

Complex Litigation & E-Discovery

Conflicting Loyalties

When corporate counsel should not represent a shareholder

By Scott I. Unger

When shareholders in a closely held corporation disagree, it is extremely likely that one or more shareholders will approach the outside counsel who represents the company, and ask counsel to represent them in shareholder litigation. Before an outside corporate counsel agrees to represent one shareholder against another in a dispute, the Rules of Professional Conduct (RPC) must be carefully considered. Violation of these important rules could lead to a successful motion to disqualify, disgorgement of legal fees, attorney malpractice or the filing of a successful ethics complaint.

The practitioner considering representing one shareholder against another should check if there are any conflicts of interest that would prohibit the representation, as well as whether counsel might be a necessary and material witness to facts in dispute between the parties. For the reasons set forth herein, outside

Unger is a shareholder in Stark & Stark's shareholder and partner disputes and litigation groups.

corporate counsel may want to consider referring litigation among the shareholders to another law firm.

Is There a Conflict of Interest?

Before agreeing to represent one shareholder against another, outside corporate counsel must consider whether or not there is a conflict of interest. Rule 1.7 of the RPC generally prohibits an attorney from taking a position that is adverse to a current client's interest. Rule 1.7(a) sets forth the general rule, while subsection (b) sets forth the parameters under which a lawyer may represent a client despite the existence of such a conflict of interest.

Rule 1.7 reflects "the fundamental understanding that an attorney will give 'complete and undivided loyalty to the client' [and] 'should be able to advise the client in such a way as to protect the client's interests, utilizing his professional training, ability and judgment to the utmost.'" *In re S.G.*, 175 N.J. 132, 139 (2003) (quoting *In re Dolan*, 76 N.J. 1, 9 [1978]). If the representation of one client will be "directly adverse to another client" or if there is a risk that representation of one client will be "materially limited by the lawyer's responsibilities to another client," the lawyer is prohibited from engaging in that representation.

In addition, a "lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, even when the matters are wholly unrelated." *Gallagher v. Atl. City Bd. of Educ.*, 2010 WL 572160, at *3 (D.N.J. Feb.17, 2010). In short, RPC 1.7 prohibits an attorney from taking a position that is adverse to another client's interest.

Rule 1.10 provides that a concurrent conflict of interest of one attorney extends to all members of that attorney's firm, disqualifying all the attorneys if any one of them would be disqualified.

There is only one exception allowing an attorney to represent a client when there is a concurrent conflict of interest: where the lawyer reasonably believes that he can represent both clients fully and fairly along with the both parties' consent. See RPC 1.7(a), (b)(1); *In re S.G.*, 175 N.J. at 138.

In *Baglini v. Lauletta*, 338 N.J. Super. 282 (App. Div. 2001), the court discussed a situation in which counsel was disqualified from representing a party because the interests of that party were adverse to the interests of another client. The plaintiffs hired attorney John Trimble to represent their interests in opposing a development application made by University Executive Corp., Inc. (UEC) and Frank Lauletta, its principal. During the course of the construction project, UEC hired Anthony Alberto as the manager for the project and, by way of agreement, Alberto became a 10-per-

cent owner of UEC.

Lauletta subsequently observed Trimble representing Alberto before a township planning board on an application to develop a piece of property. Lauletta relayed this information to his counsel in the plaintiffs' action, as he believed Trimble might be conflicted. During the course of a subsequent deposition in the litigation, the attorney representing defendants Lauletta and UEC advised Trimble that Alberto was a stockholder in UEC. At that deposition, defendants' counsel expressed:

Let the record reflect it came to my attention yesterday Mr. Alberto is Mr. Trimble's client, that he is a member of Executive Campus, Inc., and owns 10 percent of that entity so that there will be no question within the next ten days we would like some indication [what] Mr. Trimble's position is, or we will make a motion to disqualify Mr. Trimble in these proceedings based on the ground he sued one of his clients.

