rule 1.13 (emphasis added).
The Rules version provides:

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) 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, and is likely to result in substantial injury to the organization,
the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the
seriousness of the violation and its consequences, the scope and nature of the lawyer's
representation, 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. Any measures taken shall be designed to minimize
disruption of the organization and the risk of revealing information relating to the
representation to persons outside the organization. Such measures may include
among others:

(1) asking reconsideration of the matter;

(2) advising that a separate legal opinion on the matter be sought for presenta-
tion to appropriate authority in the organization; and

(3) referring the matter to higher authority in the organization, including, if
warranted by the seriousness of the matter, referral to the highest authority that can
act in behalf of the organization as determined by applicable law.

(c) If, despite the lawyer's efforts in accordance with paragraph (b), the highest
authority that can act on behalf of the organization insists upon action, or a refusal to
act, that is clearly a violation of law and is likely to result in substantial injury to the
organization, the lawyer may resign in accordance with Rule 1.16.

(d) In dealing with an organization's directors, officers, employees, members,
shareholders or other constituents, a lawyer shall explain the identity of the client
when it is apparent that the organization's interests are adverse to those of the constitu-
ents with whom the lawyer is dealing.

(e) A lawyer representing an organization may also represent any of its direc-
tors, officers, employees, members, shareholders or other constituents, subject to the
provisions of Rule 1.7. 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.

Model Rules, supra note 2, Rule 1.13 (emphasis added).
to its constituents. In subpart (e), rule 1.13 restates the second significant provision of EC 5-18, which permits corporation lawyers to represent constituents of the corporation as well as the entity, as long as there are no conflicts of interest adversely affecting the attorney's ability to represent jointly the corporation and the constituent.\textsuperscript{24} The authorization of joint representation is not inconsistent with the entity as client principal, since permitting joint representation of two separate clients does not imply any position on the identity of the primary client in constituent antagonism cases.\textsuperscript{25}

\textsuperscript{24} As would be expected, consent of both clients in joint representation situations is required in both the Code and the Rules. See Model Code, supra note 3, DR 5-105; Model Rules, supra note 2, Rule 1.7. Both the Final Draft and the Rules versions of rule 1.13 require that the consent of the corporation to the joint representation be given by an appropriate official of the corporation “other than the individual who is to be represented . . . .” Final Draft, supra note 20, Rule 1.13; Model Rules, supra note 2, Rule 1.13. The Rules version of rule 1.13 also allows the consent to be given by the shareholders of the corporation. See id. Rule 1.7 generally requires client consent to joint representation of clients whose interests conflict. See id. Rule 1.7.

\textsuperscript{25} Authorizing joint representation of a corporation and a constituent, however, does allow situations to occur that may well exacerbate the inherent problems caused by the identity of the corporate client. See supra text accompanying notes 12, 13. If a corporation attorney also represents an officer of the corporation personally, the natural presumption of confidentiality the officer would feel toward the officer's attorney may make it all the more likely that the officer may confide to the attorney that the officer has engaged in constituent misconduct. The corporation lawyer would generally have the obligation to inform the client including, in some circumstances, the board of directors, as the “higher authority" mentioned in rule 1.13. Under rule 1.6, however, all attorneys must preserve the confidences of his or her clients (including the officer). Thus, an irreconcilable conflict in the professional obligations of the corporate lawyer arises.

The conflict will, absent consent from the officer for the attorney to disclose the mis- or malfeasance to the corporation, make the attorney's position impermissible under rule 1.7.

Accordingly, the lawyer must withdraw from representing one, and quite probably both, clients. Information the corporation needs to know (the officer's constituent misconduct) can never be disclosed to the corporation. Therefore, loyalty to the client corporation demands that the corporation withdraw from representing the corporation to allow the organization to employ a lawyer who will be free to detect, independent of the first corporation lawyer's knowledge, the constituent misconduct.

