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INFORMED. INDISPENSABLE. IN-HOUSE.

Mind Your Ethics: Professional Conduct for the In-house Lawyer

Compliance and Ethics

CHEAT SHEET

- ***Potential conflicts.*** Before transitioning to a new in-house position, review prior representations, consider what could arise as a conflict and disclose up front anything that could be adverse.
- ***Compensation.*** If your client offers you stock or stock options, make sure the transaction complies with the law.
- ***Licensing.*** Practicing law in a state without a license in that state can be a crime, and having in-counsel counsel unlicensed in the jurisdiction where you practice can threaten attorney-client privilege.
- ***Reporting.*** You may be required to report your own errors or those of other in-house lawyers to management.

In-house counsel can and should be valuable members of the organizations they serve. The size of an organization and practice expertise required for an in-house practitioner vary considerably, making it very difficult to provide specific ethical advice. To add to the complexity, in-house counsel often have multiple roles within the organization. In-house counsel can be asked for all kinds of advice—some legal, some business and some “off the record” personal questions from coworkers. This blending of roles and responsibilities creates a very challenging ethical landscape for which there is a dearth of clear guidance.

While many of the published professional responsibility and ethics opinions more directly address the private practice lawyer, each state has ethical rules that apply to in-house counsel, too (e.g., *Kaye v. Rosefielde*, 75 A.3d 1168 (N.J. Super. Ct. App. Div. 2013) (rejecting as being “without a rational basis” contention that ethical rules did not apply to in-house counsel)). How they apply is sometimes less obvious and is certainly less discussed than it is for outside counsel.

Indeed, the stakes are higher for in-house counsel because, while outside counsel may just fire a particular client if things get too ethically difficult, the in-house lawyer usually doesn’t have that option. Things can move very quickly in a business operation. It is important to periodically review the basics of professional responsibility to be able to adapt and apply them to your in-house practice.

Getting hired (or promoted) in-house

Clearing potential conflicts before starting

Don’t make the mistake of overlooking potential conflicts of interest when transitioning to a new in-house position. Review prior representations and carefully consider what could arise as a conflict in the new position with any of the corporate entities you may be representing. Disclose and clear conflicts before moving in-house. Many states have adopted rules that expressly allow disclosure of client information for purposes of clearing conflicts in anticipation of a move, and others have said such disclosures are implicit in their rules. In any case, it’s a good idea to do a thorough review and disclose anything that could be adverse up front.

Under the ABA Model Rules (the “Rules”) and in many states, an in-house legal department is defined as a “firm” for purposes of the ethical rules, including conflicts. If you are conflicted, then that conflict may be imputed to the entire in-house department. Such a department-wide disqualification may produce an extreme hardship on the client.

Under Rule 1.10, when a lawyer is leaving government work to go in-house, a confidentiality wall may be set up in advance that avoids this problem. This solution may not work under all circumstances, especially where the lawyer is coming from private practice (including another in-house position).

Ethical dilemmas created by compensation

Is your compensation arrangement a “business transaction” with a client under Rule 1.8? If an in-house counsel position includes compensation in the form of stock, stock options or other significant nonmonetary consideration from an existing client, accepting the position is itself a “business transaction with a client.” Under Rule 1.8, a lawyer may not enter into a business transaction with a client unless the transaction complies with the requirements set forth in the Rule. *E.g., Kaye, supra* (in-house counsel committed ethical violation by forming new company on behalf of client and granting himself equity ownership without compliance with Rule 1.8).

Generally under this rule, the transaction must be (1) fair and reasonable to the client, (2) transmitted in writing and (3) understandable by the client. Further, the client (4) must be advised in writing to obtain other counsel to review the deal, (5) must be given time to do so before the deal is consummated and (6) ultimately give written consent to the transaction.

If the client offers you stock or stock options while you are employed in-house, then some of the conditions of Rule 1.8 are necessarily met. The offer presumably will be understandable by the client because the client is making it. You still should make sure the transaction complies with the procedural requirements of Rule 1.8, particularly advising the client in writing to have another attorney review the offer and giving the client time to do so.

This may seem like overkill when you have a good working relationship with your employer. The danger is not so much a grievance by the management but more likely a shareholder derivative suit in the future. If a disgruntled shareholder brings suit claiming management insiders (who may well include in-house counsel) looted the company, the shareholder may argue that the in-house lawyer also received the stock or stock options in an unethical fashion. If you are later offered a promotion that includes nonmonetary compensation, the same procedure should be followed.

