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In-House Counsel and Legal Ethics: Recent and Recurring Issues

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FAIRFIELD AND WOODS P.C.

Current Ethical Issues for In-House Lawyers
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Ethics for In-House Counsel

- Ethical Rules are state-by-state.
- Using ABA Model Rules today, but for any particular rule, you should check your own state's rules.

Ethics for In-House Counsel

- Numbers of in-house counsel growing greatly of late. Based on a quick computer search:
- 2020 approximately 100,000 in-house attorneys in U.S.
- First reported case involving ethics and in-house counsel was in 1989.
- This was a case involving unethical conduct by outside counsel toward in-house counsel.

Ethics for In-House Counsel

- First reported case involving ethical conduct of in-house counsel was in 1991; case arose after in-house counsel had left in-house job and regarded scope of his conflict.

- First reported case involving contemporaneous ethical issue for in-house counsel was in 1995.

- First reported malpractice case against in-house counsel was in 1998.

Ethics for In-House Counsel

- In-house counsel wears two hats.
- You need to know the Rules as they apply to you as a lawyer.
- You are also often the client representative, so you need to know the Rules as they apply to your outside counsel.

Preamble and Scope

- Traditionally, Rules only applied in disciplinary proceedings, and expressly did not set a standard of conduct.

- This changed with the “Ethics 2000” set of rule changes.

Preamble and Scope

- Comment [20]:

- “Nevertheless, since the Rules do establish standards of conduct by lawyers, a lawyer's violation of a Rule may be evidence of breach of the applicable standard of conduct.”

Terminology

- “Firm” includes “lawyers employed in a legal services organization or the legal department of a corporation or other organization.”

Terminology

- “Informed consent” “denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.”

Terminology

- "Informed consent" requires lawyer to communicate
  - adequate information and explanation
  - about the material risks of and
  - reasonably available alternatives.
- This was modeled after SEC concept of full disclosure in an offering.

Terminology

- “Partner” “denotes a member of a partnership, a shareholder in a law firm organized as a professional corporation, or a member of an association authorized to practice law.”

- As we’ll discuss later, this does not relief in-house counsel from supervisory duties.

Rule 1.1 Competence

- You have to be competent.
- If you don't know how to do it, and there is no one to train you to do it, you should not do it.
- You may want to use this as pushback with the business folks that do not understand this.

Rule 1.1 Competence

- San Diego Ethics Committee Bar Ass'n Ethics Opinion 2007-1.
- 2-person real estate firm told client they could help with patent litigation matter.
- Essentially outsourced case to India.
- Won case on summary judgment.
- Later grieved for not being competent; suspended or two months.

Rule 1.1 Competence

- Opinion said while they did win, the U.S. lawyers had no way of reviewing the work of the Indian firm.
- They were not competent to do the patent cast that they won on summary judgment.

Rule 1.2 Scope

- Client decides goals; lawyer decides means and methods.
- Cannot advise client to commit crime nor help client do so (exception for marijuana in some states) (such as Colorado).
- Note this is broader prohibition than engaging in criminal conduct yourself under Rule 8.4.

Rule 1.3 and 1.4
Diligence and Communication

- Have to keep after a matter, and apprize client as to material developments.

- This is another thing that got the San Diego firm in trouble—the lawyers didn't tell the client about using the Indian firm.

Fees and Conflicts of Interest

- Rule 1.5 (a): "A lawyer shall not make an agreement for, charge, or collect and unreasonable fee . . . ."
- Rule 1.8(a): "A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless . . . (1) the transaction and terms . . . are fair . . . in writing . . . ; (2) the client is advised in writing . . . [and given time] to seek . . . independent counsel; the (3) the client gives informed consent in writing."

Fees and Conflicts of Interest

- Hypothetical #1
- Folks want to form new company; one is a lawyer.
- Lawyer says, “I’ll perform legal work and take 10% of stock in lieu of my fees.”
- Others say “Great.”
- Lawyer says “Make sure you get your own lawyers to review the deal.”

Fees and Conflicts of Interest

- Alarm bells should be going off. Lawyer did not advise the client in writing to have another lawyer review the transaction.

- *Odish v. Cognitive Code Corp.*, 2015 U.S. Dist. LEXIS 68630 (C.D. Cal. 2015) (lawyer's interest in company declared void for non-compliance with equivalent of Rule 1.8, even though he orally told partners to have their own lawyers review transaction).

