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Growing Up and Growing Old: Ethics Issues in the Life Cycle of a Business

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Businesses can present challenging ethics and risk management issues for lawyers throughout their "life cycle." In this column, we'll look at some representative areas that can develop at the beginning, along the way and at the end of a business. The topics included are intended to be illustrative rather than encyclopedic, but touch on some of the most common.

At the Beginning

The start-up phase can present two key issues: defining the client and properly documenting fee agreements that include taking stock in lieu of fees.

Defining the Client. RPC 1.13(a), which governs entity representation, states the baseline position that "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." But, what about when an entity is being formed? Approaches vary. Some lawyers represent the entity to be formed. Others represent a lead investor with the other investors either separately represented or unrepresented. Still others attempt to represent the investors jointly provided their individual interests are completely aligned.

Regardless of the avenue chosen, it is critical that the lawyer document (preferably in writing) precisely who the lawyer is—and is not—representing.

The test for determining whether an attorney-client relationship exists is twofold under the Washington Supreme Court's leading decision on the subject, *Bohn v. Cody*, 119 Wn.2d 357, 363, 832 P.2d 71 (1992). The first is subjective: does the client subjectively believe that the lawyer is representing the client? The second is objective: is the client's subjective belief objectively reasonable under the circumstances? Lacking careful documentation, the lawyer is left open to the assertion later by a non-client that the lawyer was supposedly representing that person, too, and failed to protect that person's interests. Conflicts in this area can lead to both regulatory discipline (*see, e.g., In re Egger*, 152 Wn.2d 393, 98 P.3d 477 (2004)) and civil damage claims (*see, e.g., Eriks v. Denver*, 118 Wn.2d 451, 824 P.2d 1207 (1992)).

Taking Stock. Lawyers are allowed under RPC 1.8(a), the business transaction rule, to take their fees (in whole or in part) in stock and ABA Formal Ethics Opinion 00-418 discusses the mechanics in detail. Given the sensitivity of lawyer-client business transactions, however, RPC 1.8(a) imposes very high disclosure obligations on the lawyer to meet the requirement of "informed consent" by the client. The Court of Appeals in *In re Corporate Dissolution of Ocean Shores Park, Inc. v. Rawson-Sweet*, 132 Wn. App. 903, 911-12, 134 P.3d 1188 (2006), summarized multiple appellate decisions on this point and described these duties in unsparing terms: "To justify a transaction between an attorney and his client, the attorney has the burden to prove: (1) there was no

undue influence, (2) he gave the client exactly the same information or advice as would have been given by a disinterested attorney, and (3) the client would have received no greater benefit had he dealt with a stranger."

RPC 1.8(a) and RPC 1.5(a), which addresses fees generally, also require that the resulting fee remain reasonable for the duration of the agreement. In *Holmes v. Loveless*, 122 Wn. App. 470, 94 P.3d 338 (2004), for example, the Court of Appeals refused further enforcement of a lawyer-client business transaction when an original discount of $8,000 in fees to a new venture had returned over $380,000 to the lawyers during the next 30 years.

Lawyer-client business transactions that do not meet the high bar imposed by RPC 1.8(a) may result in regulatory discipline (*see, e.g.*, *In re McMullen*, 127 Wn.2d 150, 896 P.2d 1281 (1995)), civil damage claims for breach of fiduciary duty (*see, e.g.*, *Cotton v. Kronenberg*, 111 Wn. App. 258, 44 P.3d 878 (2002)) and put enforceability of the business deal itself at risk (*see, e.g., In re Corporate Dissolution of Ocean Shores Park, Inc. v. Rawson-Sweet*, 132 Wn. App. 903).

Along the Way

As businesses mature, two particular problem areas can develop: conflicts with corporate affiliates and internal disputes.

Affiliate Conflicts. A particularly difficult issue in the corporate setting is whether representation of one corporate affiliate will be deemed representation of an entire "corporate family." Comment 34 to RPC 1.7, the current client conflict

rule, notes that "[a] lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary." Rather, the answer is usually fact-specific and turns on a number of factors, including the extent to which affiliates share common ownership and control and whether the lawyer has specifically limited the representation to a particular entity through a carefully tailored engagement agreement. ABA Formal Ethics Opinion 95-390 doesn't provide all of the answers but does include a useful set of criteria focusing on overlapping ownership and control that offers a framework for analysis. "Guessing wrong" in this context can lead to disqualification—with *Avocent Redmond Corp. v. Rose Electronics*, 491 F. Supp.2d 1000 (W.D. Wash. 2007), and *Jones v. Rabanco, Ltd.*, 2006 WL 2237708 (W.D. Wash. Aug. 3, 2006) (unpublished), providing comparatively recent examples of firms that were disqualified based on corporate family conflicts.

Internal Disputes. Internal disputes can come in many flavors when representing a corporation, ranging from shareholder battles for control to derivative suits. Although RPC 1.13(g) allows a lawyer for a corporation to also represent a corporate "constituent" such as a shareholder, it warns that any dual representation is subject to the multiple client conflict rule—RPC 1.7. Similarly, Comment 14 to RPC 1.13 notes any potential dual representation of the corporation and corporate officials in a derivative suit is also subject to RPC 1.7.

This is another fact driven area. In *Hicks v. Edwards*, 75 Wn. App. 156, 876 P.2d 953 (1994), for example, well-qualified experts could not agree on whether a conflict arose under the particular circumstances of a derivative case. Nonetheless, lawyers who are corporate counsel should be very wary about being drawn into an intramural dispute among shareholders.

At the End

The end of a corporate representation can present its own risks. We'll look at two: conflicts in business dissolutions and documenting the end of a representation.

Business Dissolutions. Business dissolutions can quickly create conflicts if assets are insufficient to satisfy competing claimants or the dissolution will affect jointly represented clients in disparate and adverse ways. In *In re McGrath*, 178 Wn.2d 280, 288, 308 P.3d 615 (2013), for example, the Washington Supreme Court noted that the lawyer involved had been disqualified in the bankruptcy proceeding that formed the backdrop of the subsequent disciplinary case for multiple conflicts stemming (among others) from the lawyer's dual roles as a corporate "insider" (as defined by bankruptcy law) and a secured creditor. *Bertelsen v. Harris*, 459 F. Supp.2d 1055 (E.D. Wash. 2006), in turn, involved joint representation of debtors and guarantors in a failing business. Although the court in *Bertelsen* ultimately concluded that the conflict involved was both waiveable and that the lawyer had obtained a sufficient waiver, many

such conflicts are nonwaiveable because they pit jointly represented clients directly adverse to each other in the same matter.

Documenting the End. Even if a lawyer and a client part company more mundanely than through a dissolution or bankruptcy, it can be important to document that a representation has concluded. The reasons are twofold. First, you want to make sure that you won't be blamed for something "bad" that occurs later that was "not on your watch." Second, if at some point you or your firm want to take on an unrelated matter adverse to your old client, you will need to be able to show that the client is indeed a "former client" as that term is defined by RPC 1.9. The Court of Appeals in *Hipple v. McFadden*, 161 Wn. App. 550, 559, 255 P.3d 730 (2011), adopted a "reasonable expectations" test for determining when an attorney-client relationship ends that is similar to the standard articulated by *Bohn* for when it begins. A polite, professional letter to a business letting it know that you have completed your work and are "closing your file" can be critical to documenting the end of the relationship and allowing your firm to take on new matters against the business provided that they otherwise meet the standard of RPC 1.9.

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