Ethics Traps for In-House Lawyers

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Topics for Today

- Best practices to help you avoid attorney-client privilege hazards that face in-house counsel
- Practical solutions to spot and avoid conflicts of interests during transactions
- Answers to the fundamental question “Who do you represent?”

The Attorney-Client Privilege

To assert attorney/client privilege, a party must show that the communication was:

(1) between an attorney and client;

(2) made for the purpose of providing legal advice; and

(3) intended to be, and was in fact, kept confidential.

Losavio v. District Court, 188 Colo. 127, 533 P.2d 325 (1975); *Pritchard v. County of Erie*, 473 F.3d 413 (2d Cir. 2007).

Communications with Corporate Employees

Two tests to determine whether a corporate employee's communications with in-house counsel are privileged:

- **The Control Group Test** – an employee's communication with counsel is privileged if the employee was a corporate decision maker or was in a position to take part in a decision on the issue based on the attorney's advice. This is a very narrow test.
- **The Subject Matter Test** – an employee's communication is privileged if the subject matter of the communication is within the scope of the employee's duties. The Supreme Court adopted this test in the *Upjohn* case. This is a much broader test.

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Upjohn Factors

1. Whether the information was not available from higher-level management and was needed to supply a basis for legal advice
2. Whether the communications concerned matters within the scope of the employees' corporate duties
3. Whether the employees were aware that they were being questioned in order for the corporation to obtain legal advice
4. Whether the communications were considered "confidential" and were kept confidential

In-House Counsel ("Two Hats" Problem)

- Courts have repeatedly held the same standard applies to in-house lawyers and outside counsel for purposes of determining whether the privilege applies.
- Yet in practice it is often more difficult for in-house counsel to demonstrate communications are privileged given that they can often serve in dual roles as attorney and business advisor.

In-House Counsel (“Two Hats” Problem)

- When in-house counsel acts in his or her capacity as an attorney, the “attorney” requirement is met.
- Generally speaking, when counsel acts as a <u>business advisor</u> or has <u>limited involvement</u> in the matter the privilege does not apply.

Hypothetical: What Law Applies?

- Jennifer, in-house counsel for B-Corp, Inc., with headquarters in Denver, travels to California to meet with Tom, the company's regional sales director in Los Angeles, at the Company's regional headquarters there, to discuss a dispute in Oregon involving the company's sales tactics.
- What Law Applies?

Hypothetical: What Law Applies?

- In federal court, involving federal claim, *Upjohn* applies.
- In state court, the answer frequently is the one resulting in discoverability. Generally speaking, in state court:
  - a communication will be discoverable if the state with the most significant relationship to the communication allows it; however,
  - if the law of the forum state permits the discovery and admission of a communication, then the communication will likely be admitted even if the law of the state with the most significant relationship provides that the communication is privileged.

See Sterling Finance Management, L.P. v. UBS PaineWebber, Inc., 336 Ill. App. 3d 442 (2002); *Koken v. One Beacon Ins. Co.*, 911 A.2d 1021 (Pa. 2006).

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Hypothetical:
In-House Counsel Memoranda

- Company CEO tasks legal department with preparing a financial and business growth strategy memorandum that the company's COO will send to the organization's Corporate Growth Committee. Several in-house lawyers work over a 6-month period to create a 9-page memo containing a mixture of business and legal advice.
- Is the memo privileged? Is any portion of the memo privileged?

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Hypothetical: In-House Counsel Memoranda

- *RCHFU LLC v. Marriott Vacations Worldwide Corp.*, 2018 WL 3055774 (D. Colo. May 23, 2018).
- Court applies primary purpose test – "Communications by in-house counsel are privileged only where the 'communication's primary purpose is to gain or provide legal assistance.'"
- Here, "primary purpose" of memo was developing a successful business and financial strategy. Court will not parse memo (business and legal "intertwined so completely that it would be impractical to attempt redaction")
- Court: Legal Department had "duty to inform the Corporation of the operation of the privilege and to take steps to protect their advice."

