ETHICS:
ETHICAL MORASSES FACING IN-HOUSE COUNSEL MANAGING LITIGATION

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Areas for Ethical Morass Facing In House Counsel Managing Litigation

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The job of the in house lawyer has become increasingly more complex. As the economy turned south, many in house lawyers were faced with increased claims, fewer staff and increased business roles. Now that the economy has seemingly settled down, such in house lawyers still have fewer staff, the same increased business roles and litigation responsibilities. Now merger and acquisition activity has also become busier placing further demands on in house legal departments. The result of this new landscape is that in house lawyers must be more wary of ethical pitfalls and the exposure to individual liability. At the same time, as the deal flow increases, in house lawyers must be vigilant at protecting pre-deal privileges which may have attached to prior communications. This article summaries several areas of high exposure with an eye towards educating in house lawyers to reduce their risks.

Ethical Pitfalls and Individual Liability

Obviously, becoming an in house lawyer does not mean that the rules governing the practice of law no longer apply. And while certain of the model rules expressly apply to in house counsel, many of those rules that are most commonly applied to outside counsel equally apply in house.

Model Rule 1.1 – The Duty of Competent Representation

The duty to competently represent a client extends equally to those attorneys who have selected an in house career path. In house lawyers, who frequently and extensively rely on outside counsel for particular expertise, are often spread very thin and do not have the time or resources to tackle a problem as in depth as counsel that are hired for a particular project. However, the rules that require competent representation will still apply.
“A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.” ABA Model Rule 1.1

The comments to Model Rule 1.1 highlight that competence should be determined by considering: a) the relative complexity and specialized nature of the matter; b) the lawyer’s general experience; c) the lawyer’s training and experience in the field in question; d) the preparation and study the lawyer is able to give the matter; and e) whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. Comment 1 to ABA Model Rule 1.1. Notably, the comments do not make any distinction between in house lawyers and those in private practice in determining whether a lawyer has provided competent representation. Associating outside counsel with experience in the field is a helpful factor, but it does not completely absolve in house counsel of its duty of competence.

i. The Ethical Obligations of the In-House Lawyer to Understand E-Discovery and Electronic Production

For example, in 2006, The Board of Governors of The Florida Bar directed that an ethics opinion be issued to determine the ethical duties when lawyers send and receive electronic documents “in the course of representing their clients.” Fla. Bar. Ethics Op. 06-2 (2006). The Florida Bar Ethics Opinion states that when sending an electronic document to another lawyer, or when receiving such an electronic document: 1) it is the sending lawyer’s obligation to take reasonable steps to safeguard the confidentiality of all communications sent by electronic means and to protect all confidential information, including information contained in metadata; 2) the receiving lawyer may not try to obtain from metadata information relating the representation of the sender’s client; and 3) if metadata is inadvertently obtained, the lawyer must promptly notify the sender. The opinion notes that the foregoing obligations may necessitate a lawyer’s continuing training and education in the use of technology in transmitting and receiving electronic documents in order to protect client information under Rule 1.6(a).

These issues can arise in matters handled by in house counsel before outside counsel is retained. In Swofford v. Eslinger, 671 F. Supp. 2d 1274 (M.D. Fla. 2009), for example, the Court imposed sanctions against an in house lawyer when the lawyer failed to ensure that all items relating to issues raised in a pre-suit letter were preserved. In issuing the sanctions, the Court cited Zubulake v. UBS Warburg LLC, 229 F.R.D. 422, 430 (S.D.N.Y. 2004), and stated:

“It is not sufficient to notify employees of a litigation hold and expect that the [employee] will then retain and produce all relevant information. Counsel must take affirmative steps to monitor compliance so that all sources of discoverable information are identified and searched [and in this case, preserved].” Nothing of the sort was done in this case. In fact, in-house counsel professed not to have ever read the Federal Rules of Civil Procedure to ascertain on even a rudimentary level what his and his client’s obligations were in this regard….

ii. The In House Lawyer’s Obligations When Outsourcing Services

It is not uncommon, with pressure to continue cutting legal expenditures, for in house lawyers to consider outsourcing various legal services and nonlegal support services. As noted in ABA Formal Opinion 08-451 (Aug. 5, 2008), these services typically range from document reproduction, retention of a document management database for complex litigation, legal research, the engagement of foreign lawyers to draft patent applications and even to prepare pleadings in current litigation. Citing Model Rules 5.1 and 5.3, the ABA Formal Opinion recognized that the decision to outsource such services does not abrogate, in any fashion, a lawyer’s responsibility under Model Rules 1.1, 5.1 and 5.3. The ABA Formal Opinion recognized that the decision to outsource such services does not abrogate, in any fashion, a lawyer’s responsibility under Model Rules 1.1, 5.1 and 5.3. The ABA Formal Opinion recognized that the decision to outsource such services does not abrogate, in any fashion, a lawyer’s responsibility under Model Rules 1.1, 5.1 and 5.3 require lawyers to make reasonable efforts to ensure that subordinate lawyers conform to the Rules of Professional Conduct and to make reasonable efforts to ensure that the subordinate lawyer’s (or support personnel’s) conduct is compatible with the professional
obligations of the licensed lawyer.

