

The background of the slide features a photograph of several individuals in a meeting. They are seated around a table, with their hands and arms visible as they interact with documents and notebooks. A large, semi-transparent blue geometric shape, composed of overlapping polygons, is overlaid on the left side of the image. The text is placed within this blue area.

CONFLICTS:

ORGANIZATION
INDIVIDUALS

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ORGANIZATIONS V. INDIVIDUALS

- Most of us in this room represent organizations
- We typically think of organizations as single “entities” or “legal persons”
- But representing an organizational client is different than representing an individual client
 - Organizations consist of multiple individuals with potentially differing interests
 - Internal conflicts arise in the context of representing an organization that do not arise when representing an individual



“And now at this point in the meeting I'd like to shift the blame away from me and onto someone else.”

POTENTIAL CONFLICTS FOR THE ORGANIZATION'S LAWYER

- Who is the boss?
 - Board
 - CEO/Officers
 - General Counsel
 - Others
- Transactions
 - Constituent v. Constituent
 - Is it best for the organization?
- Organization v. Individual
 - Employment Issue
 - Benefits

SOURCES FOR GUIDANCE

- Entity Law (Business Organizations Code, etc.)
- Disciplinary Rules of Professional Conduct
- Common Law
- Your Judgment and Experience

TEXAS BUSINESS ORGANIZATIONS CODE

- 2.101. General Powers [of the Organization]
 - sue and be sued
 - acquire, sell, convey, mortgage, etc.
 - make contracts and incur liabilities
 - conduct its business
 - elect or appoint officers and agents
 - cease its business activities and terminate its existence by voluntary dissolution
 - etc.

TEXAS BUSINESS ORGANIZATIONS CODE

- 2.113. Limitations on Powers
 - This subchapter does not authorize a domestic entity **or a managerial official** of a domestic entity to exercise a power in a manner inconsistent with a limitation on the purposes or powers of the entity contained in its governing documents, this code, or other laws of this state.
- Officers and directors cannot act beyond the authority granted to them by law or the organizational documents.

TEXAS DISCIPLINARY RULES OF PROFESSIONAL CONDUCT

Rule 1.12. Organization as a Client

(a) A lawyer employed or retained by an organization represents the entity. While the lawyer in the ordinary course of working relationships may report to, and accept direction from, an entity's duly authorized constituents, in the situations described in paragraph (b) the lawyer shall proceed as reasonably necessary in the best interest of the organization without involving unreasonable risks of disrupting the organization and of revealing information relating to the representation to persons outside the organization.

(b) A lawyer representing an organization must take reasonable remedial actions whenever the lawyer learns or knows that:

- (1) an officer, employee, or other person associated with the organization has committed or intends to commit a violation of a legal obligation to the organization or a violation of law which reasonably might be imputed to the organization;
- (2) the violation is likely to result in substantial injury to the organization; and
- (3) the violation is related to a matter within the scope of the lawyer's representation of the organization.

(c) Except where prior disclosure to persons outside the organization is required by law or other Rules, a lawyer shall first attempt to resolve a violation by taking measures within the organization. In determining the internal procedures, actions or measures that are reasonably necessary in order to comply with paragraphs (a) and (b), a lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations. Such procedures, actions and measures may include, but are not limited to, the following:

- (1) asking reconsideration of the matter;
- (2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and

A LAWYER EMPLOYED OR
RETAINED BY AN
ORGANIZATION
REPRESENTS THE ENTITY.

PLAIN MEANING OF THE RULE

- Comment 1: A lawyer employed or retained to represent an organization represents the organization as distinct from its directors, officers, employees, members, shareholders or other constituents.
- A lawyer “employed” by an organization (meaning inside counsel) or “retained” by an organization (meaning outside counsel) is the lawyer for the organization and not for any of its constituents.

WHAT IS A “CONSTITUENT”?

