Lawyers for the Profession®

The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

July 2015 | Volume 20 | Issue 4

Conflicts of Interest — Current Clients — Distinguishing (Permissible) Economic Adversity from (Impermissible) Direct Adversity

Celgard, LLC v. LG Chem, Ltd., 594 F. App'x 669 (Fed. Cir. 2014)

Risk Management Issue: How can law firms determine whether and when mere 'economic' adversity becomes impermissible direct adversity?

The Case: In the underlying litigation, Celgard LLC, a manufacturer of lithium battery components, brought suit against LG Chem and its affiliates, a supplier of lithium batteries. Celgard sought injunctive relief preventing LG Chem's alleged infringement of a patent from manufacture and sale of its lithium batteries. Celgard moved to preliminarily enjoin LG Chem from infringing its patent by continuing to sell batteries to customers, including Apple. The district court granted Celgard's request to preliminarily enjoin LG Chem from selling to Apple and LG Chem appealed.

Jones Day, although concurrently representing Apple in other litigation matters, entered an appearance on behalf of Celgard. Jones Day limited its representation by stating that it would not counsel Celgard in any matter adverse to Apple. Apple moved for leave to intervene after Jones Day rejected Apple's request to withdraw from representing Celgard. Apple argued that Jones Day should be disqualified because the preliminary injunction covered the custom batteries LG Chem provided for Apple's products and that Jones Day currently represented Apple in commercial litigation matters.

Celgard argued that the Court should not grant disqualification because of the impingement on Celgard's right to choose its counsel. "Celgard further suggest[ed] that if Rule 1.7(a) were to cover conflicting representations merely because the client is up or down the supply chain then 'lawyers and clients would have no reliable way of determining whether conflicts of interest exist in deciding whether to commence engagements.'"

The Court determined that Jones Day's representation of Celgard required disqualification pursuant to North Carolina Rule of Professional Conduct 1.7(a), prohibiting representation directly adverse to another client: "Because Jones Day's representation here is 'directly adverse' to the interests and legal obligations of Apple, and is not merely adverse in an 'economic sense,' the duty of loyalty protects Apple from further representation of Celgard."

The Court reasoned that allowing Jones Day to represent Celgard put Apple in the position of finding a new battery supplier, and also subjected Apple to Celgard's attempts to use the injunction as leverage in negotiating a business relationship with Apple. Jones Day's attempt to limit the nature of the representation demonstrated that both Celgard and Jones Day recognized the potential for conflict and elected to continue with the representation. These circumstances demonstrated that Jones Day's representation of Celgard was improperly adverse to the interests of Apple.

Risk Management Solution: Current conflicts arise when a lawyer has a responsibility to a client that is directly adverse to another client. Comment 6 to Model Rule 1.7 states that: "On the other hand, simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients." However, as this case shows, when success on behalf of one client will actually harm the business of the other client — e.g. disrupting the other client's supply chain, and therefore its ability to function — that circumstance amounts to direct adversity. This case demonstrates the need to gather much more information at the new matter intake stage than just the names of those who may be affected by the proposed engagement. Lawyers seeking to bring in business often resist requirements to gather additional information imposed by the firm's intake process. This case provides strong support for firms to require detailed information prior to approving new business. Gathering full information about an incoming matter will permit informed decision making and help firms avoid possible disqualification, and harm to existing client relationships. However, as probably happened here, there are likely to be situations where it is extremely difficult to identify the conflict in advance, giving rise to uncomfortable outcomes.

Hinshaw & Culbertson LLP
222 North LaSalle Street
Suite 300, Chicago, IL 60601
312-704-3000
www.hinshawlaw.com
www.lawyeringlaw.com

Editors:
Anthony E. Davis and Noah D. Fiedler
Contributors:
Andrea K. Holder, Filomena E. Meyer

In-Firm Attorney-Client Privilege — "Ethics" Counsel — Ethics Counsel Advice Regarding Current Matters

Moore v. Grau, No. 2013-CV-150 (Sup. Ct. N.H. Dec. 15, 2014)

Risk Management Issue: Are communications between de-facto in-house ethics counsel and the attorneys of the firm covered by the attorney-client privilege in the same way as communications with designated firm general counsel?

