Professional Responsibility & Legal Education

Does the Attorney-Client Privilege Cover a Law Firm's Consultation with In-House Counsel About Issues Involving Current Clients?

*By Francis J. Menton, Jr.**

These last two decades have seen the dramatic rise of in-house counsel at large law firms. In 2002, Elizabeth Chambliss and David Wilkins reported that, by the late 1990s, every one of a sample of 32 large law firms had established at least a position of ethics or risk management specialist filled by an in-house lawyer, many having created that position recently.[1] A 2008 survey of the AmLaw 200 firms by the Altman Weil consulting firm found that, by 2004, 63% of them had a designated in-house general counsel; by 2008, that figure had increased to 85%.[2] A key function of such in-house counsel is to consult on conflicts and other ethical issues, many of which involve the firm's current clientele.

Yet, even as law firms rely increasingly on such in-house counsel, a spate of recent court decisions calls into question whether the attorney client privilege can be invoked to protect communications between firm lawyers and in-house counsel, as to matters involving current clients of the firm. To the surprise of many practitioners in the field, the result of each succeeding court decision has been yet another blow to the idea that attorneys at a law firm can consult an in-firm general counsel or ethics specialist regarding a current client with any degree of comfort that the attorney-client privilege will apply.[3]

Although several commentators have been critical of this judicial trend,[4] the very unanimity of the reported decisions suggests that it is not likely that the law on this subject will reverse itself any time soon. Therefore, it is important to analyze the reasoning of the decisions, and from there to assess how far the rule is likely to carry, and how, if at all, a law firm can obtain privileged advice in many sensitive situations that may involve a current client.

The conclusion reached here is that, at least from the time the firm becomes aware of a conflict between its own interest and that of a client, it is probable that the attorney-client privilege will not protect any consultation within the firm as to such a client. Therefore firms in these situations will be well advised to minimize admissions in potentially discoverable writings and, when preservation of the privilege is critical, to consider early retention of outside counsel.

With regard to an appropriate legal framework, this article urges courts to recognize the practical realities of firms attempting to identify and react appropriately to developing conflicts in ongoing situations. Such recognition could take the form of honoring the attorney-client privilege as to in-firm consultation at least for the conflict assessment process and for some reasonable time thereafter while the firm determines how to respond.

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Arguments For and Against an Intra-Firm Privilege in Matters Involving a Current Client

The attorney-client privilege is so entrenched and so widely accepted in our legal system that many practitioners find it quite counterintuitive that there could be a significant arena where a client consults with a lawyer seeking legal advice and the privilege simply does not apply. This is particularly so because the considerations that led to the existence of the attorney-client privilege in the first place—the need for expert legal advice in order to obtain maximum compliance with legal duties, and the need for complete candor in disclosing the facts in order to get the best legal advice possible—apply with the seemingly equal force in the context at issue here.

Nevertheless, the cases discussed below find that, when the consultation is between a firm lawyer and the firm's in-house counsel, and the consultation involves a current client, the usual considerations are trumped by another consideration—namely, the conflict of interest that arises when the firm simultaneously represents its client and itself. The cases find that the in-house lawyer advising the firm is, by imputation, also a lawyer for the outside client; that advising the firm where its interest is adverse to the client is a violation of the rules of ethics, particularly Rule 1.7 of the Model Rules of Professional Responsibility (and its various state counterparts); that the client is therefore within the zone of any otherwise confidential communications among firm lawyers relating to the client; and thus, that neither the in-house counsel nor the remainder of the firm can claim the privilege as against that client.

While that is one possible chain of logic, starting from first principles it is not obvious that a firm's advising itself with respect to a current client situation would or should entail vitiation of all attorney-client privilege due to the inherent conflict of interest. In 2005, the New York State Bar Association Committee on Professional Ethics explicitly stated that such a situation does not necessarily create a conflict of interest at all,[5] adding that a "law firm is not only entitled, but required, to consider the ethical implications of what it does on a daily basis"[6] and that expecting a firm to always seek outside counsel when potential conflict situations arise is "simply impractical."[7]

