

In-House Ethics Consultations and the Attorney-Client Privilege: Case Law

BY ROY SIMON

Virtually every large law firm has an in-house ethics advisor or General Counsel, a lawyer in the firm who is well versed in the rules of ethics as well as the various state and federal statutes and court rules that regulate lawyers. The proliferation of in-house ethics advisors, which began in earnest only in the 1990s, is a positive development. But a law firm's consultation with an in-house ethics advisor may or may not be protected by the attorney-client privilege, especially when the firm asserts the privilege against a current or former client.

This article reviews the seven cases (six federal, one state) that have addressed the relationship between in-house ethics consultations and the attorney-client privilege when a current or former client seeks the communications generated in the in-house consultation. In a future article, I will discuss the ethics opinions that have dealt with related issues.

The Granddaddy Case: *In re Sunrise Securities Litigation*

All of the ethics opinions and cases regarding an attorney client privilege for consultations with in-house counsel cite the seminal case of *In re Sunrise Securities Litigation*, 130 F.R.D. 560 (E.D. Pa. 1989) (Thomas O'Neill, J.), which arose in the wake of the 1980s savings and loan crisis. When Sunrise Savings and Loan Association ("Sunrise") went bankrupt, Sunrise shareholders and depositors sued (among others) the firm of Blank Rome, which had served as general counsel for Sunrise. During discovery, Blank Rome withheld a number of its documents containing communications between Blank Rome lawyers and other Blank Rome lawyers, and argued that all communications between lawyers within the firm were protected by the attorney-client privilege. Plaintiffs moved to compel.

Blank Rome cites no authority for its novel assertion that a law firm may consult its own attorneys as house counsel to secure legal advice in connection with or related to the firm's representation of a client, and as a result obtain the protection of the attorney-client privilege on the basis that it is its own client.... Blank Rome presents no facts to support treating the communications in question as between attorney and client, rather than as between members of one and the same entity.... I will not extend the attorney-client privilege to protect communications between members of a law firm....

In re Sunrise Securities Litigation, *supra*, 130 F.R.D. at 572. Blank Rome moved for reconsideration of this simplistic ruling. On reconsideration, Blank Rome argued that the attorney-client relationship between Blank Rome's lawyers and Blank Rome's in-house ethics counsel was "analogous to that between a corporation and its in-house corporate counsel." This argument persuaded the court that "it is possible in some instances for a law firm, like other business or professional associations, to receive the benefit of the

attorney-client privilege when seeking legal advice from in-house counsel. ... [O]n reflection, I am not willing to hold that a law firm may never make privileged communications with in-house counsel."

However, a law firm's consultation with its in-house counsel "may cause special problems which seldom arise when other businesses or professional organizations consult their in-house counsel." In particular, the law firm's representation of itself might create a prohibited conflict of interest with the firm's client. "The question, then," the court said, "is whether the interest in protecting clients who may be harmed by such a conflict affects the applicability of the attorney-client privilege to a law firm's communications with in-house counsel seeking legal advice for the firm."

Since no opinion had directly addressed the attorney-client privilege for communications with a law firm's in-house ethics counsel, the court analyzed the situation by analogy to *Valente v. PepsiCo*, 68 F.R.D. 361 (D. Del. 1975), a case addressing the effect of conflicting fiduciary duties on the attorney-client privilege. After Wilson Sporting Goods Co. merged into PepsiCo, minority shareholders of Wilson sued PepsiCo. Both PepsiCo's in-house counsel and a partner in PepsiCo's outside law firm sat on the Wilson board of directors, and therefore had fiduciary duties both to Wilson's shareholders and to PepsiCo. PepsiCo claimed the attorney-client privilege regarding a memorandum from inside counsel to PepsiCo concerning the interests of Wilson's shareholders and regarding a memorandum from outside counsel to PepsiCo concerning the merger. The Valente court ordered PepsiCo to turn over both documents, holding that a lawyer who owes fiduciary duties to two entities cannot "subordinate" the fiduciary obligation of one to the fiduciary obligation of the other.

Applying Valente to Blank Rome's situation, the Sunrise court held that "a law firm's communication with in-house counsel is not protected by the attorney-client privilege if the communication implicates or creates a conflict between the law firm's fiduciary duties to itself and its duties to the client seeking to discover the communication." The attorney-client privilege therefore did not protect documents containing communications or legal advice in which Blank Rome's representation of itself created an impermissible conflict of interest with the Blank Rome client seeking the document.

Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A.

After Sunrise, several cases (including two cases from the Southern District of New York) held that the attorney-client privilege applies to a law firm's consultations with its in-house ethics counsel – but in those cases, the law firm was not asserting the privilege against its own current client. See *United States v. Rowe*, 96 F.3d 1294 (9th Cir.1996) (privilege successfully asserted against government in response to subpoena in criminal investigation); *Hertzog, Calamari & Gleason v. Prudential Insurance Company of America*, 850 F.Supp. 255 (S.D.N.Y.1994) (privilege successfully asserted against opposing party in litigation when in-house counsel represented the firm in the litigation); *Lama Holding Co. v. Shearman & Sterling*, 1991 WL 115052 (S.D.N.Y.1991 (privilege successfully asserted against former client where in house communications took place after the representation ended).

In *Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A.*, 220 F. Supp. 2d 283, 286-88 (S.D.N.Y. 2002) (Ellis, M.J.), however, the court squarely rejected a law firm's assertion of privilege against a former client where the communications with the firm's in-house counsel had taken place during the representation.

Credit Lyonnais Suisse (“CLS”) retained the law firm of Rogers & Wells (“R & W”) to advise it regarding a loan to a company called International Ltd. Eventually, other banks sued Credit Lyonnais in connection with the AroChem loan, and Credit Lyonnais hired Rogers & Wells to defend it. Apparently something went wrong during the litigation, because two Rogers & Wells partners advised a Credit Lyonnais executive that the firm had committed legal malpractice. Credit Lyonnais continued to employ Rogers & Wells to defend it, but the admission about malpractice triggered an internal ethics review at Rogers & Wells regarding both the possible malpractice and possible conflicts of interest. Later, Credit Lyonnais fired Rogers & Wells and sought discovery of the documents generated by the internal ethics review. Rogers & Wells resisted discovery, claiming attorney-client privilege.

The court rejected the privilege claim. “R & W assumes that the privilege will automatically apply to in-house legal consultation,” the court said. “However, this assumption glosses over the general reluctance and narrow, grudging application of the privilege in these cases.” The court then reviewed the Sunrise case and its holding that a law firm’s communications with in-house counsel are not protected by the attorney-client privilege if the communication creates a conflict between the law firm’s fiduciary duties to itself and its duties to the client seeking to discover the communication.

The Bank Brussels court then said:

Asserting the privilege against a current client seems to create an inherent conflict against that client.

... When R & W performed the conflict check, CLS was still its client. Therefore, R & W was under an ethical duty to disclose to CLS the results of its internal conflict check, and in no position to claim a privilege against the client. While the privilege will be applicable as against all the world, it cannot be maintained against CLS.

Rogers & Wells argued that the advice sought by the law firm in performing its internal review “was not sought for the benefit of CLS,” but the court called this position “untenable” because the purpose of the conflict review was “to maintain the fiduciary duties of loyalty and confidentiality owed to the client.” Furthermore, as a policy matter, “permitting lawyers to rely on [attorney-client] privileges although they know or ought to know that they are in a perilous ethical position and in need of truly independent advice discourages them from seeking that advice.” Accordingly, the court held that “a law firm cannot invoke the attorney-client privilege against a current client when performing a conflict check in furtherance of representing that client.”

Koen Book Distributors. v. Powell, Trachtman

Less than three months after Bank Brussels was decided, the Eastern District of Pennsylvania handed down *Koen Book Distrib. v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo*, 212 F.R.D. 283 (E.D. Pa. 2002) (Bartle, J.). Koen, a book wholesaler and distributor, had retained the defendant law firm for advice concerning a security interest from one of its customers, Crown Books Corporation (“Crown”). After Crown filed for bankruptcy, the law firm continued to represent Koen as a creditor in the bankruptcy proceeding.

On July 9, 2001, Koen informed Powell Trachtman that it might sue the firm for legal malpractice, but Koen did not terminate Powell Trachtman's services until August 13, 2001. During that five week period, from July 9th until August 13th, Koen was consulting with other counsel concerning the quality of the defendants' representation. During the same period, several lawyers at Powell Trachtman who were working on the Koen matter consulted with another lawyer at Powell Trachtman about the ethical and legal issues that had arisen because of Koen's malpractice threat. When Koen later terminated Powell Trachtman and sued it for malpractice, Koen sought discovery of the internal documents generated during Powell Trachtman's internal ethics consultation.

