Multiple Representation in Shareholder Derivative Suits: A Case-by-Case Approach

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Multiple Representation in Shareholder Derivative Suits: A Case-by-Case Approach

INTRODUCTION

The shareholder derivative suit is an action by which a plaintiff-shareholder asserts a claim against the corporate entity and directors, officers or third parties who have allegedly wronged the corporation. Corporate counsel may, in such actions, wish to represent both the corporation and the individual director-officer defendants. Multiple representation may, however, run afoul of ethical guidelines which prohibit conflicts of interest.

The approaches taken by courts and commentators on the issue have not been consistent. While some courts have taken the view that the corporate and individual defendants should always be independently represented, others permit multiple representation in certain factual settings. The Model Code of Professional Responsibility ("Model Code") provides guidelines which assist the

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1. H. HENN, LAW OF CORPORATIONS 1036 (3d ed. 1983). The derivative suit was developed in the equity courts as a remedy which provided redress when management refused to pursue or neglected to vigorously pursue the rights of the corporation against directors, officers, or third parties who had damaged or threatened the interests of the corporation. W. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS 525-26 (3d ed. 1978). See Ross v. Bernhard, 396 U.S. 531 (1970), which held that the right to trial by jury extends to derivative actions.

2. "Multiple representation," as used throughout this note, refers to a single attorney or attorneys from a single firm who represent or seek to represent both the corporation and one or more of the individual director-officer defendants.


4. See infra notes 59-95 and accompanying text.

5. Id.

6. The Model Code was adopted by the American Bar Association in 1970 and by 1979 had been adopted at least in part by all states except California. See California State Bar Standing Comm. on Professional Responsibility and Conduct, Formal Op. 71 (1983), which stated that the Model Code may be persuasive authority as to ethical problems not specifically addressed by California rules or decisions. The American Bar Association replaced the Model Code in August of 1983 with the Model Rules, but the ethics rules of forty-seven states are still patterned after the Model Code. Some federal courts have also adopted the Model Code as the ethical standard governing the conduct of attorneys practicing before them. See, e.g., N.D. ILL. R. 8(a), (d); E.D. PA. R. 11.

The Model Code consists of three separate but interrelated parts: Canons, Ethical Considerations ("EC's") and Disciplinary Rules ("DR's"). The Canons are statements of axiomatic norms, expressing in general terms the
courts in their evaluation, but a uniform approach to the issue has not yet emerged.7

Resolution of the multiple representation issue must involve a careful balancing of the corporation's right to a choice of counsel and the importance of adhering to the highest ethical standards by avoiding conflicts of interest. This note proposes that the issue may best be resolved by a detailed, case-by-case analysis which focuses on the particular facts present in each derivative action and the harmony or divergence of the interests of the corporate defendant and the individual director-officer defendants. The recently adopted Model Rules of Professional Conduct8 ("Model Rules") provide an excellent framework for such analysis.

This note will first examine, in relation to the Model Code, the ethical problems inherent in any derivative action. Cases which have addressed these problems, with widely varying results, will then be considered. The focus will then turn to the Model Rules and the applicability of the approach they suggest.

BACKGROUND

The Ethical Problems Inherent in Multiple Representation

The issue of the propriety of multiple representation arises in part from the unique procedural aspects of derivative actions, which are, in legal effect, suits brought by the corporation but conducted by the shareholders.9 The corporation occupies a dual posi-

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7. See infra notes 59-95 and accompanying text.
8. For a discussion of the Model Rules as they relate to the issue of multiple representation, see infra notes 96-105, 124-31, 135-37 and accompanying text.
9. 13 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5939 (1980). Fletcher explains the dual nature of the derivative suit as follows:

[A] stockholders' suit . . . is a suit having a double aspect. The stockholders have a right in equity to compel the assertion of a corporate right of action against the directors or other wrongdoers when the corporation wrongfully refuses to sue. The suit is thus an action for specific enforcement of an obligation
tion in such litigation: while formally aligned as a defendant, it is the real party plaintiff and the beneficiary of any recovery resulting from a successful claim.\footnote{10} The interests of the corporation appear, therefore, to be closely linked with those of the individual plaintiff-shareholders. Where, for example, directors and officers are charged with fraud or illegality, the corporation and the plaintiff-shareholders have a common interest in reclaiming any fraudulently obtained benefits.\footnote{11} The corporation will, in such cases, retain the passive stance of a nominal defendant.\footnote{12}

Unity of interest between the corporation and its shareholders is not, however, always present in a derivative action. This is exemplified by the strike suit, an action generally brought by minority shareholders who hope that the nuisance value of meritless actions will generate rapid settlement by corporate defendants.\footnote{13} In such

\begin{itemize}
\item Owed by the corporation to the stockholders to assert its rights of action when the corporation has been put in default by the wrongful refusal of the directors or management to make suitable measures for its protection.

\textit{Id.} § 5941.1

\footnote{10} H. HENN, supra note 1, at 1037. The plaintiff-shareholder may, of course, indirectly benefit as a part of the entire community of corporate interests: shareholders, directors, officers and creditors. \textit{Id.}

In certain limited situations, courts have permitted individual shareholder recoveries in which the shareholder receives a pro rata share of what the corporation would have received. \textit{Id.} at 1096-97. The pro rata recovery has been permitted in three situations. First, where the action is against inside directors who have misappropriated corporate assets, recovery by shareholders prevents the funds from reverting to the control of the wrongdoers. \textit{Id.} at 1097; see Backus v. Finkelstein, 23 F.2d 531 (D. Minn. 1924); Dill v. Johnson, 72 Okla. 149, 179 P. 608 (1919); Eaton v. Robinson, 19 R.I. 146, 32 A. 339 (1895). Second, where there are both “guilty” and “innocent” shareholders the pro rata method limits recovery to the “innocent” ones. H. HENN, supra note 1, at 1097; see Brown v. De Young, 167 Ill. 549, 47 N.E. 863 (1897); Di Tomasso v. Loverro, 250 A.D. 206, 293 N.Y.S. 912 (1937), aff’d mem., 276 N.Y. 551, 12 N.E. 2d 570 (1937). Finally, where the corporation is no longer a going concern, pro rata recovery facilitates distribution of funds. H. HENN, supra note 1, at 1097; see Bailey v. Jacobs, 325 Pa. 187, 189 A. 320 (1937). Pro rata recovery is not generally permitted where creditors’ rights are involved. Some courts have refused to permit pro rata recoveries on the ground that they are inconsistent with the nature of derivative remedies; other courts disallow pro rata recovery because they view it as a forced dividend inconsistent with the corporation’s business judgment. H. HENN, supra note 1, at 1098.

\footnote{11} ABA/BNA LAWYERS’ MANUAL ON PROFESSIONAL CONDUCT 91:2602 (1984).

\footnote{12} H. HENN, supra note 1, at 1085.

\footnote{13} Id. at 1039; see Comment, Independent Representation for Corporate Defendants in Derivative Suits, 74 Yale L.J. 524, 529-30 (1963).