Is your compensation an “unethical fee” under Rule 1.5? Rule 1.5 provides “[a] lawyer shall not make an agreement for, charge, or collect an unreasonable fee.” There is no exception to this Rule (or any other Rule, for that matter) for in-house counsel. The Rule contains a list of nonexclusive factors to determine whether the fee is excessive; many can be determined only after the engagement is concluded.

Stock options in a publicly traded company may be worthless when awarded because the strike price is the same as the then-contemporaneous trading price. If the trading price increases before the options vest, however, they may become extremely valuable before they are “collected.” The argument can be made that the fee is then too high by the time it is collected (especially if the lawyer also has received a salary in the interim). Again, the concern is not so much a grievance by the management that awarded the options, but a disgruntled shareholder’s future derivative suit.

Does your compensation create an actual or potential "conflict of interest" or adversely impact your "independent judgment?" As in-house counsel, consider the limits on representation outlined in Rules 1.7 (Conflict of Interest) and 5.4 (Independent Judgment) and how they may appear in your practice. For example, consider a situation where you have stock options in the employer/client. The client is considering two possible courses of action: One will increase the price of the stock in the short run but may be riskier in the long run; the other will provide greater certainty in the long run, but the stock's value will not spike in the short run. If your advice would be different depending on what you want to do with your own personal options, then you probably are not exercising independent judgment as required by the Rules. In this situation, you should either divest the stock or not participate in the decision-making process.

Ethical risks of nonmonetary compensation vary depending on organization size

Ethical dilemmas pertaining to compensation are much riskier for an in-house counsel with a small company than a large one. If you are in-house at a publicly traded company and are one of dozens of lawyers and scores of middle management or executives getting essentially the same stock or stock option incentive package, you likely have little risk in this area. Presumably the market will have set the price of the stock itself and the transaction will have already been reviewed by other counsel (securities counsel and the activity will all be a matter of record) before it is offered to you.

General counsel at large companies who receive stock or options far in excess of others in the legal department, however, are particularly at risk. With the stakes so high, going through the relatively simple requirements of Rule 1.8 and not accepting the compensation until you have advised the client to have another lawyer review the transaction is prudent.

If you are part of a small legal department or the sole lawyer at a privately held company, valuing the stock or stock options can be very difficult. Given that in-house counsel may be involved in preparing the documentation for analysts, accountants and senior management to set the value of options and or initial offerings, it could be argued that there was an unethical self-serving valuation. If there is only one lawyer in the company, he or she may be the only person getting any particular compensation package. Determining whether it is "fair and reasonable" may be much harder than it would be with a large department. To protect yourself, advising the client to have another lawyer review the transaction (and giving the client time to do so) is much more important.

It is even more challenging for counsel at startups. It is not uncommon for early company employees, including in-house counsel, to be given stock in lieu of fees as a tool to recruit good talent, motivate fast development and limit the company's initial expenses. Compliance with Rule 1.8 is absolutely vital. If the company does well over time and the stock or stock options become extremely valuable, you do not want to be vulnerable to a claim that you accepted them in violation of the Rules.

In-house practice

Licensing

Every practicing lawyer, even in-house counsel, must be licensed to practice law somewhere. Practicing law in a state without a license in that state can be a crime, an ethical violation in the state

where you are licensed, and assisting in the unlicensed practice of law can be an ethical violation for other attorneys in your department. Having in-house counsel unlicensed in the jurisdiction where you practice can also threaten the attorney-client privilege and be a potential disaster for the client.

Under some circumstances, in-house counsel may have to be licensed in more than one jurisdiction depending on the company's locations, where it is transacting business, and where the lawyer physically goes to work every day or most days. Most states require a lawyer who regularly practices in its offices to be licensed to practice law in that state. What "regularly practices" means varies from state to state and case to case. Be sure to check the state bar rules for at least the jurisdiction where you are physically located and (if different) your company's headquarters. If you are regularly traveling to another jurisdiction to perform legal work, check with that state's bar as well as your own. Most states now have "single client" rules that allow in-house counsel who remain licensed in another jurisdiction not to have to be a member of the resident state bar. Some of these single-client rules are even effective for groups of related companies. Most, however, have requirements and limitations that you should review closely before relying on them.