The Case: Plaintiff, Cheryl Moore, M.D., engaged the legal services of Attorney Charles Grau and his firm, Upton & Hatfield, LLP, to represent her in a federal district court case. Upon conclusion of the federal action, Dr. Moore sued Grau, and Upton & Hatfield in New Hampshire state court, alleging legal malpractice, breach of contract, and statutory violations.

During the course of the malpractice action, Dr. Moore sought production of a wide range of communications in connection with Grau and Upton Hatfield's representation of her in the underlying case. These communications included emails and conversations to which any member or employee of Upton Hatfield was a party. Grau and Upton Hatfield opposed production on the grounds of attorney-client privilege. Dr. Moore moved to compel, limiting the scope of her request to seventeen emails, of which all but one were sent or received by Attorney Hilliard. Grau and Upton Hatfield claimed that the seventeen emails were protected by the attorney-client privilege because Attorney Hilliard was acting as the in-house legal counsel for the Defendants at the time of the emails. The Court held an evidentiary hearing.

Upton Hatfield's managing partner, James Raymond, testified that Attorney Hilliard had acted as Upton Hatfield's ethics counsel for over ten years and that he consulted with and represented other law firms in the state on ethics issues. Raymond also testified that there was no formal process by which Hilliard became Upton Hatfield's in-house ethics counsel. However, Upton Hatfield recognized that the benefits of in-house ethics counsel included obtaining immediate ethics advice at no additional cost.

Attorney Hilliard testified that he became very familiar with the Rules of Professional Conduct in the 1980s and acted as ethics counsel for the firm since that time. Hilliard did not bill the firm's clients for time spent in responding to an ethical issue.

At issue were two entries for time billed by Hilliard on Dr. Moore's case. Hilliard testified that he vaguely recalled consulting with Grau on theories of the client's cause of action. He also testified that the seventeen documents sought by Dr. Moore related to ethical advice, and not to advice on the substance of the case.

This was a matter of first impression for the New Hampshire Supreme Court. The Court stated that New Hampshire enforces the common-law rule that confidential communications between a client and an attorney are privileged. Where legal advice is sought from a professional legal adviser, the communications relating to that purpose, made in confidence by the client, are protected from disclosure unless the protection is waived by the client.

The court considered the "current-client" argument against the privilege: "where a current outside client threatens legal action against a law firm and the attorneys in the firm seek legal advice from the law firm's in-house counsel, the law firm is both the attorney for the outside client and itself a client, and these two 'clients' have conflicting interests." According to the New Hampshire court, most courts that consider the issue historically invoked some variation of the current client exception, ruling that where a law firm seeks legal advice from its in-house counsel in response to an adverse claim brought by a current outside client, the communications are not protected from disclosure to the outside client. While this may have been historically true, most of the recent cases addressing this issue have protected in-firm privilege, as discussed in previous editions of this newsletter (see references in the comment below).

The New Hampshire court, as with most courts in the past five years, was persuaded that recognition of an in-house attorney client privilege did not create a conflict of interest. The court reasoned that recognition of an in-house attorney-client privilege encourages lawyers to seek advice promptly about how to correct an error, so that there is some chance of allowing a mistake to be rectified before the client is irreparably damaged.

Dr. Moore did not dispute that an attorney-client privilege may exist between a law firm and its in-house counsel, but argued that the circumstances under which such a claim of privilege may be made is fully articulated in *RFF Family Partnership, LP v. Burns & Levinson, LLP*, 991 N.E.2d 1066 (Mass. 2013): (1) the law firm has designated an attorney to represent the firm as in-house counsel; (2) the in-house counsel has not performed any work on the client matter at issue or a substantially related matter; (3) the time spent by the attorneys in communications with in-house counsel is not billed to a client; and (4) the communications are made in confidence and kept confidential. Dr. Moore contended that since Hilliard's actions did not fulfill the requirements, the privilege should not apply.

The New Hampshire Court settled on a less stringent approach, citing the reality of how New Hampshire law firms are structured and function. The court adopted the requirements of *St. Simons Waterfront, LLC v. Hunter, MacLean, Exler & Dunn, P.C.*, 746 S.W.2d 98 (Ga. 2013): (1) there is a genuine attorney-client relationship between the firm's lawyers and in-house counsel; (2) the

communications in question were intended to advance the firm's interest in limiting exposure to liability, rather than the client's interests in obtaining sound legal representation; (3) the communications were conducted and maintained in confidence, and (4) no exception to the privilege applies.

