When Your Client is an Organization –
Some of the Problems Not Resolved by Rule 1.13

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More often than not, transactional attorneys will have as their client not a natural person but an organization. Kentucky Supreme Court Rule 1.13[1] sets forth particular ethical rules that apply when the client is an organization rather than an individual. At the same time the balance of the ethical obligations of an attorney as set forth in the Rules[2] remain applicable.[3] These Rules, as far as they go, can be helpful in providing guidance. The problem is that the Rules are incomplete and often fail to provide clear guidance for counsel attempting to conscientiously discharge their obligations to that organizational client. A multitude of questions continue to exist including:

- Who is the client when the organization is to be formed;
- The non-organization as an organizational client;
- Privilege vs. entity law document inspection rights;
- When the organization's counsel obligations run to the organization's constituents; and
- Change of control of an organizational client.

Let me be clear at the outset: this paper will not conclusively answer any of these questions. These issues are going to arise under highly fact-specific circumstances and, in turn will need to be resolved on a highly fact-specific basis. Rather, the objective of this presentation is to highlight the existence of ambiguities in the existing Rules vis-à-vis not uncommon fact patterns and in so doing create sensitivity to the issues and considerations that need to be carefully resolved. It is better to know that you have a problem that needs to be resolved than to be unaware that you have a problem whose resolution is then, of necessity, ignored.[4]

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[1] SCR 3.130 (1.13).

[2] All references herein to the "Rules" refer to the Kentucky Rules of Professional Conduct.

[3] *See, e.g.*, SCR 3.130(1.13), comment 6.

[4] *See also* Donald Rumsfeld, Press Conference at NATO Headquarters, Brussels, Belgium, June 6, 2002, http://en.wikiquote.org/wiki/Donald_Rumsfeld :

Rule 1.13

For purposes of this review, subsections (a), (f) and (g) will be the primary focus. Subsections (b) through (e) of Rule 1.13 are primarily focused upon the lawyer's responsibility when a constituent thereof is acting, or is likely to act, in a manner that violates either the organizational client's legal obligations or applicable law, and how such may be remedied. While certainly not meaning to minimize the importance of these Rules, they are not the focus of this article.

Rule 1.13(a) sets forth the rule as to organizational clients namely:

> A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.[5]

In its crafting, as is evidenced by the official comment thereto, this Rule is drafted against the background of the corporate form, it being invited that they apply as well to unincorporated associations, but without any explanation as to applicable taxonomy. Hence, it is provided that:

> An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client. The duties defined in this Comment apply equally to unincorporated associations. "Other constituents" as used in this Comment means the positions equivalent to officers, directors, employees and shareholders held by persons for organizational clients that are not corporations.[6]

Returning to the body of Rule 1.13, a pair of paragraphs address the relationship of the organization's attorney vis-à-vis its constituents and the ability of the lawyer to maintain a distinct relationship with one of those constituents:

> (f) In dealing with an organization's directors, officer, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with who the lawyer is dealing.

> Now what is the message there? The message is that there are no "knowns." There are things we know that we know. There are known unknowns. That is to say there are things that we now know we don't know. But there are also unknown unknowns. There are things we do not know we don't know. So when we do the best we can and we pull all this information together, and we then say well that's basically what we see as the situation, that is really only the known knowns and the known unknowns. And each year, we discover a few more of those unknown unknowns.

[5] Rule 1.13(a).

[6] Rule 1.13, Supreme Court Commentary (1).

> (g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions to Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official other than the individual who is to be represented, or by the shareholders.[7]

The Rules contemplate that both the organizational client and one of its constituents may, subject to the other applicable rules, be concurrent clients.[8] Also clearly implicated here is Rule 1.6, it dealing with the confidentiality of information related to a client's representation and providing in part:

> A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).[9]

Important for our purposes is that subparagraph (b) of Rule 1.6 authorizes an attorney to reveal information relating to the client representation "to comply with other law or a court order."[10] These provisions, to the extent they allow for "up the ladder" reporting of possible violations constitute a supplement to the otherwise generally applicable rules of Rule 1.6.[11]

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[7] Rule 1.13(f), (g).

[8] Rule 1.7 provides:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
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> (1) the representation of one client will be directly adverse to another client; or
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> (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.
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> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
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> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
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> (2) the representation is not prohibited by law;
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> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
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> (4) each affected client gives informed consent, confirmed in writing.

[9] Rule 1.6(a).

[10] Rule 1.6(b)(4). *See also infra* notes __ through __ and accompanying text.

[11] *See* Rule 1.13, Supreme Court Commentary (6). It needs to be recognized, however, that these rules are entirely "inward-looking"; they require reporting up within an organization to its ultimate authority in the effort to achieve

Under official comments (10) and (11) to Rule 1.13, it is provided that:

> [10] There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.
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> [11] Whether such a warning should be given by the lawyer for the organization to any constituent individual may turn on the facts of each case.

Official comment (12) to Rule 1.13 provides:

> [12] Paragraph (g) recognizes that a lawyer for an organization may also represent a principal officer or major shareholder.

The Rules provide as well for several issues dealing with "derivative actions," Rules that are in part based upon, as is considered below, a flawed understanding of various issues or organizational law. These comments provide:

> [13] Under generally prevailing law, the shareholders or members of a corporation may bring suit to compel the directors to perform their legal obligations in the supervision of the organization. Members of unincorporated associations have essentially the same right. Such an action may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization.[12]
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> [14] The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between

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compliance with the law and do not suggest or sanction reporting outside the organization. *See also* 1 GEOFFREY C. HAZARD, JR., W. WILLIAM HODES AND PETER R. JARVIS, THE LAW OF LAWYERING § 17.2.

[12] Rule 1.13, Supreme Court Commentary (13).

