# The Lawyers' Lawyer Newsletter

*Recent Developments in Risk Management*

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## Conflicts of Interest – Advance Waivers

***Macy's Inc., v. J.C. Penny Corporation, Inc.*, 2013 N.Y. App. Div. LEXIS 4798; 2013 NY Slip Op 4891 (June 27, 2013)**

**Risk Management Issue:** When are advance waivers of conflicts of interest valid and binding on clients, and what are the requirements that lawyers must meet in order for them to be enforceable?

**The Case:** By agreement dated March 7, 2008 an international law firm undertook to represent defendant client, a retailer, regarding certain "intellectual property litigation and trade mark registration" in Asia. The agreement expressly informed the client about the possibility that the law firm's present or future clients "may be direct competitors of [the client] or otherwise may have business interests that are contrary to [the client]'s interests," and "may seek to engage [the law firm] in connection with an actual or potential transaction or pending or potential litigation or other dispute resolution proceeding in which such client's interests are or potentially may become adverse to [the client]'s interests." The agreement unambiguously explained that the law firm could not represent the client unless the client confirmed that this arrangement was amenable to it, thereby "waiv[ing] any conflict of interest that exists or might be asserted to exist and any other basis that might be asserted to preclude, challenge or otherwise disqualify [the law firm] in any representation of any other client with respect to any such matter." The agreement also provided, [**2] "However, please note that your instructing us or continuing to instruct us on this matter will constitute your full acceptance of the terms set out above and attached."

Notwithstanding this agreement, the client sought to disqualify the law firm from representing a second retailer in this case. The trial court denied the motion to disqualify, and the New York Supreme Court, Appellate Division, First Department unanimously — and almost summarily — upheld the trial court's decision, holding that it had "providently decided" the motion. The Appellate Division found that "[i]t is undisputed that [the law firm] continued to represent defendant with respect to [the client's] Asian trademark portfolio" after the client accepted the terms set out in the engagement letter, "and, thus, defendant accepted the terms of the agreement, including waiver of the alleged conflict at issue." Further, the court noted that "the interests of defendant that [the law firm] represents, namely intellectual property litigation and trademark registration exclusively in Asia, do not conflict with defendant's interests at issue here . . ." In other words, the court implicitly concluded that the matters were unrelated, and that the law firm held no confidential information from its work on the Asian trademark portfolio that were of any relevance to this matter.

**Comment:** As we indicated in our discussion of the *Galderma* case in the May 2013 issue of the Lawyers' Lawyer, whether and when law firms should be able to rely on advance waivers of conflicts of interest involves the resolution of competing paradigms of legal ethics. On the one hand, the rules governing conflicts of interest are premised on the fiduciary duties of loyalty and the protection of client confidences. On the other hand, the law governing lawyers recognizes the principles that clients should normally be free to select counsel of their choice, free from outside interference, and that client consent can, in appropriate circumstances, form a proper basis for overcoming prohibitions on conduct that would otherwise be impermissible.

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Unlike the court in *Galderma*, the New York court summarily disposed of the motion to disqualify based upon the straightforward language of the advance waiver in the engagement letter. It appears from the transcript from the lower court decision that the letter containing the waiver was reviewed by a lawyer in the client's in-house law department. Although the waiver wasn't countersigned, the client proceeded to engage the firm, and the firm undertook the engagement on the basis of the letter. In that respect, therefore, this case goes further than *Galderma* in allowing a firm to rely on a waiver that it has supplied to the client and that has been reviewed by independent counsel and not rejected, even if it was not explicitly countersigned and agreed to. The case therefore represents another step along the way of recognition that sophisticated clients should be — and will be — held to understand, and be bound by, explicit advance waivers.