Trimble later confirmed Alberto's ownership interest in UEC, and Alberto refused to waive any conflict of interest in the plaintiffs' action against UEC, in which he was a 10-percent shareholder. Consequently, Trimble withdrew as plaintiffs' counsel in the litigation against UEC and Lauletta. The court in *Baglini* recognized a concurrent conflict of interest where Trimble represented the plaintiffs and, incidentally, Alberto, a 10-percent stockholder of the corporate defendant.

Counsel's inquiry should begin by carefully reviewing the complaint or the other shareholder's accusations to ascertain whether or not any of the allegations are or could be adverse to the currently represented corporation. When doing so, outside corporate counsel should keep in mind that they represent the corporation.

"One of the most basic responsibilities incumbent on a lawyer is the duty of loyalty to his or her clients." *In re S.G.*, 175

N.J. at 138 (citing *In re Opinion No. 653 of the Advisory Comm. on Prof'l Ethics*, 132 N.J. 124, 129 [1993]). This duty of loyalty is paramount, "[t]here are very few of the business relations of life involving a higher trust and confidence than that of attorney and client." The duty of loyalty is an important consideration because if any of the fighting shareholders' allegations appear to be detrimental to the corporation itself, then outside corporate counsel should decline representation.

Often times in minority oppression claims, one shareholder will allege that the other shareholder has: (a) misapplied or wasted corporate funds, (b) stolen from the company or (c) usurped corporate opportunities. Because those claims could have negative ramifications against the corporation itself, outside counsel should be concerned that said representation could run afoul of RPC 1.7 and the fiduciary duties counsel owes the client. That is because the interests of outside corporate counsel may be adverse to their client (the corporation itself).

In addition to considering concurrent conflicts, outside corporate counsel should consider whether or not they have represented the other shareholder in previous matters. Rule 1.9 bars an attorney from representing a client whose interests are materially adverse to the interests of a former client, unless the former client gives informed consent memorialized in writing. Hence, if outside corporate counsel has represented the adverse shareholder they should decline representation.

Am I a Fact Witness?

Under the New Jersey RPC, a lawyer may not act as an advocate in the trial in which the lawyer is likely to be a necessary witness, unless specific conditions apply. Rule 3.7(a) provides:

A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless:

(1) the testimony is related to an uncontested issue;

(2) the testimony relates to the nature and value of legal services rendered in the case; or
(3) disqualification of the lawyer would work substantial hardship on the client.

Rule 3.7(b) provides a further caveat, that "[a] lawyer may act as advocate in a trial in which another lawyer in the lawyer's firm is likely to be called as a witness unless precluded from doing so by RPC 1.7 or RPC 1.9." Rule 3.7 was implemented to prevent a situation in which a lawyer acts as both an attorney and a witness at trial, thus "creating the danger that the fact finder (particularly if it is a jury) may confuse what is testimony and what is argument, and otherwise creating an unseemly appearance at trial." *Nat'l Sec. Systems, Inc. v. Iola*, 2009 WL 3756897, at *4 (D.N.J. Nov. 6, 2009); *Main Events Prod., LLC v. Lacey*, 220 F. Supp. 2d 353, 357 (D.N.J. 2002). An attorney's testimony is considered "necessary" if concealing the testimony would prejudice a party or prevent the court from making a just determination in the action. *Iola*, 2009 WL at *4 (citing *State v. Dayton*, 292 N.J. Super. 76, 84-86 (App. Div.1996)).

Outside counsel should ask themselves whether or not they could be called as a fact witness in a "contested matter" before accepting the engagement. For example, was counsel present during the negotiation of a governing shareholders' Agreement or Operating Agreement which is now subject to varying interpretations because it contains ambiguities? If so, counsel should decline representation. Moreover, if counsel witnessed any of the now-contested actions contained in the complaint or counterclaims, they should decline representation.

In summary, outside corporate counsel should be extremely careful before agreeing to represent one shareholder against another in litigation amongst the shareholders. It could lead to disqualification, attorney malpractice and violations of the RPC. The better practice appears to be to refer the warring shareholders to another law firm. ■