> the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.[13]

The Organizational Client Before Its Organization

Rule 1.13(a), providing that the lawyer employed by an organization represents that organization, unfortunately begs a most important question, namely the organization of the organization, that being the completion of those steps that are required to bring the organization into legal existence. In the case of a corporation, the organization will not take place until the filing of the Articles of Incorporation by the Secretary of State, a similar rule applying with respect to the organization of an LLC by the filing of the Articles of Organization. In either instance, it is the Secretary of State's act of filing that document that initiates the legal existence of the organization.[14] Prior to the effective time and date of that filing, there does not exist either a corporation or an LLC capable as serving as the attorney's organizational client.[15] How, then, is a lawyer to act when approached by one or more individuals who desire, for a particular purpose, to organize a business entity? While it is certainly true that most business organization can now be brought into existence quite promptly, including by electronically filed documents with the Secretary of State, it is not true that the negotiation of the organic documents of a venture (for example, the shareholder buy-sell agreement in the case of a corporation or the operating agreement of an LLC) can be quickly resolved. These documents are often of significant complexity and, often reflecting zero-sum issues, require negotiation amongst the parties.

Who is the client when the attorney is retained, on behalf of the as yet unformed organization, to effect its organization?[16] This is not a settled question. Imagine that Laura, Micah, and Charlsey appeared at counsel's office door and asked her to represent them in the formation of a business entity. After an appropriate analysis our attorney has determined that a limited liability company is the appropriate form of entity. They agreed with her assessment and she proceeded to prepare an operating agreement and, with the consent of Laura, Micah and Charlsey, filed Articles of Organization with the Secretary of State. The LLC is now legally recognized.[17] But is the LLC the attorney's client? Recall that it was three individuals, Laura, Micah, and Charlsey, who appeared at her office door seeking legal representation with respect

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[13] Rule 1.13, Supreme Court Commentary (14).

[14] *See*, *e.g.*, KY. REV. STAT. ANN. § 14A.2-070(1); *id*. § 271B.2-010; and *id*. §§ 275.020(1), (2).

[15] The issue with partnerships can be even more complicated. While the Secretary of State's filing of the Articles of Incorporation or Articles of Organization clearly indicate the point in time in which the organization comes into existence, no similar state filing is required for the organization of a general partnership, even one that intends to (or even has) file a Statement of Qualification or Statement of Registration pursuant to which it will be a limited liability partnership.

[16] *See also* 1 HODES, HAZARD & JARVIS, THE LAW OF LAWYERING, *supra* note 11 at § 17.2 ("Once the client is properly identified as the entity only, and once the lawyer determines as best he can what the interests of the client are, those interests take precedence, as would be the case with respect to any other client.").

[17] REV. UNIF. LTD. LIAB. CO. ACT § 201(d)(1), 6B U.L.A. 456 (2008); REVISED PROTOTYPE LIMITED LIABILITY COMPANY ACT § 201(b)(1), 67 BUS. LAW. 117, 142 (Nov. 2011); KY. REV. STAT. ANN. § 14A.2-070; *id*. § 275.020; and *id*. § 275.060(1).

to the formation of a business entity. The LLC did not exist at the time the attorney-client relationship came into existence. With the LLC now in existence, is her client:

- Each of Laura, Micah, Charlsey;
- The LLC; or
- Each of Laura, Micah, Charlsey, and the LLC?

Some jurisdictions follow the "incorporation rule" under which, when the organizers consult an attorney regarding the formation of a business entity, upon its formation the attorney-client relationship shifts to the newly formed business structure.[18] However, there exists law to the contrary, namely to the effect that the attorney-client relationship does not shift to the business structure, but rather that a continuing attorney-client relationship exists between the attorney and the individual actors who sought her counsel with respect to the organization of the business venture. There is as well law indicating that, at least in the context of an unincorporated business organization, counsel to the organization (and it does not appear that the reasoning of these decisions was conditioned upon the participation of the members in the organization) constitutes representation of all members of the association,[19] although there is certainly law to the contrary.[20] Let us assume that the attorney has anticipated this quagmire in her engagement

[18] *See, e.g., Jesse v. Danforth*, 485 N.W.2d 63, 67 (Wis. 1992) (providing that with an organization as client, an attorney represents merely the entity and not the entity's constituents and providing that this rule applies retroactively "where (1) a person retains a lawyer for the purpose of organizing an entity and (2) the lawyer's involvement with that person is directly related to that incorporation and (3) such entity is eventually incorporated…."); *Manion v. Nagim*, 2004 U.S. Dist. LEXIS 1776 (D. Minn. 2004), *aff'd*, 394 F.3d 1062 (8th Cir. 2005) (confirming the holding in *Jesse v. Danforth*, that once the entity is formed the attorney's duties shift to the entity and apply retroactively so that no duties are owed to the incorporator); *Hopper v. Frank*, 16 F.3d 92, 98 (5th Cir. 1994) ("the formation of Gulf Coast [limited partnership] preempted any prior relationship with Hooper and Sanderson with respect to the delivery of final public offering documents [for the limited partnership]").

[19] *See, e.g., Pucci v. Santi*, 711 F. Supp. 916, 927 fn. 4 (N.D. Ill. 1989) (attorney for partnership also represents each general partner therein); *Schwartz v. Broadcast Music, Inc.*, 16 F.R.D. 31 (S.D.N.Y. 1954) (each member of unincorporated association if client of the association's attorney); *Margulies v. Upchurch*, 699 P.2d 1195 (Utah 1985) (facts supported finding that lawyer for partnership also represented individual partners). In *Chaiken v. Lewis*, 754 So.2d 118 (Fla. Dist. Ct. App. 2000), the Court instructed the jury that "counsel for a partnership represents the partnership entity, and does not thereby become counsel for each partner individually. *Id.* at 118. On appeal, the District Court of Appeal stated that "the instruction given … was correct and was consistent with Rule 4-1.13 of the Florida Rules of Professional Conduct … as well as American Bar Association Formal Ethics Opinion 361."