**Risk Management Solution:** Although this court did not go through the extended analysis that the Texas court did in *Galderma*, the steps recommended in our report about that case bear repeating as a useful checklist for law firms seeking to obtain enforceable advance waivers from sophisticated clients:

- First, as to existing or presently identifiable potential conflicts, in order for a waiver to have the greatest likelihood of being upheld, disclosure of both the specific facts and the potential adverse consequences should be made.
- Second, as to advance or blanket waivers of potential future conflicts, the disclosure should be as comprehensive and detailed as is possible, laying out the foreseeable types of adversity and the nature of the potential negative consequences for the client.
- Third, as to waivers of both existing and future conflicts, these should be obtained in circumstances that — as far as possible — preclude the client from later averring that the client did not understand the meaning or implications of the waiver. Waivers standing the greatest likelihood of being upheld are those where the client actually received independent legal advice with respect to the waiver – but a very significant element of the decision in this case is that in-house counsel for a corporation can serve that independent function.

Accordingly, the ideal signatory of a conflict waiver letter is a client's independent counsel — whether in-house, or outside. At a minimum, lawyers should advise clients to obtain the advice of independent counsel before signing waivers of conflicts, and, preferably, clients should be required to do so before lawyers proceed based on the waiver. Generally, this is easier where an in-house counsel is available, but, when there is not, if the law firm believes that there is any likelihood that it will later need to rely on the waiver, the case is even stronger for requiring the affected client to have another lawyer review the waiver letter before signing it.

## In-Firm Privilege – Requirements for Creation of Attorney-Client Privilege for Communications With Law Firm General Counsel

### *RFF Family Partnership, LP v. Burns & Levinson, LLP* – 465 Mass. 702 (July 10, 2013) and *St. Simmons Waterfront, LLC v. Hunter, Maclean, Exley & Dunn*, --- S.E.2d ---, 2013 WL 3475328 (Ga. July 11, 2013)

**Risk Management Issue**: What are the requirements for establishing attorney-client privilege for in-firm communications between law firm attorneys and a law firm's in-house counsel in connection with matters relating to a client after wrong-doing is alleged?

**The *RFP Family Partnership* Case:** In April 2007, plaintiff client hired defendant law firm in connection with a commercial foreclosure matter. Nearly a year into the foreclosure, a notice of claim was sent to the law firm alleging legal malpractice. The participating attorneys consulted the law firm's in-house counsel, a partner designated to respond to ethical questions and risk management issues. Following the consultation, the law firm sought to withdraw from representation. Meanwhile, the client requested that the law firm continue with the post-foreclosure sale of the property, and it did so.

In June 2012, upon completion of the sale, the client sued the law firm, alleging legal malpractice and other claims. The client sought to depose the law firm's attorneys and to obtain the intra-firm consultations with in-house counsel. The client claimed that the communications were not protected from disclosure unless the law firm withdrew from representation as counsel before seeking the advice; or the firm fully disclosed to the client there was a conflict of interest and obtained the client's informed consent to seek legal advice during the representation. The law firm moved for a protective order on the grounds that the communications were privileged.

The trial court granted the motion. On interlocutory appeal, the Supreme Judicial Court of Massachusetts affirmed, holding that confidential communications between law firm attorneys and a law firm's in-house counsel can be protected by the attorney-client privilege from disclosure to a client who has asserted malpractice claims. For the defendant to invoke the privilege, the court held that four criteria must be met: (1) the law firm has designated in-house counsel; (2) the in-house counsel has not performed work on the matter that the suit is based upon or for a substantially related matter; (3) the client is not billed for the communications; (4) the consultations are kept confidential.

The court found that here, the law firm had met all four conditions. The court noted that the attorney-client privilege exists not only for the lawyer to give professional advice, but also for the attorney to receive information to enable giving sound advice. The court acknowledged that it is not always clear when the interests of the client and the firm have become adverse and at what point a withdrawal is required. The court stated that a broad protection would encourage firm members to seek risk management help promptly and allow for the correction of mistakes. The court emphasized that is in the best interests of both the client and the law firm to have ethical issues be examined by a competent advisor. Moreover, the court found that even though it was preserving the privileged nature of the communications, the client must still receive full and fair disclosure regarding the facts of the representation from attorneys.

