

1996

The Role of the Corporate Attorney within the Takeover Context: Loyalties to Whom

Miriam Baer

Brooklyn Law School, miriam.baer@brooklaw.edu

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/faculty>



Part of the [Business Organizations Law Commons](#)

Recommended Citation

21 Del. J. Corp. L. 943 (1996)

This Article is brought to you for free and open access by BrooklynWorks. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of BrooklynWorks.

THE ROLE OF THE CORPORATE ATTORNEY
WITHIN THE TAKEOVER CONTEXT:
LOYALTIES TO WHOM?

BY MIRIAM P. HECHLER*

I. INTRODUCTION

Within the merger and acquisition context, the role of the corporate attorney is both varied and significant. In any one transaction, the attorney may be asked to fulfill several functions.¹ Theoretically, the attorney represents the corporation as an "entity."² The entity theory of representation, however, is an unrealistic approach to corporate representation in the takeover context because most takeovers involve struggles for corporate control, and in the context of these struggles, constituent interests are often adverse to one another.³ When conflicts arise between corporate constituents, the attorney who seeks to represent his "client" properly is left with little or no guidance from the Model Rules of Professional Conduct.⁴ Now that mergers and acquisitions have regained prominence in the business world, corporate lawyers should take the opportunity to formulate new Rules of Professional Conduct to provide attorneys with better guidance and preserve the integrity of the takeover process when constituent conflicts arise.

*Law clerk to The Honorable Jane R. Roth, U.S. Court of Appeals for the Third Circuit; J.D., 1996, Harvard Law School; A.B., 1993, Princeton University. Any views expressed hereby are solely those of the author.

¹See discussion *infra* part II.

²MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1983); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (1995); see discussion *infra* part III.

³The Delaware Supreme Court has recognized the potential conflict between management and shareholders in takeover situations. In 1962, the court opined, "We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult." *Bennett v. Propp*, 187 A.2d 405, 409 (Del. 1962).

⁴See generally Symposium, *The Role of Counsel in Corporate Acquisitions and Takeovers: Conflicts and Complications*, 39 HASTINGS L.J. 573 (1988). "The Model Rules of Professional Conduct . . . fail to address the role of corporate and securities counsel." George D. Reyecraft, *Conflicts of Interest and Effective Representation: The Dilemma of Corporate Counsel*, 39 HASTINGS L.J. 605, 608 (1988) (explaining that in representing the corporation as an entity, counsel struggles "with conflicting duties of loyalty, confidentiality, and zeal owed to the various 'constituents' or interest groups [the board of directors, management, and shareholders] that make up the organizational client").

This article identifies several important roles lawyers fulfill in the takeover context and then examines the ethical conflicts likely to arise throughout the performance of those roles. The lawyer's presence in the boardroom is no accident. Part II traces the Delaware courts' emphasis on process in evaluating management's decisions to engage in or resist various takeover transactions. Seminal cases, such as *Smith v. Van Gorkom*⁵ and *Unocal Corp. v. Mesa Petroleum Co.*,⁶ commonly cited because they address issues of directorial fiduciary duty, also created and enhanced the corporate attorney's role within the takeover context. Part II further argues that an implicit assumption throughout these opinions is that attorney participation enhances the integrity of the takeover process and thereby protects shareholder welfare.

Part III discusses the lawyer's ethical obligations in fulfilling the various roles defined in Part II. In particular, Part III explores the question of what a lawyer should do when it appears that management's interests are adverse to those of the shareholders. Before this question can be answered, the corporate attorney must solve a more perplexing riddle: Who is his client? The Model Code and Model Rules of Professional Conduct each treat the corporation as an "entity."⁷ The entity theory of representation is objectionable in times of competition for corporate control because the identity of the corporate attorney's client is unclear. Indeed, the "entity" may not even exist once the particular transaction in question — a merger, acquisition, or leveraged buy-out — is completed.

Part III also examines the Securities and Exchange Commission's (SEC or Commission) view of corporate representation and attorney obligation in the securities context. Voiced in the 1970s, the view affected the version of the Model Rules provision pertaining to corporate representation promulgated in 1983.⁸ Prior to the adoption of the Model Rules, the SEC attempted to impose a more stringent obligation on corporate attorneys to protect shareholders and the investor public from opportunistic officers and directors. Therefore, Part III also examines attorney responsibility for client misconduct under the SEC's disclosure regulations. Although the SEC did not succeed in getting courts to recognize an affirmative duty for lawyers to disclose client misconduct

⁵488 A.2d 858 (Del. 1985).

⁶493 A.2d 946 (Del. 1985).

⁷See discussion *infra* part III.

⁸The ABA House of Delegates approved the Model Rules of Professional Conduct on August 2, 1983. STEPHEN GILLERS & ROY D. SIMON JR., REGULATION OF LAWYERS: STATUTES AND STANDARDS xvii (1996).

to shareholders, its view of attorney responsibility nevertheless affected the corporate bar and is partly responsible for the current version of the Model Rules that pertains to corporate representation. Part III concludes that the Model Rules are more applicable to constituent conflict in the securities context than they are in the takeover context.

Part IV attempts to alleviate the corporate attorney's current lack of ethical guidance by suggesting several additions to the Model Rules. The adoption of takeover defenses and the maintenance of auctions, areas in which the corporate lawyer's loyalties are most likely to be tested, are discussed. A brief review of the board members' duties in both situations is followed by a discussion of the lawyers' corresponding obligations as provided by the Model Rules of Professional Conduct. Whereas the Delaware courts have set forth boundaries of proper director conduct, the Model Rules of Professional Conduct have failed to set forth boundaries for proper attorney conduct. As a result, Part IV suggests two reforms that attempt to provide the attorney better guidance in the takeover context.

Finally, it should be noted that the current wave of takeover activity has differed from the wave that dominated the 1980s, as many transactions are now characterized as "friendly."⁹ Although it may make defensive strategies less popular, the friendliness of the merger and acquisition environment does not reduce the need for clarification of the corporate attorney's professional responsibility. No matter how "friendly" a merger or acquisition is characterized, constituent interests will still be adverse. For example, in a so-called "friendly" environment, the current officers of a target corporation might negotiate side payments (for example, a particularly lucrative retirement package), in exchange for a lower premium for the shareholders. This type of activity illustrates the potentially adverse nature of shareholders' and management's interests, regardless of whether the takeover is friendly or hostile. Thus, the current takeover "wave," like the one that preceded it in the 1980s, requires an examination of the conflicts of interest that the corporate

⁹See, e.g., Amy Stevens, *Skadden Wins Contest for Bell Atlantic, But It Wasn't Easy*, WALL ST. J., Oct. 15, 1993, at B5 (reporting that friendlier deals of the current decade have undermined Skadden, Arps, Slate, Meagher and Flom's dominance in takeover activity since companies are less likely to turn to outside counsel for strategic assistance when takeover deals are friendly). "If companies are going to bypass their usual outside lawyers and in-house counsel for Skadden and its peers, there has to be a compelling reason." *Id.* See also Paul Gibson, *The Year of the Do-it-Yourself Megadeal*, N.Y. TIMES, Dec. 26, 1995, at A21 (discussing the rise in "do-it-yourself" deals, in which corporate managers structure megadeals without the help of investment bankers).

attorney confronts and the creation of rules or guidelines that allow the attorney to resolve those conflicts fairly and efficiently.

II. THE LAWYER'S ROLE WITHIN THE TAKEOVER CONTEXT

The lawyer plays several roles within the takeover context. First, he provides information to the directors which allows them to comply with legal rules and obligations and to protect themselves from future liability.¹⁰ Second, he serves a validation function in that his mere presence in the boardroom when important decisions are made convinces the courts that the directors' choices were well thought out and informed.¹¹ Third, the corporate attorney serves a strategic function in advising the target or acquiror how to achieve its goals in preventing or accomplishing a takeover.¹² These roles exist as a result of the Delaware judiciary's emphasis on process in reviewing actions taken in pursuit or defense of corporate takeovers.

A. Compliance

Competitions for and changes in corporate control of publicly held corporations include takeovers, acquisitions, mergers and leveraged buy-outs. Each of these transactions threatens incumbent management with

¹⁰The role of providing advice "to keep management and the board out of trouble" has been labeled a "traditional" role of the corporate lawyer. Ronald M. Loeb, *Towards a More Meaningful Role for the Corporate Lawyer in Corporate Governance*, in ADVANCED SECURITIES LAW WORKSHOP 491, 493-94 (Harvey L. Pitt, chair, Practising Law Institute 1995). "[W]hat the directors and officers typically want and what the lawyer gives is advice as to how exposure to attacks by shareholders or other constituencies may be limited and what may be done to limit directors' and officers' liability through indemnification and insurance." *Id.* at 494. Chief Justice Veasey has also written about the lawyer's role in insuring corporate managers' compliance with Delaware's common law doctrines of fiduciary duty. E. Norman Veasey, *Duty of Loyalty: The Criticality of the Counselor's Role*, 45 BUS. LAW. 2065, 2065 (1990) ("When lawyers are called upon to counsel boards of directors on their fiduciary duties, the centerpiece of these counseling sessions is normally an analysis of the application of the business judgment rule and the consequences of falling outside the rule.").

¹¹*See, e.g., Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). In examining the validity of a target's selective share repurchase, the Delaware Supreme Court noted that Unocal's board of directors had been given "detailed presentation . . . by legal counsel regarding the board's obligations under both Delaware corporate law and the federal securities laws." *Id.* at 950. *See discussion infra* part II.B.

¹²Martin Lipton is often credited with having created many of the defensive mechanisms utilized by target management in resisting takeover attempts. *See, e.g., Martin Lipton, Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

loss of power, shareholders with loss of equity, or both.¹³ Most types of takeover activity entail a fundamental change in the make-up of the corporation. Under Delaware corporation law, the officers of the corporation run the day-to-day operations of the company, with the oversight of the board of directors.¹⁴ Together, officers and directors owe a fiduciary duty of care and loyalty to the shareholders¹⁵ who own the corporation, elect the directors, and vote on extraordinary measures such as mergers.¹⁶

Ordinarily, courts do not like to substitute their own judgment for that of the corporation's management, which is presumed to have more expertise and knowledge about what is best for the corporation than a judge or shareholder.¹⁷ The presumption that management's business decisions are made with the best interests of the corporation in mind is known as the "business judgment rule."¹⁸ Once the business judgment rule is applied, "a court will not substitute its judgment for that of the board if the latter's decision can be 'attributed to any rational business purpose.'"¹⁹

Despite its protective scope, the business judgment rule did not shield directors from legal challenges to their decisions regarding takeovers and acquisitions in the 1980s. Instead, the Delaware courts spawned a number of opinions that ultimately held directors to a higher standard of conduct than the mere "rational basis" test stated years ago in

¹³See generally R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 6.51 (2d ed. 1990).

¹⁴See DEL. CODE ANN. tit. 8, § 141(a) (1991) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .").

¹⁵See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986) (describing the fiduciary duties of care and loyalty as "the bedrock of our law regarding corporate takeover issues").

¹⁶DEL. CODE ANN. tit. 8, § 251(c) (Supp. 1994) (providing in relevant part: "The [merger] agreement . . . shall be submitted to the stockholders of each constituent corporation at an annual or special meeting for the purpose of acting on the agreement . . .").

¹⁷*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (acknowledging "the managerial prerogatives" of Delaware directors).

