BETWEEN A ROCK AND A HARD PLACE: ATTORNEY AS CORPORATE DIRECTOR AND SHAREHOLDER'S ATTORNEY

I. INTRODUCTION

The attorney's professional judgment should always be exercised in the best interest of the client, within the boundaries of the law and free of compromises, influence and conflicting loyalties. An attorney who is a director of a corporation and serves as the attorney for a corporate shareholder raises ethical questions for the attorney that is even vaguely conscious of the responsibilities associated with both relationships. As a practical matter, each relationship involves independent, defined and potentially conflicting fiduciary duties. The primary focus of this Article is the attorney-client relationship and the effect that the dual roles has on this relationship.

Generally, an attorney may not represent a client when the representation involves a conflict of interest with any other position the attorney holds. The attorney's representation of a corporate shareholder while he is a corporate director may or may not fall within this prohibition. This will depend on the specific facts of each situation.

Multiple loyalties may be present. However, "[m]ultiple loyalties do not, per se constitute a breach of fiduciary duty." Loyalty is an essential element in the attorney's relationship to the client. As a general proposition, loyalty to the client prohibits undertaking representation directly adverse to that client without the client's consent.

A. Attorney's Fiduciary Duty

Rule 1.7(b) of the ABA Model Rules of Professional Conduct ex-

2. See Model Rules of Professional Conduct Rule 1.7(b) cmt. (1983).
5. Rule 1.7(b) provides:
   A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interest, unless:
   (1) the lawyer reasonably believes the representation will not be adverse-
pressly prohibits an attorney's representation of a client if the representation is materially limited by the attorney's competing interest. The appropriate inquiry is whether "the potential conflict will materially interfere with the attorney's independent judgment when considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client." The purpose of Rule 1.7(b) is to ensure that an attorney's range of options is not materially limited by other interests or responsibilities which might impair the attorney's ability to consider, recommend, or carry out an appropriate course of action.

\[ \text{B. Director's Fiduciary Duty} \]

Just as the attorney has a fiduciary relationship with the client, a director has a fiduciary relationship with the corporation. The fiduciary duties of a corporate director include the duty of care, the duty of loyalty, and the duty of independence. As part of the duty of loyalty, a fiduciary relationship prohibits a director's disclosure of confidential information. Even after termination of the relationship, the corporate director has the duty to preserve the confidentiality of any proprietary information received during the discharge of duties as a corporate director. This includes only information that is in the corporations' private domain and the corporation has an expressed interest and has a right to prevent its publication.

When the fiduciary duty exists, "[a] director must act with an ex-

\begin{itemize}
  \item \textit{Model Rules of Professional Conduct} Rule 1.7(b) (1983).
  \item See \textit{Model Rules of Professional Conduct} Rule 1.7 cmt. (1983).
  \item Id.
  \item See id.
  \item See Astarte, 865 F. Supp at 749 (citing Daniel B. Bogart, \textit{Liability of Directors of Chapter 11 Debtors in Possession: "Don't Look Back Something May Be Gaining on You,"} 68 AM. BANKR. L.J. 155, 168-79 (1994)).
  \item See id. at 750.
  \item See id.
  \item See id.
\end{itemize}
treme measure of candor, unselfishness and good faith as the office is one of trust and the director is held to the high standard of duty required of trustees."14 The prohibition on the simultaneous representation of interests is applicable only when the interests are or may be adverse. Although the situations considered by the court as circumstances that justify disqualification arose after the attorneys served on the board of governors in *Berry v. Saline Mem'1 Hosp.*15 and the board of trustees in *In re Mortgage & Realty Trust v. Zim Co.*,16 the concerns are the same as the facts under consideration in this Article.

II. ATTORNEY'S POTENTIAL BREACH OF FIDUCIARY DUTY TO THE ENTITY

The Supreme Court of Arkansas in *Berry* disqualified a law firm because an attorney, who was once a member of the board of governors of the hospital, was at the time of the filing of a medical malpractice action a member of the law firm.17 The court viewed the law firm's filing of a medical malpractice lawsuit on behalf of a deceased client as potentially adverse to the hospital's interest. The court disqualified the attorney's law firm because the attorney's fiduciary duty to the hospital prohibited his representation of an interest that was adverse to the interest of the hospital.18 The attorney would have been required to disqualify himself.19 Thus, the law firm where the attorney was employed had to be disqualified. The court held that the attorney was in a fiduciary relationship with the hospital and owed fiduciary duties to the hospital.20 The attorney's duties prohibited him and the law firm from taking any action that conflicted with that duty.21

In *Berry*, an attorney named Brewster served as a member of the hospital's board of governors and received confidential and privileged information about the hospital's quality assurance activities and the peer

15. 907 S.W.2d 736 (Ark. 1995).
17. *See* 907 S.W.2d at 739.
18. *See id.*
19. *See id.; see also* MODEL RULE OF PROFESSIONAL CONDUCT Rule 1.10 (1983).
20. *See id.*
21. *See id.*
reviews conducted by the medical staff. He was not employed as the hospital’s attorney. Shortly after Brewster’s term on the board of governors ended, plaintiff underwent emergency surgery. She died the next afternoon. Ten months later, plaintiff’s estate sought a member of Brewster’s law firm to investigate potential negligence on behalf of the hospital. Brewster’s partner sought disclosure of information contained in the hospital quality assurance and peer review programs.