Because strike suits abuse the availability of the derivative action, statutes and case law in many jurisdictions have created various procedural obstacles which must be overcome by derivative action plaintiffs. First, in order to sue derivatively, a shareholder must, in the majority of jurisdictions, have been a shareholder at the time of the alleged wrong or the shares must have later devolved upon the shareholder by operation of law. H. HENN, supra note 1, at 1058-59.

A second requirement involves the exhaustion of intracorporate remedies. A plaintiff-
instances, the interests of the corporation and the named plaintiffs diverge. The corporation may raise certain procedural defenses to the derivative action and may in some limited circumstances be permitted to actively defend on the merits. Although the simultaneous representation of named defendants superficially involves no conflict of interest, the anomalous dual role of the corporation, the divergent interests often present, and the procedural choices available to the corporation result in an inherent potential for ethical problems whenever one attorney represents both the corporation and the individual defendants.

Further complicating the analysis of the propriety of multiple representation is the issue of client consent. Ethical guidelines which deal generally with conflicts of interest require informed and objective consent to the multiple representation from the client. In a derivative suit, however, the client consent frequently comes from corporate directors who are themselves individual defend-
In view of the potential self-interest involved, it has been suggested that extreme caution be exercised when applying consent provisions to the corporate setting. Relationships which exist among corporate attorneys, shareholders, directors and officers often increase the likelihood of conflict. The corporation is recognized in law as an entity, and ethical guidelines recognize that a corporate attorney's loyalties must at all times run to that entity. Determining a course of action that is most consistent with the entity's best interests may, however, be extremely difficult. The directors who possess management power and the shareholders, particularly minority shareholders, may strongly disagree as to the propriety of a particular course of action. The lawyer's own assessment of the best course of action may be influenced by strong loyalties to the majority directors and officers with whom he has primarily worked, and by his understandably strong desire to defend corporate transactions which resulted from his contributions to the decision-making process.

Corporate decision makers must, upon instigation of a derivative suit, evaluate the merits of the action and determine the role to be assumed by the corporation. In arriving at a decision that acc-

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19. Ass'n of the City of N.Y. Comm. on Professional Ethics, Op. 842 (1960); see infra notes 132-37 and accompanying text.
22. See e.g., MODEL CODE EC 5-18 ("A lawyer employed or retained by a corporation owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative or other person connected with the entity."); MODEL RULES Rule 1.13 ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.")
24. See Shipman, supra note 20, at 280.
25. Id.
26. In Zapata Corp. v. Maldonado, the Delaware Supreme Court stated: "We recognize that the final substantive judgment whether a particular lawsuit should be maintained requires a balance of many factors — ethical, commercial, promotional, public relations, employee relations, fiscal as well as legal." Zapata Corp. v. Maldonado, 430 A.2d 779, 788 (Del. 1981) (quoting Maldonado v. Flynn, 485 F. Supp. 274, 285 (S.D.N.Y. 1980)).
commodates the interests of all, it has become common practice for corporate boards of directors to delegate to "independent litigation committees" the responsibility of determining whether a derivative action is in the best interests of the corporation.\footnote{27} The committee investigates the action, sometimes with the aid of independent special counsel, accountants and other experts.\footnote{28} If the committee is indeed independent and acts in good faith and with due diligence, the committee's decisions will be assessed under the "business judgment rule."\footnote{29} A committee determination that the suit is not in the corporation's best interest will in most circumstances bar the action.\footnote{30}

\begin{center}
\textit{Model Code Treatment of Multiple Representation}
\end{center}

Multiple representation in a derivative action involves a potential conflict of interest\footnote{31} between the corporate and individual de-
The Model Code does not specifically address the issue of conflicts within the context of derivative suits. Several of its provisions are, however, relevant to an examination of the ethical implications of multiple representation in general and have been relied upon by courts which have analyzed the issue.

Canon 5 of the Model Code, which addresses the ethical issues involved in representing conflicting interests, provides that a lawyer "should exercise independent professional judgment on behalf of a client." Disciplinary Rule ("DR") 5-105, dealing specifically with multiple representation, requires an attorney, in some instances, to decline employment by multiple clients having potentially adverse interests. DR 5-105(C) permits such employment only if it is obvious that the lawyer can adequately represent each client's interests and each client consents to the representation after full disclosure of the potential effects of multiple representation upon the lawyer's independent professional judgment.

Ethical Consideration ("EC") 5-15 states that all doubts should be resolved against the propriety of the representation.

EC 5-18 deals with multiple representation in the corporate context. The provision recognizes the complex relationships which may exist among an attorney, management and shareholders. It also acknowledges the fact that the interests of the corporation must at all times be paramount. EC 5-18 states that a lawyer retained by a corporation owes his allegiance to the entity and not to

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Rules describe a conflict situation as that in which a lawyer's representation of a client is directly adverse to another client or may be materially limited by the lawyer's other responsibilities or own interests. MODEL RULES Rule 1.7; see infra notes 96-105 and accompanying text.


33. See supra note 6.

34. For a discussion of judicial treatment of multiple representation, see infra notes 59-95 and accompanying text.

35. MODEL CODE Canon 5.

36. MODEL CODE DR 5-105. EC 5-14 also provides guidance, stating that:

Maintaining the independence of professional judgment required of a lawyer precludes his acceptance or continuation of employment that will adversely affect his judgment on behalf of or dilute his loyalty to a client. This problem arises whenever a lawyer is asked to represent two or more clients who may have differing interests, whether such interests be conflicting, inconsistent, diverse, or otherwise discordant.

MODEL CODE EC 5-14.

37. MODEL CODE DR 5-105 (C). For a discussion of the applicability of consent provisions to derivative suits, see supra notes 17-19 and accompanying text and infra notes 132-37 and accompanying text.

38. MODEL CODE EC 5-15.
any individual. A lawyer may represent a director, officer or shareholder in an individual capacity only if he is convinced that conflicting interests are not present.\textsuperscript{39}

Another provision of the Model Code, Canon 9, provides that an attorney "should avoid even the appearances of professional impropriety."\textsuperscript{40} While the Disciplinary Rules under Canon 9 do not directly pertain to conflicts of interest,\textsuperscript{41} the general duty proposed by the Canon has been used as an additional tool in resolving conflict of interest issues.\textsuperscript{42}

The Model Code provides valuable ethical guidance to the bar

\textsuperscript{39} MODEL CODE EC 5-18.

\textsuperscript{40} MODEL CODE Canon 9.

\textsuperscript{41} The Disciplinary Rules under Canon 9 deal with transition from the judicial or public sector to the private sector and with preservation of client property and funds. MODEL CODE DR's 9-101, 9-102.

EC 9-6 sets forth a more general guideline by providing that:

Every lawyer owes a solemn duty to uphold the integrity and honor of his profession, to encourage respect for the law . . . , to conduct himself so as to reflect credit on the legal profession and to inspire the confidence, respect, and trust of his clients and of the public; and to strive to avoid not only professional impropriety but also the appearance of impropriety. MODEL CODE EC 9-6.

\textsuperscript{42} ABA STANDING COMM. ON PROFESSIONAL DISCIPLINE, THE JUDICIAL RESPONSE TO LAWYER MISCONDUCT VII.6 (1984) [hereinafter cited as JUDICIAL RESPONSE]; see Emle Industries, Inc. v. Patentex, Inc., 478 F.2d 562, 571 (2d Cir. 1973) (Canon 9 used in conjunction with Canon 4, which involves client confidences); see also infra notes 51-56 and accompanying text.

