American Bar Association • Section of Litigation

VOL. 23 NO. 4 | SUMMER 2009

IN-HOUSE LITIGATOR

THE JOURNAL OF THE COMMITTEE ON CORPORATE COUNSEL

In-House Counsel Beware: Conflicts of Law May Spoil Your Privileges

By Todd Presnell

Despite the diligence with which an in-house lawyer may work to establish and protect privileged communications with company managers and employees, the varying scope of the corporate attorney-client privilege combined with the conflicts of law rules applied by state and federal courts may nevertheless operate to destroy the privilege. Consider this not-so-far-fetched hypothetical: Elise Franklin, an in-house attorney for Slovtu, Inc., a Dallas-based manufacturer of industrial filters, travels to meet with Anne Berg, a regional sales manager based in Slovtu's manufacturing facility in Portland, Oregon. During the meeting, Berg and attorney Franklin discuss the increasingly poor job performance of Berg's boss, 60-year-old national sales director Tom Mattingly, who is based in Dallas. A few months later, Mattingly is terminated, and he subsequently files an age discrimination suit in Texas. During discovery, Mattingly's lawyer attempts to depose Anne Berg in Portland about, among other things, her conversation with in-house attorney Franklin. Is this communication protected from discovery? The answer, of course, is it depends. It depends on the interaction between the appropriate scope of the corporate attorney-client privilege and the applicable conflict of law rules.

Corporate Attorney-Client Privilege

In-house counsel are lawyers, too, and corporate employees' communications with in-house attorneys are subject to the attorney-client privilege. The scope of this privilege, however,

(Continued on page 5)

A Tidal Wave of Federal Enforcement, the Changing Role of In-House Counsel, and the Foreign Corrupt Practices Act

By Sean O'D. Bosack

American corporations face an increasingly intense regulatory and enforcement environment. The role of in-house counsel continues to evolve such that in-house counsel are no longer simply legal advisors and advocates. Today, in-house counsel participate in business decisions that transcend their traditional legal support function. In 2002, after a wave of corporate scandals heightened concerns that corporate governance had failed at many high-profile companies, Congress passed the Sarbanes-Oxley Act,[1] the Department of Justice (DOJ) established the Corporate Fraud Task Force, and the DOJ and Securities and Exchange Commission (SEC) made prosecuting corporate fraud one of their top priorities.[2] Since the enactment of Sarbanes-Oxley, the DOJ and SEC have obtained more than 1,200 corporate fraud convictions against corporations, their executives, and their lawyers.[3]

These legislative and policy initiatives impose unprecedented responsibility on in-house counsel to detect, prevent, and report misconduct within their corporations. Regulators and prosecutors now view in-house counsel as gatekeepers—corporate America's first line of defense against fraud and corruption—responsible for ensuring ethical conduct and compliance with the law.[4] In the past five years, the DOJ and

(Continued on page 9)

Highlights

Published by the American Bar Association Section of Litigation • 321 N. Clark Street • Chicago, IL 60654

