

Representing Multiple Parties in Derivative Litigation

Contributed by: Richard B. Kapnick and Courtney A. Rosen, Sidley Austin LLP^{}*

Shareholder derivative actions represent a narrow exception to the general rule that a corporation's board of directors has the power to decide whether the corporation should initiate litigation.¹ In such actions, shareholders bring a lawsuit on behalf of the corporation for alleged wrongdoing by corporate officers or members of the corporation's board of directors, seeking relief for the corporation's benefit.² Accordingly, while the corporation is named as a nominal defendant, the corporation is in actuality the plaintiff and will recover any settlement or judgment.³ On its face, the corporation's anomalous position of being both a plaintiff and a defendant indicates a potential conflict of interest between the corporation and the individual director and officer defendants.⁴ This article explores these potential conflicts of interest at various stages of shareholder derivative litigation and the implications of joint representation by a single counsel for the corporation and its directors and officers.⁵

General Rules Concerning Conflicts of Interest in Derivative Litigation

The American Bar Association Model Rules of Professional Conduct provide basic guidelines for evaluating joint representation issues. Model Rule 1.13 permits joint representation in a derivative action, subject to Model Rule 1.7, which addresses concurrent conflicts of interests. Model Rule 1.13(g) 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.⁶

With respect to shareholder derivative actions, the commentary to Model Rule 1.13 states:

The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. *Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit.* However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.⁷

Referenced throughout the text of Rule 1.13 is Model Rule 1.7. Paragraph (a) of Model Rule 1.7 provides that an attorney shall not represent a client if there is a concurrent conflict of interest, which occurs if "(1) the representation of one client will be directly adverse to another client; or (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer." Paragraph 1.7 (b) states that, notwithstanding such a conflict, the attorney can represent the client if "(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; (2) the representation is not prohibited by law; (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and (4) each affected client gives informed consent, confirmed in writing."⁸

Most states have adopted some version of Model Rule 1.13, providing that an attorney representing a corporation may also represent its directors and officers, subject to Model Rule 1.7, and if consent is required pursuant to Model Rule 1.7, the consent must be given by an appropriate official other than the individual who is to be represented, or by the shareholders.⁹ The commentaries following these state statutes generally recognize that derivative actions are "brought nominally by the organization," but note that such an action "usually is, in fact, a legal controversy over management of the organization."¹⁰ And most states, adopting the Model Rules, also recognize that "[m]ost derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board." In that case, Model Rule 1.7 governs representation of the directors and the organization.¹¹

Few, if any, states, have adopted bright line rules to evaluate the propriety of joint representation in derivative actions.¹² The determination of whether a conflict of interest exists is not resolved by simple, automatic rules. Instead, the inquiry requires a thoughtful balancing of competing interests and a careful review of each case's fact pattern. Courts start by considering the distinction between "serious" and "non-serious" wrongdoing.¹³ Most courts agree that joint representation is permissible when the derivative claim is "obviously" or "patently" frivolous.¹⁴ In such cases, both the corporation and the individual defendants would benefit from a quick dismissal, *i.e.*, have a common interest, thereby negating any risks posed by joint representation.¹⁵

When the action clearly is not a strike suit, courts consider various factors to determine whether joint representation of individual director and officer defendants and the corporation is permissible. If a complaint alleges only violations of the directors' duty of care—that is, mismanagement by the directors—joint representation is generally permissible at the outset of the case.¹⁶ However, non-frivolous allegations of fraud, intentional misconduct, or self-dealing may require separate counsel for the corporation.¹⁷

Joint Representation in Derivative Litigation

Having counsel jointly represent the corporation and individual director and officer defendants at the outset of a shareholder derivative case has obvious benefits. There are inherent efficiencies arising from regular corporate counsel's relationship with the corporation and its officers and directors. This arrangement is cost effective and convenient for all parties. Joint representation also protects the individual defendants' right to choice of counsel and avoids delays in the litigation and the cost of hiring new counsel.¹⁸ It further permits all of the defendants to easily share information, present a united defense, and coordinate their strategy at this early stage of the litigation.

On the other hand, retaining separate counsel can avoid the appearance of a conflict and avoid litigation expenses should plaintiffs' counsel pursue a motion to disqualify. Accordingly, counsel should proceed with caution in determining whether joint representation of individual officer and director defendants and the corporation is permissible. In evaluating whether joint representation is appropriate, it is important to consider the stage of the litigation and the nature of the allegations.

Stage of Litigation

A few courts have suggested that joint representation is never permissible, even at the motion to dismiss stage, reasoning that regardless of the nature of the claims, the interests of the corporation and the officer-director defendants "will almost always be diverse."¹⁹ This ignores the reality of strike suits. And it is especially invalid in circumstances where a motion to dismiss for demand futility is appropriate.²⁰ If such a motion is granted, then both the corporation and the individual defendants benefit. There is no reason why the corporation should have to incur additional expense to be given its rightful opportunity to evaluate whether litigation should be pursued.