In addition to the conflict of interest problems, multiple representation in derivative suits involves a potential threat to client confidences. DR 4-101 of the Model Code provides that a lawyer may not reveal the secrets and confidences of a client. " 'Confidence' refers to information protected by the attorney-client privilege under applicable law, and 'secret' refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would likely be detrimental to the client."MODEL CODE DR 4-101. In the case of individuals, preservation of confidences may present a serious obstacle to multiple representation because an attorney might jeopardize the confidences of one client while concurrently representing another. Cannon, 398 F. Supp. at 216. This consideration is of less import in the corporate context, however, as the secrets and confidences of the corporate entity will in most instances be totally accessible to director-officer defendants. Id. at 216-17; see Comment, supra note 13, at 528-29. But see Marco v. Dulles, 169 F. Supp. 622, 628-30 (S.D.N.Y.), appeal dismissed, 268 F.2d 192 (2d Cir. 1959), where the court held that dual representation in derivative suits could involve a danger to corporate confidences in view of the fact that, when former directors are implicated, there may be recent secrets and confidences in the files of counsel wholly unknown to former directors.

Conversely, confidences reposed by directors or officers in the corporate counsel must be known to the corporation because the directors constitute the only "voice and hearing" of the corporation. See Marco, 169 F. Supp. at 628. A concern that counsel will divulge corporate confidences, or vice versa, appears, therefore, to be largely illusory. Comment, supra note 13, at 529. Accord Cannon, 398 F. Supp. at 216-17. As noted by the Cannon court, however, the possibility of release of confidences or secrets, however slim, is "one more reason to examine dual representation with caution." Id. at 217.
and the bench, but does not attempt to provide for all eventualities which may arise in practice. Ultimate resolution of the multiple representation issue and reasoned application of the ethical guidelines presented in the Model Code rest with the courts.43

**Judicial Evaluation of Conflicts of Interest**

Before proceeding to a review of cases which deal with conflicts of interest in derivative suits, it is instructive to briefly examine judicial treatment of conflicts in general. Courts are vested with considerable discretion in reviewing motions for disqualification and evaluating ethical guidelines.44 In considering motions to disqualify opposing counsel,45 courts have attempted to balance two policies: the client's right to be represented by freely chosen counsel and the need to preserve the highest standards of professional responsibility.46

The majority of circuits apply Canon 5 and DR 5-10547 in determining whether concurrent multiple representation may continue.48 Another frequently used test requires disqualification

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43. See infranotes 44-95 and accompanying text.
44. *Cannon*, 398 F. Supp. at 215; *JUDICIAL RESPONSE*, supra note 42, at VII.10

The issue most frequently arises when plaintiff-shareholders challenge the adequacy of the corporation's representation. At least one court has questioned a shareholder's standing to object to the corporation's choice of counsel. *Otis*, 57 F. Supp. at 684; see *infra* notes 64-68 and accompanying text. As noted by one commentator, however, such a bar should not be imposed. Prohibiting the shareholder's objection is tantamount to permitting multiple representation in all such cases, because the individual director-officer defendants will not object to corporate counsel representing their individual interests. Comment, *supra* note 13, at 526 n.16.
45. See *supra* note 44 and accompanying text.
46. *L. GILBERT & G. ZADOROZNY, SERVING TWO MASTERS: THE LAW OF LAWYER DISQUALIFICATION* 5 (1984). This section of the note will, in order to highlight various approaches, focus upon federal circuit court decisions. For cases involving the balancing of these two policies, see *Freeman v. Chicago Musical Instrument Co.*, 689 F.2d 715, 721 (7th Cir. 1982); *United States v. Hobson*, 672 F.2d 825, 828 (11th Cir. 1982); *United States v. Miller*, 624 F.2d 1198, 1201 (3d Cir. 1980) (the attorney's ability to practice without excessive restrictions must be considered also); *Meat Price Investigators Ass'n v. Spencer Foods, Inc.*, 572 F.2d 163, 165 (8th Cir. 1978); *Government of India v. Cook Indus.*, Inc., 569 F.2d 737, 739 (2d Cir. 1978); *Woods v. Covington County Bank*, 537 F.2d 804, 810 (5th Cir. 1976); *Waterbury Garment Corp. v. Strata Prods.*, Inc., 554 F. Supp. 63, 66 (S.D.N.Y. 1982) (an additional consideration is the defendant's right to untainted representation); *In re Asbestos Cases*, 514 F. Supp. 914, 925 (E.D. Va. 1981); *In re Airport Car Rental Antitrust Litig.*, 470 F. Supp. 495, 502 (N.D. Cal. 1979).
47. See *supra* notes 35-39 and accompanying text.
unless the attorney can demonstrate that the multiple representation will neither diminish the vigor of his representation nor lead to actual or apparent conflict. Both of these tests focus upon the client's strong interest in adequate representation.

Canon 9 of the Model Code, with its emphasis upon maintenance of public trust in the integrity of the judicial system and the legal profession, has been invoked by some courts as additional authority for resolving existing doubts against the propriety of multiple representation. A strong minority of federal courts re-


A Ninth Circuit case, In re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig., 658 F.2d. 1355, 1359 (9th Cir. 1981), reflects application of Rule 5-102(B) of the Rules of Professional Conduct of the State Bar of California, which provides that conflicting interests should not be represented except where the consent of all parties is obtained. The California Rules provide that the Model Code should be referred to in the absence of relevant state code provisions.

 cinema-5, Ltd. v. Cinerama, Inc., 528 F.2d 1384, 1387 (2d. Cir. 1976). The standard of Cinema-5 is considered the leading case in concurrent representation. Judicial Response, supra note 42, at VII.4. The standard has been applied in other Second Circuit cases. See, e.g., Board of Educ. v. Nyquist, 590 F.2d 1241 (2d Cir. 1979) (disqualification order reversed where court found no risk that lawyer's loyalty to his clients would be diminished); Glueck v. Jonathan Logan, Inc., 512 F. Supp. 223 (S.D.N.Y.) (Cinema-5 standard should be applied to suits against trade association members only when the dangers against which Canons 4 and 9 were designed to protect are compromised), aff'd, 653 F.2d 746 (2d Cir. 1981); Sapienza v. New York News, Inc., 481 F. Supp. 676 (S.D.N.Y. 1979) (disqualification warranted where same attorney represented two clients directly opposing each other in litigation); Fund of Funds, Ltd. v. Arthur Andersen & Co., 435 F. Supp. 84 (S.D.N.Y.) (Cinema-5 test applied where case involved simultaneous representation of clients with potentially conflicting interests), aff'd in part, rev'd in part, 567 F.2d 225 (2d Cir. 1977).

Other circuits have applied the Cinema-5 test. See IBM v. Levin, 579 F.2d 271 (3d Cir. 1978) (upholding a disqualification order, court relied heavily on the likelihood of conflict and on the fact that the attorney did not attempt to obtain full client consent); Unified Sewerage Agency v. Jelco, Inc., 646 F.2d 1339 (9th Cir. 1981) (representation found adequate where litigation in the two cases was quite different).