¹⁸*Id.* The business judgment rule is a presumption "that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Id.*

¹⁹*Unocal*, 493 A.2d at 954 (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)). When the director's self-interest is present, the courts apply the more rigorous "entire fairness" test outlined in *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983). Unlike the business judgment rule, the entire fairness test addresses the substantive merits of the transaction and places on directors the burden of establishing that the transaction is the result of both a fair price and fair dealing. *Id.* at 710.

Sinclair Oil Corp. v. Levien.²⁰ The watershed case that forced directors to examine the full meaning of the fiduciary duty of care was *Smith v. Van Gorkom*.²¹

In *Van Gorkom*, the Delaware Supreme Court held the directors of the Trans Union corporation personally liable to its shareholders for failing to properly value the company prior to selling it to the Pritzker family, despite the premium Pritzker paid above the stock price.²² Van Gorkom, the CEO of Trans Union, was a lawyer and certified public accountant and was nearing mandatory retirement age.²³ On September 13, 1980, Van Gorkom met with Jay Pritzker to propose a sale of the company at \$55 per share.²⁴ At this point, with the exception of the company's controller, Van Gorkom had consulted no investment bankers, lawyers or directors.²⁵ Five days later, on September 18, Pritzker and Van Gorkom met again and Pritzker agreed to the \$55 per share price and set a price at which Trans Union would issue Pritzker treasury stock — the so-called "lock up" agreement — that would be exercised in the event another buyer subsequently offered a higher price for Trans Union.²⁶

It is apparent that both Pritzker and Van Gorkom regarded their lawyers purely as drafting agents.²⁷ At the September 18 meeting, "Pritzker instructed his attorney, a merger and acquisition specialist, to begin drafting merger documents."²⁸ Later in its opinion, the court notes, "Pritzker's lawyer was then instructed to draft the merger documents, to be reviewed by Van Gorkom's lawyer, 'sometimes with discussion and sometimes not, in the haste to get it finished.'"²⁹ Pritzker gave Van

²⁰280 A.2d 717, 720 (Del. 1971).

²¹488 A.2d 858 (Del. 1985).

²²*Id.* at 893.

²³*Van Gorkom*, 488 A.2d at 865-66. According to the opinion, Van Gorkom was something of a takeover "specialist":

He had participated in many acquisitions as a manager and director of Trans Union and as a director of other companies. He was familiar with acquisition procedures, valuation methods, and negotiations; and he privately considered the pros and cons of whether Trans Union should seek a privately or publicly-held purchaser.

Id. at 866.

²⁴*Id.*

²⁵*Id.* In fact, Van Gorkom told the controller that he wanted no one on his staff to know about the leveraged buyout he planned to propose to Pritzker. *Id.*

²⁶*Id.* at 867.

²⁷See *Van Gorkom*, 488 A.2d at 867.

²⁸*Id.*

²⁹*Id.*

Gorkom only three days to answer his offer.³⁰ One day later, *after* Van Gorkom had put together this tentative deal, he retained an outside attorney "to advise Trans Union on the legal aspects of the merger."³¹ The court noted that Van Gorkom consulted neither William Browder, a former head of the legal department and then current Trans Union Director, nor William Moore, the present head of Trans Union's legal department.³²

The Delaware Supreme Court's decision in *Van Gorkom* substantially transformed the corporate attorney's role within the takeover process. The Supreme Court's opinion focused on the process employed in takeover transactions as opposed to the substantive value of managerial decisions.³³ "[T]hat [the court's] test for negligence focuses almost exclusively on the board's process, rather than the substance of its decision, is now well settled."³⁴ Chancellor Allen later affirmed this reading of *Van Gorkom* in *AC Acquisition Corp. v. Anderson, Clayton & Co.*³⁵ There, the chancellor stated that courts ordinarily would decline to review the merits of a corporate transaction, "once it is shown that the decision to accomplish the transaction was made by directors with no financial interest in the transaction adverse to the corporation and that in reaching the decision the director followed an appropriately deliberative process."³⁶

Van Gorkom's emphasis on process enlarged the corporate attorney's presence in the boardroom in two ways. First, directors and officers needed corporate attorneys to explain the *Van Gorkom* decision itself and its interpretation of "due care."³⁷ More important, attorneys

³⁰*Id.*

³¹*Van Gorkom*, 488 A.2d at 867. Ironically, the legal advice the outside counselor provided to Trans Union's directors was to tell them that they might be sued if they declined Pritzker's offer. *Id.* at 868.

³²*Id.* at 867. The court further noted that with the exception of Trans Union's controller and chief operating officer, no one was informed of the purpose of a special meeting of the Trans Union Board. *Id.*

³³*See id.* at 872-73 (stripping directors who have made "unadvised" or ill-informed judgments of business judgment rule protection).

³⁴T. Richard Giovanelli, Note, *Revisiting Revlon: The Rumors of its Demise Have Been Greatly Exaggerated*, 37 WM. & MARY L. REV. 1513, 1526 (1996) (citation omitted).

³⁵519 A.2d 103 (Del. Ch. 1986).

³⁶*Id.* at 111.

³⁷Chief Justice Veasey observes, "Since the Delaware Supreme Court's opinion in *Smith v. Van Gorkom*, practitioners have counseled directors extensively on the due care component of the directorial decisionmaking process, and that component is reasonably well understood." Veasey, *supra* note 10, at 2065.

could provide valuable counsel to corporate directors and officers in the construction and maintenance of an acceptable takeover process.³⁸

In this manner, the corporate attorney acquired the role of ensuring management's compliance with Delaware's common law doctrines of fiduciary duty. Lawyers would counsel corporate managers as to how to complete mergers and acquisitions without meeting the same results as the ill-fated Trans Union transaction. In doing so, the attorney presumably would contribute value to an "appropriately deliberative process,"³⁹ in which directors and officers would be adequately "informed."⁴⁰ These informed directors and officers, in turn, would carry out the best interests of the corporation's shareholders. Attorney participation in takeover transactions thus became a method which would guarantee the integrity of takeover process.

B. Validation

If the *Van Gorkom* decision placed the lawyer in the boardroom prior to and during takeover negotiations, then later decisions ensured that he could stay there. In *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court added an enhanced scrutiny test to the business judgment rule for evaluating the propriety of defensive conduct of incumbent board members in response to takeover bids.⁴¹ First, board members had to identify some threat to shareholder welfare justifying their defensive reaction.⁴² Second, their response had to be proportional

³⁸Barbara Gustafson has written:

[A]fter opinions like *Trans Union*, corporate directors are understandably apprehensive about relying on their own knowledge and expertise to guide them in their decision-making processes. Under these circumstances, lawyers become indispensable in leading the target directors through the detailed procedural requirements that the Delaware courts use in analyzing informed business judgment in both merger and tender offer situations.

Barbara J. Gustafson, Note, *The Lawyer as Impresario: Form vs. Substance in the Target's Boardroom*, 39 HASTINGS L.J. 759, 790 (1988).

³⁹*AC Acquisition*, 519 A.2d at 111.

⁴⁰Giovanelli, *supra* note 34, at 1526.

⁴¹*Unocal*, 493 A.2d at 954. "Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred." *Id.* In *Unitrin Inc. v. American Gen. Corp.*, 657 A.2d 1361, 1373 (Del. 1995), the Delaware Supreme Court declared: "The common law pronouncement in *Unocal* of enhanced judicial scrutiny, as a threshold or condition precedent to an application of the traditional business judgment rule, is now well known."

⁴²*Unocal*, 493 A.2d at 955. Due to the inherent conflict of interest confronted by

to the threat they were seeking to avert: "If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed."⁴³

Prior to *Unocal*, the Delaware Supreme Court had held that the business judgment rule applied to takeovers.⁴⁴ Nevertheless, citing the "omnipresent specter that a board may be acting primarily in its own interests," the *Unocal* court crafted an enhanced scrutiny test for evaluating a target corporation's defensive tactics.⁴⁵ Despite the adoption of this stricter test, the court nevertheless affirmed the defense tactic of the Unocal Board, an exclusive share repurchase, in fending off a hostile takeover bid by T. Boone Pickens.⁴⁶ Some commentators have suggested that the court's holding was in part tied to its dislike of T. Boone Pickens.⁴⁷ Another explanation for the decision in *Unocal* is the extent of attorney participation in helping the directors arrive at their decision to offer a share repurchase to shareholders.⁴⁸ The day Mesa made a two-tiered tender offer for Unocal's stock, Unocal's Board met for 9 1/2 hours, in which "detailed presentations were made by legal counsel regarding the board's obligations under both Delaware corporate law and the federal securities laws."⁴⁹ Thus, the presence of counsel in Unocal's boardroom provided a strong indication that the board's decision was reasonable and in the best interests of shareholders.⁵⁰

directors in takeover transactions, the court declared, "[D]irectors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership." *Id.*

⁴³*Id.* The directors would have to analyze the "nature of the takeover bid and its effect on the corporate enterprise" giving consideration to the adequacy of the price offered, "the nature and timing of the offer, questions of illegality," and other concerns. *Id.*

⁴⁴*Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984).

⁴⁵*Unocal*, 493 A.2d at 954.

⁴⁶*Id.* at 959. "[T]he threat was posed by a corporate raider with a national reputation as a 'greenmailer.'" *Id.* at 956.

⁴⁷Bonnie G. Camden, Note, *The Reasonableness of Defensive Takeover Maneuvers When the Corporate Raider is Mr. T. Boone Pickens: Ivanhoe Partners v. Newmont Mining Corp.*, 57 U. CINN. L. REV. 739, 759-60 (1988) (arguing that the presence of T. Boone Pickens made target's actions in the *Newmont Mining* case appear more reasonable due to the court's dislike of Pickens).

⁴⁸See Gustafson, *supra* note 38, at 781-84. The author argues that Delaware courts have adopted an approach for evaluating director conduct in takeover situations that considers the aid given to management by outside legal counsel in examining all of the relevant factors of the takeover bid. See also *Unocal*, 493 A.2d at 955 (discussing the relevant factors).

⁴⁹*Unocal*, 493 A.2d at 950. In conjunction with financial presentations made by Unocal's investment bankers, the attorney involvement led the court of chancery to conclude in part that the "directors' decision [to oppose the Mesa tender offer] was made in the good faith belief that the Mesa tender offer is inadequate." *Id.* at 958.

⁵⁰Under the enhanced scrutiny test announced in *Unocal*,

Unocal thus confirmed the corporate attorney's validation function within the takeover context. By having attorneys present at the crucial meetings, directors could prove to courts that they intended to protect shareholders from unfair bids to entrench themselves in office.

C. Strategy

The *Unocal* decision not only affirmed the attorney's validation function within the takeover process, but also rewarded strategic innovation in defending against takeovers when it upheld *Unocal*'s exclusive share repurchase.⁵¹ Although no explicit authority existed in Delaware corporation law for the type of defense tactic utilized by *Unocal*, the court nevertheless held: "[O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited."⁵² By sanctioning the growth of new defensive tactics to fend off takeover bids, the court confirmed another role lawyers had begun to fulfill in the takeover context: that of "strategist," aiding directors and officers to defend the company from profit-seeking raiders.

The corporate attorney's contribution to the creation of defensive tactics is illustrated in *Moran v. Household International, Inc.*⁵³ In *Moran*, the Delaware Supreme Court considered the propriety of an adoption of a flip-in/flip-over poison pill prior to any takeover bid or announcement of a tender offer by a potential raider.⁵⁴ After holding that the directors possessed authority to adopt the poison pill, the court then discussed the propriety of the directors' conduct under *Unocal* and *Van*

[t]he directors satisfy their threshold burden of showing a threat to corporate policy and effectiveness . . . by showing good faith and a reasonable investigation, a burden which may be satisfied by demonstrating that the decision was made by disinterested and independent directors acting upon advice of counsel and other experts.

