

12-1-1998

# The Potential Liabilities Faced By In-House Counsel

Scott L. Olson

Follow this and additional works at: <http://repository.law.miami.edu/umblr>



Part of the [Law Commons](#)

---

## Recommended Citation

Scott L. Olson, *The Potential Liabilities Faced By In-House Counsel*, 7 U. Miami Bus. L. Rev. 1 (1999)

Available at: <http://repository.law.miami.edu/umblr/vol7/iss1/2>

This Article is brought to you for free and open access by Institutional Repository. It has been accepted for inclusion in University of Miami Business Law Review by an authorized administrator of Institutional Repository. For more information, please contact [library@law.miami.edu](mailto:library@law.miami.edu).

# THE POTENTIAL LIABILITIES FACED BY IN-HOUSE COUNSEL

SCOTT L. OLSON\*

I.	INTRODUCTION .....	1
II.	WHO IS THE CLIENT? .....	4
	A. <i>Basic Rules</i> .....	4
	B. <i>Representing Constituents &amp; Third-Party Liability</i> .....	5
	1. DIRECTORS & OFFICERS .....	9
	2. EMPLOYEES .....	11
	3. SHAREHOLDERS .....	14
	C. <i>Attorney-Director Conflicts</i> .....	19
III.	MAJOR AREAS OF THE LAW GIVING RISE TO LIABILITY .....	24
	A. <i>Breach of Fiduciary Duty</i> .....	24
	B. <i>ERISA</i> .....	28
	C. <i>Securities Laws</i> .....	30
	D. <i>Aiding &amp; Abetting Liability</i> .....	33
	1. SECURITIES LAWS .....	34
	2. BREACH OF FIDUCIARY DUTY & ERISA .....	35
	3. CONSPIRACY .....	36
	E. <i>Environmental Laws</i> .....	38
	F. <i>Intellectual Property Laws</i> .....	39
	G. <i>Antitrust Laws</i> .....	40
	H. <i>Commercial Transactions</i> .....	41
	I. <i>Opinion Letters &amp; Advice</i> .....	42
IV.	MINIMIZING AND AVOIDING POTENTIAL LIABILITY .....	45
	A. <i>Attorney-Client Relationship</i> .....	45
	B. <i>Advice</i> .....	47
	C. <i>Legal Departments</i> .....	50
	D. <i>Indemnification</i> .....	52
	E. <i>Insurance</i> .....	53
V.	CONCLUSION .....	55

## I. INTRODUCTION

One of the most significant changes in the practice of corporate law during the last half of the 1900s has been the proliferation and increasing importance of law departments within corporations,<sup>1</sup> which employ about

---

\* Law clerk for the Honorable Ewing Werlein, Jr., U.S. District Court for the Southern District of Texas; B.B.A. 1992, Financial Management, University of North Dakota; 1998 J.D., University of Pittsburgh School of Law. I would like to thank Professor Pat K. Chew for her comments on earlier drafts of this article.

<sup>1</sup> See Mary C. Daly, *Ethical Challenges for Law Departments in the Twenty-First Century*, in CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS 1.301, 1.301 (Business Laws, Inc. ed., 1996).

ten to fifteen percent of all attorneys.<sup>2</sup> This transformation from outside law firms to in-house legal departments has occurred because corporations recognize the need for immediate advice from an attorney who is intimately familiar with the corporation's business affairs<sup>3</sup> and because of the increased cost savings associated with paying in-house attorneys a fixed salary instead of paying an hourly rate to outside counsel.<sup>4</sup> Consequently, corporations have been assigning larger roles to their legal departments.<sup>5</sup> Besides the growing perception that in-house counsel have the same power, prestige,<sup>6</sup> and responsibilities as outside attorneys, in-house counsel are also confronted with greater potential liabilities. Unfortunately, many in-house counsel are unaware of the extent to which they can be held liable for their actions<sup>7</sup>—a void which this article attempts to fill.

Since the perceived loyalties are different, distinguishing between in-house and outside counsel is important. Both in-house and outside attorneys strive to accomplish the same primary goal: to work for the best interests of the corporation.<sup>8</sup> The difference between the two types of attorneys lies in how they accomplish that goal. Outside counsel have numerous clients and negotiate a fee with the corporation instead of receiving a salary since they are not employees.<sup>9</sup> In contrast, in-house counsel

Furthermore, a 1995 Price Waterhouse Law Department Spending Survey suggests that the trend will continue. See Carol McHugh Sanders, *O'Brien Puts Himself Back in the Game*, CHI. DAILY L. BULL., Apr. 1, 1996, at 3 (discussing the survey results, which found that 43% of corporations had added more attorneys to their law departments, and 37% intended to increase the number of attorneys in the future).

<sup>2</sup> See Frederick, *Cutting Lawyers May Not Be the Best Way to Cut Costs*, NAT'L L.J., Oct. 17, 1994, at C6; see also 3 RONALD E. MALLIN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 24.7, at 192 (4th ed. 1996) (noting that the number of in-house attorneys has doubled over the last ten years).

<sup>3</sup> See Harry S. Hardin & Andrew R. Lee, *Pitfalls for In-House Counsel*, BRIEF, Winter 1996, at 33.

<sup>4</sup> See, e.g., Domenick C. DiCicco, Jr., *To Increase Productivity Rebuild In-House Counsel*, BEST'S REV./PROP.-CAS. INS. EDITION, Aug. 1, 1996, at 90; David Pendered, *Grady's Lawyer Costs Rising Outside the Curve: While Many Hospitals are Trimming Legal Fees by Hiring More In-House Attorneys, Grady Increasingly Retains Prestigious Law Firms*, ATLANTA J., Aug. 23, 1997, at E6 (noting the \$500,000 savings that can be achieved by hiring more in-house attorneys).

<sup>5</sup> See Eugene R. Anderson & Joshua Gold, NAT'L L.J., Apr. 15, 1996, at C27; Margaret Cronin Fisk, *In-House Lawyers Increasingly Seek Liability Coverage*, NAT'L L.J., Sept. 14, 1992, at 23.

<sup>6</sup> See Sandra Torrey, *Attorneys Who Come In-House from the Cold*, WASH. POST, July 10, 1995, at F7 (discussing the increased prestige attributed to in-house counsel positions).

<sup>7</sup> See Stephen M. Honig, *Some Practical Perspectives on Liability of In-House Counsel*, in CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS 8.201, 8.201 (Business Laws, Inc. ed., 1996).

<sup>8</sup> See Robert M. Craig III, *Dual Role of In-House Counsel (Attorney and Client) ... and Other Aspects of a "Split Personality" Profession*, in CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS 1.201, 1.202 (Business Laws, Inc. ed., 1996).

<sup>9</sup> See Thomas H. Watkins & Paula Bird, *Conflicts: The Rules and the Reality as They Apply to Business and Industry Situations*, in CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS 2.001,

work for only one client (the corporation), are an employee of that client, and receive a salary from that client.<sup>10</sup> Furthermore, in-house attorneys become involved in many more dual roles than outside counsel, including being both an attorney and a client, a businessperson and legal counsel, and an investigator and compliance officer.<sup>11</sup> This article generally focuses on the enhanced liabilities faced by in-house counsel in particular. In some instances, there are few reported cases or ethics opinions pertaining directly to in-house attorneys; thus, this article sometimes uses examples of the liabilities experienced by outside counsel to illustrate the types of liabilities which in-house counsel also can experience.

Although the duties owed to the corporate client by both in-house and outside counsel are similar, in-house counsel face some particularly different tensions and conflicts which outside counsel do not experience.<sup>12</sup>

In-house attorneys provide a valuable service by being regularly available and easily accessible to provide legal advice for problems that arise daily.<sup>13</sup>

However, this precise "coziness" with management often causes in-house counsel to face significant liabilities. This enhanced risk of liability results primarily from in-house counsel's greater knowledge of the corporation's business operations than outside counsel. Consequently, in-house attorneys are held to a higher level of responsibility for their advice and work product, which have become more complex over the years.<sup>14</sup>

Thus, it is essential that all corporate counsel—but, particularly in-house counsel—become aware of the potential liabilities which they could face, and how they can minimize or avoid those liabilities. This article continues with a discussion in Part II about who is the client and to whom counsel owes their loyalty when representing corporate constituents or when serving on the corporation's board of directors. Part III then discusses some major areas of the law under which corporate counsel can be held liable: fiduciary laws, ERISA, securities laws, aiding and abetting,

---

2.004 (Business Laws, Inc. ed., 1996).

<sup>10</sup> See *id.*; see also *General Dynamics Corp. v. Superior Court*, 876 P.2d 487, 491 (Cal. 1984) (describing how in-house counsel, because they only have one client, are disadvantaged more than outside counsel if they are unable to recover under an implied-in-fact contract claim); Todd Myers, *The In-House Attorney Employment Dilemma*, 6 KAN. J.L. & PUB. POL'Y 147, 147 (1997) (providing an example of the dilemma which in-house counsel faces because the corporation is the sole client).

<sup>11</sup> See Craig, *supra* note 8, at 1.202.

<sup>12</sup> See Hardin & Lee, *supra* note 3, at 40.

<sup>13</sup> See *id.* at 33.

<sup>14</sup> See Elise Staffenberg, Note, *Treacherous Terrain for In-House Bank Attorneys*, 14 ANN. REV. BANKING L. 405, 410 (1995). For example, during the savings and loan crisis of the early 1990s, the Office of Thrift Supervision placed some of the blame for the collapse of the savings and loan industry on in-house banking lawyers. See W. John Moore, *Clubbing Counsel*, NAT'L J., July 25, 1992, at 1714.

environmental laws, intellectual property laws, antitrust laws, commercial transactions, and providing improper advice or unsound legal opinions. Finally, Part IV offers some practical advice about how corporate counsel can minimize their liability exposure or avoid it altogether.

## II. WHO IS THE CLIENT?

The age-old question for corporate counsel is to whom do they owe their duty of loyalty? In theory, this question has a simple answer, but in practice, many difficult issues arise.<sup>15</sup> The Model Rules of Professional Conduct ("Model Rules") provide the theoretical answer: the attorney's client is the corporation.<sup>16</sup> However, in practice, "[t]he corporate lawyer who resorts to [the Model Rules] for assistance usually finds nothing more than silence or vague generalities that are of little help in solving practical, immediate concerns."<sup>17</sup> This is particularly true when the in-house attorney also represents a corporate employee or serves on the board of directors of the corporation for which he or she is employed.

### A. Basic Rules

The Model Rules clearly state that the "organization" is the client.<sup>18</sup> When representing the corporation, counsel must ensure that they act in the best interests of only the corporation. Even if the Model Rules are not considered vague, applying them is still often difficult for in-house counsel because the Rules treat in-house counsel the same as attorneys in private practice.<sup>19</sup> The problem lies with the environments in which in-house and

---

<sup>15</sup> For example, in the context of a takeover, the "entity theory of representation . . . is an unrealistic approach to corporate representation." Miriam P. Hechler, *The Role of the Corporate Attorney Within the Takeover Context: Loyalties to Whom?*, 21 DEL. J. CORP. L. 943, 943 (1996). This results from counsel's duty to determine what is in the entity's best interests, *id.* at 943, which allows counsel to look at the best interests of the corporation's constituents. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. (1983) [hereinafter, Model Rules]. However, the interests of the constituents are often adverse to each other, *Bennett v. Propp*, 187 A.2d 405, 409 (Del. 1962) (recognizing the conflict between management and shareholders), thereby making it practically impossible to consider the interests of the amorphous "entity" itself.

<sup>16</sup> See Model Rule 1.13.

<sup>17</sup> Frederick W. Kanner, *Overview of Professional Responsibility Issues for the Corporate Lawyer*, in CONFLICTS OF INTEREST IN LEGAL REPRESENTATION 211, 221 (Robert J. Jossen, chair, Practising Law Institute, 1988); see also Staffenberg, *supra* note 14, at 412 (discussing how the Model Rules provides very vague guidance about who the client is and the types of liabilities which in-house counsel can face).

<sup>18</sup> See Model Rule 1.13(a); see also MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1981) [hereinafter, Model Code] ("A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity . . .").

<sup>19</sup> See Staffenberg, *supra* note 14, at 412.

outside counsel work. For example, an in-house attorney—as an employee of the corporation—must follow the orders given by superiors or risk facing termination. Simultaneously, the in-house attorney must also comply with the professional responsibility rules which may not allow him or her to follow the orders given by superiors.<sup>20</sup> Thus, in-house counsel could be presented with a dilemma between incurring professional liability versus being fired from their only client. Although outside counsel may face the same dilemma, the consequence is not as severe since they have other clients.

In the situation previously described, the Model Rules require that counsel take some sort of action when he or she knows that an agent of the corporation is about to breach or has breached an obligation owed to the corporation or is about to violate the law or has already violated the law.<sup>21</sup> The attorney has several options: (1) ask the agent to reconsider the matter,<sup>22</sup> (2) advise that an independent legal opinion be obtained,<sup>23</sup> (3) refer the matter to a higher authority in the corporation,<sup>24</sup> or (4) if none of the previous actions are successful, counsel can resign.<sup>25</sup>

### B. Representing Constituents & Third-Party Liability

Although the organizational entity is technically the counsel's client,<sup>26</sup> the entity is a legal fiction that can not function independently without representatives.<sup>27</sup> Thus, the entity acts through "authorized constituents."<sup>28</sup>

These constituents include the corporation's directors, officers, employees, and shareholders,<sup>29</sup> all of whom counsel is allowed to represent,<sup>30</sup> unless

---

<sup>20</sup> See Model Rule 1.2(d) (prohibiting an attorney from counseling or assisting a client in committing a criminal or fraudulent act).

<sup>21</sup> See Model Rule 1.13(b).

<sup>22</sup> See Model Rule 1.13(b)(1). The only option available to counsel under the Model Code is to request that the offender rectify the fraud committed upon the corporation. See Model Code DR 7-102(B)(1).

<sup>23</sup> See Model Rule 1.13(b)(2).

<sup>24</sup> See Model Rule 1.13(b)(3). Under the Model Code, whether the attorney can reveal a corporate representative's fraud to a higher authority is unclear. See George D. Reycraft, *Conflicts of Interest and Effective Representation: The Dilemma of Corporate Counsel*, 39 HASTINGS L.J. 605, 611 (1988); see also N.Y. City Bar, Formal Op. 2 (1986) (finding that disclosure does not violate the attorney's duty to keep information confidential since the corporation, not the corporate representative, is the attorney's client).

<sup>25</sup> See Model Rule 1.13(c). However, the lawyer must be certain that there is a clear violation of the law which is likely to result in substantial injury to the corporation. See *id.*

<sup>26</sup> See Model Rule 1.13(a); Model Code EC 5-18.

<sup>27</sup> See Model Rule 1.13 cmt.; see also Martin Lowy, *A Bank General Counsel: Defining a Role as Lawyer to Board of Directors?*, BANKING POL'Y REP., June 3, 1996, at 14.

<sup>28</sup> Model Rule 1.13(b).

<sup>29</sup> See Model Rule 1.13 cmt.

such representation would create a conflict of interest.<sup>31</sup> Although alleged conflicts often arise when there is dual representation of both the corporation and its directors, employees, or shareholders,<sup>32</sup> such representation is allowed under Model Rule 1.7 if (1) the interests of the constituent and the corporation are not adverse to each other, and (2) both clients consent to dual representation.<sup>33</sup>

Model Rule 1.7 also contains the premise that counsel can and should investigate new, potential clients (i.e., the directors, employees, or shareholders) to see if representation of them would be adverse to representing the existing client (i.e., the corporation).<sup>34</sup> In the usual in-house setting, however, counsel is not looking to add new clients since he or she already has one particular client—the corporation. Instead, the usual scenario is that one of the corporation's constituents to whom counsel may owe a perceived duty of loyalty "through the derivative relationship with the corporate client"<sup>35</sup> suddenly appears with a legitimate problem. Alternatively, an attorney-client relationship may be created without the intentional knowledge of counsel,<sup>36</sup> especially "given the frequent ambiguity of the relationship between an entity's lawyer and its individual constituents."<sup>37</sup>

<sup>30</sup> See Model Rule 1.13(e); Model Code EC 5-18.

<sup>31</sup> See Model Rule 1.13(e); Model Code EC 5-18. If there is a conflict of interest, then counsel must explain to the non-entity party the identity of the client (i.e., the corporation). See Model Rule 1.13(d). However, dual representation is still allowed if consent is provided by either the shareholders or "an appropriate official of the organization other than the individual who is to be represented." Model Rule 1.13(e).

<sup>32</sup> Accord H. Ward Classen, *Lawyers Share Views on Ethical Concerns for In-House Counsel*, NAT'L L.J., Aug. 30, 1993, at S16.

<sup>33</sup> See Model Rule 1.7. The Code is even more forceful in disallowing multiple representation. See Model Code DR 5-105.

<sup>34</sup> See Model Rule 1.7; Thomas B. Metzloff, *Ethical Considerations for the Corporate Legal Counsel*, C566 A.L.I.-A.B.A. COURSE OF STUDY 109, 115 (1990).

<sup>35</sup> *Id.* at 115.

<sup>36</sup> See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 26 (Proposed Final Draft No. 1, 1996), which states:

A relationship of client and lawyer arises when:

(1) A person manifests to a lawyer the person's intent that the lawyer provide legal services for the person; and either

(a) the lawyer manifests to the person consent to do so; or

(b) the lawyer fails to manifest lack of consent to do so, and the lawyer knows or reasonably should know that the person reasonably relies on the lawyer to provide the services; or

(2) a tribunal with power to do so appoints the lawyer to provide the services.

*Id.* (emphasis added).

<sup>37</sup> Nancy J. Moore, *Expanding Duties of Attorneys to "Non-Clients": Reconceptualizing the Attorney-Client Relationship in Entity Representation and Other Inherently Ambiguous Situations*, 45 S.C. L. REV. 659, 673 (1994).

Historically, third parties could not sue attorneys for alleged harm since there was no privity.<sup>38</sup> Recently, some states have passed statutes or there have been court decisions which allow third parties to sue professionals without having any privity of contract.<sup>39</sup> Consequently, the number of third parties suing attorneys for alleged malpractice has been increasing,<sup>40</sup> with about one-fourth of all claims against attorneys being by someone other than the attorney's client.<sup>41</sup> Although in-house counsel have only one client—the corporation—they actually have a greater potential of incurring liability from third parties since the corporation is not the only one who relies on the advice of counsel.<sup>42</sup> Although still a minority view, the increasing number of cases which find third-party liability generally do so under one of three alternatives: (1) the corporation's purpose in retaining counsel was to benefit a third party directly,<sup>43</sup> (2) it was foreseeable that the third party would rely on the attorney's advice,<sup>44</sup> and/or (3) the third party was a foreseeable beneficiary of the attorney's advice.<sup>45</sup> Some courts use an approach which balances several of these factors.<sup>46</sup>

---

<sup>38</sup> See 1 MALLIN & SMITH, *supra* note 2, § 7.1, at 490; see, e.g., *Gaar v. North Myrtle Beach Realty Co.*, 339 S.E.2d 887, 889 (S.C. Ct. App. 1986) (holding that the attorney's liability is only to his client and not to third persons whose claims arise from representation of the client).

