The Double Edged Sword: Internal Law Firm Privilege and the "Fiduciary Exception"

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I. Introduction

As law firms have grown in both size and organization, internal ethics and claims advice has increasingly taken on institutional form. Where in years past a law firm lawyer might have informally sought out a seasoned colleague to discuss a sensitive question of professional ethics or a potential claim against the firm, today that same discussion is more likely to be had with a formally designated internal firm counsel or a member of a firm committee charged with providing ethics and claims advice.[1]

Paralleling this institutionalization of internal advice on ethics and claims has been the recognition of the attorney-client privilege for such internal law firm discussions not unlike the privilege long recognized for corporations and other entities.[2] At the same time, however, courts have also increasingly recognized a "fiduciary exception" to internal law firm privilege when a firm's otherwise privileged discussions put it in conflict with a current firm client. Under the fiduciary exception, the law firm's fiduciary duty to the client "trumps" the firm's internal privilege and has led to the discovery of otherwise privileged internal communications concerning the client—typically in subsequent malpractice or related lawyer civil liability litigation by the client against the firm.

The fiduciary exception is not without critics. But, regardless of its relative legal and policy merits, the fiduciary exception's increasing recognition by courts makes it a very real consideration both for internal counsel providing advice to firm lawyers and for defense counsel handling subsequent disputes in which a former client seeks such communications by way of document request or deposition. This article will examine three aspects of the fiduciary exception. First, it will briefly survey the development of the exception in the law firm context. Second, it will explore the boundaries of the exception. Third, it will then conclude with a discussion of the practical impacts of the exception for both law firm internal counsel and outside defense counsel.

II. The Fiduciary Exception in the Law Firm Context

The fiduciary exception did not originate with law firms. Rather, the

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[1] For a discussion of this trend, *see* 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 (2002); Douglas R. Richmond, *Essential Principles for Law Firm General Counsel*, 53 U. KAN. L. REV. 805 (2005); Peter R. Jarvis & Mark J. Fucile, *Inside an In-House Legal Ethics Practice*, 14 NOTRE DAME J. L. ETHICS & PUB. POL'Y 103 (2000).

[2] *See* United States v. Rowe, 96 F.3d 1294 (9th Cir. 1996); Hertzog, Calamari & Gleason v. Prudential Ins. Co. of America, 850 F. Supp. 255 (S.D.N.Y. 1994); Nesse v. Shaw Pittman, 206 F.R.D. 325 (D. D.C. 2002).

exception traces its lineage to the English trust law concept that a fiduciary is prevented from asserting the attorney-client privilege against a beneficiary on a matter of trust administration.[3] In the law firm context, the generally acknowledged starting point is *In re Sunrise Securities Litigation*.[4]

As its name implies, *Sunrise* was a consolidated series of securities claims arising out of the failure of Sunrise Savings and Loan Association (Sunrise) in the 1980s. One of the defendants was the law firm that had served as Sunrise's outside general counsel. During discovery, the law firm withheld documents that, in part, concerned internal advice from firm attorneys regarding its representation of Sunrise. The firm argued that the documents were protected from discovery by the attorney-client privilege, analogizing them to a consultation with in-house counsel in the corporate context. The claimants moved to compel their production. The court initially rejected the concept that a law firm could claim privilege for internal discussions with lawyers functioning as the equivalent of in-house counsel, but then reversed itself on reconsideration, finding 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 with seeking legal advice from in house counsel."[5] The court, however, tempered its recognition of internal privilege by applying the fiduciary exception when the internal advice created a conflict between the law firm's own interests and that of a current client.[6] The court then returned the specific application of the exception to a special discovery master.[7]

After the *Sunrise* decision, the fiduciary exception in the law firm context was essentially dormant for over a decade.[8] Although the reasons are not completely clear, one possibility is that during the 1990s law firms were expanding the use of designated internal ethics and claims counsel. It was not until that development had become more common that issues relating to internal advice began to surface during discovery in legal malpractice and related lawyer civil liability cases.[9]