Beware of the consequences of lapsed or absent licenses

UNLICENSED PRACTICE OF LAW CAN LEAD TO BAD RESULTS

By way of example, *Crews v. Buckman Labs. Int'l*, 78 S.W.3d 852 (Tenn. 2002) demonstrated the burden on counsel, coworkers and the client that can arise from the unlicensed practice of law in-house. An associate in-house counsel discovered that the general counsel was not licensed to practice law in Tennessee where the general counsel had an office. She reported this first to the general counsel and later to the company's board of directors. After considerable time, the general counsel was still not admitted, so the in-house obtained her own legal advice concerning her ethical obligations and felt compelled to report the unlicensed practice of law to the Board of Law Examiners. The associate in-house counsel was later fired and brought suit for common-law retaliatory discharge. No one should want to subject his client to this kind of embarrassment, and this was all driven by the general counsel's refusal to become licensed in the state where she practiced.

Another example of the unlicensed practice of law (although involving outside counsel) leading to bad results is the well-known *Birbrower, Montalbano, Condon & Frank v. Super. Ct.*, 17 Cal. 4th 119 (Cal. 1998). New York attorneys who regularly and repeatedly traveled to California to prepare for a California arbitration regarding California real estate were ultimately unable to collect their fees because the California Supreme Court determined they were practicing law in California without a license. The majority expressly rejected the dissent's attempt to limit the "practice of law" under California law to appearing in a California courtroom.

Not being licensed can also raise evidentiary problems for your client. There are several cases holding that communications between officers and in-house attorneys who were not licensed in the jurisdictions where they had practiced for years were not protected by the attorney-client privilege. If you only occasionally go into a jurisdiction where you are not licensed, you are probably OK. But if you have an office in or regularly travel to a state where you are not licensed, you may be risking your client's attorney-client privilege (among other things). You should review the licensure requirements of any state where you work or regularly travel.

Conflicts of interest

Although “directly adverse to client” conflicts under Rule 1.7 may not appear to affect you as in-house counsel, it is possible for in-house counsel to be directly adverse to his own clients. This may arise when there are groups of related companies for which the in-house counsel sometimes works (e.g., *In re Teleglobe Comm’ns. Corp.*, 493 F.3d 345 (3rd Cir. 2007) (in-house lawyer performed work for multiple, related companies; in a dispute among them, attorneys’ notes were available to all companies as was each company’s lawyer). It is a small step from the holding in *Teleglobe* to disqualifying both the lawyer and the entire in-house department from the litigation. This kind of conflict can also arise when in-house counsel for a small organization is asked to do personal legal work for the owner or executives. *E.g., Kaye v. Rosefielde*, supra (attorney who represented company, its owner and a trust for the benefit of the owner’s children had conflict of interests). If such a conflict does arise, then you must go through the same steps to obtain waivers of this conflict as any attorney would.

A “material limitation” conflict under Rule 1.7(a)(2) (the lawyer’s personal or other interests materially limiting the ability to represent the client) also may arise for in-house counsel — recall the discussion above regarding stock options owned by in-house counsel. If counsel cannot give objective, independent advice, he must withdraw from the matter under consideration.

Comment [35] to Rule 1.7 impresses the seriousness of being a lawyer for a company and serving on the board of directors. Although not a conflict per se, you must be vigilant regarding whether a conflict of any sort has arisen, especially when you might be called on to give advice to the board or its members.

Also, you should remember that many laypeople (and a distressing number of lawyers!) incorrectly believe that the lawyer’s presence alone shields any discussion from disclosure under the attorney-client privilege. If legal advice is neither sought nor received, then the attorney-client privilege probably does not apply. It is good to remind board members of this regularly.

Like most Rules, Comment [35] is written from the point of view of private practitioners but also applies to in-house. This area of conflicts may be even more problematic for in-house counsel because, in addition to being on the board of directors, an in-house counsel is often an officer of the company.

Who is the client?

Not everyone who works for the same company you do is a “client” for purposes of attorney-client communications. In *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981), the Supreme Court famously rejected the “control group” test (which had provided that the attorney-client privilege protected communications only between counsel and the “control group” at a company) but did not really provide an alternative test. Many courts have adopted the “subject matter” test, indicating that if the subject matter is legal advice given to a corporation, and the communication is authorized by upper management, then the communication is privileged. *E.g., National Tank Co. v. Brotherton*, 851 S.W.2d 193 (Tex. 1993) (witness statements given by non-control group employees to in-house counsel were not privileged because the witnesses had not been authorized to seek legal advice from the in-house counsel).