<sup>39</sup> See, e.g., CAL. CIV. CODE § 1714 (West 1998). *But see*, FLA. STAT. ANN. § 95.11(4)(a) (West 1998) (requiring privity for a malpractice action in either tort or contract); *Green Springs Farms v. Kersten*, 401 N.W.2d 816, 826 (Wis. 1987) (stating that a third-party cannot sue an attorney since the state has not recognized a cause of action when no privity exists). It should be noted, however, that counsel will not be liable for one constituent's breach of fiduciary duty against another constituent. *Accord* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 155 cmt. g (Tentative Draft No. 8, 1997).

<sup>40</sup> See Laura Callaway Hart et al., *From Offense to Defense: Defending Legal Malpractice Claims*, 45 S.C. L. REV. 771, 781 (1994).

<sup>41</sup> See A.B.A. STANDING COMMITTEE ON LAW. PROF. LIABILITY, *PROFILE OF LEGAL MALPRACTICE* 44-58 (1986).

<sup>42</sup> See Brian E. Fliflet, *Third Party Suits May Leave In-House Counsel Liable*, CORP. L. TIMES, Oct. 1995, at 26.

<sup>43</sup> See, e.g., *Holmes v. Winners Entertainment, Inc.*, 531 N.W.2d 502 (Minn. Ct. App. 1995) (finding that there was no "direct" benefit to the third party since corporate counsel's services flowed through the corporation before benefitting the third party).

<sup>44</sup> See, e.g., *Atlantic Paradise Assoc., Inc. v. Perskie, Nehmad & Zeltner*, 666 A.2d 211, 214 (N.J. Super. Ct. App. Div. 1995) (stating that an attorney can be liable to a nonclient for misrepresentations in public offering statements since reliance on such is foreseeable). This foreseeability requirement ensures that counsel is not liable to someone with whom he or she does not deal at arm's length. Otherwise, the attorney would be preoccupied with the possibility of incurring liability from any unknown person with whom his or her client might deal. *Accord* *Goodman v. Kennedy*, 556 P.2d 737, 743 (Cal. 1976); *B.L.M. v. Sabo & Deitsch*, 64 Cal. Rptr. 2d 335, 346 (Cal. Ct. App. 1997).

<sup>45</sup> See Gerald J. Buchwald, *In-House Target: Third Parties are Taking Aim at Corporate Counsel*, NAT'L L.J., Nov. 15, 1993, at S1. For example, in *Fely v. Hartweg*, a minority shareholder sued the corporation's counsel, alleging that counsel breached his fiduciary duty by failing to warn him



For example, in *E.F. Hutton & Co. v. Brown*,<sup>47</sup> a corporation's outside counsel met with a corporate officer the night before an SEC hearing and accompanied the officer to the hearing. About four months later, counsel also accompanied the officer to a bankruptcy hearing. In a disqualification proceeding,<sup>48</sup> counsel argued that he could not have been the officer's personal attorney since he was required to be at the hearings to represent the corporation, and the officer was there merely as a spokesperson for the corporation.<sup>49</sup> However, the court found that the officer's belief that the corporation's counsel also represented him personally was reasonable,<sup>50</sup> and therefore, an attorney-client relationship was created wherein counsel was required to exercise independent professional judgment for both the corporation and the officer.<sup>51</sup>

Fortunately for in-house counsel, the majority of courts have not accepted this view.<sup>52</sup> For instance, in *Bobbitt v. Victorian House, Inc.*,<sup>53</sup> a

---

of fraudulent financial dealings committed by several corporate officers and shareholders which caused harm to the minority shareholder. However, the court held that the attorney was not liable to the nonclient since there was no express agreement that the minority shareholder was intended to be a beneficiary of the contract between the attorney and the corporation. 523 N.E.2d 555, 557 (Ill. App. Ct. 1988). The court in *Skarbrevik v. Cohen, England & Whitfield*, went even further and stated that even if the attorney "could have foreseen the adverse consequences of his advice and its impact on [the shareholder] is not sufficient justification for fixing liability on him to a nonclient shareholder." 282 Cal. Rptr. 627, 637 (Cal. Ct. App. 1991).

<sup>46</sup> See, e.g., *Donahue v. Shughart, Thomason & Kilroy, P.C.*, 900 S.W.2d 624, 629 (Mo. 1995). The recent court decision listed the factors as:

- (1) the existence of a specific intent by the client that the purpose of the attorney's services were to benefit the plaintiffs.
- (2) the foreseeability of the harm to the plaintiffs as a result of the attorney's negligence.
- (3) the degree of the certainty that the plaintiffs will suffer injury from attorney misconduct.
- (4) the closeness of the connection between the attorney's conduct and the injury.
- (5) the policy of preventing future harm.
- (6) the burden on the profession of recognizing liability under the circumstances.

*Id.*

<sup>47</sup> 305 F. Supp. 371 (S.D. Tex. 1969).

<sup>48</sup> Although this was not a case in which liability was being alleged against counsel, it demonstrates how an attorney-client relationship can be created unknowingly, which could potentially lead to liability if counsel fails to adequately represent his or her client.

<sup>49</sup> See 305 F. Supp. at 388.

<sup>50</sup> The court emphasized that "not all corporate counsel appearing with corporate officers who are called to testify will risk disqualification." *Id.* at 398. Instead, the court put the onerous on counsel to ensure that the officer did not misunderstand whom counsel was representing. See *id.*

<sup>51</sup> See *id.* at 396; see also *Meyer v. Mulligan*, 889 P.2d 509, 515 (Wyo. 1995) (holding that an issue of fact existed as to whether counsel for a close corporation also represented an officer of the corporation).

<sup>52</sup> See *Moore*, *supra* note 37, at 684; see also *Hart*, *supra* note 40, at 781.

<sup>53</sup> 545 F. Supp. 1124, 1125 (N.D. Ill. 1982).

50 percent shareholder/director sought to disqualify an attorney from representing the corporation because he believed that the attorney also represented him personally.<sup>54</sup> The court, however, found that the attorney's work for the shareholder/director was primarily corporate related and that those were the only matters for which advice was sought; therefore, the shareholder-director could not have had a reasonable belief that the attorney also represented him personally.<sup>55</sup>

Some courts have gone so far as to require an express contract before finding that corporate counsel represents one of the corporation's constituents. For example, in *Torres v. Divis*,<sup>56</sup> an investor who subsequently took over a business sued the attorney who handled the incorporation procedures.<sup>57</sup> The investor claimed that the attorney was liable for malpractice because the attorney failed to inform him about numerous debts that the business had previously incurred.<sup>58</sup> He claimed that the attorney personally represented him and thus, filed a malpractice suit for negligence.<sup>59</sup> However, the court held that there was no attorney-client relationship because such a relationship arises "only when both the attorney and client have consented to its formation," which did not occur here because there was no evidence that the attorney expressly agreed to represent the investor.<sup>60</sup>

## 1. DIRECTORS & OFFICERS

Corporate counsel oftentimes are asked to advise the directors and officers of a corporation about the personal liability which they may incur if they agree to enter into a particular transaction or take certain corporate actions. Depending on the circumstances, a director or officer may believe that the in-house attorney is providing the advice as his or her personal attorney. Thus, they may sue the in-house attorney if they are later held liable.

For example, in *Waggoner v. Snow, Becker, Kroll, Klaris & Krauss*,<sup>61</sup> the CEO of a corporation hired counsel who initially reincorporated a corporation in Delaware and drafted a shareholders' agreement three years

---

<sup>54</sup> See *id.* at 1125.

<sup>55</sup> See *id.* at 1126-28; see also *infra* Part II.B.3 and accompanying text (discussing the creation of an attorney-client relationship in close corporations).

<sup>56</sup> 494 N.E.2d 1227 (Ill. App. Ct. 1986).

<sup>57</sup> See *id.* at 1229-31.

<sup>58</sup> See *id.* at 1230.

<sup>59</sup> See *id.* at 1230-31.

<sup>60</sup> See *id.* at 1231.

<sup>61</sup> 991 F.2d 1501 (9th Cir. 1993).

later to transfer voting control of the corporation to the CEO.<sup>62</sup> Subsequently, when the corporation's board of directors learned that the CEO had violated his fiduciary duties and removed him from office, the CEO asked counsel whether his shareholder voting rights entitled him to remove the rest of the board.<sup>63</sup> Counsel replied that the CEO had such voting rights; however, a court found that the shareholder agreement was improperly drafted.<sup>64</sup> Consequently, the CEO filed a malpractice action against the attorney claiming that counsel represented him personally as an officer of the corporation and that he relied on such representation.<sup>65</sup> The court, however, found that counsel did not personally represent the CEO because he did not affirmatively assume a duty toward the officer, despite the officer's reliance on the advice.<sup>66</sup>

A minority of courts have held counsel liable to a corporation's directors. For instance, in *Collins v. Fitzwater*,<sup>67</sup> counsel was retained to draft promissory notes according to a board-approved financing plan.<sup>68</sup> After the corporation became insolvent, purchasers of the notes sued the corporation and its directors, alleging that the corporation's attorney improperly drafted the notes because the notes were securities that had been sold without being registered.<sup>69</sup> Consequently, the directors were held jointly and severally liable to the purchasers for damages, and the directors sued the corporate counsel for malpractice.<sup>70</sup> The court held that the attorney was liable because he negligently failed to advise the directors that they might incur personal liability if unregistered securities were sold.<sup>71</sup>

---

<sup>62</sup> See *id.* at 1503.

<sup>63</sup> See *id.* at 1504.

<sup>64</sup> See *id.*

<sup>65</sup> See *id.* at 1504-05.

<sup>66</sup> See *id.* at 1508; see also *Robertson v. Baston Snow & Ely Bartlett*, 536 N.E.2d 344, 348 (Mass. 1989) (holding that, even if an attorney-client relationship was created between a corporate officer and the law firm representing the corporation, there would be no liability since the officer did not reasonably rely on the law firm's representation); *Innes v. Howell Corp.*, 76 F.3d 702, 711 (6th Cir. 1996) (upholding a jury's verdict against an officer when it found that the corporation's counsel did not personally represent the officer since actions he took on behalf of the officer in respect to environmental litigation were done for the corporation's benefit).

<sup>67</sup> 560 P.2d 1074 (Or. 1977), *overruled on other grounds*, *Lancaster v. Royal Ins. Co.*, 726 P.2d 371 (Or. 1986).

<sup>68</sup> See *id.* at 1075-76.

<sup>69</sup> See *id.* at 1076.

<sup>70</sup> See *id.*

<sup>71</sup> See *id.* But see *Hile v. Firmin, Sprague & Huffman Co.*, 595 N.E.2d 1023, 1026 (Ohio Ct. App. 1991) (holding that counsel was not liable to directors by failing to advise them of their potential personal liability for failing to remit state sales taxes because, unlike *Collins*, counsel did not act negligently to the corporation).

The majority of courts will find that an in-house attorney personally represents an officer or director only when there is formal consent to such a relationship. For example, in *Budd v. Nixen*,<sup>72</sup> an attorney was hired to defend a corporation against a contract dispute.<sup>73</sup> The president of the corporation also retained the attorney to represent him personally, and the attorney filed an answer denying that the president was personally liable.<sup>74</sup> However, counsel failed to assert a defense that the president only signed the contract in his official, representative capacity and therefore, was not personally liable for the breach of contract.<sup>75</sup> Consequently, the court found that the attorney could face an action for legal malpractice for failing to adequately represent his client, the president.<sup>76</sup>

Generally, courts find that "[t]he fact that an attorney represents a corporation does not thereby make that attorney counsel to the individual officers and directors thereof."<sup>77</sup> This helps to ensure that the attorney acts in the best interests of the corporation. Since the corporation is his or her client, in-house counsel who does not consent to represent an officer or director should not be held liable merely because the officer or director mistakenly believed that the attorney provided personal representation. To ensure that a future dispute does not arise, however, corporate counsel should advise early in the communication that his or her primary loyalty belongs to the corporation.<sup>78</sup>

## 2. EMPLOYEES

Sometimes if a cause of action is brought against both the corporation and an employee, the corporation will want in-house counsel to represent both the corporate and individual defendant.<sup>79</sup> However, because counsel's primary duty is to the entity and the defenses asserted by each client may be different, counsel's representation of the employee may be less effective than if the employee obtained his or her own counsel.<sup>80</sup> Such a situation

---

<sup>72</sup> 491 P.2d 433 (Cal. 1971), *superseded by statute on other grounds as stated in* Laird v. Blacker, 279 Cal. Rptr. 700 (Cal. Ct. App. 1991).

<sup>73</sup> *See id.* at 434.

<sup>74</sup> *See id.* at 435.

<sup>75</sup> *See id.*

<sup>76</sup> *See id.* at 438.

<sup>77</sup> *Stratton Group v. Sprayregen*, 466 F. Supp. 1180, 1184 n.3 (S.D.N.Y. 1979).

<sup>78</sup> *See infra* Part IV.A (discussing the actions which counsel should undertake when a constituent requests advice about personal liability).

<sup>79</sup> *See Hardin & Lee, supra* note 3, at 37. This provides the corporation with assurance that the events in question are presented in a unified manner. *See* C. Evan Stewart, *For In-House Counsel, Serving Two Masters Raises Ethical Issues: What are the Constraints on Multiple Representation?*, NAT'L L. J., Aug. 30, 1993, at S19.

<sup>80</sup> *See Hardin & Lee, supra* note 3, at 37.

could result in the employee filing a malpractice claim against the corporate counsel, alleging ineffective representation. One reason for the significant increase in malpractice actions against counsel is due to the increasing number of layoffs at corporations<sup>81</sup> and the increasing number of sexual discrimination lawsuits,<sup>82</sup> both of which make counsel more prone to lawsuits by disgruntled employees.<sup>83</sup>

For example, in *Goerlich v. Courtney Industries, Inc.*,<sup>84</sup> a person who was a shareholder and an employee of a corporation was fired and sued the corporation claiming breach of a shareholder's agreement which allegedly gave him employment for the duration of the corporation's existence.<sup>85</sup> After losing that suit, the former employee/shareholder sued the corporation's counsel alleging malpractice in drafting the document.<sup>86</sup> The court, however, held that the attorney was not liable to the employee because the corporation—not the corporate counsel—hired the employee.<sup>87</sup>

Claims for sexual harassment are another area of the law where the issue of joint representation frequently arises since both the harasser/employee and corporation/employer are both often named as defendants.<sup>88</sup> The attorney's first step in deciding whether to undertake dual representation is to determine whether the corporation's and employee's interests are adverse to each other. In sexual harassment cases, there are two types of claims which can be raised: (1) *quid pro quo* claims, and (2) a claim for hostile work environment.<sup>89</sup>

In a *quid pro quo* claim, a supervisor conditions employment benefits on a subordinate employee's submission to sexual favors.<sup>90</sup> The corporation is automatically liable for the supervisor's acts because the corporation is strictly liable for the acts of its agents.<sup>91</sup> The supervisor, in particular, may request that in-house counsel defend him against the

---

<sup>81</sup> See, e.g., *Announced Layoffs Up: 230,350 Job Cuts So Far in 96*, CHI. TRIB., June 11, 1996, at 3 (noting that job cuts were 6.5% greater than during the same period in 1993, which was the year in which the most downsizing in a decade occurred).

<sup>82</sup> See, e.g., Kim Stronsnider, *Businesses Buy Insurance to Protect Against*, PORTLAND PRESS HERALD, Oct. 13, 1996, at 1F (describing how sexual discrimination and harassment complaints have increased 45% in the past decade in Maine).

<sup>83</sup> See Fliflet, *supra* note 42, at 26.

<sup>84</sup> 581 A.2d 825 (Md. Ct. Spec. App. 1990).

<sup>85</sup> See *id.* at 826.

<sup>86</sup> See *id.*

<sup>87</sup> See *id.*

<sup>88</sup> See Thomas J. Griffith, *Ethical Considerations in the Employee Relations Context*, in CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS 5.001, 5.042 (Business Laws, Inc. ed., 1996).

<sup>89</sup> See Carrie A. Bond, Note, *Shattering the Myth: Mediating Sexual Harassment Disputes in the Workplace*, 65 FORDHAM L. REV. 2489, 2492 (1997).

<sup>90</sup> See *id.*

<sup>91</sup> See *id.* at 2497.

accusation made by the employee. Dual representation of the corporation and the supervisor would likely be acceptable since the interests of each client would not be adverse due to the automatic liability of the employer if the employee is found liable.<sup>92</sup>

A hostile work environment claim arises when an employee is subjected to unwelcome sexual harassment in the workplace.<sup>93</sup> The accused corporation can eliminate its liability by immediately taking actions to remedy the situation; the employee, however, can still be held individually liable for sexual harassment.<sup>94</sup> The interests of each party in a sexual harassment case would likely be adverse since the corporation and the employee would each have different defenses.<sup>95</sup> Therefore, in-house counsel would be precluded from undertaking the dual representation. If counsel decided to represent both the employee and the corporation, then the attorney may be subjected to a malpractice claim by the employee for ineffective representation since counsel's primary loyalty belongs to the corporation.

Sometimes, to represent the corporation fully, counsel may have to conduct an internal investigation and question an employee. Such questioning may lead to helpful information for the corporation's defense but could be potentially harmful to the employee—possibly because the employee thought that the attorney provided personal representation and was also looking out for his or her best interests. The employee may consequently sue the in-house attorney for inadequate representation.<sup>96</sup> Thus, to reduce potential liability, counsel must always inform the employee to whom his or her primary responsibility belongs (i.e., the entity).<sup>97</sup>

Furthermore, such an investigation could lead to tort liability being imposed upon counsel for alleged false or defamatory statements that were made because of facts which materialized during the investigation. For example, in *Pearce v. E.F. Hutton Group, Inc.*,<sup>98</sup> corporate counsel conducted an internal investigation of a corporation, wherein he found that an employee was responsible for fraudulent conduct which caused the corporation to incur liability.<sup>99</sup> The employee was eventually dismissed

---

<sup>92</sup> See *id.*

<sup>93</sup> See *id.* at 2492.

<sup>94</sup> See *id.* at 2497.

<sup>95</sup> For example, the main defense of the corporation would be that it took action to remedy the situation once it learned of the alleged harassment. See *id.* In contrast, the employee would likely deny any liability.

<sup>96</sup> See Honig, *supra* note 7, at 8.206.

<sup>97</sup> See *infra* Part IV.A (discussing the attorney's disclosure responsibilities).

<sup>98</sup> 664 F. Supp. 1490 (D.D.C. 1987).

<sup>99</sup> See *id.* at 1493.

from his position and state securities regulators more closely monitored his conduct thereafter.<sup>100</sup> The employee sued the corporation's counsel for libel, invasion of privacy, and misappropriation of the employee's name. The court held that the employee's claim for compensatory (but not punitive) damages had sufficient merit to warrant a denial of counsel's summary judgment motion, thereby suggesting that a corporation's attorney may incur liability for conducting an internal investigation,<sup>101</sup> which is one responsibility of in-house attorneys.

