Ethical Traps in M & A Transactions

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There is no "typical" or common merger and acquisition (M & A) transaction. Although they have some common processes and typical components, each M & A transaction—and its participants—is unique and potentially challenging for the lawyers involved. With so much at stake in most M & A transactions, attorneys may feel pressure to act in ways that may be contrary to their ethical obligations, their client's interests, or both. It may be difficult to determine to whom you are answerable, as well as to understand any obligations to the participants, the companies, and the deal. Moreover, lawyers may find themselves caught in the quagmire of self-preservation if a securities deal goes sideways.

The scenario

ABC, Inc., is looking to buy and merge with its competitor, XYZ, Inc. ABC has dozens of shareholders, but XYZ has only six. You represent XYZ, and have been taking direction from its CEO and majority shareholder. The terms of the deal include both cash and stock options for XYZ's shareholders, and most—but not all—are looking to convert at least a portion of their XYZ shares to ABC shares in the transaction. In addition, ABC has offered XYZ's CEO a lucrative employment deal with ABC after the merger is completed. None of the other XYZ shareholders are being offered employment, but are being asked to sign five-year noncompete agreements.

Considerations before the deal

Who is the client?

Identification of the client determines with whom you communicate and to whom you owe your duties of diligence, confidentiality, and loyalty. Client identity is typically straightforward—a lawyer retained by a company typically represents only the company, and not the individual employees or members forming the company. See RPC 1.13(a). A company cannot, however, speak on its own and so it may act through its "duly authorized constituents." For this reason, it can sometimes be tricky to determine the voice of the company, when—as in the scenario above—there are multiple stakeholders with potentially competing interests, and the client company itself can only speak through such stakeholders. Client identification may further be complicated by the fact that a putative attorney-client relationship may be formed without a fee agreement or other formalized writing.

In Oregon, the existence of this relationship is largely dependent on the putative client's subjective belief that an attorney-client relationship has been established, so long as that belief is objectively reasonable—i.e., whether it is accompanied by evidence "that the lawyer understood or should have understood that the relationship existed, or acted as though the lawyer was providing professional assistance or advice on behalf of the putative client." *In re Weidner*, 310 Or 757, 770, 801 P2d 828 (1990).

But when a lawyer speaks to multiple people on the same "side," even if it is something as simple as taking a stakeholder's call and discussing details of the deal with that person, the lawyer is at risk that person may believe the lawyer is giving them individual advice. As a result, the lawyer may need to take steps to clarify that she is not their personal attorney, that she represents the entity, and that she is not looking out for their interests.

Lawyers are encouraged to detail the client relationship in writing at the beginning of the relationship, including who the lawyer does and does not represent. A comprehensive engagement letter can resolve many of the "who is the client" issues that may arise throughout a matter.

Explaining the process

Often, participants to M & A transactions, including the client representative, may be new to or unfamiliar with the process. Lawyers have an ethical obligation to ensure that their clients are provided with sufficient information to enable informed decisions regarding the representation. See RPC 1.4(b).

A parallel communication rule requires lawyers to keep clients informed of the status of their legal matters—especially those events that affect their legal interests or are potentially determinative of the legal matter. See RPC 1.4(a). See *In re Snyder*, 348 Or. 307, 315, 232 P.3d 952, 957 (2010) (reaffirming ruling under former disciplinary rules that a failure to communicate both good and bad news to the client violates RPC 1.4). See also *Marshall v. PricewaterhouseCoopers*, LLP, 316 Or. App. 416, 505 P.3d 40 (2021), review denied, 369 Or. 855, 512 P.3d 445 (2022). In that case, attorneys who investigated a proposed transaction were subject to malpractice action when they quickly identified a risk, albeit low, that the transaction

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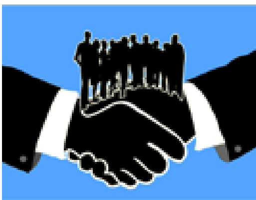
could be challenged as a fraudulent transfer in a bankruptcy proceeding, but did not inform their clients of their research before recommending that their clients go forward with the proposed transaction.

The combination of the obligations in RPC 1.4(a) and (b) also illuminates the need for attorneys involved in M & A transactions to tailor both status and other client communications to the sophistication of their particular client. You must know your audience, and take steps to provide complete and comprehendible information at every juncture.

During the deal

There are several potential pitfalls during the transaction. Successfully navigating them is largely dependent on understanding the relative goals of your client and the other participants to the deal—particularly those purportedly on your client's side. In addition to the potential ethical ramifications, this is now especially important because the current position from the court is that the ten-year period of ultimate repose under ORS 12.115(1) does not necessarily apply to all legal malpractice actions. *Marshall v. PricewaterhouseCoopers*, LLP, 316 Or. App. 416, 426, 505 P.3d 40 (2021), review denied, 369 Or. 855, 512 P.3d 445 (2022).



Understanding the motivations and goals of the participants is key to avoiding personal civil liability, as well as a disciplinary proceeding by the Oregon State Bar or the SEC.

Conflicts in sell-side transactions

Given that XYZ's CEO is being courted to join ABC's organization, the CEO's interests may not necessarily be aligned with those of XYZ or the other shareholders looking to get the highest share price for their stock and other assets. Rather, the CEO may want to maximize value for ABC, and put it in the best position to be profitable following the sale. As the lawyer for XYZ, you need to be on the lookout for this potential conflict of interest—particularly where it could arise in connection with the person from whom you are supposed to be taking direction on behalf of the client. Where the CEO's interests may be contrary to those of your client, you must still act in the interests of your client, even if the CEO is the one paying your bills. See RPC 1.8(f)(2).