L. GILBERT & G. ZADOROZNY, supra note 46, at 6-7.

51. Canon 9 provides that "A lawyer should avoid even the appearance of impropriety." MODEL CODE Canon 9.

52. See supra notes 40-42 and accompanying text.

53. The Second Circuit views Canon 9 as a rule that is a relevant factor when other Canons are violated but which does not alone suffice as grounds for disqualification. Cheng v. GAF Corp., 631 F.2d 1052, 1058-59 (2d Cir. 1980) ("where there is no danger that the underlying trial will be tainted, appearances of impropriety alone are insufficient to justify disqualification"), vacated and remanded on other grounds, 450 U.S. 903 (1981); Armstrong v. McAlpin, 625 F.2d 433, 446 (2d Cir. 1980) ("there may be unusual situations where the appearance of impropriety alone is sufficient to warrant disqualification"), vacated and remanded on other grounds, 449 U.S. 1106 (1981); Silver Chrysler...
ject application of this standard, particularly where violations of other Canons are not found, but Canon 9 is still a criterion for ethical analysis in a majority of the circuits.

Courts have become increasingly flexible and equitable in dealing with conflict of interest cases. In recent years, the judiciary

Plymouth, Inc. v. Chrysler Motors Corp., 518 F.2d 751, 757 (2d Cir. 1975) (Canon 9 dictates that any doubts be resolved in favor of disqualification).

The Third Circuit, in IBM v. Levin, 579 F.2d 271, 283 (3d Cir. 1978), found disqualification mandated by DR 5-105, and found Canon 9 to be an important additional factor in determining appropriate sanctions for violations of other Code provisions. See also United States v. Miller, 624 F.2d 1198, 1203 (3d Cir. 1980) (disqualification under Canon 9 necessary where attorney has conflict of interest or has shared confidential information with a partner).

The Fourth Circuit has held that while a Canon 9 violation may itself mandate disqualification, "[i]t cannot be a fanciful, unrealistic or purely subjective suspicion of impropriety that requires disqualification. The appearance of impropriety must be real." United States v. Smith, 653 F.2d 126, 128 (4th Cir. 1981).

The Fifth Circuit applies a two-pronged test to determine whether Canon 9 provides a basis for disqualification. First, the movant must show that there is a reasonable possibility that the appearance of impropriety will occur. Second, the likelihood of public suspicion must outweigh the client's interest in obtaining freely chosen counsel. In re Corrugated Container Antitrust Litig., 659 F.2d 1341, 1345 (5th Cir. 1981).

While the Sixth Circuit has not specifically addressed the issue, a district court decision, Lee v. Todd, 555 F. Supp. 628, 631-32 (W.D. Tenn. 1982), is in accord with the Fifth Circuit position.

The Seventh Circuit rejects Canon 9 as the sole basis for disqualification. In Freeman v. Chicago Musical Instrument Co., 689 F.2d 715, 723 (7th Cir. 1982), the court held that "[t]he possible appearance of impropriety . . . is simply too weak and slender a reed on which to rest a disqualification order in this case, particularly where the mere appearance of impropriety is far from clear."

The Eighth Circuit has held that Canon 9 may, by itself, mandate disqualification. In State of Ark. v. Dean Food Prods. Co., Inc., 605 F.2d 380 (8th Cir. 1979), the court held that where supervising counsel had been disqualified pursuant to Canons 4 and 9, counsel's staff lawyers must be disqualified under Canon 9. The court noted that the essential question is whether a member of the public, or the bar, would perceive an impropriety in the representation. Id. at 385.

The Ninth Circuit views Canon 9 as normally insufficient to mandate disqualification. United Sewerage Agency v. Jelco, Inc., 646 F.2d 1339, 1352 (9th Cir. 1981) ("We do not believe Canon 9 was intended to override the delicate balance created by Canon 5 and the decisions thereunder."). while a district court in the Tenth Circuit, citing Second Circuit decisions, has held that disqualification "is indicated where the offending attorney's conduct threatens to 'taint the underlying trial' with a serious ethical violation." Field v. Freeman, 527 F. Supp. 935, 940 (D. Kan. 1981).

The Eleventh Circuit has applied the Fifth Circuit's two-pronged test for Canon 9 disqualification. United States v. Hobson, 672 F.2d 825 (11th Cir.), cert. denied, 459 U.S. 906 (1982).

54. JUDICIAL RESPONSE, supra note 42, at VII.6.
55. See supra note 53 and accompanying text.
56. Id.
57. See, e.g., Armstrong v. McAlpin, 625 F.2d 433, 444 (2d Cir. 1980) (court adopted "a restrained approach to disqualification"), vacated and remanded on other grounds, 449 U.S. 1106 (1981); United Nuclear Corp. v. General Atomic Co., 96 N.M. 155, 629 P.2d 231 (1980) (violation of professional ethics does not automatically result in disqualifica-
has developed an evaluative process which focuses upon the particular facts and surrounding circumstances of each case in order to strike the appropriate balance between the right to choice of counsel and preservation of the highest ethical standards.\(^8\)

**Judicial Treatment of Multiple Representation in Derivative Suits**

The ethical propriety of multiple representation of a corporation and its directors or officers is an issue which has resulted in a split of authority among the courts. While several older cases permitted multiple representation,\(^5\)\(^9\) the more recent trend, in sharp contrast to that developing in non-derivative conflict cases,\(^6\) is to require the corporation to retain independent counsel.\(^6\)\(^1\)

Much discussion regarding the propriety of multiple representation has involved the nature of the wrongdoings with which the individual director-officer defendants are charged. It has been held that where the individual defendants have been charged with fraud against the corporation, the interests of the corporation and the individuals are wholly divergent and joint representation is not in the best interests of the parties.\(^6\)\(^2\) Where the complaint charges negligence rather than fraud or illegality, the propriety of joint representation may be more difficult to ascertain.\(^6\)\(^3\) In *Otis & Co. v.*
Pennsylvania R.R., 64 a 1944 decision which reflects early judicial reluctance to interfere with a corporation's choice of counsel, plaintiff-shareholders alleged that the defendant officers breached their fiduciary duty to the corporation by failing to "shop around" for the best obtainable price on a new bond issue. 65 The Otis court denied plaintiffs' request that joint counsel be removed because of conflicting interests. 66 In so doing, the court inferred a distinction between suits involving fraud and those involving negligence. 67 Joint representation was held to be permissible where plaintiffs did not allege breach of confidence or trust by individual defendants. 68 In a more recent decision, one court in dicta rejected the negligence/fraud distinction, stating that the interests of the corporation and the individual defendants are diverse regardless of the nature of the charges. 69

Courts have often pointed to the corporation's active or passive stance as an important factor in determining whether multiple representation should be permitted. 70 The Association of the City of New York Committee on Professional Ethics has also looked to this factor, recognizing that under particular circumstances joint representation may be permitted when the corporate role is passive. 71 This distinction, like the negligence/fraud distinction, has, however, been rejected by some authorities because the corporation's decision as to what stance it will take may itself be tainted,

64. 57 F. Supp. 680 (E.D. Pa. 1944), aff'd per curiam, 155 F.2d 522 (3d Cir. 1946).
65. Id. at 682.
66. Id. at 684.
67. Id.
68. Id.
69. Messing v. F.D.I., Inc., 439 F. Supp. 776, 782 (D.N.J. 1977). In Messing, plaintiffs charged violations of the Securities Exchange Act of 1934, predicated on the alleged fraud of some directors and the alleged negligence of others. Pendent state claims charged negligence, fraud, waste, and breach of fiduciary duty. The corporation took an active role by asserting a cross claim. The court, under these facts, confined its holding to the statement that, when the directors have been accused of fraud and the corporation has elected to take an active role in the litigation, the corporation must retain independent counsel. Id. at 782.