- 1.12(e) lists: an organization’s directors, officers, employees, members, shareholders or other constituents
- Comment 2: As used in this Rule, the constituents of an organizational client, whether incorporated or an unincorporated association, include its directors, officers, employees, shareholders, members, and others serving in capacities similar to those positions or capacities. This Rule applies not only to lawyers representing corporations but to those representing an organization, such as an unincorporated association, union, or other entity.
- Case law suggests that policyholders, stockholders and limited partners are constituents

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- Constituents ARE NOT clients.
 - ...unless everyone consents.
 - Rule 1.12 Comment 5: A lawyer representing an organization may, of course, also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of Rule 1.06 (Conflict of Interest)

RULE 1.12(E) INFORMS WHAT TO DO WITH CONSTITUENTS

- (e) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer **shall** explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing or when explanation appears reasonably necessary to avoid misunderstanding on their part.

WHEN ARE THE ORGANIZATION'S INTERESTS ADVERSE TO THOSE OF THE CONSTITUENTS?

- Examples:
- Shareholder derivative actions
- Limited partnership transactions
- Sale of company
- Employment disputes

SHAREHOLDER DERIVATIVE ACTIONS

- Delaware Chancery Court has approved the practice of permitting one firm (one lawyer) to jointly represent the company and the individual defendants at the motion to dismiss stage.
- Northern District of California recently confirmed that, at least at the beginning of a case, the company and the individual defendants may be jointly represented.

SHAREHOLDER DERIVATIVE ACTIONS

- Use your judgment based upon the claims asserted
 - Claims of actual malfeasance or fraud against individual officers or directors are different than run-of-the-mill merger or IPO claims or technical inaccuracies in reporting
- Know that if you start representing both the company and the individual defendants in early proceedings, there is a risk that you could be disqualified as the proceedings continue if different facts implicate adversity between your clients
 - The same California case that confirmed joint representation at the beginning of a case also observed that if the case proceeded beyond the motion to dismiss stage, the company would be advised to retain independent counsel

LIMITED PARTNERSHIP TRANSACTIONS

- Independent boards for subordinate entities
- Independent counsel for subordinate entities
- Partnership agreements should address fiduciary duties and conflicts
- Follow the agreements

SALE OF COMPANY

- Needs and interests of the organization and the individual owners of the organization may be very different
 - The tax consequences of a sale for the organization may differ from those of the individual owners. Similarly, the tax consequences for one individual owner may differ from another individual owner
 - The representations and warranties included in the sale documents may affect different individual owners differently – for example, joint and several liability on the owners means different things to a 25% owner and a 75% owner
 - Post-closing employment of different owners may differ – some individuals may remain with the company and others may not (by choice or otherwise)
- Negotiations may require the organization and each individual to have independent legal representation



EMPLOYMENT DISPUTES

- You must communicate with the organization through an individual. What happens if that individual is going to be fired or has questions about his stock options?
- You may not give advice to both the organization and an employee if interests have diverged
 - You have a duty to make sure the employee understands that you are not his counsel. Rule 1.12(e)
 - The employee should retain his own counsel

EMPLOYMENT DISPUTES

Yanez v. Plummer, 164 Cal. Rptr. 3d 309 (Cal Ct. App. 2013)

- Former employee entitled to bring claims for malpractice, breach of fiduciary duty and fraud against in house counsel
- Employee was a witness in a slip-and-fall action against company
- In house counsel represented both the company and the employee/witness at employee/witness's deposition
- Prior to deposition, employee/witness asked who would "protect" him at the deposition – counsel said he would represent both the employee and the company
- In house counsel questioned employee at the deposition and elicited testimony showing a discrepancy in employee's post-accident written statement
- Employee/witness was terminated
- In house counsel's failure to inform employee of conflict and obtain employee's consent to represent him resulted in potential malpractice liability for in house lawyer

RULE 1.12(E) INFORMS WHAT TO DO WITH CONSTITUENTS

- (e) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing or when explanation appears reasonably necessary to avoid misunderstanding on their part.