After reviewing the Sunrise case, the Koen court said that its key task was to determine "whether the defendant law firm engaged in a conflict of interest, that is, representation adversely implicating or affecting the interests of the plaintiffs, when it was receiving information from and/or providing legal advice to several of its lawyers while at the same time continuing to represent those plaintiffs." The court could not simply transplant the holding in Sunrise because, as Sunrise itself made clear, the decision regarding privilege for in-house ethics consultations "must be made on a case-by-case basis." (Powell Trachtman also claimed work-product protection, but the court noted that work-product doctrine "cannot shield a lawyer's papers from discovery in a conflict of interest context anymore than can the attorney-client privilege.")

To avoid discovery, Powell Trachtman relied heavily on the fact that from July 9th to August 13th (the period between the malpractice threat and the firm's termination by Koen) Koen had consulted with and engaged other outside counsel to represent it. The court said this made no difference. "Simply because plaintiffs may have retained other counsel does not remove the conflict so long as defendants also continued to represent them," the court said. "It is the relationship between the clients and the law firm from which discovery is sought that is central to the analysis."

The firm sought the court's sympathy by arguing that it had been in an "impossible position" between July 9th and August 13th and should not have to forego the benefit of the attorney client privilege (or the work-product doctrine) during this period. The court recognized that the firm was "enmeshed in an unenviable situation" when its client threatened a malpractice suit only two weeks before an important bankruptcy court hearing, but "the firm still owed a fiduciary duty to plaintiffs while they remained clients. This duty is paramount to its own interests." To avoid the predicament in which it found itself, the firm could either have promptly moved to withdraw or (if it reasonably believed that representation of the clients would not be adversely affected by also representing itself) could have promptly solicited the client's consent to continue the representation despite the potential for conflict. The firm did neither.

The court then turned to the documents at issue, almost all of which were e-mails from one lawyer to another in the firm concerning if and (a) how to continue to represent the clients and (b) how to respond to the clients' communications. "Permeating" the documents was "consideration of how best to position the firm in light of a possible malpractice action." Thus, the documents "clearly establish[ed]" that the law firm was "in a conflict of interest relationship" with its clients. Accordingly, the law firm had not met its burden of proof on the issues of the attorney client privilege or attorney work-product doctrine, and the court ordered it to produce all of the documents sought by Koen.

VersusLaw, Inc. v. Stoel Rives, LLP

The next decision to consider the issue was a state court case, *VersusLaw, Inc. v. Stoel Rives, LLP*, 111 P.3d 866, 878, 127 Wash. App. 309, 332 (2005) (Schindler, J.). VersusLaw hired Stoel Rives to negotiate with Matthew Bender regarding a license and royalty agreement for VersusLaw's case law database. When Matthew Bender did not pay the agreed royalties, Stoel Rives filed a claim on behalf of VersusLaw for unpaid royalties, but in late 2000, Stoel Rives attorney Deborah Elvins (who was handling the resulting arbitration) told the President of VersusLaw that Stoel Rives may have committed malpractice by missing the deadline for claiming unpaid royalties.

A few weeks later, VersusLaw retained new counsel, and eventually it sued Stoel Rives for malpractice. In the malpractice litigation, VersusLaw sought certain documents reflecting internal ethics consultations at Stoel Rives between Elvins and Joseph Dean, who served as Stoel Rives' in-house "loss prevention attorney." In that capacity, while Stoel Rives was still representing VersusLaw, Dean had advised Ms. Elvins regarding the possible malpractice claim. Stoel Rives claimed privilege and VersusLaw moved to compel. However, the trial court granted summary judgment in favor of Stoel Rives on the malpractice claim without deciding the motion to compel.

The Court of Appeals (an intermediate appellate court) found issues of material fact and reversed the grant of summary judgment. As a consequence, the trial court would now have to conduct an in camera review to decide whether the documents reflecting the internal ethics consultation at Stoel Rives were privileged. To provide guidance to the lower court, the Court of Appeals examined Sunrise and its progeny, concluding with the following instruction: "If the privilege applies, then the trial court will need to carefully examine the documents to determine whether the communications between Elvins and Dean create a conflict between the law firm's own interests and its fiduciary duty to its client, VersusLaw." If so, the documents would have to be produced.

