CALIFORNIA LAWYER

FEBRUARY 1996 $5

THE MOST IMPORTANT CASE YOU NEVER HEARD OF

A JURY SPEAKS OUT

MCLE SELF-STUDY

BY RICHARD A. ZITRIN AND CAROL M. LANGFORD

Ethical dilemmas for the partnership lawyer

Consider the situation facing attorney Esperanza Dejos. She represents HiFly Realty. HiFly was started by Gary Lavin, a real estate broker and developer with whom Dejos had worked on previous projects. Lavin organized HiFly as a limited partnership. Lavin and his two codevelopers became the three general partners. Lavin then brought in seven airline pilots as investors and limited partners. Lavin was installed as managing general partner and began receiving a monthly salary for managing the business. HiFly purchased commercial real estate in a new industrial park at the edge of town and leased out the space. The partnership has recently been looking at acquiring another similar property.

Dejos has handled several matters for HiFly, including leases and leasebacks, a few eviction matters, and a property damages lawsuit. She has also been asked by Lavin to help renegotiate HiFly's bank loan to fund the new acquisition. Dejos always finds Lavin to be cooperative, and HiFly pays its bills promptly. Though she is not on retainer, Dejos considers herself the partnership's counsel, and she considers HiFly to be one of her best clients.

One day Dejos gets a call from Andy Arthursen, the accountant who is examining the books to put HiFly's financial papers in order for the new bank loan. "Esperanza, something's come up and I'm worried," he tells Dejos. "I've got to see you right away."

At a meeting that afternoon, Arthursen tells Dejos, "I think someone's been cooking the books. Not only can't we show this to the bank, but it looks like the partnership has failed to make distributions to the pilots. It's like Gary's set up his own slush fund."

"Andy, are you saying Gary is stealing from the pilots?" asks Dejos.

"Not exactly, Esperanza. Technically, the partnership is, since the money is still in partnership accounts. But Gary's the one who controls the money, and it looks to me like it's being concealed from the investors."

"How sure are you about this, Andy?" asks Dejos.

"Well ... " Arthursen says, then pauses. "I guess I'm pretty damn sure."

What are Dejos's obligations? What advice should she give, and to whom? What disclosures should she make, and to whom? For example, should she advise the limited partners, even though she has never even met most of them?

Now, suppose Eddie O'Neill calls Dejos, introduces himself as one of the investors, and says, "Gary's been talking about a new acquisition, and I want to know what you think. I've been looking at buying a new Cessna with Red Farber, one of the other limited partners, and I've only got so much to invest. Is buying another property a good idea?" How does Dejos answer O'Neill? What, if anything, does she say about what the accountant has learned? Are her obligations to O'Neill different now that the accountant has called her?

HOW TO EARN ONE HOUR OF MCLE CREDIT IN LEGAL ETHICS

Read the article, then answer the questions that follow, checking the one best answer to each question. Mail your answers with a check for $20 to the address on the test on page 65. You will receive the correct answers with explanations and an MCLE certificate within six weeks.

ALMOST ALL LAWYERS HAVE SOME familiarity with conflicts of interest. Most also understand that when a lawyer represents an organization, it is the organizational entity itself that is the client. See Cal Rules of Prof Cond 3-600. So if the issue were literally just "who is the client," the answer to most of these questions would be simple. But lawyers who represent organizations, whether they are corporations or other organizations such as partnerships, have among the most difficult of

tasks: determining not just who their client is, but such corollary issues as which individuals speak on behalf of the client and with whom the attorney may maintain confidential communications.

These questions are difficult to answer definitively. Representing corporations—particularly small, closely held corporations—presents thorny issues of loyalty, confidentiality, and accountability to even the most experienced practitioners. Additionally, the often amorphous and ill-defined structure of many partnerships raises more concerns. Among these concerns are:

- Since the individual general partners in a partnership are jointly and severally liable, should they themselves each be considered the individual clients of the attorney?
- If the individual partners are considered separate clients, how does a lawyer deal with maintaining the confidences of any particular individual partner?
- What about limited partners? Are there situations in which individual limited partners also should be considered the clients of the attorney?
- Since rule 3-600(A) says that the organization acts through "its highest authorized officer, employee, body or constituent," who speaks for the partnership where the "highest authorized" individual has not been clearly defined?
- What happens to these client relationships when the constituency of the partnership changes and new partners are brought in or take control?