**Comment:** The case is significant because the court declined to adopt or credit the "current client" exception to the application of the attorney-client privilege in this case that some earlier decisions from other courts had developed. The "current client" exception utilizes the rule of imputation (Rule 1.10) to assert that the lawyers in a law firm cannot represent both a client and itself when the firm and client have a conflict of interest, causing confidential intra-firm communications to lose their privilege on the theory that the firm's fiduciary duty to its current client outweighed the right to claim the privilege. The court held that this would lead to a great deal of dysfunction and would preclude or chill efforts by lawyers to seek help when ethical conundrums arose. As a result, the court declined to adopt this exception.

**The *St. Simmons Waterfront, LLC* Case:** In 2006, plaintiff client hired defendant law firm in connection with a condominium development project. The law firm was retained to draft purchase form contracts which would be utilized during the pre-selling of condominiums in a development project planned for construction. Citing defects in the purchase contracts, numerous purchasers rescinded their purchase contracts in late 2007 and early 2008. After a client conference call in February 2008 regarding the problems with the purchase contracts, the law firm's participating attorneys contacted the firm's in-house counsel seeking advice. Shortly thereafter, additional advice from outside counsel was sought.

In 2009, the client sued the law firm for malpractice. During discovery, the client sought to depose and obtain communications and documents from the firm's in-house counsel, as well as outside counsel. The law firm objected and sought protective orders based upon attorney-client privilege and work product doctrine. The trial court granted the motion to compel, except to the firm's communications with outside counsel. The appellate court vacated the trial court's ruling and created a new framework to address the issue in conformity with the Rules of Professional Conduct. Thereafter, the Supreme Court of Georgia vacated the appellate court's decision. In reaching its decision, the Supreme Court held that intra-firm communications should be treated like any other potentially privileged communications without resort to the Rules of Professional Conduct, which it determined were not relevant to the analysis. The Court then remanded the case to the trial court for a determination of whether the law firm could carry the burden of establishing the elements needed to establish the privilege.

**Comment:** In this case, too, the Supreme Court examined what circumstances might determine whether an attorney-client relationship exists between the in-house counsel and the attorney for purposes of establishing the privilege. The Court noted that such things as the formality associated with the position of "firm in-house counsel," the maintenance of a separate file for the intra-firm communications, and the existence of billing procedures for matters addressed to the firm's in-house counsel would figure into the calculus of whether the privilege could

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be invoked. The Court specifically found that while the firm might have a conflict of interest in representing itself (through its general counsel) and its client when their interests diverged and a conflict developed, this fact, the rules of conflicts of interest derived from the Rules of Professional Responsibility and the so-called "fiduciary" exception do not apply, and do not abrogate either the attorney-client privilege or work product protection for documents prepared by the firm's general counsel in responding to enquiries from firm lawyers in connection with matters involving current clients.

**Editors' Note:** These two cases represent the second and third decisions of courts to uphold the attorney-client privilege for communications with law firm general, or in-house counsel and to explicitly reject the assertion of principles of conflicts of interest, or fiduciary duties to current clients as reasons to avoid the application of the privilege. (The only court to reach this conclusion previously was the U.S. District Court for the Southern District of Ohio, interpreting Ohio law, in *Tattletale Alarm Systems, Inc. v. Calfee, Halter & Griswold, LLP ("Tattletale"), 2011 WL 382627*. [This case was considered in the May 2011 issue of the Lawyers Lawyer Newsletter, Volume 16, Issue 2.]) The three cases together are powerful precedents for other courts facing these issues, and, hopefully, put to rest the conflicts of interest and fiduciary "exceptions" to the privilege that had previously been adopted in some cases.

**Risk Management Solution:** These cases extend protections for intra-firm communications so long as certain elements are met to establish the applicability of the privilege. The elements for protection of those communications were described by both courts and should instruct firms regarding the best methods to protect their intra-firm risk management or ethical communications. The elements are:

1. The establishment of a formal position of "in-house" counsel by a lawyer within the firm;
2. For that lawyer's position as "in house" to be realized in connection with the application of the privilege in any given case, he or she cannot have worked on the underlying matter (or related matter) for which risk management advice is sought;
3. Those matters should not be billed to any external source. This will commonly be accomplished by the use of "risk management" or equivalent "firm matter" billing codes for matters addressed by in-house counsel; and
4. The use of segregated filing for "in house" communications that are kept apart from the underlying matter from which the risk management issue has arisen. Those files should, of course, be kept confidential, especially from the client, so as to avoid a waiver.

