The Lawyers' Lawyer Newsletter

Recent Developments in Risk Managment

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In-House Counsel – Admission to the Bar – Availability of Attorney-Client Privilege When General Counsel Not Admitted in Jurisdiction of Principal Practice

***Gucci America, Inc. v. Guess?, Inc.*, 2011 WL 9375 (S.D.N.Y.)**

[Editors' Note: This is an update of the article in the Volume 15, Issue 4 (October 2010) edition of *The Lawyers' Lawyer Newsletter* on the decision of the magistrate judge in this case that was overturned by U.S. District Court for the Southern District of New York Judge Shira Scheindlin, as discussed here.**]**

Risk Management Issue: What should be done to ensure that in-house counsel maintain an active license and continuing good standing to practice law, and what are the consequences of instances when in-house counsel fail to maintain such a license?

The Case: U.S. Magistrate Judge James L. Cott held that corporate plaintiff Gucci's communications with its in-house attorney were not privileged because the lawyer was not an active member of any state's bar. Judge Scheindlin set aside Magistrate Judge Cott's order, and upheld the assertion of privilege with respect to communications with Gucci's in-house counsel even though he was not admitted to any bar at the time of those communications.

Judge Cott had denied the assertion of the privilege on two grounds. First, the in-house counsel was not, at the time of the communications, "a member of the bar of a court;" the court concluded that his status as an inactive member of the California Bar did not meet this standard. Second, Judge Cott had held that the lawyer's employer, plaintiff Gucci, did not have a reasonable basis to believe that the lawyer was authorized to practice law because Gucci never investigated the attorney's qualifications.

Judge Scheindlin set aside Magistrate Judge Cott's decision and order, concluding that the requirement that "the person be a [*sic*] 'a member of the bar of a court'" was met despite his inactive status in California. She held:

> More importantly, throughout the operative period, [the in-house counsel] held the position of legal counsel and director of legal services. Gucci was his sole client. Every communication on legal matters (as opposed to business advice) between [the in-house counsel] and his employer were clearly intended to be protected attorney-client communications. The purpose of the privilege is to protect the client's communication, and to encourage full and frank disclosure when seeking legal advice, which is why the client holds the privilege and only the client can assert or waive it. Gucci should not be penalized because its attorney, a member of the bar in two jurisdictions, may not have been 'authorized to practice law' based on his 'inactive' status as a member of the California bar.

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Risk Management Solution: Notwithstanding that Gucci ultimately "ducked a bullet" here, the fact that the issue was in doubt at all, and became the subject of protracted litigation, strongly suggests that in-house legal departments should institute the same kinds of controls that are customary in law firms to ensure that all those who are held out as lawyers within the entity are in fact licensed and duly admitted in each jurisdiction where they practice. Such procedures will protect the attorneys individually and collectively and also demonstrate the corporate employer-client's diligence in ensuring that all in-house counsel retain licensure.

Ensuring proper licensure may be complicated when in-house legal staff are required to travel to and advise in multiple jurisdictions on behalf of their employers or, as occurred in this case, the lawyer moves between legal and non-legal roles. The importance of licensure, demonstrated by this case, makes it essential that in-house counsel endeavor to understand the adoption (or not) of ABA Model Rule 5.5 (multi-jurisdictional practice) wherever they regularly operate, and that they comply with the registration procedures for in-house lawyers that are now available in many states.

Attorney-Client Privilege – Asserting the Privilege for Law Firm's Internal Communications – Client Conflicts

TattleTale Alarm Systems, Inc. v. Calfee, Halter & Griswold, LLP, et al., 2011 WL 382627 (S.D. Ohio 2011)

Risk Management Issue: How can law firms protect their internal communications from discovery when they communicate internally regarding the firm's potential malpractice in an existing client's matter?

The Case: TattleTale Alarm Systems brought a legal malpractice action against its former law firm, Calfee, Halter & Griswold, LLP, for the firm's alleged failure to file a patent maintenance fee on TattleTale's behalf, resulting in the lapse of the patent. TattleTale moved to compel discovery of documents relating to Calfee's internal communications after it became aware that TattleTale might assert a malpractice claim against the firm. Calfee claimed that those documents were privileged. TattleTale argued that they were created while the company was still a client of the firm (and thus owed fiduciary duties by the firm), and that accordingly, it was a conflict of interest for the firm to engage in privileged communications about its client that were adverse to the client's interests. According to TattleTale, this conflict of interest vitiated the otherwise privileged nature of such communications.

