

Ethical Issues

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By George M. Taylor, III, gtaylor@burr.com

CONTENTS

- I. Introduction
- II. General Issues
- III. Who is the Client? Representation and Conflicts Issues
- IV. Confidentiality of Information
- V. Form Joint Representation Letter

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DEALING WITH LIABILITIES

I. INTRODUCTION

The transactional lawyer has many complex issues to worry about in the context of selling or acquiring the business. These include the multiple practice areas that may be involved, the various parties with differing interests that must be brought together, and the invariably unreasonable time constraints put on us by our clients. Lurking among these issues are issues of professional responsibility that, when invoked, could turn the transaction from an aggressive negotiating and bargaining exercise between seller and purchaser into a serious dispute between the lawyer and his own clients or would-be clients. In this area, an ounce of prevention is worth a pound of cure (in many cases there being no cure), so we are all well-advised to consider carefully the ethical issues that are raised by business of transaction and to take appropriate action at the outset to avoid ethical problems that may arise later. These issues fall loosely into three categories: (1) identifying the client and avoiding conflicts of interest, (2) maintaining client confidences, and (3) exercising professional judgment on behalf of the client.

II. GENERAL ISSUES

Before we delve into the difficulties of multiple representations and conflicts of interest, we should bear in mind those general rules of ethics which are relevant to the acquisition transaction.

The first of these deal with competence. Acquisitions come in many shapes and sizes and counsel who has successfully handled dozens of acquisitions of one type might be totally out of the water in handling another. The relevant guide is Rule 1.1 of the Rules of Professional Conduct which states as follows:

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonable necessary for the representation.

We are all well-advised to remember that the take-over of a public company is not the same thing as acquisition of a dry-cleaning store. Frequently, the handling of a large acquisition requires retaining additional counsel to properly represent the interests of a client.

Acquisition counsel should also bear in mind the requirement, contained in Rule 1.4 of the Rules of Professional Responsibility, to keep a client reasonably informed about the status of a matter, and a lawyer should explain each matter to the extent reasonably necessary to permit the client to make informed decision regarding the representation.

Finally, Rule 1.5 admonishes us to discuss legal fees at the outset with our acquisition client, particularly where the client has not regularly been represented by the firm in the past.

III. WHO IS THE CLIENT? REPRESENTATION AND CONFLICTS ISSUES

One of the most difficult areas of ethics for the transactional lawyer is in determining who is the client. All of us have encountered groups of businesspeople who appear on our doorsteps with the joint instruction to form a corporation and then to proceed, jointly on behalf of the group, to acquire another business. Rarely in a group of three or more will any elect to hire a personal attorney. This concept of “joint” representation places great responsibility on the attorney to identify (a) who his client is, (b) what the services are that he will render for the client and (c) who the client isn’t and what those nonclients should expect.

At the outset, the lawyer should recognize that if he is being called upon to represent an existing corporation, his loyalty must be to the corporate entity and not to its individual officers or employees. Rule 1.13 of the Alabama Rules of Professional Conduct addresses this issue very directly:

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

Subsequent provisions of Rule 1.13 detail the obligation of the attorney who knows that an officer or employee is acting in a manner which violates a legal obligation to the organization or a violation of law which might be imputed to the organization, to proceed to act in the business interests of the organization. And, though unstated, he must do so however painful that may be. The rule specifies that whatever action is taken must be taken so as to minimize disruption of the organization, and due regard must be given to maintaining confidential information. The options to acquisition counsel when placed in such a dilemma include the following:

- asking reconsideration of the matter
- advising that a separate legal opinion on the matter be sought
- referring the matter to a higher authority in the organization

If these courses of action fail to resolve the issue, the lawyer is given the option of resigning. See Rule 1.16, Rules of Professional Conduct.

The most important issue in representing clients in acquisition transactions is in making clear at the outset who the client is and properly documenting that fact. While in years past counsel would occasionally take on the role of representing both seller and purchaser, that view is now largely discredited, and most practitioners and authorities take the position that it is never proper to represent both sides in an acquisition transaction. Some state courts, for example New Jersey, have adopted an express prohibition on representation of both sides in a complex transaction. The best general rule is for counsel to avoid such representation at all costs. Should you undertake such representation, a very detailed examination of the rules of ethics coupled with extensive written disclosure should be undertaken, all of which is beyond the scope of this paper.

The more likely scenario is the attorney being called upon to represent multiple clients on the same side of a transaction. The Alabama Rules of Professional Conduct contain an express permissive rule dealing with multiple representation:

Rule 1.13(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 (Conflicts of Interest). 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.

Such representation may well, however, involve potential conflicts of interest that may eventually lead to the requirement that the attorney disqualify himself. The commentary to Rule 1.7 of the Rules of Professional Responsibility, dealing with conflicts of interest, states expressly that while "a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, ... common representation is permissible where the clients are generally aligned in interest, even though there is some difference of interest among them."

A general rule designed to create the greatest comfort for counsel in an acquisition transaction is to represent as few parties as possible. An important corollary to this rule is to identify those persons who are not clients and notify them of that fact in writing. Once that issue is addressed, the issue remains of how to deal with the remaining (multiple) clients. Multiple client relationships are dealt with in Rule 2.2 of the Rules of Professional Conduct which bears the cryptic title of "Intermediary" but in fact is directly focused on multiple representations. Representation of common clients necessarily involves facilitating communications between them and accordingly places counsel in the role of "intermediary". Such joint representation cannot be undertaken unless each of the following conditions is met:

- the lawyer consults with each client concerning the implications of the common representation, including the advantages and risks involved, and the effect on the attorney-client privileges and obtains each client's consent to the common representation
- the lawyer reasonably believes that the matter can be resolved on terms compatible with the clients' best interest, that each client will be able to make adequately informed decision in the manner and that there is little risk of material prejudice to the interests of any of the clients if the contemplated resolution is unsuccessful; and
- the lawyer reasonably believes that the common representation can be undertaken impartially and without improper effect on other responsibilities the lawyer has to any of the clients.