Thelen Reid & Priest LLP v. Marland

Two years later, a California federal court decided *Thelen Reid & Priest LLP v. Marland*, 2007 WL 578989 (N.D. Cal. 2007) (Vaughan R. Walker, C.J.). In 1997, Francois Marland had approached Reid & Priest, claiming that he had in his possession an undisclosed "fronting agreement" through which the French bank Crédit Lyonnais had illegally bid at auction on the insurance assets of Executive Life Insurance Company ("ELIC") after ELIC became insolvent. Marland wanted to know whether he could obtain a financial benefit by divulging this information to parties in the United States. (Reid & Priest merged with Thelen, Marrin, Johnson & Bridges in 1998.) Eventually, Thelen filed a qui tam suit for Marland's benefit.

In 2002, Thelen asked Marland to produce the fronting agreement. Marland refused to produce the document and said for the first time that he had destroyed it. Thelen consulted with its in-house ethics counsel concerning the implications of this blockbuster revelation, then gave Marland 30 days' written notice of its decision to withdraw from representing him (later extending the notice period by another 30 days). Thelen claims that its attorney-client relationship with Marland then ended.

Not long afterwards, Thelen sued Marland for breach of a complex fee-sharing agreement. During discovery, Marland asked for the documents reflecting Thelen's internal ethics consultations, and Thelen claimed privilege. After analyzing Sunrise and VersusLaw, the court concluded that all of the documents

listed on Thelen's privilege log "implicate or affect Marland's interests, and Thelen's fiduciary relationship with Marland as a client lifts the lid on these communications." Accordingly, the court ordered Thelen to produce most of the logged documents.

However, taking a more nuanced approach than *Sunrise* and *VersusLaw*, the Thelen court carved out a "narrow exception" that reflected the competing policy considerations. The court recognized that law firms "should and do seek advice about their legal and ethical obligations in connection with representing a client" and that firms "normally seek this advice from their own lawyers." Therefore, the court said:

... A rule requiring disclosure of all communications relating to a client would dissuade attorneys from referring ethical problems to other lawyers, thereby undermining conformity with ethical obligations. Such a rule would also make conformity costly by forcing the firm either to retain outside counsel or terminate an existing attorney-client relationship to ensure confidentiality of all communications relating to that client. This court declines to follow such a strict rule, preferring one that is consistent with a law firm in-house ethical infrastructure. Accordingly, Thelen is to produce some but not all communications in which a Thelen lawyer seeks or gives advice on the firm's ethical obligations to Marland.

Specifically, while consultation with an in-house ethics adviser is confidential, once the law firm learns that a client may have a claim against the firm or that the firm needs client consent in order to commence or continue another client representation, then the firm should disclose to the client the firm's conclusions with respect to those ethical issues.
[Emphasis added; citations omitted.]

Applying this narrow exception, the court ordered Thelen to produce certain "conclusions" of its confidential in-house ethics consultations, meaning any communications discussing (a) "claims that Marland might have against the firm," or (b) "known errors in its representation of Marland," or (c) "known conflicts in its representation of Marland or other circumstances that triggered Thelen's duty to advise Marland and obtain Marland's consent." (Conflicts, the court said, included "any representation – whether of Thelen itself ... or another – adversely implicating or affecting the interests of Marland, when Thelen was receiving information from and/or providing legal advice to its own lawyers while at the same time continuing to represent Marland." The court referred the dispute to a United States Magistrate Judge to review in camera all of Thelen's logged documents and determine which ones should be produced to Marland, based on the court's directive.

In re SONICblue Inc.

The in-house privilege issue arose in the bankruptcy context in *In re SONICblue Inc.*, 2008 WL 170562 (Bkrtcy. N.D. Cal., Jan. 18, 2008) (Marilyn Morgan, J.). When Pillsbury Winthrop Shaw Pittman, LLP ("PWSP") claimed the attorney-client privilege regarding hundreds of documents reflecting the firm's ethics consultations with its in-house ethics counsel, the bankruptcy court noted that courts "generally have followed a restrictive approach in granting the protection of attorney-client privilege to confidential communications with in-house legal counsel." Moreover, the court said, a law firm's consultation with

in-house counsel raises “an additional layer of concern that is unique to the legal profession.”
Elaborating, the court said:

[W]hen a law firm chooses to represent itself, it runs the risk that the representation may create an impermissible conflict of interest with one or more of its current clients. In light of these ethical concerns, the courts that have considered the issue have resoundingly found that, where conflicting duties exist, the law firm’s right to claim privilege must give way to the interest in protecting current clients who may be harmed by the conflict. As a result, a law firm cannot assert the attorney-client privilege against a current outside client when the communications that it seeks to protect arise out of self-representation that creates an impermissible conflicting relationship with that outside client. [Citations omitted.]