Comment [7] to Rule 4.2 provides that the attorney-client relationship extends between the counsel and one who “supervises, directs or regularly consults with the organization’s lawyer concerning the

matter or has the authority to obligate the organization with respect to the matter." If someone who does not fit this description attempts to consult you, you should be careful. Perhaps contacting someone within the organization who is authorized to obtain legal advice for the organization and being directed to have the conversation would help preserve the privilege. This is especially tricky when an organization hires consultants or contractors to act on its behalf. These people are not employees of the company, but they may seek legal advice regarding a business transaction, intellectual property rights or strategy related to potential disputes that may give rise to arbitration or litigation. Because by definition third-party contractors do fall under the parameters of Rule 4.2, in-house counsel's communications with them are not generally considered privileged unless there is a written agreement specifying the authority of the contractor, confidentiality obligations and intent of the entity.

Tips for creating privileged communications

It is good practice to educate your internal clients early and often on how the attorney-client privilege works. Many executives think everything that goes to the lawyer is privileged, and even the most seasoned executives may try to create a privilege where there is none.

Merely copying an in-house lawyer on a chain of emails without asking for advice doesn't make the correspondence "privileged." Another common misjudgment is that sending an update email or other narrative addressed to in-house counsel and copying several other employees (without asking for legal advice) somehow protects the communication. A good habit to get into when you are providing legal advice is to include the following phrase in the subject line or top of the email or letter: "Privileged and Confidential – Providing Legal Advice." If your internal clients get into the same habit of using "Seeking Legal Advice" to label their emails, then the question of intent can be easily resolved, and it is a good exercise to help coworkers filter for what is truly privileged and what is not. Beware that if it is overdone by including this subject line on every email, it is meaningless and counterproductive.

The work-product doctrine can also apply to in-house work if properly conducted. Work performed by a paralegal or administrative support person at the direction of counsel can be work product and should be labeled as such if appropriate. For example, if in-house counsel asked a technician in the IT department to run a report on who accessed a specific company electronic file to defend an allegation of breach of privacy, it would be considered work product. If in-house counsel asked the same IT technician to run a similar report as part of routine compliance testing, however, it might not be privileged at all.

Lawyers acting in business capacity

One of the hardest things for business people (and some lawyers) to remember is that not every communication with in-house counsel is privileged. Only communications between you and your client for the purpose of obtaining legal advice are privileged. Indeed, there is not even a presumption that communications between the business side and in-house counsel are privileged. *E.g., In re E.I. DuPont de Nemours & Co.*, 136 S.W.3d 218 (Tex. 2004) (communications listed on a privilege log as being sent to or from in-house counsel needed to be subjected to in-camera review by the trial court before it could determine whether the communications were privileged).

Many in-house lawyers do not actively practice law, and it sometimes can be difficult to tell where the line between “legal advice” and “business advice” is drawn. There is no brightline test for determining whether advice is primarily legal or primarily business. One guideline may be if a nonlawyer offered such advice, would he be subject to a complaint for practicing law without a license? If not, it is likely business advice. Also, the legal advice must be the central purpose of the communication and not secondary. *E.g., Pacific Gas and Electric Co. v. U.S.*, 69 Fed.Cl. 784 (2006) (“Legal advice must predominate. … The privilege does not apply where the legal advice is merely incidental to business advice.”).

In *Finova Capital Corp. v. Lawrence*, 2001 U.S. Dist LEXIS 2087 (N.D. Tex. 2001), the in-house attorney authored numerous documents. The court held that the documents that dealt with how to structure a transaction involved legal advice and were therefore privileged but that the documents regarding corporate minutes, insurance matters and executive compensation did not involve giving legal advice and were not privileged. In *Neuder v. Battelle Pacific Northwest National Laboratory*, 194 F.R.D. 289 (D.D.C. 2000), it was held that documents created based on discussions with in-house counsel were not privileged because they primarily involved personnel decisions, not legal advice.

The fact that you are acting as a businessperson, however, does not mean that you are excused from the ethical Rules. This creates a special burden on in-house counsel acting in a business capacity. For example, it is a good idea to regularly remind your colleagues that the attorney-client privilege may not apply to conversations when the lawyer is acting in a business capacity.