The Berry case differs in that the court considered whether the attorney’s firm was to be disqualified, rather than individual attorney. However, the facts giving rise to the law firm’s disqualification were the result of Brewster’s fiduciary relationship to the hospital. Rule 1.10 provides that “while an attorney is associated with a firm, none of them shall knowingly represent a client when any of them practicing alone would be prohibited from doing so by Rule 1.7.” It also differs because the party instituting the action against the corporation was not a corporate shareholder but a consumer of the hospital’s services. But the interests were adverse and the concerns in Berry are similar to the facts under examination. The court was concerned with the effect of Rule 1.7(b) on the simultaneous existence of dual loyalties.

The court held that the duty continued with respect to information gained during service of the attorney’s term on the board of governors even after formal termination of the relationship. In Berry, the court stated that the duty associated with the attorney’s term on the board of governors imposed a fiduciary duty on the attorney. Since Brewster’s law partner sought access to the very information that was reposed to Brewster’s trust as a member of the board of governors, the law firm’s disqualification was mandatory. The court stated that the attorney should not take any action to the detriment of the hospital when the action is based upon confidential information the attorney gained during the fiduciary relationship. The court noted that Rule 1.7(b) was cast in imperative terms. The Arkansas court’s decision to disqualify the law firm was based on the Arkansas Bar’s version of Rule 1.7(b) potential conflict

22. See 907 S.W.2d at 738.
23. See id.
24. See id.
25. Id. at 739.
26. See id.
27. See Berry, 907 S.W.2d at 739.
28. See id.
of interest provision.

In Zim Co., the California Bankruptcy court held that "[w]here the conflict arises from a fiduciary relationship other than an attorney-client relationship, the other party must give a written waiver." The court disqualified the attorney and the law firm where he was of counsel because there was potential conflict arising out his fiduciary relationship to an entity where he once served as a member of its board of trustees.

Bucher was a member of the board of trustees for the Mortgage & Realty Trust (hereinafter "MRT"); Bucher did not serve as legal counsel for MRT. Four days prior to filing of the petition in bankruptcy, while Bucher was still a member of the board, the board considered and decided to enter into a contract to sell realty to Zim Co. During the same meeting, the board decided to file a petition in bankruptcy. Bucher was of counsel in a law firm whose headquarters was located in St. Louis Missouri. It had offices in nine other cities. Zim Co. hired this law firm to represent its interests in the adversary proceeding instituted by Value Property Trust (hereinafter "VPT"), which was the post-petition name for MRT. VPT challenged the contract between MRT and Zim Co. as an unauthorized post-petition transaction.

The court held that VPT was the same entity as MRT that filed the petition in the bankruptcy court for purposes of the motion. The court found that the attorney still owed certain fiduciary duties to the entity as a former trustee. The court found that the attorney's fiduciary duties included a duty of loyalty, duty of care and the duty of independence. The court analyzed the duties owed by Bucher, as a past trustee, specifically considering the duty to protect confidential information, the duty of loyalty and the duty to the creditors of an insolvent corporation. The court analyzed these duties by the standards of a director of a corporation.

The court was unpersuaded by the law firm's argument that the director's fiduciary duties terminate when the director leaves a corporate board and by analogy so did Bucher's duty end when the relationship

30. See id.
31. See id. at 745.
32. See id.
33. See id. at 745-46.
34. See Zim Co., 195 B.R. at 746.
35. See id. at 747.
36. See id. at 749-52.
was terminated with MRT. The court agreed with the law firm in its assertion that the fiduciary duty owed by Bucher ended when the relationship was terminated. But, the duty to protect and preserve confidences gained during service as a member of the board continues after the director leaves the board. Similarly, this duty continues with respect to the trustee after termination of his relationship. The duties include a duty to refrain from profiting from confidential information or disclosing it to anyone else absent an authorization by the corporation. The court found that Bucher was bound by the duty not to disclose or use for his benefit information gained during his service as a member of the board of trustees. Additionally, the Zim Co. court found that a corporate director of an insolvent corporation owed a duty to protect the corporation's unsecured creditors.

The court noted that neither Bucher nor the law firm sought MPT's consent to allow the law firm to represent Zim Co.'s interests in the adversary proceeding and the motion to disqualify made MRT's position on the matter clear. The California Bankruptcy court held that the attorney owed the entity a duty of loyalty arising from his position as a member of the board of trustees, which was essentially the same as the fiduciary duties that a corporate director owes to the corporation.