Following the lawyer's withdrawal from representation of the corporation, the interests of the officer client and the former corporation client will almost invariably conflict on the matter of the constituent misconduct. The former corporation lawyer cannot, absent consent by the corporation, use any information he or she learned as the corporation lawyer in defending the interests of the officer client regarding the constituent misconduct. Thus, the lawyer could not continue to represent the officer regarding the officer's relationship with the corporation.

Obviously, the corporation lawyer's resignation may alert the organization to suspect that the officer client has engaged in constituent misconduct; but that drawback appears unavoidable. It is also obvious that a lawyer who chooses to represent both a corporation and a constituent of that organization should make sure, at the outset of the joint representation, that the constituent is well aware of the lawyer's duty to inform the corporation of constituent misconduct under MR 1.13(b). Under MR 1.2(c), which allows for limited representation, it may be possible for the corporation lawyer and the constituent client to agree, at the outset of the
The Notes to the Final Draft rule 1.13 establish that the entity as client principle is not only consistent with other aspects of the substantive law of corporate contracts, but is also derived from the law of agency.26 Under agency law, all employees, officers, directors, and attorneys of a corporation are co-agents of the same principal, the corporation. This general principle has at least three specific legal consequences that are relevant to a consideration of the proper identity of the corporation lawyer's client.

First, each co-agent is liable to the principal for acts of constituent misconduct during the course of his or her employment and the co-agent has no general liability to fellow co-agents for such acts. The concept of co-agency also establishes that the principal, and not another co-agent, is liable to the co-agent for his or her compensation. Third, it is the principal, and not another co-agent, who is generally liable to third parties for the co-agent's misconduct in the performance of his duties. Thus, the general legal liabilities run directly between a corporation lawyer, as co-agent, and the corporation, as principal. It would therefore be illogical to extinguish the attorney's duty of loyalty to the corporation and make the attorney's duty run to the board of directors, which has neither a general legal obligation to pay the lawyer for his or her services, nor to answer for the quality of the lawyer's work.

A significant initial concern of the drafters of rule 1.13 was whether the entity as client concept should be adjusted to allow or require a corporation attorney to divulge confidential information to persons outside the corporation in order to prevent the client from causing harm through commission of a fraud or crime that would cause injury to third parties.27 One reason for the controversy over this issue was the position advanced by the Securities and Exchange Commission (SEC) in the early 1970s in the well-known National Student Marketing litigation.28 In that case, the SEC argued that a corporation lawyer had aided and abetted a violation of the federal securities laws if the lawyer learned of the corporation's past violation of those laws and failed to report the violation to the Commission.29 The court rejected the SEC argument in the case, but the ar-

representation, that the lawyer is free to report any constituent client misconduct to the corporation. If permissible, such an agreement would avoid the possible future conflict between professional obligations for the lawyer described above.

27. See Final Draft, supra note 20, Chairman's Introduction at ii.
gument stirred great controversy in the legal profession, raising the question of the propriety of attorneys assuming an "audit" or "whistle blowing" function in regards to client conduct.30

The SEC based its position upon the premise that lawyers engaged in securities work wield great power. The SEC reasoned that such power requires lawyers to assume the obligation of taking extreme steps to prevent the culmination of legally questionable client plans that may involve substantial financial harm to American investors.31 Others have suggested a second premise for ascribing an audit function to corporation lawyers: Organizations having the financial size and power that corporations are deemed to possess should not be entitled to the type of highly protective loyalty to which clients who lack such economic power are clearly entitled.32

The American Bar Association responded to the SEC argument in 1975 with a statement of policy on the application of the Code provisions to the work of securities lawyers.33 The ABA statement rejected the SEC position, strongly embraced the entity as client concept, and foreshadowed the eventual substantive content of Model Rule 1.13. In general, the ABA took the unequivocal position that a corporation lawyer performing securities work was only obligated to follow the procedures

30. In National Student Marketing, the court held that the corporation lawyers had aided and abetted the securities law violation by completing a merger transaction that the lawyers knew had been approved by shareholders on the basis of materially misleading information. 457 F. Supp. at 712. The court rejected the argument that the lawyers had also aided and abetted the violation by failing to report the violation to the SEC after the merger had occurred because “such subsequent . . . inaction by the attorneys could not substantially assist the merger.” Id. at 712-13; see also Koch, Attorney's Liability: The Securities Bar and The Impact of National Student Marketing, 14 WM. & MARY L. REV. 883 (1973); Lipman, The SEC's Reluctant Police Force: A New Role for Lawyers, 49 N.Y.U.L. REV. 437 (1973); Patterson, The Limits of the Lawyer's Discretion and the Law of Legal Ethics: National Student Marketing Revisited, 1979 DUKE L.J. 1251.