Communications with others

Whether a businessperson with whom you are dealing is “represented” is not always clear. The prohibition on contact with a represented party is on a matter-by-matter basis and applies only if you “know” (as defined in the Rules) of the representation. Just because a company has a lawyer, even an in-house counsel, does not mean the company is represented on a particular matter.

If you learn that the opposing party is represented on a particular matter, however, direct communications with it should cease until permission from the opposing counsel is obtained. It is no excuse under Rule 4.2 that the other represented party initiates the contact. As a practical matter, it is very difficult to get permission for direct communication with a party from outside counsel who believes he is representing that party. The situation becomes even murkier when the party calls and tells you that he has “fired” the outside counsel and is now free to speak directly with you. Out of an abundance of caution, you should make a good-faith effort to validate that statement. Attempt to confirm with your contact or another employee of the opposing entity that the original outside counsel was terminated and determine whether replacement counsel was hired.

The prohibition on speaking with a represented party does not apply to a lawyer from whom the client seeks a second opinion. Rule 4.2 does not prevent a lawyer from advising a client as to the communications the client is entitled to make (i.e., advising the client that the client can directly contact the other party). Even if a company is represented by outside counsel, communicating directly with in-house counsel is ethically acceptable under American Bar Association Ethics Opinion 6-443.

It is also ethically acceptable to contact a government agency that is acting in a quasi-legislative capacity (such as notice and comment rulemaking) even when counsel represents it — such is a fundamental constitutional right to petition the government. However, if the government agency is acting in a quasi-judicial capacity (such as a licensure appeal), then contact with it is unethical if it is

represented on the matter.

When dealing with an unrepresented person, Rule 4.3 prohibits a lawyer from even implying disinterest. If you are dealing with an unrepresented person, you should make it clear that you are representing your client and not giving legal advice to the unrepresented party. Making all such communications in writing is a good idea from an ethical viewpoint, although it may be cumbersome from a business perspective.

In-house counsel as supervisors

Rule 5.1 applies to in-house counsel if you are supervising another attorney (recall definition of "firm" includes "the legal department of a corporation"). It can be misconduct if a supervising lawyer "orders, encourages, or knowingly permits the conduct involved," whereby a supervised attorney violates the ethical rules. The same analysis applies to supervision of staff under Rule 5.3, although there the lawyer's duties are to make sure the staff's conduct is generally compatible with the Rules.

When things go wrong

Malpractice claims against in-house counsel happen

Although malpractice actions against in-house counsel are rare, they are not unprecedented. They used to arise mainly in response to a claim for additional compensation by terminated in-house counsel, but now, there are numerous reported stand-alone malpractice cases against in-house counsel. These cases include everything from undisclosed conflicts of interest to misdrafting of legal documents to bad advice to executives on how to exercise their stock options.

Many in-house counsel do not have malpractice insurance, perhaps relying on the company's directors and officers policy. Whether such a policy would cover a malpractice claim against in-house counsel depends on the terms of the policy. It should be noted, however, that many policies exclude coverage for "professional services" and may therefore exclude malpractice claims against in-house counsel but would cover business decisions made by in-house counsel who is an officer of the company. It's a good idea to check with the company's carrier to confirm what is covered. You may be able to obtain a rider to the policy for in-house malpractice at a nominal incremental cost. Remember that no lawyer, including someone in-house, can settle a malpractice claim with its own client without advising the client in writing to get other counsel first.

Reporting errors and misconduct

In certain circumstances, Rule 1.3 may require in-house counsel to report their own errors or those of other in-house lawyers to management. Rule 8.3 requires reporting of professional misconduct of others when the conduct "raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects." Usually, this means misuse of client funds or substance-abuse issues. It was Rule 8.3 that drove the associate counsel to report the general counsel for the unlicensed practice of law in *Crews, supra*.

Many state bar associations have professional assistance available for substance-abuse and mental-health conditions that are totally confidential. These services can be lifesavers, quite literally, for a colleague or friend in need. Lawyers, in general, have one of the highest addiction and depression rates of all the learned professions. It's important that we look out for one another.

