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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

THE PEOPLE OF THE STATE OF CALIFORNIA, *ex rel.* CAROL SPOONER, *et al.*, Plaintiffs, vs. THE PACIFICA FOUNDATION, *et al.*, Defendants.	Case No. C 00 3815 MJJ **FOUNDATION DEFENDANTS'[1] OPPOSITION TO PLAINTIFFS' MOTION TO DISQUALIFY EPSTEIN BECKER & GREEN, P.C. AS COUNSEL** Date: Time: Courtroom: Judge: Martin J. Jenkins

[1] This Memorandum is filed on behalf of the Pacifica Foundation, Mary Frances Berry, June Makela, Frank Millspaugh, Andrea Cisco, Ken Ford, David Acosta, Michael Palmer, Karolyn Van Putten, Wendell Jones, Valrie Chambers, Bertram Lee, Beth Lyons, John Murdock, Robert Farrell, and Lynn Chadwick (the "Foundation Defendants").

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I. INTRODUCTION

The plaintiffs' Motion to Disqualify Epstein Becker & Green, P.C. ("EBG") from representing the Foundation Defendants in this case is entirely baseless. As a preliminary matter, the plaintiffs, who are neither current nor former clients of EBG, lack standing to assert this claim. EBG, moreover, does not have an impermissible conflict of interest in this case.

The plaintiffs argue that EBG cannot properly represent both the Pacifica Foundation (the "Foundation") and its Directors. However, joint representation of a corporation and its Directors generally is permissible. This is true even in a derivative action — to which the plaintiffs attempt to analogize to the present case — where there is no claim that the Directors have breached of their duty of loyalty (by embezzling money from the corporation or engaging in similar conduct). Because the plaintiffs in this case have not alleged that the Foundation Directors breached their duty of loyalty, dual representation of the Foundation and its Directors is appropriate.

The plaintiffs also allege that EBG's representation of the Foundation is improper because a defendant, John Murdock, is both a Director of the Foundation and an attorney with EBG. It is well established under California law that this type of representation is generally permissible. Moreover, plaintiffs' claim that the arrangement represents impermissible self-dealing by Mr. Murdock must fail for two reasons. First, Mr. Murdock is not an "interested director" because he will not receive any compensation as a result of EBG's representation of the Foundation. Second, even if Mr. Murdock were deemed an interested director, the arrangement would be permissible because it was approved by a majority of the Board in a vote in which Mr. Murdock did not participate.

Finally, this Court must consider, in evaluating the plaintiffs' motion, the financial burden that disqualification of EBG would impose on its clients in this case. EBG provides very cost effective representation to the Foundation and certain of its Directors in this and two related cases because it is offering its services at a significantly discounted rate, and

because it is efficient to have the same firm representing both the Foundation and the majority of the individual Directors. For all of these reasons, this Court should deny plaintiffs' Motion to Disqualify.

II. ARGUMENT

Courts have consistently recognized that "a court confronted with an attorney disqualification motion should proceed with caution in order to avoid hardships on innocent clients where disqualifications are unnecessarily ordered." *In re Lee v. San Diego County Department of Social Services*, 1 Cal. Rptr.2d 375, 380 (Cal. App. 4th 1991). Further, courts have recognized that "where only speculative or minimal benefit would be obtained by disqualification of . . . counsel, the dislocation and increased expense . . . is not justified." *Id.*

A. Plaintiffs Lack Standing to Bring a Motion to Disqualify EBG from Representation of the Foundation Defendants.

Plaintiffs' Motion to Disqualify EBG purports to be based on California Rule of Professional Conduct 3-310. California courts have consistently recognized that "the rule [3-310], of course, never becomes applicable where the party seeking the attorney's disqualification fails to establish that such party was or is represented by the attorney in a manner giving rise to an attorney-client relationship." *In re Lee v. San Diego County Department of Social Services*, 1 Cal. Rptr.2d at 380 (Cal. App. 4th 1991) (*citing Civil Service Com. v. Superior Court*, 209 Cal. Rptr. 159 (Cal. App. 4th 1984)). Here, the plaintiffs have failed to allege that they are, or have ever been, represented by EBG. As Rule 3-310 makes clear, they thus lack standing to seek EBG's disqualification.

