



**New York State Bar Association
Committee on Professional Ethics**

Opinion 978 (08/06/2013)

Topic: Counsel to closely held corporation

Digest: An attorney acting as general counsel to a closely held corporation 1) represents the entity and not its directors/sole shareholders and 2) must explain to the directors/shareholders that he does not represent them when he becomes aware that action to be taken on behalf of the entity may be divergent from their personal interests.

Code: Rule 1.13(a) Rule 1.4(b)

BACKGROUND

1. An attorney acts as general counsel for a closely held corporation in which its directors are also the sole shareholders. The attorney does not represent the directors/shareholders. Discussions are on-going within the corporation as to certain issues relevant to the corporation's by-laws and shareholder agreements the result of which will impact the corporation's ability to take advantage of a tax/property evaluation benefit. While the change will benefit the corporation, half of the directors will be personally disadvantaged by it. The lawyer is aware that the interests of the individuals will diverge from those of the entity and/or the other directors/shareholders when these issues are raised and the lawyer fears the board will deadlock and be unable to take advantage of the benefit.

QUESTION

2. Is the lawyer required to raise the issues on behalf of the organization because of the relevance to the discussion or is the lawyer prohibited from raising the issues because the lawyer is aware of the divergent personal interests of the shareholder directors?

ANALYSIS

3. As Rule 1.13(a) notes, “[w]hen a lawyer employed or retained by an organization is dealing with the organization’s directors, . . . shareholders or other constituents, and it appears that the organization’s interests may differ from those of the constituents with whom the lawyer is dealing, the lawyer shall explain that the lawyer is the lawyer for the organization and not for any of the constituents.” As Professor Simon notes, “[t]he essence of the rule is in the final clause, which says that a lawyer who is employed by an organization ‘is the lawyer for the

organization and not for any of its constituents.” Simon’s New York Rules of Professional Conduct Annotated 2013 Edition, p.633.

4. The question then becomes whether the lawyer must raise the issue with the client, the organization, or remain quiet because of the awareness of the divergent interests among the director/shareholders. Rule 1.4(b) requires that “[a] lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.” If knowledge of the issue is reasonably necessary to permit the client to make an informed decision, then it must be raised. At this juncture, Rule 1.13(a) will provide guidance to the lawyer. Now that the lawyer has made the decision that this is something he must raise with his client, the organization, and that it may be adverse to the personal interests of the directors/shareholders or presents a conflict between the interests of the directors/shareholders, the lawyer is required to explain to the director/shareholders that he is the lawyer for the organization and not for any of them personally. Comment 2A to Rule 1.13(a) notes:

There are times when the organization’s interests may differ from those of one or more of its constituents. In such circumstances, the lawyer should advise any constituent whose interest differs from that of the organization: (i) that a conflict or potential conflict of interest exists, (ii) that the lawyer does not represent the constituent in connection with the matter . . . , (iii) that the constituent may wish to obtain independent representation, and (iv) that any attorney-client privilege belongs to the organization and may be waived by the organization. . . .

CONCLUSION

5. When a lawyer acting as general counsel to a closely held corporation becomes aware of an issue, the knowledge of which is necessary for the entity to make an informed decision and proposes a change that may be contrary to the personal interests of certain directors/shareholders, the lawyer must advise the entity of the issue and should consider, as appropriate, advising the directors/shareholders (1) the lawyer is the lawyer for the organization and not for the directors/shareholders, (2) that an actual or potential conflict of interest exists, (3) that the directors/shareholders may wish to retain counsel on their own behalf, and (4) that any attorney client privilege belongs to the organization and may be waived by the organization.

(71-12)