[20] *See, e.g., Williams v. Roberts*, 931 So.2d 1217 (La. App. 2006) (attorney hired by one member to organize LLC and prepare operating agreement was not counsel for other members); *Quintel Corp., N.V. v. Citibank, N.A.*, 589 F. Supp. 1235 (S.D.N.Y. 1984) (lawyer representing the limited partnership and its general partners did not necessarily have a client-lawyer relationship with limited partners); *Johnson v. Superior Court*, 45 Cal. Rptr.2d 312 (Cal. Ct. App. 1995) (on facts presented, lawyer for limited partnership owed no ethical duty to limited partners); *In re Owens*, 581 N.E.2d 633 (Ill. 1991) (lawyer who represented only the partnership did not violate prohibition on business dealings with clients by transactions with individual partners); New York City Bar Ass'n Comm. on Professional and Judicial Ethics, Formal Op. 1986-2 (1986); *Quintel Corp., N.V. v. Citibank, N.A.*, 589 F. Supp. 1235 (S.D.N.Y. 1984) (attorney representing either the general partner of a limited partnership or the limited partnership itself is not, in the absence of an affirmative assumption of a duty, the attorney for the limited partners); *Mursau Corp. v. Florida Penn Oil & Gas, Inc.*, 638 F. Supp. 259 (W.D. Pa. 1986) (indirect benefit flowing to limited partnership from services performed by attorney for limited partnership and its general partner held not sufficient to create attorney-client relationship between attorney and limited partner), *aff'd sub nom. Mursau Corp.*

letter, agreeing to a joint representation of Laura, Micah, and Charlsey until the organization of the business entity, and thereafter representation of only the entity.[21] An agreement of this nature adds clarity but if and only if the engagement letter goes on to both address the full implications of a joint-representation and to address the effects of the termination of the representation of the individuals. For example, as to the first issue, the engagement letter should make clear the inability of the attorney to maintain in confidence vis-à-vis one party to the joint-representation information learned from another party. As to the second point, may the attorney represent the LLC against a member for an alleged breach of the operating agreement?

Assume the operating agreement provides that six months after the date of organization each member will contribute an additional $10,000 to the LLC. This obligation is spelled out in the operating agreement and as well in promissory notes delivered by each member to the company. Charlsey refuses to perform. If the attorney who assisted Charlsey, Laura and Micah in the organization of the LLC undertakes the representation, how the court looks at the pre-organization work is crucial. If, even before its formation, the expected LLC was the client then the representation adverse to Charlsey may be appropriate. However, if, prior to the LLC's organization, there was an attorney-client relationship with each anticipated constituent and a shifting of the relationship to the LLC at the time of its formation, then Charlsey is (or at minimum may be) a former client of the attorney. As that representation almost certainly included the LLC's capitalization, our attorney may find himself acting against Charlsey as to the subject matter of the prior representation. Doing so, however, is not permitted absent informed consent confirmed in writing.[22] In consequence, whether the relationship begins with the to-be-formed organization or at some point shifts to it has a material impact upon counsel's obligations.

Simply put, Rule 1.13 should be modified to expressly provide for the rule set forth in *Jesse v. Danforth*,[23] which provides that, when an attorney is retained to organize an entity, the entity rule shall apply retroactively such that the pre-organization activities do not give rise to any individual attorney-client relationship with any of the constituents. Much needed clarity would result.[24]

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v. Florida Penn Oil & Gas, Inc., 813 F.2d 398 (3rd Cir. 1987); *Zimmerman v. Dan Kamphausen Co.*, 971 P.2d 236 (Colo App. 1998)("In Colorado, the fact that an attorney represents a partnership does not, standing alone, create an attorney-client relationship with each of the partners."); *Hopper v. Frank*, 16 F.3d 92 (5th Cir. 1994) (counsel retained to represent limited partnership in sale of assets represented the partnership and not the individual partners); and *Chaiken v. Lewis*, 754 So.2d 118 (Fla. Dist. Ct. App. 1994) (lawyer for partnership is counsel to the partnership and not the individual partners).

[21] *See* A.B.A. Standing Committee on Ethics and Professional Responsibility Formal Opinion No. 91-361 (discussion on treating a partnership as an entity separate from its owners). *See also generally* Robert R. Keatinge, *The Implications of Fiduciary Relationships in Representing Limited Liability Companies and Other Unincorporated Associations and Their Partners or Members*, 25 STETSON L. REV. 389 (1995).

[22] Rule 1.9(a) ("A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.").

[23] 485 N.W.2d 63 (Wis. 1992).

[24] *See also* generally Nayar, *Almost Clients: A Closer Look at Attorney Responsibility in the Context of Entity Representation*, 41 TEX. J. BUS. L. 313 (Winter 2006).

The Non-Organization as an Organizational Client

It may be that the use of the term "organization," is at least implying some sort of legal recognition separate and distinct from that of any of its constituents, leads to problems of taxonomy. These situations, which do not have the benefit of the creation of a legal entity distinct from its constituents, can present problems of a different, albeit equally difficult, nature.

Consider, for example, the situation in which a group of homeowners jointly approach counsel to represent them in a suit against a homeowners' association.[25] Obviously, there is no legal business organization which the attorney can view as being her client; there does not exist a "partnership" among the various homeowners upset with respect to the assessments at issue.[26] In this situation, counsel is compelled to undertake the representation on a joint basis. Prior to 2009, then Rule 2.2 set forth particular parameters and requirements of a joint representation. In 2009, Kentucky Supreme Court Rule 2.2 was deleted, its issues now being addressed by Rule 1.7. Setting aside the structural complexities in providing an effective joint representation,[27] it is clear that each of the individual homeowners constitutes a client of the attorney. There not being the possibility of a separate business organization which can be identified as the client, the attorney will not have the benefit, even in those states which allow the attorney-client relationship to be initiated vis-à-vis a to-be-formed organization without the creation of an attorney-client relationship between the attorney and the anticipated constituents of the venture. This will be the case even if the group of homeowners agrees amongst themselves to the formation of a "steering committee" who will serve as the point of communications between the attorney and the various plaintiff homeowners.