Unfortunately, raising these issues is far easier than finding solutions. Even the Rules of Professional Conduct are at times unclear. For example, when it comes to organizational control, the "Discussion" section of rule 3-600 ends with this buck-passing language: "When a change in [organizational] control occurs or is threatened, members are faced with complex decisions involving personal and institutional relationships and loyalties and have frequently had difficulty in perceiving their correct duty.... In resolving such multiple relationships, members must rely on case law."

While it is certainly no easier for us to provide definitive answers, let us see how a few of the questions we raised can be analyzed.

Are individual partners the lawyer's clients? According to *Responsible Citizens v Superior Court* (1993) 16 CA4th 1717, we can answer this one with a definite "maybe." In *Responsible Citizens,* the court articulated a fact-specific four-factor test to determine whether a partnership attorney represented the individual partners. The four factors are: (1) the type and size of the partnership; (2) the nature and scope of the lawyer's representation; (3) the amount of contact between the lawyer and the partner in question; and (4) the lawyer's access to information relating to the specific partner's interests. While California does not follow ABA ethics rules, a 1991 ABA opinion, No. 91-361, also takes a fact-specific approach to this question.

What the partnership agreement says might be more important than the small guidance divined from cases and rules.

What about maintaining the confidences of those in authority? This is one of the important questions Esperanza Dejos, the lawyer in our hypothetical, needs to answer. Unfortunately, the best we can do is even less certain than our definite "maybe" in the preceding paragraph. Our answer is a modified "who knows?" Here's why: Before the Rules of Professional Conduct were amended in May 1989, there were several cases (*Wortham & Van Liew v Superior Court* (1987) 188 CA3d 927 is perhaps the leading one) that held that there is no attorney-client privilege among partners on matters of partnership business, meaning that the partnership lawyer must reveal to all partners all partnership-related information obtained from any one partner. ABA Opinion No. 91-361 seems to be in agreement. It states that the information is gained on behalf of the partnership and thus must be shared among all partners.

But neither of these theorems is dispositive. First, the ABA opinion has little official value in California, where the rules are different. Second, *Wortham* was decided under the old, pre-1989 California ethics rules. Perhaps more significantly, *Wortham* relies substantially on Evidence Code section 962, which deals with evidentiary privilege, not confidences. The absence of an attorney-client privilege would require the partnership attorney to reveal information to all partners *during the course of litigation.* But that does not necessarily mean that the communication, when made, loses its confidentiality without litigation or before the onset of the litigation.

As for the substance of the ABA opinion, after stating that the confidence is to be shared by all partners, a footnote excepts from this general rule situations in which the lawyer is representing the partnership in a dispute against one of the partners. But at the time of the communication, how can the lawyer anticipate whether the matter will result in a litigated dispute? Indeed, disclosure to all partners might head off such litigation in the situation confronting Esperanza Dejos.

What about limited partners? Here the law is, if anything, even less

Richard A. Zitrin, a San Francisco sole practitioner, and Carol M. Langford, a partner with Carroll, Burdick & McDonough in Walnut Creek, teach legal ethics at several Bay Area law schools. The hypothetical in this article is from their book, Legal Ethics in the Practice of Law *(The Michie Co., 1995).*

clear. The ABA excepts limited partnerships from its opinion, even though it is these common investment structures that generally create the stickiest ethical problems. *Wortham,* too, deals with general partners. While it doesn't directly exclude limited partners from entitlement to information, at least one other case, *Kapelus v State Bar* (1987) 44 C3d 179, says limited partners are not the clients of the partnership attorney.