Fees and Conflicts of Interest

- Hypothetical #2
- Company hits—for doing initial formation documents and little IP work, lawyer now owns $4,000,000,000,000 worth of stock.
- Is this an “unreasonable fee” under Rule 1.5?
- Is this transaction “fair and reasonable to the client” under Rule 1.8?

Fees and Conflicts of Interest

- Typical Rule 1.5 analysis looks at reasonableness of fees at time agreement is made (just like other contracts).

- Argument: 10% of zero is zero, and when stock issued it was worthless, so fee must be reasonable.

Fees and Conflicts of Interest

- Counter argument: Many of the factors under Rule 1.5(a) can only be addressed in hindsight:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

Fees and Conflicts of Interest

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

Fees and Conflicts of Interest

- These factors cannot be judged until after the case is over.

- So there is some chance this fee would be determined to be unreasonable after stock skyrocketed, not at time of issuance.

Fees and Conflicts of Interest

- Hypothetical #3
- Lawyer is already in-house with client.
- Client says “I don’t have cash to pay you, but I’ll give you 10% of the company if you stay and do that IP work.”
- Lawyer says “OK; sign here.”
- Ethical issues?

Fees and Conflicts of Interest

- No change by being in-house; same issues regarding Rule 1.8 process arise.
- No exception to Rule 1.8 for lawyer already in-house.
- *Kaye v. Rosefielde*, 75 A.3d 1168 (N.J. Super. Ct. App. Div. 2013) ("no rational basis" to believe ethical rules—in particular Rule 1.8—do not apply to in-house counsel).

Fees and Conflicts of Interest

- *Kaye* is not alone in applying fee-related Rules to in-house counsel.

- *Missakian v. Amusement Industry Inc.*, 69 Cal. App. 5th 630 (2021) (offer to in-house counsel of bonus based on recovery in litigation was "contingency fee" and thus has to be in writing signed by the client to be enforced).

Fees and Conflicts of Interest

- Hypothetical #4
- Company hits and in-house lawyer has stock worth a bundle.
- Before stock agreement signed, lawyer advised client in writing to have another lawyer look at transaction and waited a week, but client never got second opinion.
- Is this a violation of Rule 1.5 or 1.8?

Fees and Conflicts of Interest

- No procedural violation under Rule 1.8—cannot make client get second opinion.
- May be substantive 1.5/1.8 violation.

Fees and Conflicts of Interest

- Hypothetical #5
- Instead of being offered stock, in-house lawyer is offered stock options at the market price.
- In-house lawyer advises client in writing to get second opinion.
- By the time the options vest, they are worth a bundle (by then, trading price much higher than option strike price).
- Does this make the fee more or less proper?

Fees and Conflicts of Interest

- Ethics 2000 rule changes went from “a lawyer’s fee shall be reasonable” to the new “a lawyer shall not . . . collect an unreasonable fee.”

- Argument that fee is judged at time collected made stronger by this change.

Fees and Conflicts of Interest

- Danger is generally not grievance from management that did deal with in-house lawyer.
- Danger is derivative suit from disgruntled shareholder when you cash out just before company tanks.
- Against all management disgruntled shareholder can argue management “looted the company,” but against lawyer can also argue “unethical conduct.”

Fees and Conflicts of Interest

- Ethics 2000 change to Comment [20] suggests ethical rules can establish standard of care or be admissible in other civil proceedings beyond disciplinary matters.

- Thus a violation of Rules 1.5 or 1.8 could give rise to a shareholder derivative malpractice claim against the in-house lawyer.

Unreasonable Costs

- Rule 1.5 also prohibits a lawyer "an unreasonable amount for expenses."
- This rule arose out of an article in the ABA Journal over 30 years ago referring to "Skaddenomics," the practice of charging clients for donuts at meeting at a 60% mark up.
- Outside counsel can mark up costs a small amount, but it has to be a reasonable approximation of actual costs.

Rule 1.6 Confidentiality

- Much broader the “confidences and secrets” under former Code of Professional Responsibility.

- With few exceptions, simply cannot talk about client matters, even if they are discussed in the local newspaper (or some other publication people actually read).

Rule 1.6 Confidentiality

- This rule can be avoided by “informed consent” (discussed above).
- This does NOT have to be confirmed in writing.

Rule 1.6 Confidentiality

- Exceptions include (all permissive):

- (1) to prevent reasonably certain death or substantial bodily harm;
- (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

Rule 1.6 Confidentiality

- Exceptions include (all permissive):

- (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;
  - This grew out of post-Enron hearings.