Other courts have also prohibited joint representation when directors are accused of fraud. See, e.g., Neidermeyer v. Neidermeyer, FED. SEC. L. REP. (CCH) ¶ 94,123 (D. Or. 1973); Rowen v. Lemars Mut. Ins. Co. of Iowa, 230 N.W.2d 905 (Iowa 1975); see infra notes 75-80 and accompanying text.
absent independent counsel, by the existence of conflict of interest.\textsuperscript{72}

Analysis of a derivative action, from the corporation's perspective, involves an evaluation of the merits of the case and the litigation role to be assumed by the corporation.\textsuperscript{73} Whether multiple representation and its potential for conflict of interest impair the objectivity of this analysis has been the subject of some dispute. Defense counsel have frequently argued, when faced with a motion for disqualification at an early point in the proceedings, that such motion is premature, that the plaintiff's complaint is without merit, and that counsel will immediately withdraw should an actual conflict arise.\textsuperscript{74} This argument was rejected in a 1975 decision, \textit{Rowen v. LeMars Mutual Insurance Co.}\textsuperscript{75} In \textit{Rowen}, policyholders sued a corporate insurer and alleged corporate insiders following the sale of a controlling interest in one corporation. The derivative action alleged bribery in connection with the sale, breach of fiduciary duty, and waste of corporate assets.\textsuperscript{76} The court, rejecting the contention that disqualification must be based upon an actual conflict of interest rather than a potential one,\textsuperscript{77} found a conflict sufficient to require disqualification.\textsuperscript{78} It held that where management of the corporation rests in the hands of implicated directors and officers, independent counsel must be obtained to ensure the objectivity of analysis of the merits of the action.\textsuperscript{79}

The \textit{Rowen} approach is similar to that taken by several other courts.\textsuperscript{80} Some commentators believe that these decisions reflect


\textsuperscript{73} See \textit{supra} notes 26-30 and accompanying text.

\textsuperscript{74} See, e.g., \textit{Cannon}, 398 F. Supp. at 214.

\textsuperscript{75} 230 N.W.2d 905 (Iowa 1975).

\textsuperscript{76} \textit{Id.} at 908.

\textsuperscript{77} \textit{Id.} at 915.

\textsuperscript{78} \textit{Id.}

\textsuperscript{79} \textit{Id.} Commentators are in accord with the \textit{Rowen} position that joint representation may prevent fair inquiry into the merits of the action. See, e.g., Comment, \textit{supra} note 13, at 531; Note, \textit{supra} note 14, at 349.

\textsuperscript{80} See, e.g., Yablonski v. United Mineworkers of Am., 448 F.2d 1175, \textit{enforced per curiam}, 454 F.2d 1036 (D.C. Cir.), cert. denied, 406 U.S. 906 (1971); Murphy v. Washington Am. League Base Ball Club, Inc., 324 F.2d 394 (D.C. Cir. 1963) (where union officers were charged with diversion of funds, the law firm which regularly represented the union and which entered appearances for both the union and the officers was not permitted to continue joint representation); Lewis v. Shaffer Stores Co., 218 F. Supp. 238 (S.D.N.Y. 1963) (corporation and individual defendants must be separately represented when complaint charged unlawful misconduct on part of individual defendants); Essential Enterprises Corp. v. Dorsey Corp., 60 Del. Ch. 343, 182 A.2d 647 (1962) (same firm not permitted to represent corporate and individual defendants; independent counsel for
increasing judicial opposition to multiple representation. For example, in Cannon v. U.S. Acoustics Corp., a 1975 decision, shareholders sought recovery for alleged misappropriation of corporate funds as well as violations of federal and state securities laws. The District Court for the Northern District of Illinois concluded that the same counsel could not represent both the corporation and the individual defendants when the complaint on its face established a conflict of interest. The court conceded that the decision infringed upon the corporation's right to choice of counsel and increased the corporation's financial burden, but it found that such concerns were outweighed by the possibility of conflict of interest. By contrast, in Clark v. Lomas & Nettleton, a 1978 decision, the court declined to follow Cannon, finding no conflict of interest where joint defense counsel initially filed a motion to dismiss on behalf of both the corporation and the individual defendants and did not otherwise participate in the lawsuit. The Clark court held that absent a showing of existence of actual conflict of interest, the client's right to choice of counsel outweighs a potential conflict.

Although cases such as Cannon reveal increasing judicial awareness of the potential ethical problems involved with multiple representation in derivative suits, this trend has not led to a uniform position among the courts. While several recent decisions have

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81. See, e.g., Comment, supra note 13, at 531; Note, supra note 14, at 349.
83. Id.
84. Id. at 220.
85. Id.
86. Id.
88. Id. at 661.
89. Id.
90. See, e.g., In re Conduct of Kinsey, 294 Or. 544, 561, 660 P.2d 660, 669 (1983) (joint counsel must withdraw "unless the claim is patently sham or patently frivolous").
91. See supra notes 87-89 and accompanying text regarding the Clark decision.
followed Cannon by imposing what amounts to a per se disqualification rule, and while commentators have taken the broad view that the corporation should always be independently represented in a derivative action, the practice of multiple representation continues, as does its acceptance by the courts in particular factual settings as exemplified by Clark.

**DISCUSSION**

*The Model Rules of Professional Conduct*

In view of the continuing split of authority regarding the propriety of multiple representation, the recently adopted Model Rules of Professional Conduct offer valuable guidance as to the appropri-

Other courts have also permitted dual representation. Jacuzzi v. Jacuzzi Bros., Inc., 243 Cal. App. 2d 1, 15, 52 Cal. Rptr. 147, 171 (1966) ("In general . . . prior to an adjudication that the corporation is entitled to relief against its officers or directors, the same attorney may represent both."); Hutchison v. Woodstock Community School Dist. No. 200, 66 Ill. App. 3d 307, 384 N.E.2d 382 (1978) (any conflict of interest arising from attorney's joint representation of school board, its members and superintendent was solely a matter for the aggrieved parties, not opposing counsel, as an attorney can represent divergent interests if his clients do not object).


93. See, e.g., H. HENN, supra note 1, at 1082. See generally Comment, supra note 13; Note, supra note 14.

94. It is impossible to accurately determine how frequently the practice occurs, but repeated references to the issue by commentators provide inferential evidence that the practice is not rare. See, e.g., Comment, supra note 13, at 524.