The court first determined that state law governed, and thus framed its opinion in terms of what the Ohio courts would likely do. The court then held that individual attorneys within a law firm may seek legal advice from their colleagues about matters relating to the firm's interests, and that when they do so, they are clients of the lawyer(s) whose advice has been sought. As a result, their communications are protected by the attorney-client privilege. Finally, the court addressed whether the Ohio courts would recognize an exception to the attorney-client privilege for loss prevention communications, and concluded that they would not.

As the court explained, under Ohio law, courts will generally create an exception to the attorney-client privilege in three circumstances: (1) when the communications sought to be protected serve no societal value (such as the types of communications that fall within the crime-fraud exception); (2) when application of the privilege would not further the policy goal of open communication between clients and lawyers; and (3) when application of the privilege would prevent a party from proving its case because all or most of the relevant evidence is contained in privileged communications.

In analyzing these categories in the context of internal loss prevention communications, the court found that important societal values are served by applying the privilege to such communications: "[I]ndividual lawyers who come to the realization that they have made some error in pursuing their client's legal matters should be encouraged to seek advice promptly about how to correct the error, and to make full disclosure to the attorney from whom that advice is sought about what was done or not done, so that the advice may stand some chance of allowing the mistake to be rectified before the client is irreparably damaged." With respect to category (3), the court noted that it would be hard to conceive of a situation where the only evidence of legal malpractice could be found within the firm's internal loss prevention documents.

Lastly, the court addressed TattleTale's argument that the firm's internal loss prevention communications were not "worthy of protection" because the law firm had developed a conflict of interest with its client but had not discharged its ethical duty to disclose the conflict and obtain the client's consent to the conflicting representation. The court noted that the theory had formed the basis for opinions from other jurisdictions in which the courts were unwilling to carve out an exception for these types of communications. In analyzing the reasoning of these cases, however, the court found that they unreasonably relied upon precedent as stating an absolute rule, when in fact a more nuanced approach was equally supportable. Drawing from a balancing test articulated in one of the more recent cases, the court held that the client could overcome the privilege here if it could make an adequate showing of good cause. In determining whether good cause had been established, the court analyzed factors such as: the extent to which a law firm's conduct may have been either criminal or fraudulent, whether the privileged communications related to past or future conduct, and whether the client had other readily available sources of proof. In this case, the court held that none of those factors favored allowing TattleTale to have access to the communications at issue.

Comment: This opinion potentially marks a major shift in the application of attorney-client privilege to internal law firm risk management communications. It also underscores the importance of law firms having a general counsel to whom such questions can be directed. While this case was decided under Ohio law, it should have application elsewhere, as Ohio law with respect to attorney-client privilege is not unusual. The good reasoning and policy sense of this opinion are also consistent with ABA Model Rule 1.6, which provides an exception to client confidentiality so that an attorney may seek legal advice regarding his or her own ethical obligations.

Risk Management Solution: Although this case should have widespread application, the law varies from jurisdiction to jurisdiction and law firms should not count on consistency in different judges' analyses of this issue. Law firms are well-advised to appoint a lawyer as general counsel, and to encourage their lawyers to take this kind of client issue exclusively to the general counsel or his or her designated deputies. Because this case is the first to give unequivocal support to the application of the privilege to communications with law firm general counsel when those communications relate to a current client, law firms may be well-advised to bring in outside counsel as soon as it is apparent that such a conflict exists in order to afford it the greatest protection possible for its communications.

Law Firm Management – Supervisory Responsibility for Ethical Violations of Lawyers and Non-Lawyer Assistants

In the Matter of a Member of the State Bar of Arizona, Jeffrey Phillips, No. SB-10-0036-D (Ariz. Sup. Ct. Jan. 11, 2011)

Risk Management Issue: What do law firms' managing partners need to do to comply with the ethical obligations imposed to assure supervision of, and ethical conduct by the firm's lawyers and non-lawyer assistants?