But should that be the rule? Where a collective will is to be represented on behalf of a collective that is itself not a legal entity, should not Rule 1.13 permit the treatment of the collective as an organization? While our group of homeowners is not a partnership or other form of business organization, it none the less is a communal organization of constituents who have come together for a common purpose. Representation of that common purpose, treating it as a Rule 1.13 "organization," would avoid many of the difficulties and limitations of a joint-representation of each constituent. At the same time the uncertainties of a joint representation such as a falling out between co-clients can be at least minimized and perhaps eliminated.[28] In such a circumstance a constituent may withdraw from the "organization" while the representation is not negatively impacted by counsel's obligation under the existing rule to treat the withdrawn client as a former client having an interest in the current dispute from whom confidential information may have been received.

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[25] This hypothetical is based upon one set forth in HAZARD ET AL., *supra* note 11 at __.

[26] *See* KY. REV. STAT. ANN. § 362.175(1) (One of the elements of a partnership being that it be "for profit"); *id*. § 362.1-202(10 (same); *see also* THOMAS E. RUTLEDGE AND ALLAN W. VESTAL, RUTLEDGE & VESTAL ON KENTUCKY PARTNERSHIPS AND LIMITED PARTNERSHIPS 50-51 (2010).

[27] *See, e.g., supra* notes __ and ___ and accompanying text.

[28] *See also City of Kalamazoo v. Mich. Disposal Serve*., 115 F. Supp. 2d 913 (W.D. Mich. 2001) (An attorney-client relationship existed between each individual defendant in environmental litigation and the attorney who served as common counsel for all defendants under a joint-defense agreement).

Privilege vs. Entity Law Document Inspection Rights

Where the client is an organization, it is the attorney's obligation to hold in confidence the organization's confidential information.[29] Waiver of the attorney's obligation of confidentiality is dependent upon direction from those who exercise control over the organization.[30] Waiver can come about in at least two other means, namely by court order or pursuant to other law.[31] It is to the latter that this discussion is addressed.

Under Rule 1.6(b)(4), an attorney may reveal information related to a client's representation "to the extent the lawyer reasonably believes necessary: … (4) to comply with the law or a court order." What is too often forgotten is that under most if not all business organization statutes, the constituent owners of the venture are afforded an opportunity to a greater or lesser degree to inspect and copy venture records.

For example, under Kentucky law, a shareholder in a Kentucky business corporation is entitled to, upon request, review certain corporate records and, upon the showing of a proper purpose, to review additional defined records.[32] In contrast, under Kentucky's partnership, limited liability company, and nonprofit corporation statutes, there exists no limitation upon the records that may be inspected by, respectively, a member of the nonprofit corporation,[33] a partner[34] or a member of an LLC.[35] Under the Kentucky adoption of the Uniform Partnership Act, there are no provisions indicating whether or not, by means of the partnership agreement, a partner's right to access partnership records may be limited. In contrast, under the Kentucky Revised Uniform Partnership Act (2006), the partnership agreement may impose reasonable limitations on the access and use of the partnership records.[36] In the case of a limited liability company, a written operating agreement may impose limitations upon the use, and therefore presumably access *ab initio* to company records.[37] Here arises counsel's quandary. His or her client is an organization, and as its counsel the attorney is obligated to act with diligence and promptness.[38] As a component thereof the attorney must communicate with the client as to information needed

[29] Rule 1.6(a).

[30] Rule 1.2(a).

[31] Rule 1.6(b)(6).

[32] KY. REV. STAT. ANN. § 271B.16-020.

[33] KY. REV. STAT. ANN. § 273.233. The right of a member to inspect and copy the records of a nonprofit corporation is not subject to limitation in either the articles of incorporation or the bylaws. *Id*. *See also* Thomas E. Rutledge, *The 2010 Amendments to Kentucky's Business Entity Laws*, 38 NORTHERN KENTUCKY LAW REVIEW 383, 417 (2011).

[34] KY. REV. STAT. ANN. § 362.240. ("Every partner shall at all times have access to and may inspect and copy any" partnership book.); *id*. § 362.1-403(2) ("A partnership shall provide partners and their agents access to its books and records.").

[35] *See* KY. REV. STAT. ANN. § 275.185(2) ("Upon reasonable written request, a member may, at the member's own expense, inspect and copy during ordinary business hours any limited liability company record, where the record is located or at a reasonable location.").

[36] *See* KY. REV. STAT. ANN. § 362.1-103(2)(b); *see also id*. § 362.1-403(4).

[37] KY. REV. STAT. ANN. § 275.185(5).

[38] Rule 1.3.

by the client to make informed decisions and from which to direct counsel.[39] In doing so the attorney must be mindful of the possibility of inadvertent disclosure and protect against that risk.[40]

Must counsel, in communicating with the organizational client's representatives, condition those communications in light of the possibility of disclosure to shareholders/partners/members that are not part of the control body? Assume, for example, that ABC, LLC is considering the termination of the employment of Daniel; he, a vice-president and a member in the LLC, is working pursuant to the terms of a written employment agreement. The LLC desires to terminate his employment "for cause" as defined therein, and for that purpose contact's the LLC's counsel to review the agreement and prepare a letter as to whether the "for cause" has been met. We would expect that counsel will carefully craft a communication that comprehensively reviews the contract, the facts and the applicable law. Ultimately that letter concludes that while certain issues militate the other way, the "for cause" has been met. The LLC then terminates Daniel, and he initiates suit for breach of contract. When in discovery his request to review counsel's letter was denied, a denial upheld by the court, he responded with a request upon the LLC to review its records, specifically all communications from counsel regarding his employment agreement.[41]

Likely Daniel will prevail.

Recall that under Rule 1.6(b)(4) the attorney's obligation of confidentiality is qualified by other law. In numerous instances the General Assembly has afforded the constituent owners of an organization either limited or complete access to company books and records. It is beyond argument that the communications received from counsel are company books and records,[42] and

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[39] Rule 1.4.