Hypothetical: Marking Documents

- Company VP comes to you about a project that's not going well and about her concern that the company may not be performing up to the contract terms. Your first thoughts are that she's being overly harsh on herself and the team: some of the things she is mentioning may not be a big deal and there is time to correct them. Then she tells you not to worry about it too much because she and her team have been marking all of their emails and other documents discussing the problems as "Attorney-Client Privileged" so that the team can write down whatever they want.
- What advice do you give her first? Is your communication conveying that advice privileged?

Hypothetical: Multi-Hat Problem

- Jennifer, an in-house lawyer, is serving on the personnel action review committee of the corporation. Jennifer, together with the rest of the committee, reviews terminations to determine if they comply with company policy and practices. When a former employee brings a discrimination claim, he seeks all records relating to the committee's work on his termination, including Jennifer's communications.
- Are the records discoverable?

Hypothetical: Negotiations

- Jennifer, in-house lawyer, serves as negotiator for various environmental provisions in a contract related to an acquisition by the company. She participates in conversations regarding the status of the negotiations, the trade-offs that the lawyers perceive the target is willing to make, and the company's options in dealing with environmental risks. The deal falls apart. The other side brings suit (alleging bogus business tort) and seeks to compel Jennifer's testimony regarding her communications about the negotiations. Are her communications privileged?
- *Georgia Pacific v. GAF Roofing Mfg. Corp.*, 1996 U.S.Dist. LEXIS 671 (S.D.N.Y. Jan. 25, 1996).

M&A Scenario – Conflicts of Interests

- You are GC of ABC Company, an international, closely held Delaware corporation headquartered in Colorado. You, a Colorado licensed attorney, have been with the company for six years (you were brought on from private practice by Susie CEO) and you have incentive equity that is junior to the preferred and common stock. ABC Company's largest (controlling) shareholder is PE Fund, which made its recapitalization investment into ABC Company two years ago.
- As part of that original investment by PE Fund, you and the Susie CEO received negotiated employment agreements. Those agreements provide for double-trigger severance. They also have very attractive healthcare benefits while employed. Susie has a special needs dependent and is reliant on the healthcare coverage. Even her large salary is eaten up by a broad range of care costs.
- PE Fund has participating preferred stock that provides for a two times preferred return and then participation pro rata with the common. PE Fund's principals have carried interest on the investment, which carried interest receives more favorable tax treatment if held for at least three years. ABC Company's board of directors (controlled by PE Fund's principals) has been approached with an unsolicited acquisition offer by a large strategic that presents a compelling premium in enterprise value but due to the payout waterfall, the incentive equity will receive no payout. The company's future prospects are less certain. That proposal will require the CEO to continue her employment with the company. That proposal is silent about your future.
- Susie comes to you and says, "GC we need to do what is right and watch out for the employees." PE Principal, who is on the board, says to you, "GC we need to do what is right, but I am concerned about leaving money on the table and not sure about the timing."
- Big Law is your law firm and represented PE Fund in its investment.

Issues to Consider

- Whom do you represent? What about Big Law?
- What potential conflicts-of-interest exist?
- How does the company handle negotiating an LOI that covers
  - general deal terms
  - employment terms for the CEO?
- When and how can you, an in-house counsel, negotiate your own deal?
- Who controls the attorney-client privilege after the deal closes? Can you act for seller in an indemnity claim?

Rule 1.13 Organization as a Client

- (a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.
- (g) in dealing with an organization's directors . . . or other constituents, a lawyer shall explain the identity of the client when the lawyer reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

Rule 1.17 Conflicts of Interests

- (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
  - (1) the representation of one client will be directly adverse to another client; or
  - (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

Organization as a Client Cont.

Rule 1.13 Comments

- [10] There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.
- [11] Whether such a warning should be given by the lawyer for the organization to any constituent individual may turn on the facts of each case.

Post-Closing Privilege and Waiver

- Rule of Professional Conduct 1.9(a) on duties to former clients:
  - **A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.**
- Rule applies in Colorado, and in virtually all (if not all) U.S. jurisdictions
- Any indemnity claim is going to be a substantially related matter, so you need to address post-closing representation in your deal documents or run a substantial risk of being conflicted out.