Hopefully, by structuring the work of law firm general counsel in conformity with these principles, law firms will be empowered to gain the full benefits of having access to their general counsel on a confidential and privileged basis, whenever professional responsibility questions or issues arise that require guidance, even in connection with current client matters.

## Inadvertently Received Privileged Documents – Applicable Law and Rules When Documents Come From Third Party – Operation of Crime/Fraud Exception

***State Bar of California Formal Opinion 2013-188***

**Risk Management Issue**: When an attorney receives from a confidential written communication between opposing counsel and opposing counsel's client from a non-party, what ethical obligations govern the conduct of the receiving attorney?

**The Case:** In California, the ethical duties of a lawyer who receives from opposing counsel an inadvertently produced document covered by the attorney client privilege has been long settled through extensive case law:



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> When a lawyer who receives materials that obviously appear to be subject to an attorney-client privilege or otherwise clearly appear to be confidential and privileged and where it is reasonably apparent that the materials were provided or made available through inadvertence, the lawyer receiving such materials should [1] refrain from examining the materials any more than is essential to ascertain if the materials are privileged, and [2] shall immediately notify the sender that he or she possesses material that appears to be privileged. The parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified.

*State Compensation Insurance Fund v. WPS, Inc.*, 70 Cal. App. 4th 644, 656-657 (1999) (*State Fund*); *Rico v. Mitsubishi Motors Corp.*, 42 Cal. 4th 807, 817-818 (2007) (*Rico*). The *State Fund/Rico* rule is an objective one. In assessing whether a lawyer has complied with the standard, courts must consider "whether reasonably competent counsel, knowing the circumstances of the litigation, would have concluded the materials were privileged, how much review was reasonably necessary to draw that conclusion, and when counsel's examination should have ended."

The question of how the *State Fund/Rico* rule applies when a document is intentionally sent from a source other than the owner of the privilege, or owner's counsel, without consent, was the subject of this State Bar of California Formal Opinion. In the opinion, the Bar's Standing Committee on Professional Responsibility and Conduct analyzed a hypothetical where a defense attorney receives an unsolicited email from an anonymous sender, who is a former employee of the opposing party and who attaches a confidential communication between the attorney's opposing counsel and opposing counsel's client, which purports to establish that the opposing party has committed a fraud, assisted by opposing counsel. The committee concluded that this factual scenario does not change the application of the *State Fund*/*Rico* rule, and the ensuing ethical duties of the attorney who receives such communication.

Noting the core value nature of the attorney-client privilege in the American justice system, the committee analyzed the two prongs of the *State Fund/Rico* trigger: (1) whether the documents "obviously appear" or "otherwise clearly appear to be confidential and privileged"; and (2) whether it is "reasonably apparent that the materials were inadvertently disseminated." On the first prong, Formal Opinion 2013-188 notes that the transmission of information between attorney and client is presumptively privileged, regardless of its content. On the hypothetical, the document is identified as a communication between employer and opposing counsel. Thus, it "obviously appears" or "otherwise clearly appears" to be privileged.

Turning to the second prong, the committee acknowledged that the document was not received from opposing counsel through inadvertence but rather was intentionally transmitted by an anonymous third party. Nevertheless, in light of the strong public policies underlying the *State Fund/Rico* rule to protect the attorney client privilege and work product doctrine, the committee concluded that the *State Fund/Rico* rule should be extended when it is "reasonably apparent that the materials were provided or made available through inadvertence" by the privilege holder's counsel himself, *or* when a third party intentionally sends privileged materials to another attorney and it is reasonably apparent that those materials were sent without their owner's authorization.