Veasey, *supra* note 10, at 2080.

⁵¹*Unocal*, 493 A.2d at 956. The court found that what it deemed the "selective exchange offer" was reasonably related to the threat posed to the corporation. *Id.*

⁵²*Id.* at 957. The court took particular note of the modern "two-tier 'front-end' loaded offers with their coercive effects" upon target corporations. *Id.*

⁵³500 A.2d 1346 (Del. 1985).

⁵⁴*See id.* The "flip-in" aspect of the poison pill allowed shareholders to exercise the Right to buy 1/100 of preferred stock for \$100. *Id.* at 1349. If the Rights were not exercised and a takeover took place, the "flip-over" portion of the pill allowed shareholders to exercise their Rights to buy \$200 of the common stock of the tender offeror for \$100. *Id.*

Gorkom.⁵⁵ In upholding the directors' actions, the court noted with approval the participation of the Wachtell, Lipton law firm in the decision-making process leading to the adoption of the poison pill, stating that

The Directors were given beforehand a notebook which included a three-page summary of the Plan along with articles on the current takeover environment. The extended discussion between the Board and representatives of Wachtell, Lipton and Goldman, Sachs before approval of the Plan reflected a full and candid evaluation of the Plan.⁵⁶

Moran, like *Unocal*, confirmed that corporate attorneys legitimately functioned as strategists within the takeover process. Implicit in the *Moran* decision was the assumption that legal strategists provided value to the entire corporate entity, as opposed to the directors and officers who controlled it.

D. Conclusion

The decisions of the Delaware judiciary expanded the corporate attorney's role within the takeover context. In order to protect their decisions, directors would have to show that they had participated in an "appropriately deliberative" process prior to making crucial takeover decisions. Corporate attorneys not only helped craft evaluative procedures that passed judicial muster, but they also assisted anxious directors of target corporations in preparing defenses against hostile takeovers. It is evident from a comparison of the Delaware judiciary's opinions in *Van Gorkom*, *Unocal*, and *Moran*, that the Delaware Supreme Court believed that lawyers would enhance the substantive value of their client's decisions by helping them negotiate the particulars of the takeover process. This process, in turn, would provide shareholders greater protection from overreaching officers and directors.

III. THE ATTORNEY'S OBLIGATIONS IN THE TAKEOVER CONTEXT: TO WHOM DOES COUNSEL OWE HIS LOYALTY?

The preceding section examined the roles corporate attorneys play within the takeover process and argued that these roles were created and

⁵⁵*Id.* at 1355-57.

⁵⁶*Id.* at 1356.

maintained by the Delaware Supreme Court's takeover jurisprudence. Unfortunately, whatever value attorneys might provide their clients in takeover situations is undermined by ambiguous rules of professional responsibility governing corporate attorneys.

A. *Who is the Client?*

As one practitioner observes, "The corporate lawyer who resorts to [the Model Rules] for assistance usually finds nothing more than silence or vague generalities that are of little help in solving practical, immediate concerns."⁵⁷ This is especially true in the context of takeover transactions.⁵⁸

According to the traditional understanding of professional responsibility, "The lawyer's professional responsibility obligations arise from the fundamental fiduciary duty that a lawyer owes to his client."⁵⁹ The primary source of confusion for the corporate attorney in the takeover context is the fact that the identity of his "client" is unclear.⁶⁰ Under the Model Code of Professional Responsibility, "A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer,

⁵⁷Frederick W. Kanner, *Overview of Professional Responsibility Issues for the Corporate Lawyer*, in CONFLICTS OF INTEREST IN LEGAL REPRESENTATION 211, 221 (Robert J. Jossen, chair, Practising Law Institute 1988). See also ANDREW L. KAUFMAN, PROBLEMS IN PROFESSIONAL RESPONSIBILITY 285-87 (3d ed. 1989) (discussing ambiguities in the Model Code and Model Rules).

⁵⁸Several commentators have set forth proposals for more context-specific ethical rules. See, e.g., Stanley Sporkin, *The Need for Separate Codes of Professional Conduct for the Various Specialties*, 7 GEO. J. LEGAL ETHICS 149, 149 (1993) (arguing that the current rules "do not provide enough fact-specific provisions that apply directly to many of the various legal specialties"); David B. Wilkins, *Legal Realism for Lawyers*, 104 HARV. L. REV. 468, 516 (1990) (stating that "legal ethics must develop a set of 'middle-level principles' that both isolate and respond to relevant differences in social and institutional context"); Bryan J. Pechersky, Note, *Representing General Partnerships and Close Corporations: A Situational Analysis of Professional Responsibility*, 73 TEX. L. REV. 919, 925 (1995) (arguing that "situational analysis" should guide ethical rules regarding representation of partnerships and closely held corporations).

⁵⁹Kanner, *supra* note 57, at 215. Kanner further indicates that the lawyer's fiduciary duty to his client

encompasses obligations of (i) confidentiality, which fosters the candor necessary for successful representation, (ii) loyalty, which ensures that the client's interests will not be compromised by any desire on the part of the lawyer to serve two masters and (iii) care, which requires the competence necessary to protect adequately the client's interests.

Id.

⁶⁰Reycraft, *supra* note 4, at 609.

employee, representative, or other person connected with the entity."⁶¹ The Model Rules of Professional Conduct, which were adopted in 1983 to supersede the Model Code, similarly refer to the corporation as an entity; "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."⁶² Constituents, in turn, are defined to include "officers, directors, employees and shareholders."⁶³

As of 1996, thirty-eight states and the District of Columbia have adopted, in some form, the Model Rules of Professional Conduct.⁶⁴ Like the Model Code, the Model Rules treat the corporation as a juridical entity, separate from its constituents.⁶⁵ Not only has this theory of representation been criticized in several contexts other than takeovers,⁶⁶ it was also proven to be a particularly inappropriate guide for an attorney who represents a corporation which may not even exist after the consummation of a particular transaction.⁶⁷

⁶¹MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1983). EC 5-18 further states, "In advising the entity, a lawyer should keep paramount its interests and his professional judgment should not be influenced by the personal desires of any person or organization." See also Reycraft, *supra* note 4, at 608 (further explaining the issues of conflicting duties of loyalty and confidentiality)

⁶²MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(a) (1995).

⁶³*Id.* cmt. 2.

⁶⁴GILLERS & SIMON, *supra* note 6, at xvii.

⁶⁵See *supra* text accompanying notes 62-63.

⁶⁶See generally Bruce A. Mann & Marcus D. Wilkinson, *The Role of Counsel in Venture Capital Transactions if Disputes Arise*, 46 BUS. LAW. 759 (1991) (discussing corporate representation of venture capital firms); Michelle D. Monse, *Ethical Issues in Representing Thrifts*, 40 BUFF. L. REV. 1 (1992) (arguing that the banking institution lawyer also is unsure of his client's identity and is therefore subject to malpractice suits from federal receivership agencies such as the Federal Deposit Insurance Corporation).

Because of the legal fiction that a corporation is a juridical person separate from any of its constituent parts, the lawyer, it is said, represents that artificial being alone. Yet artificial beings require actual beings to speak and act for them. Ordinarily the interests of the constituents and the entity coincide . . . [b]ut many instances arise in which the entity's interests are difficult to ascertain, or those interests conflict with constituents' interests or with public policy. At that point, it becomes vital, yet markedly more difficult, for the lawyer to answer the central question, "who is the client?"

Monse, *supra*, at 5.

⁶⁷Ralph Jonas, *Who is the Client?: The Corporate Lawyer's Dilemma*, 39 HASTINGS L.J. 617, 618 (1988).

[W]hen [a lawyer's] client disappears by operation of law, such as a merger in which the client is not the survivor, the lawyer presides over his client's voluntary destruction. Is it functional to argue that the lawyer's absolute allegiance to his corporate client, to the exclusion of that corporation's shareholders, permits the attorney to preside over his client's death?

Model Rule 1.13(b) provides the lawyer with some basic guidance as to how to handle officer action that he perceives to be "a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization."⁶⁸ The attorney's course of action *may* include, but is not limited to:

- (1) asking reconsideration of the matter;
- (2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
- (3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.⁶⁹

According to the Comment accompanying Rule 1.13, when officers and directors make decisions for the corporation, those decisions "ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful."⁷⁰ Only if the attorney "knows" that the officer's intended action is a "violation of law" or, more important in the takeover context, a "violation of a legal obligation to the organization," can the corporate attorney take steps to correct potentially harmful action or inaction by the corporation's officers.⁷¹

Once the attorney has ascertained a potential violation, his reaction under the Model Rules is guided by the severity of the officer's conduct.⁷² For example, a mere infraction might merit no more than the attorney's request that the officer reconsider his decision.⁷³ A more serious matter might require the lawyer to have the issue considered by a "higher authority within the organization."⁷⁴ Finally, in extreme

Id. at 618.

⁶⁸MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995).

⁶⁹*Id.* Section (c) provides for resignation by the corporate attorney under certain circumstances. Section (d) states that a lawyer should explain the "identity of the client" when the organization's interests are adverse to "those of the constituents with whom the lawyer is dealing." Section (e) provides for simultaneous representation of the organization and one of its constituents provided the organization renders its consent. *Id.*

⁷⁰*Id.* cmt. 3.

⁷¹*See id.*

⁷²*See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995).

⁷³*See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b)(1) (1995).

⁷⁴*Id.* Rule 1.13(b)(3).

circumstances, the attorney may appeal directly to the board of directors.⁷⁵ If the board then insists upon following a course of action "that is *clearly a violation of law* and is likely to result in substantial injury to the organization," the lawyer may then resign.⁷⁶ Under this framework, withdrawal is always a last resort.⁷⁷

On one hand, the Model Rules might be lauded as providing the attorney the requisite flexibility to decide upon the best course of action for his client according to the particular circumstances concerning the officer's conduct.⁷⁸ Nevertheless, there are several flaws within the Model Rules' framework of ethical representation of corporate clients when those clients are considering takeovers, mergers, or acquisitions. First, because the organization may not exist subsequent to the corporate transaction, it is difficult to ascertain what behavior would "result in substantial injury to the organization."⁷⁹ Although an unfair leveraged buy-out might result in substantial injury to shareholder interests, it might have no effect on the corporation as an entity; to the contrary, the terms of the buy-out might generate great gains for the now-privately owned corporation.⁸⁰

Second, most types of officer and director misconduct cited in cases such as *Van Gorkom* involve violations of *fiduciary duty* as opposed to violations of laws or regulations.⁸¹ Although Rule 1.13(b) refers to the officer's "legal obligation to the organization," the concept of fiduciary

⁷⁵See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. 4 (1995) ("In an extreme case, it may be reasonably necessary for the lawyer to refer the matter to the organization's highest authority. Ordinarily, that is the board of directors or similar governing body."). It has been noted that "[t]he professional rules place the onus of determining whether to go over the heads of the corporation's authorized representatives directly on the attorney. This is quite properly a recognition that ultimately it is the practitioner who must decide whether his conduct and advice are legitimate." James P. Hemmer, *Resignation of Corporate Counsel: Fulfillment or Abdication of Duty*, 39 HASTINGS L.J. 641, 655-56 (1988) (citations omitted).