At the same time, the court acknowledged, “public policy encourages lawyers to consult with in-house counsel to understand and comply with their professional responsibilities and ethical restraints.” Citing Thelen, the court said that this policy favors allowing a law firm to assert the privilege “until such time as the firm has, or should have, determined that dual representation of itself and an outside client should not continue without the informed consent of the outside client.”

PWSP sought to escape from the holdings of *Sunrise* and later cases by making a new argument. PWSP cited *United States v. Mett*, 178 F.3d 1058 (9th Cir.1999), which held that an ERISA plan administrator, as a fiduciary, could not assert the attorney-client privilege against the plan beneficiaries for any legal advice it received regarding administration of the ERISA trust. This is known as the “fiduciary exception” to the attorney-client privilege. But *Mett* also found an exception to that exception: “Where a fiduciary seeks legal advice, on its own behalf, not that of the trust, in an effort to defend against beneficiaries’ claims of improper trust administration, the attorney-client privilege could be asserted.” The court dubbed this the “personal liability exception” to the fiduciary exception. Because all the communications for which it claimed privilege were part of legal advice that PWSP sought on its own behalf in its effort to defend against the several claims that had been lodged against it, PWSP urged that PWSP’s right to invoke the attorney-client privilege remained intact.

The *SONICblue* court rejected PWSP’s argument for several reasons. First, it failed to account for “the unique attributes of the fiduciary relationship between the firm as the attorney and its client, *SONICblue*.” The very nature of the attorney-client relationship, the court said, “exceeds other fiduciary relationships where the fiduciary must execute its duties faithfully on behalf of its beneficiaries.” This is so because attorneys “are governed by an ethical code that requires the utmost loyalty on the part of the attorney, including the duty not to represent another client if it would create a conflict of interest with the first client.” Second, the scope of PWSP’s fiduciary relationship with *SONICblue* included much more than simply administering an ERISA plan, as in *Mett*. In *Mett*, the Ninth Circuit recognized that the fiduciary could not assert the attorney-client privilege against its beneficiaries for any matters within the scope of its fiduciary duties. Here, the scope of PWSP’s fiduciary duties was broad-ranging and “prohibited PWSP from engaging in any activity that was adverse to *SONICblue*’s interests.” PWSP could not invoke the privilege as to any matter within that broad scope of fiduciary activities, including “its failure to comply with its duty of loyalty by entering into a second representation that created a conflict with its representation of *SONICblue*.”

Finally, in the bankruptcy setting there was “an additional overlay of fiduciary duties.” Under the Bankruptcy Code, PWSP, as debtor’s counsel, had a duty to remain disinterested and not to represent any adverse interests. This duty was owed not just to SONICblue but also to the creditors on whose behalf it was administering the estate and to the court. The ethical lapses alleged against PWSP clearly fell within the scope of the broad fiduciary duty that it owed to all of these parties. As a result, PWSP’s “personal defense theory” could not excuse production in the conflict of interest context.

Asset Funding Group, LLC v. Adams & Reese, LLP

The most recent case in the in-house ethics consultation line is *Asset Funding Group, LLC v. Adams & Reese, LLP*, 2008 WL 4948835 (E.D. La., Nov. 17, 2008) (Ivan L.R. Lemelle, J.). The opinion provides no factual background about the underlying dispute, but during discovery Asset Funding Group, a former client of Adams & Reese, sought documents reflecting internal ethics consultations at Adams & Reese while the firm was still representing Asset Funding Group.

Following *Sunrise*, the court held that a law firm’s communication with in-house counsel is not protected by the attorney client privilege if the communication “implicates or creates a conflict between the law firm’s fiduciary duties to itself and its duties to the client seeking to discover the communications.” Under this standard, the court said, Adams & Reese’s communication with in-house counsel was not privileged relationship because it created a conflict between the law firm’s fiduciary duties to itself and its duties to Asset.

Conclusion: Is There a Conflict?

The cases are unanimous that the attorney-client privilege does not protect documents or other communications reflecting a law firm’s consultations with its in-house counsel if the consultations create a conflict between the law firm’s fiduciary duties to itself and its fiduciary duties to a client or former client seeking to discover the communications. A key question, therefore, is whether the consultations create a conflict. The cases reviewed in this column did not always analyze that issue adequately. Ethics opinions from New York and the ABA, however, have explored the conflict implications of in-house ethics consultations in depth. In a future column, I will examine those opinions.

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