

**ALASKA BAR ASSOCIATION  
ETHICS OPINION NO. 2012-3**

**REPRESENTATION OF CLOSELY HELD ORGANIZATION AND ITS  
MAJORITY OWNERS WHEN THEIR INTERESTS MAY BE ADVERSE TO  
THOSE OF MINORITY OWNERS**

**Question Presented**

What are the ethical duties of counsel for a small closely held organization when the interests of the organization and its majority owners are adverse to the interests of minority owners?

**Conclusion**

Counsel must make a fact-based analysis to determine whether a conflict exists and, if it does, whether it can be waived. As a general rule, representation of the organization does not also imply representation of an individual owner or owners. However, a conflict can arise if the attorney has represented an individual owner in other legal matters or in such a way that might cause that individual to believe that the attorney was acting on his or her separate behalf. The ultimate resolution of the question relies heavily on the specific facts of the situation.

**Discussion**

The Committee has been asked to review the ethical issues that arise when an attorney is asked to represent the interests of both a closely held corporation or LLC and the majority owner or owners of the company, in circumstances where their interests may be adverse to the position of a minority owner or owners. Because of the closely held nature of the business, there may be no “disinterested” owner from whom counsel or the company can obtain a waiver of any conflict. Under such circumstances, can the attorney represent the business and the majority owner or owners?

Alaska Rules of Professional Conduct address the ethical position of a lawyer who represents an organization. ARPC 1.13(a) states the general rule:

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

Rule 1.13 makes clear that the ethical duties of the lawyer are to the organization itself and not the “constituents” with whom the lawyer deals. Rule 1.13(f) provides:

- (f) In dealing with the organization’s directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization’s interests are adverse to those of the constituents with whom the lawyer is dealing.

Nevertheless, the Rule also recognizes that the “constituents” of the organization may have interests that are closely tied to or identical to those of the organization itself. ARPC 1.13(g) allows dual representation of the organization and

its officers, directors, 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.

Rule 1.7 deals with conflicts of interest between current clients. The Rule allows dual representation so long as the lawyer concludes that it is possible to represent both interests diligently and competently, the representation does not involve the assertion of a claim by one client directly against the other client, and both parties give informed consent in writing. See ARPC 1.7(a), (b).<sup>1</sup>

When conflict issues arise in the context of a small closely held business entity, for a number of reasons they can be very difficult to resolve. In a small, closely held organization, unlike a larger organization, each of the owners may have a direct and intimate responsibility for the operation of the business.<sup>2</sup> The attorney for the organization may have dealt directly with each owner on a regular basis on many matters, or even with respect to the particular legal matter at issue. The constituent may have used the legal services of the attorney on unrelated matters or in circumstances in which it was reasonable for the constituent to conclude that the attorney was acting as the

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<sup>1</sup> An attorney also owes a duty to former clients as well as current clients. Conflicts can arise in the business context when a former owner or employee with whom the attorney has had a close professional relationship becomes adverse to the organization. ARPC 1.9 provides guidance for dealing with conflicts between current and former clients.

<sup>2</sup> “[A] closely held business is a business whose ‘distinguishing characteristic . . . is that management and shareholding are not separated functions.’ Other characteristics of closely held businesses include the issuance of private equity (stock or interests that are not publicly-traded) and the significant personal investment of both time and capital by shareholders.” Darien Ibrahim, *Solving the Everyday Problem of Client Identity in the Context of Closely Held Businesses*, 56 Ala. L. Rev. 181, 188, Fall 2004 (quoting Michael P. Dooley, *Fundamentals of Corporation Law* at 1011 (1995) (footnotes omitted)).

constituent's attorney. When owners in a small closely held organization clash, there is a high likelihood that the attorney will previously have received information or given advice to all concerned that is relevant to the dispute. Finally, when the owners have equal or nearly equal ownership rights and responsibilities, and where each may have been directly involved in giving instructions to the attorney in the past, the attorney may find that it is hard to know who speaks for the business entity and thus who gives direction on behalf of the "client." Although ARPC 1.13(g) allows dual representation if the organization consents, it may be impossible to find an "appropriate individual" or shareholder who is genuinely disinterested and who can thus approve dual representation.

Resolving these issues requires the attorney to consider two issues. First the attorney must determine whether an attorney client relationship has arisen with the individual owners that would make representation of the business and the majority owners adverse to a minority owner a violation of the duty owed by an attorney to all clients. Second, if no attorney client relationship has arisen with the individual owners, then the attorney must determine whether he or she can satisfy the dual representation test of ARPC 1.13 (g). Some general observations are appropriate.

First, when an owner of a closely held organization, acting in a capacity as a representative or "constituent" of the organization, consults with the organization's attorney, receives legal advice or provides confidential information no attorney client relationship is formed with the constituent. No conflict of interest arises if the interests of the constituent and the organization later diverge.<sup>3</sup>

Second, and conversely, advice given by counsel to a constituent regarding the constituent's individual legal issues (including, for example, legal advice regarding the constituent's rights or claims against the organization) may create either an actual or an implied attorney client relationship that gives rise to an impermissible conflict that precludes the attorney from representing the corporation on an issue adverse to the constituent's interests.<sup>4</sup> Finally, to

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<sup>3</sup> See, e.g., *McKinney v. Means*, 147 F.Supp.2d 898 (W.D. Tenn. 2001) (lawyer not disqualified from defending close corporation in suit brought by one of two owners, since lawyer represents corporation, not owners); *Nilavar v. Mercy Health System-Western Ohio*, 143 F.Supp.2d 909, 913 (S.D. Ohio 2001) (mere exchange of confidential information between counsel and organization's officers and directors about matters of interest to the corporation does not create attorney client relationship with officer or director); D.C. Ethics Op. 2005-10 (2005) (lawyer may represent corporation against one of two 50% shareholders).