The Zim Co. court stated that the "most important purpose of the rule is to preserve confidential information received in the fiduciary relationship." If there is a probability that confidential information was received which would be relevant in a later adverse representation, a substantial relationship is presumed. Once a substantial relationship is shown between the earlier fiduciary relationship and the later adverse representation, the court must conclusively presume that the attorney possesses confidential information and order disqualification of the attorney and the law firm.

37. See id. at 751.
38. See id.
40. See id. at 751.
41. See id. at 754.
42. See id. at 750.
43. Id.
III. MULTIPLE LOYALTIES, BUT NO BREACH

The Rule 1.7(b) prohibition on the simultaneous representation of adverse interests is not absolute. It is important that the attorneys in *Berry* and *Zim Co.* did not seek or failed to obtain the informed consent of the entity where each attorney served as member on the respective boards. In *Zim Co.*, the court emphasized the attorney’s and the law firm’s failure to obtain a written waiver from the entity. The next case, which is the only one on point, demonstrates that if the attorney discloses the potential adverse relationship and obtains the informed consent of the corporation whose interest is or may be adversely affected, the outcome upon challenge will not mandate disqualification and the potentially adverse relationship and the transaction may proceed without intervention from the court.

In *Astarte, Inc. v. Pacific Indus. Sys., Inc.* the Federal District Court in Colorado held that a full and fair disclosure will avoid the breach of a duty arising out the representation of conflicting interests. The court held that a director can do business with a corporation if there is full and fair disclosure and if there is no unfairness or fraud.

Marshall served as a member of the board of directors of Pacific Industrial Management Systems (hereinafter “PIMS”) and as attorney for the corporate shareholder, Pacific Separator, Inc (hereinafter “PSI”). PIMS was formed to license and develop an international market for a new and more efficient method for extracting sugar from sugar cane. On several occasions, Marshall unsuccessfully attempted to communicate to other members of the corporate board the serious nature of the diminishing financial condition of PIMS prior to the loss of its license for the technology. PIMS asserted claims against Marshall including the breach of fiduciary duty and the usurpation of corporate opportunity.

The court found that Marshall owed a fiduciary duty to PIMS as a director to exercise his independent judgment on behalf of PIMS. The court stated that, with respect to Marshall, the evidence demonstrated that there was full disclosure, recognition and consent with regard to his ac-

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44. 865 F. Supp. 693 (D. Colo. 1994).
45. See id. at 705 (citing Swafford v. Berry, 382 P.2d 999, 1002 (Colo. 1963)).
46. See id. at 698-99.
47. See id. at 697.
48. See id. at 697-700.
49. See *Astarte*, 865 F. Supp. at 696-697.
tions in multiple roles. The evidence included correspondence between Marshal and another director of PIMS and the other director’s testimony. Plaintiffs knew from negotiations prior to execution of the agreement that Marshal was PSI’s attorney. Plaintiffs knew that Marshal he was serving on PIMS’s board as a representative of PSI and knew he was acting on behalf of PSI with regard to PIMS. PIMS clearly had knowledge and notice that Marshal, by virtue of the duties owed by him to PSI, would be acting on behalf of PSI, and his conduct was evaluated in light of the existence of dual loyalties. The court found that the corporate structure and relationships between the entities was replete with potential conflicts from its inception. The Astarte court’s decision was influenced by the sophistication, education and experience of the parties. The court mentioned that it factored into the decision that the parties were experienced in high-figure financial transactions. The court stated “[t]hat the law recognizes that there are some instances when a director may advance the best interest of . . . a third party without violating the fiduciary duties owed to the corporation.” The court found that there was full disclosure and consent regarding Marshall’s multiple roles. The court found no breach of fiduciary duty by Marshal with respect to PIMS. However, Astarte raises one question, if the circumstances involved less sophisticated parties, would the court reach a different result.

III. CONCLUSION

The attorney that is a corporate director and attorney for the corporate shareholder may, but will not definitively, violate the conflict of interest provision in Rule 1.7(b). Each role imposes on the attorney a fiduciary duty. The interests represented are not required to be adverse. A potential that the interest will be adverse is sufficient to warrant the attorney’s dismissal or to mandate withdrawal, especially where the interests that are potentially adverse are not completely the product of an attorney-client relationship. The affected third parties’ express authoriza-

50. See id. at 702.
51. See id.
52. See id.
53. See id. at 706.
54. See Astarte, 865 F. Supp. at 703.
55. See id. at 703-04.
56. Id. at 705.
tion is required. Even if the interests are adverse, the attorney may still represent both parties’ interests if there is full and fair disclosure to both the corporation and the client and informed consent follows. The disclosure should reveal the relationships, the interests, and the potential conflict involved. If after disclosure there is express or implied consent, the attorney is protected from potential disciplinary action from the Bar Association or an embarrassing but essential disqualification by a court.

Jacqueline C. Smoke