On the other hand, the *Wortham* rationale, disclosing partnership-related information to all partners who could be affected, doesn't seem to rest on a distinction between general and limited partners. In *McCain v Phoenix Resources, Inc.* (1986) 185 CA3d 575, the court ruled that a general partner could not claim attorney-client privilege to prevent the disclosure of information to certain limited partners when those limited partners had a right to access to information under the partnership agreement.

Most recently, one California appellate court held that when the lawyer in that case undertook to represent the partnership generally, this "imposed upon him an obligation of loyalty to the partnership *and to all partners in terms of their entitlement to benefits from the partnership."* [Emphasis added.] *Johnson v Superior Court* (1995) 38 CA4th 463, 479. It is of more than passing interest that the court expressly declined to determine whether the lawyer formally represented the limited partners, stating that this issue was "of no great moment" since he nevertheless had to "look out for all the partners' interests." While *Johnson* doesn't address, much less answer, the question of receiving or revealing confidences, it does raise many other issues relating to a partnership lawyer's overarching duties to each limited partner.

Who speaks for the organization? What the partnership agreement says might be much more important than whatever small guidance a lawyer can divine from the cases and rules of professional conduct. It is, after all, the partnership agreement that defines the respective obligations of the partners and makes clear who has the authority over the work being done by the partnership attorney. A recent State Bar ethics opinion, Formal Opn No. 1994-137, raises the question of what a lawyer should do when receiving conflicting instructions from two general partners, both with ostensible authority. The opinion suggests that the attorney begin by turning to the partnership agreement.

Of course, if the agreement is less than clear, as may often be the case, the lawyer is left with some tough decisions. Opinion 1994-137 suggests that the lawyer try working out a solution with the principals involved. Failing that, the opinion can only suggest withdrawal, noting that a "lawyer in this situation is adrift in perilous waters." But as a practical solution, withdrawal accomplishes little, at best passing the buck to some other attorney.

LOOK AGAIN AT THE PROBLEMS facing Esperanza Dejos. How does our analysis help her? One way it helps is for her to understand that if she is not sure of her appropriate course of conduct, at least she is not alone. Even experts in the field—those who write the rules and opinions and decide the appellate cases—have a great deal of trouble here.

But difficult—even insoluble—issues don't mean attorneys like Dejos are off the hook. They have ongoing fiduciary duties to their clients—the partnerships themselves—that they are obligated to try to resolve in a way that protects those partnerships. Lawyers who find themselves surprised by a situation like the one confronting Dejos will have to do their best to walk a tightrope on their way to a solution. Sometimes, such solutions are easier to fashion if the individual partners all agree that all information can be shared, making full disclosure to all partners possible.

Second, Dejos and other similarly situated attorneys should be able to develop a good sense of where the trouble spots are when it comes to representing partnership interests. Once they understand what the problem areas are, they should begin to take steps to avoid the most precarious positions. The reality is that once such situations occur, it is often difficult, if not impossible, to fashion an acceptable solution. Lawyers can find much more satisfying results when they "front load" solutions before problems arise.

One way of doing this is at the time the partnership is created. The partnership agreement can be drafted to contain clear ground rules, including understandings on such issues as who will be giving directives to the partnership's attorney, who has the power to hire and fire the attorney, with whom partnership information should be shared, and from whom confidential information may be received. Attorneys' retainer agreements can include similar understandings. By clarifying matters this way, lawyers will have a much better understanding of their options when trouble arises.

*Attorneys who represent partner*ships face difficult choices and ethical dilemmas. But this does not provide an excuse for lawyers to do less than their best to carefully avoid these problems wherever possible. They owe their partnership client thoughtful consideration of how to deal with difficulties before they become problems. ❖

CERTIFICATION

CALIFORNIA LAWYER has been approved by the State Bar of California as a continuing legal education provider. This self-study activity qualifies for Minimum Continuing Legal Education credit in the amount of one hour in the area of legal ethics.

CALIFORNIA LAWYER certifies that this activity conforms to the standards for approved education activities prescribed by the rules and regulations of the State Bar of California.