31. Lowenfels, Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties, 74 COLUM. L. REV. 412, 424 (1974) SEC considers the securities lawyer to have a “position of trust at the very heart of the investment process; the decisions that he makes regarding [disclosure] to the investing public may affect the savings of millions of people”); see, e.g., Lipman, supra, note 30 at 441 (SEC contends that lawyers owe primary duties to the securities market and investors); see also Koch, supra, note 30 at 885 (SEC “has taken the position that the attorney practicing in the securities field owes responsibility not only to his client, but to the investing public as well”).


indicated in the Code. Furthermore, the statement asserted that an attorney acting in accordance with the SEC view on informing to stop past or present client wrongdoing would violate the Code’s ethical requirements. Specifically, the statement adjured attorneys not to reveal information learned from a client to a third party, including the SEC, unless the client’s obligation to reveal the information is “clearly established,” which means that no “reasonable doubt exists concerning the client’s obligation of disclosure.” In such situations, the Code’s DR 4-101 would seem to apply, providing an attorney freedom to reveal client confidences in order to prevent the client from committing a crime.

Seven years after the ABA statement, the Supreme Court strongly endorsed the entity as client concept in *Upjohn Co. v. United States.* The issue before the Court was whether the evidentiary privilege shielding communications between an attorney and client applied to communications between a number of lower level executives of the corporation and the corporation’s attorney. The communications in question were written responses to a questionnaire prepared by the corporation’s lawyer calling for information about suspected corporate bribery of foreign government officials. The Sixth Circuit held that the privilege did not apply to the responses, basing its holding on the trial court’s finding that the executives responding to the questionnaire were not within the “control group” of senior executives entitled to “control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney.”

The so-called control group test applied by the circuit court had been used previously by lower federal courts, which reasoned that only an executive who can control, or at least substantially participate in mak-

34. While the statement speaks in terms of the Code requirements and obligations, it is more accurate to say that the guidance in the Code was less clear cut than those terms would imply. Nonetheless, the ABA statement accurately reflects the implications of the Code for corporation or securities lawyers.

35. *Statement of Policy,* supra note 33, at 1086. The statement develops and clarifies this pronouncement in a rather puzzling manner by indicating that the attorney may be free to disclose client confidences.

36. *See Model Code,* supra note 3, DR 4-101(c)(3). It is a crime to willfully fail to comply with the stock issuance disclosure requirements of the federal securities laws.


38. *Upjohn’s* general counsel solicited and received the communications in question. *Id.* at 386-87. The Supreme Court, and all courts below, drew no distinction between such “in-house” attorneys and “outside” attorneys for the purpose of applying the attorney-client privilege. *See Upjohn,* 449 U.S. at 395; 600 F.2d 1223, 1226 (6th Cir. 1979); 41 A.F.T.R.2d (P-H) 78-796, 78-800 (W.D. Mich. 1978).

ing decisions on corporate action, "is (or personifies) the corporation" when communicating with the corporation's attorney. The Supreme Court rejected the control group test and held the low-level executive communications were privileged. The express premise of the decision was that the attorney-client communication privilege should protect the processes used by a corporation lawyer to collect the information necessary to adequately render legal advice to the client. The Court thereby re-emphasized that the corporation as an entity is the client of the corporation lawyer, and determined that it is irrelevant if certain constituents of the corporation appear to "be" or "personify" the corporation.