[40] *See, e.g.*, Kathryn A. Thompson, *The Worlds of Ethics and Technology Collide – The Ethical Rules for Electronic Communication that Paralegals Need to Know*, PARALEGAL TODAY, http://paralegaltoday.com/issue_archive/features/feature1_so05.htm (last visited Nov. 1, 2012); American Bar Association Standing Committee on Ethics and Professional Responsibility, Formal Opinion No. 99-413 (March 10, 1999) *Protecting the Confidentiality of Unencrypted E-Mail*; _____ **[author's name is needed]**, *Lawyers Get Vigilant on Cyber Security*, WALL STREET JOURNAL (June 25, 2012); and Joel A. Osman, *Technology and the Challenge of Maintaining Client Confidences*, 25 Los Angeles County Bar Update (Oct. 2005) available at http://www.lacba.org/showpage.crm?pageid=5867 (last visited Nov. 1, 2012) ("Just because it is possible to conduct telephonic business in an airport waiting room or at the deli counter of the local market does not mean that it is a good idea to do so. The question of appropriate mobile phone etiquette is one on which society as a whole needs to work; the necessity of maintaining client confidences makes the issue of immediate concern to lawyers."). *See also Edwards v. Bardwell*, 632 F. Supp. 584 (M.D. La. 1986) (no reasonable expectation of privacy in conversation held over radio telephone where the communication could be accessed by anyone using a scanner or radio phone tuned to the same frequency); *U.S. v. Mathis*, 96 F.3d 1577, 1583 (8th Cir. 1989), *cert. denied* 110 S.Ct. 723 (1990).

[41] *See* KY. REV. STAT. ANN. § 275.185(2) ("Upon reasonable written request, a member may, at the member's own expense, inspect and copy during ordinary business hours any limited liability company record, where the record is located or at a reasonable location.").

[42] "Books and records" has been given a broad construction so as to extend to all records, contracts, paper, and correspondence to which the common law right of inspection of a stockholder might properly apply. 18A AM.JUR.2d *Corporations* § 330. *See also Meyer v. Ford Indus., Inc.*, 538 P.2d 353, 358 (Or. 1975) (holding that "books and records of account" was not limited to books and records of account "in any ordinary, literal or otherwise limited sense, but to be the subject of a broad and liberal construction so as to extend to all records, contracts, papers and correspondence to which the common law right of inspection of a stockholder may properly

the Kentucky Supreme Court has held that the common law right of inspection extends to all correspondence which relates to the business affairs of the corporation if the shareholder has a proper purpose.[43] For example, in *McCain v. Phoenix Resources, Inc.*,[44] the court wrote:

> We conclude that absent any restriction by statute or the partnership agreement, a limited partner has the right to inspect all documents and papers affecting the partnership, including those held by the partnership's attorney.

In *Burton v. Cravey*[45] the court found that the files and records for an attorney for a non-profit condominium association which related to the association were "books and records" of the association available for inspection.[46]

In this hypothetical Daniel is not attempting to reach into the attorney's file maintained on behalf of the organization, an act that these cases would indicate is permissible, but rather only to what is of record with the LLC. Kentucky's statutes do not allow the organization to declare certain records as being confidential in nature and thereby exempt from inspection. In consequence, absent permissible private ordering to the contrary,[47] it must be expected that an attorney's communication to an organization client may be accessed by a constituent thereof.

In light of this possibility, what is counsel to do? Write a less complete letter, knowingly under-informing the client as to the pros and cons of the possible courses of action. But is not that a violation of Rule 1.4? Provide a letter that is limited to the arguments that support the decision-maker's desired outcome? But then doesn't counsel need to expressly state that the advice set forth therein is limited?[48] Could the attorney satisfy his or her obligations be delivering the limited letter and making an oral presentation setting forth the nature of the letter's limitations and explaining the counter-arguments to the determination that "for cause" has been

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apply."); *State v. Malleable Iron Range Co.*, 187 N.W. 646 (Wis. 1922) ("The right of a stockholder to examine the records and books of account of a corporation extends to all papers, contracts, minute books, or other instruments from which he can derive any information which will enable him to better protect his interest and perform his duties.").

[43] *Otis-Hidden Co. v. Scheirich*, 219 S.W. 191, 194 (Ky. 1920) ("At common law the right of inspection covers all the books and records of the corporation. But the word 'record' is not used in the narrow sense of minutes of official action taken by the board of directors, but has been held to include the documents, contracts, and papers of the corporation. . . . We therefore conclude that all of the correspondence in question, which relates to the business affairs of the corporation, is subject to inspection by plaintiff, who has an interest to protect, and whose purpose is not shown to be improper or unlawful.") (citations omitted).

[44] 185 Cal. App.3d 575, 230 Cal. Rptr. 25, 26 (1986).

[45] 759 S.W.2d 160 (Tex. App. 1988).

[46] *But see Milroy v. Hanson*, 875 F. Supp. 646 (D. Neb. 1995) (minority shareholder and director denied access to attorney-client communications and records in direct and derivative suit).

[47] *See, e.g.*, KY. REV. STAT. ANN. § 275.185(5) (permitting a written operating agreement to limit the right to access company records); *id*. § 362.1-403(4) (allowing the partnership agreement to impose reasonable limitations on access to and use of partnership records); and *id*. § 362.1-103(2)(b) (same). In contrast, both the business corporation and nonprofit corporation acts preclude limitations in either the articles of incorporation or the bylaws upon the right to access company records. *See* KY. REV. STAT. ANN. § 271B.16-020(4); *id*. § 273.233.

[48] While reliance upon advice of counsel is at times sanctioned by statute, that reliance must be reasonable. *See, e.g.*, KY. REV. STAT. ANN. § 271B.8-300(4); *id*. § 386A.5-060(2). Can there be reasonable reliance upon a report that is self-described as being less than comprehensive?

satisfied? Perhaps that meets the attorney's obligations, but that assessment is open to debate. At minimum, is counsel to any organization required to generally caution it (through its management group) that communications between it and the attorney may, at least if sought by a constituent of the organization, be subject to Rule 1.6?

