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Inside Counsel: The Attorney-Client Privilege *Within* Law Firms

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In recent years it has become increasingly common for a designated lawyer or committee within law firms to handle malpractice avoidance and claims management. With small to mid-size firms, the job often falls to the managing partner or a senior litigator. Many large firms, in turn, now have general counsel or ethics/claims committees. The trend makes good sense. As the practice of law has grown more complex, lawyers within firms need seasoned advice about managing difficult issues and client relationships.

Is that advice protected by the attorney-client privilege if a client later sues the firm? The answer is a classic "Yes, but . . ."

The "yes" part is relatively clear: most courts examining the issue have concluded that legal advice rendered by designated internal claims or ethics counsel to law firm lawyers is covered by the attorney-client privilege. *See, e.g.*, *Nesse v. Shaw Pittman*, 206 F.R.D. 325 (D.D.C. 2002) (law firm general counsel); *United States v. Rowe*, 96 F.3d 1294 (9th Cir. 1996) (designated internal investigation team).

The "but" part is more problematic: an as yet small but growing series of cases developing around the country conclude that if the advice was given while the law firm was still representing the client in the matter involved the firm's fiduciary duty to the client “trumps” the law firm’s internal attorney-client privilege and the client is entitled to discover what was discussed with internal counsel in subsequent malpractice litigation.

Two recent cases illustrate both aspects.

VersusLaw, Inc. v. Stoel Rives LLP, 127 Wn. App. 309, 111 P.3d 866 (2005), *rev. denied*, 156 Wn.2d 1008, 132 P.3d 147 (2006), involved litigation that arose over a set of agreements a law firm drafted for a client that contained an agreed limitation period for claims that was shorter than the time otherwise permitted by statute. A question arose during the litigation over whether the law firm had asserted a counterclaim within the contractual limitation period. One of the lawyers involved discussed the case with the firm’s in-house counsel and two memos resulted. The client later sued the law firm for malpractice. During the lawyer’s deposition, the two memos came to light. The client sought the memos, but the law firm resisted their production under the attorney-client privilege. The client argued that because the memos were written while the law firm was still representing it the firm’s fiduciary duty to it should prevail over the attorney-client privilege. The client’s motion to compel was pending at the point the trial court granted summary judgment for the firm. The Washington Court of Appeals reversed and in remanding the case addressed the client’s motion to compel.

The Washington Court of Appeals agreed with the firm that internal law firm communications with claims or ethics counsel generally fall within the attorney client privilege. It agreed with the client, however, that a firm's fiduciary duty to a client "trumps" the attorney-client privilege when the advice was rendered while the firm was still representing the client:

> "The question is whether a law firm can maintain an adverse attorney-client privilege against an existing client. Stoel Rives cites a number of cases where the attorney-client privilege applies to in-house law firm communications. . . . But while these cases recognize the attorney-client privilege can apply to intra-firm communications, none of the cases Stoel Rives cites and relies on address whether the attorney-client privilege can be asserted against a law firm's then-current client. In addition, Stoel Rives does not cite any case where the attorney-client privilege protects communications in these circumstances. VersusLaw, however, cites authority from other jurisdictions that communications between lawyers in a firm that conflict with the interest of the firm's client may not be protected from disclosure to the client by the attorney-client privilege." *Id*. at 333-34 (citations omitted).

Thelen Reid & Priest LLP v. Marland, No. C06-2071VRW, 2007 WL 578989 (N.D. Cal. Feb. 21, 2007) (slip op.), involved a contract dispute between a law firm and its client. The law firm agreed to represent the client in a *qui tam* action in return for a contingent fee. The law firm later began representing a state agency seeking the same recovery. There was a dispute over whether the law firm disclosed the potential conflict. The law firm eventually withdrew from representing the client in the *qui tam* action but continued as its outside general counsel and also continued its fee sharing arrangement in the event the *qui tam* action proved successful. Still later, it negotiated a modification in the fee sharing arrangement that reduced the client's share of any potential recovery. The *qui tam* action eventually produced nearly $1 billion in recoveries. A dispute followed between the law firm and the client over their relative shares, with the client arguing that the modification was invalid and the law firm contending that it was enforceable.

In the course of their litigation, the client sought internal communications between the law firm's general counsel and its executive committee at the time the modification was negotiated. The law firm argued they were privileged. The client, in turn, argued that the firm's fiduciary duty to the client "trumped" the firm's internal attorney-client privilege. The U.S. District Court for the Northern District of California agreed. In doing so, the court relied on *VersusLaw* while attempting to draw a line between general advice on the firm's legal and ethical obligations with self-protective advice vis-à-vis a client once a potential conflict or claim arises:

> "[W]hile consultation with an in-house ethics adviser is confidential, once the law firm learns that a client may have a claim against the firm or that the firm needs client consent in order to commence or continue

another client representation, then the firm should disclose to the client the firm's conclusions with respect to those ethical issues." *Id*. at *8.

VersusLaw and *Thelen* echo (and rely on) several other comparatively recent decisions around the country, including *Koen Book Distrib. v. Powell, Trachtman, Logan, Carrie, Bowman & Lombardo*, 212 F.R.D. 283 (E.D. Pa. 2002), and *Bank Brussels Lambert v. Credit Lyonnais (Suisse), S.A.*, 220 F. Supp.2d 283 (S.D.N.Y. 2002). The cases recognizing what is sometimes called the "fiduciary exception" to the privilege generally turn on the position that as long as the law firm continues to represent the client that it can act only in the client's best interest, not its own.

The "fiduciary exception" cases have generated significant discussion and debate in law firm risk management circles. The contrary view is that law firms ought to be able to seek internal advice about compliance with the ethics rules in light of law firms' general duty to take reasonable steps to ensure that their lawyers and staff meet their professional obligations. A recent ethics opinion from the New York State Bar, for example, took this position. The opinion, No. 789, argued that consultation with in-house counsel was encouraged under the professional rules and did not, in and of itself, create a conflict with a client requiring disclosure. At the same time, even the New York opinion conceded that the conclusion reached by the firm's internal deliberations may warrant disclosure to the client involved and that the attorney-client privilege and its exceptions are ultimately matters of substantive evidence law. *Thelen* cited the New York opinion in drawing what is still a potentially broad exception to law firms' internal privilege.

These cases also put law firms in a very difficult practical position for a number of reasons.

When lawyers become (or should be) aware that they have committed malpractice in an on-going representation, they have a duty under the state variants of ABA Model Rule of Professional Conduct 1.7(a)(2) and corresponding fiduciary law to inform their client and seek a waiver before proceeding. Most such waivers, however, do not include specific language to the effect that the firm will be conducting internal analysis vis-à-vis the client and will seek to shield that analysis from the client in the event of a claim. Frankly, if they did, most clients probably wouldn't sign them (which, ironically, underscores the nature of the conflict).

Similarly, because the "fiduciary exception" has only been applied to discussions and memoranda generated while the firm is still representing the client, some commentators have suggested that a firm withdraw at the first sign of a problem so that it is free to review the situation without the fear that its own analysis will be used against it in a later malpractice case. To state this approach is to highlight its practical problems for both lawyers and their clients.

Thelen's attempt to draw a line between general and self-protective advice reflects both its criticism of this approach and its imperfect practical solution.

Finally, it is often precisely when law firms are handling difficult matters for "difficult" clients that advice from internal claims or ethics counsel will be of greatest benefit. The specter of *VersusLaw*, *Thelen* and similar cases should not prevent that advice altogether. They may, however, make that advice more circumspect in light of the potential for disclosure later.

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