B. EBG's Representation of Both the Foundation and Certain of its Individual Directors is Appropriate Because there is No Actual Conflict Among the Foundation Defendants and all of them Have Consented to the Arrangement.

It is the general rule that an attorney "representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to provision of rule 3-310." Cal. R. Prof. Conduct 3-600. The

exception, set out in California Rule of Professional Conduct 3-310(C) is that an attorney "shall not, without the informed written consent of each client . . . accept representation of more than one client in a matter in which the interests of the clients potentially conflict." As EBG has undertaken to represent only those Directors whose positions respecting plaintiffs' claims are completely aligned with the Foundation's, there is no conflict among the parties it represents. (*See* Declaration of Daly D.E. Temchine, Exhibit A, Sample of E-Mail Sent to Foundation Directors). Moreover, California courts recognize that, where a conflict is potential as opposed to actual, there may be joint representation if preceded by full disclosure and informed written consent by all of the affected clients. *See Klemm v. Sup. Ct.*, 75 Cal. App.3d 893, 899 (1977); *see also* Cal. State Bar Comm. Prof. Resp. Formal Opinion 1999-153 (attorney may represent a corporation and one of its two shareholders in suit by second shareholder where first shareholder, CEO, or president has authority to retain corporate counsel and gives informed consent).

In this case, EBG first undertook to represent the Foundation, and then after deciding what strategy would be most appropriate for the Foundation, inquired whether the Directors of the Foundation would take a similar position on this litigation. (*See* Declaration of Daly D.E. Temchine, Exhibit A, Sample of E-Mail Sent to Foundation Directors). EBG, through Mr. Temchine, specifically advised the Directors that:

> a key element of our [EBG's] ability to undertake that representation is that you perceive your interests and views respecting the plaintiffs' claims and judicial relief they seek, as being wholly aligned with the Foundation's position. Its firm position, as you know, is that all such claims are without merit, and the plaintiffs are not entitled to any of the relief they demand.

Id.

Only those Directors who unambiguously took a position that did not conflict with the Foundation's position were taken on as clients. Indeed, EBG declined to represent a Director, defendant Leslie Cagan, when it appeared that she was less than completely certain of her position. (Declaration of Daly D.E. Temchine, Exhibit B, Letter to Leslie Cagen dated

October 10, 2000). Directors who took a position contrary to the Foundation's, or desired their own counsel, have sought independent representation. EBG has fulfilled the requirements of California Code of Professional Responsibility Rule 3-310, and plaintiffs' claim that EBG should be disqualified due to a conflict created by its dual representation of the Foundation and certain of its Directors must fail.

C. Because Plaintiffs Have Not Alleged that the Directors Breached Their Duty of Loyalty to the Foundation, Joint Representation is Appropriate.

Because the plaintiffs do not allege that any of the Foundation Directors breached their duty of loyalty to the corporation, dual representation of the corporation and the Directors is entirely appropriate.

1. Even in a Shareholder Derivative Action, Dual Representation is Appropriate in the Absence of Allegations that the Directors Breached their Duty of Loyalty.

The plaintiffs rely on *Forest v. Baeza*, 58 Cal. App. 4th 65 (1997) (*"Forest"*), for the proposition that "case law clearly forbids dual representation of a corporation and directors in a *shareholder derivative suit*, at least where, as here, the *directors are alleged to have committed fraud*." *Id.* at 74 (emphasis added). The present case is not a shareholder derivative action. Moreover, even if the present case were deemed analogous to a shareholder derivative action, the principle cited in *Forest* would be inapplicable. The principal applies only where it is alleged that the directors have breached their duty of loyalty to the corporation, thereby making the corporation and the directors truly adverse. *Bell Atlantic Corporation v. Bolger*, 2 F.3d 1304 (3rd Cir. 1993).[2] In fact, the commentary