Privilege and Representation of a Client Adverse to a Constituent Thereof

As previously noted, when the client is an organization, it is that legal entity that is the client, and the attorney does not, by reason of representing the organization, undertake an attorney-client relationship with any of the constituents. The attorney is charged to "diligently" represent the interests of the client,[49] and in accordance with Rule 1.6 is obligated to protect the client's confidential information.[50]

This problem is exemplified in the recent Kentucky case of *Lach v. Man O'War*.[51] This case involved the restructuring of a limited partnership into the form of an LLC. Prior to the restructuring, there was a dispute among the incumbent partners as to who would be a successor general partner. Unable, consequent to that dispute, to achieve the necessary unanimous approval for the designation of a new general partner,[52] the incumbent general partners, allied with certain of the limited partners, began, in consultation with the partnership's counsel, investigation of various means to restructure the relationship such that Lach would not continue to have a blocking position, ultimately settling upon a contractual sale of assets and interest exchange of the limited partnership into an LLC.[53]

Further, as part of that reorganization, any partner in the limited partnership who did not sign off on the transaction was, pursuant to its terms, precluded from having voting rights in the LLC; in the prior limited partnership, Lach had held in excess of a twenty-seven percent (27%) interest. Subsequent to the transaction's consummation, Lach filed suits on a number of bases,

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[49] Rule 1.3. The charge to "zealously" represent the client was in _____ dropped in favor of "diligently." The word "zeal" does appear in the Supreme Court's comment to SCR 1.13. *See also* Paul C. Saunders, *What Ever Happened to 'Zealous Advocacy'?*, 245 NEW YORK LAW JOURNAL (March 11, 2011); OHIO RULES OF PROFESSIONAL CONDUCT, Rule 1.3, Comparison to former Ohio Code of Professional Responsibility:

> Neither Model Rule 1.3 nor any of the Model Rules on advocacy states a duty of "zealous representation." The reference to acting "with zeal in advocacy" is deleted from Comment [1] because "zeal" is often invoked as an excuse for unprofessional behavior. Despite the title of Canon 7 of the Ohio Code of Professional Responsibility and the content of EC 7-1, no disciplinary rule requires "zealous" advocacy.

[50] *See supra* note ___.

[51] 256 S.W.3d 563 (Ky. 2008).

[52] *See* KY. REV. STAT. ANN. § 362.690; *id*. § 362.235(7). This limited partnership, formed in 1986, was governed by Kentucky's 1970 adoption of the 1916 Uniform Limited Partnership Act and, consequent to linkage, the Kentucky adoption of the Uniform Partnership Act.

[53] The merger of the existing limited partnership into a newly-created LLC was not an option in that limited partnership of this milieu did not have the capacity to engage in a merger transaction. A conversion of the limited partnership into an LLC was precluded by the requirement that any such conversion would require the unanimous approval of all of the partners. KY. REV. STAT. ANN. § 275.370. An effort by Lach to have the transaction set aside as a de facto conversion for which the required minimum construction was not given was rejected.

most importantly, for these purposes, the assertion that the reorganization violated the general partner's fiduciary obligations.

Under the controlling limited partnership statute, a general partner had no authority to "do any act which would make it impossible to carry on the ordinary business of the partnership."[54] Working from the notion that "the doing of an act prescribed by [law] is a breach of [the general partner's fiduciary] duty,"[55] and having determined that the reorganization of the limited partnership into the form of an LLC made it impossible for the limited partnership to carry on its business, was impermissible; the general powers afforded the general partners "can be not construed to allow them the power to transform the partnership into a limited liability company, in order to favor a majority of the partners in their selection, or substitution of the general partners/managers of the business, without the approval of all the limited partners."[56]

Were that the sum total of *Lach v. Man O'War* case, it would not be particularly relevant to the matters here under consideration. However, that was not the end of the case. The plaintiff, Lach, in the course of the suit sought access to the communications between the various general partners and the attorneys who structured the ultimately condemned reorganization. On the basis that the general partners' breach of fiduciary duty constituted fraud,[57] and on reliance upon the rule that the attorney-client privilege does not apply with respect to future actions contemplating fraud, it was held that the attorney-client privilege could not be utilized to protect the requested documents from review and inspection.[58]

Likewise, in the iconic case of *Steelvest, Inc. v. Scansteel Serv. Ctr., Inc.*,[59] the Kentucky Supreme Court famously (a) defined (a nearly insurmountable) standard for granting summary judgment and (b) classified a breach of fiduciary duty as constituting fraud.[60] For our purposes, the more important aspects of the decision is that aimed at Tom Scanlon's legal counsel. Briefly, while an employee of Steelvest, Scanlon initiated efforts to organize a new and competing venture.[61] It was ultimately determined that in doing so Scanlon had breached his fiduciary

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[54] KY. REV. STAT. ANN. § 362.490(2). While no longer set forth in KRS, this Act governs limited partnerships organized on or after June 18, 1970 and prior to July 15, 1988 that have not elected to be governed by a subsequent limited partnership act. *See also* THOMAS E. RUTLEDGE AND ALLAN E. VESTAL, RUTLEDGE & VESTAL ON KENTUCKY PARTNERSHIPS AND LIMITED PARTNERSHIPS § [3.2] (2010). The 1970 Kentucky adoption of the 1916 Uniform Limited Partnership Act is reproduced in *id*., Appendix 8.

[55] 256 S.W.3d at 569, quoting *Gundelach v. Gollehon*, 598 P.2d 521, 523 (Colo. App. 1979).

[56] 256 S.W.3d at 571.

[57] *See Lach*, 356 S.W.3d at 572, citing *Steelvest, Inc. v. Scansteel Serv. Ctr., Inc*., 807 S.W.2d 476, 487 (Ky. 1991).

[58] *Lach*, 356 S.W.3d at 572. As already noted, Lach should have prevailed on a request to review those documents based upon his right, as a partner, to review partnership records. *See* KY. REV. STAT. ANN. § 362.500(1)(a) ("A limited partner shall have the same rights as a general partner to (a) have the partnership books kept at the principal place of business of the partnership, and at all time to inspect and copy any of them.").

[59] 807 S.W.2d 476 (Ky. 1991).