Here, the Court found that Grau and Upton Hatfield made a *prima facie* showing that the attorney-client relationship existed between Grau and Hilliard, and that Hilliard functioned as *de facto* ethics counsel for the Upton Hatfield firm. Under these circumstances, in order for the information to be privileged, the advice Hilliard gave must be within the purposes articulated by the courts in both *RFF Family Partnership* and *St. Simons Waterfront*. If not, the privilege would improperly be used to shield relevant and admissible evidence from the plaintiff. The Court ordered an *in camera* review and further briefing from Dr. Moore to determine whether the communications were intended to advance the firm's interest in limiting exposure to liability rather than a client's interest in obtaining sound legal representation.

Comment: This case follows earlier cases identified above and others on the same topic, discussed in prior issues of the *Lawyer's Lawyer Newsletter*. See Vol. 19, Issue 4, September 2014 (discussing *Crimson Trace Corp. v. Davis Wright Tremaine LLP*, (2014) 355 Or. 476 (May 30, 2014)); Vol 18, Issue 4, September 2013 (discussing *RFF* and *St. Simons*); and Vol 20, Issue 2 (discussing *Palmer v. Superior Court*, 231 Cal. App. 4th 1214 (2014)).

Risk Management Solution: The New Hampshire decision rejecting the "current client" exception to the attorney-client privilege continues the recent trend of applying attorney-client privilege to an attorney's consultation with in-firm counsel regarding current-client ethical issues. While the trend is to permit the application of the privilege, firms should not take lightly the requirements established by the courts. Despite the New Hampshire decision, it is advisable for law firms to formally designate an in-house attorney as the firm's General Counsel, rather than relying on a *de facto* practice. In addition, in order to prevail in asserting the privilege, the designated counsel should not perform work on the particular client matter, and should at all costs refrain from billing the client for the time spent on the communications.

Former Client Conflicts — Substantial Relationship Test — Imputation of Conflict to New Employer's Entire In-House Legal Department and Outside Counsel — Screening

Dynamic 3D Geosolutions, LLC v. Schlumberger Ltd., et.al., A-14-CV-112-LY (W.D. Tex. March 31, 2015)

Risk Management Issue: What steps are required of both in-house law departments and law firms to avoid disqualification resulting from former client conflicts of interest?

The Case: Plaintiff, a subsidiary of a patent licensing and enforcement company, filed suit against defendant, an oilfield services giant, because the latter's software platform allegedly infringed on plaintiff's recently acquired patent — a Microsoft Windows-based software application for three-dimensional geologic visualization, mapping and reservoir modeling.

Shortly after being served with the lawsuit, defendant moved to disqualify plaintiff's entire in-house legal department, as well as its outside counsel, based on the participation of defendant's former deputy general counsel in the litigation. Several months earlier, plaintiff's mother company successfully wooed defendant's former deputy general counsel for intellectual property away from defendant. In the new role as plaintiff's senior vice president and associate general counsel, defendant's former deputy general counsel was tasked with helping plaintiff identify sector patents that could be monetized through litigation. The patent that engendered the infringement action was a product of those efforts.

The problem, defendant argued, was that in the seven years the former deputy general counsel was in its employ, she gained intimate knowledge of defendant's allegedly infringing software. She had allegedly led a twelve-person team responsible both for assessing the software's vulnerabilities to intellectual property lawsuits and for broadening its intellectual property coverage. Defendant introduced evidence that its former deputy general counsel had also been involved in rendering advice relative to the software and had personally represented defendant in a variety of matters related to the patent infringement action. It was precisely because of this insider information, defendant posited, that she advised plaintiff to acquire the patent and sue defendant and several others. Defendant's evidence established that within a month after joining plaintiff, defendant's former deputy general counsel was instrumental in acquiring the geologic modeling software patent and then placing it with plaintiff. Plaintiff, with the knowledge and approval of defendant's former deputy general counsel, then initiated the patent infringement action against defendant and others.

These facts, defendant urged, warranted the former deputy general counsel's disqualification. Defendant argued that her participation in the patent acquisition and the infringement action gave rise to an incurable conflict of interest jeopardizing the integrity of the judicial proceeding. This conflict, defendant urged further, ought also to be imputed to plaintiff's entire in-house legal department and its outside counsel because these attorneys likely gained access to its confidential information through its former counsel. Finally, defendant sought dismissal of the entire action on the ground that these insidious conflicts of interest had "infected" the action against it from inception.