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[2] *See also Forest,* 58 Cal. App. 4th at 75 (recognizing need for separate counsel for corporation where directors are accused of embezzling from the corporation); *Messing v. FDI, Inc.*, 439 F. Supp. 776, 782 (D.N.J. 1977) ("in this case, serious questions have been raised as to whether the corporation has *expended funds on behalf of the directors in violation of the law*") (emphasis added); *In re Oracle Securities Litigation*, 829 F. Supp. 1176, 1188 (N.D. Cal. 1993) (recognizing that corporate counsel cannot represent corporation in a *securities fraud* case "where counsel advocates a settlement highly favorable to the individual defendants who are his superiors") (emphasis added); *Cannon v. U.S. Acoustics Corporation*, 398 F. Supp. 209 (N.D. Ill. 1975) (recognizing that same counsel cannot represent corporation and select directors accused of misappropriation of corporate funds); *Lewis v. Shaffer Stores Co.*, 218 F. Supp. 238

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to Rule 1.13 of the American Bar Association's Annotated Model Rules of Professional Conduct (2d ed. 2000), which plaintiffs cite,[3] states: "Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit."

In *Bell Atlantic*, the court held that dual representation of a corporation and its directors in a shareholder derivative action was appropriate where the complaint alleged "only mismanagement, a breach of the fiduciary duty of *care*." *Id.* at 1316 (emphasis added). The *Bell Atlantic* court, noting that there were no allegations of fraud or self-dealing, stated that "we do not understand plaintiffs to have accused defendants of breaching their duty of ***loyalty*** which requires a director to act in good faith and in the honest belief that the action taken is in the corporation's best interests." *Id.* (emphasis added). In other words, where it is alleged that the directors have breached their duty of loyalty (and it is therefore possible that the directors will be liable to the corporation), dual representation may be inappropriate.[4] Where, as here, there are no such allegations, the directors will not

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(S.D.N.Y. 1963) (recognizing that interests of directors and corporation were adverse in an action against directors to recover short swing profits); *Murphy v. Washington American League Base Ball Club*, 324 F.2d 294 (D.C. Cir. 1963) (recognizing that interests of directors and corporation were adverse in a derivative suit challenging salary increases to members of the board); *Dukas v. Davis Aircraft Products Co.*, 494 N.Y.S.2d 632 (N.Y. Sup. 1985) (recognizing that interests of directors and corporation were adverse in a derivative action challenging the transfer of corporate property to another corporation owned and controlled by board members). The plaintiffs also cite *Essential Enterprises Corporation*, 182 A.2d 647 (Del. Ch. 1962). This case does not deal with disqualification of counsel, but rather with allocation of litigation expenses. In addition, the plaintiffs cite *Garlen v. Green Mansions, Inc.*, 9 A.D.2d 760, 193 N.Y.S.2d 116 (1959), a one paragraph opinion that does not reveal whether the directors were accused of a breach of their duty of loyalty.

[3] Plaintiffs' Memorandum of Points and Authorities in Support of their Motion to Disqualify Defendants' Counsel at 8, 11 and A-1.

[4] Only a handful of cases have held directors liable in the absence of a breach of the duty of loyalty. The best known of these cases is *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), in which the court imposed individual liability on the directors upon a showing of gross negligence. However, in that case, the directors completely failed to inform themselves of the relevant facts prior to approving a merger. Moreover, although the court did not explicitly rely on this fact, it found it noteworthy that the case involved an element of self-dealing in that one of the directors was approaching retirement age and thus stood to benefit personally from the transaction, which resulted in a significant short term increase in the value of his shares. *Id.* at 866. Moreover, in the present case, none of the plaintiffs' allegations would suffice to impose individual liability on the Directors even under the theory of gross negligence.

be liable to the corporation and dual representation is therefore appropriate.