In-House Counsel Beware: Conflicts of Law May Spoil Your Privileges

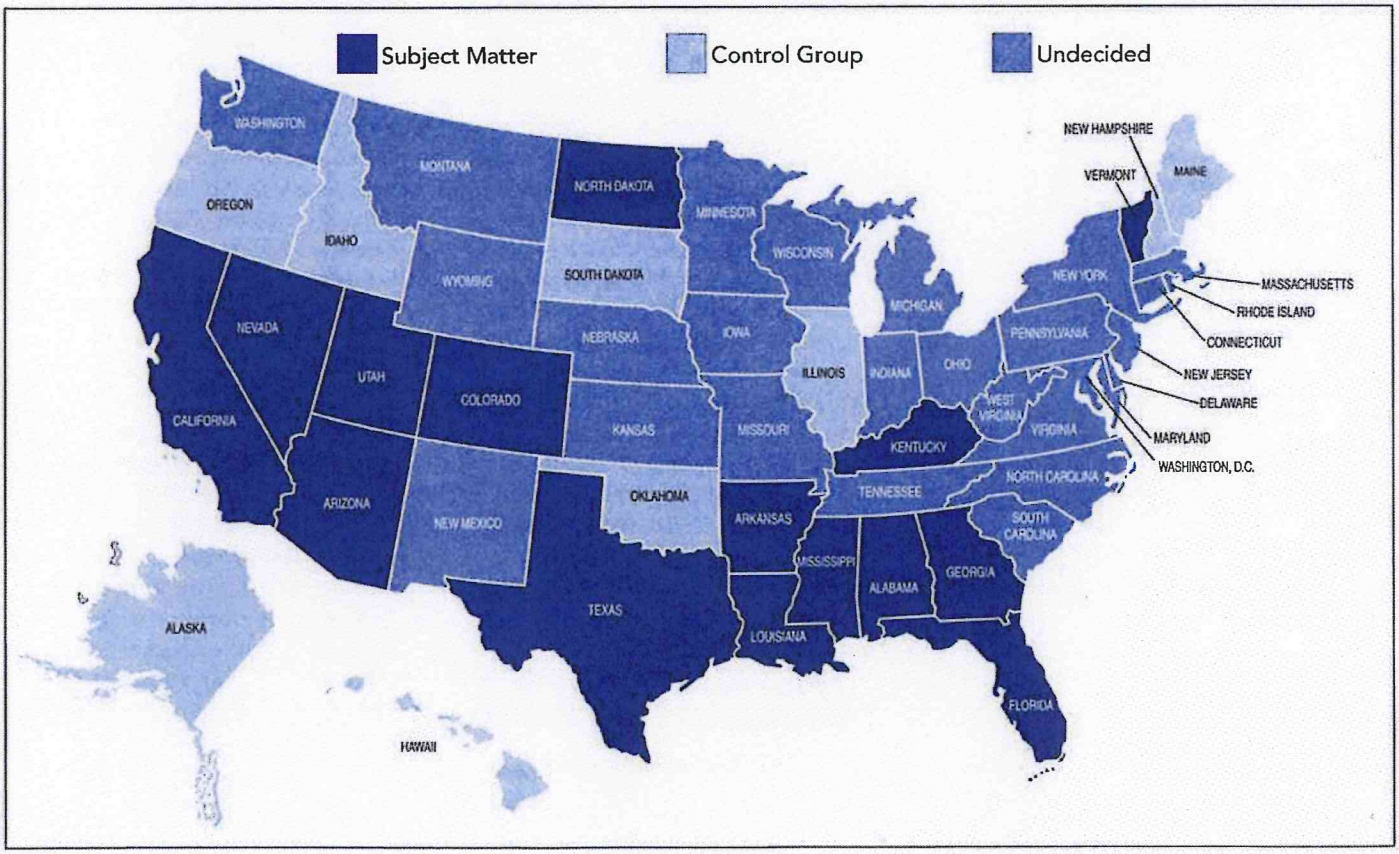
(Continued from page 1)

varies between the states and between state and federal courts. Generally speaking, two tests have evolved to determine whether a particular corporate employee's communications with in-house counsel are privileged. The original assessment, labeled the control group test, provides that an employee's communications with counsel are privileged if the communication was intended to be and actually was kept confidential, the communication was obtained for the purpose of the in-house lawyer rendering legal advice to the company, and the employee was a corporate decision-maker or otherwise in a position to control or take substantial part in a decision about an action the company may take based upon the in-house attorney's advice.[1] This test is a narrow one, and it only protects from discovery the communications of high-level corporate employees who are in a position to make decisions based upon the advice of the in-house attorney. In the Slovtu hypothetical, Ms. Berg's communication would likely not be privileged under the control group test because, as a regional sales manager, she does not have authority to act on behalf of the corporation upon the advice of counsel.

Following the Supreme Court's decision in *Upjohn Co. v. United States*,[2] the so-called subject matter test became the more prevalent test to determine whether a corporate employee's communications with corporate counsel are privileged. Under this test, an employee's communications are privileged if it is made for the purpose of the in-house lawyer rendering legal advice to the company, the employee made the communication at the direction or request of his or her supervisor, the subject matter of the communication was within the scope of the employee's duties, and the communication was not copied or forwarded beyond those corporate employees who have a need to know.[3] In the Slovtu hypothetical, Ms. Berg's communications would likely be privileged, because her comments to attorney Franklin fall within the scope of her duties.