For these reasons, most courts acknowledge that the analysis of whether joint representation is appropriate is highly dependent upon the stage of litigation. Under this approach, joint representation generally is permitted during a motion to dismiss the derivative lawsuit. At this stage, the only issue typically is whether the plaintiff's complaint states a claim as a matter of law.²¹ One court explained this dividing line as follows:

I find that there is no conflict of interest requiring disqualification in the narrow instance when one law firm represents a derivatively sued corporation and its individually sued directors and the law firm initially files a motion to dismiss on behalf of its clients, does not otherwise participate in the lawsuit, and withdraws from representation of either the corporation or the individual directors when either the motions to dismiss are overruled or when it becomes necessary to actively participate in the defense of the corporation and the individual directors. At this stage of the proceedings, when the court must make a determination on whether as a matter of law the defendants should be in the

lawsuit, unless it can be shown that an actual conflict exists or that certain confidences are being jeopardized, I think the client's right to select the counsel of his choice outweighs any potential conflict of interest.²²

If there is an adverse ruling on the motion to dismiss, counsel must reevaluate the representation issue, as joint representation may well no longer be appropriate. The easiest situation is where the court issues a decision providing its reasoning for the denial—*i.e.*, it found conflicts between the defendants and the corporation, or found plausible evidence of actionable misconduct. The hard situation is when the court issues a cursory order simply denying the motion to dismiss. Assume that the judge issues such an order. Can the attorney continue to represent the corporation?

The Third Circuit, in *Bell Atlantic v. Bolger*, suggests that it may sometimes be appropriate for the same attorney to represent the corporation and the individual defendants so long as the allegations against the directors only involve breaches of the duty of care. After examining Model Rule 1.13's "serious charges of wrongdoing" requirement, the court explained:

We believe serious charges of wrongdoing have not been leveled against the individual defendants. We say this because plaintiffs have alleged only mismanagement, a breach of the fiduciary *duty of care*. But we do not understand plaintiffs to have accused defendants of breaching their *duty of loyalty* which requires a director to act in good faith and in the honest belief that the action taken is in the corporation's best interests. There are no allegations of self-dealing, stealing, fraud, intentional misconduct, conflicts of interests, or usurpation of corporate opportunities by defendant directors.²³

Bolger can also be viewed as an outlier limited to its facts. Although the court contended otherwise, the *Bolger* case may have turned on the district court's finding that the directors acted in good faith in investigating plaintiffs' demands. A special committee and independent counsel "after undertaking an exhaustive investigation, [had] determined the corporation's interests were more in line with those of the defendants than the plaintiffs."²⁴

The better view is that, absent certain circumstances, following the denial of a motion to dismiss, the corporation should retain separate counsel. Following the denial of a motion to dismiss, discovery begins. Cases involving allegations of conscious disregard, fraud, intentional misconduct or self-dealing clearly require separate counsel.²⁵ While the plaintiff represents the corporation's interests, it does not have access to the corporation's documents. The corporation's document production should be conducted free of any taint of a conflict. Consequently, an attorney cannot represent both the corporation and the director and officer defendants where there are credible allegations that the individual defendants in the derivative action engaged actionable misconduct, including conscious disregard, fraud, self-dealing, or theft.²⁶

Successive Representation of Defendant Officers and Directors by Former Corporate Counsel

Courts have permitted counsel to continue representing officers and director defendants, despite their prior representation of the corporation. For example, in *Lewis v. Shaffer Stores Co.*, a law firm, which had been general counsel for the defendant corporation for many years, filed a joint answer on behalf of the corporation and the defendant officers, directors, and majority shareholder in a case involving claims under the Securities Act of 1933 and the Securities Exchange Act of 1934.²⁷ The law firm submitted an affidavit stating that it felt "an obligation to defend the officers and directors whom it has advised," which the court found to be "understandable" and proper.²⁸ The question was whether the law firm could also represent the corporation. The court held that it could not, stating:

The interests of the officer, director and majority stockholder defendants in this action are clearly adverse, on the face of the complaint, to the interests of the stockholders of [the corporation] other than defendants. I have no doubt that [the law firm] believe[s] in good faith that there is no merit to this action. Plaintiff, of course, vigorously contends to the contrary. The court cannot and should not attempt to pass upon the merits at this stage. Under all the circumstances, including the nature of the charges, and the vigor with which they are apparently being pressed and defended, I believe that it would be wise for the corporation to retain independent counsel, who have had no previous connection with the corporation, to advise it as to the position which it should take in this controversy.²⁹