To stay in compliance, the Standing Committee on Professionalism and Ethics recommended that lawyers who coordinate such efforts: a) conduct reference checks and investigate the background of the person providing the services; b) investigate the security of the premises and workspace of the person providing such services which may include an in person visit “regardless of its location or the difficulty of travel;” c) when using a foreign locations, assess whether the system of legal education is comparable to that in the U.S.; d) consideration of the judicial system of the country where the services will be performed to assess the risk of loss of client information or disruption of the project in the event that a dispute arises between the service provider and the licensed lawyer. Additionally, the Standing Committee opined that it may be necessary for the lawyer to provide information concerning the outsourcing relationship to the client and obtain informed consent to the engagement of lawyers or support personnel.

Previously, the Standing Committee had opined that when a lawyer engaged the services of a temporary lawyer, an obligation to advise the client of that fact and to seek client’s consent would arise if the temporary lawyer was to perform independent work for the client without the close supervision of the hiring lawyer. See Formal Opinion 88-356. Further, in a typical outsourcing relationship, no information protected by Rule 1.6 maybe revealed without the client’s informed consent. The Standing Committee noted that “the implied authorization of Rule 1.6(a) and its Comment [5] thereto to share confidential information within a firm does not extend to outside entities or to individuals whom the firm lacks effective supervision and control.”

Model Rule 1.2(d) – The Prohibition Against Assisting In Fraud

“A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.”

The edicts of Model Rule 1.2(d) are one of the cornerstones for the legal profession. Model Rule 1.2, Comment [10] explains that a lawyer may not continue assisting a client in conduct the lawyer originally supposed was legally proper but then discovers is criminal or fraudulent. In SEC v. Fehn, 97 F.3d 1276 (9th Cir. 1996), the SEC brought suit against an attorney, H. Thomas Fehn, to enjoin his aiding and abetting violations of various securities laws. Originally, Fehn has been engaged to represent the corporate entity, CTI, with a pending SEC investigation. During the course of the investigation, Fehn became aware that CTI was not in compliance with certain report requirements. Fehn then reviewed and edited CTI’s Form 10-Q for the quarter ending March 31, 1988 and then, based on that 10-Q, prepared 10-Qs for subsequent quarters. The SEC sued Fehn and alleged that his preparation of the 10-Qs constituted aiding and abetting of various federal securities laws. While Fehn asserted a laundry list of defenses, the one we are concerned with here is that “he acted in good faith in rendering professional advice .... and that this alleged good faith precludes a finding that he rendered ‘substantial assistance’ in the primary violations.” Id. at 1294.

In rejecting this argument, the Ninth Circuit noted that the U.S. securities industry depends on lawyers advising their clients of proper disclosure requirements and a requirement “to insist that their clients comply with them.” Where a lawyer is called on to perform a “legal audit” of the client, ABA Model Rule 2.3 provides that a lawyer may undertake an evaluation of a matter affecting a client for the use of someone other than the client if the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer’s relationship with the client. The comments to Model Rule 2.3 caution that, “if the lawyer is acting as advocate in defending the client against charges of fraud, it would normally be incompatible with that responsibility of the lawyer to perform an evaluation for others concerning
the same or a related transaction.” As such, the Ninth Circuit affirmed the injunction and held that Fehn’s failure to ensure that the 10-Qs complied with the disclosure requirements constituted substantial assistance in the primary disclosure violations.

The complex interaction between the obligations of Model Rule 1.2(d) and certain provisions of Sarbanes-Oxley can expose the in house lawyer to significant liability and ethical violations. Since the SEC adopted a final rule pursuant to Section 307 of the Sarbanes-Oxley Act, effective August 5, 2003, an in house lawyer has an affirmative duty to inspect the truthfulness of the SEC filings. See 17 C.F.R., Part 205. Section 307 addresses the professional responsibilities of attorneys and requires that a rule be implemented that requires “an attorney report evidence a material violation of securities law or breach of fiduciary duty or similar violation by the issuer up-the-ladder within the company.” Rule 205 requires lawyers practicing before the SEC to report material evidence of wrongdoing up the chain of command within a company and permits, although it does not require, outside disclosure of wrongdoing.”