The control group test remains valid in a few states, including Alaska, Hawaii, Idaho, Illinois, New Hampshire, Oklahoma, Oregon, and South Dakota. The subject matter test is applied in all federal courts hearing cases under federal question jurisdiction (i.e., where a federal claim is involved) as well as a majority of states. Several states have not directly addressed the issue and therefore remain in the undecided column. For ease of reference, the map below shows the test applied in each of the 50 states.[4]

Regardless of the test that any particular jurisdiction may apply, in-house counsel must continually realize that they operate under a privilege microscope. Because in-house lawyers are perceived, whether real or imagined, as serving a legal and a business function (i.e., the proverbial two-hat theory), courts apply a heightened scrutiny when determining whether a communication to in-house



counsel is privileged. Under this increased scrutiny, courts require the proponent of the privilege to make a "clear showing" that the communication was made for legal rather than business purposes.[5] The clear showing requirement means that the in-house attorney will need to set forth specific facts that the communication was for a legal purpose.[6] Returning to the Slovtu hypothetical, the company's claim of privilege for the Berg-Franklin meeting will be decided, as a threshold matter, on whether the communication was made for the purpose of Franklin rendering legal advice to the company.

Conflict of Law Issues

Conflicts of law may invoke painful memories of studying for the bar examination, but this area of law is critically important to the ultimate application of the corporate attorney-client privilege. The conflicts of law issues in the area of evidentiary privileges become readily apparent when reviewing the Slovtu hypothetical. In this scenario, the privileged communication between Berg and Franklin occurred in Oregon, a control group state, but Mattingly has the option of filing a state-law age discrimination case in a state court in Texas, a subject matter state. If there is diversity jurisdiction, however, Slovtu could remove the case to federal court, a subject matter jurisdiction. Alternatively, Mattingly could file a federal law age discrimination case in a Texas federal court, but he could also add supplemental claims under Texas law. The question, therefore, is whether the Berg-Franklin communication will be analyzed under Oregon, Texas, or federal law.

State courts have issued differing conflicts of law rules in tort and contract cases; unfortunately, however, courts have not been as prolific in deciding conflicts of law matters in the area of the attorney-client privilege. While a few states have an amalgam of choice of law rules, most states that have decided the conflicts of law issue with respect to evidentiary privileges follow either the "territorial approach" or the "most significant relationship" test. The territorial approach, as set forth in § 597 of the *Restatement (First) Conflict of Laws*, provides that the law of the forum determines the admissibility of evidence. In tort cases, this rule mandates that the law of the state where the tort occurred governs. In contract cases, this rule holds that the law of the state where the contract was signed or was to be performed controls. In the context of evidentiary privileges, the law of the state where the action is pending would control. This rule appears to be followed in Alabama, Alaska, Arkansas, Nevada, and Virginia. Other states, including Connecticut, Georgia, Kansas, New Mexico, and South Carolina, have not specifically decided this issue but apply the territorial approach to other choice of law questions and, therefore, would likely follow this approach on the choice of law issue for evidentiary privileges.

While the territorial approach is simplistic, the most significant relationship approach requires a more detailed, complex analysis. This approach, enunciated in §139 of the *Restatement (Second) Conflict of Laws*, favors admission of communications. Under this approach, evidence that is not privileged under the law of the state that has the most significant relationship to the communication will not be admitted even if the law of the state where the action is pending considers the communication to be privileged, unless the admission of the evidence would be against the "strong public policy of the forum."[7] Similarly, evidence that is privileged under the law with the most significant relationship to the communication will nevertheless be admitted if the communication is not privileged under the law of the state in which the action is pending, unless "there is some special reason why the forum policy favoring admission should not be given effect."[8]

These counterintuitive paragraphs can be abridged by saying that (1) a communication will be admitted if the state with the most significant relationship allows it; however, (2) if the law of the forum state permits the discovery and admission of a communication, then the communication will be admitted even if the law of the state with the most significant relationship provides that the communication is privileged. The only exception to the second provision is that "countervailing reasons" may negate this rule and preclude admission of the communication. These reasons include the number and nature of the contacts in the forum state, the degree of relevance of the evidence sought to be precluded, the type of privilege involved, and fairness to the parties.[9] Importantly, courts should be "more inclined to give effect to a privilege if it was probably relied upon by the parties."[10]