A natural corollary to this enabling rule is found in Rule 2.2(c) which states unequivocally that the lawyer must withdraw if any of these conditions are no longer satisfied.

It is fair so say that Rule 2.2 is more honored in the breach and that few acquisition counsel actually go through the steps of informing clients of the benefits and disadvantages of joint representation before engaging in an acquisition transaction for them. Indeed, most attorneys do not even realize that they are representing multiple clients in such circumstances. If the representation is undertaken without complying with the provisions of

the Rule, the attorney could face liability from one or more disgruntled clients as the transaction progresses.

The best general advice for dealing with the multiple representation situation is as follows:

- At the outset, decide whom you intend to represent. Where there are actual and potential conflicts of interest, consents should be obtained in writing early in the process.
- Be on the lookout for persons involved in the transaction who are not your clients. Notify them in writing of the desirability of obtaining separate counsel.
- Explain to the multiple clients the significance of the joint representation, the scope of the work you are going to perform and the issues of client confidences. Agree at the outset that all information will be shared with all of the joint clients, no matter what the source of that information is.
- When in doubt, put it in writing. There is no way to over estimate the importance of clear and comprehensive written disclaimers both to those being represented and those not being represented.

IV. CONFIDENTIALITY OF INFORMATION

Attorney-client privilege also comes to play in the field of multiple representation. In a common representation, the lawyer is still required both to keep each client adequately informed and to maintain confidentiality of information relating to the representation. Complying with both requirements while acting as an intermediary requires an almost impossible balance. The prevailing rule is that as between commonly represented clients, the privilege does not attach. Acquisition counsel must assume that if litigation occurs between the clients, the privilege will not protect any communications and the clients should be so advised at the outset.

Common representation does not diminish the rights of each client in the client-lawyer relationship. Notwithstanding the joint representation, each has the right to loyal and diligent representation and the right to the protection of the Rules of Professional Conduct (primarily Rule 1.9) concerning obligations to a former client.

From a practical standpoint, acquisition counsel should deal with the problem of client confidences in the same manner as other joint representation issues by a clear and comprehensive disclosure and disclaimer at the beginning of the relationship. Such a disclaimer should provide for joint consent by each of the clients that all information disclosed by one can be shared jointly with the other and that no confidentiality privilege will be asserted with respect to any of the information, regardless of its source.

V. FORM JOINT REPRESENTATION LETTER

Mr. Smith
Ms. Jones
Mr. Rogers
Ms. Anderson

Birmingham, Alabama

Re: Ultra Goods, Inc.

Gentlemen:

This letter confirms your joint engagement of _____ as legal counsel for matters concerning the purchase of substantially all the assets of Ultra Goods, Inc. located in Prattville, Alabama (the "Assets").

It is understood that our client, for purposes of this representation, will initially be all four of you as a "joint client group." There are many issues where you may or will have conflicting or potentially conflicting interest such as compensation, ownership shares, control of the enterprise -- just to name a few. Notwithstanding the above, you have each agreed that, to keep legal costs to a minimum, you wish our law firm to represent all four of you.

If you disagree on any issue, we will ask you to resolve your differences among yourselves, without our assistance. If you cannot resolve your differences, we will not be able to represent any one of you as to that issue. If the differences are serious enough, we may be required by applicable ethics rules to withdraw from the matter completely.

It is our understanding that you intend to form a corporation to close the purchase of the Assets. When the corporation begins functioning, we will send our statements to the corporation. Until the corporation is formed, we will send our bills to _____. From that point forward our only client will be the corporation, and we will not be counsel for any of you individually.

For your information, our fees are based upon traditional factors governing establishment of attorneys' fees (i.e., experience, time and skill required, novelty and difficulty of the questions involved). For convenience, we have assigned each of our lawyers an hourly rate, and we use these hourly rates to make our billing more efficient. The present hourly rate for my time is \$_____ per hour. The hourly rate for the associate attorney I intend to use in assisting with this matter is \$_____ per hour. As indicated above, the principal basis for computing our fees will be time spent on the matter by persons involved multiplied by the individual hourly rate.

We will send you monthly statements for legal services rendered and out-of-pocket costs incurred by us on your behalf during the immediately preceding month. These statements will summarize each matter for which legal services are rendered and the fee charged for the matter. The statements will also include an itemized description of out-of-pocket costs advanced by us on your behalf and generally may include the following: travel

expenses; long distance telephone calls; cost of terminal time for computer research; postage fees; filing, recording, certification and registration fees charged by governmental bodies; and the cost of photocopied material. Payment is due in full upon receipt of our statements.

It is important that you understand that in asking us to represent you as a joint client group, we will treat all communications and actions by any of you and us in regard to the purchase of the Assets as common knowledge to be shared by all of you (while, of course, maintaining strict confidentiality as to anyone else and to unrelated matters in which we have or are now representing any of you). However, because of the joint representation, there is no assurance that any of this shared information will be subject to the attorney-client privilege and it may be subject to discovery in any subsequent proceeding. Furthermore, we cannot take action for one of you that is not known and agreed to by the others. If any of you decides to terminate this joint representation, which you can do at any time, it will be necessary for us to withdraw from this matter, unless the withdrawing party retains separate counsel and consents to our continued representation of the other parties.

If the foregoing meets with your approval, please indicate your acceptance by signing this letter in the space provided below. Please return the original to me and retain a copy for your records. We certainly appreciate the opportunity to work with you and look forward to a mutually satisfactory relationship.

Very truly yours,

Agreed to and accepted:
