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Duty to the Target: Is an Attorney's Duty to the Corporation a Paradigm for Directors?

by
ROBERTA S. KARMEL*

An attorney representing a corporation represents the entity itself, as governed by its authorized constituents. Although the corporation may act through individual agents, the attorney does not thereby become the lawyer for corporate officers, directors, or stockholders, either individually or as a separate group within the corporate entity.[1]

Controversy over the role of counsel in corporate governance surrounded the drafting and adoption of the American Bar Association's (ABA) Model Rules of Professional Conduct (Model Rules).[2] The controversy focused primarily on whether an attorney has any obligation to disclose illegal management conduct and, if so, to whom.[3] The response to these queries depended upon whether an attorney's duty was to the corporate entity, as proposed by the Model Rules drafters, or to the marketplace, as urged by the Securities and Exchange Commission (SEC).

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1. G. HAZARD, JR. & W. HODES, THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT 231 (1985) [hereinafter G. HAZARD, JR. & W. HODES, HANDBOOK].

2. MODEL RULES OF PROFESSIONAL CONDUCT (1983) (amended 1987) [hereinafter MODEL RULES].

3. *See, e.g.*, Block & Barton, *Securities Litigation*, 8 SEC. REG. L.J. 333, 335-36 (1981); Lorne, *The Corporate and Securities Adviser, The Public Interest, and Professional Ethics*, 76 MICH. L. REV. 425, 434-45 (1978); *see also* Exchange Act Release No. 16,045, Fed. Sec. L. Rep. (CCH) ¶ 82,144 (July 25, 1979); Exchange Act Release No. 16,769, Fed. Sec. L. Rep. (CCH) ¶ 82,501 (Apr. 30, 1980).

Although the Model Rules adopted the entity theory,[4] the issue has resurfaced in the context of defending a target corporation against a hostile takeover.[5]

Assuming the entity-client theory retains its prominence, the question arises whether, in a takeover, a corporate attorney may counsel preservation of the corporation rather than work to cash out shareholders at a premium price. Some courts have suggested that an attorney may have a duty to shareholders in such a situation.[6] Part I of this Article suggests, to the contrary, that the entity theory permits counselling the survival of the corporate entity while overlooking shareholder interests.

The role of corporate counsel has not been alone in the debate; the proper role of directors confronted with a hostile takeover has also been under intense scrutiny in recent years. Although directors, like attorneys, owe a duty to the corporation, a corporate director's primary duty is to the shareholders as a body, rather than to the corporate entity.[7] Nevertheless, while a target company board cannot prefer itself or management over shareholders,[8] constituencies beyond the shareholders may be considered.[9]

No one, it seems, owes a duty to the combined future enterprise in a merger or takeover. There has been no suggestion that the board of the target corporation owes a duty to the shareholders of the acquiror, or that the board of an acquiring corporation owes a duty to the shareholders of the target. Part II of this Article suggests that, under the entity-client theory, a duty to the continuing business enterprise by a corporate director can be extrapolated from an attorney's duty to the corporation in the takeover situation.

I. Duty of an Attorney

A. The Entity Theory

Despite intense debate over changes in phraseology, modern legal ethics fairly consistently have taught that the corporate entity is the cor-

4. MODEL RULES, *supra* note 2, Rule 1.13. The entity theory is also endorsed as an aspirational guideline in the Model Code of Professional Responsibility. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1980) [hereinafter MODEL CODE].

5. *See In re* Allied Stores Corp., [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,142 (June 29, 1987).

6. *See infra* notes 58-66 and accompanying text.

7. *See infra* notes 67-77 and accompanying text.

8. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986).

9. Some states have legislated a duty to consider more complex interests. *See infra* notes 94-97 and accompanying text.

porate lawyer's client. The ABA's first mention of a corporate lawyer's ethical responsibility to his client occurs in the preliminary draft of the Model Code of Professional Responsibility (Code)[10]. Ethical Consideration (EC) 6-17 of that draft contains a short statement consonant with the traditional view that the client of a lawyer employed by an entity is the entity itself and not "a stockholder, director, officer, employee or representative thereof."[11] Most of the language of EC 6-17 was incorporated into the final draft of the Code in EC 5-18.[12] This adoption made it clear that the concept of the entity client was specifically applicable to corporations.

In 1977, less than ten years after the Code was passed, the ABA was convinced the Code was inadequate and formed a commission (Kutak Commission) to draft a new code. The Kutak Commission released a discussion draft of its proposed model rules in 1980.[13]

The discussion draft, in Model Rule 1.13, reworded the entity-client theory embodied in EC 5-18 of the Code[14] and provided a detailed schedule as to how a corporate attorney should proceed in the face of intracorporate conflict or management wrongdoing.[15] These proposed "whistle-blowing" provisions were not well-received by the legal community. Lawyers perceived these new rules as a departure from the ABA's philosophy of self-regulation in ethical matters, requiring corporate lawyers to place the interests of the public before those of the corporation itself.[16]

10. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 6-17 (Preliminary Draft 1969).

11. *Id.* Ethical Consideration 6-17 does allow an attorney to serve the individual if he or she is convinced that no conflict of interest exists.

12. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1969). The Code has been adopted, with modifications, in all states except California. *See* Note, *Disqualification of Corporate Counsel in Derivative Actions: Jacuzzi and the Inadequacy of Dual Representation,* 31 HASTINGS L.J. 347, 348 (1979).

13. Kutak, *Coming: The New Model Rules of Professional Conduct,* 66 A.B.A. J. 46 (1980).

14. MODEL CODE, *supra* note 4, EC 5-18. Model Rule 1.13 provided: "A lawyer employed or retained to represent an organization represents the organization as distinct from its directors, officers, employees, members, shareholders or other constituents." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (Discussion Draft 1980).

15. *See id.* Recommended actions include (1) seeking reconsideration of the matter, (2) referring the matter to a higher authority in the organization, (3) revealing information relating to the representation of the organization, and (4) other remedial action that the lawyer reasonably believes to be in the best interest of the organization.

16. *See* G. Hazard, Jr. & L. Silverman, Will the ABA Draft Model Rules of Professional Conduct Change The Concept of the Lawyers Role?, The Third Orison S. Marden Memorial Lecture, Association of the Bar of the City of New York 22-25 (Dec. 9, 1986); Winter, *Muting the Whistle,* 69 A.B.A. J. 421, 422 (1983). Perhaps this reaction to the Kutak Commission's proposals was overblown. *See* G. HAZARD, JR. & W. HODES, HANDBOOK, *supra* note 1, at

Despite this criticism, rule 1.13 substantially retained the language from DR 5-110 of the draft:[17] "A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." Beyond identifying who the corporate lawyer represents, rule 1.13 addresses the dilemma of the corporate lawyer who has gained knowledge of proposed or actual illegal acts of certain corporate officers or employees. Unfortunately, the Rule does not deal directly with the more difficult question of how the corporate lawyer should proceed when conflicts of interest arise among various constituents of the corporation.

Contrary to the opinion of those who feared that the Model Rules would alienate the corporate lawyer from the corporate structure by making the role of counsel that of policeman, the language of the Model Rules actually supports the view that a corporation's lawyer should *not* interfere with the directions issued from the top of the corporate hierarchy unless the directors themselves are taking an illegal course of action. Rule 1.13 assumes that, barring any question of illegality, the corporate lawyer fulfills his duties by competently advising the corporation's management or officers.[18] In practical terms, this means that a corporate

239-40; Kutak, *Whom Does The Corporate Counsel Represent?*, 1 CORP. DIRECTOR 1, 3 (1981).

17. As adopted by the ABA House of Delegates in August 1982, the final draft of rule 1.13 (a) provided: "A lawyer employed or retained to represent an organization represents the organization as distinct from its directors, officers, employees, members, shareholders or other constituents." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (Final Draft 1982). Because of amendments proposed by the American College of Trial Lawyers at the 1983 midyear ABA meeting, an exception was added onto this rule as follows: "except where the interests of any one or more of the group may be adverse to the organization's interest." Winter, *supra* note 16, at 422. This amendment was eliminated in the version of rule 1.13(a) that was finally adopted by the ABA House of Delegates in August 1983, which provides: "A lawyer employed or retained by an organization represents the organization acting through its duty authorized constituents." MODEL RULES, *supra* note 2, Rule 1.13.

To date, the Model Rules have been adopted in 24 states. *See* ABA/BNA LAWYER'S MANUAL ON PROFESSIONAL CONDUCT 01:3 (1987). In 1985, the New York state bar rejected a proposed version of the Model Rules. The Model Rules have not yet been considered in California.

18. The official comment to Model Rule 1.13 states:

> When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations including ones entailing serious risk, are not as such in the lawyer's province. However, different considerations arise when the lawyer knows that the organization may be substantially injured by action of constituent [sic] that is in violation of law.

MODEL RULES, *supra* note 2, Rule 1.13 comment; *see* Forrow, *The Corporate Law Department Lawyer: Counsel to the Entity*, 34 BUS. LAW 1797, 1799 (1979); Kutak, *Model Rules of Professional Conduct: Ethical Standards for the '80's and Beyond*, 67 A.B.A. J. 1116, 1118 (1981).

lawyer has a duty to follow the directions given by the corporation's officers unless he knows that such directions are both illegal and will substantially injure the corporation.

Although the entity-client theory has been embraced by the ABA in Model Rule 1.13 and by the courts in general, its acceptance has not been unanimous. The ABA, the courts, and legal commentators all have expressed their dissatisfaction with the entity-client fiction.

On behalf of the ABA, the Kutak Commission itself contemplated, but rejected, a group theory of representation in which the corporate lawyer represent several distinct clients—the shareholders, the directors, the employees—rather than a juridical whole.[19] This formula was considered untenable, however, because it would have required a corporation's lawyer to abandon his service to the corporation if a conflict of interest arose among the several groups.[20]

Several courts have expressed dissatisfaction with the lack of guidance the entity-client theory offers in the face of conflicts among several constituent groups that make up the fictional corporate entity.[21] These courts have offered alternatives, including analogizing counsel's duty to the duty of a corporate director and articulating a direct duty to shareholders.[22] The courts generally acknowledge, however, that the entity-client theory is controlling.[23]

Legal commentators have likewise expressed their dissatisfaction with the entity-client fiction and have offered several alternative analyses.[24] One commentator, Scott Fitzgibbon, has suggested that there are

19. G. HAZARD, JR. & W. HODES, HANDBOOK, *supra* note 1, at 232-33.

20. *Id.* at 233.

21. *See, e.g.,* Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir.), *cert. denied,* 401 U.S. 974 (1970); Rowen v. Le Mars Mut. Ins., 282 N.W.2d 639 (Iowa 1979).

22. *See infra* notes 53-66 and accompanying text.

23. *See* Radiant Burners, Inc. v. American Gas Ass'ns, 320 F.2d 314, 318-19 (7th Cir. 1963); A.B. Pick Co. v. Man, 95 F. Supp. 83, 102 (S.D.N.Y. 1950); Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639, 651 (Iowa 1979).

24. Among the several alternative theories, commentators have argued for a "counsel to the situation" or "group" theory approach. *See* Shipman, *The Need for SEC Rulemaking Concerning the Duties and Civil Liabilities of Attorneys,* 30 BUS. LAW. 34, 35-36 (1975); *see also* Weddington, *A Fresh Approach to Preserving Independent Judgment—Canon 6 of the Proposed Code of Professional Responsibility,* 11 ARIZ. L. REV. 31, 35-36, 52 (1969) (proposing a balancing approach). Arguing for a similar approach in certain specified circumstances, see Probert & Hendricks, *Lawyer Malpractice: Duty Relationships Beyond Contract,* 55 NOTRE DAME LAW. 708, 724-25 (1980) (partnership organization) and Paul, *A New Role for Lawyers in Contract Negotiations,* 62 A.B.A. J. 93 (1976). *But cf.* G. HAZARD, JR. & W. HODES, HANDBOOK, *supra* note 1, at 232-33 (group theory rejected as unworkable in the case of intracorporate conflict). Another alternative is a joint-client approach. *See* S. FITZGIBBON, PROFESSIONAL ETHICS, ORGANIZING CORPORATIONS, AND THE IDEOLOGY OF CORPORATE ARTICLES AND BY-LAWS 7-8 (1982).

four situations in which the entity-client fiction breaks down: corporate deadlocks, battles for corporate control, disputes about the propriety of management's behavior in office, and, arguably, situations in which the corporation is the alter ego of an individual.[25]

As authority for the assertion that the entity-client theory appears not to apply to corporate deadlock or battles for corporate control, Fitzgibbon relies on a 1932 ABA Informal Opinion[26] and *Yablonski v. United Mine Workers of America.*[27] The ABA Informal Opinion, however, if read in its entirety, actually is an early articulation of the entity-client theory that holds that a corporation's general counsel must refrain from taking sides in an internal struggle for corporate control precisely because the corporate counsel represents the entity and not a specific constituent group thereof.[28] And *Yablonski* fits better under Fitzgibbon's third category—disputes about the propriety of management's behavior in office.[29] While there is some authority for this exception, the trend is toward a conflict-of-interest analysis that is more consistent with the entity-client concept.[30]

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25. S. FITZGIBBON, *supra* note 24, at 2, 9. The last situation, in which an attorney for a close corporation owes a duty to individual shareholders, is both rare and problematic. *See* Egan v. McNamara, 467 A.2d 733 (D.C. App. 1983); *see also* C. WOLFRAM, MODERN LEGAL ETHICS § 8.3.2 (1986) (principle that the loyalty of a corporate lawyer must be directed solely toward the interests of the entity is somewhat more ambigious regarding conflicts issues for small, closely held corporations than for large corporate clients).

26. S. FITZGIBBON, *supra* note 24, at 9 n.27 (citing ABA Comm. on Professional Ethics and Grievances, Informal Op. 86 (1932)).

27. 448 F.2d 1175, *enforced per curiam*, 454 F.2d 1036 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 906 (1972).

28. ABA Comm. on Professional Ethics and Grievances, Informal Op. 86 (1932). This opinion has, in any event, been superseded. *See* ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1056 (1968) (attorney for a corporation may advise the corporate president of a method of electing directors, provided he sincerely believes his advice to be legally sound and supportable and not contrary to the interests of the corporation itself).

29. *Yablonski* involved a § 501 Labor-Management Reporting and Disclosure Act suit brought by United Mine Workers of America members against the union and its individual officers asking for an accounting and restitution of funds allegedly misappropriated and misspent by union officers. 448 F.2d at 1176-77. At issue in the case was whether it was proper for regular outside counsel to the union to represent both the union and the individual officers. The U.S. Court of Appeals for the District of Columbia held that independent outside counsel had to be retained for both the union and its officers. *Id.*

30. For two good overviews of the problem and the trend towards requiring corporations to retain independent counsel in shareholders' derivative suits alleging misconduct by corporate officers where the counsel has defended the officers previously in related litigation, see Note, *supra* note 12, and Note, *Independent Representation for Corporate Defendants in Derivative Suit*, 74 YALE L.J. 524 (1965). *See also* Annotation, *Propriety of Attorney Who Has Represented Corporation Acting For Corporation in Controversy With Officer, Director, or Stockholder*, 1 A.L.R. 4TH 1124 (1985) (discusses state and federal cases dealing with propriety of counsel's conduct).

B. Duty to the Marketplace

The SEC position that attorneys owe a duty to investors or the marketplace that transcends their duty to the corporation contributed to the controversy surrounding Model Rule 1.13. This SEC theory first surfaced in the Commission's complaint in *SEC v. National Student Marketing*,[31] in which the SEC named lawyers from two prominent law firms as defendants. The SEC argued a novel theory of corporate counsel's obligations: If corporate counsel received last minute information indicating certain financial statements could be inaccurate, after a shareholder vote and just prior to management's signing of a merger agreement, counsel had a duty, in absence of management action, to disclose this information to company shareholders or to the SEC. The agency asserted counsel aided and abetted management's securities law violations by failing to meet this duty of disclosure.

The complaint and the SEC theory caused a storm of controversy.[32] In effect, the SEC argued that a lawyer has an obligation to go beyond advice to a client (in this instance to proceed with the merger) and to make public disclosure of information if the client fails to take the appropriate action. Subsequent settlements in the case and a confusing district court opinion left the SEC theory hanging, neither accepted nor rejected by the courts.

The securities bar strenuously objected to SEC efforts to impose a duty to the marketplace on lawyers. While *National Student Marketing* was pending, the ABA adopted a policy recommendation of the securities bar Section of Corporation, Banking and Business Law. The recommendation rejected the principle that a lawyer is permitted or obliged to disclose to the SEC otherwise confidential information, because such disclosure would be contrary to the "confidentiality of lawyer-client consultations and advice and the fiduciary loyalty of the lawyer to the client" as prescribed by the Code.[33] In other words, while a lawyer has a duty to

31. 457 F. Supp. 682 (D.D.C. 1978).

32. *See, e.g.*, Karmel, *Attorney's Securities Laws Liabilities*, 27 BUS. LAW. 1153 (1972); Koch, *Attorney's Liability: The Securities Bar and the Impact of* National Student Marketing, 14 WM. & MARY L. REV. 883 (1973); Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U. L. REV. 437 (1974); Patterson, *The Limits of the Lawyer's Discretion and the Law of Legal Ethics:* National Student Marketing *Revisited*, 1979 DUKE L.J. 1251.

33. *Statement of Policy Adopted by American Bar Association Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered By The Securities and Exchange Commission, reprinted in* 31 BUS. LAW. 543 (1975). In February, 1974 the ABA added a proviso to DR 7-102(B) of the Code, which under some circumstances obligates a lawyer whose client has perpetrated a fraud on a person or tribunal to reveal the fraud. The proviso excepted information protected as a privileged communication. MODEL CODE, *supra* note 4, DR 7-102(B).

advise a corporation to comply with SEC disclosure requirements, the Code prohibits the lawyer from assuring that compliance by undermining the juridical entity and making disclosures directly to the SEC.

The SEC, however, continued to argue for a greater role for lawyers in corporate governance whereby an attorney for a corporation would become an independent promoter of the public interest. At the 1980 ABA convention, SEC chairman Harold Williams voiced the Commission's position, criticizing the proposed Model Rules as not going "far enough along the road in confirming the corporate lawyer's role and responsibility" as an independent professional.[34] The Commission's efforts were largely ineffective.

While the Model Rules were being debated, the SEC published for comment a proposed rule drafted by the Institute for Public Representation, a public-interest academic group. The rule would have required companies to certify to shareholders each year that all employed or retained attorneys were instructed to report to the board of directors any corporate activities that "violate or probably violate any law."[35] In addition, the rule would have required companies to disclose to shareholders written agreements between a corporation and its outside attorney that specified, among other things, the frequency and nature of the counsel's contacts with the board and his obligations regarding any illegal conduct he might discover.[36]

The SEC further explicated its views on the ethical responsibilities of corporate counsel in an administrative proceeding pursuant to SEC rule 2(e),[37] *In re Carter & Johnson.*[38] This proceeding involved the lia-

34. Address by Harold M. Williams, Professionalism and the Corporate Bar, Section of Corporation, Banking and Business Law, Honolulu (Aug. 5, 1980), *reprinted in* 36 BUS. LAW. 159, 167 (Nov. 1980).

35. Exchange Act Release No. 16,045, Fed Sec. L. Rep. (CCH) ¶ 82,144 (July 25, 1979). The SEC declined to take this action after receiving public comment. Securities Exchange Act Release No. 16,769, Fed Sec. L. Rep. (CCH) ¶ 82, 501 (Apr. 30, 1980).

36. *Id.*

37. 17 C.F.R. § 201.2(e) (1970). Rule 2(e) provides that the SEC may discipline and sanction any person, by means of a suspension or permanent bar from practice before the agency, who is found:

> (i) Not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws, or the rules and regulations thereunder.

A discussion of the SEC's authority to promulgate rule 2(e) and the wisdom of its policy in prosecuting lawyers is beyond the scope of this Article. The author's objections to the Commission's use of rule 2(e) to discipline attorneys are long standing and can be very briefly summarized. First, as a matter of statutory construction, the Commission's authority to promulgate rule 2(e) is questionable. That is, the general power to "make such rules and regulability of attorneys under the securities laws for the failure of a financially pressed client to make adequate disclosure about its deteriorating financial condition. The SEC held that it had jurisdictional authority to sanction an attorney under rule 2(e) for either aiding and abetting a securities law violation by a client or for unethical or improper professional conduct.[39] The proceeding established that drafting SEC disclosure documents was "substantial assistance" in a client's fraud that justified the imposition of a sanction if the attorney had the requisite improper intent.[40] The SEC also expressed the view that it could sanction a lawyer for unprofessional conduct if the lawyer was significantly responsible for a company's compliance with SEC disclosure requirements, became aware that the client is engaged in a continuing failure to satisfy those requirements, and did not take prompt steps to end the client's noncompliance.[41] Although the *Carter & Johnson* opinion does not explicitly reject the entity-client theory of the Code or Model Rules, it elevates a duty to the marketplace over any duty to keep the corporation afloat.

The SEC view that an attorney owes a duty to the marketplace was embraced by a statute proposed (but never enacted) in 1983.[42] The statute would have amended the mail fraud statute to make criminal a lawyer's failure to make timely disclosure to federal law enforcement authorities of knowledge of a client's misconduct if he learned either that his client intended to commit or with his services has committed a criminal or fraudulent act.

Much of the debate over the SEC views on professional responsibility and the adoption of the Model Rules focused on a perceived effort to abrogate an attorney's duty to maintain client confidences. In the final analysis, however, the entity theory is the center of the dispute. The SEC

tions as may be necessary or appropriate to implement" the provisions of the securities laws is not a sufficient predicate for a program to discipline professionals, particularly attorneys. Second, the SEC's utilization of rule 2(e) to promote the agency's regulatory policies is an unwarranted interference with the right to the effective assistance of counsel of persons regulated by the Commission. When the author was a Commissioner of the SEC, she articulated these views in a dissent in *In re* Keating, Muething & Klekamp, Exchange Act Release No. 15,982, 17 SEC Docket 1149, 1157-63 (July 2, 1979). *See also* Daley & Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 EMORY L.J. 747, 762-65 (1975). This questioning of the SEC's authority over attorneys has continued. *See* Address by Edward H. Fleischman, Aligning the Compass for the SEC's Relationship with its Practicing Bar, Annual Ray Garrett, Jr. Corporate and Securities Law Institute, Chicago, Ill. (Apr. 30, 1987).

38. Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981).

39. *Id.* at 84,165-69.

40. *Id.* at 84,166.

41. *Id.* at 84,172-73.

42. Lawyers Duty of Disclosure Act of 1983, S. 485, 98th Cong., 1st Sess. (1983).

assumes that a lawyer who assists in the preparation of disclosure documents represents investors and owes a duty to the marketplace. This doctrine is troublesome enough in the context of management wrongdoing or illegality. It is even more troublesome in the context of representing a target company in a hostile takeover because there may be a conflict between the interests of different constituencies within the corporate entity and a further conflict between the target and non-shareholder investors.

After a number of years of relative quiescence in the prosecution of attorneys by the SEC,[43] the Commission has revived its enforcement program against corporate counsel by bringing an administrative proceeding against George C. Kern, Jr.[44] The SEC charged Kern, the head of mergers and acquisitions at a major New York City law firm, with violating the federal securities laws based on his failure to advise Allied Stores Corp. (Allied) to amend a Williams Act[45] filing in response to a tender offer to disclose merger negotiations with a white knight. Although Kern was a director of Allied, the SEC's case seems to be based on his activities as a lawyer. Furthermore, the materiality of the disclosure involved is not clear-cut.[46]

Among the many troublesome issues raised by this prosecution is the disparity between the duty to the corporate entity set forth in the Code and the Model Rules and the duty to the marketplace asserted by the SEC. Whether Allied's strategy in dealing with a white knight and maintaining silence about these negotiations was in the corporate entity's best interest was probably a difficult legal judgment. Even if the SEC is correct in its view that these negotiations should have been disclosed, an attorney can be held liable only for a breach of professional ethics on a theory that he owed a duty to investors.[47] This may explain why the SEC did not bring this case under rule 2(e) charging improper profes-

43. At the beginning of 1982 the SEC General Counsel announced a self-imposed limitation on rule 2(e) cases to situations in which there was a violation of state law professional ethics or in which there was a direct impact on the SEC's internal processes. Remarks of Edward F. Greene, SEC Disciplinary Proceedings Against Lawyers Reviewed, Jan. 13, 1982, *reprinted in* N.Y.L.J. 15 (Jan. 2, 1982). For the next five years no significant cases under rule 2(e) were brought against an attorney.

44. *In re* Allied Stores Corp., [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,142, (June 29, 1987).

45. Securities Exchange Act § 14(d)(4), 15 U.S.C. § 78n(d)(4) (1934).

46. *See* Block & Hoff, *SEC Kern Proceeding Is Ill-Advised Decision*, N.Y.L.J. 5, 6 (July 16, 1987).

47. 17 C.F.R. § 240.14d-9 (1984), promulgated under the Williams Act, requires a subject company to describe any transaction, board resolution, agreement in principle, or signed contract in response to a tender offer that relates to or would result in, among other things, an extraordinary transaction such as a merger, a purchase, sale or transfer of a material amount

sional conduct, but rather charged Kern with being a "cause" of Allied's violation.

C. Resolving Conflicts

The entity theory of rule 1.13 suggests that an attorney for the target corporation does not owe a direct duty to shareholders, but to the target corporation itself. It could thus be argued that the entity theory would permit the lawyer to work for the preservation of the corporation as a viable business entity and need not be concerned about whether shareholders are cashed out at a premium price.

