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**Keeping Company:  
Representing Start-Up Businesses in Good Times and Bad**

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No matter what the economic climate, start-up companies pose special conflict of interest challenges for the lawyers who work with them—whether the businesses are on the way up or the way down.

One of the most common issues that confronts lawyers who work with start-up companies is multiple client conflicts. Although some founders of start-up companies are well-capitalized enough to afford separate counsel for each, many are not. Therefore, several founders of a proposed new venture who want to pool their resources will often ask a single lawyer or law firm to assist them in forming the business. To use a recurring example: one founder has the bright idea; the second has the cash; and the third has the management expertise. If things don't go well, the once hopeful joint venturers may later ask that same lawyer or law firm to represent them in dissolving the business.

Oregon's ethics rules, cases and opinions address both new business formation and dissolution.<sup>1</sup> This article first draws those resources together in discussing conflicts in new business formation and then does the same for business dissolution.

## Conflict Issues in New Business Formation

The conflict issues surrounding new business formation flow from the rules governing multiple current client representation in DR 5-105(A), (E) and (F). Those rules are built on three basic concepts.

*First*, if the clients have an “actual” conflict, then the lawyer cannot represent more than one of them *even if* they are willing to consent. DR 5-105(A)(1) defines an “actual” conflict as a situation in which “the lawyer has a duty to contend for something on behalf of one client that the lawyer has a duty to oppose on behalf of another client.” In the new business formation context, this means that you can’t bargain with one client against another over material aspects of the structure of the enterprise, their respective shares or the like. See OSB Legal Ethics Op No. 2000-158 at 2-3 (2000) (discussing “actual” conflicts generally).<sup>2</sup> A useful way to think about “actual” conflicts is the proverbial “zero-sum game” where if one party “wins” the other must necessarily “lose.” See Peter R. Jarvis & Bradley F. Tellam, “When Waiver Should Not Be Good Enough: An Analysis of Current Client Conflicts Law,” 33 Willamette L Rev 145, 174 (1997) (using this analogy to identify “actual” conflicts). If you are in a situation where if Client A wins on a material issue, Co-Client B must necessarily lose, they probably have an “actual” conflict that cannot be cured by a waiver because their interests are in direct conflict in the same matter.

*Second*, if the clients have a “likely” conflict, then the lawyer can represent more than one client with full disclosure to and the consent of all of the clients involved.<sup>3</sup> DR 5-105(A)(2) defines a “likely” conflict broadly as “all other situations (other than ‘actual’ conflicts) in which the objective personal, business or property interests of the clients are adverse.” Professors Hazard and Hodes in their leading national treatise, *The Law of Lawyering*, explain this concept more concretely in the context of new business formation:

“Because *each* of the clients \* \* \* faces the risk that the shared lawyer will be disabled from provid[ing] loyal representation *because of responsibilities to another of the clients*, [ABA] Model Rule 1.7(b) [which is the functional equivalent of DR 5-105(E)-(F) in Oregon] applies \* \* \*. \* \* \* Thus, before proceeding with the representation, the shared lawyer must first make an independent determination that the representation may be conducted without material adverse effect on any of the parties. If that threshold is satisfied, the lawyer must still explain the risks of joint representation and obtain informed consent from each of the clients.” § 11. 4 at 11-41 (emphasis in original; footnote omitted).

*Third*, if the clients’ interests are wholly aligned at the outset of the representation, then there is *no* conflict—at least at that point—even if there is a *theoretical possibility* that a conflict may develop later. As the Oregon Supreme Court explained in *Kidney Association of Oregon v. Ferguson*, 315 Or 135, 146, 843 P2d 442 (1992), even if it is “conceivable at the outset that a conflict could develop \* \* \*[,] a theoretical potential for conflict is not a *likely* conflict.” (Emphasis in original.).

The Oregon Supreme Court in *In re Samuels/Weiner*, 296 Or 224, 230-31, 674 P2d 1166 (1983) and the Oregon State Bar in Legal Ethics Opinion No.