There has been a slight increase in the number of lawsuits (frequently for defamation) filed against corporate counsel when employees are terminated.<sup>102</sup> Fortunately for in-house counsel, there have been very few cases which have held counsel liable. Nonetheless, because of the increased exposure to liability, many corporations more frequently prohibit their in-house attorneys from representing employees.<sup>103</sup> This seems the most equitable course of action since it ensures that both the employee and the corporation receive independent, objective advice and are fully represented. Since corporate employees act on behalf of the corporation, however, they should receive advice from the corporation's counsel when requested.<sup>104</sup> Instead of having in-house counsel provide the advice, a better option would be for the corporation to pay separate representation for its employees instead of risking a potential conflict of interest situation for the corporation's counsel.<sup>105</sup>

### 3. SHAREHOLDERS

The most significant area of corporate law in which third-party liability has been imposed on attorneys includes securities offerings and commercial deals.<sup>106</sup> The third party who oftentimes attempts to bring a mal-

---

<sup>100</sup> See *id.* at 1493-94.

<sup>101</sup> See *id.* at 1517. A federal jury subsequently exonerated the corporate counsel. See *Griffen Bell, in Speech to Corporate Counsel, Says CEO of the Future will be Trained to Disclose Everything in the Wake of Disaster*, CORP. CRIME REP., Nov. 13, 1989, at 1 [hereinafter *Griffen Bell*].

<sup>102</sup> See, e.g., *Mandelblatt v. Perelman*, 683 F. Supp. 379, 380 (S.D.N.Y. 1988) (noting the "growing number of suits seeking to redress adverse employment action on a theory of defamation").

<sup>103</sup> See Ruth L. Tkacz, *In-House Ethics*, in *CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS* 1.701, 1.706 (Business Laws, Inc. ed., 1996).

<sup>104</sup> Metzloff, *supra* note 34, at 116. One commentator has suggested that corporate employees could be considered quasi- or "derivative" clients. 1 GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, *THE LAW OF LAWYERING* § 1.3:108 (2d ed. 1997).

<sup>105</sup> The Model Rules allow a corporation to pay for an employee's or director's representation when corporate counsel's representation would create a conflict of interest, providing that both clients consent and such a situation maintains counsel's professional independence. See Model Rule 1.7 cmt.

<sup>106</sup> See Buchwald, *supra* note 45, at S1; 1 HAZARD & HODES, *supra* note 104, § 7.1, at 490 (stating that counsel face "enormous financial exposure" to nonclients for claims involving large

practice action is an investor—either a bondholder or stockholder—who has a claim based on a violation of the securities laws,<sup>107</sup> fraud,<sup>108</sup> or negligence.<sup>109</sup> For instance, in *Egan v. McNamara*,<sup>110</sup> the estate of a majority shareholder in a close corporation wanted to rescind an agreement made between the shareholder and the corporation.<sup>111</sup> The estate claimed that the corporation's attorney (who was also a director and shareholder of the corporation) breached his duty to both the corporation and the deceased shareholder, whom the estate claimed the attorney also represented.<sup>112</sup> Despite numerous prior representations by the attorney for the deceased shareholder,<sup>113</sup> the court cited an ethical code section similar to Model Rule 1.13 and held that the attorney "represents the entity, not its individual shareholders, officers and directors," thereby finding that the attorney's primary concern was to protect the best interests of the corporation.<sup>114</sup>

In a case factually similar to *Egan*, the court in *Fassihi v. Sommers, Schwartz, Silver, Schwartz & Tyler, P.C.*,<sup>115</sup> also found that no attorney-client relationship was created when the attorney who drafted an agreement for two members of a professional corporation assisted one of the fifty percent shareholders in ousting the other.<sup>116</sup> Instead, the court found that the attorney had a fiduciary relationship with the ousted shareholder who placed his faith, confidence, and trust in the attorney's judgment and advice.<sup>117</sup> Consequently, the ousted shareholder's fraudulent concealment claim against the corporate attorney was allowed to proceed on the theory that counsel failed to reveal his dual representation of the corporation and the other shareholder.<sup>118</sup>

---

commercial transactions and "significant exposures" under the securities laws).

<sup>107</sup> See, e.g., *Zendell v. Newport Oil Corp.*, 544 A.2d 878 (N.J. Super. App. Div. 1988) (holding that counsel may be held liable to investors for an illegal offering of unregistered securities).

<sup>108</sup> See 1 MALLIN & SMITH, *supra* note 2, § 8.8.

<sup>109</sup> See, e.g., *Schmidt v. Frankewich*, 819 P.2d 1074 (Colo. Ct. App. 1991) (shareholders who guaranteed corporate debt); *Renovitch v. Kaufman*, 905 F.2d 1040 (7th Cir. 1990) (investors who sued for securities violations and fraud).

<sup>110</sup> 467 A.2d 733 (D.C. 1983).

<sup>111</sup> See *id.* at 736-37.

<sup>112</sup> See *id.* at 738.

<sup>113</sup> See *id.* at 736 (describing the personal services as preparing tax returns, drafting wills, and forming various corporations).

<sup>114</sup> *Id.* at 738.

<sup>115</sup> 309 N.W.2d 645 (Mich. Ct. App. 1981).

<sup>116</sup> See *id.* at 648.

<sup>117</sup> See *id.*

<sup>118</sup> See *id.* at 649; see also *Schaeffer v. Cohen, Rosenthal, Price, Mirkin, Jennings & Berg, P.C.*, 541 N.E.2d 997, 1002 (Mass. 1989) (stating that "it is fairly arguable that an attorney for a close corporation owes a fiduciary duty to the individual shareholders").



In some cases, corporate counsel have also been found to owe a duty to protect the interests of minority shareholders. For instance, in *Delano v. Kitch*,<sup>119</sup> a one-third shareholder who was also a director and officer of a corporation had the corporation's counsel find a buyer for the corporation's stock.<sup>120</sup> In return, counsel demanded the right to impose a finder's fee to which the director/officer/shareholder agreed.<sup>121</sup> Subsequently, counsel found a buyer who purchased a majority of the stock, which induced the plaintiffs to sell their stock.<sup>122</sup> Those minority shareholders, however, brought a breach of fiduciary duty action against the corporate attorney because of his failure to inform them about the finder's fee. Counsel argued that he did not breach a fiduciary duty allegedly owed to the minority shareholders and, furthermore, he actually benefitted them by finding a buyer to whom they were able to sell their shares on the same terms as the majority shareholders.<sup>123</sup> The court, nonetheless, agreed with the minority shareholders and held that counsel did breach his fiduciary duty since he "violated an established rule that no fiduciary or agent may serve his own interests or those of a third party by accepting a secret commission from the third party."<sup>124</sup>

Each of the above cases involved shareholders of close corporations.<sup>125</sup> While the entity concept embodied in the Model Rules may be sufficient for large, public corporations, it is often difficult to apply to small, closely-held corporations.<sup>126</sup> This results from the often difficult situation which arises in close corporations of attempting to distinguish between the identities of shareholders and the corporation. Thus, some courts have been more willing to dispel with the entity representation theory in close corporations. For example, in *In re Banks*,<sup>127</sup> an attorney drafted a ten-year employment contract for the "creator, organizer, founder, chief executive, and driving force" of a close, family-held corporation which was also partly owned by his wife and two daughters.<sup>128</sup> In addition, the attorney did personal work for the family, such as drafting their wills and planning their

---

<sup>119</sup> 663 F.2d 990 (10th Cir. 1981).

<sup>120</sup> *See id.* at 994.

<sup>121</sup> *See id.*

<sup>122</sup> *See id.*

<sup>123</sup> *See id.* at 996.

<sup>124</sup> *See id.* at 998-99.

<sup>125</sup> A close corporation generally has three attributes: (1) non-publicly traded shares, (2) small number of shareholders, and (3) the officers, directors, and shareholders are the same individuals. *See* PAT K. CHEW, *DIRECTORS' AND OFFICERS' LIABILITY* 213 (1996).

<sup>126</sup> *See* Lawrence E. Mitchell, *Professional Responsibility and the Close Corporation: Toward a Realistic Ethic*, 74 CORNELL L. REV. 466, 469 (1989).

<sup>127</sup> 584 P.2d 284 (Or. 1978).

<sup>128</sup> *Id.* at 285.

estate.<sup>129</sup> After the rest of the family gained control of the corporation and took actions against the principal, the principal brought disciplinary charges against the attorney because of an allegedly ineffective employment contract, which the attorney argued that he drafted in his capacity as a representative of the corporation, not the principal.<sup>130</sup> However, the court did not apply the theory of entity representation to the close corporation because “[a]t the time of the drawing of the contract [the principal] was the corporation.”<sup>131</sup> Thus, the court held that “[i]n such a situation, . . . common sense dictates that the corporate entity should be ignored.”<sup>132</sup>

More definitively, in *In re Kinsey*,<sup>133</sup> the court noted that the entity theory in a closely-held corporation would be disregarded only “where the controlling stockholder was the corporation.”<sup>134</sup> *Kinsey* involved a shareholder derivative suit brought by a minority shareholder against the majority shareholders/directors for an alleged usurpation of a corporate opportunity, which the majority shareholders allegedly accomplished with the assistance of the corporation’s attorney.<sup>135</sup> The court upheld the state bar’s disciplinary claim against the attorney because he breached his duty owed to the corporation when he represented the majority shareholders in an action against the corporation.<sup>136</sup>

Thus, while there is a presumption that corporate attorneys only represent the close corporation, the presumption is rebuttable.<sup>137</sup> As the above cases demonstrate, the situation can arise where counsel may unwittingly have not one, but several clients. This again leads to the problem of determining if an attorney-client relationship is created. For example, in *Rosman v. Shapiro*,<sup>138</sup> two shareholders who each owned fifty percent of a corporation consulted an attorney to create a distribution contract for the corporation.<sup>139</sup> However, a disagreement developed between the two shareholders, and the corporation’s attorney became the

---

<sup>129</sup> See *id.*

<sup>130</sup> See *id.* at 291-92.

<sup>131</sup> *Id.* at 290.

<sup>132</sup> *Id.*

<sup>133</sup> 660 P.2d 660 (Or. 1983).

<sup>134</sup> *Id.* at 670 n.10.

<sup>135</sup> See *id.* at 661-62.

<sup>136</sup> See *id.* at 671.

<sup>137</sup> See, e.g., *Bobbitt v. Victorian House, Inc.*, 545 F. Supp. 1124, 1126 (N.D. Ill. 1982) (stating that “representing [a close] corporation does not inherently mean also acting as counsel to the individual directors-shareholders”). Clearly, an attorney who represents only one shareholder in a close corporation and not the corporation itself does not owe a fiduciary duty to the other shareholders. See, e.g., *Kurker v. Hill*, 689 N.E.2d 833, 836 (Mass. App. Ct. 1998).

<sup>138</sup> 653 F. Supp. 1441 (S.D.N.Y. 1987).

<sup>139</sup> See *id.* at 1444.

individual attorney for one of the shareholders.<sup>140</sup> The other shareholder subsequently sought to disqualify the attorney from the individual representation because he believed that the counsel was also representing him individually, thereby creating a conflict of interest.<sup>141</sup> The court agreed and stated that, when there is a close corporation whose shareholders each have an equally proportionate ownership interest, it is reasonable for each shareholder to believe that the attorney represents him or her individually.<sup>142</sup>

The majority of courts have held that minority shareholders do not have a cause of action for malpractice against the corporate attorney. For instance, in *Palmer v. Fox Software, Inc.*,<sup>143</sup> a minority shareholder sued the corporation's attorney for malpractice, alleging a breach of duty resulting from his assisting corporate officers in allegedly usurping a corporate opportunity.<sup>144</sup> The shareholder claimed that, because counsel had previously provided personal services to him regarding business and family affairs, he relied on the attorney's advice.<sup>145</sup> However, the court held that insufficient evidence existed to demonstrate that personal reliance on the advice provided to the corporation was reasonable; thus, the court held that the shareholder had no direct cause of action for malpractice and that it had to be derivative.<sup>146</sup>

Whether an attorney-client relationship will be created with a shareholder in a close corporation will depend on the facts of each individual case.<sup>147</sup> The confusion and uncertainty results from the inability of the Model Rules or Model Code to provide guidance to a corporate form

<sup>140</sup> See *id.* at 1443-45.

<sup>141</sup> See *id.* at 1445.

<sup>142</sup> See *id.*; see also *Farrington v. Law Firm of Sessions, Fishman*, 687 So. 2d 997, 997 (La. 1997) (suit by a 50% shareholder alleging (1) breach of fiduciary duty in failing to provide advice about the corporate structure, and (2) a conflict of interest against an attorney who represented the corporation and the other shareholder in enjoining her from allegedly causing harm to the corporation).

<sup>143</sup> 107 F.3d 415 (6th Cir.), *cert. denied*, 1997 WL 437076 (U.S. Oct. 6, 1997) (No. 97-57).

<sup>144</sup> See *id.* at 416.

<sup>145</sup> See *id.* at 420.

<sup>146</sup> See *id.* at 420-21.

<sup>147</sup> See A.B.A. Comm. on Ethics and Professional Responsibility, Formal Op. 361, at 6 (1991).

Factors to be considered include:

whether the lawyer affirmatively assumed a duty of representation to the individual [shareholder], whether the [individual] was separately represented by other counsel when the [corporation] was created or in connection with its affairs, whether the lawyer had represented an individual [shareholder] before undertaking to represent the [corporation], and whether there was evidence of reliance by the individual [shareholder] on the lawyer as his or her separate counsel, or evidence of the [shareholder's] expectation of personal representation.

*Id.* Cf. Mitchell, *supra* note 126, at 506-08 (proposing a rule for close corporations whereby counsel for the corporation automatically becomes counsel for each individual shareholder unless instructed to the contrary).

which is treated more like a partnership than an entity.<sup>148</sup> The key is to ensure that counsel who represents the corporation “does *not* thereby (and without more) become the lawyer for any of the entity’s members, agents, officers or other . . . constituents.”<sup>149</sup> Most courts do not appear willing to extend the attorney-client relationship beyond the corporate entity to other constituents.<sup>150</sup> Nonetheless, corporate counsel for small corporations should undertake a special effort to clarify whether he or she represents either the entity or its individual members, or both.<sup>151</sup>

### C. Attorney-Director Conflicts

The number of counsel who serve on the board of directors of their corporate employers has been declining during recent years,<sup>152</sup> although about seventeen percent of all public companies have their corporate counsel serve on the corporation’s board.<sup>153</sup> Despite the inherent conflict

---

<sup>148</sup> See Mitchell, *supra* note 126, at 470-71. The Model Rules also failed to address the fact that the entity theory has been disregarded for partnerships. See 1 HAZARD & HODES, *supra* note 104, § 1.13:102, at 390.

<sup>149</sup> See 1 HAZARD & HODES, *supra* note 104, § 1.13:102; see also Lee v. Mitchell, 953 P.2d 414, 426 (Or. Ct. App. 1998) (stating that “the mere existence of an attorney-client relationship between a corporation and an attorney does not in itself create an attorney-client relationship or any other basis for fiduciary duties between the attorney and a corporate stockholder”); ABA Comm. on Ethics and Professional Responsibility, Formal Op. 361, at 3 (1991) (describing how, when an attorney represents a partnership, an attorney-client relationship between an individual partner and the attorney is not automatically created); accord Meehan v. Hopps, 301 P.2d 10, 13 (Cal. Ct. App. 1956) (stating that an attorney representing the corporation does not automatically become liable to a corporate officer merely because of his corporate representation); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 155 cmt. b (Tentative Draft No. 8, 1997).

<sup>150</sup> See Moore, *supra* note 37, at 679. Those jurisdictions which do recognize attorney liability to nonclients take a case-by-case approach in determining whether the attorney should be held liable. See, e.g., Delano v. Kitch, 663 F.2d 990 (10th Cir. 1981). However, as one court stated, to allow suits by third parties in all cases “could conceivably encourage a party to contractual negotiations to forego personal legal representation and then sue counsel representing the other contracting party for legal malpractice if the resulting contract later proves disfavorable in some respect.” Chalpin v. Brennan, 559 P.2d 680, 682 (Az. Ct. App. 1976). But see Donnelly Constr. Co. v. Oberg/Hunt/Gilleland, 677 P.2d 1292, 1296 (Az. 1984) (requiring that a case-by-case approach must be used to determine whether professionals should be liable to third parties).

<sup>151</sup> See 1 HAZARD & HODES, *supra* note 104, § 1.13:104, at 391.

<sup>152</sup> See Robert P. Cummins & Megyn M. Kelly, *The Conflicting Roles of Lawyer as Director*, LITIG., Fall 1996, at 48 (noting the declining number of counsel who sit on boards); Barbara Franklin, *Cutting Their Losses: Insurers Seek to Limit Exposure Due to Lawyers*, N.Y. L.J., June 27, 1991, at 5 (stating that the number of lawyers serving on boards of directors has been declining over the last ten years).

<sup>153</sup> See Gail Diane Cox, *For Lawyers Lure of the Boardroom Has Its Perils: Serving on a Client’s Board Can Lead to Conflicts that Could Get an Attorney Fired or Sued*, NAT’L L.J., July 1, 1996, at B1. Specifically, 78 out of the 250 largest industrial corporations in the United States had corporate counsel who served on their corporate clients’ board, as did nearly half of the nation’s largest

that can arise by undertaking the dual role, the Model Rules currently permit it.<sup>154</sup> Furthermore, after a recent two-year study, the ABA concluded that such a relationship should not be prohibited, but stated that it should be discouraged in most circumstances.<sup>155</sup>

Some corporations prefer having counsel serve on the corporations board of directors for several reasons. First, it allows counsel to become more knowledgeable about the affairs of the corporation, thereby allowing the attorney to provide more effective legal advice.<sup>156</sup> Second, since the board must be fully informed about critical issues facing the corporation, counsel can provide greater guidance sooner in the transaction, thereby heading off potentially greater problems in the future.<sup>157</sup> Third, counsel's role as a director creates a perception that he or she is an equal partner who has the same liabilities as the other directors, thereby providing the other board members with a greater level of comfort in counsel's legal advice and opinions.<sup>158</sup> Finally, serving on the board of directors allows counsel to become an integral part of the business, thereby helping to quiet the continuous questioning of the corporate legal department's necessity.<sup>159</sup>

However, the enhanced liabilities which attorney-directors face<sup>160</sup> should make counsel seriously reconsider a decision to accept a position as

financial institutions. See Dominic Bencivenga, *Corporate Boards: ABA Sees Inherent Risks in Lawyers' Dual Role*, N.Y. L.J., July 17, 1997, at 5 [hereinafter "Bencivenga, *Corporate Boards*"].

<sup>154</sup> See Model Rule 1.7 cmt.; see also RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 216 cmt. (d) (Proposed Final Draft No. 1, 1996) (allowing counsel to serve both as an attorney and director since the dual roles often compliment each other); *Niagara Fire Ins. Co. v. Pepicelli, Pepicelli, Watts & Youngs, P.C.*, 821 F.2d 216, 220-21 (3d Cir. 1987) (stating that "an attorney may simultaneously act as a lawyer and as an officer or director of a business"). But see, Code of Professional Ethics of the American Institute of Certified Public Accountants, Rule 101, Interpretation 101-1(B)(1) (specifically prohibiting accountants from serving on their clients' boards of directors).

<sup>155</sup> See Bencivenga, *Corporate Boards*, *supra* note 153, at 5.

<sup>156</sup> See James H. Cheek, III & Howard H. Lamar, III, *Lawyers as Directors of Clients: Conflicts of Interest, Potential Liability and Other Pitfalls*, 712 PRAC. L. INST./CORP. 461, 464 (1990); Watkins & Bird, *supra* note 9, at 2.203; Robert H. Mundheim, *Should Codes of Professional Responsibility Forbid Lawyers to Serve on Board of Corporation for Which They Act as Counsel*, 33 BUS. LAW. 1607 (1978) (stating that the increased liability of being both counsel and a director will ensure that counsel fully understands the corporation's business).