Although there is no case law directly on point to guide a corporate attorney facing a hostile takeover situation, there is some authority to indicate that a corporation's attorney may reasonably aid the corporation's officers to retain power but only if such aid is in the corporation's best interest.[48] Other cases, primarily shareholder's derivative suits alleging fraudulent and illegal acts on the part of the corporation's officers, indicate that shareholder's interests are of paramount importance.[49] These cases are not necessarily determinative in analyzing or resolving the conflicts in hostile takeover situations. The conflicts between corporate constituents of a target are more complicated than in a derivative action and may shift as events unfold. Furthermore, it may not be clear whether management is acting illegally in seeking to retain control.

In general, the law seems to countenance the perpetuation of the corporate entity and therefore permits a corporate attorney to defend the corporation against outsiders. Nevertheless, the law sometimes imposes on counsel a duty to shareholders when the shareholders have grounds to challenge the legality of the actions of other constituents, generally officers or inside directors. The ABA, adhering closely to the entity-client theory, has spelled out the ethical responsibilities of the corporate lawyer in several opinions involving constituent conflicts.[50] In a 1968 Informal Opinion,[51] the ABA stated that a corporation's lawyer might properly advise incumbent officers how to defeat a bid for power by minority

of assets by the subject company, or a tender offer for or other acquisition of securities by the subject company.

48. *See infra* notes 51-52 and accompanying text.

49. *See infra* notes 58-61 and accompanying text.

50. *See, e.g.*, ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1056 (1968); ABA Comm. on Professional Ethics and Grievances, Formal Op. 202 (1940); ABA Comm. on Professional Ethics and Grievances, Informal Op. 86 (1932). For similar ABA Informal Opinions, see ABA DIVISION OF EDUCATION, PROFESSIONAL RESPONSIBILITY: A GUIDE FOR ATTORNEYS 278-79 (1978).

51. ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1056 (1968).

stockholders in a proxy battle, so long as the lawyer "sincerely believes such advice to be legally sound and supportable and not contrary to the interests of the corporation itself."[52]

In that situation, a corporation's attorney, who was also a stockholder, advised the president of the corporation to call for separate elections on each nomination of a director in order to dilute the strength of the minority shareholders' votes and frustrate their attempt to obtain representation on the board of directors. While the ABA stressed the entity-client theory of representation and concluded that such advice was proper only if it was not contrary to the interest of the corporation itself, the opinion also seemed to indicate that there might be an affirmative duty to render such advice under the circumstances. The opinion indicated that the lawyer's ethical duties would be similar in the event of a tender offer from outsiders.

In *Egan v. McNamara,*[53] the Court of Appeals for the District of Columbia held in part that the only obligation of corporate counsel who drew up a buy-sell agreement for a close corporation was "to ensure that the agreement was in the best interest of the company, regardless of its impact on individual shareholders."[54] The buy-sell agreement restricted the transferability of stock and contained a provision whereby upon the death of any stockholder the corporation was required to purchase all of the deceased's shares. Upon the death of a major stockholder, Egan, a coexecutor of his estate, brought suit against the surviving shareholders and the corporation seeking to rescind or reform the buy-sell agreement to require return of the deceased shareholder's stock.[55] One of Egan's theories for recovery was that the corporate attorney who executed the buy-sell agreement and who was also an officer and shareholder of the corporation owed a fiduciary duty to the deceased. The attorney allegedly breached the fiduciary duty by putting the corporation's interest before that of the deceased in developing the buy-sell agreement.[56]

The court rejected the notion that corporate counsel stood in a fiduciary relationship to any individual shareholder, even in a close corporation, and held that corporate counsel's duty was to place the corporation's continued existence and safety from outside parties before

52. "To hold otherwise would deprive management of the advice of the lawyer most familiar with the corporation's affairs, which in turn could result in exposing both management and the corporation itself to disruption and damaging and expensive litigation which could have been avoided." *Id.* at 3.

53. 467 A.2d 733 (D.C. App. 1983).

54. *Id.* at 739.

55. *Id.* at 737.

56. *Id.* at 738.

the interests of any corporate constituent.[57] While *Egan* does not stand for the proposition that a corporation's attorney may ignore stockholder interests in an effort to defeat a hostile takeover, the *Egan* decision does recognize that a corporate attorney may have a duty to protect the continued existence of the corporation and to keep it safe from outside parties who may have an interest in taking over the company, despite the impact on shareholders.

Other decisions, mostly shareholder's derivative suits focusing on corporate counsel's duty to disclose communications made to corporate officers, or knowledge of corporate officers' illegal acts, suggest that the corporation's attorney owes an ultimate duty of loyalty to the corporation's shareholders. Because these cases equate the shareholders with the corporate entity-client itself, they implicitly reject the entity-client theory.

In *Rowen v. Le Mars Mutual Insurance Co.*,[58] involving a breach of fiduciary duty in the sale of control, the Supreme Court of Iowa found that counsel to an insurance company owed a duty to the corporation analogous to that of a corporate director: "[the attorney's] duty is to the entire body of shareholders, or, in this case, policyholders. His obligation, indeed, is similar to, if not identical with, that of director."[59] Le Mars policyholders brought a derivative action against Le Mars and another insurance company that illegally purchased control of Le Mars by paying off its directors to resign. Le Mars' counsel assisted in the sale and was to become a corporate director of Le Mars as a result of the transaction. The trial court did not address the liability to policyholders, but found Le Mars' attorney liable for a breach of his fiduciary duty as an incoming director of Le Mars.[60] The supreme court, however, specifically found that the attorney was liable as Le Mars' attorney for breaching his duty to the policyholders.[61]

The leading case of *Garner v. Wolfinbarger*,[62] involving the attorney-client privilege, provides another example of a court's implicit rejection of the entity-client theory. *Garner* held that communications between a corporation's attorney and its officers were subject to discovery in a shareholders' class action suit charging the corporation and its officers with violations of state and federal securities law. The Fifth Circuit rec-

57. *Id.* at 739-40.
58. 282 N.W.2d 639 (Iowa 1979).
59. *Id.* at 654 (citation omitted).
60. *Id.*
61. *Id.* at 654-56.
62. 430 F.2d 1093 (5th Cir.), *cert. denied*, 401 U.S. 974 (1970).

ognized that the attorney-client privilege enjoyed by corporate clients was not invalid merely because those demanding disclosure were stockholders of the corporation. Nevertheless, the court held that:

> where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance.[63]

Underlying this balancing of the interests of the corporation, the stockholders, and the public, however, is a rejection of the entity-client theory in favor of a premise that the stockholders' interests override those of the other constituents.[64]

The Fifth Circuit also appeared to credit, though it did not adopt, a joint client formulation of the corporate attorney's role.[65] Under this analysis the corporate attorney serves both the corporation and the stockholders as joint clients. Neither the corporation nor the stockholders could then assert the attorney-client privilege against the other party. Such a conception seems flawed in that it would doubly favor stockholders' interests both as one of the joint clients and as a constituent group within the other.