Rule 1.6 Confidentiality

- Exceptions include (all permissive):
- (4) to secure legal advice about the lawyer's compliance with these Rules;
- (5) 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;

Rule 1.6 Confidentiality

- Different points of view on what is a "controversy":
  - Majority rule: flames on line are not "controversy" that lets the lawyer out of Rule 1.6.
  - Minority rule: flames on line from client are a "controversy," but lawyer cannot respond more than is absolutely required to correct record.

Rule 1.6 Confidentiality

- Exceptions include (all permissive):

- (6) to comply with other law or a court order; or
- (7) to detect and resolve conflicts of interest arising from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client.

Rule 1.7 Conflicts

- Two types of conflicts:
  - Directly adverse (Rule 1.7(a)(1)); and
  - Material limitation conflict (Rule 1.7(a)(2)).

Rule 1.7 Conflicts

- Directly adverse rare for in-house, but it has happened.
- Often in-house counsel also does work for the owner, officers, or related companies.
- Once you do this, they are all your clients.
- This can create directly-adverse conflict.

Rule 1.7 Conflicts

- Hypothetical #6
- You do work for parent and subsidiaries that are principally but not exclusively owned by parent.
- New proposed deal is struck that can be done so profit comes in at either parent or subsidiary level.
- CEO of parent asks your advice on how to structure deal.

Rule 1.7 Conflicts

- Likely.
- You are now counsel for both parent and subsidiary.
- You have to go through the same conflicts analysis like you did back in the day when you were in private practice.

Rule 1.7 Conflicts

- Hypothetical #7
- You do work for company and an employee because there interests are aligned on a one-off matter.
- Later, the interests are no longer aligned on that matter.
- Do you withdraw from representing the company, the employee, both, or neither?

Rule 1.7 Conflicts

- You have to withdraw from both.

- *Yanez v. Plummer*, 164 Cal. Rptr. 3d 309 (Cal Ct. App. 2013) (where in-house lawyer was also lawyer for bystander witness/employee, he had conflict when the witness's story changed to detriment of company, and could be sued for malpractice).

Rule 1.7 Conflicts

- *Dinger v. Allfirst Fin., Inc.*, 82 Fed. Appx. 261 (3d Cir. 2003).

- Where in-house lawyer gave legal advice to officers about personal matter, he owed them duty and could be sued for breach of fiduciary duty if advice was bad.

Rule 1.7 Conflicts

- Also need to be sensitive to material limitation conflicts (Rule 1.7(a)(2)).

- Anytime something materially limits your ability to give objective advice.

Rule 1.7 Conflicts

- Hypothetical #8:
  - You have significant stock options
  - Company is considering two courses of action, one will spike price in short run but is risky in long run.
  - Other is better long-term bet, but no spike.
  - Does this give you a conflict of interests?

Rule 1.7 Conflicts

- Yes, if the concerns are material.
- This is classic material limitation conflict.
- If your advice to the company depends on anything other than the best interest of the client, then you have a conflict.

Rule 1.7 Conflicts

- Material limitation are real conflicts; just like directly adverse conflicts.
- If you have either type, you have to go through the same conflict waiver analysis.
- Consent from a client must be confirmed in writing.

Rule 1.7 Conflicts

- "Confirmed in writing" means:
  - Client sends writing to you (email fine).
  - You have oral conversation with client, and then you confirm to client in writing within reasonable time.

Rule 1.7 Conflicts

- "Confirmed in writing" does NOT mean:
  - "We've worked together a while, and I don't think you'll see this as a problem. If I am wrong, let me know."
  - Must be confirmation not assumption.

Rule 1.10 Imputed Conflicts

- Hypothetical #9

- While representing Client A, you work on a contract with Company B.
- Company B is so impressed with your work that it hires you in-house.
- The contract you worked on becomes an issue between Client A and Company B.

Rule 1.10 Imputed Conflicts

- Rule 1.10 (Imputed Conflicts) is the only substantive rule that refers directly to in-house counsel.

- Comment [1] reiterates from definitions that "firm" for purposes of imputed disqualification includes in-house department.

- So not only is attorney disqualified, but entire in-house department is.

Rule 1.10 Imputed Conflicts

- A confidentiality wall can work depending on circumstances.
- Needs to be timely (better before lawyer changing firms even starts) and effective.

1.13 Organization as client

- Organization, not constituents you deal with, is client.
- If constituents get confused about this, the lawyer has to explain it to them.