In addition, keep in mind the risk for aiding and abetting breach of fiduciary duty by a majority owner to minority owner. See *Granewich v. Harding*, 329 Or. 47, 985 P.2d 788 (1999). In that case, attorneys representing the corporation knew of and participated in a scheme to "squeeze out" a minority shareholder, which resulted in breach of fiduciary duties of controlling shareholders. The court upheld a valid claim against the attorneys for joint liability. Accordingly, care should be taken to avoid perceived participation in actions that fail to consider the effects on minority shareholders, or which could otherwise be viewed as a breach of fiduciary duties. If you find yourself in such a situation, you may consider pointing out the "perceived conflict" to the majority actor (here, XYZ's CEO) and suggest that the CEO consider how the actions would look to others or the public. You may also consider having a committee of disinterested members of the board assume responsibility for the M & A transaction, or agree to act in an oversight capacity.

Other conflicts may exist too, for example, when there are multiple classes of stock, and the parties must allocate transaction consideration (and risk) among different groups of shareholders. Lawyers are sometimes asked by a majority or minority shareholder to assess or protect its individual interests. A lawyer should be on the lookout for diverging interests and reassess conflicts as cases move forward.

Diligence and discovery

Often, complying with requests during due diligence necessitates overcoming two client tendencies: under-sharing and over-sharing. A lawyer should take steps to instruct the client about what to provide—and what not to provide—without crossing ethical lines. After all, the goal is to complete the sale. As such, there is a certain skill and often a bit of strategy that must be employed in determining what to produce on the spectrum of absolutely everything that might potentially be responsive (e.g., all the dirty laundry) to nothing more than is unequivocally requested (i.e., "buyer beware").

A client's misunderstanding about the scope of material to provide in due diligence does not equate to consent. It is incumbent upon a lawyer to ensure that the client provides responsive documentation without surrendering potentially negative information that is beyond the scope of what has been requested or lawfully required.

Supervision of subordinate lawyers

It is often both practical and cost-effective to delegate review of documentation to associates or paralegals. It is important, however, to keep in mind both the relative experience and thoroughness of those individuals.

Under RPC 5.1(b), a lawyer is responsible for the unethical conduct of another lawyer working under their supervision if they know

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of the subordinate lawyer's conduct at a time when its consequences could be avoided or mitigated, but they failed to take reasonable remedial action. RPC 5.3(a) & (b) impose similar requirements for non-lawyers working under your direction. This means that a lawyer may be subject to discipline if they do not ensure the subordinate lawyer acts in accordance with the ethical obligations under the Rules of Professional Conduct. See, e.g., *In re Kang*, 32 DB Rptr 191 (2018). In that case, the respondent managing partner was suspended for 60 days when he assigned a new associate to a pending personal injury client's matter, and almost immediately—without contacting the client or obtaining his approval—the associate made an offer to settle the case, which was accepted. See also *In re Taylor, 23 DB Rptr 151 (2009) and In re Idiart, 19 DB* Rptr 316 (2005) in which both were publicly reprimanded for delegating tasks to non-lawyer staff without making reasonable efforts to ensure that the staff's conduct was compatible with the disciplinary rules.

In addition to the licensing ramifications, such delegation of seemingly mundane tasks can be financially costly as well. See, e.g., "Are Attorneys Responsible For $600M 'Stupid' Mistake?" *Above the Law* (Mar 3, 2022).

Other tasks, however, are not so mundane (such as due diligence and disclosure schedules, an area often tasked to associates), and a lawyer should take care to make sure associates new to the area understand their obligations.

Planning for post-closing privilege issues

If XYZ is transferred and incorporated into ABC, a common question arises following closing in regard to whether ABC could or would claim the attorney-client privilege and demand the lawyers' communications with XYZ prior to and during the transaction. Given that they now have become XYZ (or rather XYZ has become ABC), they may be entitled to this information. Even more potentially concerning is what ABC might do with this information, and whether they elect to treat it differently than did the XYZ management. For example, the XYZ managers and directors would not waive privilege in a government investigation or suit because they may have personal liability; ABC, however, may not care).

There are two primary categories of privileged documents to consider: (1) those communications relating to the business operations of the selling business, and (2) those communications relating to the negotiation of the merger or transaction. Jurisdictions vary on how they approach the continued confidentiality of both categories. A lawyer may want to consider whether to include a provision in the final documentation regarding where the privilege lies post-closing. Privilege questions, however, are complicated and we recommend that a lawyer consult experienced counsel before doing so.

Conclusion

While seemingly fraught with peril, the M & A process is challenging and rewarding work that requires careful analysis and sometimes creative approaches to "make the deal." Understanding the motivations and goals of the participants is key to avoiding personal civil liability, as well as a disciplinary proceeding by the Oregon State Bar or the Securities and Exchange Commission. ◆

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The ideal attorney (shareholder) will have 8+ years as a practicing attorney with experience in real estate transactions and litigation and an ability to manage a larger volume of cases.

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The ideal attorney (associate) will have at least two years as a practicing business attorney with experience in new business entity creation, business contracts, real estate, and M&A.

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Please send a resume to resumes@buckley-law.com with a cover letter and your targeted compensation range.