Under recent changes to Rule 1.6(b), you may reveal client information as necessary to rectify the consequences of the client's fraudulent or criminal conduct if your services were used in perpetuation of the crime or fraud. This change generally reconciles a prior conflict between the ethical rules and the rules of evidence (i.e., this "new" ethical rule essentially mirrors the "crime/fraud" exception to the attorney-client privilege). Note that this is permissive and not recommended except under compulsory process, as it will almost certainly lead to a malpractice suit.

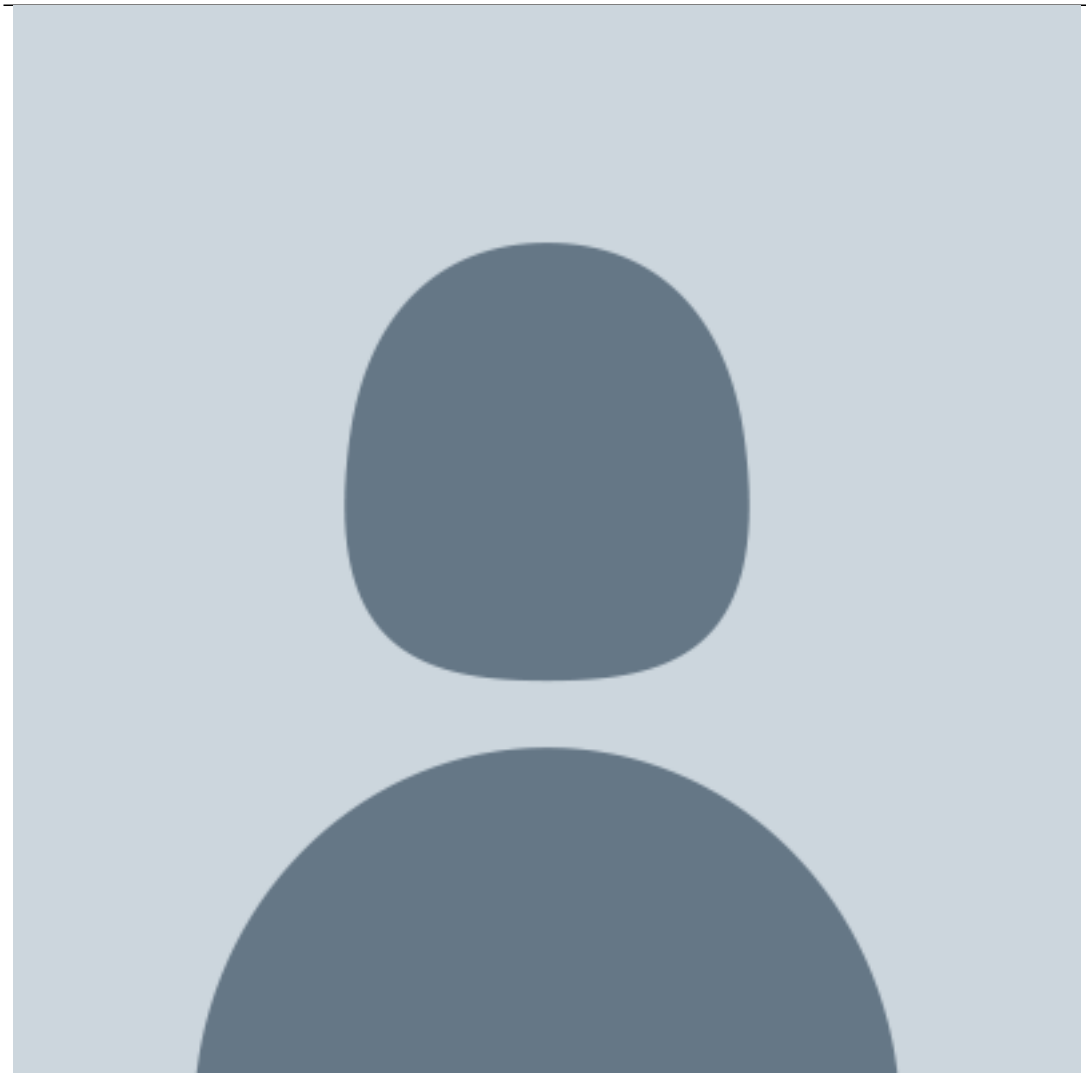
Withdrawal as counsel

Rule 1.16(b) generally describes the circumstances under which a lawyer can withdraw. Rule 1.16(d) provides that when withdrawing, "a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client [and] allowing time for employment of other counsel." There is no exception for in-house counsel. Thus, it may be that in-house counsel cannot simply quit as other employees can (at least, not without violating the Rules).