⁷⁶MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(c) (1995) (emphasis added). Rule 1.13(c) is restrictive, because lawyers will rarely ever be able to perceive a "clear" violation of law, particularly where fiduciary duties are concerned. Hemmer, *supra* note 75, at 658. Moreover, the rule merely *permits* the lawyer to resign, it does not compel him to. *Id.*

⁷⁷MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (1995). For more on withdrawal and its function as a disclosure device, see Ronald D. Rotunda, *The Notice of Withdrawal and the New Model Rules of Professional Conduct: Blowing the Whistle and Waving the Red Flag*, 63 OR. L. REV. 455, 471-84 (1984).

⁷⁸MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (1995).

⁷⁹MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995).

⁸⁰Hemmer, *supra* note 75, at 655.

⁸¹See *Van Gorkom*, 488 A.2d at 872.

duty is not even mentioned in the Rule's commentary, which, in conjunction with the resignation clause in 1.13(c), focuses exclusively on violations of law.⁸² Similarly, Rule 1.2(d), which proscribes an attorney's participation in the perpetration of fraud, says nothing about the lawyer's contribution to a person's violation of fiduciary duty.⁸³ Moreover, Model Rule 1.6 imposes on the attorney a strict duty of confidentiality, allowing him to disclose his client's confidences only if necessary to prevent a criminal act likely to result in imminent death or substantial bodily harm.⁸⁴ Thus, an attorney apparently cannot reveal the board's violations of fiduciary duty to shareholders. Taken as a whole, Rules 1.2, 1.6, and 1.13 create an ethical vacuum that all but swallows managerial violations of fiduciary duty. The ABA not only recognizes this vacuum, but implicitly supports it in ABA Opinion 94-380 by indicating that an attorney representing a fiduciary owes a duty of responsibility to his client only, and not to the fiduciary's intended beneficiary.⁸⁵

⁸²Compare MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995) with MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(c) & cmt. 5 (1995).

⁸³See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 (1995) (indicating that "[a] lawyer shall not . . . assist a client, in conduct that the lawyer knows is criminal or fraudulent . . ."); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(c) (1995) (allowing counsel to resign when the board insists upon engaging in conduct that is a violation of law).

⁸⁴See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1995):

(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except . . .

(b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:

(1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or

(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.

Id.

As written, Rule 1.6 prohibits corporate attorneys from disclosing client confidences to regulatory agencies, even when those clients intend to break particular regulations or laws. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1995). It is unclear if Rule 1.6 applies to disclosures to shareholders, because the owners of the corporation arguably may be considered the "client" for purposes of confidentiality. See *id.*; see also MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (1995).

⁸⁵ABA Comm. on Ethics and Professional Responsibility, Formal Op. 94-380 (1994) [hereinafter ABA Formal Op. 94-380]. The opinion states in relevant part:

A lawyer who represents the fiduciary in a trust or estate matter is subject to the same limitations imposed by the Model Rules of Professional Conduct as are all other lawyers. The fact that the fiduciary has obligations to the

A third problem with Rule 1.13 is that its resignation option may be difficult to invoke when managers fail to uphold fiduciary duties to shareholders in the takeover context. Because Rule 1.13(c) speaks only of clear violations of law "likely to result in *substantial injury* to the organization," the attorney may not be able to resign.⁸⁶

Rule 1.16(b), the general withdrawal provision, also allows voluntary resignation when a client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent" or other "good cause for withdrawal exists."⁸⁷ The attorney cannot take advantage of the provision for voluntary withdrawal of Rule 1.16, however, unless "withdrawal can be accomplished without material adverse effect on the interests of the client."⁸⁸ Because timing is often of the essence in the takeover context, it is difficult to conceive of *any* withdrawal that would *not* create a material adverse effect for the client.

Finally, Rule 1.13 appears to restrict attorneys from disclosing fiduciary violations to shareholders,⁸⁹ arguably the constituency most deserving of protection in takeover situations. The Rule stresses that the

beneficiaries of the trust or estate does not in itself either expand or limit the lawyer's obligations to the fiduciary client under the Model Rules, nor impose on the lawyer obligations toward the beneficiaries that the lawyer would not have toward other third parties. Specifically, the lawyer's obligation to preserve the client's confidences under Rule 1.6 is not altered by the circumstance that the client is a fiduciary.

Id. See also Robert W. Tuttle, *The Fiduciary's Fiduciary: Legal Ethics in Fiduciary Representation*, 1994 U. ILL. L. REV. 889, 892 (criticizing the ABA's opinion). Tuttle criticizes the ABA Opinion for failing to take account of the special nature of fiduciary representation. *Id.* He indicates that "ABA 94-380 ignores the peculiar nature of the fiduciary's role and relationship with the beneficiaries, and risks incoherence in its attempt to force fiduciary representation into the basic model of the attorney-client relationship." *Id.* It is important to note that the corporate attorney is *not* bound by this Formal Opinion because he represents the corporation as an entity, not the corporation's managers (who owe fiduciary duties to the corporation and its shareholders). See ABA Formal Op. 94-380, *supra*.

⁸⁶MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(c) (1995) (emphasis added). This rule in practice "will seldom permit counsel to resign." Hemmer, *supra* note 75, at 658. The author indicates that, in practice, violations of law involving issues of business judgment are not clear. *Id.*

⁸⁷MODEL RULES OF PROFESSIONAL CONDUCT Rules 1.16(b)(1), (6) (1995). Rule 1.16(a), which mandates withdrawal in limited circumstances, is generally inapplicable to problems encountered in the takeover context unless the attorney firmly believes that his "representation will result in violation of the rules of professional conduct or other law." *Id.* Rule 1.16(a)(1). It is doubtful that the violations of fiduciary duty discussed throughout this article would qualify under this provision of the Model Rules.

⁸⁸MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(b) (1995).

⁸⁹See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995).

attorney should move cautiously "in the best interest of the organization," minimize any "disruption," and reduce the risk of revealing information to "persons outside the organization."⁹⁰ The text does not clarify whether shareholders are considered persons "outside the organization."⁹¹ The Rule goes on to say, however, that the attorney may reveal misconduct to "the highest authority that can act in behalf of the organization."⁹² As shareholders lack the authority to act on behalf of the corporation,⁹³ this language would appear to preclude disclosure to shareholders.⁹⁴ Thus, under the current framework, "the strongest action a lawyer may take is to resign, but resignation must be triggered by harm to the corporation, not to third parties."⁹⁵ The Rule fails to state with clarity whether shareholders are to be considered the attorney's "client" or mere third parties.

Close examination of the Model Rules of Professional Conduct raises many issues about proper attorney conduct in the takeover context, but provides little guidance on these issues.⁹⁶ It is clear that if the corporation's management intends to engage in illegal conduct, the attorney may appeal to the board, and if that fails, the attorney may resign from his position.⁹⁷ However, if the board of directors wishes to engage in action that violates its fiduciary duties to shareholders, the attorney is at a loss to determine a proper course of action.⁹⁸ Rule 1.13(b) allows him to appeal to the board, but Rule 1.13(c) seemingly does not give him enough latitude to resign, and Rule 1.6 may keep him from revealing the intended harm to shareholders.⁹⁹ In short, the lawyer's

⁹⁰*See id.* An earlier draft of the Rule permitted the attorney to disclose client confidences to persons outside the organization if the board refused to alter its action to comply with the law. *See* Stephen Gillers, *Model Rule 1.13(c) Gives the Wrong Answer to the Question of Corporate Counsel Disclosure*, 1 GEO. J. LEGAL ETHICS 289, 298-99 (1987); Tuttle, *supra* note 85, at 924-25.

⁹¹*See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 & cmts. (1995).

⁹²MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b)(3) (1995).

⁹³*See, e.g.*, DEL. CODE ANN. tit. 8, § 141 (1991).

⁹⁴*See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995). Commentators have identified "'the highest authority' as including only those who are legally competent to act on the corporation's behalf — i.e., not shareholders." Tuttle, *supra* note 85, at 924-25 & n.190. *But see* Jeffrey N. Pennell, *Representations Involving Fiduciary Entities: Who is the Client?*, 62 FORDHAM L. REV. 1319, 1338 (1994) (assuming attorneys may disclose confidences to shareholders without breaking the Rules of Professional Conduct if such disclosure is in the best interest of the corporation and is reasonably necessary).

⁹⁵Hemmer, *supra* note 75, at 658 n.67.

⁹⁶*See generally* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (1995).

⁹⁷*Id.*

⁹⁸*See id.*

⁹⁹*See generally* MODEL RULES OF PROFESSIONAL CONDUCT Rules 1.13(b), (c) & 1.6

hands are tied when he knows that the corporation's board plans a course of action that violates the duties of loyalty and care owed to its shareholders.

B. *The SEC's View of Attorney Responsibility*

As discussed above, the Model Rules of Professional Conduct treat the corporation as an entity, attempting to guide the corporate attorney with a flexible course of action based on the severity of the officer's suspected misconduct. This next section examines the subject of officer misconduct in the securities context and argues that the Model Rules' emphasis on disclosure was the result of the corporate bar's reaction to the SEC's attempts to enforce strict standards of attorney conduct in the late 1970s and early 1980s.¹⁰⁰ The Rule therefore fails to address structural issues that plague the takeover context.¹⁰¹

Throughout the last three decades, the SEC has moved back and forth in its view of corporate attorney responsibility where securities are involved.¹⁰² In the late 1970s, the SEC adopted an aggressive view of attorney responsibility where disclosure requirements were concerned.¹⁰³ In 1978, the Commission set forth its view in *SEC v. National Student Marketing*¹⁰⁴ that corporate attorneys harbored a direct obligation to

(1995) (addressing confidentiality of information).

¹⁰⁰For a more in-depth discussion of the securities lawyers' obligations under the SEC rules and regulations, see Marc I. Steinberg, *Attorney Liability for Client Fraud*, 1991 COLUM. BUS. L. REV. 1. See also Ann Maxey, *Competing Duties? Securities Lawyers' Liability After Central Bank*, 64 FORDHAM L. REV. 2185 (1996).

¹⁰¹Obviously, overlap exists between the "takeover" and "securities" contexts. A merger or acquisition might involve both violations of fiduciary duty and violations of the securities laws. The ethical dilemmas with which this article is concerned involve the attorney's perception of management's violations of common law doctrines of fiduciary duty, not violations of written securities laws or regulations. Thus, the term "securities context" refers to instances in which the attorney is aware of an officer's or director's violation of a particular law or regulation. "Takeover context," on the other hand, indicates those instances in which the attorney perceives conduct throughout the takeover process that suggests the officer's or director's failure to uphold fiduciary duties of care or loyalty to the corporation and its shareholders.

¹⁰²Simon M. Lorne & W. Hardy Callcott, *Administrative Actions Against Lawyers Before the SEC*, 50 BUS. LAW. 1293 (1995). "The proper forum for SEC actions against lawyers has been a subject of considerable controversy for the past twenty-five years, as has the standard governing the decision whether to institute such actions, as well as the standards which should determine how those actions, once instituted, are decided." *Id.* at 1294.

¹⁰³Roberta S. Karmel, *Reining the Bar By Naming Lawyers as "Causes,"* N.Y. L.J., Apr. 18, 1996, at 3, 35.

