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RISKY BUSINESS: FAMILY BUSINESS SUCCESSION AND THE RULES OF PROFESSIONAL CONDUCT

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I. INTRODUCTION

Ironically, the California Rules of Professional Conduct[1] ("CRPC" or "Rules") actually tend to hinder rather than help the transfer of a family business from one generation to the next. This becomes apparent if you compare conduct under those Rules to the "best practices" developed by other professionals in the family business succession field. Of course, hindering rather than assisting the succession process is hardly the purpose of the Rules, but it is often the effect.

To frame this discussion we begin with the fact that Rule 1-100 (A) provides in part as follows:

> "Rule 1-100.[2] Rules of Professional Conduct in General
>
> "(A) Purpose and Function.
>
> "The following rules are intended to regulate professional conduct of members of the State Bar through discipline. They have been adopted by the Board of Governors of the State Bar of California and approved by the Supreme Court of California pursuant to Business and Professions Code sections 6076 and 6077 to protect the public and to promote respect and confidence in the legal profession."

Do the Rules "protect" the public, or do they hurt the public and generate risks for the public when the lawyers work on the family business succession process? Is it possible that Rules designed to protect the public actually contribute to the generally accepted statistics[3] that only 34% of family businesses succeed to the second generation and only about 14% to the third generation?

This article explores these questions and related issues. Specifically, the authors:

- examine possible root causes of the family business failure rates cited above to understand better why the best practice approach of other family business succession professionals may make sense for attorneys;
- discuss a best practice approach that has been developed by practitioners in other professional fields (e.g., organizational development consultants,[4] clinical psychologists,[5] psychiatrists,[6] family business consultants,[7] business management consultants[8]) to help the family business succession process;
- compare that best practice approach to the limitations that our Rules of Professional Conduct impose on estate planning lawyers and suggest how a lawyer might work more effectively with the family business client within the framework of the Rules;
- examine whether our Rules may prevent us from addressing the root causes of the failure rates cited above and thus indirectly contribute to those failures;
- identify what, if anything, attorneys can do to address those causes within the constraints of the Rules.

II. ROOT CAUSES FOR THE FAILURE RATES IN FAMILY BUSINESS SUCCESSION.

Findings from one of the first empirically-based research studies[9] identifies three factors as those most often leading to succession breakdowns. This study may provide some insight into the unintended consequences of our well intentioned Rules. The research conclusions[10] indicate that the high rates of family business failures are due to three factors:

1. 60% of typical breakdowns arise from relationship issues or "how we get along";
2. 25% of typical breakdowns arise from heirs lacking competence and being unprepared; and
3. 10% of typical breakdowns arise from tax and traditional estate planning issues.

Other issues account for the remaining reasons that family businesses fail.

In light of these findings, we draw your attention to two points related to our estate planning practices. First, estate planners and business owners generally spend their time on activities related to 10% of the causes[11] of succession breakdowns rather than on activities related to the factors accounting for 85% of the breakdowns. Second, attorneys' skills and competencies in tax and governance matters are the least[12] effective ways to address family relationship issues (60% of the cause) or the needs of heirs who are unprepared to assume their new duties (25% of the cause).

Assuming that these two points are reasonable, two potential improvements suggest themselves. First, it may be useful for estate planners and business owners to adopt a broader view and more comprehensive approach to the succession planning process (granted, more easily said than done!). Second, estate planners trained exclusively in tax, investment and trust law might seriously consider revising[13] their current advisory approaches by developing

knowledge and skills that would enable them to address more effectively the main causes of breakdown in family-business succession. In fact, the Rules may actually "require" attorneys to acquire the appropriate skills or "associate with, or where appropriate, professionally consult another lawyer reasonably believed to be competent" (Rule 3-310(C)[14]) in these matters.

However, given the limitations imposed on attorneys by the Rules, it may not be possible for lawyers to broaden the scope of their representation of family businesses. To understand why the lawyer (and even the family business client) may be at risk if the lawyer tries to "do the right thing," we will first review a generally accepted "best practice" approach for family business consultation. This approach has been developed by the other professional fields mentioned above. Then we examine whether the estate planning lawyer can use that approach.

III. "BEST PRACTICE" FOR A FAMILY BUSINESS, SUCCESSION CONSULTATION

There is no shortage of suggested best practices for family business succession consultations. Books, journals, family-business magazines, and websites all provide plenty of guidance. In the following section, we outline a generally accepted, best practice approach for family business succession consultations. However, we first define a family business, and then outline the best practice approach, although it is *not* the only one developed in the other professional fields.

A. What Is a Family Business?

A family business is a hybrid in that it combines two separate, but interrelated, complex systems: the family system and the business system.[15] Each system contains elements that are related such that a change in any one part of either system will influence, or produce change in one or both parts of the system.[16] The interrelatedness of the elements in a system is exemplified by the idea that a butterfly flapping its wings in South America can change the weather in California.