1991-123 (1991) have applied these general concepts to new business formation. Legal Ethics Opinion No. 1991-123, which relies on *Samuels/Weiner*, summarizes these rules in the new business formation context:

“[A]n attorney may represent multiple current clients in a matter without disclosure and consent if neither an actual nor a likely conflict is present. If, on the other hand, a likely conflict is present, an attorney may represent multiple current clients only if each of the clients consents after full disclosure. If an actual conflict is present, an attorney may not represent multiple current clients even if the clients consent after disclosure.” OSB Legal Ethics Op No. 1991-123 (1991) at 2.

As Legal Ethics Opinion No. 1991-23 notes, the facts will dictate whether a particular situation presents no conflict at all, a “likely” (waivable) conflict or an “actual” (nonwaivable) conflict. Let’s look at examples of all three in this order.

It may be the case that our three founders are all sophisticated veterans of new ventures, come to the lawyer with all material aspects of their business plan already developed fully and only need the lawyer’s assistance with a discrete task in which their interests are completely in concert. In that event, it might be possible for a single lawyer or law firm—as in *Samuels/Weiner*—to represent all three in forming their business without going through disclosure and consent because their interests (at least at the outset) are aligned fully. A lawyer in this situation should still, of course, monitor the situation closely as the representation progresses to determine whether any conflicts have developed and, if so, whether they can be waived. Moreover, even if the founders’ interests appear to be aligned entirely at the outset, a single lawyer or law firm in this circumstance

would still be well advised to obtain conflict waivers anyway as a precaution before proceeding.

Changing the facts slightly, let's assume instead that our three founders have agreed on most—but not all—of the material aspects of their business plan. They anticipate (but are not positive) that they will be able to work out among themselves the remaining details and hope to use the lawyer to handle only the aspects of their business plan on which all three agree. In this situation where the *potential* for conflicts is more concrete, it should still be possible for the lawyer to at least begin the joint representation with full disclosure to and the consent of all three because their interests (at least at the outset) are aligned. But, especially where material aspects of the business plan remain undecided, the lawyer should monitor the situation carefully to avoid being drawn into nonwaivable conflicts as the representation progresses.

Changing the facts still further, let's now assume that our three founders have agreed on few, if any, of the material details of their business plan and the primary focus of the initial legal work would involve sorting out the economic value of each of the three's contributions to the business and incorporating those respective values into the ownership and management structure. In this situation where their individual interests are already diverging on material issues at the starting gate, the lawyer would immediately be put in the untenable (and nonwaivable) position of negotiating for one client against another. This would

involve the “zero sum game” and would present the lawyer with an “actual” (nonwaivable) conflict if the lawyer attempted to represent more than one client.

Drawing the line between “actual,” “likely” and no conflicts can often be very difficult. In light of this difficulty, other approaches that a single lawyer or law firm may wish to explore in new business formation involve limiting the scope of the representation to avoid the conflicts altogether. Section 12.9 of the 1998 supplement to *The Ethical Oregon Lawyer* explores this in detail and I commend it to readers who might be interested in this approach. Two approaches are sometimes used in the context of new business formation to limit the scope of a single lawyer’s or law firm’s representation in an effort to avoid creating multiple client conflicts.

In the first, the single lawyer or law firm would represent only one of our three founders and the other two (if they chose) would be unrepresented. This approach is used most often when one of the three founders (typically the one providing the financing) already has a lawyer and the three have already agreed on their business plan for the most part anyway. In this circumstance, there is no conflict because the lawyer is only representing one of the three. But, the lawyer in this situation would also be wise to send “nonrepresentation” letters to the other two confirming that the lawyer’s only professional relationship is with the single founder and the lawyer will not be representing the other two.<sup>4</sup> Further, consistent with this approach and DR 7-104(A)(2), the lawyer should *not* provide

legal advice to the other two. If the lawyer does, the lawyer risks inadvertently turning the other two founders into clients<sup>5</sup> and possibly creating the very multiple client conflict that the lawyer was trying to avoid in the first place.