1.13 Organization as client

- “Up the ladder” reporting can be required when company is engaged in unlawful conduct or constituent is violating duties to client.

- May have to report to the highest authority within the organization if conduct continues.

1.13 Organization as client

- If “up the ladder” reporting does not work, you may report outside the organization “only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization” even in violation of Rule 1.6.

- This will likely get you sued for malpractice, so make sure it is worth it.

1.13 Organization as client

- If you get fired for “up the ladder” reporting, you have to report that.
- If fired for up-the-ladder reporting, any recourse?

1.13 Organization as client

- Numerous federal cases allowing in-house whistle-blowers to sue for monetary damages but not reinstatement, regardless of state ethical rules.

- This is under standard supremacy clause analysis, *i.e.*, federal whistle-blower protections trump state law ethical rules.

1.13 Organization as client

- Cases involving state court whistle-blower protections are more complicated.
- Court has to decide which public policy is more important (legal ethics or whistle-blower protections).
- E.g., *Pang v. International Document Services*, 356 P.3d 1190 (Utah 2015) held in-house lawyer fired for internal whistle-blowing had no claim, because public policy favoring absolute choice of counsel by client outweighed whistle-blower protection policy.

1.13 Organization as Client

- Claims for malpractice against in-house lawyers on the rise.
- Many in-house lawyers rely on company's D&O policy.
- Beware: many D&O policies exclude professional services, and there are numerous cases enforcing such exclusions.
- You may be able to get a rider for next to nothing.

1.14 Client with diminished capacity

- Try to keep relationship as “normal” as possible.
- If things get really bad (client at risk of harm), you may disclose Rule 1.6 information to get help for the client.

1.18 Duties to Prospective Client

- A lawyer has most of the same duties to prospective clients that the lawyer has to actual clients.
- This is why a lawyer should do a conflicts check before having even the briefest conversation with a prospective client.
- Cocktail party" exception.
- Recall *Dinger* (by giving advice to company officers, in-house counsel created duty to them).

3.3 Candor to the Tribunal

- Cannot make false statements to tribunal.
- If client does, try to get client to correct false statements.
- If client won't, you have to tell court testimony was false—this trumps Rule 1.6.
- This will probably create a conflict of interest.

3.4 Fairness to Opponent

- Cannot obstruct another's access to information.
- This is hot area in Electronically Stored Information ("ESI")
- Many recent cases seriously sanctioning litigants for discovery abuses re: ESI.
- Sanctions often higher when in-house counsel involved.

3.4 Fairness to Opponent

- *Haeger v. Goodyear Tire and Rubber Co*, 793 F. 1122 (9th Cir. 2015) (sanctions for improper discovery responses and withholding of documents, made much worse because in-house counsel was involved in discovery process).

- *Eaton Corp. v. Frisby*, 133 So.3d 735 (Miss. 2013) (same).

3.4 Fairness to Opponent

- *Sun River Energy v. Nelson,* 800 F.3d 1219 (10th Cir. 2015). Trial court rejected "innocent mistake" argument:

  "Regardless of the precise *mens rea* of general and outside counsel in failing to investigate properly and disclose the existence of insurance, they must be viewed as significantly culpable."

Rule 4.2 Communications with Represented Persons

- You cannot communicate with a person known to be represented in a matter.
- Knowledge can be inferred from the circumstances.
- It does not matter who initiates the communication.

Rule 4.2 Communications with Represented Persons

- Hypothetical # 10
- You are negotiating a contract, and business person you dealing with on other side says, “Before we finalize this, I’ll have to run the warranty issue past legal.”
- Do you have to cease talking to business person on other side?

Rule 4.2 Communications with Represented Persons

- Probably not. Rule 4.2 is on a matter-by-matter basis.

- You do not “know” within the meaning of the Rules that other company is currently represented on that matter.

Rule 4.2 Communications with Represented Persons

- Hypothetical # 11
- You are negotiating a contract, and business person on other side you dealing with says, “I was discussing this with Ms. Smith in legal last night, and she had some thoughts about the warranty.”
- Do you have to cease communicating?

Rule 4.2 Communications with Represented Persons

- Yes.
- Now you know other party has a lawyer and you cannot discuss matter without Ms. Smith's consent.

Rule 4.3 Communications with Unrepresented Persons

- Hypothetical #12
- You are negotiating contract with unrepresented person. He asks, “What does this warranty provision in our draft contract mean?”
- Can you answer?