¹⁰⁴457 F. Supp. 682 (D.D.C. 1978).

shareholders to protect them from overreaching directors and officers.¹⁰⁵ The SEC filed a complaint for injunctive relief under the antifraud provisions of the Securities Exchange Act¹⁰⁶ against White & Case and Lord, Bissell & Brook for their failure to speak out at a merger closing even though they knew that the proxy materials given to shareholders prior to the closing were materially defective.¹⁰⁷ The SEC asserted in its complaint that the two firms were guilty of aiding and abetting a violation of securities laws and regulations by failing to uphold their duty to disclose their clients' actions to either the SEC or to the investor public.¹⁰⁸ The SEC argued that if recalcitrant board members were unwilling to follow disclosure regulations, then their attorneys should disclose the defects in the materials to either the Commission or the shareholders.¹⁰⁹

Although the district court found that Lord, Bissell & Brook and its attorneys¹¹⁰ had aided and abetted a securities fraud by participating in the merger closing, it did not adopt the SEC's expansive view of

¹⁰⁵The court indicated:

The Commission's allegations of aiding and abetting by the defendants, . . . seem to fall into four basic categories: (1) the failure of the attorney defendants to *take any action to interfere* in the consummation of the merger; (2) the issuance by the attorneys of an opinion with respect to the merger; (3) the attorneys' subsequent failure to withdraw that opinion and *inform the Interstate shareholders or the SEC* of the inaccuracy of the nine-month financials; and (4) the issuance by the attorneys and Brown of an opinion and letter, respectively, concerning the validity of the stock sales under Rule 133.

Id. at 712 (citations omitted) (emphasis added). The first and third categories of the SEC complaint implied that corporate attorneys harbored whistle-blowing obligations under the securities laws. *Id.*

¹⁰⁶*Id.* at 686.

¹⁰⁷*Id.* at 699-700.

¹⁰⁸*National Student Marketing*, 457 F. Supp. at 699-701.

¹⁰⁹*Id.* at 701. The Supreme Court recently called into question the Commission's ability to bring actions under the antifraud provisions of the Securities Exchange Act of 1934 when it decided *Central Bank v. First Interstate Bank*, 114 S. Ct. 1439 (1994). In *Central Bank*, the Court held that private parties could not bring "aiding and abetting" causes of action under § 10(b) of the 1934 Act. *Id.* at 1446. "That decision swept away thirty years of federal common law by limiting the reach of private remedies against lawyers and others who provide services in connection with the offering of securities." Maxey, *supra* note 100, at 2187. The *Central Bank* decision also created doubt about the Commission's ability to bring similar types of actions under § 16(b) against attorneys and others accused of aiding or abetting securities violations. Congress, however, explicitly authorized the Commission to bring such actions in 1995, when it enacted the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67. See generally Maxey, *supra* note 100, at 1287-89.

¹¹⁰White & Case had settled its part of the case by this time. Kanner, *supra* note 57, at 258.

attorney obligation.¹¹¹ Instead, the district court adopted a middle ground between complete passivity and whistle blowing.¹¹² The court was, however, highly critical of the attorneys for taking no steps to delay the closing of the merger: "the attorneys' responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders."¹¹³ The court concluded, "[A]t the very least, [the lawyers] were required to speak out at the closing concerning the obvious materiality of the information and the concomitant requirement that the merger not be closed until the adjustments were disclosed and approval of the merger was again obtained from the . . . shareholders."¹¹⁴ Merely providing advice to the client was not enough; henceforth, attorneys would be expected to take some steps to *prevent* fraud or lack of disclosure prior to a closing.¹¹⁵

Despite the SEC's prodding, the district court would not go so far as to hold that the attorneys harbored a whistle-blowing obligation *after* the merger had taken place.¹¹⁶ Rejecting the SEC's expansive view of attorney obligation, the district court denied the injunction on the grounds that the attorneys could not be involved in a continuing violation of securities law after the merger had already taken place.¹¹⁷

In addition to its power to bring cases against attorneys in Article III courts, the SEC also asserted administrative power to sanction and disqualify attorneys from practicing before it under Rule 2(e) of the SEC's Rules of Practice, which provides:

¹¹¹*National Student Marketing*, 457 F. Supp. at 712. The court indicated that it "concur[red] with regard to the attorneys' failure to interfere with the closing, but must conclude that the remaining actions or inaction alleged to constitute aiding and abetting did not substantially facilitate either the merger or the stock sales." *Id.*

¹¹²*Id.* at 712-14.

¹¹³*Id.* at 713.

¹¹⁴*Id.*

¹¹⁵As for the SEC's suggestion that the attorneys had a responsibility to "undo" the merger, the district court responded, "The SEC's contention with regard to counsel's alleged acquiescence in the merger transaction raises significant questions concerning the responsibility of counsel." *National Student Marketing*, 457 F. Supp. at 714.

¹¹⁶*Id.* at 714-15.

¹¹⁷*National Student Marketing*, 457 F. Supp. at 714-17. The court indicated that [e]ven if the attorneys' fiduciary responsibilities to the . . . shareholders continued beyond the merger, the breach of such a duty would not have the requisite relationship to a securities transaction, since the merger had already been completed. It is equally obvious that such subsequent action or inaction by the attorneys could not substantially assist the merger.

Id. at 714-15.

(e) Suspension and disbarment. (1) . . . The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . (ii) [t]o be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) [t]o have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.¹¹⁸

This rule allowed the SEC to sanction any lawyer before it in an enforcement proceeding and to set standards of professional conduct for those who wished to continue the practice of securities law.¹¹⁹ Starting in the late 1960s, the SEC attempted to use Rule 2(e) to punish attorneys who aided or abetted securities law violations.¹²⁰

The SEC's vision of attorney obligation elicited great concern from the corporate bar.¹²¹ Most lawyers complained that the SEC's view of attorney responsibility violated the confidential attorney-client relationship mandated by various sections of the Model Code, the relevant source of professional guidelines and regulations at the time.¹²² Others commented

¹¹⁸SEC Rules of Practice, 17 C.F.R. § 201.102(e) (1996). Section 201.102(e) was formerly 17 C.F.R. § 201.2(e) (1986) and is generally referred to as Rule 2(e).

¹¹⁹Lorne & Callcott, *supra* note 102, at 1296. See Roberta S. Karmel, Rule 2(e) — A Reprise, N.Y. L.J., Oct. 21, 1993, at 3, 38 n.6 (citing comments). Karmel, a former commissioner of the SEC, questioned the SEC's statutory authority to enforce standards of legal responsibility under Rule 2(e).

¹²⁰Lorne & Callcott, *supra* note 102, at 1297.

¹²¹See Junius Hoffman, *On Learning of a Corporate Client's Crime or Fraud — The Lawyer's Dilemma*, 33 BUS. LAW. 1389, 1404-05 n.38 (1978) (citing scholarly response to SEC's view); see also Lorne & Callcott, *supra* note 102, at 1301 n.34 (same).

¹²²See Kanner, *supra* note 57, at 260-61. The ABA issued a Statement of Policy that took the position that the confidentiality of attorney-client consultations, which is vital to the basic function of the lawyer as counselor, would be destroyed or seriously impaired if it were accepted as a general principle that lawyers must inform the SEC or others regarding confidential information received by lawyers from their clients in circumstances where the Model Code would not permit or require such disclosure.

Id. at 260. Lorne and Callcott similarly recognized the necessity of maintaining the attorney-client relationship: "A client, especially one who finds itself at odds with a government agency such as the SEC, wants and is entitled to a lawyer who will zealously represent its interests with undivided loyalty." Lorne & Callcott, *supra* note 102, at 1303. See also Charles Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relation*, 85 YALE L.J. 1060, 1061 (1976) (arguing that an attorney's primary loyalty is to his client); Stephen L. Pepper, *The Lawyer's Amoral Ethical Role: A Defense, A Problem, and Some Possibilities*, 1986 AM. B. FOUND. RES. J. 613, 626 (suggesting that the lawyer is not responsible for the

that the SEC lacked the statutory authority to promulgate standards of professional responsibility for the attorneys who practiced before it.¹²³

Several years later, in *In re Carter*,¹²⁴ the SEC moved away from its aggressive stance.¹²⁵ In this case, two attorneys assisted a client, the National Telephone Company, in obtaining financing while failing to ensure that the client's proxy statements to shareholders adequately disclosed the difficulties it was having in obtaining capital.¹²⁶ Although the attorneys advised officers of the corporation's duty to disclose the information, they did not contact the corporation's board of directors when the officers refused to disclose the information.¹²⁷

The procedural history of the case suggests that the Commission itself was unsure of how far to push the corporate attorney's duty of disclosure under Rule 2(e).¹²⁸ First, the SEC brought an injunctive action against two attorneys under Rule 2(e), stating that their participation in assisting a client in the preparation of proxy materials required more from them than mere communication of the client's disclosure obligations.¹²⁹ The attorneys were found guilty of aiding and abetting their client's disclosure violation pursuant to Rule 2(e).¹³⁰ The SEC then reversed the ALJ's finding and issued an interpretation of the ethical standards required under Rule 2(e).¹³¹

The SEC reversed for several reasons. First, according to the Commission, the attorneys involved could not be guilty of aiding or abetting under Rule 2(e) because they lacked the necessary scienter, knowledge or recklessness.¹³² Second, the SEC declined to sanction the

moral behavior of the client but is a mere representative); Tuttle, *supra* note 85, at 918-19 (indicating that "[t]he moral good of autonomy requires lawyers to assist individuals as they make their way through this complex [regulatory] system").

¹²³Karmel, *supra* note 119, at 3. "[T]he commission has simply arrogated this power to itself, claiming expertise and the need for private sector assistance in policing the securities markets. However, the licensing and discipline of attorneys and accountants is a matter properly committed to state licensing bodies and professional associations." Congress has not granted the SEC the authority to regulate the practice of the attorneys who come before it. *Id.*

¹²⁴*In re Carter*, Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,145 (Feb. 28, 1981).

¹²⁵*Id.* at 84,173. The Commission found that at the time in question, standards of appropriate conduct under the circumstances had not been fully adopted. *Id.* at 84,146.

¹²⁶*Id.* at 84,152.

¹²⁷*Id.* at 84,157-64.

¹²⁸See generally *In re Carter*, Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,145 (Feb. 28, 1981).

¹²⁹*Id.* at 84,152.

¹³⁰*Id.* at 84,146. An Administrative Law Judge (ALJ) ruled on this matter. *Id.*

¹³¹*Id.*

¹³²*In re Carter*, Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH)

attorneys for violations of standards not yet enunciated by the Commission.¹³³ Although the SEC ultimately did not sanction the attorneys under Rule 2(e), it nevertheless declared that their conduct would be inadequate in the future.¹³⁴

The SEC then outlined the corporate lawyer's obligations.¹³⁵ The SEC indicated that "[w]hen a lawyer . . . becomes aware that his client is engaged in a substantial and continuing failure to satisfy . . . disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's [sic] non-compliance."¹³⁶ The SEC then set forth the attorney's recommended course of action by stating that at first "counselling accurate disclosure is sufficient."¹³⁷ After the corporate lawyer ascertains his client's continued unwillingness to follow SEC disclosure regulations, the lawyer should "take further, more affirmative steps" to end his client's violation.¹³⁸ The SEC further stated: "A direct approach to the board of directors or one or more individual directors or officers may be appropriate; or he may choose to try to enlist the aid of other members of the firm's management."¹³⁹ Resignation is an option in the event that other options fail, although not mandatory in all instances.¹⁴⁰ Above all, the lawyer is expected to demonstrate to the SEC that he "engaged in efforts to correct the underlying problem, rather

¶ 82,847, at 84,166-69.

¹³³*Id.* at 84,170.

¹³⁴*Id.*

¹³⁵*Id.* at 84,172.

¹³⁶*In re Carter*, Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH)

¶ 82,847, at 84,172.