In the second, the lawyer would agree to represent only the entity to be formed—with the founders either separately represented or unrepresented. Although something of a legal fiction, this approach is intended to reinforce the concepts expressed in the conflict rules by having the lawyer only act for the agreed interests of the collective rather than the possibly competing interests of the individual founders. Again, the lawyer using this approach would be wise to send “nonrepresentation” letters to all three of the individuals spelling out the relationships and should again take care not to inadvertently create attorney-client relationships with the individuals that might give rise to the conflict that the lawyer was attempting to avoid.

### **Conflicts in Business Dissolution**

Although some new businesses are wildly successful, many fail. Therefore, the same founders who sought the lawyer’s help in creating their business may come calling again for the lawyer’s assistance in dissolving it (or the functional equivalent by way of sale or reorganization).<sup>6</sup> This situation, too, poses its own set of ethical issues. Because the analysis is somewhat different depending on whether the founders are still the lawyer’s current clients or not,

let's first discuss current client conflicts in business dissolutions and then turn to the situation in which at least one of the founders has become a former client.

***Current Client Conflicts***

If the lawyer continues to represent more than one of the founders individually and perhaps the corporation as well, then a business dissolution can often present the “zero sum game” of an “actual” (nonwaivable) conflict even more starkly than a business formation. As Legal Ethics Opinion No. 1991-123 put it: “There is a difference between individuals who wish to come together in order to do business together and who, therefore, have a substantial common interest (in addition to potential differences) and individuals who are seeking to go their separate ways and who thus lack such a continuing common interest.” *Id.* at 3 n.3. Therefore, it is inherently more difficult to find circumstances in the business dissolution context that would allow a single lawyer or law firm to represent multiple parties than in a business formation.

*In re Phelps*, 306 Or 508, 760 P2d 1331 (1988), upon which this facet of Legal Ethics Opinion No. 1991-123 rests, illustrates this practical difficulty. Two brothers whom the lawyer represented asked him to assist them in dissolving a farming partnership. The lawyer, wary of the potential conflict involved, told the brothers that he would only undertake the representation on the condition that he would only be responsible for documenting a dissolution plan to which the brothers had already agreed. The Supreme Court found that there was no



conflict at the outset of the joint representation because the lawyer was only proposing to handle the brothers' common objective. *Id.* at 519. But, once the representation began, the brothers quickly disagreed over the value of some of the assets being divided. Despite this disagreement, the lawyer continued to represent both brothers. The Supreme Court found that the lawyer had an "actual" (nonwaivable) conflict at that point and should have withdrawn from representing both brothers. *Id.* The rapid descent in *Phelps* from no conflict as the representation was proposed to an "actual" (nonwaivable) conflict shortly after it began reinforces Legal Ethics Opinion No. 1991-123's caution—when assets are being divided and former joint venturers are going their separate ways it will be very rare that conflicts will not preclude joint representation.

But, to vary the facts of *Phelps*, the lawyer there should in most instances have been able to represent one brother adverse to the other brother with full disclosure to, and the consent of, both brothers as long as the dissolution was unrelated to the other matters on which the lawyer continued to represent the brother against whom the lawyer would be adverse in the dissolution. For the lawyer's own protection, the lawyer will want to carefully document any waiver granted in accord with DR 10-101(B)—including the required recommendation to the clients to seek independent counsel in deciding whether to grant the waiver.

***Former Client Conflicts***

If one of the founders has become a former client, the conflicts calculus changes somewhat.

Former client conflicts are governed by DR 5-105(C)-(D). Under those rules, former client conflicts arise in two situations (or a combination of both). The first kind of former client conflict is usually called a “matter-specific” former client conflict. It occurs when a lawyer is asked to take on a new matter that is either the same or significantly related to a matter that the lawyer handled earlier for the former client. The second kind of former client conflict is usually called an “information-specific” former client conflict. It occurs when a lawyer is asked to take on a new matter that would (or would likely) require the lawyer to use the former client’s confidential information against the former client. If neither situation is present, then the lawyer has a former client, but not a former client conflict. If one of the former client conflict triggers is present, then it is also important to remember that all former client conflicts can be waived—with full disclosure to and the consent of both the current client and the former client.