2. Plaintiffs Have Not Alleged A Breach of the Duty of Loyalty.

In the present case, the plaintiffs have not alleged that the Foundation Directors have breached their duty of loyalty. The "business judgment rule," moreover, creates a presumption that a director has fulfilled his or her duties of care and loyalty; to overcome this presumption, a plaintiff must plead with particularity that a director breached one of these fiduciary duties. *See Aaron v. La Moderna*, 1997 WL 564064, 9 (N.D. Cal. 1997); *see also Aronson v. Lewis,* 473 A.2d 805, 814 (recognizing that the plaintiff must plead with particularity that the challenged transaction was not the product of a valid business judgment); *In re Silicon Graphics Inc. v. McCracken*, 183 F.3d 970, 990 (9th Cir. 1999) ("At the pleading stage, [Corporate] Board independence and compliance with the business judgment rule are presumed.").

None of the plaintiffs' allegations states a claim of fraud, bad faith or self-dealing (which would amount to a breach of the duty of loyalty). For instance, the plaintiffs allege that the Foundation changed its stations' programming format to encourage a "wider more affluent, more 'mainstream' listening audience." (Compl. ¶ 19). Although it may be argued in the abstract that the Directors should have decided otherwise, that allegation falls far short of a claim of a breach of the duty of loyalty.

Next, plaintiffs complain that the Foundation changed its bylaw provisions relating to the election of Directors to comply with the mandates of the Corporation for Public Broadcasting ("CPB"). (Compl. ¶ 24). That, of course, is not fraudulent conduct, self-dealing or bad faith. It is highly pertinent, moreover, that California Corporation Code Section 5232 specifically provides that "section 5231 [the business judgment rule statute] governs the duties of directors as to any acts or omissions in connection with the election, selection, or nomination of directors." Therefore, the decision to amend the Foundation's bylaws in order to avoid the "threat of immediate withholding [of] the second half of CPB funding," (Compl. ¶ 24) unambiguously is a decision covered by California's statutory

business judgment rule. The opinion of a group of individuals that the Foundation should have foregone CPB funding does not amount to an allegation of a breach of the duty of loyalty.

The plaintiffs further contend that the Foundation Defendant Directors improperly terminated station staff members when they concluded that these individuals had violated broadcast standards (Compl. ¶ 25, 29). They also complain that these defendants improperly hired a security service and a public relations firm to protect the Foundation's personnel, property, and reputation. (Compl. ¶ 29). Even if a plausible argument could be made that plaintiffs' point of view as to these actions were correct, these allegations do not amount to claims of fraud, bad faith or self-dealing. To the contrary, all they show is that the Directors made business decisions that the plaintiffs would not have made.

In short, the plaintiffs have failed to allege any conduct by any of the Directors that amounts to fraud, bad faith, or self-dealing. For this reason, they have failed to overcome the presumption, under the business judgment rule, that the Directors have fulfilled their duty of loyalty. Thus, as the Foundation's interests are aligned with the Directors' interests, the dual representation by EBG is appropriate.

3. Dual Representation is Appropriate When the Dispute Focuses on the Rights of Competing Factions to Select Directors.

The plaintiffs' claims relate primarily to who should be allowed the right to elect Directors to the Foundation Board. An analogous situation was addressed in *Schmidt v. Magnetic Head Corporation*, 97 A.D.2d 151, 162 (1983). There, the plaintiff shareholders alleged that they were entitled to designate a director to replace a prior designee who resigned. The same counsel represented the corporation and the individual defendants. The court in *Schmidt* held that representation of the corporation and its directors by the same law firm was appropriate because the action involved merely "the rights of competing stockholder factions to select a corporate director," and the corporation itself would not benefit or suffer from the outcome of the lawsuit. *Id.* The plaintiffs in the present case

principally argue that self-appointed listener-sponsors and members of the Local Advisory Boards have the right to appoint Directors to the Foundation Board.[5] (*See* Compl. at ¶¶ 21, 22, 24-25). Thus, as in *Schmidt*, it is entirely appropriate for EBG to represent both the Foundation and the majority of its Directors.