<sup>157</sup> See Cheek & Lamar, *supra* note 156, at 464; Watkins & Bird, *supra* note 9, at 2.203; Dominic Bencivenga, *In-House Counsel Redefine Their Corporate Role*, N.Y. L.J., June 6, 1996, at 5 [hereinafter Bencivenga, *In-House Counsel*]; Mundheim, *supra* note 156, at 1607 (stating that being both counsel and a director provides the attorney with greater access to the board and the ability to provide early warnings about potential problems).

<sup>158</sup> See Cheek & Lamar, *supra* note 156, at 464; Watkins & Bird, *supra* note 9, at 2.203.

<sup>159</sup> See Bencivenga, *In-House Counsel*, *supra* note 157, at 5.

<sup>160</sup> See Robert E. O'Malley & Harry H. Schneider, *Danger: Lawyer on Board*, 79 A.B.A. J. 102, 102 (1993). The ABA has been concerned with this problem for some time. See . . . in the Spirit

a director of the corporation which they represent. This dual role creates a problem for the attorney-director as being not only counsel to the corporation but also becoming his or her own client.<sup>161</sup> This arises because as counsel, he or she represents the corporation; however, as a board member who acts in the best interests of the corporation, counsel also becomes one of the corporation's constituencies (as a board member) whom he or she also represents derivatively. Thus, when deciding whether to sit on a client's board, counsel must ensure that the dual roles as attorney and director do not conflict and that there is not a "material risk that the dual role will compromise the lawyer's independence of professional judgment."<sup>162</sup>

For those attorneys who choose to serve as directors, the difficulties that confront them continue to increase.<sup>163</sup> In a study of outside counsel, a lawyer who also serves as a director is much more likely to be sued for legal malpractice than an attorney who is not a director of his or her client.<sup>164</sup> One reason for this enhanced liability risk results from the attorney-director being held to a higher standard of care than either a director or an attorney who each act as independent persons.<sup>165</sup> Because they are directors, attorney-directors are required to use "the care an ordinarily prudent person in a like position would exercise under similar circumstances" in fulfilling their fiduciary duties.<sup>166</sup> However, the heightened level of liability arises because of the "special background, qualifications and management responsibilities" which the attorney-director possesses since he or she is also an attorney.<sup>167</sup>

For example, in the historic case of *Escott v. BarChris Constructors Corp.*,<sup>168</sup> an attorney-director was sued in his capacity as a director because of false statements contained in the prospectus which he prepared.<sup>169</sup> In

---

of Public Service: A Blueprint for the Rekindling of Lawyer Professionalism, 112 F.R.D. 243, 281 (1986).

<sup>161</sup> See O'Malley & Schneider, *supra* note 160, at 102.

<sup>162</sup> Model Rule 1.7 cmt. However, sitting on a board automatically eliminates counsel's independence and objectiveness. See O'Malley & Schneider, *supra* note 160, at 102; see also *infra* notes 406-08 and accompanying text (discussing the independence of counsel).

<sup>163</sup> See Cummins & Kelly, *supra* note 152, at 48.

<sup>164</sup> See O'Malley & Schneider, *supra* note 160, at 102. Furthermore, many of the cases in which an attorney has been found liable for securities violations have involved general counsel who is also a director. See Harry J. Haynsworth, *The Code of Professional Responsibility, the Model Rules, and the Business Lawyer*, A.L.I.-A.B.A. COURSE OF STUDY 35, Apr. 2, 1996, at 85 n.72.

<sup>165</sup> See, e.g., *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 690 (S.D.N.Y. 1968).

<sup>166</sup> REVISED MODEL BUS. CORP. ACT § 8.30 (1994).

<sup>167</sup> *Id.*

<sup>168</sup> 283 F. Supp. 643 (S.D.N.Y. 1968).

<sup>169</sup> See *id.* at 689-90.

preparing the registration materials, the court found that the attorney had the mistaken belief that the information provided by other corporate officers was accurate.<sup>170</sup> The court held the attorney-director liable under section 11 of the 1933 Securities Act because, in his dual positions as both an attorney and a director, he should have taken steps to ensure the accuracy of the information which was provided to him.<sup>171</sup> The court further stated that this "does not establish an unreasonably high standard in other cases for company counsel who are also directors."<sup>172</sup>

Moreover, the court in *BarChris* considered the attorney-director to be an outside director.<sup>173</sup> Almost all in-house attorney-directors would likely be considered inside directors because of their presumably intimate familiarity with both the legal and business aspects of the corporation. Consequently, an in-house attorney who is also a director would have an even higher level of responsibility as an inside director. "Inside directors with intimate knowledge of corporate affairs and of the particular transactions will be expected to make a more complete investigation and have more extensive knowledge of facts supporting or contradicting inclusions in the registration statements than outside directors."<sup>174</sup> Such a person would be almost a "guarantor of accuracy" and would have no reasonable belief in relying on the statements of others.<sup>175</sup> Therefore, the potential liability for in-house counsel who serves on the board of directors is significantly greater than for a director who is not an expert in both corporate and legal matters.

For instance, in *Golden Nugget, Inc. v. Ham*,<sup>176</sup> a director and corporate counsel purchased a leasehold interest for himself when he should have known that the land was an opportunity which belonged to the corporation.<sup>177</sup> The corporation sued the attorney-director for constructive fraud, claiming that he violated the fiduciary duty which he owed to the corporation as a director.<sup>178</sup> The court agreed and held the attorney-director

---

<sup>170</sup> See *id.* at 690.

<sup>171</sup> See *id.* Although the attorney was not required to conduct a full-fledged audit of the figures, he was required to check the information which was easily verifiable. See *id.*

<sup>172</sup> *Id.* at 692.

<sup>173</sup> See *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 575 (E.D.N.Y. 1971) (noting *BarChris's* treatment of the attorney as an outside director, despite his being a director for eight months). An outside director is one who is not employed by the corporation on a full-time basis. See CHEW, *supra* note 125, at 18.

<sup>174</sup> *Feit*, 332 F. Supp. at 578.

<sup>175</sup> Folk, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 1 SEC. L. REV. 3, 25 (1969); see also *Feit*, 332 F. Supp. at 580.

<sup>176</sup> 589 P.2d 173 (Nev. 1979).

<sup>177</sup> See *id.* at 174.

<sup>178</sup> See *id.* at 175-76.

could be liable because (1) as a director, he had a duty to inform the corporation about the opportunity, and (2) as counsel, he had an additional duty to inform the corporation both about the opportunity and the corporation's rights in taking advantage of the opportunity.<sup>179</sup>

Similarly, in *Blackely v. Lisac*,<sup>180</sup> several corporate shareholders filed a class action lawsuit against, among others, the corporation's attorney-director who prepared a securities offering prospectus which contained several misrepresentations.<sup>181</sup> The attorney-director claimed that the shareholders were suing him in his capacity as an attorney, not as a director.<sup>182</sup> Consequently, the attorney used a due diligence defense, claiming that his reliance on information provided to him by the corporate officers fulfilled his fiduciary obligation.<sup>183</sup> However, the court found that, because of his dual role as both an attorney and director, his "role was . . . 'beyond a lawyer's normal one,' and he is held to even a higher standard of care."<sup>184</sup>

In addition to possible liability exposure for failing to exercise a higher standard of care, another area of potential liability for any in-house counsel, but especially for an attorney-director, arises because he or she must wear two hats: a business and a legal one. To provide sound legal advice, it is important that in-house counsel be aware of the strategic business plan and the commercial objectives to be achieved before he or she renders legal advice. Furthermore, to provide such advice competently, counsel must understand the corporation's objectives: how they were formed, how they are to be achieved, and the desired outcome.<sup>185</sup> The concern is that the attorney-director's legal advice may be evaluated based on his or her business expertise and that such business advice may be evaluated based on his legal expertise,<sup>186</sup> thereby creating problems not only for the corporation's counsel but also for the corporation itself.<sup>187</sup>

---

<sup>179</sup> See *id.* at 175.

<sup>180</sup> 357 F. Supp. 255 (D. Or. 1972).

<sup>181</sup> See *id.* at 259-60.

<sup>182</sup> See *id.* at 266.

<sup>183</sup> See 1933 Securities Act § 11(b)(3), 15 U.S.C.A. § 77 K(b)(3) (1933) (commonly referred to as the due diligence defense).

<sup>184</sup> 357 F. Supp. at 266 (quoting *SEC v. Frank*, 388 F.2d 486, 489 (2d Cir. 1968)).

<sup>185</sup> See Scott E. Squillace, *In-House Practitioners: 'Real' Lawyers?*, INT'L BUS. LAW., Dec. 1996, at 529.

<sup>186</sup> See Cummins, *supra* note 152, at 51; see also *infra* notes 388-99, 422-34 and accompanying text (discussing the problems associated with distinguishing between legal and business advice).

<sup>187</sup> One frequently litigated area concerns the attorney-client privilege and whether the advice provided is business advice (to which the privilege does not apply) or legal advice (to which the privilege does apply). The vast area of attorney-client privilege is beyond the scope of this article; however, for good discussions of the topic, see Scott R. Flucke, *The Attorney-Client Privilege in the Corporate Setting: Counsel's Dual Role as Attorney and Executive*, 62 UMKC L. REV. 549 (1994);



The easiest way to avoid potential conflicts and liabilities that could arise from attorney-director situations is simply to choose not to serve on the board. Serving as a director conflicts with the role of an attorney, which is that of an advisor. Since attorney-directors must have the knowledge of both a businessperson and a lawyer in order to fulfill the fiduciary duties in their respective capacities, they should be held to a higher standard of care than either a director or an attorney who acts in just one capacity. Thus, courts have increasingly held attorney-directors to a higher standard of care and have more frequently held them liable because of the dual knowledge which they must possess.

### III. MAJOR AREAS OF THE LAW GIVING RISE TO LIABILITY

The majority of actions brought against corporate counsel are for professional malpractice, which generally has four elements: (1) an attorney-client relationship has been created,<sup>188</sup> (2) breach of a duty, (3) proximate cause between the plaintiff's injury and the attorney's negligence, and (4) proof of actual damages caused by the negligence.<sup>189</sup> The number of malpractice claims filed have increased in frequency over the last decade.<sup>190</sup> An exhaustive list of every area of the law in which in-house counsel may be held liable is not possible. However, this section discusses some of the major areas of the law under which corporate counsel, in particular, have the greatest potential of being subjected to liability: breaching a fiduciary duty, breaching a duty owed under ERISA, violating the securities laws, aiding and abetting a director or officer in violating the law, violating the environmental laws, infringing upon intellectual property rights, committing antitrust violations, erring in commercial transactions, and providing incorrect advice in opinion letters.

#### A. Breach of Fiduciary Duty

Corporate counsel has a fiduciary relationship as an attorney with the corporation for which he or she works.<sup>191</sup> That fiduciary duty is breached

---

Business Laws, Inc., *Corporate Counsel's Guide to the Attorney-Client Privilege*, in CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS 3.001 (1996); Elizabeth G. Thornburg, *Sanctifying Secrecy: The Mythology of the Corporate Attorney-Client Privilege*, 69 NOTRE DAME L. REV. 157 (1993).

<sup>188</sup> If there is a lack of privity, then courts sometimes allow suits for a non-malpractice tort.

<sup>189</sup> See Lynn A. Epstein, *Post-Settlement Malpractice: Undoing the Done Deal*, 35 CATH. U. L. REV. 453, 462-63 (1997).

<sup>190</sup> See 1 MALLIN & SMITH, *supra* note 2, § 1.6, at 20 (noting the increasing number of malpractice claims although the rate of increase is decreasing).

<sup>191</sup> See *Bryan v. Bartlett*, 435 F.2d 28, 37 (8th Cir. 1970) (holding a corporate attorney to the same fiduciary standard as a director of the corporation); *Cf. Lane v. Chowning*, 610 F.2d 1385, 1389 (8th Cir. 1979) (reasoning that, since a bank's directors and officers owed no fiduciary duties to the

when counsel serves the interests of third parties instead of the corporation itself.<sup>192</sup> For example, in *International Community Corp. v. Young*,<sup>193</sup> a corporation's attorney was accused of breaching his fiduciary duty owed to the corporation when he prepared documents that conveyed corporate property to a trust owned by a corporate officer.<sup>194</sup> The court held that the attorney could be liable for breaching his fiduciary duty if he knew or should have known that he was assisting the corporate officer in usurping a corporate opportunity.<sup>195</sup>

In-house counsel can also be subjected to liability for failing to take sufficient actions upon learning that a corporate representative has breached a fiduciary duty, which would cause substantial harm to the corporation. Counsel has the responsibility to act with reasonable diligence in representing the corporation.<sup>196</sup> Although counsel is not designated as a "corporate watchdog,"<sup>197</sup> counsel must consider the best interests of the corporation before taking any action.<sup>198</sup> Specifically, the Model Rules require counsel to undertake certain steps to protect the best interests of the corporation when he or she "knows" that a corporate agent is engaging in or intends to engage in actions which violate the law.<sup>199</sup> Failure to take the necessary steps could result in liability.

For example, in *FDIC v. Clark*,<sup>200</sup> two corporate attorneys represented a bank whose officers, Nowfel and Eynden, conducted a seven-month "heist money scheme" whereby two bank officers approved fraudulent, non-collateralized, poorly documented loans to Vecchio and Rizzo who were also involved in the scheme.<sup>201</sup> The bank's attorneys allegedly became aware of the scheme when Vecchio and Rizzo sued the bank seeking to cancel repayment of their loan obligation because of the improper documentation procedures.<sup>202</sup> The corporate attorneys questioned

---

CEO, the bank's attorney also owed no fiduciary duty to the CEO).

<sup>192</sup> See Staffenberg, *supra* note 14, at 414. A breach of fiduciary duty claim can be brought not only for malpractice but also as a separate tort cause of action against an attorney if there was no malpractice. See, e.g., *Klemme v. Best*, 941 S.W.2d 493, 496 (Mo. 1997) (stating that clients can sue attorneys for the tort of breach of fiduciary duty as a cause of action separate from malpractice if no malpractice occurred).

<sup>193</sup> 486 So. 2d 629 (Fla. Dist. Ct. App. 1986).

<sup>194</sup> See *id.* at 630.

<sup>195</sup> See *id.*

<sup>196</sup> See Model Rule 1.3.

<sup>197</sup> 1 HAZARD & HODES, *supra* note 104, § 1.13:301, at 410.1.

<sup>198</sup> See Model Rule 1.13(a).

<sup>199</sup> See Model Rule 1.13(b); see also *supra* notes 21-25 and accompanying text.

<sup>200</sup> 978 F.2d 1541 (10th Cir. 1992).

<sup>201</sup> See *id.* at 1546.

<sup>202</sup> See *id.* at 1547.

Nowfel about the suit and Nowfel said "that it was simply a misunderstanding between borrowers and would be resolved."<sup>203</sup> The attorneys took no further actions, and the scheme continued until it eventually caused the bank to lose \$1.7 million.<sup>204</sup> The FDIC then brought an action against the attorneys. The attorneys argued that they could not be held liable when their client lies and defrauds them.<sup>205</sup> Nonetheless, the court held the attorneys liable because "the presence of fraud did not cancel the attorney's duty of due care" which could have been fulfilled had they conducted a reasonable, independent investigation instead of merely relying on the incorrect facts provided by the officer.<sup>206</sup>

Conversely, in *Resolution Trust Corp. v. Blasdel*,<sup>207</sup> the court held that the bank's attorneys did not have a duty to conduct an independent investigation.<sup>208</sup> In that case, the law firm performed various services for a savings and loan, including forming the institution, performing work on loans, providing advice about liabilities of the directors and officers, opining about regulatory matters, and working on the S&L's public offering.<sup>209</sup> After the S&L failed, the RTC filed an action against the law firm claiming that counsel did not fulfill its duty to investigate one of the substantially large loans which was issued in violation of federal regulations and which gave rise to the institution's failure.<sup>210</sup> The court found that the law firm was not under a duty to be vigilant about possible regulatory violations, and it was reasonable for them to rely on the S&L's internal compliance procedures; thus, the court held that the law firm was not liable since it had no duty to investigate.<sup>211</sup>

The *Blasdel* case can be distinguished, however, since the attorneys who represented the S&L were outside counsel who were not as intimately familiar with the S&L's operations as in-house counsel would have been. In-house counsel more frequently have been held to a higher standard of care because they have greater access to corporate information and have more knowledge about how the corporation operates. Therefore, most courts have held that in-house counsel do have an obligation to alert the organization to wrongdoings by corporate officers and to take sufficient action to verify the information which is provided to them.<sup>212</sup>

---

<sup>203</sup> *Id.*

<sup>204</sup> *See id.* at 1548.

<sup>205</sup> *See id.* at 1549.

<sup>206</sup> *Id.*

<sup>207</sup> 154 F.R.D. 675 (D. Ariz. 1993).

<sup>208</sup> *See id.* at 688.

<sup>209</sup> *See id.* at 678.

<sup>210</sup> *See id.* at 680.

<sup>211</sup> *See id.* at 688-89.

<sup>212</sup> *See William A. Hanock, What Is an Attorney's Responsibility to Warn?, in CORPORATE*

The extent of counsel's duty to investigate will depend on the reliability of the information that they receive.<sup>213</sup> Sometimes this information comes from informal channels of communication such as conversations which are overheard during lunch. The corporate attorney must decide how much credence needs to be given to such information, which may be merely gossip or rumor. If, however, the information is provided directly by a third person, then it may be more reliable and warrant greater attention. The reliability of such information could be determined based on the prior dealings which the attorney has had with the information's provider. Counsel are generally allowed to assume that corporate directors and officers perform their duties in good faith,<sup>214</sup> but they can not turn a blind eye and make such an assumption when circumstances suggest otherwise.

Counsel must also be sure that the suspected fraud or criminal activity is actually being committed before making such a disclosure. Otherwise, he or she could face liability for an improper disclosure. For example, in *X Corp. v. Doe*,<sup>215</sup> in-house counsel attempted to disclose 4,800 pages of documents which he believed contained information about a longtime fraud being committed by the corporation against the federal government.<sup>216</sup> However, the corporation sued the previously fired attorney for, among other things, breach of fiduciary duty for failing to maintain a confidential relationship, which allegedly occurred when counsel disclosed the information to his private attorney when he filed a *qui tam* action against the corporation.<sup>217</sup> The court, however, found that counsel would further breach his fiduciary duty by publicly disclosing the documents because confidential information can be revealed only when it "clearly" establishes fraud; the documents in this case were only "arguably suggestive of a regulatory violation."<sup>218</sup> Although the court merely entered an injunction against counsel's public disclosure of the documents,<sup>219</sup> this case suggests

---

COUNSEL'S GUIDE TO LAWYERING LAWS 1.601, 1.603 (Business Laws, Inc. ed, 1996). Regardless, corporate counsel cannot incur liability to a minority shareholder because of a breach of fiduciary duty to the corporation. See, e.g., *Felty v. Hartweg*, 523 N.E.2d 555, 557 (Ill. App. Ct. 1988) (stating that, even if corporate counsel knew that he was expected to protect minority shareholders, his breaching of a fiduciary duty to the corporation which harmed the shareholders would not give rise to them for a breach of fiduciary duty cause of action).