WHEN EXPLANATION APPEARS REASONABLY NECESSARY TO AVOID MISUNDERSTANDING

Examples:

- Special investigations
- Advising about corporate governance documents
- Advising about routine employment issues

SPECIAL INVESTIGATIONS

- If an organization or its employees are investigated for any reason (fraud, violation of law or regulations, etc.), the organization's counsel must only represent the organization and cannot represent any individual who may have committed wrongdoing
- Privilege implications:
 - The organization, not the individual, enjoys the privilege with counsel
 - An organization may waive the privilege in order to defend itself – and waiver may necessarily point the finger at individual officers, directors or employees
 - The individual officers, directors or employees may attempt to assert the privilege if they were working as an agent for the company at the time of the privileged communication
 - Separate counsel is needed to advocate these disparate positions

THE YATES MEMO AND UPJOHN WARNING

- September 2015, the DOJ issued the Yates Memo
- A company can only be eligible for cooperation credit if it discloses ***all*** relevant facts about individuals in corporate misconduct
- In other words, the organization must “serve up its bad actors” with full disclosure

THE YATES MEMO AND UPJOHN WARNING

- This highlights the need for full Upjohn warnings
 - Develop a formal script (and follow it)
 - Provide witness with a written summary of the critical points of the warning
 - Specifically disclosing that the organization may unilaterally disclose to the government the content of the interview
 - Require written acknowledgment from the witness

ADVISING ON CORPORATE GOVERNANCE DOCUMENTS

- Roles and powers of officers
- Indemnity for officers and directors
- Addressing fiduciary duties
- Securities (preferred stock, pre-emptive rights, etc.)

ROUTINE EMPLOYMENT ISSUES

- Your “person” in the organization may be the one with issues
 - Negotiating stock options, negotiating non-competes, etc.
 - Disciplinary issues or termination
- Layoffs or sale of a division
- You might be advising adverse to your own interests

RULE 1.12 COMMENT 4: CLARIFYING THE LAWYER'S ROLE

- Care should 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 insofar as that individual is concerned.
- 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.

YOU MUST PROCEED IN THE BEST INTERESTS OF THE ORGANIZATION – NOT THE CONSTITUENT

- Rule 1.12(a)
- (a) A lawyer employed or retained by an organization represents the entity. **While the lawyer in the ordinary course of working relationships may report to, and accept direction from, an entity's duly authorized constituents,** in the situations described in paragraph (b) **the lawyer shall proceed as reasonably necessary in the best interest of the organization** without involving unreasonable risks of disrupting the organization and of revealing information relating to the representation to persons outside the organization.

RULE 1.12 COMMENT 1: THE ENTITY AS A CLIENT

...Unlike individual clients who can speak and decide finally and authoritatively for themselves, an organization can speak and decide only through its agents or constituents such as its officers or employees. In effect, the lawyer-client relationship must be maintained through a constituent who acts as an intermediary between the organizational client and the lawyer. This fact requires the lawyer under certain conditions to be concerned whether the intermediary legitimately represents the organizational client.

IN OTHER WORDS...

- The interests of the organization are not always the same as the interests of the individual officer or employee – or the interests may diverge over time
- As counsel to the organization, it is your job to put the organization's interests first



RULE 1.12(B) – WHEN ARE YOU REQUIRED TO DO SOMETHING?

- (b) A lawyer representing an organization **must take** reasonable remedial actions whenever the lawyer learns or knows that:
 - (1) an officer, employee, or other person associated with the organization has committed or intends to commit a violation of a legal obligation to the organization or a violation of law which reasonably might be imputed to the organization;
 - (2) the violation is likely to result in substantial injury to the organization; **and**
 - (3) the violation is related to a matter within the scope of the lawyers representation of the organization

RULE 1.12(C) – WHAT ARE YOU REQUIRED TO DO?

- (c) Except where prior disclosure to persons outside the organization is required by law or other Rules, **a lawyer shall first attempt to resolve a violation by taking measures within the organization.** In determining the internal procedures, actions or measures that are reasonably necessary in order to comply with paragraphs (a) and (b), a lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyers representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations.

RULE 1.12(C) –WHAT ARE YOU REQUIRED TO DO? (CONTINUED)

- Such procedures, actions and measures may include, but are not limited to, the following:
 - (1) asking reconsideration of the matter;
 - (2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
 - (3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.
- *Sarbanes-Oxley may require more specific “up the ladder” reporting requirements (to the Chief Legal Officer, CEO or appropriate Committee of the Board) for lawyers practicing before the SEC (providing advice to an issuer)