In February of 2008, Robert Graham, the former assistant general counsel of General Re Corporation, was convicted in connection with his role in an alleged fake insurance deal between Gen Re and AIG. See U.S. v. Ferguson et al, Case No. 06-CR-137 (D. Conn. 2006). The government had alleged that Graham, along with four other defendants, schemed to inflate AIG’s loss reserves by creating two sham reinsurance transactions. AIG was forced to restate the transactions in 2005 causing losses of more than $400 million for AIG’s shareholders. Graham was found guilty of criminal conspiracy and securities fraud and an appeal is currently pending.

Model Rule 1.6(a) – The Protection of Confidentiality of Information

“A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).”

Model Rule 1.6(b)(5) states that counsel can disclose a client’s confidential information “to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer’s representation of the client.” The Comment to this rule explains that the disclosure should be no greater than the lawyer reasonably believes is necessary to establish her innocence.

In U.S. v. Stevens, an in house lawyer for GlaxoSmithKline was charged with obstructing an FDA inquiry into company-sponsored promotional programs about the weight loss benefits from a drug approved for use only for depression, concealing documents in a federal investigation, and three counts of false statements to the FDA. The charges were the result of Stevens’ involvement, as in house counsel, in responding to an FDA request for certain promotional materials. The government alleged that Stevens discovered certain facts during her investigation which were contrary to the representation she subsequently made to the government that Glaxo “has not … maintained any activity to promote or encourage, either directly or indirectly, the use of [the drug] as a means to achieve weight loss…..,” and that attendees were “not paid reimbursed or otherwise compensated to attend” speaking events promoting the drug.

After Stevens was indicted, U.S. District Court Judge Roger Titus threw out the indictment after finding that prosecutors had erred in their presentation of the case to a grand jury. Stevens was charged again and the trial began in April, 2011. On May 10, 2011, Judge Titus acquitted Stevens and held that there was not sufficient evidence to submit it to the jury. Judge Titus stated, “I conclude on the basis of the record before me that only with a jaundiced eye and with an inference of guilt that’s inconsistent with the presumption of innocence could a reasonable jury
ever convict this defendant.” While no witness lists had been made public, it was widely anticipated that King & Spalding lawyers would be called to testify, and that documents would show it was the King & Spalding lawyers who conducted a dozen employee interviews, wrote the first drafts of the letters Stevens wrote to the FDA and spearheaded the entire Glaxo response. Stevens claimed that it was the King & Spalding team who made the decision not to send certain items to the FDA, but rather to seek a meeting with the FDA to discuss the issues.

Model Rule 1.7 – Conflict of Interest: Current Clients

“(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or
(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.”

One way this rule commonly arises for in house counsel in the representation of subsidiary or related entities. The simultaneous representation of a parent and a wholly owned solvent subsidiary with aligned interests generally will not create a conflict. See generally Morrison Knudsen Corp. v. Hancock, Rothert & Burnshoft, 69 Cal. App. 4th 223 (1999) (citing ABA Formal Op. 95-390 (addressing conflicts of interest in the corporate family context)). However, conflicts can arise from representing both parent and subsidiary entities that disagree concerning the terms of transactions between the parent and subsidiary. See Bowles v. Na’i Assoc. of Home Builders, 224 F.R.D. 246 (D.D.C. 2004). They can also arise when subsidiaries become insolvent (and therefore must be managed for the benefit of creditors). See A.R. Teeters & Assoc., Inc. v. Eastman Kodak Co., 836 P.2d 1034, 1043 (Ariz. App. Ct. 1992). See also Assoc. of Corporate Counsel, “All in the Family? In-House Counsel Representing Parents/Subs/Affiliates: Conflicts and Confidentiality” (2006), available at www.acc.com/public/attyclientpriv/ parentsbcrpcrsntnethics.pdf. While many in house counsel regularly represent the entire corporate family in matters where the entities’ interests are aligned, careful consideration should be given to counsel’s ethical obligations in matters where the related entities lack common ownership, are (or may become) adverse, or where insolvency is involved.

Model Rule 1.13 – The Organization Is The Client

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents. (b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

In U.S. v. Graf, 610 F.3d 1148 (9th Cir. 2010), the Defendant, James L. Graf, was a founder of a corporation that purported to provide health care benefits coverage. In reality, the plan was nothing more than an elaborate scheme to defraud. At trial, several attorneys were compelled to testify after the Court determined that the lawyers represented only the corporate entity and that Graf had no individual attorney client relationship to establish a privilege that would be violated by the proffered testimony. Graf asserted that the attorney client privilege was jointly held with his employer with akerman.com
In deciding the issue, the Ninth Circuit explained that as of the date of the opinion, “[w]e have yet to adopt a particular standard by which to determine whether a corporate employee holds a joint privilege over communications with corporate counsel.” The Court determined that a five factor test, originally created by In re Bevill, 805 F.2d 120 (3d Cir. 1986) governed. These five factors are: (1) the person must demonstrate that he or she approached counsel to seek legal advice; (2) the individual must demonstrate that it was made clear to counsel that they were seeking legal advice in their individual capacity; (3) they must demonstrate that the attorney communicated with them in their individual capacity, recognizing that a conflict might arise; (4) the conversations with the attorney must be confidential; and (5) the substance of the conversations with counsel must not have concerned matters within the company or the general affairs of the corporation. This test has been adopted by the First, Second and Tenth Circuits, and cited with approval by the Sixth Circuit. In this case, Graf failed to establish factors two, three and five and therefore, the testimony of the lawyers was properly allowed. This test was applied both to outside counsel as well as the entity’s General Counsel.