In sum, this test utilizes the most significant relationship to determine whether to admit a communication between a corporate employee and an in-house attorney, but does so in a way that favors admission of the communication. For in-house counsel, who are already highly scrutinized in the area of privileges, this rule provides little reassurance that their communications will be precluded from discovery and trial. Unfortunately for in-house counsel, this test is applied in a majority of the states that decided the issue, including California, Colorado, Delaware, Florida, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, New York, Ohio, Pennsylvania, Texas, Utah, Washington, and Wisconsin. Several states have not decided the conflicts of law issue with respect to evidentiary privileges but follow the approach of the Restatement (Second) in other areas and, therefore, would likely do so in a privilege analysis. These states include Arizona, Hawaii, Idaho, Indiana, Kentucky, Louisiana, Missouri, Montana, Nebraska, New Hampshire, New Jersey, North Carolina, North Dakota, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Vermont, West Virginia, and Wyoming. The illustration on the following page summarizes the approach taken by the various states.[11]

The conflict of law rules in federal courts add another layer of analysis. When a federal court entertains a case under federal question jurisdiction, then the court will employ the *Upjohn* subject matter test to determine whether the corporate attorney-client privilege applies.[12] If the court entertains a state-law case under diversity jurisdiction, however, then the federal court will look to the law of the state in which it sits to determine whether the attorney-client privilege applies, including that state's choice of law rules.[13] In other words, the

federal court will first look to its home-state conflict of law rules to determine which state's privilege law should be applied.

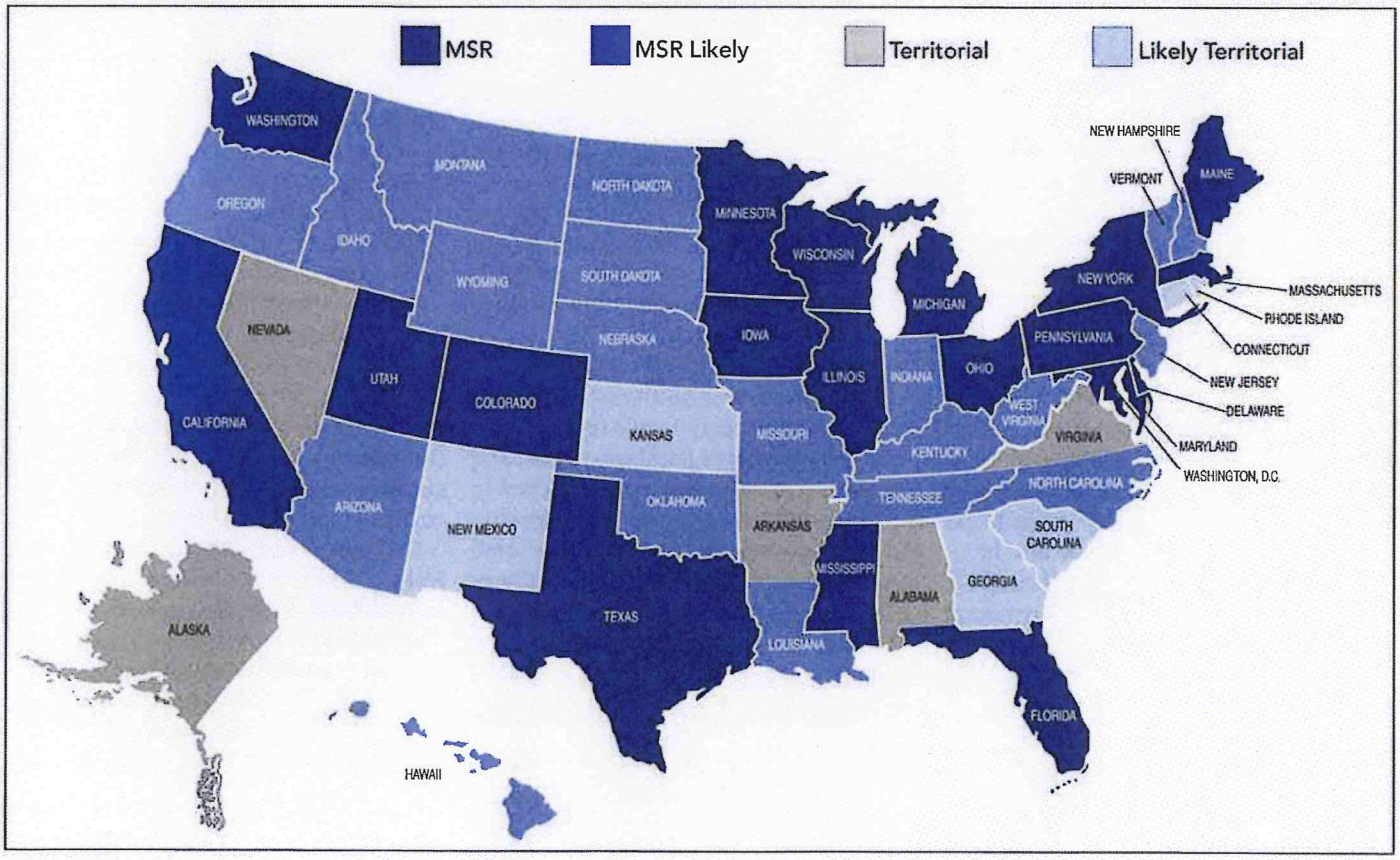
An interesting issue arises when a plaintiff includes supplemental or pendent state law claims to a federal cause of action. In the Slovtu situation, this would involve Mattingly filing suit in federal court, alleging violations of the federal and Texas age discrimination statutes. The question is whether the privileged nature of the Berg-Franklin meeting would be decided under federal law (because there is a federal claim) or state law (because there is a state-law claim). Rule 501 is not clear on this issue.[14] Most federal courts, however, apply federal privilege law even when state law claims are involved.[15] This is especially true when the federal law does not recognize a privilege even if the applicable state law would recognize the privilege.