¹³⁷*Id.* The SEC indicated that counselling would be sufficient even if the advice was not followed. *Id.*

¹³⁸*Id.* If the lawyer determines that his client is not in good faith seeking his advice, the lawyer must take steps to avoid the inference that he is taking part in the "scheme of non-disclosure." *Id.*

¹³⁹*Id.* The essence of what is required is "prompt action." *Id.*

¹⁴⁰*In re Carter*, Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH)

¶ 82,847, at 84,172 n.77. The SEC stressed that an unsuccessful attempt to advise a client to comply with SEC regulations does not necessarily demand an attorney's resignation. *Id.* The SEC indicated that

[i]n those cases where resignation is not the only alternative, should a lawyer choose not to resign, we do not believe the action taken *must be successful* to avoid the inference that the lawyer had improperly participated in his client's fraud. Rather, the acceptability of the action must be considered in the light of all relevant surrounding circumstances.

Id.

than having capitulated to the desires of a strong-willed but misguided client."¹⁴¹

It is important to note that the SEC's opinion in *In re Carter* did not impose an obligation to disclose wrongdoing to the SEC or the investing public on corporate attorneys.¹⁴² Unlike its complaint in *National Student Marketing*,¹⁴³ the SEC's pronouncement in *In re Carter* of proper and ethical attorney conduct under Rule 2(e) appeared to adopt a middle ground between whistle-blowing and silent acquiescence in managerial misconduct.¹⁴⁴ The attorney's professional obligation is met insofar as he takes prompt steps to end the violations by his client.¹⁴⁵ Nevertheless, the SEC refused to issue a definitive statement concerning the attorney's disclosure obligations to third parties or the public when the client intended to commit fraud or an illegal act.¹⁴⁶

The ABA's Model Rule 1.13, adopted only two years after the SEC's decision in *In re Carter*, was similar to the *Carter* standard in that it permitted the attorney to take his concerns to the board and allowed the attorney to resign under certain circumstances.¹⁴⁷ Nevertheless, the Rule clearly rejected any notion of an ethical obligation to take "prompt steps" to end a client's noncompliance with the law, and left the silent attorney plenty of room to argue that he had taken all the steps necessary on behalf of the corporation, given the circumstances of the time.¹⁴⁸ The Rule thus represented an attempt to preserve the lawyer's autonomy while placating regulators' concerns.¹⁴⁹ In the process, the ABA rejected the

¹⁴¹*Id.* at 84,172.

¹⁴²*Id.* at 84,172-84,173.

¹⁴³457 F. Supp. 682 (D.D.C. 1978).

¹⁴⁴See *In re Carter*, Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,172-73.

¹⁴⁵*Id.* at 84,172-73.

¹⁴⁶*Id.* at 84,173 n.78. The Commission stated: "This case does not involve, nor do we here deal with, the additional question of when a lawyer, aware of his client's intention to commit fraud or an illegal act, has a professional duty to disclose that fact either publicly or to an affected third party." *Id.*

¹⁴⁷See *supra* part III.A. discussing the attorney's options under the Model Rules.

¹⁴⁸*Id.* *In re Carter*, Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,168-69 (discussing the effect of an attorney's silence or inaction).

¹⁴⁹See Kanner, *supra* note 57, at 266-68 (providing a basic history of the formation of Model Rule 1.13).

In 1978, as the Model Rules project got underway, a monitoring committee for the ABA Business Law Section concluded that legal ethics rules were not just grounds for discipline but had become "the basic source of law" from which courts and administrative agencies "draw the responsibilities of lawyers." Armed with this insight, the committee lobbied successfully for a rule that would be demanding enough to convince the SEC not to impose

SEC's view of the corporate attorney as a "gatekeeper,"¹⁵⁰ and preserved the traditional structure of attorney-client confidentiality by prohibiting the attorney from disclosing any confidential information to anyone "outside the organization."¹⁵¹

Whether Model Rule 1.13 ultimately served as a useful or proper scheme for the prevention of securities fraud is a matter debated by scholars and practitioners.¹⁵² Developments in recent years suggest that the SEC and other agencies are beginning to embrace a more aggressive enforcement regime of attorneys who advise unscrupulous clients.¹⁵³

tough new whistleblowing standards on corporate lawyers who encounter company wrongdoing yet would be hedged enough to keep relations between corporate lawyers and management workable.

Ted Schneyer, *The ALI's Restatement and the ABA's Model Rules: Rivals or Complements?*, 46 OKLA. L. REV. 25, 32 (1993) (citations omitted).

¹⁵⁰A "gatekeeper" is an individual who, by virtue of his position as an indispensable facilitator of certain action, exercises power to enforce legal rules and norms over certain actors. Under this theory, lawyers are "gatekeepers" because they facilitate corporate transactions. The SEC's attempts to mandate attorney disclosure therefore represented an attempt to use third parties (lawyers) to deter corporate misconduct. Lorne & Calcott, *supra* note 102, at 1297. See *id.* at 1297 n.10 for general commentary regarding the desirability of treating attorneys as gatekeepers (citing articles). See also Richard W. Painter, *Toward a Market for Lawyer Disclosure Services: In Search of Optimal Whistleblowing Rules*, 63 GEO. WASH. L. REV. 221 (1995) (arguing that attorney disclosure services should be regulated solely by the market).

¹⁵¹See Lorne & Calcott, *supra* note 102, at 1297 (explaining that the SEC brought actions against attorneys on the ground that they were "gatekeepers" to the securities market who facilitated their clients' crimes). In contrast, the 1981 Final Draft version stated:

When a matter has been referred to the organization's highest authority . . . and that authority insists upon action, or refuses to take action, that is clearly a violation of a legal obligation to the organization . . . [a] lawyer may take further remedial action . . . Such action may include revealing information relating to the representation of the organization

Kanner, *supra* note 57, at 267 (emphasis added).

¹⁵²See Lorne & Calcott, *supra* note 102, at 1297 n.10 (setting forth a list of the various commentary on the SEC's labelling of corporate attorneys as "gatekeepers"); see also Painter, *supra* note 150, at 221-25 (setting forth the pros and cons of whistleblowing and arguing that attorney "disclosure services" should be strictly regulated by the market).

¹⁵³*In re Kern*, [1988-1989 Transfer Binder] Fed Sec. L. Rep. (CCH) ¶ 84,342, at 89,580 (Nov. 14, 1988).

In 1987, the SEC brought an enforcement proceeding under § 15(c)(4) of the Securities Exchange Act of 1934 against an attorney, George Kern, who assumed responsibility to carry out his client's disclosure obligations and failed to reveal negotiations for the sale of assets of his client, who was trying to defend itself against a hostile takeover bid. *Id.* at 85,590-96. Although the Administrative Law Judge found Kern liable for causing the client to commit disclosure violations, the SEC dismissed the proceeding, and consequently "did not reach the issue of whether the respondent had committed any violation." Lorne & Calcott, *supra* note 102, at 1304.

In addition, in 1990, Congress enacted the Securities Enforcement Remedies Act,

Setting the securities issue to one side, there is little question that Model Rule 1.13, with its theme of "entity representation" and its concurrent emphasis on disclosure and resignation, fails to clarify the corporate attorney's role in the structural conflict imposed by takeovers, mergers, and other transactions fundamentally affecting the corporation's identity.

IV. ATTORNEY OBLIGATIONS IN THE TAKEOVER CONTEXT: POTENTIAL MISCONDUCT AND POTENTIAL REFORM

As discussed in the preceding section of this article, Model Rule 1.13 unfortunately has several failings as applied to corporate attorneys who advise, defend against, or negotiate takeover transactions. By adopting the fiction that the corporation is a single entity, the Rule leaves some constituents (officers and directors) in a better position than others (shareholders). In addition, Rule 1.13 masks the conflict of interests likely to arise between various constituents when takeover transactions are imminent. As a result, the corporate attorney who perceives violations of fiduciary duty by officers and directors must choose between the twin evils of (1) enabling those violations or (2) breaking his own duties of confidentiality.

This section offers two reforms to the Model Rules to better reflect the realities of corporate representation in the takeover context. The first reform addresses some of the concerns that arise when a target erects takeover defenses to ward off an acquisition. Although the Delaware courts have recognized that the directors' interests are more likely to conflict with those of the shareholders in constructing and evaluating such defenses,¹⁵⁴ the Model Rules fail to differentiate between this type of conduct and ordinary directorial decision making. To alleviate this

which allows the SEC to issue cease and desist orders against anyone who "causes" a security violation. Karmel, *supra* note 103, at 3. This portion of the Act has been criticized as "an unfortunate return to the SEC's program of the 1970s to use Rule 2(e) as a general enforcement tool." *Id.* at 35. Compare Karmel, *supra* note 103 (arguing against a return to such rules), with Lorne & Calcott, *supra* note 102, at 1307-08 (arguing that "[i]mplicitly, enactment of these provisions must be taken to reflect a congressional view that SEC administrative proceedings are a fair and appropriate forum in which to judge the actions not only of members of the securities industry, but of anyone else, presumably including lawyers, whose conduct implicates the securities laws").

See *In re Fishbein*, [1992-1993 Transfer Binder] Fed. Banking L. Rep. ¶ 89,040, at 81,256 (Mar. 1, 1992). In 1992, the Office of Thrift Supervision used its administrative hearing process to freeze the assets of Kaye, Scholer, Fieran Hays & Handler, who later agreed to pay a sizable settlement to the agency. See Lorne & Calcott, *supra* note 102, at 1295 n.5 (citing both negative and positive reactions to the *Fishbein* case).

¹⁵⁴See *supra* text accompanying notes 41-56.

problem, this section suggests a revised rule that allows attorneys to request that the board obtain a second legal opinion regarding the takeover defense and, if the board fails to do so, allows the attorneys to withdraw his representation.

The second reform addresses some of the issues that arise in the context of auctions. Auctions generally become necessary when directors or officers undertake transactions which entail a sale of corporate control.¹⁵⁵ To function as a source of protection for shareholders, auctions must not be skewed by unfair practices. Consequently, this article offers a reform whereby attorneys must notify directors when they become aware of an officer's misconduct.

Both of the reforms suggested in this article attempt to provide better guidance to attorneys in the takeover context, without unduly limiting their flexibility. In addition, these rules protect corporate constituents such as shareholders without stripping the board of the powers with which it has been statutorily endowed. In any event, they are intended to evoke discussion regarding the corporate attorney's proper role within the takeover process.

A. Takeover Defenses

Takeover defenses include any type of action undertaken by the target to prevent takeover by another corporation or private group. Usually, such defenses are authorized by the board of directors.¹⁵⁶ Among the most well-known defenses are the poison pill,¹⁵⁷ greenmail,¹⁵⁸ staggered boards,¹⁵⁹ and crown jewels.¹⁶⁰ According to the *Unocal* standard, courts will review the propriety of the directors' adoption of

¹⁵⁵See *infra* discussion at part IV.B.

¹⁵⁶See *Revlon*, 506 A.2d at 176.

¹⁵⁷A poison pill is a "rights plan" whereby "shareholders receive the right to be bought out by the corporation at a substantial premium on the occurrence of a stated triggering event." *Id.* at 180.