<sup>213</sup> See T. William Porter, *Corporate Legal Opinions in Texas—An Overview of Potential Liabilities*, BULL. BUS. L. SEC. STATE BAR TEX., Nov. 1986, at 4.

<sup>214</sup> See 1 HAZARD & HODES, *supra* note 104, § 1.13:301, at 410.1.

<sup>215</sup> 816 F. Supp. 1086 (E.D. Va. 1993).

<sup>216</sup> See *id.* at 1088-1091.

<sup>217</sup> See *id.* at 1091.

<sup>218</sup> *Id.* at 1091-1092.

<sup>219</sup> See *id.* at 1097.

the carefulness with which counsel must proceed before blowing the whistle against their corporate clients and officers within the corporation.<sup>220</sup>

Although counsel may not even know about management's fraud or self-dealing, liability may still result. Since in-house counsel have the general responsibility of ensuring that the corporation complies with the law, they should be required to undertake a more extensive investigation and be placed under a higher duty of inquiry than outside counsel. This is especially true if counsel sits on the corporation's board of directors,<sup>221</sup> since an attorney-director should not only be intimately familiar with the legal aspects of the corporation but also its business operations. Thus, counsel must be aware of situations that could give rise to a claim for breaching their legal fiduciary duty to the corporation and must ensure that they undertake their due diligence responsibilities.

## B. ERISA

Corporate counsel who advise ERISA (Employee Retirement Income Security Act)<sup>222</sup> plans are also under a separate fiduciary duty. Under ERISA, corporate counsel can be held liable not only as a fiduciary<sup>223</sup> but also as a nonfiduciary.<sup>224</sup> Numerous cases have decided whether an attorney who represents a pension plan is a fiduciary.<sup>225</sup> Fiduciary liability arises when counsel has discretionary authority over plan assets.<sup>226</sup> It is a functional definition which focuses on the actual duties performed, independent of the title held by counsel.<sup>227</sup> An attorney who represents a pension plan does not automatically become a fiduciary, however, as long

<sup>220</sup> A full discussion about attorneys who blow the whistle because of allegedly illegal activities committed by their corporate clients and the retaliatory discharge claims that usually result is beyond the scope of this article. However, for good discussions of this topic, see H. Lowell Brown, *The Dilemma of Corporate Counsel Faced with Client Misconduct: Disclosure of Client Confidences or Constructive Discharge*, 44 BUFF. L. REV. 777 (1996); John Jacob Kobus, Jr., Note, *Establishing Corporate Counsel's Right to Sue for Retaliatory Discharge*, 29 VAL. U. L. REV. 1343 (1995); Patricia Leigh O'Dell, *Retaliatory Discharge: Corporate Counsel in a Catch-22*, 44 ALA. L. REV. 573 (1993).

<sup>221</sup> See *supra* Part II.C (discussing the enhanced liabilities of attorney-directors); see also, *Escott v. BarChris Constr. Co.*, 283 F. Supp. 643, 691 (S.D.N.Y. 1968) (finding that the attorney-director had no knowledge of material facts but was held liable because he could have easily obtained the information).

<sup>222</sup> 29 U.S.C. §§ 1001-1461.

<sup>223</sup> See *id.* § 1002(21)(A).

<sup>224</sup> See *id.* § 1106.

<sup>225</sup> Most cases hold that counsel who merely provide legal representation are not plan fiduciaries. See, e.g., *Hotel Employees & Restaurant Employees Int'l Union Welfare Fund v. Gentner*, 50 F.3d 719, 722 (9th Cir. 1995); *Chapman v. Klemick*, 3 F.3d 1508, 1510 (11th Cir. 1993).

<sup>226</sup> *Liss v. Smith*, 991 F. Supp. 278, 302 (S.D.N.Y. 1998).

<sup>227</sup> See *Blatt v. Marshall & Lassman*, 812 F.2d 810, 812 (2d Cir. 1987).

as he or she performs only the ministerial tasks and day-to-day activities required to provide legal advice to the plan.<sup>228</sup>

Nonfiduciary liability of counsel arises under one of two theories. First, counsel can be held liable for participating in transactions that are prohibited by ERISA.<sup>229</sup> Second counsel can be held liable when they knowingly participate in a trustee's breach of fiduciary duties.<sup>230</sup> This occurs when a trustee breaches a fiduciary duty, counsel knows that the trustee is a fiduciary who is breaching the duty, and damages resulted from the breach of duty.<sup>231</sup> In 1993, the Supreme Court decided *Mertens v. Hewitt Associates*,<sup>232</sup> wherein it held that nonfiduciaries are not liable for money damages (i.e., legal damages) resulting from a fiduciary's breach of duty as long as the professional services which the nonfiduciaries provide are merely advisory in nature and they do not become fiduciaries themselves.<sup>233</sup> Lower courts, however, have subsequently interpreted the *Mertens* decision very narrowly and have allowed recovery from nonfiduciaries for restitution and other equitable relief (i.e., equitable damages).<sup>234</sup>

Nonetheless, corporate attorneys can be held liable both as fiduciaries and as nonfiduciaries. For example, in *Liss v. Smith*,<sup>235</sup> an attorney who advised ERISA plan trustees was sued as both a fiduciary and nonfiduciary for breach of his fiduciary duty.<sup>236</sup> Counsel's alleged nonfiduciary breach of duty arose from his failure to advise the trustees about their duties to consider investment risk, to obtain professional advice about investments, to use benchmarks to assess performance, to monitor broker fees and commissions, and to diversify assets.<sup>237</sup> The court held that a willful failure to advise constituted a knowing participation in a breach of the trustees' fiduciary duty for which the attorney could be held liable as both a fiduciary and a nonfiduciary.<sup>238</sup>

---

<sup>228</sup> See *Custer v. Sweeney*, 89 F.3d 1156, 1162 (4th Cir. 1996).

<sup>229</sup> See 29 U.S.C. § 1132(a)(3)(B) (1998); *id.* § 1106 (listing the prohibited transactions); *see, e.g., Liss*, 991 F. Supp. at 306; *Reich v. Compton*, 57 F.3d 270, 285-87 (3d Cir. 1995); *Reich v. Rowe*, 20 F.3d 25, 31 (1st Cir. 1994); *Nieto v. Ecker*, 845 F.2d 868, 873-74 (9th Cir. 1988).

<sup>230</sup> See *Liss*, 991 F. Supp. at 304.

<sup>231</sup> See *id.* at 305.

<sup>232</sup> 508 U.S. 248 (1993).

<sup>233</sup> See *id.* at 272.

<sup>234</sup> See, *e.g., Reich v. Stangl*, 73 F.3d 1027, 1032 (10th Cir. 1996) (holding that the ERISA statute does not bar suits against nonfiduciaries for equitable relief); *see also Concha v. London*, 62 F.3d 1493, 1503-04 (9th Cir. 1995); *Reich v. Compton*, 57 F.3d 270, 287 (3d Cir. 1995); *Reich v. Rowe*, 20 F.3d 25, 33 (1st Cir. 1994).

<sup>235</sup> 991 F. Supp. 278 (S.D.N.Y. 1998).

<sup>236</sup> See *id.* at 302.

<sup>237</sup> See *id.* at 308.

<sup>238</sup> See *id.* at 303-06.

Courts have been more willing to assess equitable damages against counsel as nonfiduciaries who represent ERISA plans. The extent to which counsel goes beyond merely advising a pension plan's trustee will determine whether they will also be held liable for a direct breach of fiduciary duties owed to the plan.

### C. Securities Laws

Liability arising under the securities laws likely provides the greatest area of concern to corporate attorneys since there are many aspects in which counsel can be involved: drafting merger agreements and offerings statements, creating lending agreements, conducting investor negotiations, issuing opinions, and drafting disclosure documents. There are generally two ways that counsel can be held liable for securities matters: professional malpractice or direct primary liability to an investor due to violations of the securities laws.<sup>239</sup> The second type of liability arises because any person—including in-house counsel—who effects "material misstatements or omissions concerning publicly traded securities will have liability to the investing public" (i.e., third parties).<sup>240</sup>

In 1991, the SEC issued a report in response to the Salomon Brothers debacle wherein the agency explained the supervisory responsibilities of corporate counsel.<sup>241</sup> In *In re Gutfreund*, Salomon's chief legal officer became aware of a criminal act committed by a senior officer who submitted a false bid. Although counsel advised that the action was criminal and should be reported to the SEC, he took no further action himself to disclose the false bid. The SEC, however, found that counsel in such situations would have the obligation under section 15(b)(4)(E) of the 1934 Exchange Act "to take affirmative steps to ensure that appropriate action is taken to address the misconduct."<sup>242</sup> The SEC's purpose in issuing the report was to require "... that [counsel has] to take action, that it isn't good enough to simply advise."<sup>243</sup> Taking action against attorneys

---

<sup>239</sup> See, e.g., *Brennan v. Reed, Smith, Shaw & McClay*, 450 A.2d 740, 747 (Pa. Super. Ct. 1982).

<sup>240</sup> Honig, *supra* note 7, at 8.203; see also *supra* notes 106-51 (discussing third-party liability to shareholders).

<sup>241</sup> See *In re Gutfreund*, Exchange Act Release No. 34-31554, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) & 85,067 (Dec. 3, 1992).

<sup>242</sup> *Id.* at 83,608-609. Section 15(b)(4)(E) of the 1934 Exchange Act makes it unlawful for anyone to assist or counsel a broker or dealer in committing a violation of the securities laws.

<sup>243</sup> Jonathan M. Moses, *SEC Spotlights Role of In-House Counsel in Salomon Report*, WALL ST. J., Dec. 7, 1992, at B3 (quoting Joseph I. Goldstein, SEC's associate director of enforcement in 1992); see also *In re Carter & Johnson*, Exchange Act Release No. 34-17597 [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH) & 82, 847 (Feb. 28, 1981) (holding that, if counsel's advice is not followed, then counsel must take affirmative steps to avoid being co-opted into an ongoing fraud); *SEC v.*

forces them to monitor clients more closely and deters a corporation from engaging in misconduct.<sup>244</sup>

Such a requirement places a significant responsibility on in-house counsel and can pose a dilemma. For example, in-house counsel may learn about management's attempted fraud or self-dealing in connection with a securities offering. Such conduct could occur by failing to make full disclosures to the SEC, investors, or the public, all of whom are constituents of the corporation. In-house counsel has the difficult task of deciding what actions are in the best interests of the corporation. Perhaps management's conduct is necessary to raise the money needed to keep the corporation out of bankruptcy, thereby protecting the investor constituents. However, not reporting the alleged fraud may get the corporation *and* the corporate attorney into significant trouble with the SEC and result in the imposition of a substantial fine. Such a situation must be approached with extreme caution.

Despite the SEC's hard line and clear rule emanating from the *Gutfreund* report, there have been an increasing number of lawsuits against attorneys who allegedly have failed to take sufficient action upon learning of an ongoing fraud committed by their corporate client.<sup>245</sup> Investors have brought many of these claims, alleging that they relied on false or misleading offering materials which were prepared by corporate counsel.<sup>246</sup>

Some investors have also brought claims against counsel on the theory that, by merely providing routine legal services such as preparing the offering materials and issuing legal opinions, counsel assisted the corporation and its officers in committing the fraud.<sup>247</sup>

Most courts have required that plaintiffs bringing a cause of action for reliance on false or misleading materials to plead scienter and to

---

National Student Mktg. Corp., 457 F. Supp. 682, 713 (D.D.C. 1978) (holding counsel liable as an aider and abetter under § 17(a) for assisting in misleading shareholders during the closing of a merger because counsel failed to disclose updated financial information which was material and known).

<sup>244</sup> Ann Maxey, *SEC Enforcement Actions Against Securities Lawyers: New Remedies vs. Old Policies*, 22 DEL. J. CORP. LAW 537, 537 (1997).

<sup>245</sup> See Reycraft, *supra* note 24, at 612.

<sup>246</sup> See, e.g., *Kilmartin v. H.C. Wainwright & Co.*, 580 F. Supp. 604 (D. Mass. 1984) (purchasers of partnership interest alleged violations of §§ 12(1), 12(2), and 17(a) of the 1933 Securities Act and Rule 10b-5 of the 1934 Exchange Act).

<sup>247</sup> See, e.g., *Seidel v. Public Serv. Co. of N.H.*, 616 F. Supp. 1342, 1346 (D.N.H. 1985) (holding that law firm could be held liable under § 12(2) of the 1934 Exchange Act because it was "uniquely positioned to ask relevant questions, acquire material information, or disclose [the] findings" (quoting *Hagert v. Glickman, Lurie, Eiger & Co.*, 520 F. Supp. 1028, 1035 (D. Minn. 1981))); *Koehler v. Pulvers*, 606 F. Supp. 164, 168 (S.D. Cal. 1985) (holding that counsel could be liable under ' 12 of the 1934 Exchange Act although he was not in privity of contract with the investor because he did not draft the prospectus).



demonstrate that counsel had knowledge that their actions were in violation of the securities laws.<sup>248</sup> However, some courts have held that, even if counsel did not know about management's actions, liability could still result as an aider and abettor if the actions were so flagrantly obvious that they should have known about the illegal conduct.<sup>249</sup>

Thus, in working with the issuer of a corporation's securities, counsel has a responsibility to ensure that the information which he or she uses to draft documents is updated, thereby requiring counsel to undertake an affirmative duty of inquiry.<sup>250</sup> For example, in *FDIC v. O'Melveny & Meyers*,<sup>251</sup> counsel who prepared private placement documents relied solely on the information provided by the S&L's two principals and sole shareholders.<sup>252</sup> The issuers, however, attempted to disguise the institution's dwindling net worth, which would have easily become known had counsel spoken directly to the corporation's accountants. The law firm argued that it had neither a duty to uncover its client's fraud nor a duty to advise the S&L or regulators of that fraud.<sup>253</sup> Nonetheless, the court held that securities counsel must make a reasonable, independent investigation to detect and correct false or misleading materials.<sup>254</sup>

The SEC has also imposed cease and desist orders against attorneys for negligently representing their corporate clients. For example, in *In re Candies', Inc.*,<sup>255</sup> the SEC obtained a consent order from attorneys who negligently misinterpreted the safe-harbor provisions of Regulation S.<sup>256</sup> In

<sup>248</sup> See, e.g., *Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (2d Cir. 1979) (requiring the plaintiff to plead those events which "give rise to a strong inference that the defendants had knowledge of the [primary securities law] violation"); *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983) (requiring that an aider and abettor have knowledge of the securities law violation); see also *Renovitch v. Kaufman*, 905 F.2d 1040, 1046 (7th Cir. 1990) (stating that if there is no direct evidence of scienter, then a court can also look for indirect evidence of scienter, demonstrated by whether counsel profited from the alleged fraud).

<sup>249</sup> See *SEC v. Frank*, 388 F.2d 486, 489 (2d Cir. 1968) (stating that "a lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand"). The court also stated, however, that counsel should not be held liable for technical information provided by the client which is beyond the understanding of counsel (such as how a corporation's chemical processing plant operates). See *id.*

<sup>250</sup> Tower C. Snow, Jr. et al., *Defending Securities Class Actions*, C123 A.L.I.-A.B.A. COURSE OF STUDY, June 2, 1995, at 710. In-house counsel likely have a greater duty to inquire than outside counsel since in-house attorneys have greater access to corporate information. Accord RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 155 cmt. b (Tentative Draft No. 8, 1997).

<sup>251</sup> 969 F.2d 744 (9th Cir. 1992), *rev'd on other grounds*, 512 U.S. 79 (1994).

<sup>252</sup> See *id.* at 747.

<sup>253</sup> See *id.* at 748.

<sup>254</sup> See *id.* at 749.

<sup>255</sup> Exchange Act Release No. 36,865, 61 SEC Docket 0938 (Dec. 14, 1996).

<sup>256</sup> See *id.* at 0944. The SEC noted that the sales, however, were in compliance with Regulation S. See *id.*

In *re Goodman*,<sup>257</sup> the SEC obtained a consent order against an attorney who negligently failed to discover that his corporate client—not the attorney himself—had prepared a misleading disclosure document.<sup>258</sup> Consequently, the SEC's willingness to impose a negligence standard against corporate counsel heightens the level of scrutiny and inquiry which corporate attorneys must undertake.

Finally, one area of particular concern for counsel who serve as a director is the potential liability under section 11 of the 1933 Securities Act. Section 11 contains the anti-fraud provision of the securities laws and states who will be held liable for any untrue statement of material fact or omission of material fact which should have been stated to prevent the registration statement from being misleading.<sup>259</sup> Under that section, counsel is not specifically liable unless he or she signed or expertised the registration statement.<sup>260</sup> However, counsel who also serve as directors significantly enhance their liability because directors are automatically liable under the statute.<sup>261</sup> For example, in *BarChris*<sup>262</sup> and *Feit*,<sup>263</sup> lawyer-directors were held liable under section 11 because of the higher standard of care which they owed to the corporation. If those attorneys were not directors, however, then they may not have been held liable.<sup>264</sup>

#### D. Aiding & Abetting Liability

The number of aiding and abetting claims has increased significantly over the last two decades.<sup>265</sup> To be held liable as an aider and abetter, counsel (1) must know of sufficient information to justify an inquiry into the potential violation, and (2) have substantially assisted in achieving the violation.<sup>266</sup> Aiding and abetting liability can arise in several areas of the law such as securities and ERISA, including breach of fiduciary duty.

---

<sup>257</sup> Exchange Act Release No. 36,951, 6 SEC Docket 2690 (Dec. 14, 1995).

<sup>258</sup> See *id.* at 2698-99.

<sup>259</sup> Securities Act of 1933 § 11, 15 U.S.C.A. § 77k (West 1998).

<sup>260</sup> See, e.g., *Hagert v. Glickman, Lurie, Eiger & Co.*, 520 F. Supp. 1028, 1035 (D. Minn. 1981) (holding that a law firm was not liable as a primary violator under section 11 since none of the firm's attorneys signed or expertised any part of the registration statement).

<sup>261</sup> See 1933 Securities Act § 11(a)(2), 15 U.S.C.A. § 77k (West 1998).

<sup>262</sup> *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968).

<sup>263</sup> *Feit v. Lesco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971).

<sup>264</sup> See *Ahern v. Gaussoin*, 611 F. Supp. 1465, 1482 (D. Or. 1985) (distinguishing *Feit* and *BarChris* because the attorneys in those cases were also directors).

<sup>265</sup> See, e.g., Patrick J. McNulty & Daniel J. Hanson, *Liability for Aiding and Abetting by Silence or Inaction: An Unfounded Doctrine*, 29 TORT & INS. L. J. 14, 15-16 (1993) (describing the significant increase in aiding and abetting claims for securities law violations).