The law firm was permitted to continue its representation of the officer and director defendants.³⁰ Based on these considerations "in cases where the line is blurred between the duties of care and loyalty, the better practice is to obtain separate counsel."³¹

It is interesting that the law firm was permitted to continue representing the individuals after being disqualified from representing the corporation. This is the most common result where courts have found a potential or actual conflict of interest in shareholder derivative litigation: courts disqualify the attorney from representing the corporation but allow continued representation of the individual directors and officers.³² In fact, the reported cases do not indicate that courts have disqualified an attorney from representing *both* the corporation and the individual director and officer defendants.³³ Whether this is based on pre-existing waiver agreements or on informed consent (or acquiescence) of the corporation is unclear.

One court suggests this approach sometimes has a more practical origin, *i.e.*, where the interests of officers and directors are so intertwined with a close corporation that they are essentially the same client. In *Forrest v. Baeza*, one attorney represented two of three officers and directors of a closely held family-corporation, in addition to the corporation from which those individuals were accused of embezzling.³⁴ The third officer and director moved to disqualify that attorney, alleging a conflict of interest

due to his representation of the directors, officers and the corporation in prior litigation. The court denied the motion in part, holding that the attorney would be disqualified from representing the corporation,³⁵ but would be allowed to represent the two individual officers and director defendants. The court found that it was the corporation that should secure independent counsel, stating: "the attorney who formerly represented both clients may continue to represent the individual ones."³⁶ The court grounded its decision in the fact that an attorney's personal loyalties most often lie with the executives who hired him, not with the inanimate corporation of which he is nominally the representative.³⁷

Similarly, in *Baytree Capital Associates, LLC v. Quan*, the District Court for the Central District of California disqualified counsel from representing a corporation in a shareholder's derivative suit but permitted counsel to continue to represent the corporation's directors.³⁸ Counsel for the corporation had previously represented the individual director defendants in related suits, which were based on the same conduct underlying the derivative suit. After finding that the interests of the corporation and the director defendants were adverse, the court concluded that it would be inappropriate to allow counsel to continue representing the corporation, even if counsel were disqualified from simultaneously representing the individual directors.³⁹ The court determined that counsel's ties to the individual director defendants created a high likelihood of bias and inadequate representation.⁴⁰ According to the court:

A residual bias in favor of the individual defendants might continue to undermine counsel's judgment. This potential bias would stem from the fact that counsel's first loyalty might remain with the directors and officers of the corporation, who have been his principal contact with the inanimate corporate client in the past. In addition, counsel might fear that rendering advice antagonistic to the insiders' interest would impair future relations with his corporate client. For these reasons . . . [having] the corporation secure new counsel seems the sounder alternative.⁴¹

In this setting, however, strict application of the former client rule would possibly create a separate conflict of interest, absent consent.⁴² This issue was also addressed in *Forrest v. Baeza*.⁴³ One of the parties to the litigation argued that allowing counsel to continue to represent the individual director defendants would violate counsel's duties to his former clients (of which the corporation was now one) under Rule 3-310 of the California Rules of Professional Conduct.⁴⁴ The court recognized that the purpose of this rule was to prevent counsel from using a former client's confidential information against it.⁴⁵ However, the court found that the rule had no applicability to the situation at bar, in which the counsel for a corporation subsequently represented the corporation's directors and officers. The court explained: "Where, as here, the functioning of the corporation has been so intertwined with the individual defendants that any distinction between them is entirely fictional, and the sole repositories of corporation information to which the attorney has had access are the individual clients, application of the 'former client' rule would be meaningless."⁴⁶

Conflicts between Defendant Officers and Directors

Conflicts are not limited to those between the corporation and its directors and officers. Conflicts can also arise between the officers and directors depending on their role in the alleged misconduct, *i.e.*, officer, inside director, or independent director. The complaint may further allege serious wrongdoing, such as fraud, on the part of managers and vague generalities of mere mismanagement on the part of independent directors. In such situations, who needs separate counsel? Is counsel permitted to represent both the corporation and the independent directors, or should each party retain separate counsel?

Again, counsel's first step should be to conduct a careful investigation of the claims against each of the defendants. If, at the outset of the case, there is no clear conflict, then representation of all defendants may well be appropriate until there is a ruling on a motion to dismiss. However, counsel should consider whether certain defendants have unique defenses. For instance, if the independent director defendants are accused only of mismanagement, while management defendants are accused of intentional wrongdoing or fraud, then, depending on the jurisdiction, the independent directors likely have an exculpatory charter provision (or in the parlance of Delaware law, a Section 102(b)(7)) defense that may not be shared with the officer defendants. If counsel determines that the independent directors have their own strong grounds for dismissal, it may be appropriate for these directors to submit their own motion to dismiss.