D. The Fact that Mr. Murdock is an Employee of EBG and Also a Director of The Foundation is Not a Basis for Disqualifying EBG in this Case.

California courts have consistently recognized that a lawyer may properly serve as counsel to a corporation even though he also is a director of that corporation. As one court has explained:

> [Lawyers often] serve as directors on boards of corporations for which they also work. . . . the practice is widespread and has its defenders, who point out that corporations should not be deprived of special skills such 'interested directors' can provide, and that the potential conflicts of interest can be avoided by full disclosure.

Tenzer v. Superscope, 39 Cal.3d 18, 32 (Cal. 1985).

Here, plaintiffs argue that because John Murdock is an attorney at EBG, a Director of the Foundation, and a defendant in this case, the Foundation's retention of EBG constituted an impermissible self-dealing transaction by an interested Director in violation of Cal. Corp. Code § 5233. California Corporation Code § 5233, however, is utterly silent with respect to disqualification of counsel issues. More importantly, as discussed below, the Foundation's retention of EBG fully complied the requirements of Section 5233 and the retention therefore does not constitute an impermissible self-dealing transaction by Mr. Murdock.

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[5] In addition, the plaintiffs request "judgment awarding damages according to proof in favor of Pacifica Foundation and against defendants Berry, Acosta, Farrell, Ford, Makela, Millspaugh, Palmer, [and] Chadwick . . . jointly and severally, for breach of charitable trust." Prayer For Relief at ¶ 17. The plaintiffs apparently base this request for relief on the Foundation Defendants' retention of security services to protect KPFA personnel and equipment from protestors. Complaint at ¶ 29. This allegation does not rise to the level of fraud or a violation of the duty of loyalty.

1. Because Mr. Murdock is Receiving No Compensation for EBG's Work for the Foundation, He is Not an Interested Director.

In *Katz v. Chevron Corporation*, 27 Cal. Rptr. 2d 681, 690 (Cal. App. 4th 1994), the court recognized that "[a] director's association with a company that does business with the corporation does not in and of itself establish a lack of independence." The *Katz* court noted that if a director's compensation is not tied to the work done for the corporation for which he is a director, then the mere fact that his company does work for the corporation does not make him an interested director. *Id.*

California Corporation Code Section 5233 provides that a director must have a "material interest" in the matter at issue in order to be characterized as an "interested director" within the meaning of the statute. John Murdock never has received, nor will he ever receive any compensation in any form because EBG represents the Foundation. (Declaration of Daly D.E. Temchine, Exhibit C, Affidavit of John M. Murdock, ¶¶ 3,4). Therefore, Mr. Murdock has no "material interest" in the arrangement, and he cannot be an interested Director.

2. Even If, Hypothetically, Mr. Murdock were an Interested Director, the Foundation's Retention of EBG Would Still be Proper Because it was Approved by a Majority of Non-Interested Directors.

California Corporation Code Section 5233(d) provides that a transaction is not an impermissible self-dealing arrangement where "[t]he corporation entered into the transaction for its own benefit . . . [t]he transaction was fair and reasonable as to the corporation at the time the corporation entered into the transaction . . .[a] person authorized by the board approved the transaction . . . [i]t was not reasonably practicable to obtain approval of the board prior to entering into the transaction [and] . . . [t]he board, after determining in good faith that the conditions [above] were satisfied, ratified the transaction at its next meeting by a vote of the majority of directors then in office without counting the vote of the interested director."

The retention of EBG satisfies all of these criteria. The Foundation entered into the

