



Lawyers' Professional Liability UPDATE

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Conflicts & Privilege

Corporate Officer's Communications With Firm Not Privileged

Mueller Industries, Inc. v. Berkman, 399 Ill. App. 3d 456, 927 N.E.2d 794 (2nd Dist. 2010)

A law firm initially represented a corporation and its president. That representation continued after the corporation was acquired by Mueller Industries (Mueller). After the president resigned and went to work for a competitor, Mueller sued him for fiduciary breaches as president for favoring a primary supplier in which he had an undisclosed financial interest. The issue before the court was the discoverability of communications with the law firm relating to the supplier.

The court turned to a decision by the U.S. Court of Appeals for the Third Circuit, *In re Bevill, Bresler & Schulman Asset Management Corp.*, 805 F.2d 120 (3d Cir.1986), in which the court adopted a five-part test as to whether a corporate officer may assert an individual attorney-client privilege as to communications with an attorney who concurrently represented the corporation:

- (1) the officer must have approached the corporate counsel for the purpose of seeking legal advice;
- (2) the officer must have made it clear from the start that the officer sought advice in his or her individual capacity;
- (3) corporate counsel chose to advise the officer, despite knowing that a potential conflict could arise;
- (4) the officer's communications with counsel were confidential; and
- (5) the substance of the communications did not concern "matters within the company or the general affairs of the company."

Here, the fifth prong was not met because the communications with the law firm were not "outside the scope of the corporation's concerns and affairs." The document request related to the legal advice that the law firm had provided to the president regarding his relationship with the supplier and the creation of a competitor to Mueller, while a corporate officer of Mueller.

The court also found the crime-fraud exception applicable to a breach of the president's fiduciary duty to Mueller whereby he profited from his relationship with a supplier, without Mueller's knowledge. The intentional breaches of fiduciary duty equated

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with the nature of fraud required for the crime-fraud exception. The trial court, however, needed to determine by *in camera* review whether the documents sought showed an intent to further a fraudulent scheme.

Sanctions

Second Circuit Splits on Authority of Magistrate Judge to Impose Rule 11 Sanctions Absent Consent of the Parties

Kiobel v. Millson, 592 F.3d 78 (2nd Cir., Jan. 8, 2010)

In summary, a panel of the U.S. Court of Appeals for the Second Circuit filed separate concurring opinions on the nature of a magistrate judge's authority to issue Fed. R. Civ. P 11 orders sanctioning attorneys absent consent of the parties. Because the panel split evenly, the question of the deference to be paid to a magistrate judge's sanctions order remains unresolved.

The Federal Magistrate Judge Act (Act), 28 U.S.C. § 636(b)(1)(A), authorizes magistrate judges to issue orders resolving certain pretrial matters without the parties' consent. Excluded from the scope of that authority are "dispositive motions such as motions for injunctive relief." The magistrate judge in this case ordered Rule 11 sanctions of money and attorney fees related to the Rule 11 motion against members of the defense team for two factual statements with respect to certain testimony and evidence in a class certification proceeding. Chief Judge Kimba Wood of the district court applied a deferential "clearly erroneous or contrary to law" standard of review for both the imposition and amount of the sanctions, and affirmed the magistrate judge's opinion and order. Defense counsel appealed on the merits, and contended that absent the parties' consent to the magistrate judge's authority to issue dispositive decisions, the district court properly should have treated the magistrate judge's order not as a dispositive decision, but rather as a "report and recommendation" under 28 USC § 636(b)(1)(B), thus subject to *de novo* and not deferential review by the district court.

A panel of the Second Circuit reversed the district court's order imposing sanctions because it disagreed with the imposition of sanctions on the merits. In three separate opinions, the panel then addressed the degree of deference that the district court should accord to a magistrate judge's sanctions decision absent the parties' consent.

Judge Jose A. Cabranes agreed with other courts that have analyzed the scope of a magistrate judge's sanctions authority from the starting point of independent claims, because a magistrate judge's disposition (in contrast to a report and recommendation) of those is not allowed under the Act without the parties' consent. To Judge Cabranes, a Rule 11 sanctions award should be treated as the functional equivalent of an independent claim. As such, for a magistrate judge to decide sanctions with the force of an order on a "dispositive" issue (as opposed to issuing a "report and recommendation" on the issue), and thus to be entitled to deference on review, a magistrate judge's sanctions decision would require the parties' consent.