In summary, the entity as client concept is supported by the logic of traditional doctrine in the fields of corporations and agency law and has been validated by a very recent Supreme Court decision. Aside from legal doctrine and precedent, a public policy argument also supports the entity as client concept. Investment by individuals in corporations is universally acknowledged to stimulate the economy and benefit society, and legal doctrines making such investment more likely are therefore desired. Corporate investment is more likely to occur if the investors know that their interests, to the extent of the value of their stock in the corporate entity, are the focus of the professional concern of the corporation lawyer, rather than if investors must question if the lawyer's focus is the legal well-being of influential corporate constituents.

Accordingly, the entity as client concept was firmly established in subpart (a) of the Final Draft version of Model Rule 1.13 and subpart (b) specifically imposes a duty on the corporation lawyer who learns of constituent misconduct to take measures to protect the best interests of the corporation, including referring the matter, if necessary, to the corporation's board of directors. All such measures taken by the attorney must

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40. To avoid confusion, and to note the Supreme Court's stress on the theoretical premise underlying the control group test, consider the full quotation amplifying the test:

"Keeping in mind that the question is, Is it the corporation which is seeking the lawyer's advice when the asserted privileged communication is made?, the most satisfactory solution, I think, is that if the employee making the communication, of whatever rank he may be, is in a position to control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney, . . . then, in effect, he is (or personifies) the corporation when he makes his disclosure to the lawyer and the privilege would apply.


As noted in the text, the Court rejected the control group test after this quotation. See id. at 392-93.

41. _Upjohn_, 449 U.S. at 392.

42. Rule 1.13(b)(3) authorizes the corporate attorney to report constituent misconduct "to the highest authority that can act in behalf of the organization as determined by applicable
be consistent with the duty of confidentiality, which binds the attorney not to reveal confidential information relating to the representation of the corporation. In practical terms, this means not revealing the information to anyone outside the corporation, and, within the corporation, revealing it only to those persons who necessarily must be informed to protect the corporation’s interests.

In both the Final Draft and the Rules, subparts (a) and (b) of rule 1.13 are consistent with the entity as client concept, and, with minor variations of wording, the subparts have the same meaning. Subpart (d), which sets out an explicit ethical obligation of a corporation lawyer, was also virtually the same in the Final Draft version as in the Rules. Under the entity as client concept, because the attorney must protect the corporation’s interests, even if it requires informing the board of directors of an individual employee’s misconduct, it is correct to give the lawyer the specific duty to inform the constituents with whom the lawyer works that he has a professional duty to report constituent misconduct to higher authorities. Thus, Model Rule 1.13(d) requires the attorney to “explain the identity of the client when it is apparent that the organization’s interests are adverse to those of the constituents with whom the lawyer is dealing.”

It is interesting to compare Model Rule 1.13(d) with the provisions of the American Lawyer’s Code of Conduct (Code of Conduct), adopted by the Roscoe Pound-American Trial Lawyers Foundation in 1982. The Code of Conduct, which no state has yet adopted, apparently rejects the law. Model Rules, supra note 2, Rule 1.13(b)(3). This language was in the Final Draft and was continued almost verbatim into the Rules. The Comments to the Final Draft rule 1.13 stated, however, that the phrase “highest authority” could, in some situations include the independent members of the board of directors, id. Rule 1.13 comment (The Entity as Client), meaning those members of the board who were not also company officers. H. Henn & J. Alexander, supra note 19, § 204, at 553 n.17. The Final Draft comment also specifically discussed the situations in which the corporation’s attorney might take a matter beyond the board to the shareholders of the company. In the Rules, as finally adopted, any reference to the shareholders as possible “highest authority” and any discussion of going beyond the board with a matter of constituent misconduct was omitted.

43. The requirement that a corporation lawyer comply with all other rules of professional conduct when acting in accordance with rule 1.13 is expressly stated in the Comment to the rule. Model Rules, supra note 2, Rule 1.13 comment. See rule 1.6(a) for the Rules formulation of the duty of confidentiality and the exceptions to the general rule of secrecy. Also note the discussion of the interaction of rule 1.6 and rule 1.13(c) in the text infra note 53.