Legal Ethics Opinion No. 1991-11 (1991) deals with former client conflicts generally—including the business dissolution context. In doing so, it draws heavily on the Supreme Court’s decision in *In re Brandsness*, 299 Or 240, 702 P2d 1098 (1985). Among the former client conflict scenarios that Legal Ethics Opinion No. 1991-11 explores is the following:

“Attorney D represents Melvin and Henry in buying a corporation or partnership from third parties. When Melvin and Henry later have a falling out, Melvin seeks separate counsel, and Henry asks Attorney D to represent him against Melvin in connection with litigation or negotiations pertaining to dissolution of the corporation or partnership.” *Id.* at 1.

Legal Ethics Opinion No. 1991-11, again drawing on the Supreme Court’s *Brandsness* decision, read the concept of “matter” broadly in concluding that the dissolution would be significantly related to the acquisition because it involved the same asset. It found, therefore, that the new representation would involve a “matter-specific” former client conflict. *Id.* at 2. It is possible to argue that the concept of a “matter” should not be read so broadly if many years have passed since the lawyer helped form a business and the nature of the business has changed materially since its formation. But, because many new businesses fail relatively soon after they are launched, the “new business dissolution” context may be closer to the situation addressed in Legal Ethics Opinion No. 1991-11. This opinion also cautions that a business dissolution might pose an “information-specific” former client conflict as well depending on the nature of the confidential information the lawyer learned in the course of the earlier representation and the proposed use of that confidential information adverse to the former client in the new representation.

## Summing Up

Lawyers often perform a critical role in assisting entrepreneurs forming new businesses and, if things don’t go well, unwinding them in an orderly

fashion. But, because lawyers are often asked to represent more than one client in these circumstances, they need to be attentive to the conflict issues presented at both the outset of such representations and as they progress.

#### **ABOUT THE AUTHOR**

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Endnotes

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1. For additional authorities on these issues from a national perspective, see Restatement (Third) of the Law Governing Lawyers § 130 at 360 (Illustration 4) and 361 (Illustration 5) (2000) and G. Hazard and W. Hodes, The Law Governing Lawyers § 11.14 at 11-41 to 11-45 (3d ed 2000). Oregon's approach to these issues is generally in accord with other jurisdictions around the country.
2. The Bar's formal legal ethics opinions are now available at its Web site at [www.osbar.org](http://www.osbar.org).
3. For more on the disclosure and consent requirements and process, see DR 10-101(B), Chapter 12 of *The Ethical Oregon Lawyer, In re Brandt/Griffin*, 331 Or 113, 10 P3d 906 (2000) and S. Stevens, "Full Disclosure: What is it, and isn't," Oregon State Bar Bulletin, February/March 2001 at 27.
4. Although beyond the scope of this article, business lawyers will also want to stay attuned to the evolving law of breach of fiduciary duty. See, e.g., *Granewich v. Harding*, 329 Or 47, 985 P2d 788 (1999); *Roberts v. Feary*, 162 Or App 546, 986 P2d 690 (1999).
5. In Oregon, the existence of an attorney-client relationship is measured under a standard that is usually called the "reasonable expectations of the client test" that was initially articulated by the Oregon Supreme Court in *In re Weidner*, 310 Or 757, 770, 801 P2d 828 (1990). See also Oregon State Bar Legal Ethics Op. No. 1991-85 (1991) (addressing "who is the client" in the context of corporations and partnerships). This standard involves both subjective and objective components: (1) the client must subjectively believe that an attorney-client relationship exists; and (2) that subjective belief must be objectively reasonable under the particular circumstances presented.
6. The same general considerations would also apply where the there was a falling out between the shareholders and the lawyer was being asked to assist the corporation in terminating the employment of one or more of the founders.