¹⁵⁸*Unocal*, 493 A.2d at 956 n.13. Greenmail "refers to the practice of buying out a takeover bidder's stock at a premium that is not available to other shareholders in order to prevent the takeover." *Id.*

¹⁵⁹*Camden*, *supra* note 47, at 752. Staggered boards prevent takeovers by keeping the corporate raider from putting his own board of directors in place; thus, the raider's ability to run the company is hindered. *Id.* at 752 n.99. Instead of electing every board member at once, shareholders elect a few directors every few years. *Id.*

¹⁶⁰When a target wishes to deter a hostile takeover, it might make a deal with a white knight to sell its crown jewel (i.e., the most successful division of the company), and thus make the corporation a less desirable target. See *Unocal*, 493 A.2d at 957; *Camden*, *supra* note 47, at 751. A white knight is a "friendly third party investor." *Id.* at 751 n.92.

takeover defenses with enhanced scrutiny due to the "omnipresent specter" of officer and director self-interest.¹⁶¹

The Model Rules, however, do not treat the corporation any differently when directors adopt takeover defenses.¹⁶² Thus, if an attorney perceives self-interested conduct by board members in the erection of takeover defenses that might be detrimental to shareholders in the short or long term, he can do nothing more than counsel the board to uphold its fiduciary duty of loyalty.¹⁶³

Moreover, given the attorney's own interest in retaining his position as counsel to the corporation, it is unlikely that he would express concern about management's self-interested conduct. This is especially true when attorneys institute fee schedules based on results or "performance" and not hourly billing.¹⁶⁴ Thus, it is doubtful that an attorney would give up lucrative fees by counseling a corporation's board to "cave in" to a hostile offer. The institution of "performance" billing, although alarming in the takeover context, is completely sanctioned by the Model Rules.¹⁶⁵

Given the shareholder's inherent lack of protection, some commentators have suggested that shareholders should have their own attorney present in these situations in order to protect their interests.¹⁶⁶ This has been labeled the "counsel for the constituencies" argument.¹⁶⁷ Under this approach, the corporate attorney's role within this context

¹⁶¹*Unocal*, 493 A.2d at 954.

¹⁶²MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (1995).

¹⁶³See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(c) (1995). Since there is no clear violation of law, it is *highly* unlikely that a corporate attorney could withdraw in this situation. See discussion *supra* part III.

¹⁶⁴See Daniel Hertzberg & James B. Stewart, *Contingency Legal Fee for Merger Breaks Ground, Stirs Controversy*, WALL ST. J., Oct. 24, 1986, at 31. The *Wall Street Journal* reported that Wachtell, Lipton, a prominent takeover law firm, instituted a billing system for takeovers based on "performance." *Id.* These performance fees were similarly used by Skadden Arps, who indicated that "the firm takes a 'value approach' toward its billing, which includes consideration of the result achieved and the size of the transaction." *Id.*

The corporate attorney's interest in getting paid undermines his independence. See Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 S. CAL. L. REV. 507, 545 (1994). Painter states that lawyers invest human capital in shaping transactions, and have monetary interest in seeing that the deal is closed and therefore, "lawyer intermediaries thus become part of the multitude of constituencies seeking to influence corporate governance." *Id.*

¹⁶⁵See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(a)4 (1995) (allowing the lawyer to include "the amount involved and the results obtained" when calculating his fee).

¹⁶⁶Marc I. Steinberg, *Attorney Conflicts of Interest in Corporate Acquisitions*, 39 HASTINGS L.J. 579, 584 (1988).

¹⁶⁷*Id.*

"would be to ensure that the views of the major constituencies from both a legal and policy perspective are brought to the board's attention."¹⁶⁸ Despite the presence of constituent counsel, the board would still retain the power to make the ultimate decisions regarding the future of the company, including reaction to potential takeovers or acquisitions.¹⁶⁹

It is important to note that, under this framework, the constituent counsel provides independent oversight and voices the concerns of shareholders; he does not have any power to make ultimate decisions affecting the corporation.¹⁷⁰

Although the "constituent" framework alleviates some of the corporate attorney's ethical dilemma, it also creates new problems within the takeover process. First, given the number of constituents that make up a corporation (such as shareholders, employees, and creditors), the provision of an attorney for each constituent could be prohibitively expensive. Second, confidentiality issues would surface regarding how much information the corporate attorney should reveal to the constituent counsels. Third, conflicts might develop within the constituency itself, thus reducing the effectiveness of the constituent counsel.¹⁷¹ Finally, the board might go through with the same action it was planning in the first place after it hears the views of the constituent counsel. As a facilitator of that action, the corporate attorney still is left in the ethically uncomfortable role of watching passively as directors and officers place their own interests above those of shareholders and the corporation.

Another suggested reform is the "consultative attorney," whereby the board hires a second attorney, unconnected to the corporation, to offer an opinion as to whether the board's course of action is in the best interests of the corporation.¹⁷² As opposed to the constituent attorney,

¹⁶⁸*Id.*

¹⁶⁹*Id.* at 584. "Although management may reject the positions asserted, the presence of separately retained independent counsel would help ensure that the various countervailing arguments will be communicated and explained to the board." *Id.* To say otherwise would be to strip the board of its powers under Delaware law. See DEL. CODE ANN. tit. 8, § 141(a) (1991) (indicating that the business affairs of every corporation organized under this chapter shall be managed by or under the direction of the board of directors).

¹⁷⁰Steinberg, *supra* note 166, at 585. Such counsel would only act as a "'communicator' of the diverse views held by the constituencies to ensure that the board is cognizant of the various positions." *Id.*

¹⁷¹*Id.* at 584-85. It has been noted that "the legal and economic interests of a large, diverse group of shareholders may be internally adversarial" and that "the legal and economic interests of one or more groups of shareholders may conflict with the best interests of the corporation, when that entity is looked upon as a discrete, independent entity having a perpetual life of its own." Jonas, *supra* note 67, at 618.

¹⁷²Steinberg, *supra* note 166, at 586. The consultative attorney would be neutral and

"the consultative attorney represents the entity as a whole rather than the various constituencies."¹⁷³ In this sense, the consultative attorney parallels the independent director concept.¹⁷⁴ The "independent attorney" is someone who has had no direct ties to the firm, and therefore is less likely to feel an allegiance to the board and officers at the expense of shareholder interests.¹⁷⁵

The idea of the consultative attorney might have more success as a takeover reform than the constituent counsel concept. Chancellor Allen has endorsed the concept of the "independent attorney" in the context of management sponsored buy-outs (MBOs).¹⁷⁶ The special committee of independent directors, whose job it is to evaluate the adequacy of management's offer, is not sufficient protection for the shareholder unless that committee feels a special "sense of duty."¹⁷⁷ This duty, in turn, is assumed by the attorneys who advise it.¹⁷⁸ Allen regards the advisor's role "in establishing the integrity of this process as absolutely crucial. Indeed, the motives and performance of the lawyers and bankers who specialize in the field of mergers and acquisitions is to my mind the great, largely unexamined variable in the process [of MBO transactions]."¹⁷⁹ According to Allen, the lawyers who advise the special committee

must be independent of management. They must accept in their hearts that in the MBO or the auction context, their client is the committee and not management. They must clearly and emphatically remind their client that at this juncture, the CEO and his associates are to be treated at arm's-length. . . . That means that from the outset, the advisors must be prepared to forego future business.¹⁸⁰

would render a "second opinion." *Id.*

¹⁷³*Id.* Consequently, any conflict resulting from multiple representations does not "explicitly surface." *Id.* at 586-87.

¹⁷⁴*See id.* at 586-88.

¹⁷⁵*Id.* at 586.

¹⁷⁶*See* William T. Allen, *Independent Directors in MBO Transactions: Are They Fact or Fantasy?*, 45 BUS. LAW. 2055, 2056-61 (1988).

¹⁷⁷*Id.* at 2061.

¹⁷⁸*Id.*

¹⁷⁹*Id.*

¹⁸⁰Allen, *supra* note 176, at 2062. It must be noted that Allen's comments apply solely to MBO situations, in which management's self-dealing is apparent and an intrinsic part of the transaction in question.

While takeover defenses, unlike MBOs, do not ordinarily involve "self-dealing," they may nevertheless be the product of director or officer self-interest at the expense of shareholder welfare. When such conflict of interest is present, Chancellor Allen's comments regarding independent attorneys are as applicable to takeover defenses as they are to MBOs.

In sum, the consultative or independent attorney reform offers corporate constituencies protection without overly undermining the power of the directors to make decisions for the corporation. It may be very expensive, however, for a target corporation to hire a second attorney each time it considers an offer from a potential acquiror. Thus, the responsibility for suggesting that the directors hire independent counsel should be placed on the corporate attorney. The following is a possible draft of such a rule:

Model Rule 1.13(f). Takeover defenses; independent counsel.

When the corporation is the subject of struggle for corporate control, and the Board of Directors is considering a response to a potential acquirer's bid, the corporate attorney shall recommend that the Board solicit the opinion of an independent counsel whenever it appears that the director's or officer's interests *may have the appearance* of having prejudiced its judgment in responding to a bid for corporate control.

(i) If the Board refuses to do so, and the attorney believes that the Board has violated its fiduciary duties to the corporation, he may take the action defined in 1.13(c) of these Rules.

This proposal strengthens the attorney's ability to request a second opinion when he perceives potential violations of fiduciary duty by a corporation's directors and officers when they promulgate takeover defenses. The current Model Rule 1.13 permits an attorney to ask for a second opinion only if he "knows" that an officer intends to violate a legal obligation to the organization which will result in substantial injury to the organization.¹⁸¹ The proposed reform recognizes the special nature of takeover defenses, as well as the concern that managers might employ them for purposes of entrenchment instead of protecting shareholder

¹⁸¹MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995).

welfare. Consequently, the proposed reform permits a corporate attorney to take action to prevent fiduciary violations before they have occurred. Under the above proposal, the attorney can suggest that the board retain a separate attorney to evaluate the board's intended action so long as he perceives the "appearance" of directorial self-interest. The invocation of this Rule need not be taken as a suggestion of wrongdoing; rather, the attorney can state, "I believe that you are doing this for the good of the company, but other people might not. Therefore, you should get a second opinion." If the board rejects the attorney's suggestion and he is sure that the board has violated its fiduciary duties, he may resign. This clarifies Model Rule 1.13(c) by including within its scope violations of fiduciary duty as well as clear violations of law.

B. Auctions

According to *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,¹⁸² when the breakup of a company becomes inevitable, the directors' duties change "from the preservation [of the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."¹⁸³ Although auctions technically are not mandatory in all transfers of corporate control, managers nevertheless find them to be the best method of maximizing the shareholders' value.¹⁸⁴ In the process of auctioning the corporation, directors have a considerable amount of latitude in deciding which bid is the "better" offer for shareholders.¹⁸⁵

When management auctions the company, lawyers often assist with the preparation of a process to accept and deliberate over competitive bids. The Delaware Supreme Court has stated that the auction process "requires the most scrupulous adherence to . . . fairness in the interest of promoting the highest values reasonably attainable for the stockholders'

¹⁸²506 A.2d 173 (Del. 1986).

¹⁸³*Id.* at 182. The Delaware Supreme Court has expanded the application of enhanced scrutiny to all sales of corporate control. *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 36 (Del. 1994).

¹⁸⁴*See* Giovanelli, *supra* note 34, at 1552-53.

¹⁸⁵*See* *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 (Del. 1987). In assessing the bid,

the board may under appropriate circumstances consider the inadequacy of the bid, the nature and timing of the offer, questions of illegality, the impact on constituencies other than shareholders, the risk of nonconsummation, and the basic stockholder interests at stake, including the past actions of the bidder and its affiliates in other takeover contests.