[60] 807 S.W.2d at 487 ("Accordingly, we determine, as a matter of law, that a breach of fiduciary duty is equivalent to fraud.")

[61] 807 S.W.2d at 479.

obligations as a director and officer of the corporation.[62] Crucial for our purposes, the Supreme Court held that the communications between Scanlon and his legal counsel were not protected by the attorney-client privilege and could be discovered.[63]

This outcome presents obvious problems to counsel advising a business entity that is considering actions adverse to the interest of a constituent thereof. Even when, by private ordering, the constituent has no right to inspect the company records that include communications with counsel,[64] there is the possibility that those communications may be ultimately discoverable if those in control of the venture violated a fiduciary duty to a constituent.

What, in light of this possibility, is counsel to do? Assuming that no attorney would advise "What you are planning to do is a clear violation of your fiduciary duties, let me help you accomplish your plan," is it still necessary to counsel the client "If a court determines that this course of action is a breach of fiduciary duty, all of our communications may be discoverable."? It is likely unreasonable to assume that those communications will seldom lack pejorative statements vis-à-vis the constituent at issue and will contain other statements and information otherwise not helpful to the organization's case. Are attorneys obligated to keep the file "clean" of such references at the risk they will later be presented to a jury?

When the Organization's Counsel's Obligations Run to the Organization's Constituents

Even when the client is an organization, there exists circumstances in which the attorney's diligent representation thereof can impose a duty to act as well on behalf of someone other than the organization or expose the attorney to liability to someone other than the organizational client. Both of these circumstances fly in the face of Rule 1.13 and its definition of the organization as the client. As set forth in section 51 of the Restatement (Third) of the Law Governing Lawyers, it is provided that:

> For purposes of liability under § 48,[65] a lawyer owes a duty to use care within the meaning of § 52[66] in each of the following circumstances:

[62] 807 S.W.2d at 483-84.

[63] 807 S.W.2d at 488.

[64] *See supra* note _____.

[65] The Restatement (Third) of the Law Governing Lawyers § 48 provides:

> In addition to the other possible bases of civil liability described in §§ 49, 55 and 56, a lawyer is civilly liable for professional negligence to a person to whom the lawyer owes a duty of care within the meaning of § 50 or § 51, if the lawyer fails to exercise care within the meaning of § 52, and if that failure is a legal cause of injury within the meaning § 53, unless the lawyer has a defense within the meaning of § 54.

[66] The Restatement (Third) of the Law Governing Lawyers § 52 provides in part:

* * *

> (4) To a nonclient when and to the extent that:
>
> (a) The lawyer's client is a trustee, guardian, executor or fiduciary acting primarily to perform similar functions for the nonclient;
>
> (b) The lawyer knows that appropriate action by the lawyer is necessary with respect to a matter within the scope of the representation to permit or rectify the breach of a fiduciary owed by the client to a nonclient, where (i) the breach is a crime or a fraud or (ii) the lawyer has assisted or is assisting the breach;
>
> (c) The nonclient is not reasonably able to protect its rights; and
>
> (d) Such a duty would not significantly impair the performance of the lawyer's obligations to the client.[67]

The application of these rules in the context of an organizational client have not yet been fully explored, and that lack of certainty is a basis for concern. While Restatement section 51, as well as its comments, are written in terms of the fiduciary duties that arise in the traditional donative trust and probate contexts,[68] the term "fiduciary" has obvious application in the context of organizational clients wherein particular actors stand in a fiduciary relationship with either the organization or the organization and some or all of the constituents.[69] In the context of the *Lach*

> (1) For purposes of liability under §§ 48 and 49, a lawyer who owes a duty of care must exercise the competence and diligence normally exercised by lawyers in similar circumstances.

[67] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 (2000). It bears noting that it can be argued that § 51 of the Restatement is not applicable as here described (reliance being made upon comment h) thereto, it providing that:

> The lawyer is hence less likely to encounter conflicting considerations arising from other responsibilities of the fiduciary-client than are entailed in other relationships in which fiduciary duty is only part of a broader role. Thus, Subsection (4) does not apply when the client is a partner in a business partnership, a corporate officer or director, or a controlling stockholder.

RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51, comment *h*. This comment, however, is restricted by its terms to inter-se relationships among the constituents of a business organization, and is open to debate whether it applies vis-à-vis obligations of the organization to a constituent.

[68] *See, e.g.*, RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51, comment *h* ("The duty recognized under Subsection (4) is limited to lawyers representing only a limited category of the persons described as fiduciaries – trustees, executors, guardians, and other fiduciaries acting primarily to fulfill similar functions. Fiduciary responsibility imposing strict duties to protect specific property for the benefit of specific, designated persons, is the chief end of such relationships."); *id*. ("The scope of a client's fiduciary duties is delimited by the law governing the relationship in question (see, e.g., Restatement (Second), Trusts §§ 169-185.").

[69] *See, e.g.*, KY. REV. STAT. ANN. §§ 271B.8-300(1)(a)-(c) (fiduciary duties of corporate directors owed to the corporation); *id*. §§ 273.215(1)(a)-(c) (same); *id*. §§ 275.170(1), (4) (duty of care owed to LLC by members of

v. Man O'War dispute we could see these rules played out, perhaps ultimately to the unappreciated risk of the attorneys. The general partners of the Man O'War limited partnership clearly stood in a fiduciary relationship with each limited partner including Lach;[70] element (4)(a) of Restatement section 51 is satisfied. The plan of reorganization either conceptualized or at minimum implemented by the attorney is (ultimately determined to be) a breach of fiduciary duty and therefore a fraud;[71] element 4(b) of Restatement section 51 is satisfied. Skipping ahead, the lawyer can act, without significantly impairing his or her obligations to the client, by not implementing a plan that constitutes a breach of fiduciary duty by the client; element 4(d) of Restatement section 51 is satisfied in that an attorney cannot assist a client in effecting a fraud.[72] That leaves element (c), namely whether the non-client beneficiary of the fiduciary obligation is "reasonably able to protect is rights.[73] Ultimately, Lach was able to do so, but only after a case was appealed to the Kentucky Supreme court. At what point does the cost of litigation, costs that may ultimately not be subject to recovery from the disloyal fiduciary,[74] constitute a bar to the beneficiaries' capacity to protect his or her rights. Alternatively, are any costs incurred by one who is the beneficiary of a fiduciary, particularly a duty of loyalty, acceptable?