National Student Marketing Corp.[66] also enforced a corporate attorney's duty to inform shareholders of illegal acts by other corporate constituents when the court found a substantial impairment of stockholder interests. Yet disclosure would have prevented the consummation of a merger that may have been in the corporate entity's best interests.

As the foregoing analysis suggests, the duty of an attorney when confronted by conflicts among corporate constituencies is not entirely clear. The fact that the counsel involved had a dual role, such as officer, director, or shareholder, complicates the problem. When the attorney is perceived as having compromised his independence by an alignment with management, he is more likely to be held to have breached a duty to shareholders. Obedience to management's lawful instructions, however, is precisely the teaching of Model Rule 1.13.

Furthermore, SEC and judicial attempts to carve out exceptions from the entity-client theory for situations involving unlawful management or director behavior puts an attorney in a difficult situation. Gener-

63. *Id.* at 1103-04 (footnote omitted).

64. "Conceptualistic phrases describing the corporation as an entity separate from its stockholders are not useful tools of analysis. They serve to obscure the fact that management has duties which run to the benefit ultimately of the stockholders." *Id.* at 1101.

65. *Id.* at 1103.

66. 457 F. Supp. 682 (D.D.C. 1978).

ally, the very decision that imposes a duty to shareholders on the attorney—long after the fact—is the same decision that finds management conduct unlawful. This is because officers and directors normally are the corporation's representatives and agents, and only egregious behavior calls into question their authority to act for the corporation and instruct counsel. But the illegality of management's conduct under securities laws or similar statutes may not seem so clear to counsel during the course of a transaction as it does to a court later on.

II. Duty of Directors to the Target Corporation

Directors, like attorneys, may sometimes be caught in a cross-fire between conflicting corporate constituencies when the question of which constituency is primary arises. The directors also owe certain basic duties to the corporation itself. These similarities between the dilemmas facing corporate directors and corporate counsel suggest that the duty owed to the corporation by attorneys may be a useful model for directors' duties.

A. Duties of Care and Loyalty

Directors owe a duty of care to their corporation.[67] This duty generally is expressed as that degree of skill, diligence, and care that an ordinary prudent person would exercise in similar circumstances.[68] In reaction to decisions imposing liability on directors for failure to exercise due care in responding to change of control situations[69] and to the director and officer insurance liability crisis,[70] Delaware and numerous other states passed legislation permitting corporations to limit or eliminate the personal liability of directors for breach of the duty of care.[71]

67. A director must discharge his duties "in good faith" and "with the care an ordinarily prudent person in a like position would exercise under similar circumstances." REVISED MODEL BUSINESS CORPORATION ACT § 8.30 (1984). The prior version of this provision (§ 35) has been adopted in 7 of 22 states that had duty of care statutes. Also, 28 states had established a common-law duty of care. *See* ALI, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 12 (Tent. Draft No. 3, 1984) [hereinafter Tent. Draft No. 3].

68. REVISED MODEL BUSINESS CORPORATION ACT § 8.30 (1984); *see* D. BLOCK, N. BARTON & S. RADIN, THE BUSINESS JUDGMENT RULE 24-30 (1987).

69. *See, e.g.,* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

70. *See* Veasey, Finkelstein & Bigler, *Responses to the D&O Insurance Crisis,* 19 REV. SEC. & COMMODITIES REG. 263 (1986).

71. Shareholders can adopt a charter provision limiting or even eliminating the personal liability of a director except for breach of the duty of loyalty or intentional misconduct. DEL. CODE ANN. tit. 8, § 102(b)(6) (1974). Many other states have followed this approach. *See, e.g.,* N.Y. BUS. CORP. LAW § 717(b) ch. 367 § 1(b) (McKinney Supp. 1988). Other states have simply lowered the duty of care. *See* Hazen, *Corporate Directors' Accountability: The Race to*

Directors also owe a duty of loyalty to their corporation.[72] Sometimes this is expressed as a duty of fair dealing.[73] When directors have a conflict of interest, they must demonstrate the fairness of a transaction in which they were interested.[74]

The burdens imposed upon directors by the duties of care and loyalty are threshold requirements that must be met before a court will apply the business judgment rule, which shields directors from liability for disinterested business decisions made with due care, in good faith and without an abuse of discretion.[75] In cases involving target company defenses against hostile takeovers, the line between the duty of care and the duty of loyalty has sometimes become blurred because courts have presumed that directors are interested in remaining in office.[76] In Delaware, therefore, the business judgment rule applies to defensive mechanisms against takeovers only if the directors have reasonable grounds to believe that a danger to the corporation exists and the defensive mechanism is "reasonable in relation to the threat posed."[77]

B. Beneficiaries of Fiduciary Duties

The primary beneficiaries of the fiduciary duties owed to the corporation by directors are the shareholders,[78] because a basic objective of the corporation is to enhance shareholder value.[79] Directors also owe duties to other groups, especially creditors.[80] Numerous laws and regulatory

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the Bottom—The Second Lap, 66 N.C.L. REV. 171 (1984); King, *Director Protection Under Virginia Law,* 20 REV. SEC. & COMMODITIES REG. 129, 129 (1987).

72. R. CLARK, CORPORATE LAW 141 (1986).

73. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

74. 3 W. FLETCHER, CYCLOPEDIA OF CORPORATIONS § 931 (perm. ed. 1986); *see, e.g.,* Drobin v. Nicolet Instrument Corp., 631 F. Supp. 860, 880 (S.D.N.Y. 1986); Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 298, 93 A.2d 107, 110 (Del. 1952); Alpert v. 28 Williams St. Corp., 63 N.Y.2d 557, 570-71, 473 N.E.2d 19, 26-27 (1984); *see also* Tent. Draft No. 3, *supra* note 67, at 107-41.

75. D. BLOCK, N. BARTON & S. RADIN, *supra* note 68, at 24.

76. *See, e.g.,* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (enhanced scrutiny demanded by "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders").

77. *Id.*

78. Dodge v. Ford Motor Co., 240 Mich. 459, 500-02, 170 N.W. 668, 684 (1919); Berle, *Corporate Powers as Powers in Trust,* 44 HARV. L. REV. 1049, 1049 (1931). Directors owe their duty to the shareholders as a body, not as individual shareholders. *See* Goodwin v. Agassiz, 186 N.E. 659, 660 (Mass. 1933); 3 W. FLETCHER, CYCLOPEDIA OF CORPORATIONS § 848 (perm. ed. 1986).