Finally, the committee analyzed the potential effect of the crime fraud exception to the attorney client privilege upon the receiving attorney's ethical duties in this scenario, and concluded that there is no effect. Like any other crime-fraud exception scenario, the recipient attorney would have to establish for a court the *prima facie* elements of the crime-fraud exception through nonprivileged information. As such, the mere assertion that the attachment at issue might (or does) prove fraud is insufficient to abrogate the receiving attorney's ethical duties to refrain from review of the communication under *State Fund* and *Rico.* The committee declined to opine whether or not the cover email from the ex-employee could be sufficient to prove those *prima facie* elements.

**Comment:** Given that inadvertent transmission of material is a frequent occurrence — among many reasons for which are such digital "traps" as "Reply All" and the autocomplete function in most email systems — we have frequently had occasion in the past to consider this subject. Our previous forays into the subject of inadvertent disclosure and related issues include: discussion of *In re Nitla, S.A. de C.V.*, *The Lawyers' Lawyer Newsletter*, August 2003, Volume 8, Issue 4; *Maldonado v. State of New Jersey*, *The Lawyers' Lawyer Newsletter*, April 2005, Volume 10, Issue 2; ABA Formal Opinion 05-437, February 2006, Volume 11, Issue 1; *Rico v. Mitsubishi Motors Corp., The Lawyers' Lawyer Newsletter*, February 2008, Volume 13, Issue 2 (Note: This is one of the key California cases with which the new Opinion is consistent); *White v. Withers LLP and Marcus Dearle*, *The*


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*Lawyers' Lawyer Newsletter*, August 2011, Volume 16, Issue 3; and *Merits Incentives, LLC, et al. v. Eighth Judicial District Court of the State of Nevada, et al*., June 2012, Volume 17, Issue 2.

In the California formal opinion considered here, which is consistent with extensive case law in the state, California evidently takes an extreme view of the duties of lawyers to others than their clients in protecting the privilege of adverse parties. Other states take different views. At the opposite extreme, Pennsylvania, in a very brief informal opinion, Pennsylvania Bar Ass'n Comm. on Legal Ethics and Professional Responsibility, Inquiry No. 2011-010 [Revised], May 18, 2011, notes that a lawyer's first duty is to his or her client, and if an attorney receives a document that will assist his or her representation of the client, the lawyer's duty is to use the document as needed for the benefit of the client and not to protect the person who mistakenly transmitted it, or the adverse party who would otherwise have a privilege claim. In many (perhaps most) state the position remains unclear, either under case law or ethics opinions — especially where, as in the particular circumstance examined in this Opinion, the source of the disclosure is a third party and not the adverse party or its representative. The position is further confused because, even as to materials inadvertently produced by adversaries, the position adopted by the American Bar Association (ABA) in its original ethics opinion on the subject (which required lawyers to stop reading, notify the adversary, and abide by the adversary's instructions), has been modified by the much more limited rule contained in the most recent version of Model Rule 4.4, (discussed in ABA Formal Opinion 05-437, discussed in the *Lawyers' Lawyer Newsletter* of February 2006, Volume 11, Issue 1) and adopted in many states, which merely requires notification of the adversary. The problem with this approach is that it leaves up in the air — and for courts to determine — whether and to what extent the receiving lawyer may still proceed to use the material thus received, or, conversely may be required to return the material to the adverse party and to refrain from using it.

**Risk Management Solution:** Because the governing rules and case law vary so greatly from jurisdiction to jurisdiction as to the proper handling of inadvertently produced material — whether received from the adversary or a third party — or of material deliberately produced by a third party who had no authority to provide the material, guidance for lawyers and law firms as to how to deal with these situations is problematic. Even where a given state's rules are clear — like California — the applicable rule may not be the rule in place in the lawyer's home state, as when the situation arises in a litigation before a tribunal in another jurisdiction whose own (different) rules may apply. Accordingly, the best general advice to lawyers is that, whenever they receive material that, for any reason, they believe may have been inadvertently transmitted, or transmitted by someone without authority, they should *immediately* consult their firm's general counsel (if there is one) or seek outside professional responsibility advice if not, in order to avoid missteps. The consequences of failing to follow the correct rule may include disqualification, sanctions, loss of fees or fee disgorgement, and even potentially professional discipline. Practice leaders, and law firm general counsel should regularly educate their firms on the need to seek guidance whenever these situations arise.

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