It is beyond the scope of this discussion to resolve this issue.[75] What is important for these purposes is to recognize that attorneys representing organizational client may notwithstanding the limitations of Rule 1.13 have obligations to protect the interests of the organization's constituents.

Change of Control of an Organizational Client

The attorney's obligation to maintain privilege with respect to client information is a right and asset of the organization. To that end, the organization may, as it sees fit, waive that privilege. At the same time, the attorney has no right to keep information from the client; the attorney does not, with respect to the client, have any right of privilege.

These rules can create troubling situations upon the change of control of an organizational client in that, upon the change of control, a different group of actors will have the

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member managed LLC or managers of manager managed LLC); *id*. §§ 275.170(2), (4) (duty of loyalty owed to LLC by members of member-managed LLC or managers of manager-managed LLC); *id*. § 362.1-404(3) (duty of care owed by each partner to the partnership and other partners); and *id*. § 362.1-404(2) (duty of loyalty owed by each partner to the partnership and the other partners).

[70] *See* KY. REV. STAT. ANN. § 362.690; *id*. § 362.490; and *id*. § 362.250.

[71] *Lach v. Man O'War*, 256 S.W.3d at __; *Steelvest, Inc. Scansteel Serv. Ctr. Inc*., 807 S.W.2d at ___.

[72] Rule __. The author does not, in this example mean to suggest that counsel to the Man O'War limited partnership had a conscious appreciation that they were engaged in a breach of fiduciary duty owed to Lach. While the author believes the ultimate ruling in the case to have been normatively correct, the dissent by Justice Abramson is ample proof that reasonable minds can differ on the point.

[73] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(4)(c).

[74] *See* Thomas E. Rutledge and Thomas Earl Geu, *The Analytic Protocol for the Duty of Loyalty Under the Prototype LLC Act*, 63 ARKANSAS LAW REVIEW 473, 498 (2010) (discussing recovery of attorney's fees in successful action for breach of the duty of loyalty).

[75] It is as well way above the pay grade of this author.

right and capacity to direct the attorney with respect to both the disclosure of confidential information and disclosure back to the organization.

Consider the following hypothetical. Holding Co., Inc. is the sole shareholder of ABC, Inc. It has been determined that ABC, Inc. will be sold pursuant to a stock sale to XYZ, LLC. Upon the consummation of the stock purchase agreement, XYZ, LLC is the sole shareholder of ABC, Inc. The LLC's management, desiring to gain the maximum information possible in connection with the final adjustments to the purchase price, directs ABC, Inc.'s legal counsel to disclose to them any and all information in their possession with respect to the negotiation of the stock purchase agreement that might be helpful in their efforts to reduce the ultimate purchase price.[76]

Cases of this nature present particular problems, and there is little direction as to the appropriate outcome. That said, what guidance is available is troubling. For example, in *Commodity Futures Trading Commission v. Weintraub*,[77] in what must admitted to be dicta, it was stated that "when control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well."[78]

Lower courts have not, however, treated this aspect of the *Weintraub* ruling as dicta but rather have elevated it to a substantive rule. This is seen, for example, in *In re Cap Rock Electric Cooperative, Inc*.[79] wherein, citing *Weintraub*, it was observed "the attorney-client privilege extends to corporate entities as well as to individuals when a corporation passes to new management, the authority to assert the privilege passes as well."[80] In *Tekni-Plex v. Meyner & Landis*[81] it was stated:

> *Weintraub* establishes that, where efforts are made to run the pre-existing business entity and manage its affairs, successor management stands in the shoes of prior management and controls the attorney-client privilege with respect to matters concerning the company's operations. It follows that, under such circumstances, the prior attorney-client relationship continues with the newly formed entity.

Applying these principles with respect to a sale of a subsidiary by one sophisticated party to another, the court in *Medcom Holding Co. v. Baxter Travenol Laboratories, Inc*. wrote:

> It is reasonable then to treat the parties to a subsidiary divestiture by sale of stock as having contracted on the assumption that after

[76] There are, under scenarios such as this, complicated questions of whether there is a joint-representation/client. Those issues, while of crucial importance, are beyond the scope of this article.

[77] 471 U.S. 343 (1985).

[78] 471 U.S. at 349.

[79] 35 S.W.3d 222 (Tex. Ct. App. 2000).

[80] 35 S.W.3d at 227.

[81] 651 N.Y.S.2d 954 (N.Y. 1996).

> the sale management of the divested corporation will control its attorney-client privilege. The parties are free to vary this rule by agreement. For example, if the selling parent will have a continuing interest after the sale in contracts, assets or liabilities of the subsidiary the parent can negotiate for special access or control to protect that interest. Similarly, if the attorneys who present a corporate parent also represent its subsidiary in the sale of the subsidiary's stock they run the resulting risk that after the acquisition subsidiary management will waive the privilege with respect to *its* communications with those attorneys. A seller who wishes to avoid that result can do so by agreement with the purchaser or by employing separate counsel for the subsidiary and limiting to the parent's own attorneys those communications which the parent wishes to protect.[82]

Clearly counsel for organization clients undertaking a negotiated acquisition need to be aware of these rules and as appropriate plan necessary limitations.

Conclusion

We are admonished by no less than Albert Einstein that "everything should be made as simple as is possible, but not simpler."[83] In light of the significant questions and ambiguities that exist vis-à-vis the application of Rule 1.13, it must be wondered, and can be safely concluded, that the Rule violates Einstein's admonition.

[82] 1988 WL 33826, *3.

[83] Collected Quotes from Albert Einstein, http://rescomp.stanford.edu/~cheshire/EinsteinQuotes.html (last visited Nov. 2, 2012) .