A return to the Slovtu hypothetical illustrates the operations of these rules. If Mattingly files suit in a Texas federal court, asserting only a claim under the Federal Age Discrimination Act, then the court will apply federal law—the subject matter test—and likely find that the Berg-Franklin communications are covered by the corporate attorney-client privilege. If Mattingly also includes an age discrimination claim under Texas law, the federal court will likely look to federal privilege law rather than looking to Texas's choice of law rules as to whether to apply Texas or Oregon state privilege law.

If Mattingly files a purely state-law age discrimination claim in a Texas state court, the privilege question becomes tricky. Oregon, where the Berg-Franklin communication occurred, is a control group state, whereas Texas, where the claim is filed, is a subject matter state. Thus, the decision of which state's law applies will determine whether this communication is privileged. To answer this question, the Texas court will look to its conflict of laws rules. Texas follows the most significant relationship (MSR) test[16] and, therefore, will analyze whether Oregon has the more significant relationship to the communication to Texas. Assuming the answer is yes, then the Texas court will use Oregon's control group test and likely find the communication not to be privileged. Thus, the communication will be discoverable in the Texas action—even though the communication would likely be privileged under Texas's subject matter test—unless the Texas court finds that there is some special reason for the communication not to be discoverable.

Practice Tips

The application of the control group test or the subject matter test will depend upon the type of claim (federal or state) that is asserted, the state in which the claim is asserted, and whether the claim is filed in federal court or can be removed to federal court. In any given case, however, a communication between an in-house lawyer and a corporate employee will not be challenged or reviewed by a court until months, and likely years, after the communication was made. Thus, it is at best difficult to know, at the time the communication is made, whether a challenge to its privileged status will be made in state or federal court or, because of conflicts of law



rules, will be analyzed under the control group or subject matter test.

What is the in-house practitioner to do? While there is no absolute answer to this question, some practice tips are noteworthy. First, in-house counsel must recognize that their communications will be more strictly scrutinized by the courts and, consequently, they must diligently and consistently ensure that their communications with corporate employees are in fact for the purpose of rendering legal advice rather than for business-related purposes. Regardless of whether the control group or subject matter test is involved, if there is little evidence of the legal reason for the communication, then the privilege will not apply.

Second, in-house counsel should attempt to predict as much as possible whether the potential claim that may arise from the subject matter of the communication will be filed in a federal court. For example, many wage and hour claims and intellectual property claims are filed in, or are removed to, federal court. Thus, if the in-house lawyer's communications with an employee pertain to these potential claims, then the lawyer may feel more comfortable that federal privilege law will apply. Similarly, if the claim about which the communication is made pertains to a tort or breach of contract matter, then there is a better chance that these claims will be filed in state court where the conflicts of law rules will be more unpredictable. In these situations, the in-house lawyer should act under the assumption that the privilege will not apply and govern subsequent communications and documentation accordingly. The ability to predict is admittedly difficult, but the in-house lawyer will be better-served by making an attempt, and hopefully the corresponding illustrations will aid in that endeavor.