79. *See* Schwartz, *Defining the Corporate Objective: Section 2.01 of the ALI's Principles,* 52 GEO. WASH. L. REV. 511, 512, 528-29 (1984).

80. Pepper v. Litton 308 U.S. 295, 307-10 (1939) (holding directors cannot disregard their fiduciary duty to outside creditors by subordinating the creditors' claims to their own doubtful claims against the corporation); Clark, *The Duties of the Corporate Debtor to its Cred-*

agencies require corporations and their directors to assume duties to employees,[81] customers,[82] and society generally.[83]

In the day-to-day operation of a corporation, the duties that directors owe to various groups are not difficult to reconcile, although compliance with legal obligations to non-shareholders may diminish shareholder profits. Society and the courts concluded long ago that the single-minded pursuit of corporate profits should be ameliorated by voluntary or statutory obligations to non-shareholder constituencies.[84]

Nevertheless, when directors are confronted by a hostile takeover their actual or felt obligations to non-shareholder groups may conflict with their duty to shareholders. In part, this conflict results because the very existence of the corporation is at stake. If the corporation is liquidated or merely merged out of existence the shareholders may gain, but various other constituencies, particularly employees, may lose the value of their claims on corporate assets. As in a bankruptcy, the liquidation value of the corporation may not be as great as the going concern value, at least not to all of the constituencies that the corporation touches.

Although the courts have demonstrated some sympathy for the dilemma of directors caught in such a conflict of interest situation, the ability of directors to prefer non-shareholder constituencies to shareholders is extremely limited. Furthermore, it is clear that directors cannot put their own interests ahead of shareholder interests. When a corporation becomes insolvent, the duty of directors to creditors is elevated.[85] Perhaps a takeover should work a similar rearrangement of director allegiance.

These principles are well demonstrated by *Revlon, Inc. v MacAn-*

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itors, 90 HARV. L. REV. 505, 510-11 (1977). The majority rule is that the duty of directors to creditors of a solvent corporation is not a fiduciary duty, but a contractual duty. *See* Simmons v. Cogan, No. 8890 (Del. Ch. Dec. 2, 1987) (WESTLAW, State database, Del.).

81. *See, e.g.,* Occupational Safety & Health Act, 29 U.S.C. §§ 651-678 (1982); Employee Retirement Income Security Act, 29 U.S.C § 1004(a)(1) (1982).

82. *See, e.g.,* Food, Drug and Cosmetic Act, 21 U.S.C. §§ 301-392 (1982); *see also* United States v. Park, 421 U.S. 658, 667-69 (1975) (president of national good chain convicted for violating Food, Drug and Cosmetic Act).

83. *See, e.g.,* Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1376 (1948); Clean Air Act, 42 U.S.C. §§ 7401-7626 (1955); Toxic Substance Control Act, 15 U.S.C. §§ 2601-2629(1976). Juggling the interests of competing corporate constituencies is difficult enough. Instructing directors to take society's interests into account would only further matters. Lipton, *Corporate Governance in the Age of Finance Corporatism,* 136 U. PA. L. REV. 1, 42, 43 (1987).

84. A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 153-54, 98 A.2d 581, 586 (1953).

85. Automatic Canteen Co. v. Wharton, 358 F.2d 587, 590 (2d Cir. 1966); New York Credit Men's Adjustment Bureau, Inc. v. Weiss, 110 N.E.2d 397, 398 (N.Y. 1953).

drews & Forbes Holdings,[86] in which the court enjoined Revlon, Inc. (Revlon) from consummating an option granted to a "white knight" to purchase certain Revlon assets (lock up) and to deal exclusively with the white knight (no shop). In order to protect shareholders against a hostile takeover at an inadequate price, the Revlon board had enacted a rights plan and then made a self tender in exchange for notes and preferred stock. The bidder then raised its bid significantly. Revlon then negotiated with the white knight and made a merger contract, which provided protection for the noteholders.[87] The court of chancery held that the directors were protected by the business judgment rule with regard to adoption of the rights plan and the self tender. Furthermore, neither the lock up nor the no shop provision were illegal per se.[88] This portion of the opinion rejects the view that directors confronted by a takeover bid should simply auction off the company.[89]

Once the business situation changed from preserving the corporation to an auction, however, *Revlon* held that the duty of the directors was to obtain the best price for the shareholders. The directors breached their duty of loyalty by making concessions to the white knight out of concern for their liability to the noteholders, rather than maximizing the sale of the company for the shareholders' benefit.[90]

This case leaves open the question of how vigorously the directors can defend against a hostile takeover for the purpose of keeping a corporation in existence as an independent entity. Courts have given directors wide latitude to defend the independence of the corporation if justified as necessary for long-term shareholder interests.[91]

In *GAF Corp. v. Union Carbide Corp.,*[92] the court allowed directors to defend against an unwanted hostile takeover by making a defensive exchange offer and selling off assets. In so doing, the court noted that the directors could take employee interests into account and concluded that the exercise of independent honest business judgment by directors is the way to deal fairly with "both the protection of investors on the one hand, and the legitimate concerns and interests of employees and management

86. 506 A.2d 173 (Del. 1986).

87. *Id.* at 179.

88. *Id.*

89. Easterbrook & Fischel, *The Proper Role of A Target's Management in Responding to a Tender Offer,* 94 HARV. L. REV. 1161, 1194-95 (1981).

90. *Revlon,* 506 A.2d at 185.

91. *See* Sussman & Sussman, *Takeover Cases Eye Non-Stockholder Interest,* Legal Times, Apr. 28, 1986, at 24. Recent cases on directors' responses to hostile offers are summarized in Brownstein, *Takeovers and the Business Judgment Rule,* 20 REV. SEC. & COMMODITIES REG. 177 (1987).