95. See supra notes 87-89 and accompanying text.

96. Since the ABA's adoption of the Model Rules in 1983, virtually every state supreme court or bar association has established a committee charged with considering adoption of the Model Rules. ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 17 (1985). As of this writing, the supreme courts of Arizona and New Jersey have adopted new ethical codes based on the Model Rules, and at least seven other states have recommended adoption of the Model Rules. While the adopted and proposed codes contain certain amendments to the Model Rules, largely concerning certain confidentiality and advertising provisions, the amendments do not concern the conflict of interest provisions discussed here. *Id.* at 17, 70-71, 191, 237, 264, 306, 334, 445, 534.

On May 17, 1984, the United States Court of Claims adopted the Model Rules verbatim. *Id.* at 240.

The Model Rules are written in a directive, restatement format rather than the regulatory format of the Model Code. The Preamble to the Model Rules describes their scope as follows:

The Rules of Professional Conduct are rules of reason. They should be interpreted with reference to the purposes of legal representation and of the law itself. Some of the Rules are imperatives, cast in the terms "shall" or "shall not". These define proper conduct for purposes of professional discipline. Others, generally cast in the term "may", are permissive and define areas under the Rules in which the lawyer has professional discretion. No disciplinary action should be taken when the lawyer chooses not to act or acts within the bounds of such discretion. Other Rules define the nature of relationships be-
ate resolution of the issue. The Model Rules are similar to the Model Code in that they recognize that the corporate counsel's foremost loyalty must run to the corporate entity itself.\textsuperscript{97} Further, the Model Rules articulate specifically what the Model Code implies, that is, that a lawyer representing the corporation may at times represent its individual constituents if consent is obtained.\textsuperscript{98} The consent must be given by a corporate representative other than the official who is being represented, or by the shareholders.\textsuperscript{99}

Unlike the Model Code, however, the Model Rules address the issue of representation in derivative suits. Comment 12 to Rule 1.13 indicates that the corporation's attorney may defend derivative suits because such suits are an ordinary incident of a corporation's conduct of business.\textsuperscript{100} The comment cautions, however, that some derivative suits may engender a conflict between duty to the corporation and loyalty to directors.\textsuperscript{101} Should such a conflict arise, the comment suggests that Model Rule 1.7 govern whether representation by corporate counsel may continue.\textsuperscript{102}

Rule 1.7 sets forth the general standard to be applied in determining whether conflicts of interest preclude representation. The rule provides that a lawyer shall not represent clients with conflicting interests, or clients whose representation may be limited by the
tween the lawyer and others. The Rules are thus partly obligatory and disciplinary and partly constitutive and descriptive in that they define a lawyer's professional role. Many of the Comments use the term "should". Comments do not add obligations to the Rules but provide guidance for practicing in compliance with the Rules.

\textbf{MODEL RULES Preamble (1983).}

\textsuperscript{97} \textit{MODEL RULES} Rule 1.13. The rule provides: "A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."

\textsuperscript{98} \textit{Id.} Part (e) provides:

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

\textbf{MODEL RULES Rule 1.13(e).} For a discussion of Rule 1.7, see \textit{infra} note 103 and accompanying text. See \textit{supra} note 37 and accompanying text for the Model Code provision regarding client consent to multiple representation.

\textsuperscript{99} \textit{MODEL RULES} Rule 1.13.

\textsuperscript{100} \textit{Id.} comment 12. The focus upon the particular problems which arise in derivative suits is typical of the restatement format of the Model Rules by which they address specifically issues addressed only indirectly by the Model Code. \textit{ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT} 70-71 (1985).

\textsuperscript{101} \textit{MODEL RULES} Rule 1.13 comment 12.

\textsuperscript{102} \textit{Id.}
The lawyer's responsibilities to another, unless the lawyer reasonably believes that the quality of the representation will not be adversely affected and unless the client consents after consultation.\textsuperscript{103}

The Model Rules require an attorney contemplating dual representation in any setting, including a derivative action, to examine the facts and circumstances in order to determine whether divided loyalties might impair the quality of representation.\textsuperscript{104} If counsel believes that multiple representation will not engender a conflict, the client then must examine the relevant facts and circumstances and determine whether multiple representation is compatible with its best interests.\textsuperscript{105}

The drafters of the Model Rules have thus rejected a per se prohibition against multiple representation in derivative suits, adopting instead an ethical standard which focuses not upon the unique attributes of derivative actions but, rather, upon the ethical considerations which accompany any representation involving potential conflicts of interest. A case-by-case analysis such as that proposed

\textsuperscript{103} \textbf{Model Rules Rule 1.7.}

Participants in the 1984 BNA Conference on Legal Ethics noted that there is not a significant amount of difference between the Model Code and the Model Rules in the conflicts area. The Model Rules, rather than attempting to change the conflicts law, merely try to encompass the case law developed under or "in spite of" the Model Code. \textit{ABA/BNA Lawyers' Manual on Professional Conduct} at 119-20.

The Model Code comparison published by the ABA in conjunction with the Model Rules notes that:

Rule 1.7 clarifies DR 5-105(A) by requiring that, when the lawyer's other interests are involved, not only must the client consent after consultation but also that, independent of such consent, the representation reasonably appears not to be adversely affected by the lawyer's other interests. This requirement appears to be the intended meaning of the provision in DR 5-105(c) that "it is obvious that he can adequately represent" the client, and was implicit in EC 5-2, which stated that a lawyer "should not accept proffered employment if his personal interests or desires will, or there is a reasonable probability that they will, affect adversely the advice to be given or service to be rendered the prospective client."

\textbf{Model Rules Model Code Comparison to Rule 1.7 (1983).}

\textsuperscript{104} The comment to Rule 1.7 provides that:

A possible conflict does not itself preclude the representation. The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.

\textbf{Model Rules Rule 1.7 comment (1983).}

\textsuperscript{105} The comment to Rule 1.7 provides:

[When a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances, the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client's consent. When more than one client is involved, the question of conflict must be resolved as to each client.]
by the Model Rules provides a vehicle whereby bar and bench can address the ethical concerns which have prompted many disqualifications while simultaneously addressing the practical realities of corporate practice which underlie many multiple representation decisions.

**ANALYSIS**

Evaluation of the propriety of multiple representation involves the preservation of a delicate balance between the right to freely chosen counsel and the need to maintain the highest ethical standards. The danger that divided attorney loyalties might threaten the corporation's interests must be weighed along with other, possibly conflicting considerations. Among these are the corporation's interest in being represented by long-retained and trusted counsel, the significant expense involved in substituting counsel, and the preservation of the corporation as a self-governing entity. The balance must be maintained in order to preserve public trust in the integrity of the bar and to protect the interests of clients.

*The Efficacy of the Case-by-Case Approach*

In attempting to strike the appropriate balance between ethical standards and corporate choice of counsel, it is useful to recall one judge's admonition that consideration of ethical principles requires a painstaking analysis of facts and careful application of precedent rather than a sweeping broad-strokes approach. The relationships and interests present in the corporate setting are so complex and so varied that an optimal balancing of interests may not appropriately be reduced to a set of mechanical rules. There is in the nature of derivative suits nothing which renders such cases inappropriate vehicles for the flexible analysis used in other conflicts cases. Indeed, broad-strokes approaches such as those found in

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106. *Emle Indus., Inc. v. Patentex, Inc.*, 478 F.2d 562, 564-65 (2d Cir. 1973); see *supra* note 46 and accompanying text.