By contrast, Judge Pierre Leval interpreted the Act as giving magistrate judges broad powers to hear and determine a range of matters, excepting those expressly prohibited within the Act. Although resolution of dispositive issues is outside the scope of a magistrate judge's powers absent the parties' consent, a Rule 11 sanction does not dispose of a claim. Therefore, magistrate judges' decisions on sanctions should be entitled to deference on review, regardless of the parties' consent. Judge Leval cited a 1990 decision in which the court there held that monetary sanctions are not "dispositive," and noted Congress's silence on the issue when it subsequently amended the Act in 2000 to give magistrate judges enhanced punitive and contempt authority.

Chief Judge Dennis Jacobs declined to join the opinion of either of his colleagues and instead noted the gulf between their two opinions. He cited the same 1990 decision as Judge Leval, but concluded that Congress's subsequent silence created more ambiguity, not less. Because the Act did not offer clear direction, Chief Judge Jacobs wrote that he would defer the issue to Congress or the U.S. Supreme Court to unravel.

This opinion offers litigators two contrasting views of the nature of a magistrate judge's powers under the Act, and the consequent standard of review on appeal. Until either the Supreme Court or Congress follows the suggestion of Chief Judge Jacobs to resolve the Act's inherent ambiguity, good arguments can be made on both sides, and the Second Circuit's opinions will provide potentially persuasive authority for either result.

Privilege

State Appeals Court Adopts U.S. Supreme Court's Recent *Mohawk Industries* Holding: Privilege Ruling Not Subject to Interlocutory Appellate Review

Kurstin v. Bromberg Rosenthal, LLP, 191 Md. App. 124, 990 A.2d 594 (Md. App. 2010)

In summary, discovery rulings adverse to the attorney-client privilege are not immediately appealable under the collateral order doctrine. The law firm of Bromberg Rosenthal LLP (Bromberg) represented a client in her divorce. A contract dispute involving the divorce settlement agreement later arose. In that dispute, the client employed new counsel and eventually settled. Bromberg later sued the former client for unpaid legal fees. The client brought a malpractice counterclaim based on economic harm she had suffered in settling the post-divorce litigation. Bromberg argued that this harm was caused by her new counsel, rather than by Bromberg's work on the original divorce settlement. Bromberg sought to depose the client's new counsel and sought discovery of all documents related to his representation of the client. The client moved for a protective order based on her attorney-client privilege. The Montgomery County Circuit Court (Maryland) denied the motion based on waiver of the privilege. The client sought immediate appeal of this order.

The Maryland Court of Special Appeals held that the order was not immediately appealable. It noted that the order was not appealable as a final order, and that the parties had not argued the issue of finality. The court focused on whether the order was appealable under the common law collateral order doctrine, which allows immediate appeal if: (1) the order is conclusive, (2) the order resolves an important issue, (3) the issue is completely separate from the merits of the case, and (4) the order would be effectively unreviewable following appeal from final judgment. The court held that the client's appeal met none of these four requirements, relying in part on the conclusion that the pretrial discovery ruling was not tantamount to a ruling on admissibility at trial.

The court alternatively held that discovery orders are almost categorically excluded from immediate appeal. In doing so the court relied substantially on *Mohawk Industries, Inc. v. Carpenter*, 558 U.S. ___, 130 S. Ct. 599 (2009), in which the U.S. Supreme Court held that most discovery orders are not immediately appealable as a matter of right, and specifically that the vitality of the attorney-client privilege is adequately protected by post-judgment and other review mechanisms. Improper disclosure of privileged material, the U.S. Supreme Court held, can be remedied on appeal by "vacating an adverse judgment and remanding for a new trial in which the protected material and its fruits are excluded from evidence." The Supreme Court also noted that if an order is particularly injurious, litigants have other immediately available avenues, such as requesting an interlocutory appeal, petitioning for a writ of mandamus, or defying the order and incurring sanctions (which would be subject to review after final judgment). The Supreme Court was not swayed from its categorical holding by the fact that certain orders adverse to the attorney-client privilege may be imperfectly repairable.