The issue is also analyzed differently in the case of successive (as opposed to simultaneous) joint representation of individual defendants and the corporation. For instance, counsel who first represents a board of directors in examining allegations made in a shareholder demand letter, and prior to completing its investigative report, is engaged as litigation counsel for the corporation and the director defendants relating to that shareholder's complaint and is open to the criticism of "needlessly risk[ing] . . . a conflict by . . . assuming a dual role as the Board's investigation and litigation counsel."⁴⁷ Similarly, courts have criticized counsel who served as a corporation's outside general counsel and represented individual officers in prior criminal proceedings, who then subsequently advised independent directors in connection with a shareholder demand that the corporation sue those officers to recover losses incurred as a result of the criminal proceeding's subject matter.⁴⁸ The better practice often is for the corporation to retain new counsel when the existing corporate counsel has already advised individual officers or directors with respect to the subject matter of the derivative litigation.

Who Should Choose Independent Counsel?

Once the decision is made to hire independent corporate counsel, who should select the corporation's new lawyers? Normally, the corporation's managers and directors select outside corporate counsel for the corporation, but once a conflict has arisen, it may no longer be appropriate to permit them to select the new attorneys. Notwithstanding, all parties to a lawsuit—including corporations—have a right to counsel of choice. The tension between the inherent conflict and the right to counsel of choice has led to a split in authority. While some jurisdictions permit the

corporation's management, even if those individuals are named as defendants, to select new counsel, other jurisdictions require that the decision to hire counsel be made in the manner any other decision would be made when a conflict of interest exists.⁴⁹

For instance, the court in *Cannon v. U.S. Acoustics, Inc.* refused to involve itself in the process for selecting independent counsel for the corporation.⁵⁰ The *Cannon* court noted that a lawyer's duty for the corporation is to his client, so even if the officer-director defendants select new counsel for the corporation, that counsel's loyalty is required to lie with the client corporation, and not with the individual defendants.⁵¹ While *Cannon* favors giving the defendant directors and officers the discretion to select independent counsel for the corporation, recent decisions are mixed.

In *Natomas Gardens Inv. Group LLC v. Sinadinos*, the court allowed an individual manager to select independent counsel for the company even though it found a clear conflict of interest between the LLC and all of its managers, holding that, "considering that only [the manager and his attorney] have the necessary information, including all relevant corporate documents, to impart to new counsel, the court will permit them to select new counsel for [the company]."⁵² This approach is in line with *Cannon* and recognizes the experience and expertise that the corporation's managers and directors may bring in choosing counsel.

In *Musheno v. Gensemer*, rather than give the corporate officers and directors free reign to select the corporation's counsel or force court-appointed counsel on the corporation, the court directed the corporation to "select independent counsel in the manner it would act in any other circumstance where a conflict of interest exists."⁵³ As such, the corporation was encouraged to appoint an ad hoc committee of independent directors who would choose independent counsel.⁵⁴ In certain derivative actions, this middle ground may appropriately balance the corporation's right to counsel of choice with the rights of the shareholders. Of course, if there is clear evidence of corporate malfeasance implicating the entire board of directors, a court will be more likely to appoint counsel itself. But when liability is unclear—as is the case in many derivative actions—courts are likely to defer to the corporation and permit the directors and officers some leeway in selecting new counsel.

Conclusion

Shareholder derivative suits present complex ethical and legal questions, particularly relating to conflicts of interest. While the majority of jurisdictions subscribe to Model Rule of Professional Conduct 1.13, which permits joint representation subject to the provisions of Model Rule of Professional Conduct 1.7, they can provide differing interpretations and rulings, and thus it is important to start any inquiry with research into the relevant jurisdiction.

Derivative actions are a fact of modern corporate life and part of the normal business of a corporation.⁵⁵ Generally, at the outset of a case, *i.e.*, prior to a ruling on a motion to dismiss, joint representation of a corporation and its directors and officers is proper if counsel has undertaken an investigation and found no evidence of serious

liability by any individual defendant. However, if a preliminary investigation into the claims at issue reveals the potential for merit to serious charges of wrongdoing or fraud, then separate counsel should be obtained for the corporation and for the affected individual(s). If joint representation is undertaken prior to the motion to dismiss, it should be revisited if the motion to dismiss is denied. At that stage, best practice often will require that the corporation and individual defendants have separate counsel.

Richard B. Kapnick, a partner in the Chicago office of Sidley Austin LLP, is an experienced litigation attorney serving as lead counsel in numerous litigation matters involving securities fraud, corporate governance and derivative claims, mergers and acquisition transactions, bankruptcy and complex commercial contracts. Mr. Kapnick can be contacted at rkapnick@sidley.com.