The period of quiet ended in 2002 with two decisions, *Bank Brussels Lambert v. Credit Lyonnais (Suisse), S.A.*, 220 F. Supp.2d 283 (S.D.N.Y. 2002), and *Koen Book Distributors, Inc. v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo, P.C.*, 212 F.R.D. 283 (E.D. Pa. 2002). Both cases involved claims for legal malpractice,[10] and both involved motions to compel internal law firm documents. Of the two, *Koen Book* presented both the privilege and the exception in the starker terms. The documents involved in *Koen Book* included internal discussions concerning ethical and legal issues triggered by a possible malpractice claim that took place while the firm was still representing the client involved.[11] *Bank Brussels* and the *Koen Book* relied on *Sunrise* for both the

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[3] Although they reach differing conclusions in the specific context of ERISA trustees, United States v. Mett, 178 F.3d 1058 (9th Cir. 1999), and Wachtel v. Health Net, Inc., 482 F.3d 225 (3rd Cir. 2007), both contain extended discussions of the origins, history and general application of the fiduciary exception.

[4] *In re* Sunrise Securities Litigation, 130 F.R.D. 560 (E.D.Pa. 1989) (Sunrise). For a detailed study of the early cases applying the fiduciary exception in the law firm context, s*ee* Elizabeth Chambliss, *The Scope of In-Firm Privilege*, 80 NOTRE DAME L. REV. 1721 (2005).

[5] Sunrise at 595.

[6] *Id.* at 595-98. At the time, conflicts between a law firm's own interests and those of a current client were governed by ABA Model Rule of Professional Conduct 1.7(b) and its state-adopted counterparts. The ABA Model Rules have since been amended and that category of conflict is now found in ABA Model Rule 1.7(a)(2).

[7] *Id.* at 597-98.

[8] *See* Elizabeth Chambliss, *The Scope of In-Firm Privilege*, 80 NOTRE DAME L. REV. at 1736.

[9] *See* note 1, *supra*.

[10] *Bank Brussels* also included a parallel claim for breach of fiduciary duty.

[11] *Bank Brussels*, by contrast, focused largely on conflict checks and related analysis.

proposition that the attorney-client privilege applies to consultations with internal counsel within law firms and that the fiduciary exception "trumps" the privilege when the discussions involved put the firm in conflict with a then-current client.

In the wake of *Bank Brussels* and *Koen Book*, knowledgeable commentators criticized both the legal basis for applying the fiduciary exception in the law firm context and the policy reasons for doing so.[12] The former focused primarily on *Sunrise's* importation of the fiduciary exception from trust law into a context that, while invoking central fiduciary duties, is governed by its own regulatory structure (both in terms of the professional rules and the application of the attorney-client privilege).[13] The latter noted that the exception puts law firms in a position that other professionals and their corporate counterparts do not face.[14]

Although those criticisms were well-articulated, courts since 2002 have continued to apply the fiduciary exception nonetheless. Because both the privilege and the exception typically arise on motions to compel at the trial court level, most of the reported decisions are from federal district courts. They include, chronologically:

- *VersusLaw, Inc. v. Stoel Rives, LLP*, 111 P.3d 866 (Wash. App. 2005), in which the Washington Court of Appeals reversed summary judgment in favor of the law firm and in remanding the case also dealt with a motion to compel internal law firm communications that remained pending

- *Thelen Reid & Priest LLP v. Marland*, No. C 06-2071 VRW, 2007 WL 578989 (N.D. Cal. Feb. 21, 2007) (unpublished), in which the United States District Court for the Northern District of California ordered the law firm to produce previously withheld documents requested by its clients, relying again on *Sunrise* and *Stoel Rives*;

- *Burns v. Hale and Dorr LLP*, 242 F.R.D. 170 (D. Mass. 2007) in which the District Court for the District of Massachusetts relied on *Bank Brussels* and *Koen Book* to reject a law firm's claim of privilege for its internal communications;

- *In re SONICblue Inc.,* No. 07-5082, 2008 WL 170562 (Bankr. N.D. Cal. Jan. 18, 2008) (unpublished), in which the Bankruptcy Court compelled internal law firm communications in the restricturing context;

- *Asset Funding Group, LLC v. Adams & Reese, LLP*, No. 07-2965, 2008 WL 4948835 (E.D. La. Nov. 17, 2008) (unpublished), in which the District Court for the Eastern District of Louisiana compelled production of internal firm communications with designated internal counsel citing the *Koen Book* and *In re SONICblue*.