92. 624 F. Supp. 1016 (S.D.N.Y. 1985).

of a corporation who service the interests of investors, on the other."[93]

C. New State Laws

In reaction to the perception that hostile takeovers result in the loss of employment, some state legislatures have been persuaded to change the nature of a director's duty, substituting the concept of duty to various constituencies for the traditional duty to shareholders.[94] Pennsylvania, the first state to effect this change, has a statute that provides that in discharging their duties, directors may, "in considering the best interests of the corporation, consider the effects of any action upon employees, upon suppliers and customers of the corporation and upon communities in which offices or other establishments of the corporation are located, and all other pertinent factors."[95]

A number of states have followed the Pennsylvania model, some with variations on this theme of balancing constituencies. A Missouri statute, which is specifically addressed to acquisition proposals, allows directors to consider the social and economic efforts of the acquisition on employees, suppliers, customers, and communities. In addition, directors may consider the current value of the corporation if orderly liquidated and the future value of the corporation over a period of years as an independent entity.[96] Similarly, a recent Ohio statute provides that in determining the best interests of the corporation, a director can consider the "long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continuing independence of the corporation."[97]

Although differently phrased, these statutes are a product of political dissatisfaction with the traditional judicial principle that directors faced with a takeover owe their primary allegiance to shareholders. Rather, these statutes posit a duty to other constituencies and a concern for the survival of the corporate entity.

93. *Id.* at 1020. Similarly, in Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972), the court upheld the Denver Post's defensive tactics to a hostile bid, noting the interests of readers and employees of the paper.

94. One commentator has pointed out that the Midwestern and New England states faced with the demise of manufacturing and high unemployment are more receptive to the coalitions which lobby for such laws. Coffee, *The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards,* 8 CARDOZO L. REV. 759, 770 (1987).

95. 42 PA. CONS. STAT. ANN. § 8363 (Purdon Supp. 1987).

96. MO. ANN. STAT. § 351.347 (Vernon Supp. 1987).

97. OHIO REV. CODE ANN. § 1701.59 (Anderson Supp. 1987). Similar statutes have been passed in other states. *See, e.g.,* ME. REV. STAT. ANN. tit. 13-A, § 716 (Supp. 1986); MINN. STAT. ANN. § 302A.251 (West 1987).

D. Duty to the Enterprise

The notion that directors, in a change of control situation, owe a duty to the corporation as well as stockholders is suggested by the opinions in some cases involving target resistance to a hostile takeover. For example, in *Unocal Corp. v. Mesa Petroleum Co.,*[98] the court noted that "the board's power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source."[99] Nevertheless, the court pointed out that when a board addresses a takeover bid, there is an "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[100]

In *Revlon*[101] and *Union Carbide,*[102] the courts likewise recognized the legitimacy of a duty to the corporation that is larger than shareholders. These and other cases[103] suggest that directors may take into consideration the interests of non-shareholder constituencies, particularly employees, in fighting for the survival of a corporation as an independent entity. The decisions recognize that the self-interest of directors in wishing to remain in office can taint their decision-making.[104]

The too-easy identification of management interests with employee interests makes the balancing of constituencies by directors difficult and frequently suspect. New state statutes permitting directors to take non-shareholder interests into account may tilt the balance against hostile takeovers, but otherwise they provide little guidance for how the conflicts among corporate constituencies should be resolved, or what objectives directors should pursue in effecting such a resolution. Applicable court cases also are not helpful in identifying any new duty to replace the tradi-

98. 493 A.2d 946 (Del. 1985).

99. *Id.* at 954.

100. *Id.*

101. Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 180-81 (Del. 1986) (directors can legally resist a hostile takeover if they have reasonable grounds for believing there is a danger to corporate policy, effectiveness, or the corporate enterprise as a whole).

102. GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985) (court recognized directors' duty to consider employees and management as well as investors).

103. *See, e.g.,* Panter v. Marshall Field & Co., 646 F.2d 271, 293-97 (7th Cir. 1981) (directors' resistance to merger offers was not a breach of fiduciary duty to shareholders even though directors considered such factors as the desire to build value in the company itself and the belief that such value might be diminished by a given offer); Moran v. Household Int'l, 500 A.2d 1346, 1354-57 (Del. 1985) (implementation of a rights plan, a defensive takeover measure, by corporate directors was not a breach of fiduciary duty to shareholders, although directors considered the vulnerability of the corporate entity to bust-up and two-tiered takeovers).

104. Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 265 (2d Cir. 1984).

tional duty to shareholders that often has been honored in the breach in allowing directors some latitude in dealing with unwanted bids.

The purpose of this Article has been to inquire whether the concept of duty to the corporation owed by attorneys would be a useful model for directors. To the extent that the Model Rules articulate a principle of neutrality when an attorney is caught in a conflict between different corporate constituencies, the attorney model could be helpful to directors who believe that shareholder interests should not be paramount in a contested takeover. This would be a particularly apt model if the result of the takeover is liquidation of the corporate entity since attorneys are permitted to counsel corporate survival.

Yet the analogy between attorneys and directors cannot be stretched too far. Attorneys are agents of the corporation and directors are principals. Therefore the permission given to attorneys in the Model Rules to presume that management is acting in the best interests of the corporation raises some troubling questions as a model for directors. Similarly, while attorneys may consult a higher authority than management—the board—in certain situations, the board itself must always exercise its own judgment. Furthermore, the board does not owe the corporation the duty of confidentiality that influences an attorney's conduct.

Nevertheless, the central principle of the attorney's duty to the corporation—that counsel should act as an independent, neutral advisor—could add a helpful gloss on the duty of a director if it served to express a duty to the business enterprise. Various corporate constituencies stand to lose or gain in any takeover. Critics who charge that the long-term interests of the corporation are sacrificed in a takeover really mean that the long-term value of the assets under management are eroded instead of enhanced by a contest for control. Directors should be permitted to decide in what hands the assets of the corporation will be best managed for the benefit of all concerned constituencies. Unfortunately, most cases focus on tactics, power, and conflicts of interest, rather than an appraisal of the best interests of the business enterprise as a going concern.

A judgment about the long-term value of a business enterprise may be more appropriate to an appraisal proceeding than a typical takeover case. Nevertheless, if courts began viewing the director's duty to the corporation as a positive obligation to the business enterprise rather than as a check upon or justification for defensive tactics, a model of directors' duty could evolve that would be more appropriate for contests for corporate control than current models have proven.

Conclusion

Contests for corporate control are severely testing long-established principles of corporate law. In this process, the duty owed by a director to stockholders is being re-examined. State legislatures and some courts have expressed dissatisfaction with traditional theories by positing a duty to constituencies in addition to or different from a duty to shareholders and have supported defensive tactics designed to assure corporate survival.

This Article inquires whether an attorney's duty to the corporate entity is a possible paradigm for a target corporation's directors' duty to the corporation. Despite the significant differences in the role of directors and attorneys, the concept of a duty to the corporate entity, as distinct from separate and conflicting corporate constituencies, could prove useful. If, however, the SEC were to succeed in undermining the entity theory of an attorney's duty to the corporation and establish a corporate duty owed directly to investors, the duty of corporate counsel would add nothing to existing models for the duty of corporate directors assessing a takeover bid.