Rule 4.3 Communications with Unrepresented Persons

- Very bad idea to do so; you may be giving legal advice and putting yourself in conflict situation.
- Best, “You need to get your own lawyer for that.”
- Perhaps acceptable: “I am not your lawyer and do not represent you. But here is what it means to means to me . . .”
- If going this route, doing it in writing is best.

Rule 4.4 Respect for Rights of Third Persons

- If you receive inadvertently produced document, only duty is disclosure to sender.

- Old days of “complying with instructions” of sender (such as to destroy) gone, unless you get the instructions before you receive the document.

[Former] Rule 4.5 Threatening Prosecution

- ABA has eliminated this Rule, but many states still have it.
- Cannot threaten prosecution or a grievance to gain advantage in a civil case.
- Okay to notify lawyer that lawyer's conduct violates Rules.
- This is a rule for lawyers, not clients.

Rules 5.1 and 5.3 Supervisory Responsibilities

- Generally, senior lawyer's obligation to make sure junior lawyers and subordinates act consistently with rules.

- Areas of emphasis are confidentiality, conflicts, and avenues to express ethical concerns confidentiality.

Rule 5.4 Professional Independence

- "A lawyer shall not permit a person who recommends, employs, or pays the lawyer . . . for another to direct or regulate the lawyer's professional judgment."

- "for another" in the context of in-house counsel includes an employee who is not "the client."

Rule 5.4 Professional Independence

- Thus lawyers reporting to non-lawyers, except at the highest (client) level, could be a problem.

- Current push to "integrated department" (*e.g.*, law, employment, compliance) could cause problems if junior lawyer reporting to mid-level management non-lawyer.

Rule 5.5 UPL

- Many in-house lawyers are not licensed in the states where they practice. This can be Unauthorized Practice of Law.

- Many states have “single-client” rules that allow a lawyer licensed in another state to work in-house.

Rule 5.5 UPL

- Issues vary state-to-state, but remember:
  - UPL is a crime.
  - UPL is an ethical violation in the state where you are licensed.
  - UPL can get your colleagues in ethical trouble.

Rule 5.5 UPL

- UPL can affect the client's attorney-client privilege.

- Multiple cases holding that where in-house lawyer was not licensed where practicing, he was not attorney, thus attorney-client privilege did not apply to communications.

5.6 Restrictions on Right to Practice

- Unethical to sign covenant not to compete.
- Multiple state and local ethics opinions says this Rule means exactly what it says and applies to in-house counsel as written.
- Multiple court cases that say it does not apply to in-house counsel.
- What happens if both in-house counsel and also an officer of the company?

Rule 5.7 Law-related Services

- When you are in a law-related service, the Rules still have some application.

- If services “not distinct” from legal services, then Rules generally still apply.

Rule 5.7 Law-related Services

- You can “opt out” of Rules by advising the customers (not clients) that you are not acting as a lawyer and the attorney-client privilege does not apply.

- This should be done carefully as can create privilege issues in the event the communication included legal advice.

Rule 5.7 Law-related Services

- Many in-house lawyers are often asked to give business advice.
- Attorney-client privilege does not apply when legal advice is not being given.

Rule 5.7 Law-related Services

- There are many cases requiring in-house lawyers to testify about communications with company officers because conversation was about business, not legal issues.

- Good idea (if not ethically required) to let client asking business advice know that the conversation may not be privileged.

Rule 5.7 Law-related Services

- When in-house lawyer also acts as a different officer (Secretary, etc.), ethical rules probably still apply.

- Argument that conduct was as officer, and not attorney, so the Rules do not apply was another argument rejected in *Kaye*.

Rule 8.3 Reporting Misconduct

- Required to report misconduct of other lawyers if:
  - other lawyer's conduct "raises substantial question as to the lawyer's honesty, trustworthiness, or fitness to practice law."

Rule 8.3 Reporting Misconduct

- Conduct that "raises substantial question as to the lawyer's honesty, trustworthiness, or fitness to practice law" generally is:
  - Serious crimes;
  - Misuse of client funds; or
  - Substance abuse.

Rule 8.4 Misconduct

- Ethical violations are only crimes if conduct "reflects adversely on the lawyer's honesty, trustworthiness, or fitness as a lawyer in other respects."
- Driving 85 in a 65 is not an ethical violation.
- Driving 85 is a school zone is.
- Compare to Rule 1.2: advising a client to drive 85 in a 65 is an ethical violation.

Questions?

- Ask me.
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