State court rules related to immediate appeal, including the collateral order doctrine, may vary from state to state, and generally are not controlled by U.S. Supreme Court precedent related to federal court appeals. This opinion is significant because Maryland chose to follow the U.S. Supreme Court's categorical holding in *Mohawk Industries* denying interlocutory appellate review. Moreover, both opinions do little if anything to differentiate attorney-client privilege issues from other evidentiary issues in the context of immediate appeals. Despite the admitted importance of the privilege, neither the federal nor the state court was willing to afford it special treatment.

"But For" Causation

The Trial-Within-a-Trial Presents an Issue of Fact as to What a Party in the Underlying Matter Would Have Done Absent the Law Firm's Error

Suder v. Whiteford, Taylor & Preston, LLP, 413 Md. 230, 992 A.2d 413 (Md.2010)

Plaintiff was appointed personal representative of her husband's estate. Because she was uncertain about whether to elect to take her statutory share instead, several extensions of time to do so were requested and granted. The first two she requested *in pro per*. The law firm then undertook her representation and made additional requests, but it failed to request a

fifth extension, precluding plaintiff from making an election. Had plaintiff been able to do so, the decedent's son, as the sole residuary beneficiary, would have received one-third less. The law firm did not dispute fault, but contended that the cause of loss was plaintiff's initial failure to request an extension until after the time to do so had lapsed, although the court granted the request. In the legal malpractice action, the trial court granted summary judgment for the law firm.

The Maryland Court of Appeals held that the issue of causation was to be determined by the trial-within-a-trial methodology. Plaintiff contended that it did not apply here because the son challenged the fifth request for an extension, raising no issue about the first request, which would have been voidable though not void. The predicate of the doctrine is to determine what would have occurred had the law firm timely filed a fifth request for an extension. The law firm's challenge was not precluded merely because the son did not challenge the timeliness of the first request. Thus, the court remanded for an evidentiary determination of what the son knew and what would likely have occurred if the law firm had not erred.

Conflicts

Conflicting Testimony of Fault Concerning Adverse Representation Was for the Jury to Resolve

Alpha Capital Management, Inc. v. Rentenbach, ___ Mich. App. ___, ___ N.W.2d ___, 2010 WL 1051193 (2010)

Burrell and Warfield jointly owned ACM, a financial consulting business. Burrell also owned SymCom, an information systems and management consulting business to which the law firm of Dykema Gossett, P.L.C. (Dykema) served as general counsel. The law firm also formed ACM and acted as its counsel. The two principals undertook to terminate their relationship. Dykema requested a conflict waiver so it could represent Warfield. Although Burrell refused, the law firm prepared draft agreements for the buyout and billed ACM. Burrell and ACM sued Warfield and others, and Dykema undertook to defend Warfield and the other defendants, which ultimately settled in favor of Burrell and ACM.

ACM then brought a legal malpractice action for fiduciary breach. The court started its analysis from the premise that even in a closely held corporation, as here, with each shareholder owning 50 percent, the law firm's client is the entity. The common law and ethical rules imposed a duty of loyalty and confidentiality where the matters are both adverse and substantially related. Both sides presented expert witnesses whose opinions diverged widely as to whether the conduct was adverse to ACM. The expert witness for ACM testified that confidential information was necessarily involved in counseling the clients regarding the financial terms and structures. The defense witness testified that no confidential information was implicated or used in the drafting of agreements. After the jury found for the law firm, the trial court rejected plaintiff's motion for judgment notwithstanding the verdict.

The appellate court affirmed on the ground that the issue of breach was one of fact for the jury and commented that there was no evidence of information presented at trial that was not known to all parties. The court approved a jury instruction that referenced the testimony of the expert witnesses concerning ethics rules, and cautioned: "you must keep in mind that a violation of the Michigan Rules of Professional Conduct do not create the basis for a claim, nor does it create any presumption that a legal duty has been breached. The Michigan Rules of Professional Conduct are not designed to be a basis for civil liability."

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