In a family business, the two systems are linked by their intertwined relationship. Each system is distinguished by its difference from the other, but linked by the underlying unity of the two being connected.[17] In other words, each system has its own elements of rules and expectations, yet is continually influencing and being influenced by the other system, such that when the two systems are combined it produces a family business[18] with its own unique configuration of elements of both family and business.

To understand the applicability of the "best practice" approach described below, let's briefly review the rules, roles, and expectations[19] of each of these two systems.

- A family system involves kinship, relationships, unity, marriage, children, gender,[20] brother, sister, sibling rivalries, and the various roles family members play for each other, such as the parent, child, the older, younger and middle sibling, the grandchild, the scapegoat, the victim, the black sheep, the outsider, the hero, the loser, the winner, the favorite, the entrepreneur, the business owner and the power holder, among others. A family consists of a set of stories or plots "some of which are inherited, some created and others are the myths that people live out as part of the family legacy."[21]

- A business system[22] consists of the many rules and expectations that center on money, profit, efficiency, capital, markets, sales, competition, performance, and operations.

The unique management and succession challenges in family business stem from the two systems and hybrid nature of the entity. Not incidentally, planning for and implementing succession often intensifies the effect of family dynamics on the business and of business dynamics on the family, and rarely for the better. In response to those challenges, the professionals noted above have generated research, literature and practices designed to help both the family business and the family.

B. The Basic "Best Practice" For Family Business Succession Consultation

There are several models for entering, assessing, intervening, implementing and completing a family business succession consultation, but assessing them all is beyond the scope of this article. Instead, we want to address two underlying characteristics of the various best practices that are most germane to this discussion.

1. Identity of the Client

Upon entering the situation, the first question to address, as in the practice of law, is to identify the client. However, unlike law, in terms of best practices, it is generally accepted that the family business system[23] itself is the client. However, the advisor works with both systems and spans the boundaries of each system. The complex linkages between the family system and the business system dictate that the best practice is to work with both systems.

This means that the consultant must consider the interests, goals, values, actions and other aspects of the two systems. Thus, the consultant "represents" and deals with each individual and each group (including family members who do and do not work in the business), and perhaps with non-family members in the business, as well as the organization itself, which in turn interfaces with the markets, vendors, and political, social and economic environments.[24]

2. Assessment, Intervention, and Implementation

A generally accepted model for organizing the assessment, intervention and implementation is the "action research model."[25] The action research model typically involves fact finding, diagnosis, planning based on the findings, action based on the plans, and evaluation of the results of the actions taken.[26] "The idea is that data or information can help promote change or improvement. In the case of a family business system, it [the information] motivates and guides changes in leadership behavior, organizational and family culture, managerial practices and policies, leadership of the succession process, and perhaps even

ownership structures."[27] Success depends on the validity and compelling quality of the information gathered and the efficacy of the feedback to the family business system's principals."[28]

The point is that the advisor is a participant/observer and change agent without becoming a member of the family business system, and is a coach to both the family system and the business system. This in turn implies constant communication and feedback to both systems by the consultant.

These two points inform all consultations, communications, diagnoses, interventions, and other activities that comprise best practices for family business succession planners in the other above noted professions. As will be seen, these two points are the crux of the issue this article examines, which is attorneys' behavior under the Rules. So in the remainder of this article, we use the term "best practice" to encompass both these points and the professional, succession planning and transition activities that they inform (that is, consultations, communications, diagnoses, and so on).

Given this generally accepted best practice, to what degree can the estate planning lawyer guide, lead, and participate in the succession process given the Rules of Professional Conduct?

Before we answer that question, we will briefly review the ways in which a lawyer can represent a client in estate and succession planning as described in the legal literature.

IV. FIVE REPRESENTATION MODELS

The legal literature recognizes five basic models for a lawyer representing a client. These models have been more or less accepted (amid some ongoing debate) in the legal literature since 1908.[29] The models include the single client or "hired gun" model,[30] the joint representation model,[31] the separate multiple representation model,[32] the reasonable-expectation or intermediary model,[33] and the single entity model.[34] The following sections summarize each of these five models. Then, in the subsequent section, we will compare these models of representation and their levels of compatibility with the best practice approach discussed above.

A. The Single Client or "Hired Gun" Representation Model

Most observers assume that the single-client or hired-gun representation model, with its exclusive emphasis on the client, has always been the primary form of legal practice. This model has informed both legal culture and lawyers' understanding of their professional role. Although it has become the dominant representation model and dictates most aspects of legal representation, the single client model was not in fact the dominant form of legal practice until relatively recently.

