



CORPORATE GOVERNANCE AND PROFESSIONAL LIABILITY UPDATE

Corporate Governance and Compliance Practice

Lawyers in Sidley's Corporate Governance and Compliance practice regularly advise corporate management, boards of directors and board committees on a wide variety of corporate governance matters, including corporate responsibility, SEC disclosure, legal compliance, fiduciary duties, board oversight responsibilities and issues arising under Sarbanes-Oxley. Our advice relates to the procedural aspects as well as the legal consequences of corporate and securities transactions and other corporate actions, including takeover defenses, proxy contests, SEC filings and disclosure issues, stock option issues and general corporate law matters. Our broad client base allows us to provide advice regarding best practices and trends in such matters as directors' and officers' responsibilities, board and committee practices, disclosure controls and procedures, internal controls, executive compensation and other matters.

Accountants/Professional Service Firms Liability Practice

With highly skilled and experienced lawyers in Chicago, Los Angeles, New York, San Francisco and Washington, D.C., we are able to provide efficient and comprehensive assistance in matters arising all over the country. Each of the more than two dozen partners in our Accountants/Professional Service Firms Liability practice has many years of experience regularly representing accounting firms and individual accountants, and our lawyers have represented accountants and accounting firms in matters in at least 38 states. In addition, we have extensive international experience, representing foreign firms in matters pending within the United States and assisting those clients in matters pending outside the United States.

To receive future copies of this and other Sidley updates via email, please sign up at www.sidley.com/subscribe

Recent Privilege Decision Suggests That Corporations Should Check the Bar Status of In-House Lawyers

A recent decision by a federal Magistrate Judge held that the attorney-client privilege did not protect corporate personnel's communications with the in-house legal counsel for the company, because at the time of those communications the individual in question was not authorized by any state to engage in the practice of law, and because the company's belief that the individual was a lawyer was unverified and therefore unreasonable.¹ As a result of this ruling, in the future corporations that employ in-house attorneys may want to protect internal privileged communications by establishing procedures to:

- Confirm the good standing and active bar status of each person they hire for an in-house legal position;
- Verify compliance with any applicable local registration requirements of their in-house lawyers who are licensed only in states outside of the state in which they work; and
- On an ongoing basis, periodically reconfirm the continued good standing of their in-house lawyers under applicable rules.

Inactive Status

The individual in question graduated from law school and was admitted to the California bar in 1993. In 1996, however, he transferred to "inactive" status with the California bar. He did not return to "active" status until February 2010 – shortly after the privilege issue in the case arose. There was contradictory evidence as to whether the initial position for which the company hired him in 2002 was a lawyer position, but the undisputed evidence showed that thereafter he acted as an in-house lawyer. At no time prior to the litigation in question, though, did the company ever check to determine the lawyer's California bar status.

The Magistrate Judge held that the lawyer's inactive California bar status did not make him a lawyer for privilege purposes. And while the websites of the United States

¹ *Gucci America, Inc. v. Guess?, Inc.*, 09 Civ 4373 (SAS) (JLC) (S.D.N.Y. June 29, 2010).

District Courts for the Central and Southern Districts of California reflected him as an active member of the bars of those courts, under the respective rules of those courts his inactive California state bar status meant that he was also automatically suspended from practice before those courts as well.

Reasonable Belief; Due Diligence Obligation of Corporate Employer

The Magistrate Judge acknowledged that the company might nonetheless claim the privilege successfully if it could show that it reasonably believed the individual in question was a lawyer at the time of the communications in question. Courts have given considerable leeway to clients who have a genuine belief that someone with whom they communicate is a lawyer, even if it later turns out that that belief was incorrect.² The Magistrate Judge held, however, that the company's belief that he was a lawyer was not reasonable, because it did nothing to verify his professional status. The Magistrate Judge concluded that the company had an obligation to conduct due diligence to confirm its understanding of his professional status, and that the failure to do so rendered its belief on that subject unreasonable.³

Of particular note was the Magistrate Judge's conclusion that corporations have an affirmative obligation to check the bar status of the in-house attorneys whom they hire, and that the failure to do so may render communications with those individuals unprivileged if it develops that there is a flaw in the individual's professional standing. Such checks can often be conducted fairly readily on-line, and many law firms have for years conducted initial on-line searches regarding the good standing of the attorneys they hire. The *Gucci* case may signal

² See, e.g., *United States v. Boffa*, 513 F. Supp. 517, 523 (D. Del. 1981).

³ The Magistrate Judge left open the possibility that the communications in question might nonetheless be covered by the work product protection.

the need for corporations employing in-house lawyers to adopt such a practice, if they have not already done so.