The number of courts that have addressed this issue to date remains relatively small. The exception, therefore, does not yet "prove the rule." At the same time, the increasing number of decisions and their relative uniformity makes the fiduciary exception a practical feature on the legal landscape that law firms and their lawyers cannot ignore.[15]

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[12] *See, e.g.*, Douglas R. Richmond, *Essential Principles for Law Firm General Counsel*, 53 U. Kan. L. Rev. at 820-832; Elizabeth Chambliss, *The Scope of In-Firm Privilege*, 80 NOTRE DAME L. REV. at 1733-1765.

[13] Douglas R. Richmond, *Essential Principles for Law Firm General Counsel*, 53 U. KAN. L. REV. at 820-832.

[14] Elizabeth Chambliss, *The Scope of In-Firm Privilege*, 80 NOTRE DAME L. REV. at 1733-1765

[15] The fiduciary exception, of course, is not the only circumstance in which internal law firm privilege can be waived. In some instances, for example, a firm may choose to waive privilege. *See, e.g.*, Spur Products Corp. v. Stoel Rives LLP,

III. Boundaries of the Exception

Even where the fiduciary exception has been recognized, three important boundaries remain.[16]

First, the fiduciary exception has never been held to unequivocally require disclosure to a client of any consultation regarding the client by a law firm with its internal counsel. The American Bar Association, in Formal Ethics Opinion 08-453 (2008), which addresses ethics issues associated with internal consultations,[17] emphasizes that internal ethics consultations do not *automatically* create a conflict between a law firm and its client. Formal Ethics Opinion 08-453 notes that a conflict only arises under ABA Model Rule of Professional Conduct (Model Rule) 1.7(a)(2) when "there is a significant risk that the representation of one or more clients will be materially limited by . . . a personal interest of the lawyer."[18] Formal Ethics Opinion 08-453 observes that in most circumstances both the law firm and the client have similar interests in having the law firm's conduct comport with the applicable professional rules. In those circumstances, Formal Ethics Opinion 08-453 finds that generally a law firm would not have an obligation to inform the client of the consultation under Model Rule 1.4, which governs the duty of communication. By contrast, if a law firm committed a material error in handling a matter for a client, it would have a duty to inform the client (under Model Rule 1.4) and to obtain a conflict waiver from the client (under Model Rule 1.7(a)(2)) to remain on the matter (or withdraw). Formal Ethics Opinion 08-453 concludes that in this latter situation a law firm—at least as a matter of ethics[19]—may, but need not necessarily, inform the client that its conclusion was the result of internal consultation.[20]

Second, even the decisions applying the fiduciary exception to date noted above have limited it to consultations with internal—rather than outside—counsel. This limitation is inherent in their conflict analysis. Under *Sunrise* and its descendants, the conflict identified (as articulated in those cases) arises because a law firm lawyer (whether a designated firm counsel or committee or an ad hoc equivalent selected to address a particular matter on behalf of a firm) is advising the firm vis-à-vis a current firm client. ABA Model Rule 1.10(a), the so-called "firm unit rule," generally imputes a conflict by one firm

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122 P.3d 300 (Idaho 2005). In other instances, the crime-fraud exception may apply. *See generally In re SONICblue Inc.*, 2008 WL 170562 at *11 (discussing the crime-fraud exception generally in the law firm context).

[16] The fiduciary exception cases have generally applied it to materials otherwise protected from discovery by both the attorney-client privilege and the work product rule. *See, e.g.*, Koen Book Distributors, Inc. v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo, P.C., 212 F.R.D. at 286-87; Thelen Reid & Priest LLP v. Marland, 2007 WL 578989 at *8-*9; *In re SONICblue Inc.,* 2008 WL 170562 at *10.