The single client or hired gun representation model has two origins: (a) It is a product of "the rights revolutions" of the 1950's and 1960's which shifted the primary objectives of the law from maintaining the purity of the legal system toward engaging the system to advance individual rights;[35] (b) it also traces back to 1908 which was the beginning of the creation of all existing Rules, which resulted from a time when lawyers were unable to influence clients to act in socially desired ways, but now represent a client no matter what their goals might be.[36]

Essentially, the single-client or hired gun representation model fulfills clients' legitimate expectations of confidentiality and loyalty. It also upholds the public's interest in vigorous advocacy, which is thought, at present, to be essential to the proper working of our adversarial system of justice.[37]

In this context, the key Rules set forth in the law that concern the estate planning lawyer include, but are not limited to, the following:

1. The duty of confidentiality (Rule 3-100 and the Cal. Business and Professions Code § 6068(e))[38]

2. The duty of undivided loyalty to the single client (Rule 3-310), by avoiding any conflicts of interest whether potential or actual(see Rules 3-300[39] and 3-310(C))[40]

3. The duty to represent a client diligently and competently (Rule 3-110[41]) to the exclusion of all else[42]

4. The duty to respect the rights of other lawyers not to communicate with their clients (see Rule 2-100).[43]

B. The Joint Representation Model

In representing multiple clients, the lawyer focuses on achieving the common objective of the clients. Here the emphasis is on elements that unify, rather than divide, the clients.[44] For example in joint multiple representation, the same lawyer can represent a husband and a wife "jointly." They all coordinate their efforts. There are no secrets, and confidences relevant to the joint representation disclosed by the lawyer may be shared with the spouse.[45]

C. The Separate Multiple Representation Model

In separate multiple representation, the same lawyer represents both a husband and a wife but each is regarded by the lawyer as his or her separate and distinct client.[46] Under this model, the lawyer is governed by the Rules described above in the single-client or hired gun representation model.

D. The Reasonable Expectation or "Intermediary" Representation Model

A lawyer acts as an "intermediary" when he or she represents two or more parties with potentially conflicting interests.[47] The concept of a lawyer as "intermediary" has its origins with Justice Louis Brandeis's[48] (1917) concept of the role of a lawyer as "counsel for the situation."[49] This concept attempts to balance the rights and obligations of each party in order to arrive at a solution equitable to each party.

Before a lawyer may act as an "intermediary," four[50] conditions must be met:

1. The lawyer must obtain informed consent from each client after having explained the advantages and disadvantages of common representation;

2. The lawyer must "reasonably" believe that the potentially conflicting interests, identified by the lawyer can be resolved with terms compatible to the clients' best interests;

3. Each client will be able to make adequately informed decisions in the matter; and

4. There is little risk of material prejudice to the interests of any of the clients if the contemplated resolution is successful.

In this model, having concluded that the requisite four beliefs described above are "reasonable" and having obtained the clients' consent, the lawyer may act as an "intermediary."[51]

E. The Single Entity Model

Sometimes the single-entity representation model is associated with an earlier conception of the lawyer as a "generalist" representing the whole family, as conveyed in the notion of the "family lawyer," but this association is erroneous.

The single-entity representation model[52] draws on the corporate client image of Rule 3-600[53] with the client as "the family unit." The lawyer represents the clients in and through their unit as a "family." Instead of representing the clients as separate individuals with shared or conflicting interests and objectives, the single-entity representation model returns us to the Rules conception of a "single-client."[54]

The duty of a lawyer representing an organization or family as a "single-entity" is to maintain a client-lawyer relationship with the "entity" only; he or she does not owe a duty to any individual member or members of the entity.[55] Note that the joint multiple representation model and the reasonable-expectations/ "intermediary" representation model both require informed and explicit consent by the client to demonstrate a genuine understanding and agreement. In contrast, under the single entity representation model implied individual consent suffices and requires neither individual consent nor understanding.[56]

V. THE RISKS TO THE FAMILY AND TO THE LAWYER

Let us now turn to the very real potential risks to which the Rules of Professional Conduct expose both families and lawyers in family business succession situations.

A. The Risks To The Family

The risks to the family are real if the Rules of Professional Conduct are used to remove the lawyer from any further representation of the family and the family business. Assuming that the lawyer is trying to work with the family and utilize to one extent or another the best practice model discussed above, and even assuming that the lawyer may have carefully used the proper multiple representation letter with the "Zador Waiver" (see discussion below), one disgruntled family member may still be able to remove the lawyer from any further representation of any other family members and the family business.[57] If the lawyer is removed, negative consequences may result for the family, including the following:

- The money spent by the family to educate the lawyer about the family issues and business concerns may be lost;

- The lawyer's relationships with the family and the family business may be lost and the family may lose a trusted advisor;

- Family relationships may be strained, tainted or even destroyed for subsequent generations;

- Significant economic and emotional turmoil may occur for the family business and the family;

- Family members and the family business may have to hire separate lawyers, which would significantly increase future legal fees;

- The succession process will be delayed, perhaps indefinitely, with a significant risk that the issues will never be solved without court action at some point;

- Each new lawyer will be more or less forced to use the "hired gun" representation model, which significantly reduces the chances that they will be able to work together as a team, and increases the probability of feuds fueled by adversarial approaches and their having to "take sides" because they lack knowledge of the complexities of the family business and the family.