<sup>4</sup> See, e.g. *Home Care Indus., Inc., v. Murray* (154 F.Supp.2d. 861 (D.N.J., 2001) (attorney's receipt of confidences from and substantial dealings with one corporate constituent created an implied attorney client relationship with that constituent).

the extent that it is not possible to reconcile the conflict under the Rules of Professional Conduct, or it is not possible to determine who can make decisions on behalf of the client, the attorney must withdraw, rather than express a preference for one client over another.<sup>5</sup>

The attorney for a closely held business entity can and should make clear that the attorney represents the organization, and not the individual owners.<sup>6</sup> The attorney can and should make the implications of this clear as well. Any communications from one owner to the attorney regarding the affairs of the business are not likely to be protected from the other owner.<sup>7</sup> The attorney may not favor the interests of one owner over another during the course of representing the business.<sup>8</sup> If a conflict should arise among the owners the attorney may be required to withdraw from representing any party if the owners cannot agree on a waiver or some method of resolving the conflict.<sup>9</sup>

Several examples illustrate these principles. An attorney prepares the

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<sup>5</sup>See Alaska Bar Association Ethics Opinion No. 84-2 (attorney for partnership cannot represent one partner against another in partnership dispute); *In re: Banks*, 584 P.2d 284, 292 (Or. 1978) (only ethical position for attorney to adopt when substantially identical interests which he has represented become divergent is to represent neither the individual nor the corporation).

<sup>6</sup> See Alaska Rule of Professional Conduct 1.13, comment:

There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.

<sup>7</sup> See, e.g., *Cohen v. Acorn International Ltd.*, 921 F.Supp.1062 (S.D.N.Y. 1995) (motion to disqualify counsel denied; former client could not reasonably believe that an attorney client relationship existed when his only communications with counsel were in the course of managing the business; former client had no reasonable expectation that the communications would be kept confidential from the current business and its directors); *MacKenzie-Childs LLC v. Mackenzie-Childs*, 262 F.R.D. 241, 254 (W.D.N.Y. 2009); *Nilavar v. Mercy Health System-Western Ohio*, 143 F.Supp.2d 909, 913 (S.D. Ohio 2001) (mere exchange of confidential information between counsel and organization's officers and directors about a matter of interest to the organization does not, by itself, create an attorney client relationship with officer or director.)

<sup>8</sup> *In re: Banks*, 584 P.2d at 292 (Or. 1978); see also, *Morris v. Morris*, 306 A.D.2d 449-452 (N.Y. App. 2003).

<sup>9</sup> *Reed v. Hoosier Health Systems, Inc.*, 325 N.E.2d 408, 412 (Ind. App. 2005) (counsel may not resolve conflict by "firing" the disfavored client).

necessary legal documents to create a corporation, including the shareholder agreement to be signed by the two shareholders of the new business. At no time does the attorney meet with either of the individual shareholders to discuss the shareholder's personal legal rights or responsibilities under the agreement. The corporation pays for the legal services involved and there was no prior attorney-client relationship with either shareholder. Later, the attorney, on behalf of the corporation, sues one of the shareholders for violation of the shareholder agreement. Disqualification is not required because there was no attorney client relationship with the individual shareholder. See *McKinney v. Means*, 147 F.Supp.2d 898, 901 (W.D. Tenn. 2001).

In contrast, a CEO of a corporation has a dispute with an employee. The CEO contacts a law firm and asks for representation in dealing with this dispute. The law firm interviews the CEO, and, in the course of the investigation, provides legal advice to the CEO. Eventually, the dispute results in termination of the CEO under a termination agreement. In litigation regarding enforcement of the termination agreement, the law firm enters an appearance on behalf of the corporation against the former CEO. The law firm is disqualified from representing the corporation. Regardless of whether the law firm understood it had previously represented the corporation or the CEO, the law firm provided legal advice to the CEO, was given confidential information by him, and failed to make clear that the firm was representing the interests of the corporation and not the CEO with respect to the incident. It was reasonable for the CEO to believe that the law firm was acting on his behalf as well as on behalf of the corporation. See *Home Care Industries, Inc. v. Murray*, 154 F.Supp.2d 861, 869 (D.N.J. 2001).

In resolving these kinds of issues, the attorney must refer to the provisions of ARPC 1.7, 1.9 and 1.13. To the extent that there are "independent decision makers" to whom the attorney can turn for guidance as to the best interests of the business, the attorney may do so pursuant to 1.13(g). However, if, a conflict is determined to exist, the attorney cannot ignore the conflict and must take steps to ensure that the interests of the clients are recognized and protected.

Approved by the Alaska Bar Association Ethics Committee on October 12, 2012.

Adopted by the Board of Governors on October 26, 2012.