
CONFLICTS OF INTEREST IN NEW BUSINESS FORMATIONS

BACKGROUND:

One issue which frequently arises in organizing a new business with multiple owners is conflicts of interest in the attorney's representation of the individual parties involved in the new company and the attorney's representation of the new company itself. These issues may arise whenever there are multiple owners regardless whether the new company is organizing as a partnership, a corporation, or a limited liability company.

The conflicts generally are caused by the fact that the individual interests and objectives of one potential new company owner on certain issues may, at some times, be inconsistent with the other new owners' interests and objectives as well as the company's interests or other clients that KIRK & SIMAS regularly represents. For instance:

- ◆ Frequently we find that a KIRK & SIMAS attorney has an existing attorney – client relationship with one of the parties to the new company and expects to continue to serve as business or personal counsel for that individual in the future.
- ◆ Occasionally we find that a KIRK & SIMAS attorney has an existing attorney – client relationship with some third party with which the new company intends to do business.

MULTIPLE REPRESENTATION RISKS:

Representation of multiple interests by an attorney has significant implications which every new company owner should consider. For example, rather than vigorously asserting a single client's interest on an issue, it is likely that we will be called upon to balance interests between the parties represented. Because the principals in a business enterprise may have different talents, energy, personal goals, financial resources and interests in the company's activities, aggressive advocacy for one party could result in more favorable treatment for that party compared to the more even-handed approach KIRK & SIMAS attorneys typically follow in representing multiple interests.

KIRK & SIMAS' representation of multiple principals in the new company may also result in the loss of the attorney – client privilege for communications between the parties and members of the firm because anything disclosed by one client on a matter of common interest may be disclosed to a jointly represented client in a civil proceeding between them. Further, if there is a dispute between the parties, all KIRK & SIMAS attorneys may be precluded from representing any individual party without first obtaining the consent of all concerned.

For these reasons, KIRK & SIMAS' normal practice in these circumstances is to represent only one party. However, clients forming new businesses frequently advise us that none of them wishes to seek other counsel and instead, desire that KIRK & SIMAS represent their multiple interests and the new company in its organizational and ongoing activities.

RULES OF PROFESSIONAL CONDUCT:

KIRK & SIMAS' attorneys are governed by specific rules relating to their representation of clients when actual or potential conflicts of interest exist. Rule 3-310 of the Rules of Professional Conduct of the State Bar of California provides as follows:

“Rule 3-310: Avoiding the Representation of Adverse Interests.

(B) *A member shall not accept or continue representation of a client without providing written disclosure to the client where:*

(1) *The member has a legal, business, financial, professional or personal relationship with a party or witness in the same matter; or*

(2) *The member knows or reasonably should know that:*

(a) *the member previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter, and*

(b) *the previous relationship would substantially affect the member's representation; or*

(3) *The member has or had a legal, business, financial, professional or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by resolution of the matter; or*

(4) *The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.*

(C) *A member shall not, without the informed written consent of each client:*

(1) *Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or*

(2) *Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or*

(3) *Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.”*

Accordingly, when clients request that we represent multiple interests in relation to their new company, we request, as part of our fee agreement, that each principal in the new company sign and return to us a letter, acknowledging that:

- ◆ Each party has been advised of Rule 3-310 and of any known conflicts associated with their respective interests in the new enterprise; and
- ◆ Each party has been advised of KIRK & SIMAS' existing and continuing relationship with one or more of the parties (if applicable); and
- ◆ Each party has been advised that KIRK & SIMAS has previously counseled and continues to represent one or more third parties with which the new company will be engaged in a business transaction (if applicable); and
- ◆ Each party nevertheless desires KIRK & SIMAS to represent him or her in connection with the new company.

SUMMARY:

We recognize that dealing with these issues can be distracting from a client's goal of trying to get a new business off to a successful start. We have found however, that addressing them at the earliest stages in the business formation process is not only required by the ethical standards to which attorneys are held accountable, it also serves to make for a more open, candid and ultimately more successful attorney – client relationship.