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Example Waiver

- Conflict Waiver. Recognizing that Bryan Cave Leighton Paisner LLP has acted as legal counsel to ABC Company and certain of the Owners prior to the Closing Date and that Bryan Cave Leighton Paisner LLP may act as legal counsel to certain of the Owners after the Closing, the Buyer and ABC Company hereby waive, each on its own behalf, and agree to use Commercially Reasonable Efforts to cause their respective Affiliates to waive, any conflicts that may arise in connection with Bryan Cave Leighton Paisner LLP representing any Owner after the Closing concerning the transactions contemplated herein in a manner adverse to ABC Company, the Buyer or its Affiliates, even though Bryan Cave Leighton Paisner LLP may have represented ABC Company in a matter substantially related to a dispute between such parties.

Example Privilege Designation

- In addition, all communications prior to the Closing involving attorney-client confidences between any Owner, ABC Company and their respective Affiliates, on the one hand, and Bryan Cave Leighton Paisner LLP, on the other hand, relating to the negotiation, documentation and consummation of the transactions contemplated herein (the "Communications") shall be deemed to be attorney-client confidences that, following the Closing, belong solely to the Owners (and not the Buyer or any Acquired Company). Accordingly, neither the Buyer nor ABC Company, nor any of their Affiliates, shall have access from and after the Closing to any Communications or to the files of Bryan Cave Leighton Paisner LLP relating to the negotiation, documentation or consummation of the transactions contemplated in this Agreement.
- Without limiting the generality of the foregoing, from and after the Closing, (a) the Owners shall be the sole holder of the attorney-client privilege with respect to the Communications, (b) to the extent the files of Bryan Cave Leighton Paisner LLP constitute property of its client for purposes of the transactions contemplated herein, only the Owners shall hold such property rights, and (c) Bryan Cave Leighton Paisner LLP shall have no duty whatsoever to reveal or disclose any Communications or such files to ABC Company or any of its Affiliates by reason of any attorney-client relationship between Bryan Cave Leighton Paisner LLP and the Company or otherwise. Notwithstanding anything to the contrary contained in this Agreement, the Buyer and ABC Company acknowledge and agree that the Owners may have removed from each Acquired Company's premises or servers any email, document or other record containing Communications.

Joint Representation Scenario – Who do You Represent?

- ABC Company, from Sean's earlier scenario, is not sold. Instead, ABC Company decides to go into a new line of business: taco sauce. You help ABC set up the new wholly-owned subsidiary that will run the taco sauce operations: Taco Time.
- You are the General Counsel of ABC and regularly provide legal services to Taco Time in the ordinary course of its business.
- Taco Time and its CEO are sued for trade secret theft by XYZ Corp. CEO used to work for XYZ. Now, XYZ claims that Taco Time improperly obtained inside information regarding XYZ's super-secret taco sauce recipe.

Issues to Consider

- Can you represent Taco Time? Do you need to get advance conflict waivers to do so?
- Can you also represent the CEO?
- If the Company would like you to represent the CEO in addition to the corporate defendants, what investigation should you do in the first instance before agreeing to represent him?
- Should you have an engagement letter with the CEO?
- Should you recommend the CEO obtains his own legal counsel?
- If you do not intend to represent the CEO, what disclosures/statements must you be sure to make to the CEO?

Comments to Rule 1.7 – Common Representation

- [29] In considering whether to represent multiple clients in the same matter, a lawyer should be mindful that if the common representation fails because the potentially adverse interests cannot be reconciled, the result can be additional cost, embarrassment and recrimination. Ordinarily, the lawyer will be forced to withdraw from representing all of the clients if the common representation fails. In some situations, the risk of failure is so great that multiple representation is plainly impossible. For example, a lawyer cannot undertake common representation of clients where contentious litigation or negotiations between them are imminent or contemplated. Moreover, because the lawyer is required to be impartial between commonly represented clients, representation of multiple clients is improper when it is unlikely that impartiality can be maintained. Generally, if the relationship between the parties has already assumed antagonism, the possibility that the clients' interests can be adequately served by common representation is not very good. Other relevant factors are whether the lawyer subsequently will represent both parties on a continuing basis and whether the situation involves creating or terminating a relationship between the parties.
- [30] A particularly important factor in determining the appropriateness of common representation is the effect on client-lawyer confidentiality and the attorney-client privilege. With regard to the attorney-client privilege, the prevailing rule is that, as between commonly represented clients, the privilege does not attach. Hence, it must be assumed that if litigation eventuates between the clients, the privilege will not protect any such communications, and the clients should be so advised.
- [33] Subject to the above limitations, each client in the common representation has the right to loyal and diligent representation and the protection of Rule 1.9 concerning the obligations to a former client. The client also has the right to discharge the lawyer as stated in Rule 1.16.