Courtney A. Rosen, a partner in the Chicago office of Sidley Austin LLP, has experience representing clients and conducting trials in a wide variety of commercial litigation, including matters involving breach of fiduciary duty, mergers and acquisitions, breach of contract, bankruptcy and securities fraud class action litigation. She has represented corporations, directors and officers in shareholder derivative lawsuits, officers' and directors' liability claims, bankruptcy related litigation and SEC investigations. Ms. Rosen can be contacted at crosen@sidley.com.

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¹ It is well established that "directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984). This includes the power to decide whether the company should engage in litigation. See *Levine v. Smith*, 591 A.2d 194, 200 (Del. 1991), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

² Other corporate stakeholders, such as debtholders, may also bring derivative actions under very narrow circumstances. See, e.g., *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101–102 (Del. 2007) (directors of insolvent Delaware corporations owe fiduciary duties to the corporation's creditors that are enforceable in a derivative action); *Prod. Res. Group, LLC v. NCT Group, Inc.*, 863 A.2d 772, 776 (Del. Ch. 2004) (creditor of insolvent corporation has standing to bring derivative claims against directors and officers).

³ See *Cannon v. U.S. Acoustics Corp.*, 398 F. Supp. 209, 213 (N.D. Ill. 1975), *aff'd in relevant part*, 532 F.2d 1118, 1119 (7th Cir. 1976) (per curiam).

⁴ See *id.* at 214; see also *Musheno v. Gensemer*, 897 F. Supp. 833, 835 (M.D. Pa. 1995); *Clark v. Lomas & Nettleton Fin. Corp.*, 79 F.R.D. 658, 660 (N.D. Tex. 1978) (quoting *Cannon*).

⁵ Such representation is variously referred to in the case law as "dual," "joint" and "simultaneous." See, e.g., *Forrest v. Baeza*, 58 Cal. App. 4th 65, 74 (Cal. Ct. App. 1997) ("simultaneous or dual representation"); *Scattered Corp. v. Chicago Stock Exch., Inc.*, C.A. No. 14010, slip op. at 5 (Del. Ch. Apr. 7, 1997) ("dual representation"); *Messing v. FDI, Inc.*, 439 F. Supp. 776, 781 (D.N.J. 1977) ("joint representation"); *Bell Atl. Corp. v. Bolger*, 2 F.3d

1304, 1315 (3d Cir. 1993) ("simultaneously representing"). The term "joint" is used most predominately herein.

⁶ Model Rules of Prof'l Conduct R. 1.13(g) (emphasis added).

⁷ Model Rules of Prof'l Conduct R. 1.13 cmt. 14 (emphasis added). *Cf. Restatement (Third) of the Law Governing Lawyers* § 131, cmt. g (2000) ("Even with informed consent of all affected clients, the lawyer for the organization ordinarily may not represent an individual defendant as well. (See § 128, Comment c). If, however, the disinterested directors conclude that no basis exists for the claim that the defending officers and directors have acted against the interests of the organization, the lawyer may, with the effective consent of all clients, represent both the organization and the officers and directors in defending the suit (see § 122).").

⁸ Some courts have held that the corporation's consent is not effective to waive the conflict unless as Paragraph 1.13 provides the consent is given by "the shareholders" or by an "appropriate official" of the corporation who is not a defendant in the lawsuit. *See Cannon*, 398 F. Supp. at 216 n.10; *Forrest*, 58 Cal. App. 4th at 77. *See also In re Oracle Sec. Litig.*, 829 F. Supp 1176, 1189 (N.D. Cal. 1993) ("It is also clear that an inanimate corporate entity, which is run by directors who are themselves defendants in the derivative litigation, cannot effectively waive a conflict of interest as might an individual").

⁹ Forty-five states have adopted some version of Model Rule 1.13. *See* ABA, Center for Professional Conduct Policy Implementation Committee, *Variations of the ABA Model Rules of Professional Conduct: Rule 1.13* (Oct. 23, 2009), available at http://www.abanet.org/cpr/jclr/1_13.pdf. Texas does not have this specific provision, but does have commentary concerning derivative actions. *See* Tex. R. Prof'l Cond. 1.12.

¹⁰ *See, e.g.,* Ala. R. Prof'l Cond. 1.13 (cmt. — Derivative Actions); Del. R. Prof'l Cond. 1.13 (cmt. 10); Ill. R. Prof'l Cond. 1.13 (cmt 13 Derivative Actions).