Conclusion

In-house practice is not an oasis away from the Rules of Professional Responsibility. They still apply, and often, the stakes are higher when they do. You must be familiar with the Rules and be prepared to counsel your client consistently with them. Don't be afraid to reach out to your colleagues to review questionable circumstances. You may be able to steer clear of any ethical violations with clear communication and documentation up front and save yourself and your client from expense and reputational harm.

Nicole B. Guerin



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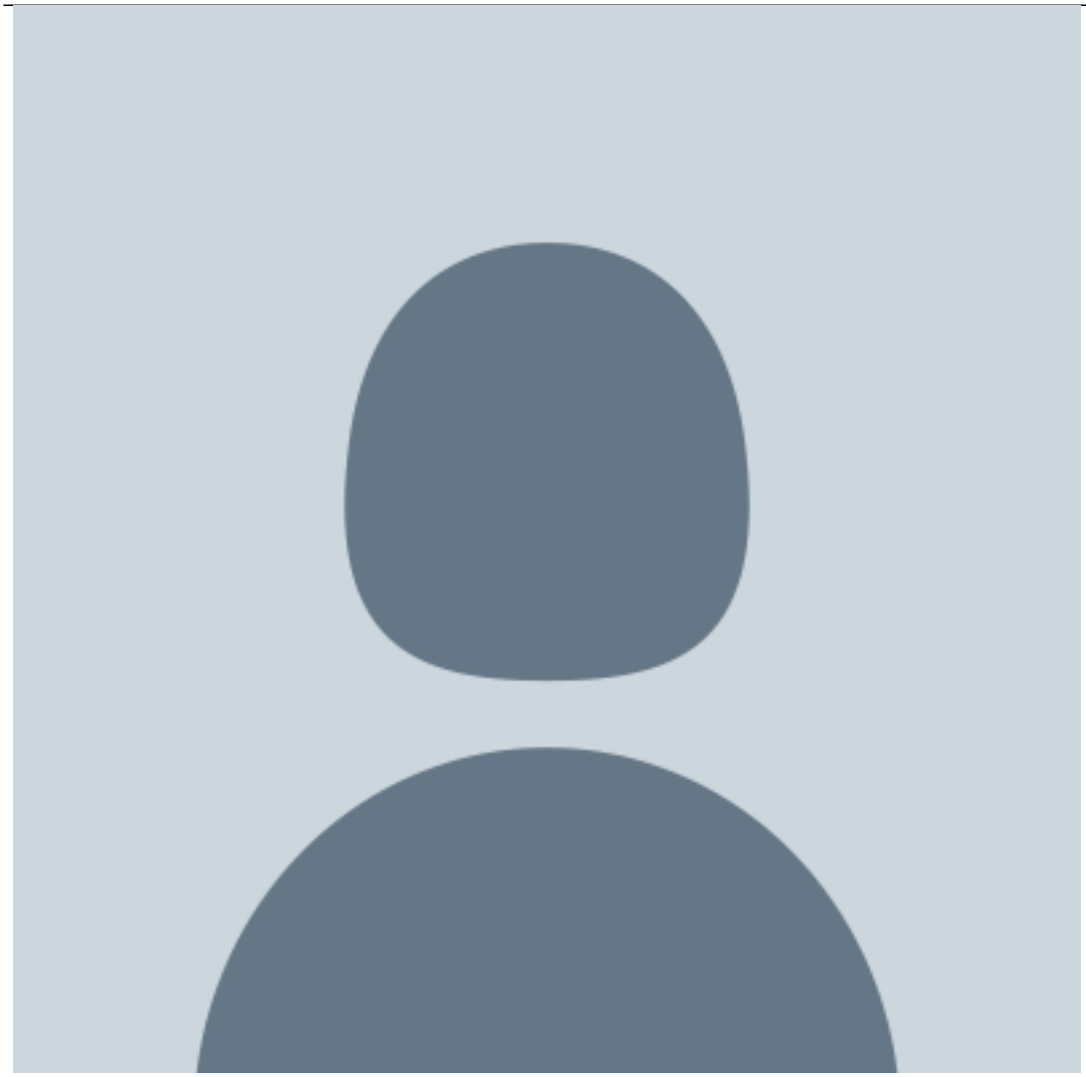

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