Significant consequences, while unintended, are likely since the relationship between the lawyer, the law, and the family business system is complex and subject to a "butterfly" effect. For example, legal issues that may appear technical and inconsequential can have a cumulative effect from one generation to the next.[58]

B. The Risks To The Lawyer

The risks to the lawyer for violating the Rules of Professional Conduct, even if it is a "de minimis violation,"[59] are real and include the significant possibility of losing the entire family and family business as a client and for being named in a malpractice lawsuit. On the first page of the *Guide To the California Rules of Professional Conduct For Estate Planning, Trust and Probate Counsel*, the authors state that,

> Despite this disclaimer (that the Rules of Professional Conduct are not intended to create new civil causes of action that is written into the Rule 1-100(A)), ... it is clearly established in California that the violation of an ethical rule may give rise to causes of action for legal malpractice, breach of fiduciary duty and consequent damages.[60]

The authors continue on page 2 of the *Guide to the Rules of Professional Conduct* by quoting from a California appellate case,[61] which reinforces the above comments that the lawyer may be forced to use the supplemented "hired gun" model (see below) for any family business succession representation, as follows:

> Furthermore, "it is an attorney's duty to 'protect his client in every possible way,' and it is a violation of that duty for the attorney to assume a position adverse or antagonistic to his client without the latter's free and intelligent consent given after full knowledge of all facts and circumstances." The attorney is "precluded from assuming any relation which would prevent him from devoting his entire energies to his client's interest." (Citations omitted.) An attorney's failure to perform in accordance with his duty is negligence. (Citations omitted.) From the time he became the (clients') attorney, (the attorney) was obligated to abide by these high standards of professional responsibility. (Citations omitted.)
>
> The authors continued the quote,[62]
>
> An attorney's duty, the breach of which amounts to negligence, is not limited to his failure to use the skill required of lawyers. Rather, it is a wider obligation to exercise due care to protect a client's best interests in all ethical ways and in all circumstances.
>
> The standards governing an attorney's ethical duties are conclusively established by the Rules of Professional Conduct. They cannot be changed by expert testimony. If an expert testifies contrary to the rules of professional conduct, the standards established by the rules govern and the expert testimony is disregarded." (Citations omitted.)

VI. COMPARISON OF REPRESENTATION MODELS WITH BEST PRACTICES — CAN WE DO IT?

The vast majority of estate planning attorneys care deeply for their clients and do not want to foment family conflicts. Given this, can the attorney use the body of knowledge developed by the other family business succession professional fields? Can the attorney implement the best practice approach to enhance the chances that the family business will successfully transition to the succeeding generation(s)?

The answer to these questions is "not really," given the lawyer's responsibilities under the Rules of Professional Conduct. But why?

To answer that question, let's return to the fundamental theme of the best practice approach, then review the rules that determine who the client may be, review the representation Rules that control how the attorney must practice, see how the best practice approach blends with the models of representation discussed above, and then show how the "hired gun" representation model can be supplemented to help the family and the lawyer avoid facing the risks discussed above yet still allow the lawyer to follow more closely the best practice approach in representing the family business client.

A. Fundamental Theme for the Best Practice Model

Recall that the best practice approach described earlier is designed to enhance the chances of a family business moving successfully to the next generation. For the attorney, this approach requires that the lawyer communicate with many, if not all, members of the family business system regarding the "big picture" in order to maintain a balance in the relationship between the family system and the business system.

In this section, we address the question of whether this requirement of constant communication conflicts with any of the Rules of Professional Conduct. If it does conflict with the Rules, in what way does this impact an attorney's use of the best practice approach for family business succession consultations? In this section, we also discuss a few more underlying principles of the best practice approach. Our goal in doing so is to understand why the approach may just not work within our Rules without a modification of the hired gun representation model. We will discuss this modification later in this article.

In a family business succession consultation, an attorney should begin by explaining what happens if conflicts of interest arise among family members if the attorney is to represent more than one family member. This is necessary under the existing Rules, but some attorneys believe, with good reasons, that it somehow raises negative possibilities and, if there is any family turmoil, conveys the idea that "things may go from bad to worse." At the very least, it suggests that conflict is "bad." Given that some form of conflict is natural in families everywhere, these attorneys are concerned about adding tension to what may be an already tense situation. Let's compare the notion that conflict is bad with the best practice approach's view of conflict.

In contrast to the lawyer's view in this situation, from the best practice perspective, conflict is neither "good" nor "bad" but rather a natural and expected part of the family business system. When conflict arises it is treated as "information" from the system. It is viewed as symptomatic of individual, group, or organizational issues and dynamics in the family and family business system.

Because conflict represents "new information", it blends into the action research model underlying the best practice approach. Conflict represents an opportunity to "work through" existing issues, reframe the conflict by understanding its meaning and normalizing its existence and restructuring, at least to some extent, family business and family dynamics.