¹¹ Forty-two states have adopted some version of this comment, or rely upon it for guidance. *See* ABA, Center for Professional Conduct Policy Implementation Committee, *State Adoption of Comments to Model Rules of Professional Conduct* (Nov. 11, 2009), available at <http://www.abanet.org/cpr/jclr/comments.pdf>. Of the states that have adopted a version of Model Rule 1.13, only Missouri, Montana, Nevada and Oregon have not adopted this comment or do not rely upon it for guidance. *See* Missouri S. Ct. R. Prof'l Cond. 4-1.13; Mont. R. Prof'l Cond. 1.13(e); Nev. R. Prof'l Cond. 1.13(g); Or. R. Prof'l Cond. 1.13(g).

¹² The California authorities strongly discourage joint representation in non-frivolous derivative actions suggesting that it would rarely if ever be permitted. *See Forrest*, 58 Cal. App. 4th at 74 ("the rule of disqualification . . . is a *per se* or 'automatic' one," holding that attorney could not represent both corporation and directors in derivative action); *see also Elberta Oil Co. v. Superior Court of Kings County*, 108 Cal. App. 344 (Cal. Ct. App. 1930) (holding that attorney could not represent corporation and its officers and directors). Although one California case permitted joint representation in a derivative action alleging fraud, *Jacuzzi v. Jacuzzi Bros., Inc.*, 243 Cal. App. 2d 1, 35–36 (1966), this decision "has been criticized as illogical and against the weight of authority." *Forrest*, 58 Cal. App. 4th at 75 (citing *In re Oracle Sec. Litig.*, 829 F. Supp. 1176, 1188 n.8 (N.D. Cal. 1993)). In contrast, the only applicable Louisiana authority permitted joint representation under a rationale that would seemingly apply in most derivative cases. *See Robinson v. Snell's Limbs & Braces of New Orleans, Inc.*, 538 So. 2d 1045, 1048 (La. Ct. App. 1989) ("[A]lthough the corporation appears as a party on both sides of the lawsuit, its true interest lies with the plaintiff shareholder; it is only nominally a defendant. Therefore, [defense counsel] represents only the interests of the individual [defendants] and the plaintiff's counsel actually represents the interest of the corporation.").

¹³ *Bell Atl. Corp.*, 2 F.3d at 1316; *Murphy v. Washington Am. League Base Ball Club, Inc.*, 324 F.2d 394, 398 (D.C. Cir. 1963); *Milone v. English*, 306 F.2d 814, 817 (D.C. Cir. 1962); *Cannon*, 398 F. Supp. at 215; *Lewis v. Shaffer Stores Co.*, 218 F. Supp. 238, 240 (S.D.N.Y. 1963); *Marco v. Dulles*, 169 F. Supp. 622, 630-31 (S.D.N.Y. 1959).

¹⁴ *See, e.g., Bell Atl. Corp.*, 2 F.3d at 1317; *Rogers v. Virgin Land, Inc.*, No. 1996-13M, slip op. at 3 (D. V.I. May 13, 1996); *Evans v. Perl*, No. 602898/05, slip. op. at 3–4 (N.Y. Apr. 9, 2008); *Campellone v. Cragan*, 910 So.2d 363, 365 (Fla. Dist. Ct. App. 2005); *In re Kinsey*,

660 P.2d 660, 669 (Or. 1983); *Schwartz v. Guterman*, 441 N.Y.S.2d 597, 598 (N.Y. Sup. Ct. 1981); *Rowen v. LeMars Mut. Ins. Co.*, 230 N.W.2d 905, 915 (Iowa 1975). See also *Restatement (Third) of the Law Governing Lawyers* § 131, cmt. g (2002) ("If . . . the disinterested directors conclude that no basis exists for the claim that the defending officers and directors have acted against the interests of the organization, the lawyer may, with the effective consent of all clients, represent both the organization and the officers and directors in defending the suit.").

¹⁵ See *Schwartz*, 441 N.Y.S.2d at 598 ("[I]f the suit is baseless, the true interests of the business entity will be adverse to plaintiff's and aligned with the insider defendants' interests.").

¹⁶ *Bell Atl. Corp.*, 2 F.3d at 1316 (noting that plaintiff did not allege "self-dealing, stealing, fraud, intentional misconduct, conflicts of interest, or usurpation of corporate opportunities by defendant directors"); see also *Selama-Dindings Plantations, Ltd. v. Durham*, 216 F. Supp. 104, 115 (S.D. Ohio 1963) ("it is not improper or illegal for a law firm to represent, in a shareholders' derivative suit, the corporate defendant and the individual directors when there is no conflict of interest and no breach of confidence or trust").

¹⁷ *Bell Atl. Corp.*, 2 F.3d at 1317; *Musheno*, 897 F. Supp. at 837.

¹⁸ See *Scott v. New Drug Servs., Inc.*, C.A. No. 11336, slip. op. at 3 (Del. Ch. Sept. 6, 1990).