<sup>266</sup> See RESTATEMENT (SECOND) OF TORTS § 876(b) (1977). See generally, Stanley Pietrusiak, Jr., Comment, *Changing the Nature of Corporate Representation: Attorney Liability for Aiding and*

## 1. SECURITIES LAWS

The securities laws have probably provided the most fodder for claims of aiding and abetting liability, particularly under section 10(b) or rule 10b-5 of the Securities and Exchange Act of 1934. Generally, however, liability will not be imposed unless counsel has a duty of disclosure to third parties.<sup>267</sup> For example, in *Abell v. Potomac Insurance Co.*,<sup>268</sup> a law firm represented the issuer's underwriters who prepared the offering statement for securities, which allegedly omitted material facts about the investment.<sup>269</sup> Although a jury found in favor of the investor plaintiffs, the Fifth Circuit reversed.<sup>270</sup> The court found that the law firm knew that the FBI, SEC, and the National Association of Securities Dealers were investigating the issuer; did not itself investigate what the issuer had done to warrant the investigations; made material changes to the offering materials without inquiring about the reason for such changes; and failed to investigate the truth of the statements in the offering materials.<sup>271</sup> Nonetheless, the court held that the law firm could not be liable, despite the reckless disregard of its duties.<sup>272</sup> The reason was that the services provided by the law firm were for routine, everyday activities, and there was no proof that the firm was actually aware of its participation in the fraudulent scheme.<sup>273</sup>

In 1994, the Supreme Court decided the historic case of *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*<sup>274</sup> In that case, the Court held that no private cause of action existed for aiding and abetting liability under section 10(b) of the Securities Act.<sup>275</sup> This decision effectively overruled the precedent in all eleven circuits.<sup>276</sup> However, in the 1995 Private Securities Litigation Reform Act, Congress effectively overruled *Central Bank* and enacted sections 21(d) and 20(f) of the

---

*Abetting the Breach of Fiduciary Duty*, 28 ST. MARY'S L.J. 213 (1996).

<sup>267</sup> See J. Randolph Evans & Ida Patterson Dorvee, *Attorney Liability for Assisting Clients with Wrongful Conduct: Established and Emerging Bases of Liability*, 45 S.C. L. REV. 803, 822 (1994); see also *Dirks v. SEC* 463 U.S. 646, 666 (1983) (requiring knowledge of an omission and a duty to disclose).

<sup>268</sup> 858 F.2d 1104 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989).

<sup>269</sup> See *id.* at 1111-12. One fact allegedly omitted was that numerous investigations were being conducted of the issuer for possible securities violations. See *id.*

<sup>270</sup> See *id.* at 1128.

<sup>271</sup> See *id.* at 1127.

<sup>272</sup> See *id.* at 1128.

<sup>273</sup> See *id.*

<sup>274</sup> 511 U.S. 164 (1994).

<sup>275</sup> See *id.* at 177.

<sup>276</sup> See *In re Leslie Fay Cos.*, 871 F. Supp. 686, 689 (S.D.N.Y. 1995).

Securities Exchange Act, which allows the SEC (but not private parties) to bring an action for aiding and abetting under section 10(b).<sup>277</sup>

Section 20(f), however, requires that the secondary violator knowingly give substantial assistance to primary violators.<sup>278</sup> The extent of liability under this knowing standard is uncertain because it has not yet been interpreted by the courts. If the courts use the Rule 10b-5 standard of knowing, then it would encompass reckless actions.<sup>279</sup> This interpretation would potentially expose corporate counsel to even greater liability because a cause of action could be brought even if he or she acted in good faith.

There has been an increasing trend in recent years of attempting to hold corporate counsel liable under the securities laws for aiding and abetting their clients. This attempted liability has not only resulted from knowingly assisting a corporate client,<sup>280</sup> but also for not saying something when there might be a duty to do so.<sup>281</sup> Such strict liability is appropriate, however—particularly for in-house counsel—since they should be intimately familiar with the corporation's activities and should know about any information which might give rise to a violation of the securities laws. Thus, counsel needs to be extremely vigilant to ensure proper disclosure under the strict securities laws to avoid liability.

## 2. BREACH OF FIDUCIARY DUTY & ERISA

Corporate counsel can also be held liable under a new, emerging standard for aiding and abetting corporate officers and directors in breaching the fiduciary duties which they owe to the corporation.<sup>282</sup> Although the case did not involve a suit against an attorney, *Q.E.R., Inc. v. Hickerson*<sup>283</sup> is illustrative of the potential liabilities which counsel can face for assisting another in breaching his or her fiduciary duties. In *Hickerson*, the director of HEC assigned HEC's oil and gas leases to a

---

<sup>277</sup> See 15 U.S.C. § 78t(f) (1997).

<sup>278</sup> See *id.*

<sup>279</sup> See Ann Maxey, *Competing Duties? Securities Lawyers' Liability After Central Bank*, 64 FORDHAM L. REV. 2185, 2196 (1996).

<sup>280</sup> See, e.g., *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991) (requiring a high level of knowledge if the aider and abetter owed no duty to the injured).

<sup>281</sup> See, e.g., *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974) (finding liability if the aider and abetter merely knew about the alleged violations of the law). See generally McNulty & Hanson, *supra* note 265 (discussing whether aiding and abetting liability can arise under the securities laws because of a person's failure to disclose known information).

<sup>282</sup> See, e.g., *Weingarten v. Warren*, 753 F. Supp. 491, 495 (S.D.N.Y. 1990) (stating that an attorney could be held liable for aiding and abetting a trustee in breaching his fiduciary duty). See generally, Pietrusiak, *supra* note 266 (discussing the emerging theory of an attorney being held liable for aiding and abetting a breach of fiduciary duty).

<sup>283</sup> 880 F.2d 1178 (10th Cir. 1989).

partnership in which the company was involved with another corporation, Q.E.R., to develop oil and gas prospects. Subsequently, the director of HEC assigned the same leases to a company which threatened to sue HEC for its failure to repay a debt.<sup>284</sup> Consequently, Q.E.R. sued the director of HEC for aiding and abetting HEC's breach of fiduciary duty owed to Q.E.R. as a general partner.<sup>285</sup> The court held that aiding and abetting the breach of a fiduciary duty was a recognized tort and that sufficient facts existed to find that the partner of HEC aided the company in breaching its fiduciary duty owed to the partnership.<sup>286</sup>

Considerable concern also exists that corporate counsel could be held liable under ERISA as an aider and abetter if he or she knowingly assisted a person who was the primary fiduciary of a pension plan's assets in breaching the fiduciary duty that the person owed to the trust.<sup>287</sup> For example, in *Thornton v. Evans*,<sup>288</sup> attorneys for insurance companies were charged with aiding and abetting for allegedly drafting documents which assisted the principal in defrauding a pension plan out of \$1.1 million when those funds were channeled to the principal through companies that the attorneys represented.<sup>289</sup> The court stated that nonfiduciaries have a "duty . . . to refrain from conspiracy to facilitate actions by . . . fiduciaries constituting fraud on the [plan]."<sup>290</sup> Thus, the court held that counsel could be liable for aiding and abetting the plan's trustee in breaching his fiduciary duty, which occurred when counsel drafted documents that assisted in the deceptive transfer of funds.<sup>291</sup>

### 3. CONSPIRACY

Akin to aiding and abetting liability, counsel can also be held liable for conspiring with corporate officers and directors to commit a violation of the law.<sup>292</sup> For example, in *In re American Continental Corp./Lincoln*

<sup>284</sup> See *id.* at 1181.

<sup>285</sup> See *id.*

<sup>286</sup> See *id.* at 1183.

<sup>287</sup> See *Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1220 (2d Cir. 1987); Christopher G. Sablich, Note, *Duties of Attorneys Advising Financial Institutions in the Wake of the S&L Crisis*, 68 CHI.-KENT L. REV. 517, 540 (stating that "[t]he federal pension laws of ERISA give rise to much of the federal case law regarding attorneys aiding and abetting breaches of fiduciary duties").

<sup>288</sup> 692 F.2d 1064 (7th Cir. 1986).

<sup>289</sup> See *id.* at 1081-82.

<sup>290</sup> *Id.* at 1082, n.42.

<sup>291</sup> *Id.* at 1082-83.

<sup>292</sup> See, e.g., *Skarbreik v. Cohen, England & Whitfield*, 282 Cal. Rptr. 627, 639 (Cal. Ct. App. 1991) (stating that "[c]onspiracy liability may properly be imposed on nonfiduciary agents or attorneys for conduct which they carry out not simply as agents or employees of fiduciary defendants, but in furtherance of their own financial gain").

*Savings and Loan Securities Litigation*,<sup>293</sup> a law firm conducted a pre-compliance audit for a savings and loan before a regulatory agency's examination.<sup>294</sup> During this review, the law firm found several regulatory violations—including backdated files, destroyed appraisals, and record alterations—and advised the client how to rectify the deficiencies so that the regulatory agency's auditors would not notice them.<sup>295</sup> Consequently, the Resolution Trust Corporation filed a RICO violation against the law firm for aiding and abetting the thrift in deceiving federal regulators. The court held (1) that sufficient evidence existed to find that the law firm failed to provide clear and direct information to its client that its conduct violated the law, and (2) that the law firm may even have assisted the thrift in deceiving regulators.<sup>296</sup>

However, in *Skarbrevik v. Cohen, England & Whitfield*,<sup>297</sup> the court found that a corporation's attorney could not be liable for conspiracy to the minority shareholder of a corporation because the attorney had no individual duty<sup>298</sup> to the minority shareholder nor did he receive a personal financial interest from the transaction.<sup>299</sup> In *Skarbrevik*, the corporation's attorney perfected an amendment which diluted the minority shareholder's interest, knowing that the minority shareholder had not been given notice of the amendment and that no annual meeting had been held wherein the amendment would have been voted upon.<sup>300</sup> Although the minority shareholder asserted a conspiracy claim against the corporate counsel, the court held that the attorney could not be held liable because he "had no personal duty to disclose the facts intentionally concealed."<sup>301</sup>

Counsel, nonetheless, can be held liable for conspiracy under three alternatives: (1) when the attorney acts not only as an agent of the corporation, but also attempts to obtain a personal financial gain from the actions; (2) counsel violates his or her own duty to the client when conspiring with another; or (3) counsel violates an independent duty owed

---

<sup>293</sup> 794 F. Supp. 1424 (D. Ariz. 1992).

<sup>294</sup> See *id.* at 1450.

<sup>295</sup> See *id.* (stating that the violations about which the firm allegedly had knowledge included backdating of files, destruction and removal of records, and instructions not to issue written reports when their representations were unfavorable).

<sup>296</sup> See *id.* at 1452.

<sup>297</sup> 282 Cal. Rptr. 627 (Cal. Ct. App. 1991).

<sup>298</sup> See *supra* notes 106-151 and accompanying text (discussing counsel's liability to third-party shareholders).

<sup>299</sup> See 282 Cal. Rptr. at 640.

<sup>300</sup> See *id.* at 637.

<sup>301</sup> *Id.* at 639. This also would have been true if the attorney was representing the majority shareholders instead of the corporation. See *id.*

to an injured third party.<sup>302</sup> Thus, whether counsel will be liable for conspiracy will depend on the facts of each case. Although numerous cases have been reported where corporate counsel have been charged with conspiracy, very few have actually held counsel liable.<sup>303</sup>

### E. Environmental Laws

Under both the Resource Conservation and Recovery Act (RCRA)<sup>304</sup> and the Comprehensive Environmental Regulatory Act (CERCLA),<sup>305</sup> owners, operators, generators, and transporters of hazardous waste can be held liable for violations of the environmental laws.<sup>306</sup> Theoretically, these laws could encompass in-house counsel<sup>307</sup> since they provide advice to the corporate client about whether its actions violate the environmental laws. However, there has not been a plethora of suits filed against attorneys alleging that they fall into one of those four categories and can incur environmental liability.

One of the first and most widely-known cases filed against counsel for alleged environmental law violations involved InFerGene Co., a biotechnology company in California which filed for bankruptcy in 1991.<sup>308</sup> After being evicted by its landlord, the company allegedly abandoned containers containing radioactive waste and cultures of sexually transmitted diseases. This alleged abandonment occurred because an associate at the corporation's law firm believed that removal of the materials would constitute a pre-petition claim under the Bankruptcy Code. Thus, the associate wrote to the landlord stating that the company could not remove the waste.

The California District Attorney's office, however, filed felony charges against, among others, the law firm and the associate who sent the letter to the landlord. The basis for the charges was the belief that the letter effectuated an abandonment of hazardous waste, which was a disposal, thereby violating the environmental laws. Stating that the attorneys knew or should have known that they were causing hazardous waste to be

---

<sup>302</sup> See, e.g., *Doctors' Co. v. Superior Court*, 775 P.2d 508, 512 (Cal. 1989); see also *Metts v. Clark Oil & Ref. Corp.*, 618 S.W.2d 698, 702 (Mo. Ct. App. 1981).

<sup>303</sup> But see *Dempsey v. Sternik*, 498 N.E.2d 310 (Ill. App. Ct. 1986) (holding a corporate attorney liable for conspiracy because he solicited the customers of one corporate client which he represented for another corporate client); *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964) (holding that sufficient evidence existed to find a corporate attorney liable for conspiring with the company's auditor during the registration of securities).

<sup>304</sup> 42 U.S.C.A. §§ 6901-6992k (West 1995).

<sup>305</sup> *Id.* §§ 9601-9675.

<sup>306</sup> See also Buchwald, *supra* note 45, at S1.

<sup>307</sup> See 3 MALLEN & SMITH, *supra* note 2, § 22.14, at 32.

<sup>308</sup> See generally Michelle D. Jordan, *Counsel's Duty to Disclose and Liability for Environmental Risks and Audits*, 445 P.L.I./LITIG. 857, 872-73 (1992).

disposed, the prosecutor stated that the case stands for the proposition "that attorneys advising clients to violate environmental laws will be prosecuted." Although a municipal court judge twice dismissed the charges against the law firm,<sup>309</sup> the case provides an indication of the potential liability which counsel may face for environmental crimes.

Research has revealed only one reported case, *City of North Miami v. Berger*,<sup>310</sup> that attempted to hold a corporation's counsel liable as an "operator." In *Berger*, the city contracted with the operator of a landfill which was declared a hazardous site under CERCLA. Consequently, the city brought a claim against (among others) the corporation's counsel who provided legal advice to the landfill, was the corporate secretary, and had a 15 percent investment interest in the corporation, claiming that he was an "operator" under CERCLA.<sup>311</sup> The court found that, although his legal advice furthered the project's development, the corporation's counsel could not be held liable as an "operator" because he did not have any ultimate decision-making authority over the corporation's day-to-day operations.<sup>312</sup> However, without the minimal distinction that counsel had no authority, the attorney could likely have been held liable as an operator.<sup>313</sup>

Since corporate counsel do not run the daily business affairs of the corporation, holding them responsible for their advice regarding whether a potential environmental problem exists would be inappropriate. The only circumstance under which it might be appropriate to hold attorneys liable is when their advice knowingly assists their client in committing or continuing to cover up environmental contamination.<sup>314</sup> Given the dearth of cases regarding environmental liability issues and clients' attorneys, it nonetheless appears that counsel's incurrence of liability for the environmental crimes committed by their corporate clients will be minimal, although a significant potential for liability does exist.<sup>315</sup>

#### F. Intellectual Property Laws

Counsel can only be held directly liable under the intellectual property laws if he or she infringes upon an already patented invention, copyright, or

---

<sup>309</sup> See Marianne Lavelle, *Judge Drops Charges Against S.F. Law Firm*, NAT'L L.J., Apr. 6, 1992, at 15.

<sup>310</sup> 828 F. Supp. 401 (E.D. Va. 1993).

<sup>311</sup> See *id.* at 411-12.

<sup>312</sup> See *id.*

<sup>313</sup> See 3 MALLEN & SMITH, *supra* note 2, § 22.14, at 32.

<sup>314</sup> This action may not only lead to liability under the environmental laws but would also lead to malpractice liability since an attorney can not assist a client in engaging in conduct which the attorney knows is criminal. See Model Rule 1.2(d).

<sup>315</sup> See generally, J.B. Ruhl, *Malpractice and Environmental Law: Should Environmental Law "Specialists" Be Worried?*, 33 HOUSTON L. REV. 173 (1996).



trademark.<sup>316</sup> However, counsel have occasionally been subjected to malpractice actions by their clients for negligence in their representation regarding intellectual property matters. Until recently, there have been few such actions, probably because corporate clients are frequently unable to detect errors due to the technical nature of intellectual property work.<sup>317</sup>

All of the recent cases have found liability based on the negligent handling of transactions relating to copyrights, patents, and trademarks. Such liability arises from the same fiduciary obligations and ethical responsibilities as other attorneys who do not specialize in the practice of intellectual property law.<sup>318</sup> For example, actions have been brought for failing to perfect a patent,<sup>319</sup> failing to search for pending trademark applications,<sup>320</sup> failing to find an already existing patent,<sup>321</sup> failing to file a patent within the applicable time limit,<sup>322</sup> and failing to advise of liability resulting from infringing on a patent.<sup>323</sup> No cases have been found, however, which have held an attorney directly liable for violating the intellectual property laws.

### G. Antitrust Laws

Antitrust liability under the Sherman Act<sup>324</sup> arises when a corporate agent actively and knowingly assists the corporation in violating the antitrust laws.<sup>325</sup> Thus, an attorney can be held liable under the antitrust laws, but only if he or she actively participates in intentionally furthering anticompetitive goals.<sup>326</sup> For example, the court in *Brown v. Donco Enterprises, Inc.*,<sup>327</sup> held that counsel was not liable for merely advising the corporation on only legal and not policy matters.<sup>328</sup>

<sup>316</sup> 35 U.S.C.A. § 271 (West 1984).

<sup>317</sup> See 3 MALLEN & SMITH, *supra* note 2, § 22.23, at 76.

<sup>318</sup> See *id.*

<sup>319</sup> See, e.g., *Lex Tex Ltd., Inc. v. Skillman*, 579 A.2d 244, 245 (D.C. Cir. 1990).

<sup>320</sup> See, e.g., *Ameracount Club, Inc. v. Hill*, 617 S.W.2d 876, 876 (Tenn. 1981).

<sup>321</sup> See, e.g., *Jackson Jordan, Inc. v. Leydig, Voit & Mayer*, 633 N.E.2d 627, 628 (Ill. 1994).

<sup>322</sup> See, e.g., *Boehm v. Wheeler*, 223 N.W.2d 536, 537 (Wis. 1974), *overruled on other grounds*, *Hansen v. A.H. Robins, Inc.*, 335 N.W.2d 578 (1983).

<sup>323</sup> See, e.g., *In re SMEC, Inc.*, 160 B.R. 86, 88-89 (M.D. Tenn. 1993).

<sup>324</sup> 15 U.S.C.A. §§ 1-37a (West 1997).

<sup>325</sup> See *Amarel v. Connell*, 102 F.3d 1494, 1522 (9th Cir. 1996); *Brown v. Donco Enter., Inc.*, 783 F.2d 644, 646 (6th Cir. 1986).

<sup>326</sup> See *Brown*, 783 F.2d at 646.

<sup>327</sup> 783 F.2d 644 (6th Cir. 1986).

<sup>328</sup> See *id.* at 647; see also *Amarel*, 102 F.3d at 1523 (reinforcing that there must be proof that corporate counsel exerted influence over the corporate agents to violate the antitrust laws); *Spanish Int'l Communications Corp., Sin v. Leibowitz*, 608 F. Supp. 178, 180 (S.D. Fla. 1985) (stating that an attorney could not be held liable when insufficient facts were plead to demonstrate that counsel had a financial interest or was a principal in the antitrust violations), *aff'd*, 778 F.2d 791 (11th Cir. 1985).