Comments to Rule 1.7 – Future Waiver

- Consent to Future Conflict
- [22] Whether a lawyer may properly request a client to waive conflicts that might arise in the future is subject to the test of paragraph (b). The effectiveness of such waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. The more comprehensive the explanation of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the requisite understanding. Thus, if the client agrees to consent to a particular type of conflict with which the client is already familiar, then the consent ordinarily will be effective with regard to that type of conflict. If the consent is general and open-ended, then the consent ordinarily will be ineffective, because it is not reasonably likely that the client will have understood the material risks involved. On the other hand, if the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, such consent is more likely to be effective, particularly if, e.g., the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation. In any case, advance consent cannot be effective if the circumstances that materialize in the future are such as would make the conflict nonconsentable under paragraph (b).

The Story Continues

In the course of discovery, it becomes clear that Taco Time's CEO continued to stay in touch with his best friend over at XYZ, and did in fact solicit and obtain information regarding the taco sauce from the XYZ insider.

Issues to Consider

- Are CEO's interests now adverse to those of Taco Time? How about ABC?
- Can you continue representing the CEO?
- If you plan to continue representing the CEO, do you need to get informed consent from the CEO based upon Taco Time's adverse position to the CEO

The Final Chapter

Now presume that Taco Time is spun off after the disastrous damages award against it in the XYZ litigation. A few months later ABC discovers that Taco Time employees have been soliciting ABC's employees, in violation of the sale agreement. ABC wants to sue Taco Time.

Issues to Consider

- Can you, as General Counsel, represent ABC in the litigation against Taco Time?
- Do you need to get a waiver from Taco Time in order to do so?

Best Practices – Privilege

- Educate employees re: (i) basics of the privilege and (ii) sending email to or copying counsel does not automatically confer privilege
- Don't try to create privilege by funneling documents through or copying in-house counsel.
- Label protected documents "Privileged and Confidential – Attorney-Client Communication." Don't overuse labels.
- Restrict distribution of privileged materials (also helps avoid waiver).
- Employees: Write "Request for Legal Advice" at top of email to in-house counsel
- Counsel: Write "this information is being requested for the purpose of rendering legal advice."
- Don't discuss business and legal topics in the same communication.
- Counsel should use only legal titles (e.g., "Assistant General Counsel") not business titles.

Best Practices – Conflicts

- Target companies should include an express waiver in purchase agreement to allow Target Company counsel to represent the seller group post-closing. That waiver should ideally allocate attorney client privilege with respect to advice given to Target in the transaction to the Seller group post-closing.
- Consider including a waiver in auction NDAs to address ahead of time situations where Target’s outside law firm may also represent the prospective bidder in an unrelated matter.
- Executive employment agreements should include “not your lawyer” language to protect against implied attorney-client relationships.
- Re-evaluate conflicts continuously throughout a transaction. What is not a material conflict initially may change or the steps taken to address it may need to change.
- Seek a second opinion. Be clear. Put it in writing.

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Best Practices – Joint Representation

- Clarify that you represent the company, not the individual constituent
- Inform the employee that he/she would be well-advised to seek independent counsel, particularly when there are signs of potential trouble down the road or potential adversity to the company.
- Warn the employee that the attorney-client privilege may not protect his/her communications with you if the company decides to disclose them.
- Phrase legal advice in terms of the corporation's best interests and from the corporation's perspective, letting the individual know that you are not ethically permitted to provide advice inconsistent with the corporation's interests.

This Presentation provides a general summary and is for information/educational purposes only. It is not intended to be comprehensive, nor does it constitute legal advice. Specific legal advice should always be sought before taking or refraining from taking any action.