In-House Registration Requirements

In recent years many states have adopted versions of Rule 5.5(d)(1) of the American Bar Association's Model Rules of Professional Conduct, which provides a "safe harbor" with respect to unauthorized practice ethical issues for a lawyer admitted in another jurisdiction who provides legal services to his or her employer or its organizational affiliates. In adopting local versions of MRPC 5.5(d)(1), however, many states have also adopted requirements that in-house lawyers who are otherwise covered by that provision register with, or seek a "limited" in-house counsel admission from, the state bar. In response to the proliferation of different state in-house counsel registration provisions, the American Bar Association adopted a Model Rule for Registration of In-House Counsel in 2008, and today many states have some form of such a rule.⁴

In the past, unauthorized practice issues in the in-house context have not generally attracted much attention. It is not difficult to envision a situation, however, in which a party attempting to overcome a corporation's privilege claim attempts to use the *Gucci* decision to argue that an in-house lawyer admitted only in a jurisdiction other than where he or she works, and not registered under the local in-house rule, should not be regarded as lawyer for privilege purposes. While previously privilege cases have tended to inquire only whether the lawyer in question was admitted and in good standing somewhere,⁵ the limited in-house registration rules are a relatively new phenomenon, and it is unclear how they might affect future

⁴ See *Comparison of ABA Model Rule for Registration of In-House Counsel With State Versions*, http://www.abanet.org/cpr/mjp/in-house_comp.pdf.

⁵ See, e.g., *Georgia-Pacific Plywood Company v. United States Plywood Corporation*, 18 F.R.D. 463 (S.D.N.Y. 1956) (a corporate general counsel licensed in Pennsylvania and the District of Columbia, but officed in New York, was a lawyer for privilege purposes).

privilege rulings. This would suggest that corporations should not only be checking whether their newly-hired in-house lawyers are in good standing with a bar *somewhere*, but also whether they may be subject to a local in-house registration requirement in the jurisdiction in which they are officed. Where an in-house lawyer arguably has not been in compliance with a local registration requirement for some period of time, consultation regarding the application process with counsel familiar with the relevant bar regulatory authority may be advisable.

Periodic Updates

Finally, the *Gucci* decision focused on the obligation to check an in-house lawyer's status at or around the time that a lawyer is hired. Bar admissions, however, must be kept up to date; among other things, lawyers generally must re-register (and pay a fee) annually, and in many jurisdictions must satisfy continuing legal education requirements. In light of this, many law firms perform periodic good standing checks regarding their lawyers. A corporation establishing a process for verifying in-house counsel's good standing at the time of employment may, therefore, also want to consider creating a process for periodic update checks, as protection against a future argument that the failure to perform such checks should be viewed as undermining the reasonableness of the corporation's assumption that its lawyers continue to be lawyers.

For more information and assistance regarding this matter, please contact any member of the Sidley Austin LLP Corporate Governance and Compliance or Accountants/Professional Service Firms Liability Practice Group.

This **Sidley update** has been prepared by Sidley Austin LLP for informational purposes only and does not constitute legal advice. This information is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. Readers should not act upon this without seeking advice from professional advisers.

Attorney Advertising - For purposes of compliance with New York State Bar rules, our headquarters are Sidley Austin LLP, 787 Seventh Avenue, New York, NY 10019, 212.839.5300 and One South Dearborn, Chicago, IL 60603, 312.853.7000. Prior results do not guarantee a similar outcome.

BEIJING BRUSSELS CHICAGO DALLAS FRANKFURT GENEVA HONG KONG LONDON LOS ANGELES NEW YORK PALO ALTO SAN FRANCISCO SHANGHAI SINGAPORE SYDNEY TOKYO WASHINGTON, D.C.

www.sidley.com

Sidley Austin LLP, a Delaware limited liability partnership which operates at the firm's offices other than Chicago, London, Hong Kong, Singapore and Sydney, is affiliated with other partnerships, including Sidley Austin LLP, an Illinois limited liability partnership (Chicago); Sidley Austin LLP, a separate Delaware limited liability partnership (London); Sidley Austin LLP, a separate Delaware limited liability partnership (Singapore); Sidley Austin, a New York general partnership (Hong Kong); Sidley Austin, a Delaware general partnership of registered foreign lawyers restricted to practicing foreign law (Sydney); and Sidley Austin Nishikawa Foreign Law Joint Enterprise (Tokyo). The affiliated partnerships are referred to herein collectively as Sidley Austin, Sidley, or the firm.