It is further not obvious, even assuming a conflict exists, that the attorney-client privilege would or should be destroyed by it. Indeed it could well be that a general rule providing for no attorney client privilege for the firm in such a situation is not in the overall best interest of the clients.[8] Denying attorney-client privilege to firms for in-house consultation as to any current client situation could likely lead to one or all of three results: (1) firms minimizing communications, and particularly writings, in the process of conflict assessment and response, (2) early retention of outside counsel, and/or (3) encouraging firms more frequently to seek to withdraw from

the client relationship in ambiguous situations. As to the first result, a less robust communication process could well lead to less robust and accurate assessment of conflicts and compliance with responsibilities. That is exactly the reasoning that supports the existence of an attorney-client privilege in the first place. Since clients have a real interest in accurate compliance with ethics principles, suppressing communication on this subject is potentially as harmful to clients' interests as to firms.' With regard to early retention of outside counsel, clients would likely be generally indifferent, but that still means that significant costs may be imposed on the firm for no identifiable benefit to the client—and the costs may ultimately be passed on to the client. Finally the third potential result, encouraging withdrawal in possibly ambiguous situations, could well cause net harm to clients' interests.

Nevertheless, the cases decided so far appear to turn less on broad consequences of the stated rule of law and more on the unsavory appearance of law firms seeking to position themselves in anticipation of malpractice claims.[9] Since the reported decisions tend to arise out of situations in which the conflict of interest was fairly stark, there is good reason to think that the trend in the case law will continue.

Court Decisions Regarding Intra-Firm Privilege in Matters Involving a Current Client

With four new decisions on the subject in 2007 and 2008, there are now at least eight decisions that consider whether attorney-client privilege can be asserted as to an intra-firm consultation in a matter involving a current client.[10] While most of them recognize that there could be at least some circumstances where a law firm can have privilege on in-house consultation as to a current client, all eight decisions ultimately order, on the facts before them, that discovery must be made over the assertion of the privilege.

The progenitor of this line of cases is *In re Sunrise Securities Litigation*,[11] a 1989 case from the Eastern District of Pennsylvania. Like several later cases, *Sunrise* conceded the possibility that there may be situations in which privilege would be preserved in this context,[12] and even stated that the analysis of privilege must be made on a case-by-case basis.[13] But *Sunrise* ordered documents to be produced at least going forward from the date when an identifiable conflict with the client arose; and all the subsequent decisions have followed it on this point. None of the cases considers the issue of whether identifying the moment when such a conflict has arisen may be difficult in the onrush of real world events.

Sunrise involved consolidated claims of the SEC, Federal Savings and Loan Insurance Corporation, and depositors of a failed savings and loan association (Sunrise) against several defendants, including former officers and directors of Sunrise and the law firm Blank Rome, which had been counsel to Sunrise. Although a lengthy decision covering many issues, the *Sunrise* court's discussion of the question at issue here is short. Director defendants sought document discovery from Blank Rome, including documents relating to legal advice to the firm from in house counsel at the firm. Blank Rome resisted discovery of this category on the ground of privilege. Searching for precedent, the court found none that specifically addressed the situation of a law firm giving itself legal advice about a current client, and therefore relied principally on a case involving a corporate director with conflicting duties, *Valente v. PepsiCo*.[14]

In *Valente*, a 1975 case from the District of Delaware, the court found that a corporate director's conflicting fiduciary duties—on the one hand to the corporation's shareholders as a whole, on the other to the majority shareholder who had named him to the board—vitiated his attorney-client privilege with the majority shareholder.[15] Following *Valente*, the court in *Sunrise* ruled:

> Applied to the situation presented here, the reasoning of *Valente* would dictate 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 will protect only those otherwise privileged documents withheld by Blank Rome which do not contain communications or legal advice in which Blank Rome's representation of itself violated Rule 1.7 with respect to a Blank Rome client seeking the document.[16]

Beyond that, however, the court gave no further guidance, and referred the individual documents to a special master for rulings.

