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Multi-Party Representation of an Organization in Formation

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Tax Practice

Ethics of Multi-Party Representation—Part 3: Representing an Organization

By William D. Elliott

This column is the third in a series on the ethics of multi-party representation and concerns representing an organization, whether in formation, in operation, or in termination.

Part 1 of the series was an introduction to the subject of ethics and tax practice. Tax lawyers confront a triad of ethics regulation.[1] The state where the lawyer practices is the primary regulatory sphere. The closest thing to a national ethics code is the ABA Model Rules, which pertain to practice of tax law whether or not one is a member of the ABA since the vast majority of federal courts indicate they are influenced by the ABA Model Rules and related ABA ethics opinions.[2] Finally, the Treasury Department somewhat regulates Federal tax practice through Circular 230, even though in recent times, the vigor of the Treasury's enforcement mechanism seems to be lacking.

Part 2 of the series concerned the ubiquitous conflict of interest from the point of view of concurrent representation of current clients, representation of current clients potentially adverse to former clients, and prospective clients.[3] Conflicts of interest are said to be the "silent killers" in legal malpractice.[4]

The various facets of ethical guidance confront the tax practitioner who struggles to make choices every day as to how to navigate guidance—however, difficult the rules are to understand—while at the same time trying to respond to clients and their legal matters.

Reality of Multi-Party Representation

A primary reason for the interest in the subject of ethical guidance when representing an organization is the reality that on Main Street the experience of lawyers representing multiple persons who are co-owners of an entity or organization is commonplace. Also frequently encountered on Main Street is the representation of multiple family members in business or family organizations. The centerpiece of many an estate plan is the presence of a family partnership or family limited liability companies.[5]

Even though the Model Code and the ethical codes of the various states do not warmly embrace the notion of representing multi-persons concurrently,

important Bar-related groups, such as the American College of Trusts and Estates Counsel (ACTEC) recognize and even encourage this type of intertwined multiple representation. In the ACTEC Commentaries on the Model Rules of Professional Conduct, the economies of scale by a common representation, improved and more efficient communications, better coordination of planning and better understanding of client and property facts are highlighted as compelling factors favoring multiple representation of owners of an organization.[6] Although the ACTEC Commentaries highlight representation of a family organization, the same advantages discussed there apply equally to representation of multi-party organizations. Professor Geoffrey Hazard, noted ethics expert, has emphasized the important role that a lawyer can play in representing business associates or family members by discouraging or even mediating escalation of conflict and contributing historical perspective and judgment.[7]

Despite the commonality of representing multi-parties in an organization, whether a family organization or conventional organization, the legal and ethics risks of such a representation abound. The guidelines and comments of ABA Model Rule 1.7, which concerns conflicts of interest, point out the hazards of multi-party representation when potentially adverse interests of the various parties with the concurrent representation cannot be reconciled. When a lawyer confronts irreconcilable conflict or potential conflict making multi-party representation impossible, then the only pathway forward is for the lawyer to withdraw.[8]

There is a striking absence of clear guidance from the courts and bar disciplinary organizations for those who undertake to represent the closely-held business. The ABA Model Rules and state ethical codes are not straightforward on this subject. These ethical codes have developed through the years mostly from a vantage point of litigation and controversy. From the earliest of days, legal ethics were aimed at the single, individual client being represented by the single, individual lawyer. As the modern law practice has evolved into what it is today, ethical codes have responded, somewhat grudgingly it would seem, to the reality of representing organizations. Reading the ABA Model Code today one is left with the impression that it was mostly written by litigators, or at least lawyers who do not confront business or family organizations with any frequency. Further, the ABA Model Code today has a flavor of being written by Wall Street for Wall Street. For those of us on Main Street, we are left with many ethical challenges and risks when representing an organization.

Organization as Client: Entity or Aggregate

For better or worse, ABA Model Rule 1.13 is the national guidepost, such as it is, in stating that a lawyer retained by an organization represents the organization and does not, by virtue of that representation, represent any of the constituents of that organization, such as an officer or director, in an individual capacity.[9] Since an organization does not have an individual voice, the organization can only act through individuals who are responsible for the organization, such as officers and directors. Model Rule 1.13 helps somewhat with understanding to whom the lawyer owes ethical responsibility. Model Rule 1.13 adopts an entity theory and thus the ethical duty runs to the organization.[10]

The inherent problem with Model Rule 1.13 is the bifurcation of the entity and its constituents, or the identity of the client or clients, if you will. On Wall Street, if you are in a large law firm representing some large company in a merger or acquisition, you are usually not in doubt over the identity of the client. The large, publicly traded company has a clear existence with definite owners, directors, and officers with reasonably well-defined legal rights and duties relative to one another.[11]

On Main Street, small partnerships and limited liability companies and, to a lesser extent, closely-held corporations occupy center stage in the daily life of the practitioner, along with other small organizations such as homeowners' organizations or non-profit entities. These small organizations are constantly being formed, operated, changed, purchased, sold, and terminated. The practice of representing the small organization is the bread and butter of the practice for many lawyers.

The dilemma for the Main Street practitioner is that the distinction between the organization or entity from its constituents can be blurred and, frankly, is usually vague. An entity-based ethical rule such as Model Rule 1.13 makes sense, in theory, but the reality of how small partnerships, LLCs, and corporations are formed, operated, and terminated illustrates that there is usually no separation of the individuals into owners and managers. Thus, the aggregate theory probably better reflects the reality of the relationships that exist. Individuals who form, own, and manage a small company think of themselves as partners and act like it. Owners of business or family organizations do not easily separate into owners, directors, and managers. The organization might be an entity insofar as the rest of the world is concerned, but the reality is that as between the individuals, they act as partners with

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