44. As discussed, supra note 42, there is a significant difference in the comments that foreshadow the deviation of the Rules subpart (c) from both the language and the entity as client concept embraced in the Final Draft subpart (c).

45. Model Rules, supra note 2, Rule 1.13(d). In the Final Draft version of subpart (d), the obligation to “explain the identity of the client” arose “when necessary to avoid misunderstanding” on the part of the constituents. Final Draft, supra note 20, Rule 1.13(d).
entity as client concept and substitutes the board of directors as the corporation lawyer's client in the area of constituent antagonisms.\textsuperscript{46} Rule 2.5 of the Code of Conduct requires a corporation attorney to bring potential constituent antagonisms to the attention of the board of directors "as early as possible in the lawyer-client relationship" for the purpose of receiving a board policy instruction of the attorney’s duties in such situations.\textsuperscript{47} In contrast to Model Rule 1.13(d), rule 2.5 places a positive duty upon the attorney to act early to prevent misplacement of confidence by constituents. Finally, rule 2.5 requires the attorney who has received a policy from the board to "take reasonable steps to ensure that officers with whom the lawyer deals, and the shareholders, are made aware of how the lawyer has been instructed to resolve conflicts of interest."\textsuperscript{48}

The major divergence between the Final Draft and the Rules is found in subpart (c). In that subpart, the Rules version differs markedly from the Final Draft version in language, prescribed duties, and identity of the client concept.\textsuperscript{49} Subpart (c) addresses the obligation of the corporation lawyer who has reported constituent misconduct to the board of directors, and the board has refused to follow the attorney’s recommendations to protect the corporation's interests. The Final Draft stays true to the entity as client concept of Model Rule 1.13 subparts (a), (b), (d), and (e), while the Rules adopt the board as client concept advanced by Mr. Jonas and adopted, \textit{sotto voce} in the American Lawyers Code of Conduct.\textsuperscript{50}

The Rules version of Model Rule 1.13(c) takes the position that, if the board has refused to act to protect the corporation, the corporation’s attorney must accept that decision as final \textit{and} as subject to the duty of confidentiality that the attorney should accord the client.\textsuperscript{51} The only course of conduct the Rules authorize, other than silent continuation as the corporation’s attorney, is resignation with continued silence regarding the board’s action and the underlying constituent misconduct. Thus, subpart (c) subordinates the interests of the corporation, which is the

\textsuperscript{46} See \textit{The American Lawyer's Code of Conduct} Rule 2.5 (Revised Draft 1982) [hereinafter \textit{Code of Conduct}].

\textsuperscript{47} \textit{Code of Conduct}, supra note 46, Rule 2.5; see \textit{supra} note 42 and accompanying text.

\textsuperscript{48} \textit{Id.}

\textsuperscript{49} See \textit{supra} note 23.

\textsuperscript{50} See \textit{supra} text accompanying notes 46-48.

\textsuperscript{51} The corporation attorney's duty of confidentiality regarding the board's decision and the underlying constituent misconduct is clarified in comment 6. This comment provides that the provisions of Rule 1.13 do not limit the lawyer's responsibility of confidentiality under Rule 1.6. \textit{Model Rules}, supra note 2, Rule 1.13 comment (Relation to Other Rules).
attorney's client under subpart (a), and directs the lawyer to act as if the board was the lawyer's client. This prescription is established for the very situation in which the attorney's duty to act to protect the corporate entity from being abused is most crucial: those situations where the board has decided for its own reasons not to protect the corporation's interests.

It is true that the board will be liable for breaching its fiduciary duty to the corporation, but the breach of this obligation probably will be hard to detect and may cause irremedial harm to the corporation. It is most likely that the board will refuse to act to protect the corporation when the board has collectively engaged in misconduct and wishes to keep the fact secret, or when individual officers that have engaged in misconduct can persuade the board to take no action and to keep the matter secret. In such situations, the corporation as an entity and the general shareholder interests that the entity represents are most in need of the protection of the corporation lawyer's skill and efforts. Under the Rules, the corporation lawyer is prohibited from doing so as a matter of professional ethics.