[17] The opinion acknowledges the issues of evidentiary privilege raised by the fiduciary exception, but only addresses associated questions under the professional rules. In the *Asset Funding Group* case noted above, the defendant law firm moved for reconsideration in light of Formal Ethics Opinion 08-453. The court denied reconsideration, noting that Formal Ethics Opinion 08-453 left questions of privilege to evidence law. Asset Funding Group, L.L.C. v. Adams and Reese, L.L.P., No. 07-2965, 2009 WL 1605190 (E.D. La. June 5, 2009) (unpublished).

[18] The ABA Model Rules have been adopted (with local variation) in most states. The ABA Center for Professional Responsibility maintains an updated list of jurisdictions which have adopted (again, with local variation) the ABA Model Rules at http://www.abanet.org/cpr/mrpc/alpha_states.html. The ABA Center for Professional Responsibility's web site also has links to state professional rules throughout the country.

[19] As noted earlier, the fiduciary exception usually arises as a matter of evidentiary privilege in subsequent legal malpractice or related lawyer civil liability litigation.

[20] For similar analysis and conclusions, *see also* New York State Bar Association Committee on Professional Ethics Op. 789 (2005). ABA Formal Ethics Opinion 98-411 (1998) addresses the more general issue of lawyer-to-lawyer consultation.

lawyer to the firm as a whole. Therefore, under the rationale advanced in the cases applying the fiduciary exception to date, the law firms' "self-representation" as described in *Sunrise*[21] lies at the heart of the conflict identified. Because the focus is on the lawyer being consulted rather than on the firm seeking the consultation, there is no conflict under the *Sunrise* line when a firm consults with outside counsel who does not have those dual interests. In fact, at least some of the cases state outright that the exception would not apply if the firm consults with outside rather than internal counsel.[22] In short, at least to date, the decisions advancing the exception have effectively been self-limiting by the rationale advanced to internal counsel only.

Third, none of the decisions from *Sunrise* forward in any way suggest that the fiduciary exception applies to any law firm communications with counsel—whether internal or external—occurring or generated *after* the attorney-client relationship comes to an end. A central rationale for the exception (again as expressed in the decisions noted) is that the firm's fiduciary duty to its *current* client overrides the firm's internal privilege.[23] Indeed, the fiduciary exception decisions find that a remedy to ensure that privilege is preserved (albeit an often impractical one) is to withdraw in advance of the consultation (whether internal or external).[24] Again, therefore, the decisions advancing the exception have effectively been self-limiting in this respect as well.

IV. Practical Impacts of the Exception

The increasing recognition of the fiduciary exception has had two broad practical impacts for law firm internal counsel and their outside defense counterparts.

First, the trend has underscored the importance of establishing privilege in the first place. Just as in-house corporate counsel have long had to take steps to ensure that their legal advice to internal corporate clients was cloaked within the privilege, so, too, must counsel with the increasing number of internal law firm counsel.[25] These steps include: (a) formally designating internal counsel (whether by position, title or committee)[26] so the "attorney" side of the attorney-client privilege is clearly delineated; (b) not mixing lawyers providing the advice with those receiving it so the "client" side of the attorney-client privilege is equally demarcated; (c) billing internal counsel's time (and that of the firm lawyers seeking the consultation) to the firm so that it will

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[21] *See, e.g.,* Thelen Reid & Priest LLP v. Marland, 2007 WL 578989 at *7, *In re SONICblue Inc.*, 2008 WL 170562 at *9 and Asset Funding Group, LLC v. Adams & Reese, LLP, 2008 WL 4948835 at *3 (using that same description).

[22] *In re SONICblue Inc.*, 2008 WL 170562 at *11 ("[R]esearch has not uncovered any decision where a court denied the application of the privilege between a law firm and its outside counsel due to the law firm's breach of a fiduciary duty owed to its own client[.]"); *see also* Thelen Reid & Priest LLP v. Marland, 2007 WL 578989 at *7.

[23] *See, e.g.,* Koen Book Distributors, Inc. v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo, P.C., 212 F.R.D. at 286 ("[T]he firm still owed a fiduciary duty to plaintiffs while they remained clients. This duty is paramount to its own interests."); *accord* Thelen Reid & Priest LLP v. Marland, 2007 WL 578989 at *7.