Several courts have stated that corporate counsel could be held liable under the Sherman Act if they "exert[] . . . power and influence to direct the corporation to engage in . . . anticompetitive acts."<sup>329</sup> This means that "an attorney is not immune from antitrust liability if he becomes an active participant in formulating policy decisions with his client to restrain competition."<sup>330</sup> Nonetheless, the prevailing view is that counsel can not be subjected to antitrust liability for the advice which they provide to their corporate clients.<sup>331</sup> The Ninth Circuit best summarized the state of the law in *Tillamook Cheese & Dairy Ass'n v. Tillamook County Creamery Ass'n*:<sup>332</sup>

We do not believe [the general] rule can be applied to the counsel for a corporation whose activity is brought into question, if the role of the counsel was only that of a legal adviser [sic]. This would be true even if, as counsel, he mistakenly advised corporate officers that a particular course of conduct would not violate [the antitrust laws]. But if he goes beyond that role and, acting by himself or jointly with others, makes policy decisions for the corporation, then he subjects himself to liability . . . as in the case of any executive officer of the company performing a similar function.<sup>333</sup>

Thus, given that there have not been many cases where liability has even been asserted against corporate counsel and the inability to find any cases which hold corporate counsel liable under the Sherman Act, counsel's exposure to antitrust liability appears to be minimal.

#### H. Commercial Transactions

There is a vast spectrum over which counsel may potentially incur malpractice liability for commercial transaction work. Some of the more typical errors which have lead to liability include failing to record documents necessary to protect the corporation's best interests,<sup>334</sup>

---

<sup>329</sup> 783 F.2d at 646-47.

<sup>330</sup> See, e.g., *Pinhas v. Summit Health, Ltd.*, 894 F.2d 1024, 1033 (9th Cir. 1989) (citing *Tillamook Cheese & Dairy Ass'n v. Tillamook County Creamery Ass'n*, 358 F.2d 115, 118 (9th Cir. 1966)), *aff'd*, 500 U.S. 322 (1991).

<sup>331</sup> See 3 MALLIN & SMITH, *supra* note 2, § 22.9, at 24.

<sup>332</sup> 358 F.2d 115 (9th Cir. 1966), *aff'd*, 500 U.S. 322 (1991).

<sup>333</sup> *Id.* at 118.

<sup>334</sup> See, e.g., *Hansen v. Anderson*, 831 P.2d 717, 719 (Or. Ct. App. 1992) (failing to perfect a security interest); *Peoples Nat'l Bank of Rockland County v. Weiner*, 514 N.Y.S.2d 772, 775 (N.Y. App. Div. 1987) (liability imposed for failing to determine whether a UCC financing statement needed

improperly preparing contracts,<sup>335</sup> and failing to properly draft agreements.<sup>336</sup>

Although not all suits against counsel for alleged malpractice in undertaking commercial transactions succeed, defending against such suits involves considerable time and expense. Other claims which have been made against counsel but have not succeeded include attempts to hold attorneys liable for a corporation's unsuccessful venture,<sup>337</sup> and the alleged failure to provide proper advice about obtaining financing.<sup>338</sup> Thus, corporate counsel must be continuously vigilant about the quality of their work to avoid potential liability relating to commercial transactions.

### I. *Opinion Letters & Advice*

In complex commercial litigation, the client often seeks an opinion (or "comfort") letter prepared by counsel to provide advice about all of the legal and technical consequences of a proposed transaction.<sup>339</sup> Such letters are often critical to closing a deal, particularly in securities transactions.<sup>340</sup> Therefore, counsel must be sure to exercise careful due diligence in preparing opinion letters, especially since they reflect counsel's professionalism and expertise. For instance, the ABA has issued an opinion requiring that an attorney who issues a comfort letter about the sale of unregistered securities undertake an inquiry if there are any suspect or inconsistent facts provided to the attorney.<sup>341</sup>

There have been increasing attempts to hold counsel liable for the good faith advice which they provide to clients in the form of opinion letters.<sup>342</sup>

to be filed which caused the corporation to lose its status as a secured creditor); *Modica v. Crist*, 276 P.2d 614 (Cal. Ct. App. 1954) (liability arising from the failure to record notice that a business was being sold, thereby subjecting the seller to claims of the corporation's creditors).

<sup>335</sup> See, e.g., *Boyles v. Smith*, 759 P.2d 518, 519-20 (Alaska 1988) (attempting to impose liability on an attorney for creating a usurious contract).

<sup>336</sup> See, e.g., *Haenel v. November & November*, 567 N.Y.S.2d 713 (N.Y. App. Div. 1991) (suit for alleged malpractice resulting from the drafting of an invalid shareholder agreement which allowed an officer-shareholder to commit waste, thereby reducing the corporation's stock price).

<sup>337</sup> See, e.g., *Vitale v. Coyne Realty, Inc.*, 414 N.Y.S.2d 388, 392 (N.Y. App. Div. 1979) (holding an attorney not liable since his legal opinion was not sought regarding a business venture).

<sup>338</sup> See, e.g., *Yusefzadeh v. Ross*, 932 F.2d 1262, 1265 (8th Cir. 1991) (holding an attorney not liable since the corporation failed to prove that it could have obtained financing).

<sup>339</sup> See Leslie L. Gardner, *Attorney Liability to Third Parties for Corporate Opinion Letters*, 64 B.U.L. REV. 415, 419 (1984).

<sup>340</sup> See Darrel A. Rice & Marc I. Steinberg, *Legal Opinions in Securities Transactions*, 16 J. CORP. L. 375, 375 (1991).

<sup>341</sup> See A.B.A. Comm. on Ethics and Professional Responsibility, Formal Op. 335 (1974); see also *supra* notes 200-214 and accompanying text (describing the extent of counsel's duty to investigate facts).

<sup>342</sup> See Joel Cohen & Norman Bloch, *Can Lawyers be Prosecuted for the Advice They Give?*,

Opinion letters can be issued either to the client or, upon the client's request, to a third party who is expected to rely on the opinion letter.<sup>343</sup> Opinion letters issued directly to the client usually will not result in liability to corporate counsel. The rationale for such a result is that, absent a confidential or fiduciary relationship to a third party, there is no duty of disclosure to the third party.<sup>344</sup>

The Model Rules specifically allow counsel to prepare a document for a third party that evaluates a situation affecting the counsel's corporation.<sup>345</sup> Because there is an expectation that the third party will rely on the opinion, an increasing number of courts have held attorneys liable for malpractice to a third party because of improper advice provided in opinion letters when the attorney knew or should have known that a third party would rely upon the letter.<sup>346</sup> For example, in *Montgomery County v. Jaffe, Raitt, Heuer & Weiss, P.C.*,<sup>347</sup> the county sued a law firm for misstatements contained in an opinion letter that the law firm sent to the county on behalf of the law firm's client, a partnership which was working on a project for the county.<sup>348</sup> The court held that the law firm could be liable since the county was the intended beneficiary of the agreement which gave rise to the opinion letter.<sup>349</sup>

Similarly, in *Crossland Savings FSB v. Rockwood Insurance Co.*,<sup>350</sup> counsel issued a legal opinion containing false representations to a partnership which obtained financing in the form of promissory notes from a bank which assigned the notes to another lender.<sup>351</sup> A surety company guaranteed those notes. When the assignee for its guaranty sued the surety of the uncollectible notes, the surety brought an action against the law firm, claiming that the law firm should be held liable for the notes because of its incorrect legal opinion. The law firm, however, moved for summary

---

N.Y. L.J., July 23, 1991, at 1.

<sup>343</sup> See Gardner, *supra* note 339, at 419-20.

<sup>344</sup> See, e.g., *Rubin v. Schotterstein, Zox & Dunn*, 110 F.3d 1247, 1256 (6th Cir. 1997); *Schatz v. Rosenberg*, 943 F.2d 485, 490 (4th Cir. 1991); *Roberts v. Peat, Marwich, Mitchell & Co.*, 857 F.2d 646, 653 (9th Cir. 1988).

<sup>345</sup> See Model Rule 2.3. There is no analogous "evaluation" provision in the Model Code.

<sup>346</sup> See also *supra* Part II.B (discussing liability to nonclient, third parties). Cf. *Washington Elec. Coop., Inc. v. Massachusetts Mun. Wholesale Elec. Co.*, 894 F. Supp. 777, 785-86 (D. Vt. 1995) (holding that attorneys could not be liable to a nonclient third-party who relied on a legal opinion, despite counsel's direct interaction with the third-party).

<sup>347</sup> 897 F. Supp. 233 (D. Md. 1995).

<sup>348</sup> See *id.* at 235.

<sup>349</sup> See *id.* at 237; see also *Mehaffy, Rider, Windholz & Wilson v. Central Bank of Denver, N.A.*, 892 P.2d 230, 237 (Colo. 1995) (holding that attorney could be liable to a nonclient for opinion letters upon which the attorney knew that the nonclient would rely).

<sup>350</sup> 700 F. Supp. 1274 (S.D.N.Y. 1988).

<sup>351</sup> See *id.* at 1275.

judgment, alleging that it could not be liable to the assignee since its client was the bank and it did not even know about the assignment.<sup>352</sup> Nonetheless, the court denied the motion and held that the law firm could be liable to the third party assignee,<sup>353</sup> stating that "a lawyer [cannot] be held liable in negligence only to those who pay her bills, . . . [especially] [w]hen the lawyer represents that she is acting on the third party's behalf."<sup>354</sup>

Even if counsel is not held liable under a malpractice theory because they lack privity with the third party, they can still be held liable under a separate negligent misrepresentation tort theory. For example, in *F.E. Appling Interests v. McCamish, Martin, Brown & Loeffler*,<sup>355</sup> an attorney representing a financial institution signed a settlement agreement attesting that it complied with various statutory requirements before it could be effective, including that it had been approved by the board.<sup>356</sup> The board never approved the agreement, however, and the relying party brought suit against the financial institution's attorney because the agreement could not be enforced.<sup>357</sup> The court found that a malpractice claim could not be asserted by the third party because there was no privity, and an attorney in Texas only owes a duty to his or her client.<sup>358</sup> Nonetheless, the court held that the attorney could be liable for negligent misrepresentation, which is a cause of action separate from a malpractice claim.<sup>359</sup> Privity is not required for a negligent misrepresentation claim; liability can arise if the attorney was aware of the third party's reliance and intended such reliance.<sup>360</sup>

Despite the above examples, counsel who err about an unsettled point of law or theories about which similarly situated lawyers would have reasonable doubts likely will not incur liability for the resulting erroneous advice which they provided.<sup>361</sup> Although most courts generally hold counsel who regard themselves as a specialist in a particular area of the law to a higher standard of care,<sup>362</sup> some courts also require that every attorney,

---

<sup>352</sup> See *id.* at 1283.

<sup>353</sup> See *id.*; accord *Vereins-UND Westbank v. Carter*, 691 F. Supp. 704, 710 (S.D.N.Y. 1988) (holding that attorney could be liable to an assignee although its identity was not known when the opinion letter was written).

<sup>354</sup> 700 F. Supp. at 1282.

<sup>355</sup> 953 S.W.2d 405 (Tex. Ct. App. 1997).

<sup>356</sup> See *id.* at 406.

<sup>357</sup> See *id.* at 407.

<sup>358</sup> See *id.* (citing *Barcelo v. Elliot*, 923 S.W.2d 575 (Tex. 1996)).

<sup>359</sup> See *id.* at 408.

<sup>360</sup> See *id.*

<sup>361</sup> See, e.g., *Martinson Mfg. Co. v. Seery*, 351 N.W.2d 772 (Iowa 1984) (attorney not liable for misinterpreting an IRS provision since well-informed lawyers could disagree about the provision's correct interpretation).

<sup>362</sup> See, e.g., *Transcraft, Inc. v. Galvin, Stalmack, Kirschner & Clark*, 39 F.3d 812, 815 (7th Cir.

whether or not a specialist, should be knowledgeable about certain substantive and procedural aspects of various fields of the law.<sup>363</sup> Thus, if counsel renders incorrect advice about a fundamental area of the law, then they may be held liable for malpractice. Moreover, in giving advice, counsel also has the duty "to discover those additional rules of law which, although not commonly known, may readily be found by standard research techniques."<sup>364</sup> Although these amorphous concepts do not provide much guidance to counsel, they do suggest the potential malpractice liability to which counsel may be subjected if they fail to use adequate care in rendering legal advice.

#### IV. MINIMIZING AND AVOIDING POTENTIAL LIABILITY

It is a challenge to balance the traditional roles of a lawyer as a counselor and advocate with the newer roles of investigator, informer, and sometimes prosecutor. But I submit that it is a challenge that corporate counsel must meet appropriately in order to successfully carry out his or her professional responsibility to the entity.<sup>365</sup>

Despite the many liabilities faced by in-house counsel, there are ways to minimize and even avoid incurring liability. Of course, the easiest way would be to say or do nothing, but that is not feasible. Instead, to minimize the potential of incurring liability, at least three steps can be taken: (1) clearly identify what type of client relationship exists, if any; (2) when providing advice, attempt to distinguish between legal and business advice; and (3) create centralized in-house legal departments. Even if every precaution is taken to avoid incurring liability, lawsuits—even if not meritorious—are still likely to be brought against in-house counsel. Thus, counsel should also ensure that they are covered under their corporation's indemnification and insurance policies.

##### A. Attorney-Client Relationship

---

1994); *St. Paul Fire & Marine Ins. Co. v. CEI Fla., Inc.*, 864 F. Supp. 656, 673 (E.D. Mich. 1994).

<sup>363</sup> See, e.g., *Bucquet v. Livingston*, 129 Cal. Rptr. 514, 519 (Cal. Ct. App. 1976) (holding that any attorney doing estate planning should know certain tax laws).

<sup>364</sup> *Smith v. Lewis*, 530 P.2d 589 (Cal. 1975), *overruled on other grounds*, *In re Marriage of Brown*, 544 P.2d 561 (Cal. 1976).

<sup>365</sup> H.J. Aibel, *Corporate Counsel and Business Ethics: A Personal Review*, 59 MO. L. REV. 427, 439 (1994).

As discussed in Part II, many claims arise because a constituent of the corporation believes that the corporate counsel represents him or her personally. For example, many corporate executives do not realize that corporate counsel represents only the corporation, not them individually.<sup>366</sup> There are several steps that counsel can take to clarify their role in the corporation.

First, counsel must undertake the responsibility to ensure that the third-party constituent understands to whom counsel's loyalty belongs and the repercussions resulting from a misunderstanding about whether an attorney-client relationship has been created. Therefore, according to Model Rule 1.13(d), counsel has the responsibility of identifying to a nonentity constituent that he represents the corporation.<sup>367</sup> Similarly, the Model Code requires that counsel explain the different interests involved, the advantages of seeking independent legal advice, and the advantages and disadvantages to the nonentity client.<sup>368</sup> Although the Rules and Code provide the attorney discretion about when they should give such a warning,<sup>369</sup> to reduce the potential of liability being imposed by a constituent, counsel is best advised always to provide such a warning if there is even the slightest possibility that a conflict could develop.<sup>370</sup>

Second, a corporation's general counsel must be proactive and ensure that the corporation has a "formal conflict of interest policy that covers all management and other decision-making personnel."<sup>371</sup> One step that should be taken is to alert others in the corporation that the in-house counsel represents the corporation and not its constituents. This could be accomplished by including a section in employee handbooks which clearly states that the corporation's attorneys represent the corporation and not its individual employees. This is sometimes referred to as a "corporate *Miranda*."<sup>372</sup>

A third action that would be helpful in clarifying the corporate counsel's role is to create an ethics committee to which both counsel and nonlawyers could turn for guidance. This would not only help avert

---

<sup>366</sup> See Sally R. Weaver, *Ethical Dilemmas of Corporate Counsel: A Structural and Contextual Analysis*, 46 EMORY L.J. 1023, 1028 (1997).

<sup>367</sup> See Model Rule 1.13(d).

<sup>368</sup> See *In re James*, 452 A.2d 163, 176 (D.C. 1982) (describing Model Code DR 4-101(B) and DR 5-104(A)).

<sup>369</sup> See Model Rule 1.13 cmt.

<sup>370</sup> See *Hardin & Lee*, *supra* note 3, at 37; see also *E.F. Hutton & Co. v. Brown*, 305 F. Supp. 371, 400 (S.D. Tex. 1969) (stating that counsel has the responsibility to inform his clients of potential conflicts of interest resulting from dual representation).

<sup>371</sup> *Conflicts of Interest: The General Counsel and Related-Party Transactions*, BNA CORP. COUNS. DAILY, Aug. 1, 1996, at D6.

<sup>372</sup> Tkacz, *supra* note 103, at 1.705.

conflicts but also would remind management and employees that counsel's loyalty is to the corporation, not to the individual employees or officers.<sup>373</sup>

Finally, counsel should periodically reinforce the notion that his or her responsibility is to the corporation, not its individual constituents. For example, counsel could regularly remind the board of directors or management at meetings that his or her primary responsibility is to the corporation.<sup>374</sup>

Nonetheless, in the case where dual representation of both the corporation and a corporate constituent may arise, providing a warning is not necessary if counsel reasonably believes that the constituent understands to whom counsel's duty is owed.<sup>375</sup> However, in most circumstances, it is advisable to provide cautionary notice to the constituent and to take the following steps:

- Tell the [constituent] the reason for the meeting.
- Explain that, as the corporate attorney, he or she is representing the company.
- Explain that he or she may also represent the [constituent] in the matter if the [constituent] consents and if there is no conflict.
- Explain the details of the attorney-client privilege—that the privilege belongs to the company, and the company can subsequently waive it.
- Dictate and file a memo memorializing the conversation.<sup>376</sup>

Although following the above steps may not avoid a future conflict, it would at least limit counsel's liability exposure.

#### B. Advice

The success of corporate lawyers depends on the relationship that they develop with the corporation's executives and on their ability "to make professional contributions to the management's achievement of its business

---

<sup>373</sup> See Daly, *supra* note 1, at 1.307-1.308.

<sup>374</sup> See Weaver, *supra* note 366, at 1034.

<sup>375</sup> See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 163 cmt. 3 (Tentative Draft No. 8, 1997). Issuing no warning may even be in the best interests of the corporation to ensure full disclosure of the information. See *id.*

<sup>376</sup> C. Evan Stewart, *For In-House Counsel, Serving Two Masters Raises Ethical Issues: What are the Constraints on Multiple Representation?*, NAT'L L. J., Aug. 30, 1993, at S19.



goals."<sup>377</sup> Making this contribution often means that counsel must provide more than pure legal advice. Because of the inherent problems that exist when in-house counsel becomes too close to management,<sup>378</sup> they must ensure that they maintain their independence and objectivity.<sup>379</sup> However, this may be nearly impossible, as found by the court in *In re Oracle Securities Litigation*.<sup>380</sup> In *Oracle*, the general counsel allegedly represented only the corporation in a derivative lawsuit against the corporation's inside directors.<sup>381</sup> The court stated, however, that "in-house attorneys are inevitably subservient to the interests of the [inside] directors and officers whom they serve . . . particularly where corporate counsel advocates a settlement that is highly favorable to the individual defendants who are his superiors."<sup>382</sup>

Maintaining one's independence may be particularly difficult if counsel is also a director of the corporation.<sup>383</sup> Although the corporation may feel that counsel's "advice and vote will be more calculated to protect the company and advance its goals" if he or she also becomes a director,<sup>384</sup> it actually reduces counsel's independence, which may result in future legal problems. Therefore, the "challenge is to render advice based upon both business considerations and legal theory, keeping in mind [the] role as a lawyer, and having objectivity as the main goal."<sup>385</sup> However, with the dual loyalties both to the corporation through counsel's fiduciary duty and the accountability to one's superior as an employee, this independence is nearly impossible for in-house counsel to achieve.<sup>386</sup> Regardless, the Model Rules and Code require that counsel "exercise independent professional judgment."<sup>387</sup>

In such situations where there may be an appearance that counsel lacks independence, counsel would be best advised to seek an opinion from outside counsel. Such situations may arise, for example, where a shareholder brings a derivative lawsuit against one of the corporation's

<sup>377</sup> Aibel, *supra* note 365, at 428.