RULE 1.12 COMMENT 6: DECISIONS BY CONSTITUENTS

- When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province. However, different considerations arise when the lawyer knows, in regard to a matter within the scope of the lawyer's responsibility, that the organization is likely to be substantially injured by the action of a constituent that is in violation of law or in violation of a legal obligation to the organization. In such circumstances, the lawyer must take reasonable remedial measure. See paragraph (b). It may be reasonably necessary, for example, for the lawyer to ask the constituent to reconsider the matter. If that fails, or if the matter is of sufficient seriousness and importance to the organization, it may be reasonably necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization. The stated policy of the organization may define circumstances and prescribe channels for such review, and a lawyer should encourage the formulation of such a policy. Even in the absence of organization policy, however, the lawyer may have an obligation to refer a matter to higher authority, depending on the seriousness of the matter and whether the constituent in question has apparent motives to act at variance with the organization's interest. At some point it may be useful or essential to obtain an independent legal opinion.

RULE 1.12 COMMENT 6: DECISIONS BY CONSTITUENTS

- When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful.
- Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province.
- However, different considerations arise when the lawyer knows, in regard to a matter within the scope of the lawyer's responsibility, that the organization is likely to be substantially injured by the action of a constituent that is in violation of law or in violation of a legal obligation to the organization. In such circumstances, the lawyer must take reasonable remedial measures.

RULE 1.12(D) – ONE MORE OPTION

- (d) Upon a lawyer's resignation or termination of the relationship in compliance with Rule 1.15, a lawyer is excused from further proceeding as required by paragraphs (a), (b) and (c), and any further obligations of the lawyer are determined by Rule 1.05 (Confidentiality and potential obligation to report outside of the organization).

SO, WHAT CAN YOU DO?

- Ask constituent to reconsider action;
- Ask for a separate legal opinion;
- Refer the issue to a higher constituent in the organization;
- To the extent confidentiality permits, reveal the information to someone outside the organization (limited); or
- Resign representation of the organization.
- *Sarbanes-Oxley may require more specific “up the ladder” reporting requirements (to the Chief Legal Officer, CEO or appropriate Committee of the Board) for lawyers practicing before the SEC (providing advice to an issuer)



***“How do you want me to answer that question, Norm?
As an attorney, or as your best friend?”***

IN PRACTICE

- Inside and outside counsel are both obligated to honor the distinction between the client organization and the individuals who work for the organization
- Strictly speaking, when counsel represents the organization counsel should avoid offering advice (other than a referral) to individual equity holders, officers or directors on any issue that is not also the organization's issue (i.e. trust and estate work or setting up other business ventures for the individual)
 - A lawyer who advises the individual on such matters may establish an attorney-client relationship with the individuals that may become problematic

HOW LAW FIRMS HANDLE

At a law firm, there are procedures for handling the potential conflict of representing an organization and also representing an organization's employee on an unrelated matter, such as trust and estate work:

- conflicts checks
- engagement letter
- ethical walls, etc.

Client of the Firm

Because Bracewell has been engaged to represent the Client only, the engagement does not include the Client's family members, affiliated or related entities, or their respective individual officers, directors, partners, equity owners or employees.

Unless otherwise specifically stated in the Engagement Letter, our representation does not include any parent, subsidiary, or affiliated entity; employee, officer, director, shareholder, member or partner of an entity; or, any commonly owned entity. For any trade association, our representation does not include any member of the trade association; and for individuals, our representation does not include any employer, partner, spouse, sibling, or other family member. In the event we are asked to undertake representation of any other entity in connection with this engagement, we will do so only by agreement defined in the Engagement Letter.

Our Relationship with Others and Conflicts of Interest

We have performed a conflicts check on the names you provided to Bracewell. Based on a check of these names, and under the applicable standards in the governing rules of professional conduct, we believe Bracewell is free to undertake the Matter. If we identify a conflict after work on this Matter has begun, you agree to use reasonable efforts to help us resolve the conflict to the satisfaction of all parties.

Bracewell accepts this engagement on the understanding that our representation of you will not preclude us from accepting another engagement from a new or existing client provided that (1) such engagement is not substantially related to the subject matter of services we provide to you and (2) such other engagement would not impair the confidentiality of related client information.

IN HOUSE COUNSEL

- In house counsel likely do not use engagement letters and likely do not run conflicts checks prior to providing advice to individual employees of the company
- As a result, in house counsel must look back at the Rules, the case law, and his own experience and judgment for guidance

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