107. *See infra* notes 109-23 and accompanying text.


When dealing with ethical principles, . . . we cannot paint with broad strokes. The lines are fine and must be so marked. Guideposts can be established when virgin ground is being explored, and the conclusion in a particular case can be reached only after a painstaking analysis of the facts and precise application of precedent.

110. *See supra* notes 20-25 and accompanying text.

111. *See supra* notes 57-58 and accompanying text.
Rowen\textsuperscript{112} and Cannon\textsuperscript{113} seem particularly incompatible with the multiplicity of factual patterns underlying derivative actions.

In addition, in contrast to a per se rule, the case-by-case approach reflects a sensitivity to the harsh consequences of attorney disqualification. The main burden of disqualification rests upon the corporation, which loses the counsel of its choice.\textsuperscript{114} This loss, and the reduction of corporate autonomy which accompanies it, should be avoided whenever possible.\textsuperscript{115} On a more practical level, the corporation also loses an attorney who is familiar with both the clients and the case.\textsuperscript{116}

Disqualification of corporate counsel involves significant time and expense spent in preparing a new attorney,\textsuperscript{117} and in some cases the quality of representation by the new attorney may never equal that offered by experienced corporate counsel.\textsuperscript{118} Disqualification of counsel also imposes harsh consequences upon the attorney. The transaction being challenged may result in part from the attorney's contribution to the corporate decision-making process. If disqualified from representing the corporation, he therefore loses both a client and the opportunity to defend his work and advice.\textsuperscript{119}

A flexible facts and circumstances approach limits the settings in which disqualification will be mandated, thereby diminishing the potential for abuse and the increase in volume of disqualification motions.\textsuperscript{120} It is widely recognized that disqualification motions are often interposed for tactical reasons;\textsuperscript{121} a litigation tactic disguised as a motion for disqualification unfairly burdens the clients,
the attorneys, and the judicial process. Furthermore, disqualification motions, even when made in good faith, inevitably generate delay and increased expense.

In any derivative suit, the corporation's desire to retain trusted counsel must be balanced against the danger that divided attorney loyalties could threaten the corporation's interests. The goal of achieving the proper balance may be attained only if particular facts and circumstances are carefully evaluated in an analysis of whether corporate and individual defendant interests are common or divergent.

**Application of the Case-by-Case Approach**

Analysis of the propriety of multiple representation must begin with establishment of a mechanism whereby the merits of the case may be objectively evaluated and consent to dual representation given in a non-illusory manner. Once this threshold step has been taken, Model Rule 1.7 provides a guideline for flexible analysis by requiring the attorney, faced with a potential conflict of interest, to determine whether he reasonably believes that his representation will not be adversely affected, and to inform his clients of the potential ramifications of joint representation. If counsel believes that effective representation may continue, and if the consent of the corporation is freely given, multiple representation may occur. Should potential conflict outweigh the corporation's right to choice of counsel, the corporation's board of directors must select independent counsel.

**Preserving the Objectivity of Consent and Evaluation**

Rule 1.7 of the Model Rules provides an excellent guideline for analysis of the factual setting accompanying a derivative action. Under the rule, an attorney contemplating multiple representation must first examine the circumstances to determine whether ethical conflicts preclude the representation. Significant factors in the attorney's analysis will include the composition of the board of di-

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123. *Id.* The degree of expense and delay potentially involved is exemplified by Westinghouse Elec. Corp. v. Kerr-McGee Corp., 580 F.2d 1311 (7th Cir. 1978), in which attorneys were disqualified after 2.5 million dollars in attorney fees had been incurred. In *Emle Indus.*, disqualification motions delayed proceedings for three years. 478 F.2d at 574.

124. See supra notes 103-05 and accompanying text.

125. *Id.*
rectors, the extent to which the board is allegedly implicated in the wrongdoings charged, the period of time for which the attorney has worked with management, and similar factors which reflect the degree to which the attorney’s actions may be influenced by loyalty to the directors. The attorney must also examine the nature of the charges and the corporation’s anticipated role in the litigation. Under Rule 1.7, a review of the circumstances must also be made by the corporation and the individual defendants. If defendants consent after full consultation regarding the possible ramifications, multiple representation may continue.

Some commentators have questioned the applicability of a consent rationale to derivative suits in view of the fact that consent to multiple representation frequently comes from the directors who are the individual defendants. While some caution may be warranted, consent to dual representation may nonetheless play an important role in some derivative actions. Should the board be comprised, at least in part, of independent non-defendant directors, such directors may, after receiving from counsel full disclosure of the potential ramifications of joint representation, be able to convey the entity’s non-illusory consent to such representation. Model Rule 1.13 is in accord with this view, specifically providing that consent to representation by corporate counsel of other corporate constituents may be given by a non-implicated corporate official. Rule 1.13 provides another avenue to effective consent by permitting consent to be given by shareholder vote. If, however, effective consent cannot be obtained by either of these methods, independent counsel for the corporation must be retained in order

126. Whether the board is composed largely of insiders or outsiders may, for example, be a factor.
127. See supra notes 103-05 and accompanying text.
128. The comment to Model Rules Rules 1.13 states that “if the [derivative] claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer’s duty to the organization and the lawyer’s relationship with the board.” MODEL RULES Rule 1.13 comment.
129. MODEL RULES Rule 1.7.
130. Id; see supra note 105 and accompanying text.
131. MODEL RULES Rule 1.7.
132. See, e.g., Comment, supra note 13, at 528; see supra notes 17-19 and accompanying text.
133. See supra notes 20-25 and accompanying text for a discussion of corporate relationships which affect the consent issue.
135. MODEL RULES Rule 1.13.
136. Id. Presumably, shareholders who are also defendants cannot take part in giving consent.
to maintain ethical standards.\textsuperscript{137}

Closely aligned with the issue of the efficacy of corporate consent is the issue of the objectivity of corporate determination regarding the merits of a derivative suit and the position the corporation should assume in the litigation. The \textit{Rowen} court held that dual representation prevents fair inquiry into the merits of the action.\textsuperscript{138} This holding fails to consider an essential factor: the independence and composition of the board of directors. A unanimously implicated board, guided by corporate counsel long affiliated with and loyal to that board, may indeed be unable to reach an objective conclusion regarding the merits of the action. A board which is comprised at least in part of unimplicated directors may, however, be entirely capable of making a reasoned determination untainted by self-interest and conflict.\textsuperscript{139}

The \textit{Rowen} court’s reasoning is clearly inconsistent with judicial holdings which have upheld the decisions of independent litigation committees.\textsuperscript{140} Such decisions recognize the fact that defendant corporations are capable of reaching objective conclusions regarding the merits of derivative actions.\textsuperscript{141} Formation of an independent litigation committee, and injection of independent counsel into the evaluative stage of the derivative action where needed, provide a mechanism whereby the objectivity of the corporation’s analysis of the action may be ensured. Since preservation of this objectivity was an important factor in \textit{Rowen},\textsuperscript{142} \textit{Cannon},\textsuperscript{143} and other decisions which ordered disqualification of corporate counsel,\textsuperscript{144} use of the committee appears to eliminate a major obstacle to multiple representation. The procedure thus protects the need for objective evaluation while also protecting the corporation’s right to retain traditional counsel for the proceedings which follow the committee’s decision.\textsuperscript{145}