Now we turn to issues related to determining who the client may be, which may help us supplement the hired gun model for the lawyer interested in using the best practice approach for family business clients.

B. Who is the Client?

The first three questions the attorney and client must answer before the attorney represents a family business succession planning client, particularly when the lawyer may be talking to other family members, are as follows:

1. Who will be the client?

The answer to this question is typically clear in that the usual fee and representation agreement are prepared by the lawyer and presented to a particular, identified client.

2. What if other family members also consider themselves clients?

As will be more fully discussed below, if another family member is considered an actual or implied client, then the attorney will be required to follow all of the Rules of Professional Conduct relative to such person. This includes the rule of confidentiality and the rule requiring the lawyer to avoid any potential or actual conflicts with the other clients of the lawyer. Thus, if another family member is a client within the Rules, then he or she would have the right to object to the lawyer's continuing to represent any other family members at any time.

How could a family member be considered a client when there is no formal agreement with the attorney and the attorney does not consider that person the client? The California State Bar has issued an opinion[63] in which it reviews the rules dealing with how an attorney-client relationship may *impliedly* occur and thereby require the lawyer to act in accordance with all the Rules relative to that "implied" client.

The Opinion states, in part, that,

> An attorney-client relationship, together with all the attendant duties a lawyer owes a client...may be created by contract, either express or implied. In the case of an implied contract, the key inquiry is whether the speaker's belief that such a relationship was formed has been reasonably induced by the representations or conduct of the attorney.[64]

The Opinion goes on,

> Whether the attorney's representations or conduct evidence a willingness to participate in a consultation is examined from the viewpoint of the reasonable expectations of the speaker. The factual circumstances relevant to the existence of the consultation include: whether the parties meet by pre-arrangement or by chance; the prior relationship, if any, of the parties; whether communications took place in a public or private place; the presence or absence of third parties; the duration of the communication; and, most important, the demeanor of the parties, particularly any conduct of the attorney encouraging or discouraging the communication and conduct of either party suggesting an understanding that the communication is or is not confidential.[65]

Thus, in order to avoid the risks to the family and to the lawyer discussed above, the lawyer representing a client with a family business and trying to work with the entire family, possibly within the best practice approach, will need to clearly state in writing who is and who is not a client.

3. Even if a family member is clearly not a client, may the lawyer still owe a duty of confidentiality to that family member during discussions with that family member?

The simple answer is "yes," the lawyer may owe a duty of confidentiality to a non-client, which can result in the lawyer being disqualified from representing any other family members. The above-referenced Formal Opinion No. 2003-161 provides, in part,

> Even if no attorney-client relationship is created, an attorney is obligated to treat a communication as confidential if the speaker was seeking representation or legal advice and the totality of the circumstances, particularly the representations and conduct of the attorney, reasonably induces in the speaker the belief that the attorney is willing to be consulted by the speaker for the purpose of retaining the attorney or securing legal services or advice in his professional capacity, and the speaker provided confidential information to the attorney in confidence.[66]

The Opinion goes on,

> The obligation of confidentiality that arises from such a consultation prohibits the attorney from using or disclosing the confidential or secret information imparted, except with the consent or for the benefit of the speaker. *The attorney's obligation of confidentiality may also bar the attorney from accepting or continuing another representation without the speaker's consent*.[67] (Emphasis added)

Thus, the lawyer will have to state clearly that the family member is not a client and also that any conversations with that family member will not be protected for confidentiality.

C. Two Fundamental Duties Lawyers Owe Their Clients

Of the professional duties that a lawyer owes the client, two are fundamental in shaping how to best represent a family business client, namely, the duty of confidentiality and the duty of loyalty to avoid any conflict of interest.

1. The Duty of Confidentiality

Rule 3-100[68] provides, in part,

> (A) A member shall not reveal information protected from disclosure by Business and Professions Code Section 6068, subdivision (e)(1) without the informed consent of the client...

In the Discussion section of the Rules, the authors state,

> [1] Duty of confidentiality. Paragraph (A) (of Rule 3-100) relates to a member's obligations under Business and Profession Code section 6068, subdivision (e)(1), which provides it is a duty of a member: "To maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client." A member's duty to preserve the confidentiality of client information involves public policies of paramount importance (citation omitted)...Paragraph (A) thus recognizes a fundamental principle in the client-lawyer relationship, that in the absence of the client's informed consent, a member must not reveal information relating to the representation. (Citation omitted).