<sup>378</sup> See Hardin & Lee, *supra* note 3, at 38.

<sup>379</sup> See generally, Robert W. Gordon, *The Independence of Lawyers*, 68 B.U. L. REV. 1 (1988) (discussing the independence of lawyers).

<sup>380</sup> 829 F. Supp. 1176 (N.D. Cal. 1993).

<sup>381</sup> See *id.* at 1188.

<sup>382</sup> *Id.* at 1188-89. *Accord* General Dynamics Corp. v. Superior Court, 876 P.2d 487, 498 (Cal. 1994) (noting "the distinguishing feature of the in-house attorney is a virtually complete dependence on the good will and confidence of a single employer to provide livelihood and a career success").

<sup>383</sup> See Cummins & Kelly, *supra* note 152, at 50; see also *supra* Part II.C (discussing attorney-director conflicts).

<sup>384</sup> See Cummins & Kelly, *supra* note 152, at 50.

<sup>385</sup> Hardin & Lee, *supra* note 3, at 38.

<sup>386</sup> See Metzloff, *supra* note 34, at 114.

<sup>387</sup> Model Rule 2.1; see also Model Code Canon 5.

officers for breaching a duty of loyalty to the corporation. If counsel has a close working relationship with the officer, then he or she likely may be perceived as lacking the independence necessary to pursue the matter. Consequently, to avoid the personal liability which may result from counsel's own breach of fiduciary duty in failing to adequately represent the corporation, counsel may want to seek an independent opinion from outside counsel.

In addition, corporate counsel must be acutely aware of which hat they wear when providing advice: the business hat or the legal hat.<sup>388</sup> One of the best ways to do this is to clarify beforehand whether they are being asked to provide business or legal advice. The problem is that such advice cannot be easily distinguished.<sup>389</sup> One attempt to explain what constitutes legal advice is that which relates "to facts communicated for the purpose of securing a legal opinion, legal services or assistance in a legal proceeding."<sup>390</sup>

Historically, courts have used a case-by-case approach to determine if the advice provided by counsel was legal or business in nature,<sup>391</sup> with protection being afforded only to legal advice. Recently, courts have become more polarized in determining whether advice is legal or business in nature. For example, in *Georgia Pacific Corp. v. GAF Roofing Manufacturing Corp.*,<sup>392</sup> the court held that an in-house attorney who conducted negotiations for the corporation was performing a business function instead of a legal function,<sup>393</sup> despite the fact that such an activity is one of the primary functions of a corporate attorney. The prevailing view, however, is that expressed in *Kelly v. Ford Motor Co.*,<sup>394</sup> where the Third Circuit held that corporate counsel's legal advice to the board of directors is protected by the attorney-client privilege although the advice was used as the basis for a business decision.<sup>395</sup> Usually, if more legal

---

<sup>388</sup> See Craig, *supra* note 8, at 1.205; see generally, Grace M. Giesel, *The Legal Advice Requirements of the Attorney-Client Privilege: A Special Problem for In-House Counsel and Outside Attorneys Representing Corporations*, 48 MERCER L. REV. 1169, 1190-1217 (1997).

<sup>389</sup> See Shira A. Scheindlin, *Legal/Business Advice Dichotomy*, N.Y. L.J., Aug. 5, 1993, at 7. One court stated: "Although the rule is clearly stated, its application is difficult, since in the corporate community, legal advice 'is often intimately intertwined with and difficult to distinguish from business advice.'" *Leonen v. Johns-Manville*, 135 F.R.D. 94, 98-99 (D.N.J. 1990) (quoting *Sedco Int'l, S.A. v. Cory*, 683 F.2d 1201, 1205 (8th Cir. 1982)).

<sup>390</sup> *United States v. Bay State Ambulance & Hosp. Rental Serv., Inc.* 874 F.2d 20, 27-28 (1st Cir. 1989).

<sup>391</sup> See generally *Advanced Cardiovascular Sys., Inc. v. C.R. Bard, Inc.*, 144 F.R.D. 372 (N.D. Cal. 1992).

<sup>392</sup> No. Civ. 93-5125, 1996 WL 29392 (S.D.N.Y. Jan. 25, 1996).

<sup>393</sup> See *id.* at \*4.

<sup>394</sup> 110 F.3d 954 (3d Cir. 1997).

<sup>395</sup> See *id.* at 966.

advice is provided—even if it contains substantial nonlegal aspects—then the standard usually would be met, and the advice would be protected.<sup>396</sup>

Nonetheless, to limit potential liability which may result from losing the attorney-client privilege, any advice should begin with introductory phrases that clearly indicate whether the advice being provided is legal or business in nature. Furthermore, it would also be helpful to “clearly identify legal theories and conclusions and distinguish them from general business advice” in communications where legal and business advice are intermixed.<sup>397</sup> For example, in written matters, counsel should always use letterhead and stationery that clearly states his or her legal capacity.<sup>398</sup> This allows both counsel and the receiver of the advice to know the extent to which they can rely upon the information. Clearly distinguishing between legal and business advice is essential, especially when counsel attempts to recover from his or her insurance carrier if liability arises.<sup>399</sup>

Finally, another important requirement is that counsel should always deliver advice to the appropriate person. This person is the one who has the ultimate authority to execute on the decision.<sup>400</sup> A direct channel of communication is much more beneficial than going through an intermediary since an intermediary may have a stake in the transaction.<sup>401</sup> For example, a subordinate may have an ulterior motive in making a favorable recommendation to his superior if landing a big contract provides a personal benefit because a profit-sharing distribution will consequently be greater. Counsel should also ensure that the person who receives the advice understands that the advice could be incorrect. This could occur, for instance, if the advice was based on improperly communicated facts, thereby resulting in incorrect judgments.<sup>402</sup>

### C. Legal Departments

Creating separate legal departments in each corporate business unit may allow attorneys to become more familiar with the business side of potential problems.<sup>403</sup> However, it also increases the likelihood that courts

---

<sup>396</sup> See Flucke, *supra* note 187, at 558.

<sup>397</sup> *Id.* at 578.

<sup>398</sup> See *id.* at 577.

<sup>399</sup> See *infra* notes 422-34 and accompanying text (discussing the problem which counsel face in recovering from their insurance company when there is uncertainty over whether the advice was legal or business in nature).

<sup>400</sup> See Cecil D. Quillen, *The Professional Responsibilities of In-House Lawyers*, in *CORPORATE COUNSEL'S GUIDE TO LAWYERING LAWS* 1.101, 1.103 (Business Laws, Inc. ed., 1996).

<sup>401</sup> See *id.*

<sup>402</sup> See *id.*

<sup>403</sup> See Bencivenga, *In-House Counsel*, *supra* note 157, at 5; accord, *What's the Return on Your Investment? These Legal Departments are Proving Themselves to Clients, Demanding More*

will not look at advice provided by such attorneys as legal in nature because of the perceived increase in coziness that the attorney has with management in the smaller business unit.<sup>404</sup> Thus, the risk increases that the attorney-client privilege will be waived and that the number of conflicts of interest may rise, both of which could increase counsel's exposure to potential malpractice liability.

Limiting liability by funneling all of the legal decisions through one corporate law department would be more advantageous.<sup>405</sup> This assists in ensuring the independence of counsel and that the advice is objective since it would decrease the likelihood that a manager of a particular corporate division would dominate counsel.<sup>406</sup> In addition, for attorneys who are specialists (particularly in large legal departments), they could occasionally be reassigned to other specialties to avoid "attachment" to a particular department or set of management employees.<sup>407</sup> This would help to ensure that they do not become "well-nigh clones" of the department's management or develop tunnel vision which prevents them from identifying problems outside their area of specialization.<sup>408</sup>

Corporations also "must recognize and be sensitive to the fact that in-house counsel are pulled in many directions."<sup>409</sup> Thus, to protect in-house counsel against suits by nonclients, corporations should create internal guidelines for their in-house counsel (who are employees) and clearly define their role within the corporation.<sup>410</sup> For example, if a corporation defined the specific fiduciary duties of corporate counsel, then counsel could develop defenses against a breach of fiduciary duty lawsuit.<sup>411</sup> Another example is aiding and abetting liability discussed in Part III.D. To provide a defense against aiding and abetting claims, corporations could write specific job descriptions for in-house counsel, which would allow them to assert a defense if they have never seen, and had no responsibility to see, a particular document which allegedly should have provided counsel with notice of a legal violation.<sup>412</sup>

---

from *Others*, CORP. L. TIMES, Apr. 1997, at 34 [hereinafter *What's the Return*] (stating how the law firm then becomes an integral part of the business).

<sup>404</sup> See *supra* notes 13-14 and accompanying text.

<sup>405</sup> See Sam A. Snyder, *Special Liability for In-House Counsel*, 515 PRAC. L. INST./CORP. 377, 381 (1986).

<sup>406</sup> See *id.* at 381; accord *What's the Return*, *supra* note 403, at 34 (stating how tensions are created when counsel has to report to the head of a corporate division).

<sup>407</sup> See Snyder, *supra* note 405, at 382.

<sup>408</sup> See *id.*

<sup>409</sup> Staffenberg, *supra* note 14, at 423.

<sup>410</sup> See *id.*

<sup>411</sup> See *id.*; see also *supra* Part III.A.

<sup>412</sup> See Staffenberg, *supra* note 14, at 423.

Finally, an area of the law where counsel could potentially be exposed to a malpractice action is in failing to "ensure that the [law department] has in effect measures giving reasonable assurances that all lawyers in the [law department] conform to the rules of professional conduct."<sup>413</sup> Particularly, general counsel could be exposed to liability for work done by those over which he or she has supervisory authority,<sup>414</sup> which would presumably be all of the attorneys in the law department. Nonetheless, for general counsel to be liable for malpractice resulting from other attorney's violations of the Model Rules, counsel must have ordered or approved the conduct,<sup>415</sup> or having known about the conduct, failed to take action which could have avoided or mitigated the resulting consequences.<sup>416</sup> This supervisory liability rule also applies to nonlawyers such as secretaries, paralegals, law clerks, and investigators.<sup>417</sup>

#### D. Indemnification

No matter how many precautions corporate attorneys take to protect against liability, the risk of a lawsuit and resulting liability always remains. Furthermore, although some examples previously described in this article may not have found counsel liable, there is still a significant cost involved in defending against such lawsuits. Thus, counsel must ensure that they are protected against having to pay personally for defending against such claims, which is the purpose of indemnification agreements. However, in-house counsel must look at each individual state's corporate statute to determine whether they are even entitled to indemnification. Some state statutes are permissive and do not automatically require that the corporation provide indemnification.<sup>418</sup>

Even if a corporate charter contains provisions that provide indemnification for directors and officers, such language may be too broad to protect in-house counsel fully.<sup>419</sup> Thus, it would be advantageous to have "an express indemnification agreement which defines the actions

---

<sup>413</sup> Model Rule 5.1(a); *see also* Model Rule 5.1 cmt. (expressly stating that Rule 5.1 applies to legal departments in an organization).

<sup>414</sup> *See* Model Rule 5.1(b).

<sup>415</sup> *See* Model Rule 5.1(c)(1).

<sup>416</sup> *See* Model Rule 5.1(c)(2).

<sup>417</sup> *See* Model Rule 5.3.

<sup>418</sup> *See e.g.*, CAL. CORP. CODE § 317 (West 1990) (permitting indemnification); MASS. GEN. LAWS ANN. ch. 156B, § 67 (West 1992) (permitting indemnification). *Cf.* MINN. STAT. ANN. § 302A.521 (West 1985 & Supp. 1997) (requiring indemnification if acted in official capacity); N.C. GEN. STAT. § 55-8-56 (1996) (requiring indemnification for officers unless otherwise provided in the articles of incorporation).

<sup>419</sup> *See* Honig, *supra* note 7, at 8.207.

indemnified, the procedures for indemnification (and defense), and the availability of indemnification following termination of employment.”<sup>420</sup>

### E. Insurance

In-house attorneys, as individuals, do not have deep pockets from which to defend against or settle claims brought against them. Thus, in-house counsel must rely on insurance to help them defend against individual liability lawsuits.<sup>421</sup> The problem is that legal malpractice insurance policies only protect against acts, errors, and omissions done while performing professional services in one's capacity as a lawyer.<sup>422</sup> For example, the Attorney's Liability Assurance Society (ALAS), who underwrites many legal malpractice insurance policies, specifically excludes from coverage any claims of malpractice if, at the time of the conduct complained of, a member of the law firm representing the corporate client held any type of officer position in the corporation.<sup>423</sup> Under this “business pursuits” exclusion, professional liability policies do not cover actions taken as a corporate officer or director.<sup>424</sup> Since the line between legal and business advice is not always clear,<sup>425</sup> the attorney might be without sufficient insurance coverage.

Corporate counsel may also be covered as an officer under a corporation's directors' and officers' (D&O) liability insurance policy. However, such policies frequently do not cover actions which counsel undertake in their legal capacity.<sup>426</sup> Furthermore, many claims made against corporate attorneys are based on fraud;<sup>427</sup> yet, most D&O policies exclude coverage for fraud.<sup>428</sup> Even if counsel is covered by two policies (a legal malpractice policy and a D&O policy), each insurance carrier oftentimes argues that the other policy covers the liability.<sup>429</sup> This often

---

<sup>420</sup> *Id.* at 8.207-8.208.

<sup>421</sup> Of course, as one commentator suggested: “When third parties are suing, they're often looking for deep pockets. By buying malpractice insurance, the lawyer may be setting himself or herself up.” Fisk, *supra* note 5, at 23.

<sup>422</sup> See 4 MALLIN & SMITH, *supra* note 2, § 33.24, at 350.

<sup>423</sup> See ATTORNEY'S LIABILITY ASSURANCE SOCIETY, LOSS PREVENTION MANUAL, Tab IIE at 8.

<sup>424</sup> See *id.*

<sup>425</sup> See *supra* notes 388-99 and accompanying text (discussing the problem with distinguishing between legal and business advice).

<sup>426</sup> See Honig, *supra* note 7, at 8.209; see, e.g., Adamo v. State Farm Lloyds Co., 853 S.W.2d 673 (Tex. App. 1993) (holding that a D&O carrier did not have to defend a claim which concerned a breach of fiduciary duty based on a legal relationship).

<sup>427</sup> See Anderson & Gold, *supra* note 5, at C27.

<sup>428</sup> See, e.g., National Union Fire Ins. Co. of Pittsburgh v. Brow, 787 F. Supp. 1424, 1429 (S.D. Fla. 1991), *aff'd*, 963 F.2d 385 (11th Cir. 1992).

<sup>429</sup> See, e.g., St. Paul Fire & Marine Ins. Co. v. American Home Assurance Co., 514 N.W.2d

results from "other insurance" clauses that are often included in policies. These clauses preclude coverage under a policy if the liability is covered under another policy.<sup>430</sup>

Therefore, attorneys are often in a catch-22: if they only get one policy, then they may be denied coverage because that policy does not cover the particular type of claim, and if they have two policies, then there may be an extensive battle between the insurance companies about who will be liable. Consequently, when an action is brought against counsel, he or she may be forced to bring another suit against both of his insurance carriers to determine which of his two hats—lawyer or business advisor—he was wearing at the time when he rendered the advice.<sup>431</sup> For example, in *Niagara Fire Insurance Co. v. Pepicelli, Pepicelli, Watts and Youngs, P.C.*,<sup>432</sup> a corporation brought a malpractice suit against its counsel who was an officer of another corporation involved in the suit. Subsequently, the attorney sued its malpractice insurer for failing to defend him in the action. The insurance carrier alleged that it had no duty to defend the attorney since the policy excluded coverage for officers.<sup>433</sup> However, the court held that the insurance carrier had an obligation to defend against the suit because the malpractice claim did not arise out of counsel's activities as an officer of the other corporation.<sup>434</sup> Although counsel in this case was victorious, it still demonstrates the additional time and expense which counsel can incur in attempting to recover under an insurance policy.

Although professional insurance for counsel is very rare,<sup>435</sup> corporations should provide all counsel with insurance sufficient to cover all actions that may arise during representation of the corporation. However, because of the potential for being denied coverage, corporate counsel must thoroughly investigate the extent of their coverage before a claim is made and determine what types of activities are considered the practice of law and which are business activities. Even more advantageous

---

113, 121 (Mich. 1994) (holding that "other insurance" clauses in attorney's multiple liability insurance policies were not irreconcilable).

<sup>430</sup> See *Anderson & Gold*, *supra* note 5, at c. 27 n.16; see, e.g., *United States Fidelity & Guar. Co. v. Executive Ins. Co.*, 893 F.2d 517, 520 (2d Cir. 1990) (providing an example of "other insurance" policies).

<sup>431</sup> See *Cummins & Kelly*, *supra* note 152, at 51; see also *Mt. Airy Ins. Co. v. Greenbaum*, 127 F.3d 15, 20-21 (1st Cir. 1997) (finding that a claim asserted against attorneys was not covered under their malpractice insurance because their liability arose from business acts which were specifically excluded in the policy).

<sup>432</sup> 821 F.2d 216 (3d Cir. 1987).

<sup>433</sup> See *id.* at 220.

<sup>434</sup> See *id.*

<sup>435</sup> See *Honig*, *supra* note 7, at 8.209 (stating that "professional liability insurance for counsel is the exception, not the rule").

would be to receive examples from the insurance carrier of each type of activity which would and would not be covered under the policy. Furthermore, to prevent disputes about whether the professional malpractice or a D&O policy applies, counsel should try to obtain both policies from the same insurance company.<sup>436</sup> This would help to prevent overlap in coverage, eliminate costly disputes about which policy applies, and possibly lower the total premiums paid because of the ability to pay a composite premium.

## V. CONCLUSION

Fortunately for in-house counsel, there have not been a plethora of liability actions brought specifically against them.<sup>437</sup> However, with the increasing number of in-house counsel who "have become an integral part of the management structure,"<sup>438</sup> the potential for liability has also increased. In addition, with the number of in-house counsel increasing, it is likely that the number of actions brought against them will likewise increase. Thus, counsel need to be aware of the areas in which potential liability may arise and take the necessary steps to ensure that they are protected when it does arise. Although counsel can minimize or even avoid some of the risks, it might not be advantageous to completely eliminate all risks. As one corporate counsel has stated, "A risk-free society would be less than productive and would doubtlessly be a boring and unhappy place."<sup>439</sup>

---

<sup>436</sup> See 4 MALLEN & SMITH, *supra* note 2, § 33.28, at 361.

<sup>437</sup> See Honig, *supra* note 7, at 8.210.

<sup>438</sup> Aibel, *supra* note 365, at 427.

<sup>439</sup> Snyder, *supra* note 405, at 387.