¹⁹ *Messing v. FDI, Inc.*, 439 F. Supp. 776, 782 (D.N.J. 1977).

²⁰ The first pleading in a shareholder derivative action often is a motion to dismiss for failure to plead demand futility. Specifically, a shareholder's right to bring a derivative action is limited by the "demand requirement," which mandates "that shareholders seeking to assert a claim on behalf of the corporation must first . . . mak[e] a demand on the directors to obtain the action desired." *Spiegel v. Bunrock*, 571 A.2d 767, 773 (Del. 1990). A shareholder derivative complaint must be dismissed unless the plaintiff can plead facts with particularity showing that demand should be excused. See, e.g., *Beam v. Stewart*, 845 A.2d 1040, 1057 (Del. 2004); *Brehm v. Eisner*, 746 A.2d 244, 254-55 (Del. 2000) (particularity requirement "does not permit a stockholder to cause the corporation to expend money and resources in discovery and trial in the stockholder's quixotic pursuit of a purported claim based solely on conclusions, opinions or speculation"). Because this challenge relates to plaintiffs' right to pursue the litigation, there is rarely, if ever, a conflict among the defendants with respect to this argument.

²¹ See, e.g., *Clark*, 79 F.R.D. at 661; *Campellone*, 910 So.2d at 365 (joint representation appropriate where counsel initially only files motion to dismiss and "does not otherwise participate in the lawsuit."); *Scattered Corp.*, C.A. No. 14010, at 8 (rejecting motion to disqualify, stating that "at the dismissal stage, the [corporate defendant's] interest was identical to that of the individual defendants-to seek the dismissal of the complaint."); *Scott*, C.A. No. 11336, at 4 (denying motion to disqualify on motion to dismiss, stating it would be "unreasonable and wastefully expensive to require separate counsel to represent the corporate and individual defendants"). There are many reported cases illustrating that representing corporate and individual defendants pending a motion to dismiss decision is a regular practice. See, e.g., *In re Triarc Cos., Inc.*, No. C.A. 98-31-SLR, slip. op. at 1 (D. Del. Sept. 30, 1998); *Ciro, Inc. v. Gold*, 816 F. Supp. 253, 255 (D. Del. 1993). Cf. *Garlen v. Green Mansions, Inc.*, 193 N.Y.S.2d 116, 117 (N.Y. App. Div. 1959) (when "an appearance and answer by [a] corporation [is required], such appearance must be by independent counsel whose interests will not conflict with those of the individual defendant.").

²² *Clark*, 79 F.R.D. at 661.

²³ *Bell Atl. Corp.*, 2 F.3d at 1316 (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) and *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983)). The court also "recognize[d] that corporate law has traditionally distinguished between breach of the duty of care and breach of the duty of loyalty, the latter being more grave." *Id.* at 1317 (citing 8 Del. C. § 102(b)(7) (limiting director liability for breaches of duty of care, but not for breach of duty of loyalty)).

²⁴ *Id.* at 1316 (emphasis added).

²⁵ *Id.* at 1317. *Forrest*, 58 Cal. App. 4th at 80–81; *Lower v. Lanark Mut. Fire Ins. Co.*, 114 Ill. App. 3d 462, 469, 448 N.E.2d 940, 947 (Ill. App. Ct. 1983); *Cannon*, 398 F. Supp. at 215.

²⁶ *Musheno*, 897 F. Supp. at 837; see also *Bell Atl. Corp.*, 2 F.3d at 1316-17.

²⁷ 218 F. Supp. at 239.

²⁸ *Id.*

²⁹ *Id.* at 239-40.

³⁰ Likewise, in *Cannon*, 398 F. Supp. at 219-20, *aff'd in relevant part*, 532 F.2d 1118, 1119 (7th Cir. 1976) (per curiam), the court found that the same counsel could not represent both the individual director defendant and the corporation where the complaint alleged a misappropriation of corporate funds and violation of securities laws by the directors. It did not disqualify counsel from representing the individual defendant.

³¹ *Cf. Bell Atl. Corp.*, 2 F.3d at 1317 ("in cases where the line is blurred between duties of care and loyalty, the better practice is to obtain separate counsel").

³² See, e.g., *Musheno*, 897 F. Supp. at 838 n.5 ("It is unclear whether Plaintiffs seek to disqualify [counsel] from representing any Defendant in this litigation, or whether they merely seek to prevent the firm from representing [the company]. In any event, there is nothing to prevent [counsel] from continuing to represent the Directors."); *Messing*, 439 F. Supp. at 781-83 (holding that the corporation had to obtain independent counsel without suggesting that new counsel was necessary for the director defendants); *Wittenborn v. Pauly*, No. 87 C 5814, slip. op. at 4. (N.D. Ill. Apr. 1, 1988) (same); *Lower*, 114 Ill. App. 3d at 469-70, 448 N.E.2d at 946-47 (same).