transaction for its own benefit. The transaction was, and remains, fair and reasonable to the Foundation (EBG is charging the Foundation below market rates, and the Foundation is benefiting from the efficiency of having the same firms represent both the Foundation and certain of its Directors). The decision to retain EBG was appropriately made by the Foundation's Executive Director Bessie Wash, who is authorized to retain counsel on behalf of the Foundation. While it was not reasonably practicable for Ms. Wash to obtain approval of the Foundation Board prior to retaining EBG, a majority of the disinterested Directors on the Board approved the transaction at its next meeting, when — after discussing the fact that EBG would be representing both the Foundation and certain of its Directors and the fact that that Mr. Murdock was a Director, an attorney at EBG, and a defendant in the litigation — they voted not to direct the executive director to discharge EBG. (*See* Declaration of Daly D.E. Temchine, Exhibit D, Transcript of Foundation Board Meeting of September 17, 2000, at page 55, line 7 through page 56, line 8);[6] (Declaration of Daly D.E. Temchine, Exhibit C, Affidavit of John M. Murdock, ¶ 6). Additionally, Executive Director Bessie Wash obtained an opinion letter from an independent attorney, John Crigler, determining that the Board of Directors could properly retain EBG. (Declaration of Daly D.E. Temchine, Exhibit E, Letter from John Crigler dated September 13, 2000).

E. Where Only Speculative or Minimal Benefit Would be Obtained Through Disqualification, the Increased Expense to the Defendants is Not Justified and the Motion for Disqualification Must be Denied.

In the present case, no conflict of interest has been demonstrated. However, even where such a conflict exists, disqualification is not automatic. Rather, California's courts have adopted a balancing test for the disqualification of attorneys subject to such a conflict:

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[6] The plaintiffs in this case attached an incomplete and, in some respects, inaccurate transcript of the September 17, 2000 board meeting. The official version of the transcript, which is attached, clearly shows that the hiring of EBG was approved by a majority of non-interested Directors. *Compare* (Declaration of Daly D.E. Temchine, Exhibit D, Transcript of Foundation Board Meeting of September 17, 2000, at page 55, line 7 through page 56, line 8) with (Declaration of Gary D. Evans, Exhibit A, unofficial transcript, at page 16, line 20 through page 17).

> The court must weigh the combined effect of a party's right to counsel of choice, an attorney's interest in representing a client, the financial burden on a client of replacing disqualified counsel and any tactical abuse underlying a disqualification proceeding against the fundamental principle that the fair resolution of disputes within our adversary system requires vigorous representation of parties by independent counsel unencumbered by conflicts of interest.

Allen v. Academic Games Leagues of America, Inc., 831 F. Supp. 785, 789 (C.D.C.A. 1993).

Here, plaintiffs have completely failed to demonstrate how EBG's representation of the Foundation and certain of its Directors wrongfully disadvantages them. Likewise, there is no allegation or demonstration that this joint representation provides the defendants with any inappropriate tactical advantage to the material detriment of plaintiffs. In sum, plaintiffs' motion for disqualification is a tactical ploy to deprive the Foundation Defendants of their chosen counsel.

In the present case, because EBG is providing services to the Foundation at a significantly discounted rate, and because of the obvious efficiencies that result from having the same firms represent both the Foundation and the Directors who support the Foundation's positions in this litigation, it would impose a significant financial burden on the defendants if EBG were disqualified. In short, the motion must be denied because there is no conflict of interest, because the equities weigh in favor of permitting the Foundation and its Directors to maintain their cost effective relationship with their current counsel, and because the plaintiffs' motion amounts to a bad faith litigation tactic.

III. CONCLUSION

EBG's representation of both the Foundation and certain of its Directors in this case is proper. Because they have failed to allege a breach of the duty of loyalty, the plaintiffs have stated no claim that could plausibly be expected to put the Foundation and the Directors represented by EBG in positions adverse to one another. This case is not remotely analogous to those cases cited by the plaintiffs in which, for instance, a director has embezzled money from a corporation and the suit seeks to recover those funds. Moreover, the dual representations, and the role of Mr. Murdock as a defendant, a Director, and an

attorney at EBG were fully disclosed and approved by a majority of the disinterested Directors on the Foundation's Board when they ratified the retention of EBG. Therefore, the Foundation Defendants respectfully request that this Court deny the plaintiffs' Motion to Disqualify Defendants' Counsel, and to provide the Foundation Defendants with such other relief as the Court deems proper under the circumstances.

Dated: November 20, 2000

Respectfully submitted,
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