Id. at 1341-42.

benefit."¹⁸⁶ *Mills Acquisition Co. v. Macmillan, Inc.* unfortunately stands as one of the most flagrant examples of managerial misconduct in holding an auction.¹⁸⁷

In *Macmillan*, the Chief Executive Officer, Edward P. Evans and Chief Operating Officer, William F. Reilly, tainted the process by which the company was auctioned.¹⁸⁸ Prior to an auction between Maxwell International and Kohlberg, Kravis, Roberts and Co. (KKR), Evans and Reilly attempted to "restructure" the company in response to several offers from the Bass Group.¹⁸⁹ This restructuring would have left Macmillan's officers in control of the company and its shareholders with less payment for their shares than they would have had under the Bass Group's offer.¹⁹⁰ After the Delaware Court of Chancery enjoined the Macmillan Board from accepting management's restructuring offer, a competition for control of the company began in earnest between KKR, which would give Macmillan's incumbent management up to twenty percent ownership in the newly formed company,¹⁹¹ and Maxwell Communications Corporation, which made an all-cash \$80 per share offer.¹⁹²

Macmillan did not respond to Maxwell's offer for five weeks.¹⁹³ Despite the fact that Maxwell's offer was five dollars higher than any bid Macmillan had yet received for the sale of the company, Macmillan's investment banker, Wasserstein, Perella, found the offer unfair and inadequate.¹⁹⁴

Many aspects of the ensuing auction process unfairly favored KKR over Maxwell.¹⁹⁵ First, whereas "KKR was given detailed internal, non-public, financial information, . . . culminating in a series of formal 'due

¹⁸⁶*Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1264 (Del. 1988). The court further indicated that "fairness" must be considered from a general, as opposed to an individual, standpoint. *Id.*

¹⁸⁷*Id.* at 1264-65.

¹⁸⁸*Macmillan*, 559 A.2d at 1264-65. The court found "breaches of the duties of loyalty and care by various corporate fiduciaries which tainted the evaluative and deliberative processes of the Macmillan Board, thus adversely affecting general stockholder interests." *Id.*

¹⁸⁹*Id.* at 1265. See also *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227 (Del. Ch. 1988).

¹⁹⁰*Macmillan*, 559 A.2d at 1265-71.

¹⁹¹*Id.* at 1273.

¹⁹²*Id.* at 1272.

¹⁹³*Id.*

¹⁹⁴*Macmillan*, 559 A.2d at 1272, 1281. Wasserstein, Perella was later described as one of Evans's hand-picked investment advisors originally retained as an advisor, not to the company at large, but to "Macmillan's senior management." *Id.* at 1281. Further, Evans persuaded Wasserstein to declare Maxwell's bid of \$80 per share unfair. *Id.*

¹⁹⁵*Id.* at 1272-78 (recounting the problems in detail).

diligence' presentations to KKR representatives," Maxwell "was furnished with some, but not all, of the confidential financial information that KKR had received."¹⁹⁶

On September 7 and 8, Macmillan representatives informed all potential bidders that the auction process was ending and that all bids would be due on the afternoon of September 9.¹⁹⁷ The result was that Robert Maxwell increased his bid to \$84 all-cash per share.¹⁹⁸ Despite this deadline, Macmillan extended it to the morning of September 10 to allow Macmillan representatives to negotiate overnight with KKR.¹⁹⁹ Thereafter, KKR submitted a bid to acquire ninety-four percent of the company "through a management participation, highly leveraged, two-tier, transaction, with a 'face value' of \$85 per share."²⁰⁰ Although the Macmillan Board discounted KKR's offer to \$84.76 per share, they nevertheless declared KKR the winner and announced the merger of KKR and Macmillan on September 12, 1988.²⁰¹

Three days later, Robert Maxwell announced that he would increase his all-cash offer to \$86.60 per share.²⁰² In response, Wasserstein, Perella set in place procedures to decide on final bids and notified the potential bidders that their offers were due by 5:30 p.m. on September 26, 1988.²⁰³ Maxwell raised his offer to \$89 per share.²⁰⁴ KKR submitted another blended bid at \$89.50 per share, payable in a combination of cash and securities but subject to three conditions.²⁰⁵

Upon the request of Evans and Reilly, "unidentified financial advisors" informed the Macmillan managers of the price and forms of the two bids.²⁰⁶ Fearful that KKR would lose the auction, Evans, in the presence of Reilly and *a Pittsburgh lawyer who had previously advised the board*, telephoned a KKR representative and tipped KKR off that

¹⁹⁶*Id.* at 1272-73. "Indeed, throughout the bidding process, and despite its repeated requests Maxwell was not given complete information [about Macmillan] until September 25 — almost two months after such data had been furnished to KKR." *Id.* at 1273.

¹⁹⁷*Id.* at 1273.

¹⁹⁸*See Macmillan*, 559 A.2d at 1274.

¹⁹⁹*Id.*

²⁰⁰*Id.* KKR's bid was payable in a "mix of cash and subordinated debt securities." *Id.*

²⁰¹*Id.*

²⁰²*Macmillan*, 559 A.2d at 1274.

²⁰³*Id.*

²⁰⁴*Id.* at 1275.

²⁰⁵*Id.* The conditions were: "(1) imposition of the 'no-shop' rule, (2) the grant to KKR of a lockup option to purchase eight Macmillan subsidiaries for \$950 million, and (3) the execution of a definitive merger agreement by 12:00 noon, the following day." *Id.*

²⁰⁶*Macmillan*, 559 A.2d at 1275.

Maxwell's bid was higher.²⁰⁷ Not surprisingly, KKR came back with a higher bid and won the auction, as Macmillan granted KKR a "lockup" agreement which essentially ended the bidding.²⁰⁸ On September 27, when Macmillan's Board deliberated, it was not informed of Evans's tip to KKR.²⁰⁹ "Throughout the meeting Evans and Reilly remained silent, deliberately concealing from their fellow directors their misconduct of tipping Maxwell's bid to KKR."²¹⁰

In response to these facts, the Delaware Supreme Court invalidated Macmillan's agreement with KKR, holding that due to the taint of self-interest, the auction would be reviewed according to the rigorous "entire fairness" standard.²¹¹ The Delaware Supreme Court asserted that "[w]hat occurred here cannot survive that [entire fairness] analysis."²¹² Management violated its fiduciary duties to shareholders by tainting the auction process and favoring KKR over Maxwell despite Maxwell's higher bid, and by concealing this information from Macmillan's board of directors.²¹³ The Delaware Supreme Court concluded that "Evans' and Reilly's deliberate concealment of material information from the Macmillan Board must necessarily have been motivated by an interest adverse to Macmillan's shareholders."²¹⁴

According to the court's opinion, Charles Queenan, the lawyer present when Evans tipped KKR, was apparently an attorney advisor to Evans and Macmillan's management, and not counsel to the corporation.²¹⁵ Nevertheless, questions remain: Where were Macmillan's lawyers while the auction was taking place? Surely, they must have known that Evans and Reilly were constructing a process tainted by self-interest and unfair dealing?

²⁰⁷*Id.* The lawyer present at the time of Evans's phone call to KKR was Charles J. Queenan of Kirkpatrick & Lockhart. *Id.* Several months earlier, Queenan had helped Evans select Wachtell, Lipton to represent Macmillan's special committee of independent directors to evaluate management's proposed restructuring. *Id.* at 1268 n.10.

²⁰⁸*Id.* at 1276-77. Moments before the deadline, KKR revised its offer and submitted a final offer of \$90 per share. *Id.* at 1276.

²⁰⁹*Id.* at 1277.

²¹⁰*Macmillan*, 559 A.2d at 1277.

²¹¹*Id.* at 1279. In *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983), the Delaware Supreme Court held that when self-dealing or self-interested conduct was evident, the contested transaction was subject to an "entire fairness" test in which the Court would examine it for both "fair price" and "fair dealing."

²¹²*Macmillan*, 559 A.2d at 1279.

²¹³*Id.* at 1280-83.

²¹⁴*Id.* at 1279.

²¹⁵*Id.* at 1268 n.10, 1275.

Had the corporation's lawyers been present when Evans delivered his tip to KKR, they might have been able to take action under Model Rule 1.13(b) to notify the board of directors.²¹⁶ Beyond this, however, the lawyers might not have been able to withdraw under 1.13(c), as Evans's actions may not have qualified as a "clear violation of law."²¹⁷ When officers take action throughout the auction process that is likely to taint it or undermine shareholder welfare, the corporation's lawyers should have both the ability and *responsibility* to rectify this failure to uphold fiduciary duty. Moreover, the seriousness of this violation is such that informing the board of an officer's misconduct should be *mandatory* as opposed to *discretionary*. Therefore, the following rule should be promulgated in response to the conduct that took place in *Macmillan*:

Model Rule 1.13(g): Auctions

When the corporation's attorney is aware or is made aware of managerial conduct that *threatens the integrity of the auction process*, that attorney *must*:

- (i) contact the Board of Directors to inform them of this misconduct; and
- (ii) if the Board of Directors fails to take any action to rectify this matter, the attorney *shall* take the action contemplated by Rule 1.13(c).

A mandatory rule such as the one suggested would force the attorney to separate personal interests from the interests of the corporation's officers. The rule would also strengthen the board's oversight and monitoring function. If the board was informed of officer conduct that threatened the integrity of the auction process, it would be able to put an end to it *before* an unhappy bidder initiated expensive litigation.

A potential drawback to this rule is that it might encourage officers to perform their illicit activities in private, out of the earshot of lawyers. Nevertheless, the new rule would at least preserve the integrity of the legal profession. If officers plan to defraud board members and shareholders, they should be forced to do so without the hand holding or silent assent of the corporation's attorneys.

²¹⁶MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995).

²¹⁷*Id.* Rule 1.13(c). See discussion *supra* part III.A.

V. CONCLUSION

Attorneys play an important role within the takeover process. The role was created and enlarged by the Delaware judiciary, which put a premium on deliberative decision-making in cases such as *Van Gorkom* and *Unocal*. These cases suggested that if lawyers participated in the takeover process, they would assist directors in the takeover context and protect shareholder welfare.

Unfortunately, the Delaware courts failed to consider the fact that representing a corporate entity in times of struggle for corporate control is not a simple task. Although the Model Rules of Professional Conduct attempts to provide a flexible course of action when the lawyer becomes aware of client misconduct, this course of action clearly is more applicable to the securities context than it is to situations involving takeovers, mergers, and acquisitions. When lawyers perceive management misconduct in the takeover context, they can do little more than inform the board of directors, and they have no leverage to compel management to consider shareholder welfare.

With these problems in mind, two additions to the Model Rules of Professional Conduct have been suggested. These rules attempt to provide lawyers with more guidance, and shareholders with more protection in the takeover context. The first reform, "Rule 1.13(f)," is discretionary, and provides the corporate attorney with the latitude to suggest a second opinion from an independent attorney if the corporate attorney perceives a violation of fiduciary duty in the adoption or consideration of various takeover defenses. The second reform, "Rule 1.13(g)," is mandatory, and forces the lawyer to go the board upon the realization of any conduct that might "threaten the integrity" of the auctioning process. The mandatory rule enforces both the attorney's and the board's monitoring function and simultaneously protects shareholders.

These reforms will increase the protection of shareholder welfare in the takeover process without overly restraining the lawyer's flexibility or violating the confidential relationship between the attorney and corporate client. It should be noted that the SEC's extreme view that lawyers have a whistle-blowing obligation to regulatory agencies or the public at large in the face of management's misconduct has not been adopted. A whistle-blowing rule undermines the takeover process because it discourages management from seeking advice from counsel and closes lawyers out of the process completely.

Whether these reforms are adopted or not, *some change* is necessary. As takeover activity regains momentum in the 1990s, the corporate bar should take on the responsibility of better defining the role of the corporate attorney within the takeover process.