Thirteen years later a similar case arose in the same federal district, the Eastern District of Pennsylvania, *Koen Book Distributors v. Powell, Trachtman, Logan, Carde, Bowman & Lombardo, P.C.*[17] In *Koen Book*, the plaintiffs, clients of the defendant law firm, informed the firm in July 2001 that they were considering bringing a malpractice claim against it, but the firm continued to represent the client into August, about a month later. During that month, the firm consulted in-house counsel as to how to proceed, generating in the process some twenty-nine documents that "would clearly have been protected from discovery by the attorney-client privilege… if a third party… sought access to them," but as to the current client were "[p]ermeat[ed]… [with] consideration of how best to position the firm in light of a possible malpractice action."[18]

The *Koen Book* court stated: "My colleague, Judge Thomas O'Neill, faced a like issue a number of years ago in *[Sunrise]*." It then proceeded explicitly to follow the *Sunrise* decision, including the reliance on *Valente*,[19] quoting the following articulation of the common interest exception as the core holding of *Valente*:

> It is a common, universally recognized exception to the attorney-client privilege, that where an attorney serves two clients having common interest and each party communicates to the attorney, the communications are not privileged in a subsequent controversy between the two.... The fiduciary obligations of an attorney are not served by his later selection of the interests of one client over another.[20]

In 2002, in *Bank Brussels Lambert v. Credit Lyonnais Suisse,*[21] the Southern District of New York held that a firm's conflict of interest is always imputed to all lawyers in the firm (including its in-house counsel),[22] and, relying on *Sunrise*, found that a firm has an ethical duty to disclose the results of its internal conflicts checks to a current client.[23] In 2005, in *VersusLaw Inc.*

v. Stoel Rives LLP,[24] the Washington Court of Appeals, again citing to *Sunrise,* acknowledged that "privilege can apply to intra-firm communications," but then held that the existence of a conflict can destroy the privilege as to communications that arise after the conflict; because the record before it was unclear regarding issues of timing, it remanded to allow the trial court to determine more precisely when the conflict between the firm and its current client arose.[25] In 2007, in *Thelen Reid & Priest LLP v. Marland*,[26] the court stated that *Sunrise* was instructive and, after discussing its holding, stated that a law firm's communications with its general counsel regarding a dispute with a current client were not privileged because the firm's fiduciary duty to its client "lifts the lid" on such conflicted communications.[27] The court went on to state:

> 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.[28]

Also in 2007, in *Burns v. Hale and Dorr LLP*,[29] the District of Massachusetts, discussing *Bank Brussels* and *Koen Book*[30] (both of which relied on *Sunrise*), found that a firm cannot invoke attorney client privilege on behalf of itself as a "client" against one of its current clients, as the conflict between its own interests and the fiduciary duty that it owes its current client vitiates the privilege.[31] In 2008, in *In re SonicBLUE Inc.*,[32] quoting *Sunrise*, the bankruptcy court for the Northern District of California stated that "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."[33]

Finally, in 2008, in *Asset Funding Group v. Adams & Reese*,[34] the Eastern District of Louisiana, citing to *Upjohn Co. v. United States*[35] and *Valente*, and relying explicitly on *Sunrise*,[36] held that "[a]sserting the privilege against a current client seems to create an inherent conflict against that client."[37] This most recent formulation of the rule would seem to reverse the causal relationship between conflict and privilege in a way to imply that the vitiation of in-firm privilege may be inherent as to all current client advice at all times during the relationship, whether or not the advice occurred at a time when an actual conflict between client and firm had or could have been identified.

In assessing how entrenched the rule of *Sunrise* has become, it may be significant that seven of these eight cases were decided in the federal courts,[38] and there is very little state court authority on the subject. Thus a state court may be persuaded to adopt a different rule. However, the one state court case, *VersusLaw*, follows *Sunrise,* just as each of the six post-*Sunrise* federal decisions. None of these decisions goes into much depth as to a fact-intensive conflict analysis (perhaps because the existence of conflicts is clear in these cases) and none questions the proposition that the current client conflict rightfully should vitiate the privilege. None of the cases addresses the extent to which the rule relied on is ultimately beneficial to clients or may create a difficult and even unworkable situation for law firms.