[24] *See, e.g.,* Koen Book Distributors, Inc. v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo, P.C., 212 F.R.D. at 286 ("To avoid or minimize the predicament in which it found itself, the firm could have promptly sought to withdraw as counsel[.]"); *accord* Thelen Reid & Priest LLP v. Marland, 2007 WL 578989 at *7.

[25] *See generally* Barbara S. Gillers, *Preserving the Attorney Client Privilege for the Advice of a Law Firm's In-House Counsel*, 11 Prof. Law (ABA) 107 (Symposium Issue 2000); Brendan F. Quigley, *The Need to Know: Law Firm Internal Investigations and the Intra-Firm Dissemination of Privileged Communications*, 20 GEO. J. LEGAL ETHICS 889 (2007).

[26] If a firm lawyer is chosen to conduct an investigation on an ad hoc basis, the lawyer's appointment should be confirmed by firm management so that the lawyer's role as special counsel to the firm is clear. *See, e.g.,* United States v. Rowe, 96 F.3d 1294 (9th Cir. 1996).

be clear that the firm itself is the client for the advice rendered;[27] and (d) giving (and keeping) the advice in a confidential setting for the same reasons done so generally for the privilege to attach and to be preserved. All the arguments in the world against application of the fiduciary exception are non-starters if the privilege has not attached to the discussions involved in the first place.

Second, prudent internal corporate counsel has long recognized that even well-grounded assertions of privilege may be subject to claims of waiver. Further, because the fiduciary exception arises most often at the trial court level on motions to compel, avenues for interlocutory appellate review of an unfavorable decision from the law firm's perspective may be limited. As a practical matter in today's environment where firm counsel often advise large numbers of lawyers across multiple offices it is simply unrealistic for advice not to be communicated by email in many if not most situations. However, given the expansive nature of the fiduciary exception, internal counsel should remain diligent in crafting advice with the expectation of waiver of privilege.

As an equally practical matter, however, firm counsel and firm lawyers should be mindful of the fiduciary exception cases when both providing and receiving that advice in a world where quick emails dashed off without circumspection often become the fodder of very large demonstrative exhibits for the jury at trial. This is especially the case when the advice concerns conduct which has already occurred and might conceivably lead to a claim against the firm. The latter situation is also one that will most often give rise to a need for a conflict waiver for the firm to proceed.[28] Therefore, even though the client may not have been informed at the time of the internal discussions that led to the conclusion that a waiver was needed, it will not involve "rocket science" for a reasonably astute claimants' counsel in subsequent malpractice litigation to look there for internal documents. This will, in turn, put the fiduciary exception again in the cross-hairs of discovery.

V. Conclusion

The United States Supreme Court described the essence of the attorney-client privilege in *Upjohn Company v. United States*, 449 U.S. 383, 389, 101 S. Ct. 677, 66 L. Ed.2d 584 (1981): "Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." It is well to remember that *Upjohn* itself addressed (and upheld) the attorney-client privilege as applied to internal corporate counsel. *Upjohn*'s description of the importance of the attorney-client privilege within organizations highlights that it is precisely when a law firm encounters a difficult issue of professional ethics or a possible claim that advice from internal counsel is of the greatest benefit. Although the ultimate outcome of the debate over the fiduciary exception remains to be written, the exception has gained enough notoriety that law firm internal counsel and their outside defense lawyers need to be acutely aware of it.

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[27] Under ABA Model Rule 1.13(a), a lawyer's client when representing an entity is the entity itself acting through its constituents. Like their corporate counsel counterparts, internal firm lawyers need to maintain that boundary so they will not inadvertently take on the lawyers consulted as individual clients as well and thereby create (at least in some circumstances) conflicts between the firm as a client and the individual firm lawyers as separate clients. *See* Peter R. Jarvis & Mark J. Fucile, *Inside an In-House Legal Ethics Practice*, 14 NOTRE DAME J. L. ETHICS & PUBLIC POL'Y at 111.

[28] *See* ABA Formal Ethics Op. 08-453 at 3.