In other words, unless the client gives "informed consent" (see discussion below), the attorney is prohibited from "revealing secrets and confidences of his or her client at any time, but that protection is waivable by the client."[69]

2. The Duty of Loyalty

Rule 3-310[70] sets forth the rules that the attorney must follow to avoid any conflict of interest which an attorney may have with multiple clients. The conflict of interest Rules aim to ensure the attorney's absolute and undivided loyalty and commitment to the client.[71] Rule 3-310 is not only a disciplinary rule but can also be used by the courts to determine whether lawyers or law firms should be disqualified from representation.[72]

Taken literally, Rule 3-310 is so controlling that it may, in and of itself, preclude the lawyer from using the best practice approach for the family business. Rule 3-310(C) provides in part that,

> (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*. (Emphasis added)

In other words, a lawyer may not even begin to represent more than one client in a family unless the lawyer obtains from all of the clients an "informed written consent" that sets out any potential and actual conflicts. In setting out the conflicts for the purposes of the Rules and avoiding the risks described above, it is in the lawyer's and the family's interests that the lawyer be as specific and as complete as possible. However, even if all family members agree to the lawyer's representation, telling the family in writing that they have potential or actual conflicts may have a chilling effect on family members' views of each other and of their relationship with the lawyer.

It gets worse. If the family agrees to joint representation and all sign the informed written consent, if any of the potential conflicts becomes an actual conflict, the lawyer must ask the clients to sign another waiver.[73]

So in addition to the chilling effect of the lawyer raising the idea of potential conflicts, there may be later ramifications of the lawyer asking for the informed written consent from the various family-member clients. Clearly, pointing out possible and actual conflicts may have negative impact during representation. For example, one of the family members or the spouse of that family member may, after signing the written disclosure, no longer fully trust the lawyer, which may impact the lawyer's ability to help resolve future family conflicts.

Given these restrictions within the Rules, can the lawyer's duties of confidentiality and loyalty be waived so the lawyer can at least minimize the risks to the family and to the lawyer if, during the representation, the lawyer tries to use the best practice approach? We take up this issue in the next section.

D. Can The Fundamental Duties of Confidentiality and Loyalty Be Waived[74] by the Client?

Given the importance to the family of the lawyer being able to address the root causes of family business succession failures, can the family waive their rights of confidentiality and loyalty in advance such that the lawyer can utilize the best practice approach? The answer will become apparent when the cases and Bar opinions are analyzed.

The appellate court in *Zador*[75] addressed the issue of wavier of confidentiality and loyalty and then upheld the waiver's validity in the particular set of facts of that case. In that case, the Court analyzed the application of the waiver (the "Zador Waiver") by first reviewing the conflict waiver letter, reviewing the particular facts of the case, and reviewing the laws and Bar opinions dealing with blanket waivers. The court then noted the delay in the time it took for opposing counsel to file the motion for disqualification after the new counsel was hired. The court concluded that the blanket waiver in this case was valid and the initial attorney who represented the two clients was not disqualified from continuing to represent the one client after the actual conflict developed.

Because of its importance as an example of how to waive the lawyer's duties of loyalty and confidentiality to the client, we quote that letter in part:

> Based on the information that has been provided to us, we do not believe that our representation currently involves any actual conflict of interest. You should be aware, however, that our representation may in the future involve actual conflicts of interests if the interests of the Co-defendants become inconsistent with your interests. Should that occur, we will endeavor to appraise you promptly of any such conflict so that you can decide whether you wish to obtain independent counsel.
>
> Multiple representation may result in economic or tactical advantages. You should be aware, however, that

multiple representation also involves significant risks. First, multiple representation may result in divided or at least shared attorney-client loyalties. Although we are not currently aware of any actual or reasonably foreseeable adverse effects of such divided or shared loyalty, it is possible that issues may arise as to which our representation of you may be materially limited by our representation of the Co-defendants.

Furthermore, because we will be jointly retained by both of you and the Co-defendants in this matter, in the event of a dispute between you and the Co-defendants, the attorney-client privilege generally will not protect communications that have taken place among all of you and attorneys in our firm. Moreover, pursuant to this 'Joint Client' arrangement, anything you disclose to us may be disclosed to any of the other jointly represented clients.

In the event of a dispute or conflict between you and the Co-defendants, there is a risk that we may be disqualified from representing all of you absent written consent from all of you at that time. We anticipate that if such a conflict or dispute were to arise, we would continue to represent the subsidiary companies of Miramar Hotel & Investment Co., Ltd. (the 'Companies'), whose legal interests in this matter are aligned, *notwithstanding any adversity between you and the Companies' interests*. Among the Companies are Zador (California) Corporation, Zador Corporation N.V. and YCS Investments. Accordingly, we are now asking that you consent to our continued and future representation of the Companies and agree not to assert any such conflict of interest or to seek to disqualify us from representing the Companies, *notwithstanding any adversity that may develop*. By signing and returning to us the agreement and consent set forth at the end of this letter, you will consent to such arrangement and waive any conflicts regarding that arrangement. Notwithstanding such waiver and consent, depending on the circumstances, there remains some degree of risk that we would be disqualified from representing any of you in the event of a dispute.