Practical Implications and a Suggested Judicial Approach

The court decisions under discussion have, to date, not included any in-depth analysis of the practical implications of their results. But those implications could be substantial. On the current state of law, there could even be some doubt whether any aspect of the internal conflict or ethics evaluation process at a law firm will receive the protection of the attorney-client privilege as against a current client. A large law firm must evaluate conflicts as to every new matter, and also as to various changes in ongoing matters, and typically makes thousands of assessments and decisions on such issues within a year. A meaningful percentage of these decisions involve close questions and judgment calls. On some such judgment calls, a court may later differ in hindsight, although the firm was proceeding in all good faith. If a court does differ in hindsight, may it then view the entire conflict checking process as adverse to the client from the inception? Such a result would provide very perverse incentives with respect to the duty, expressed in the above-cited New York State Bar Association opinion, that a "law firm is not only entitled, but required, to consider the ethical implications of what it does on a daily basis."[39]

For the law firm seeking to arrive at the best ethical decisions through an unrestrained internal debate, no simple solution presents itself. One recommendation of several commentators has been the creation of a full time, salaried, quarantined position for in-house counsel, the idea being that if counsel is shielded from client interaction and not dependent on profits made from client representation, she is representing only the firm, while the firm's other attorneys are representing only the clients.[40] The hope in using this procedure would be to avoid the imputation of conflict to the quarantined in-house counsel, and thereby preserve the privilege. While a court may be persuaded to allow this approach, no court has yet endorsed it, and nothing in the current case law gives comfort that it will work. There is moreover good reason to suspect that it would not work. Under the Model Rules of Professional Conduct, the general imputation of conflicts among lawyers at a firm applies to salaried lawyers as well as to equity partners and does not turn on whether a particular lawyer works on a particular matter.[41]

That leaves three potential courses of conduct, all with significant potential drawbacks: (1) engage in ethical and conflict analysis defensively, while writing down as little as possible, (2) hire outside counsel at the first hint of a problem, and (3) when in doubt, seek to withdraw. Courses (2) and (3) promise potentially slower decision-making, added expense, and potential disruptions to clients in ongoing matters. But the consequences of action (1) are potentially even worse: less robust consideration and debate of complex issues, leading to less good decision-making; in other words, the consequence at the core of the reason for the existence of the attorney client privilege in the first place. All three of these potential drawbacks could be drawbacks for the clients' interests as well as those of the law firm.

For a court persuaded of the basic correctness of the approach of *Sunrise* and its progeny, there can still be limits on the application of the rule that could minimize some of its

perverse practical consequences. Allow protection under the attorney-client privilege at least for internal law firm discussions and documents constituting the initial and ongoing conflict and ethical evaluation process, if not the results of the process. Give a firm some reasonable amount of time to identify the issue and conduct a process to figure out if it has a problem, before the existence of the conflict will be deemed to vitiate privilege even for the process of figuring out if there is a conflict. Allow this time even if the existence of a conflict at an early date appears obvious in hindsight.

The courts rightly come to these issues with the perspective that their paramount concern should be the protection of the client's interests. But they must take care not to arrive at rules of law that may serve the immediate interest of the client in the case before them, but not the ultimate interest of all clients in the best possible regime of ethical compliance by lawyers.

Endnotes

1 Elizabeth Chambliss & David B. Wilkins, *The Emerging Role of Ethics Advisors, General Counsel, and Other Compliance Specialists in Large Law Firms*, 44 Ariz. L. Rev. 559, 564-5 (Fall/Winter 2002).

2 Altman Weil, 2008 Results of confidential "Flash" Survey on Law Firm General Counsel 1, *available at* http://www.altmanweil.com/dir_docs/resource/f5b642dd-99a1-423a-a6a1-16bdb67a3464_document.pdf.

3 In re Sunrise Securities Litigation, 130 F.R.D. 560 (E.D. Pa. 1989); Koen Book Distributors v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo, PC, 212 F.R.D. 283, 286 (E.D. Pa. 2002); Bank Brussels Lambert v. Credit Lyonnais, 220 F. Supp. 283, 287 (S.D.N.Y. 2002); VersusLaw Inc. v. Stoel Rives LLP, 111 P.3d 866, 878-9 (Ct. App. Wash., Div. 1 2005); Thelen Reid & Priest LLP v. Marland, 2007 WL 578989, at *6-7 (N.D. Cal. Feb. 21, 2007); Burns v. Hale and Dorr LLP, 242 F.R.D. 170, 173 (D. Mass. 2007); In re SonicBLUE Inc., 2008 WL 170562, at *9 (Bkrtcy. N.D. Cal. Jan. 18, 2008); Asset Funding Group v. Adams & Reese, 2008 WL 4948835, at *2 (E.D. La Nov. 17, 2008).