The Final Draft approach to the issue of board acquiescence in constituent misconduct was very different. If a three-part test is satisfied under the Final Draft subpart (c), the corporation's lawyer would have the option of revealing the information about the constituent misconduct and the board's acquiescence in it to the corporation's shareholders or to authorities. Thus the lawyer was authorized to reveal such information if the board's acquiescence to the constituent misconduct was for the pur-

52. For a general statement of the board's fiduciary duty to the corporation, see H. Henn & J. Alexander, supra note 19, § 235, at 625-28.

53. The ABA House of Delegates took a similar approach when considering the Final Draft version of rule 1.6, the provision setting out the lawyer's duty of confidentiality. The ABA decided against giving attorneys the option to disclose a client's secrets in a number of situations in order to protect innocent people from fraud or other harm. Specifically, the Rules version precludes attorneys from divulging client secrets in every possible instance except when it is necessary either to prevent a future crime involving the likelihood of death or substantial bodily harm or to protect or further the lawyer's own interests in any controversy relating to the attorney's representation of the client. See Model Rules, supra note 2, Rule 1.13. The Final Draft authorized attorney disclosure to prevent future crimes or frauds likely to result in substantial injury to the financial interest of a third party, to rectify the consequences of a client's criminal or fraudulent act perpetrated with the use of the lawyer's services, or "to comply with other law." See Final Draft, supra note 20, Rule 1.6.

In rejecting the Final Draft version of rule 1.6, the ABA chose to structure the standards of professional ethics to protect the interests of the client over the interests of third parties. In rejecting the Final Draft version of rule 1.13(c), the ABA chose to protect the interests of third parties over those of the client. In the rule 1.13 situation, the third parties are in the position to hire, fire and set compensation for the attorney.
pose of furthering the "personal or financial interests of members of the board," if those personal or financial interests conflicted with the corporation's interests, and if revealing the information was "necessary in the best interest of the organization."

The Final Draft version of Model Rule 1.13(c) is consistent with the entity as client concept, although tempered by the deference the attorney should give to the disinterested business judgment of the board. It is only when that judgment is both self-interested and adverse to the corporation's best interests that the attorney has the option to reveal the misconduct to the corporation's shareholders or to third-party authorities. The Final Draft version of subpart (c) is also consistent with the spirit of Model Rule 5.4(c) as it appears in the Rules, because it allows the corporation attorney to exercise his or her professional judgment for the benefit of the attorney's client without being controlled by the persons paying the lawyer's compensation.

Conclusion

Although the Code embraces a "pure" entity theory, the Rules version of Model Rule 1.13(c), effectively enacts the proposition Mr. Jonas advances: In cases of constituent antagonism, the attorney's professional obligation will be toward his ultimate client, the board of directors. This proposition would be particularly significant in those instances in which the board of directors of a corporation facing a hostile takeover is willing, in order to save their positions or the positions of corporate management, to squander the corporation's assets through poison pills, pac man defenses and the like, or as a final step, to create insupportable golden parachutes.

When faced with such a situation, the corporation lawyer should have the option to take his or her concerns beyond the board of directors

54. MODEL RULES, supra note 2, Rule 1.13(c).
55. Courts generally apply the business judgment rule to the board's business decisions. Under this standard, directors and officers of a corporation have no liability if they honestly believe their decision was in the corporation's best interests and was the product of careful, unbiased, and good faith business judgment. H. HENN & J. ALEXANDER, supra note 19, § 242, at 661-63.
56. A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services. MODEL RULES, supra note 2, Rule 5.4(c). This provision is substantially identical to the terms of DR 5-107 in the Code. Rule 5.4(c), "Professional Independence of a Lawyer," provides:
   (c) A lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.
to the shareholders or to the appropriate authorities. This option, which was proposed in the Final Draft version of Model Rule 1.13(c) but ultimately rejected by the ABA, would significantly clarify the role of a corporation attorney in cases of constituent antagonism.