Notwithstanding these risks, you have advised us that in this matter at the present time you do not desire to seek other counsel but instead you desire that we represent multiple interests of yourself and the Co-defendants. Because the interests of the Co-defendants may become inconsistent with your interests, under the ethical standards discussed below we are required to bring this matter to your attention and to obtain your consent, as well as the consent of the Co-defendants, before representing you in the matter described above....

Accordingly, we request that you signify your informed written consent by signing and returning this letter to us. We encourage you to seek independent counsel regarding the import of this consent, if you so desire, and we emphasize that you remain completely free to seek independent counsel at any time even if you decide to sign the consent set forth below.... (Emphasis added)

In its analysis, the *Zador* court seemed to focus on the exact terms of the waiver letter, as quoted above, and even specifically mentioned several times that the above waiver letter said, *"notwithstanding any adversity that may develop"* when upholding the blanket waiver. The court also spent considerable time reviewing exact facts of the case in some detail, including a review of the facts that developed after the former client had separate counsel. In addition, the court also noted that in the letter to the former client, after the actual conflict arose, the former client was asked again to waive the conflict and signed the wavier again.

The court also noted that when the former client first signed the original blanket waiver, that client reasonably should have known about the conflict. It was not until the *Zador* lawyer found out about it and notified the former client to seek separate counsel that the new lawyer, a few years after his retention, asked that the *Zador* attorney be removed. The court held that the former client of the *Zador* lawyer had made valid waiver and, therefore, the *Zador* lawyers were not disqualified.

The point we can develop from the *Zador* case, and the other authorities discussed below, is that generally a blanket waiver in advance is possible but it is subject to several considerations before it is upheld, namely,

- whether the waiving party made an informed waiver, which can be determined by a fact-specific inquiry;
- whether the waiver was for a potential conflict (Rule 3-310(C)(1)) versus an actual conflict (Rule 3-310(C)(2), and
- whether the "continued representation (of the remaining, original client) would seriously compromise the integrity of the judicial process and the fairness of the particular proceeding (see Formal Opinion 1989-115)."

How does a lawyer know if the waiver she is asking the client to sign is informed? In Vapnek, Tuft, Peck & Wiener, Cal. Prac. Guide: Professional Responsibility (The Rutter Group 2005) at page 4-5, the authors state,

> "Informed written consent" means the client's... written agreement to the representation following written disclosure (CRPC 3-310(A)(2)). Thus, each client... involved in the conflict must agree in writing to the representation following counsel's full written disclosure of the "relevant circumstances" and the "actual and reasonably foreseeable adverse consequences to the client...(citations omitted) Clearly, as a threshold matter one must know of, understand and acknowledge the presence of a conflict of interest before one can give informed consent to its existence.

In addition, the State Bar of California, in Formal Opinion No. 1989-115, also cited in the *Zador* case, states in part,

> Whether a client's waiver of the protections provided by Rule 3-310 (conflicts) or Business and Profession Code section 6068(e) (confidentiality) is "informed" is obviously a fact-specific inquiry.
>
> The Bar Committee summarized its holdings by stating:
>
> In summary, then, it is the opinion of the Committee that the execution of an advance waiver of conflict of interest and confidentiality protections is not per se improper; that to the extent that the waiver of confidentiality is "informed," it is valid; that to the extent that a potential conflict ripens into an actual conflict, the advance waiver may or may not be sufficient depending upon the degree of involvement and the nature of the subsequent conflict... In concluding, we observe that it is possible in appropriate circumstances and with knowledgeable and sophisticated clients to clarify obligations and responsibilities by agreements of the sort discussed. It is also possible that in many circumstances the agreement will be ineffectual and may well be perceived as over-reaching on the part of the lawyer...

Thus, the answer to the question about whether a waiver will be valid and the lawyer and the family can rely on it to avoid the risks to a multi-family representation by the lawyer can be framed as follows: Yes, it is possible, but no, not really!

Having discussed who is the client, reviewed the duties of confidentiality and loyalty, and established that the validity of a waiver is uncertain, let's now review the models of representation in conjunction with the best practice approach. Our aim here is to see if it is possible for an attorney to shape his or her representation of a family business client to be able to address the root causes of family business succession failures.

E. Blending Best Practice with the Classic Models of Representation: Is it possible?

Given the application of the above Rules, Bar opinions, and cases, which of the models of representation, if any, can the attorney use to minimize the risks to the attorney and the family as outlined above and address the root causes of succession failures? Let's examine the hired gun and the multiple representation models to see how each one permits or restricts the attorney using the best practice approach.