4 *See, e.g.*, Elizabeth Chambliss, *The Scope of In-Firm Privilege*, 80 Notre Dame L. Rev. 1721 (May 2005); Douglas R. Richmond, *Law Firm Internal Investigations: Principles and Perils*, 54 Syracuse L. Rev. 69 (2004).

5 New York State Bar Association committee on Professional Ethics, Opinion 789, Oct. 26, 2005, *available at* http://www.nysba.org/AM/TemplateRedirect.cfm?template=/CM/ContentDisplay.cfm&ContentID=13638.

6 *Id.*

7 *Id.*

8 *See* Chambliss, *supra* note 4, at 1721, 1747-8.

9 *See, e.g.*, *Bank Brussels Lambert*, *supra* note 3, at 287 (because attorneys must avoid even the appearance of representing conflicting interests, a firm must disclose to its current clients the results of its conflict checks).

10 *Supra* note 3.

11 130 F.R.D. 560 (E.D. Pa. 1989).

12 *See In re* Sunrise Securities, 595 ("I am now persuaded 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.… I am not willing to hold that a law firm may never make a privileged communication with in-house counsel.").

13 *See In re* Sunrise Securities, *supra* note 3., at 597, n.11.

14 Valente v. PepsiCo, 68 F.R.D. 361 (D. Del. 1975).

15 68 F.R.D. 361, 368-9 (D. Del. 1975).

16 130 F.R.D. at 597 (E.D. Pa. 1989).

17 *See Koen Book, supra* note 3.

18 212 F.R.D at 286.

19 212 F.R.D at 284-85.

20 212 F.R.D at 285 (quoting *Valente*, 68 F.R.D. at 368).

21 *See Bank Brussels Lambert, supra* note 3.

22 220 F. Supp. 283, 287-8 (S.D.N.Y. 2002).

23 220 F. Supp. 283, 287 (S.D.N.Y. 2002).

24 *See VersusLaw, supra* note 3.

25 111 P.3d 866, 878-9 (Ct. App. Wash., Div. 1 2005).

26 *See Thelen Reid & Priest.*

27 2007 WL 578989, at *6-7 (N.D. Cal. Feb. 21, 2007).

28 *Id.* at *8 (citing to ABA Model Rule of Prof Conduct 1.7 and N.Y. eth Op 789).

29 *See Burns, supra* note 3.

30 242 F.R.D. 170, 172 (D. Mass. 2007).

31 *Id.* at 173.

32 *In re* SonicBLUE Inc., 2008 WL 170562 (Bkrtcy. N.D. Cal. Jan. 18, 2008).

33 2008 WL 170562, at *9 (Bkrtcy. N.D. Cal. Jan. 18, 2008)

34 *Asset Funding Group, supra* note 3.

35 Upjohn Co. v. United States, 449 U.S. 383 (1981).

36 2008 WL 4948835, at *4 (E.D. La Nov. 17, 2008).

37 *Id.* at *2.

38 *In re* Sunrise Securities, 560; *Koen Book Distributors* 283, 286; *Bank Brussels Lambert,* 283, 287; *Thelen Reid & Priest*, at *6-7; *Burns*,170, 173; *In re* SonicBLUE, at *9; *Asset Funding*, at *2.

39 New York State Bar Association committee on Professional Ethics, Opinion 789 ¶ 12, Oct. 26, 2005, *available at* http://www.nysba.org/AM/TemplateRedirect.cfm?template=/CM/ContentDisplay.cfm&ContentID=13638.

40 *See, e.g.*, Barbara S. Gillers, *Preserving the Attorney-client Privilege for the Advice of a Law Firm's In-House Counsel* Prof. Law. 107, 110-11 (2000); Richmond, *Law Firm Internal Investigations*, 104-106; Chambliss, *supra* note 4, at 1721, 1757-66.

41 American Bar Association, Model Rules of Professional Conduct, Rule 1.10.