Former Client Conflicts, continued on page 4

In opposition, the former deputy general counsel denied any in-depth knowledge of defendant's software and characterized her exposure to it as very limited (and only with reference to older versions). Plaintiff also argued that there was no proof that the former deputy general counsel shared defendant's trade secrets with the plaintiff. In addition, plaintiff asserted that she was not co-counsel in the patent infringement action, and had never worked for plaintiff, but rather was employed rather by plaintiff's parent company, which was not a party to the patent infringement proceeding. Finally, plaintiff conceded that she had been walled off from any discussion of defendant or its technology.

To resolve the motion, the court, looked to ABA Model Rule 1.9(b), Texas Rule 1.09 and the decision in *In re American Airlines*, 972 F.2d 605, 610 (5th Cir. 1976) and employed the "substantial relationship" test. Under this test, a moving party in defendant's position, is required to prove two elements to secure disqualification: (1) an actual attorney-client relationship between the moving party and the attorney it seeks to disqualify; and (2) a substantial relationship between the subject matter of the former and present representations. Proof of both factors gives rise to an irrebuttable presumption that relevant confidential information was disclosed during the period of the former representation and that disqualification is proper.

Applied to the case before it, the district court found a substantial relationship between the two representations, persuaded by evidence that the allegedly infringing features of defendant's software existed in older versions that its former deputy general counsel admittedly dealt with, and by evidence of her prior involvement in efforts to license the software on defendant's behalf. The subject matter, the court reasoned, need only be "akin to the present action;" it did not need to be relevant in the evidentiary sense to satisfy the substantial relationship test. The court concluded that this substantial relationship triggered the conclusive presumption that the former deputy general counsel acquired defendant's confidential information, requiring her disqualification from the present action.

The district court then turned to the issue of whether the presumed acquisition of confidential information should be imputed to disqualify plaintiff's entire in-house legal department and outside counsel. The court noted that a determination that confidential information was acquired during the earlier representation gives birth to a second presumption — albeit rebuttable — that these same confidences were shared with other lawyers at the new firm.

In fact, in a deposition, the former deputy general counsel testified that after she joined plaintiff's company, she participated in meetings with inventors of the patent, was involved in the decision-making process that culminated in the acquisition of the patent, and that defendant and its software were discussed at these meetings in her presence. She also freely admitted that she made the decision to retain outside counsel for the patent infringement action that was being planned against her former employer/client, and had approved the recommendation to acquire the patent and sue the latter. The record also revealed multiple conversations and communications between the former deputy general counsel and members of plaintiff's in-house legal department and outside counsel regarding the patent infringement litigation. On this evidence, the district court found a failure on plaintiff's part to rebut the second presumption and on that basis, decided to disqualify all of plaintiff's in-house legal department as well as its outside counsel.

The court was unmoved by plaintiff's contention that it did not employ the counsel in question and had an existence separate from the parent company, the former deputy general counsel's actual employer. The court observed that plaintiff was a wholly-owned subsidiary and depended entirely on the in-house legal department of its mother company for the strategy and conduct of litigation. The court also found it of no legal moment that it was dealing in part with an in-house legal department, and saw no reason for a difference in treatment.

Having determined that all of plaintiff's legal representatives deserve disqualification, the court concluded that dismissal of the action without prejudice was also warranted. The court held that though the result was harsh, it was necessary to prevent the "significant prejudice" that would be sustained by defendant if plaintiff was permitted to pursue its claims.

Risk Management Solution: This decision showcases one risk of hiring lateral attorneys. Although jurisdictions may vary, in those jurisdictions that have not adopted Model Rule 1.10 with respect to screening of laterals, and that apply the substantial relationship test and the conclusive presumption that follows a substantial relationship finding, there may be no way to prevent the disqualification of the lateral hire in a suit that is related to a former representation. Even in jurisdictions that have adopted the Model Rule 1.10 screening provisions, it behooves both in-house legal departments and outside law firms to follow a rigorous screening process for lateral hires so that the company or firm does not end up disqualified from cases related to those on which the lateral hire had previously worked. Even in the absence of a rule permitting screening, in some jurisdictions law departments and law firms may be able to rebut the imputation of confidences, and avoid disqualification, by erecting a rigorous wall around a lateral hire so that the laterally-hired lawyer has absolutely no contact with a representation adverse to a former client and no communication with anyone involved in the file.