1. The Single Client or Hired Gun Representation Model

Unlike the best practice approach, the single client or hired gun model permits the gathering of information only from a very narrow source. In family business succession planning, information has traditionally come from the senior generation.[76] The attorney's duties of confidentiality and loyalty to a single client have thus led to the creation of what might be called "closet plans." These are plans developed in an attorney's office without the benefit of candid conversations with other family members.[77]

However, the single client or hired gun representation model is understandably the safest for attorneys, given its compatibility with the California Rules of Professional Responsibility. Aside from issues inherent in the separate representation of spouses, this model seldom creates serious ethical problems for the attorney regarding the duties of confidentiality and loyalty.[78]

If one were to assume that the hired gun is the most prevalent representation model, and that conflicts and other adversarial relationships undermine the succession process, it may be valid to conclude that this model may be a significant contributing factor to the commonly accepted statistics of family business failures (i.e., 34% succeed to the second generation and 14% to the third generation). It may also be valid to conclude that although it may be the best model for the lawyer to use, the hired gun model may be the least beneficial to the family business client.

2. The Various Multiple Representation Models

Unlike the best practice approach, the various multiple representation models convey the idea of an engagement which is an "experiment" and tends to emphasize the "bad" conflicts that may exist or arise in the succession process. This is suggested by the attorney's obligation to highlight, at the beginning, all of the "potential conflicts" in the waiver and the possibility that even if one of the family member clients should withdraw, notwithstanding a blanket wavier of the attorney's duties, the representation of the entire family and family business could end for everyone, thereby forcing the family to face the risks discussed above.

Not one of the classic attorney representation models fully allows the attorney to completely implement the best practice approach for the family business client. Is it, however, possible to supplement the hired gun approach to better balance the needs of the family and the lawyer so that the lawyer can to some extent implement the best practice approach.

F. Supplement to the Hired Gun Model to Accommodate the Best Practice Approach

If the goal for the family business is to successfully transition to the next generation, then it may be best for the attorney to try to use the best practice approach by communicating with all members of the family business system to one extent or another, even during times of conflict. To achieve this goal, it seems that the attorney should supplement the classic hired gun model as follows, bearing in mind that each family business system is unique:

- Represent only one client, usually the senior generation. This avoids the risk found in the multi-representation models that any unhappy family-member client may disqualify the attorney from representing any family member(s).

- Have the client waive the lawyer's duty of confidentiality for at least the members of the family business system and the

consultant (discussed below). This will allow the lawyer to communicate freely with any person in the family business system. This is a critical aspect of the best practice approach, because open communication will allow other family members to see the "big picture" and eliminate the risk that the lawyer may inadvertently discuss confidential information.

- Have each person in the family business system (except the client) sign a letter that clearly states that the attorney does not represent all of the other family members and that no conversations between the family member and the attorney are confidential. In addition, the letter should suggest that the family member consult with his or her own attorney before signing the letter acknowledging the non-representation acknowledgement and confidentiality waiver.

- Consider using a consultant. Although this issue is beyond the scope of this article, the attorney should consider recommending that the family agree to use a consultant to implement aspects of the best practices approach. (Properly advised of the purposes of the role, the "consultant" could be any of the other advisors who the family may be using, such as the CPA or a financial advisor.) This consultant does not face the obstacles attorneys do in representing family business clients and can move easily within the family and business systems. The consultant thus functions as participant, observer, and communicator of the "big picture" to all family members. In this way, the consultant can address the needs of the family as a single entity and attend to individual and group needs.

VII. CONCLUSIONS: WHAT SHOULD THE LAWYER DO?

The following is a simple two-step approach for the lawyer to consider when entering into or continuing representation of a family business system to help both the family and the lawyer minimize the risks they face in such an engagement:

1. Discuss the advantages and disadvantages of each representation model with the client, possibly pointing out the following:

- The single client or hired gun representation model is the safest for the lawyer but poses the greatest chance of some level of conflict within and between the generations.

- The supplemented, single representation model may be the safest approach for both the lawyer and the family business system in that it helps minimize the risks to both. Recall that the supplemented, single representation model uses the single representation agreement for one client with a confidentiality waiver from that client, and a non-representation letter and confidentiality wavier for all family members and for the family business. In addition, consider adding to the planning team an independent consultant in the proper role, who can work for the family business perhaps in a modified version of the best practice model. The supplemented hired gun model may substantially increase the chances of successful succession.

- The various multiple representation models with a Zador Waiver may be the best way for the lawyer to help the family successfully transition the family business from one generation to the next generation. However, any such multiple representation model poses the risks outlined above to the family business system and to the lawyer.

2. Let the client decide which model of representation the lawyer should implement, and document your file accordingly.

As discussed above, and as all practicing estate planning lawyers know, each family business system is unique; therefore, what may be appropriate in one family business system may not be appropriate in another. The suggestions presented here are intended to enable attorneys to maximize the chances of successful family business succession, or at the very least to minimize the chances of contributing to an unsuccessful one, while conforming to the California Rules of Professional Conduct.[79]

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79. The authors view this matter as a work in progress and welcome comments, ideas, and experiences from planners regarding the concepts and ideas presented in this article. We also encourage discussion of ways to minimize the risks to the lawyer and to the family business system. Please email your comments, ideas, or experiences to ambrecht@taxlawsb.com. Thank you.

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