Are Confidential Communications with a Firm's In-house General Counsel Really Privileged?

Most firms beyond a certain size will designate one of their lawyers as counsel to the firm; his or her role will be to counsel firm lawyers not only on questions of ethics, but also on questions involving potential exposure to professional-liability and disciplinary claims. Typically, firm lawyers will be instructed that when engaging in communication with the firm's counsel, such communication should be labeled "confidential" and "attorney-client privileged." But when such advice is sought, especially when it concerns issues involving clients the firm currently represents, is it really privileged, especially in a subsequent legal-malpractice or other professional-liability action where the now-former client seeks discovery of such communication? This issue was addressed recently in an appellate decision that offers an especially comprehensive and scholarly analysis of the issue.

In *Stock v. Schnader Harrison Segal & Lewis LLP*, ___ N.Y.S.3d ___, 2016 WL 355655 (Sup.Ct., App. Div.), a firm attorney negotiated a separation agreement involving a client's departure from his former employer. What the client did not know, and what he was allegedly not advised of by his counsel, was that his separation triggered an accelerated period in which to exercise his vested stock options granted under his former employer's plan. Specifically, his exercise period was shrunk from 10 years to between 90 and 120 days, depending on the options in question. Moreover, his stock-option administrator also did not inform him of this development until after all of the exercise periods had expired. Client allegedly sustained a loss of $5 million in the aggregate.

Client retained other attorneys from the same law firm in a federal lawsuit against his former employer and in an arbitration proceeding against his stock-option administrator before the Financial Industry Regulatory Authority, both in an effort to recover for his loss. Eleven days before the scheduled beginning of the arbitration hearing, the stock-option administrator gave notice of its intent to call the firm attorney who had represented client in negotiating his separation agreement as a witness. The administrator took the position that client's loss was not its fault but instead was the fault of client's counsel who had negotiated the termination agreement on his behalf.

This development prompted the firm lawyer who handled the separation agreement and the firm lawyers who represented client in the lawsuit and arbitration proceeding to confer with firm counsel. This resulted in the exchange of two dozen emails among the four firm lawyers and firm counsel prepping the lawyer who handled the separation agreement for her arbitration testimony. When the law firm and the firm lawyer who had negotiated the separation agreement were sued by client for breach of fiduciary duty and malpractice, among other claims, client sought production of these emails. But the defendants refused to produce them, producing instead a privilege log and claiming that confidential communications between the firm lawyers and the firm counsel were protected by the attorney-client privilege, notwithstanding that they involved a current client of the firm. The trial court granted client's application to compel production of these emails, and the defendants appealed to the New York Supreme Court, Appellate Division, which ultimately reversed.

Client argued that the fiduciary exception to the attorney-client privilege, articulated in *Riggs Natl. Bank of Washington, D.C. v. Zimmer*, 355 A.2d 709, 711-712 (Del. Ch. 1976), applied. This exception, as the court quoted in the Restatement (Third) of the Law Governing Lawyers, § 84, Comment b, "prevents a trustee from invoking attorney-client privilege to withhold from trust beneficiaries 'evidence of the trustee's communications with a lawyer retained to advise the trustee in carrying out the trustee's fiduciary duties.' " In *Riggs*, the trustee had retained an attorney to prepare a legal memorandum "for the trustee, at the trust's expense, in anticipation of potential tax litigation on behalf of the trust." There, the fiduciary exception was applied because the court found as "a significant factor" that payment was made "out of the trust assets," unlike in *Stock*, where client did not pay for the consultation. The court's view in *Riggs* was that the "*real clients* were the beneficiaries of the trust, and the trustee … in his capacity as a fiduciary, was, or at least should have been, acting only on behalf of the beneficiaries in administering the trust." The court deemed that the fiduciary exception does not apply in the instant case because the firm lawyers seeking counsel were seeking it for themselves and not for their clients and that they were the "real client" and not the clients they represented.

The court in *Stock* noted a recent trend in case law and a 2013 resolution of the American Bar Association (ABA) House of Delegates in that the fiduciary exception to the attorney-client privilege does not or should not apply "when lawyers seek the advice of their firm's in-house counsel concerning possible conflicts, ethical obligations and potential liabilities arising from the representation of a current firm client, [where] the in-house counsel's 'real clients' are the lawyers and the firm itself — not the firm client from whose representation the issues arise — and, therefore, evidence of communications seeking or rendering such advice may be withheld from the firm client as privileged." In doing so, the court rejected, among other authority, *In re Sunrise Securities Litigation*, 130 F.R.D. 560 (E.D. Pa. 1989), which is older case law interpreting Pennsylvania law.

Accordingly, the court rejected application of the fiduciary exception as a basis to justify production of the emails. The court also rejected the argument that the exception applied because of "the fact that, when the communications took place, neither plaintiff nor [the firm] was threatening to sue the other." In so doing, the court rejected the proposition that a lawyer seeking in-house counsel for guidance on how to act properly with respect to the firm's client, regardless of whether to act ethically or otherwise in the client's best interest, "represents interests differing from those of [the client]."

The court also rejected application of the so-called "current-client exception," recognized in cases such as *Bank Brussels Lambert v. Credit Lyonnais [Suisse] S.A.*, 220 F.Supp. 2d 283 (S.D.N.Y. 2002). Under the current-client exception, "a law firm cannot invoke attorney-client privilege to withhold from a client evidence of any internal communications within the firm relating to the client's representation, including consultations with the firm's in-house counsel, that occurred while the representation was ongoing." The rationale behind this exception is the argument "that the law firm's in-house counsel's advice to other firm attorneys, on a matter as to which the firm's interests and those of a current outside client are not congruent, involves the firm in an impermissible simultaneous repre-

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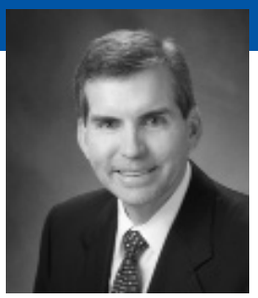
Avoiding Liability



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sentation of conflicting interests, namely, those of the outside client and those of the firm, as the in-house counsel's client." In rejecting this argument, the court noted the existence of "a significant body of case law" among the state courts "that unequivocally rejects the current-client exception to the attorney-client privilege" as well as the 2013 ABA resolution.

For such communications to be deemed privileged, in the view of the *Stock* court, the following requirements must be met: 1) Firm counsel must never have worked on any of the law firm client's matters and 2) The law firm client must not be charged for such consultation. Moreover, such privileged communication need not be limited to consultations concerning ethics issues nor must the law firm's client be in an adverse position to the law firm when the consultation occurs.

Firms should carefully consider these criteria when engaging in-house counsel to address ethical or professional-liability issues.