³³ See *Campellone*, 910 So. 2d at 365 (overturning trial court order disqualifying counsel from representing the corporation or individual defendant and instead holding representation of the individual defendant permissible). Moreover, "if the advice of the lawyer acting for the organization was an important factor in the action of the officers and directors that gave rise to the suit, it is appropriate for the lawyer to represent, if anyone, the officers and directors and for the organization to obtain new counsel." *Restatement (Third) of the Law Governing Lawyers* § 131, cmt. g (2002) (internal citation omitted).

³⁴ *Forrest*, 58 Cal. App. 4th at 80–81.

³⁵ *Id.*

³⁶ *Id.* (citing *Musheno*, 897 F. Supp. at 838; *Lewis*, 218 F. Supp. at 239).

³⁷ *Id.* (citing *Developments in the Law-Conflicts of Interest in the Legal Profession*, 94 Harv. L. Rev. 1244, 1341 (1981)).

³⁸ No. CV 08-2822 CAS (AJWx), slip. op. at 14 (C.D. Cal. Aug. 18, 2008).

³⁹ *Id.* at 8–9.

⁴⁰ *Id.* at 9.

⁴¹ *Id.* at 9–10 (quoting *Comment, Independent Representation for Corporate Defendants in Derivative Suits*, 74 Yale L.J. 524, 533–534 (1965). See also *Natomas Gardens Inv. Group LLC v. Sinadinos*, No. CIV. S-08-2308 FCD/KJM, slip. op. at 5–9 (E.D. Cal. Sept. 14, 2009) (relying upon the holding in *Baytree* to disqualify counsel from representing an LLC in a derivative suit, but permit the attorney to continue to represent the individual manager defendant).

⁴² ABA Model Rule of Prof'l Cond. 1.9(a) ("A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.").

⁴³ See *Forrest*, 58 Cal. App. 4th at 81–82.

⁴⁴ In relevant part, the rule provides: "A member shall not, without the informed written consent of the client or former client, accept employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment." Cal. R. Prof'l Cond. 3-310(E).

⁴⁵ *Forrest*, 58 Cal. App. 4th at 81–82.

⁴⁶ *Id.* at 82.

⁴⁷ *In re PSE&G S'holder Litig.*, 801 A.2d 295, 316 (N.J. 2002).

⁴⁸ *Stepak v. Addison*, 20 F.3d 398 (11th Cir. 1994) (holding that the directors were not entitled to the protection of the business judgment rule where they relied on a conflicted law firm to investigate the shareholder demand).

⁴⁹ *Rowen v. LeMars Mut. Ins. Co.*, 230 N.W.2d 905 (Iowa 1975) is an outlier in which the court appointed independent counsel itself. In *Rowen*, the plaintiffs brought a derivative action and sought to disqualify the same law firm from representing both corporate defendants and the individual defendants. *Id.* at 913. The Supreme Court of Iowa found that a potential conflict of interest existed and that this conflict required the corporation to obtain separate counsel. *Id.* at 915. While noting the importance of respecting corporate autonomy, the court found that in derivative actions, permitting the directors to select corporate counsel would mean that "[c]ounsel for the corporation would be subject to the control of those accused of wrongdoing." *Id.* at 916. To best protect the interests of the policyholders and to best serve the public interest, the court held that the trial court should select independent counsel for the corporations. *Id.*; *but see id.* at 916-18 (Moore, C.J., dissenting) ("The majority holding is unprecedented, unwarranted, and unwise.").

⁵⁰ 398 F. Supp. 209, 220 (N.D. Ill. 1975), *aff'd in part, rev'd in part on other grounds*, 532 F.2d 1118 (7th Cir. 1976); *see also Lewis*, 218 F. Supp. at 240 ("The fact that the selection of such independent counsel will necessarily be made by officers and directors who are defendants does not seem to me to present any insuperable difficulty.").

⁵¹ *Cannon*, 398 F. Supp. at 220.

⁵² No. Civ. S-08-2308 FCD/KJM, slip op. at 3. (E.D. Cal. Nov. 24, 2009).

⁵³ 897 F. Supp. 833, 839 (M.D. Pa. 1995).

⁵⁴ *Id.*; *see also Messing*, 439 F. Supp. at 783-84 ("It is the duty of the directors . . . to act in the corporation's best interest. If they are disqualified from acting on this or on any other matter, then it is for them, in the first instance, to devise a method to accommodate the need to continue the corporate enterprise while refraining from participating in any corporate decision in which they might have a personal interest.").

⁵⁵ Model Rules of Prof'l Cond. R. 1.13 (cmt. 14).