\textsuperscript{137} \textit{Model Rules} Rule 1.7.
\textsuperscript{138} 230 N.W.2d 905, 915 (Iowa 1975); see supra notes 75-79 and accompanying text.
\textsuperscript{139} \textit{See infra} notes 140-45 and accompanying text.
\textsuperscript{140} See supra notes 27-30 and accompanying text.
\textsuperscript{142} 230 N.W.2d 905 (Iowa 1975); see supra notes 75-79 and accompanying text.
\textsuperscript{143} 398 F. Supp. 209 (N.D. Ill. 1975), aff’d in part, rev’d in part, 532 F.2d 1118 (7th Cir. 1976); see supra notes 82-86 and accompanying text.
\textsuperscript{145} This avoids the delay, expense and inadequacy of representation often encountered when disqualification is mandated. See supra notes 114-19 and accompanying text.
Evaluation of Potential Conflicts

It is essential that the corporation develop an independent procedure whereby the merits of the case may be objectively determined and consent to multiple representation freely given. This threshold step is, however, merely the beginning of analysis of the propriety of multiple representation. Once the merits of the suit have been evaluated and the corporation's position in the litigation determined, corporate counsel and either an independent board quorum or the shareholders must, consistent with Model Rule 1.7, determine whether the interests of the corporate defendant and the individual defendants are common or divergent. Key factors to be carefully evaluated include the nature of the charges, the role of the corporation, and the stage of the litigation. Should the interests be so divergent that a conflict of interest appears likely to arise, the attorney should decline the multiple representation immediately in order to avoid an expensive, time-consuming substitution of counsel at a later stage in the litigation. In view of the importance of adhering to ethical standards, any doubts should be resolved against the propriety of the representation.

While the strength of the Model Rules approach lies in its flexibility and its emphasis upon the particular circumstances of each case, it is possible to identify certain factual patterns which have played a major role in past court decisions and which should play a significant role in future analyses under Rule 1.7. The presence or absence of these patterns may point to the unity or divergence of the interests present.

A classic example of a derivative action in which the defendants have unanimity of interest is the strike suit. Where the suit is patently without merit, the interests of all defendants are unified because all are concerned with terminating a meritless suit which involves significant expense to defendants with no possibility of recovery for the corporation. To require independent counsel in such a situation would result in time delays and a waste of corporate assets. Moreover, the unnecessary expenses encountered in obtaining separate counsel would ultimately be borne by the share-

146. MODEL RULES Rule 1.7. See supra note 105 and accompanying text.
147. For a discussion of various factual patterns see infra notes 151-59 and accompanying text.
148. See supra notes 116-18 and accompanying text.
149. MODEL CODE EC 5-15.
150. See supra notes 104-05 and accompanying text.
151. See supra note 13 and accompanying text.
holders of the corporation.152

In sharp contrast to the defendants' unity of interests in the strike suit context is the situation in which, in a potentially meritorious action, the individual director-officer defendants are charged with fraud or illegality. The interests of the corporation and the individual defendants are, in such an instance, totally divergent because the corporation must in its best interests pursue the recovery of any benefits fraudulently obtained by individual defendants.153 Even courts such as the Otis court, which exhibited in general a deference to choice of counsel,154 have recognized that joint representation in this situation is probably not in the best interests of the parties.155 Where fraud against the corporation is the essence of the charges against the individual defendants, right to choice of counsel is outweighed by the considerable potential for conflict of interest, and independent counsel must be obtained.156

Review of derivative actions reveals other factual settings in which the unity or divergence of corporate and individual interests is not as clearly defined.157 In certain of these settings, the defendants' interests may be so harmonious that multiple representation does not threaten the attorney's duty of undivided loyalty to his clients. Such cases typically involve attacks upon transactions approved as a result of the business judgment of the corporation's board of directors.158 Where independent directors believe in good faith in the validity of the business judgment and believe also that a defense against minority shareholder charges is in the best interests of the corporation, corporate counsel should be permitted to represent the corporation and the individual defendants because they have common interests.159


154. Otis, 57 F. Supp. 680; see supra notes 64-68 and accompanying text.


156. See Messing, 439 F. Supp at 782.


158. See supra note 29 and accompanying text.

159. This approach is consistent with judicial respect for, and deference to, good faith decisions of independent litigation committees. See supra notes 27-30 and accompanying text.
These are just some factual settings which might be analyzed to determine the propriety of multiple representation in derivative suits. Each derivative action must be evaluated on its own facts in arriving at a balance between choice of counsel and avoidance of a conflict of interest between the co-defendants.\textsuperscript{160}

\textit{Selection of Counsel}

If it is determined, after analysis of the particular setting, that potential conflict exists such that multiple representation is impermissible, the question remains as to how a bar to such representation may best be implemented. Courts and commentators agree that the corporation should retain independent counsel.\textsuperscript{161} The alternative solution of requiring the individuals to secure new counsel while the corporation retains its original attorney has been rejected because loyalties to directors and officers might create on the part of the corporate counsel a residual bias in favor of the individual defendants which could undermine the quality of corporate representation.\textsuperscript{162}

As to the selection process, it has been uniformly held that the corporation's board of directors, rather than the courts, may make the selection.\textsuperscript{163} The selection of independent counsel by implicated directors does not create an insurmountable problem.\textsuperscript{164} The newly selected attorney, cognizant of his ethical responsibilities, should recognize his duty to represent only the corporate entity's interests.\textsuperscript{165} Additionally, judicial relief is available should problems arise in the selection process.\textsuperscript{166} Selection of independent counsel by the corporation's board of directors is entirely appropriate as it recognizes the independence of the corporate entity and the management powers of the board of directors and does not exacerbate the loss of corporate autonomy already involved in forgoing the representation of traditional corporate counsel.\textsuperscript{167}

\textsuperscript{160} Only if counsel is convinced that he is capable of representing his clients with vigor and undiluted loyalty, and only if independent representatives of the corporation approve such representation after full disclosure, may dual representation occur.

\textsuperscript{161} See, e.g., Cannon, 398 F. Supp. at 220; Lewis, 218 F. Supp. at 240; Comment, supra note 13, at 533.

\textsuperscript{162} Comment, supra note 13, at 533.

\textsuperscript{163} See, e.g., Cannon, 398 F. Supp. at 220; Lewis, 218 F. Supp. at 240.

\textsuperscript{164} Lewis, 218 F. Supp. at 240.

\textsuperscript{165} Cannon, 398 F. Supp. at 220.

\textsuperscript{166} Id.

\textsuperscript{167} See supra notes 114-15.
CONCLUSION

A determination of the propriety of multiple representation in shareholder derivative suits involves a delicate balancing of the corporation's right to counsel of its choice and the attorney's ethical responsibility to provide undivided loyalty to his clients. Achievement of the proper balance is best served by a case-by-case analysis of the facts present in a particular derivative action rather than by a per se disallowance of multiple representation.

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