Graf follows the Ninth Circuit’s prior decision in U.S. v. Ruehle, 583 F.3d 600 (9th Cir. 2009). In Ruehle, the Court was tasked with exploring the “treacherous path which corporate counsel must tread under the attorney-client privilege when conducting an internal investigation to advise a publicly traded company on its financial disclosure obligations.” Ruehle was the former CFO of a publicly traded semiconductor supplier that engaged in backdating of company stock options. At issue in Ruehle was the defendant’s statements made by him to the entity’s outside counsel. The District Court found that an attorney client relationship existed between counsel and Ruehle individually and that the lawyers breached their ethical duties in disclosing what he had told them in a preliminary interview.

On appeal, the Ninth Circuit held that the District Court’s reliance on California law was in error because such issues of privilege are governed by federal common law which placed the burden on Ruehle to establish the privileged nature of the communications. The Court found that Ruehle had failed to prove that his communications were made in confidence, a crucial element. Ruehle had testified that he understood the fruits of the lawyer’s inquiries would be disclosed to the auditors and shared with other shareholders. Further, the Ninth Circuit held that any arguable violation of the California Rules of Professional Conduct by the lawyers did not warrant suppression. “A state rule of professional conduct can not provide an adequate basis for a federal court to suppress evidence that is otherwise admissible.” See id.
Protecting the Privilege in Corporate Transactions

Model Rule 1.6 – Confidentiality of Communications

“A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation....”

Increased transactional activity also creates additional ethical and liability exposures to in house attorneys. In the context of a stock sale, most courts hold that the corporate attorney-client privilege of the target entity passes to the purchaser, except with respect to the transaction itself. See Tekni-Plex, Inc. v. Meyner and Landis, 674 N.E.2d 663 (N.Y. 1996). This can have significant implications for in house attorneys managing litigation for a company that may be purchased. It is possible that all communications, whether internal or with outside counsel, concerning actual or potential claims against the company may ultimately be disclosed to the purchasing entity. Moreover, many purchase transactions include express representations and warranties which require full disclosure of all known actual or potential claims against the company, and the purchaser’s post-closing access to what the legal department may have believed to be protected communications can create exposure for in house counsel and corporate clients relating to assertions of undisclosed liabilities.

While most courts have held that the privilege generally does not pass to the purchaser in an asset transaction, See Goodrich v. Goodrich, 960 A.2d 1275 (N.H. 2008), there is at least one case which has held that the purchaser in an asset deal controls the privilege with respect to communications about the purchased assets. See Graco Children’s Products, Inc. v. Regalo Int’l LLC, 1999 WL 553478 (E.D. Pa. July 29, 1999). In light of these uncertainties, and in order to reduce exposure to these pitfalls, consider the following protective measures:

• Consider how the structure of the transaction can impact privilege issues on the front end of a deal
• Keep communications concerning the actual transaction separate and apart from unrelated subjects (to preserve privileged deal communications)
• Consider where privileged communications are kept and whether this impacts how the parties describe the assets and excluded assets involved in the transaction (e.g., are all emails kept on a single server, can certain custodians’ email files be removed before closing, etc.)
• Ensure that representations and warranties are completely accurate to avoid any confusion that may arise from post-closing access to the Legal Department’s files
• Consider including language in the deal documents which dictates who will control the privilege after the transaction closes, and for which subjects

Conclusion

Although the foregoing summary is not an exhaustive list of pitfalls and exposures facing in-house counsel, it illustrates that the current economic and legal environment requires heightened vigilance by internal legal teams. The first step to reducing these exposures is to identify and understand them. Many lessons can be learned from the conviction of Robert Graham (former assistant general counsel of General Re Corporation), the acquittal of Lauren Stevens (in house lawyer for GlaxoSmithKline), and others. In house lawyers can further protect themselves by taking a proactive approach by, among other things, remaining cautious about conflicts of interest, staying current on new areas of law like e-discovery, and documenting matters, such as who will control privileges in corporate transactions, to avoid confusion whenever possible. While there is no way to completely avoid the complex problems that in house attorneys face, these fairly simple preventative measures will surely be worth a pound of cure.
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