> In-house lawyers should consider including a specific choice of privilege law provision in the company's contracts.

Finally, in-house lawyers should consider including a specific choice of privilege law provision in the company's contracts. Many times, whether in a business agreement or an employment agreement, companies include general choice of law provisions in their contracts. Although there is relatively little law on the subject, these general provisions likely will not suffice to require a court to apply the privilege law of the chosen state rather than its state's own conflict of law rules. The court's decision in *Hercules, Inc. v. Martin Marietta Corp.*[17] is constructive. In this case, Hercules and Martin Marietta were in a contract dispute, and Martin Marietta sought to discover documents that Hercules claimed were protected by the accountant-client privilege. Although most of the activities arising under the contract were performed in Utah, the case was filed in a Colorado federal court, and the contract between the parties included a choice of law provision designating Colorado law as the governing law. As to the accountant-client privilege, Utah did not recognize the privilege, but Colorado did. The question, therefore, was whether the choice of law provision in the contract included a choice by the parties that Colorado law would govern privilege questions. This issue was dispositive as to whether the documents would or would not be produced.

The choice of law provision provided that "[t]he contract shall be governed by, subject to, and construed according to the laws of the State of Colorado."[18] Hercules therefore argued that this provision governed the discoverability of the documents and, because Colorado recognized the accountant-client privilege, the documents were privileged. The court, however, found that the clause pertained to the interpretation of the contract itself and that "[n]othing in the express terms of the contract applie[d] to the law of privileged communications."[19] The court further noted that the choice of law provision did not "take into consideration the specific contract terms, the relevant evidentiary events, or the justification for application of any privilege."[20] Accordingly, the court rejected the Colorado choice of law provision, found that Utah law applied, rejected Hercules's claim of privilege, and ordered that the documents be produced.

The lesson to be learned is that general choice of law contractual provisions will likely not be construed so broad as to govern application of evidentiary privileges. Thus, the in-house lawyer should consider adding specific language to the choice of law provisions in all contracts that provide that the law of the chosen state (i.e., the state with the broadest privilege application) will apply to all matters of privileged communications and documents. ■

Todd Presnell is a member in the Nashville office of Miller & Martin PLLC. He may be reached at tpresnell@millermartin.com.

Endnotes

1. *See, e.g.*, Hercules, Inc. v. Exxon Corp., 434 F. Supp. 136, 145 (D. Del. 1977).
2. 449 U.S. 383 (1981).
3. *See id.* at 386; Diversified Industries, Inc. v. Meredith, 572 F.2d 596 (8th Cir. 1978).
4. Please contact the author for specific case or rule citations.
5. *See* In re Sealed Case, 737 F.2d 94, 99 (D.C. Cir. 1984).
6. *See* North Carolina Electric Membership Corp. v. Carolina Power & Light Co., 110 F.R.D. 511, 515 (M.D.N.C. 1986).
7. RESTATEMENT (SECOND) CONFLICT OF LAWS § 139(1).
8. *Id.* § 139(2).
9. *Id.* cmt. d.
10. *Id.*
11. Please contact the author for specific case or rule citations.
12. FED. R. EVID. 501; Reed v. Baxter, 134 F.3d 351, 355 (6th Cir. 1998).
13. FED. R. EVID. 501; Samuelson v. Susen, 576 F.2d 546, 549 (3d Cir. 1978).
14. Jaffee v. Redmond, 518 U.S. 1, 15 n.15 (1996) (noting the disagreement concerning the proper rule in cases where "evidence would be privileged under state law but not federal law").
15. *See, e.g.*, von Bulow v. von Bulow, 811 F.2d 136 (2d Cir. 1987); Pearson v. Miller, 211 F.3d 57 (3d Cir. 2000); Hancock v. Dodson, 958 F.2d 1367 (6th Cir. 1992).
16. *See* Ford Motor Co. v. Leggat, 904 S.W.2d 643 (Tex. 1995).
17. 143 F.R.D. 266 (D. Colo. 1992).
18. *Id.* at 268
19. *Id.*
20. *Id.*