The Case: Jeffrey Phillips, the responding attorney in disciplinary proceedings before the Supreme Court of Arizona, is the founder and managing partner of a high-volume, "consumer law firm" that handled personal injury, bankruptcy and criminal defense matters exclusively. At the time of the proceedings, the law firm employed approximately 250 people, including 38 lawyers. Phillips had general control over the firm and was responsible for setting firm policy on billing and client-intake procedures, among other things. A disciplinary hearing officer found that he was responsible for violating Arizona's ethical rules (ERs) 5.1 and 5.3, where the law firm's lawyers and non-lawyer assistants breached ethical duties to the firm's clients.

The disciplinary charges against Phillips stemmed from multiple client complaints over the course of time, which the hearing officer placed into three categories: (1) breakdowns in client communications due to a high per attorney caseload (in the bankruptcy department); (2) client misunderstandings and unmet expectations regarding the scope of the firm's engagement (arising out of the firm's intake procedures); and (3) "high pressure tactics" used by legal administrators to discourage clients from discharging the law firm. On this last category, the hearing officer noted that the administrators' bonuses were tied, in part, to client retention, which provided a "motive for the misconduct."

Phillips had been disciplined previously for similar problems at the law firm. That had led to an Order requiring the law firm to make certain changes to its internal practices. For example, the firm was required to have a licensed attorney meet with all prospective clients and approve fees to be charged before the firm could sign an engagement agreement with the client. The firm was prohibited from giving bonuses to intake staff which were based upon the number of clients that retained the firm and the fees generated by those clients. The Order also required timekeepers in the criminal department to keep contemporaneous time records, so as to enable the firm to review the total fee charged in hindsight to determine if the client was due a refund.

Based upon multiple client complaints over the course of three years, the hearing officer found that Phillips had violated ER 5.1(a), governing a supervising partner or lawyer's duties to assure compliance with the ethical rules by other attorneys, and 5.3(a), governing the duty to assure compliance by non-lawyer assistants. Phillips petitioned for review, arguing that the hearing officer had erred by applying a "vicarious liability" standard to him and that he was being held responsible for the ethical violations committed by others in the firm. He also contended that he had introduced "mountains of evidence" of compliance with the firm's revised policies, and that actual ethical violations were "relatively rare."

The Arizona Supreme Court disagreed that the hearing officer erred. The Court found that Phillips was not being held liable for the others' violations; rather, he was found responsible because of his own failure to comply with the requirements of ERs 5.1 and 5.3. The Court commented that Rules 5.1(a) and 5.3(a) impose direct responsibility on a partner or other lawyer with managerial authority to make reasonable efforts to ensure that the firm has measures in place to give reasonable assurance that all attorneys in the firm conduct themselves ethically. Similarly, managing lawyers are directly responsible for making sure that the firm takes measures to ensure ethical conduct by its non-attorney employees. In order to comply with the ethical rules, the manager must not only undertake direct supervision of others, but also implement policies that are reasonably designed to ensure ethical conduct.

The Supreme Court also noted that in a high-volume firm such as Phillips', compliance with the ethical rules may require a more rigorous effort. Drawing from the comments to the ethical rules, the Court stated that what is "reasonable" depends on the facts; firm size is relevant, and in high-volume firms such as Phillips' "more elaborate supervision may be necessary."

Comment: This case illustrates the tension that frequently exists between a law firm's business model and its duties to comply with the rules of professional responsibility. Although violations of other ethical obligations were alleged in this case—for example, duties of competence and client communications—the disciplinary authorities focused on those ethical violations that stemmed from the firm's client intake and retention policies, billing or time-keeping practices, and non-lawyer compensation incentives. Law firms of all sizes implement and practice policies—formal and informal—which are designed to maximize productivity and profit. It may be more difficult to ensure ethical compliance when such "motives for misconduct" are present, as the hearing officer noted.

Risk Management Solution: Law firm managers and supervisory partners are cautioned that even when a firm adopts policies reasonably designed to assure ethical compliance, it is necessary for them to participate actively in overseeing the actual practice of junior lawyers and assistants. Managing lawyers will not be permitted to rest on the existence of reasonable procedures in order to comply with their own direct obligations. Law firm managers may consider establishing a mechanism for regular feedback from lawyers responsible for supervising matters in progress in order to improve day-to-day oversight in a positive manner.

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