Bloomberg BNA

BNA's Corporate Counsel Weekly™

VOL. 31, NO. 28 PAGES 217 – 224 JULY 20, 2016

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Corporate Counsel Weigh New Plan of Attack After Losing 'Intrafirm' Privilege Case in N.Y.

A corporate executive who claims he lost $5 million in stock options because of a lawyer's poor advice can't discover communications between the allegedly negligent attorney and her firm's general counsel, a New York intermediate appeals court held in a June 30 opinion that was cheered by many large U.S. law firms but criticized by some of their most lucrative clients (*Stock v. Schnader Harrison Segal & Lewis LLP*, 2016 BL 210609, N.Y. App. Div., No. 651250/13, 6/30/16).

The ruling could make New York the latest of a growing list of jurisdictions that recognize a privilege for internal communications between lawyers who serve as their firms' general counsel and colleagues who approach them for advice on thorny ethical issues.

The appellate panel's determination that such communications can be privileged—even if they concern potential liability to a firm client—was a victory for 74 law firms that joined an amicus brief urging the court to recognize the so-called ''intrafirm'' privilege.

Many firms that staked out that position did so despite the fact that some of their top clients—large businesses and the in-house lawyers who manage corporate legal budgets—have adamantly opposed efforts to establish the intrafirm privilege.

Amar Sarwal, the vice president and chief legal strategist of the Association of Corporate Counsel, said his organization viewed this case as a ''last stand''—a sort of ''Maginot Line'' that had to hold if corporate clients were going to have any luck reversing a string of recent defeats over the intrafirm privilege in other states.

Sarwal also told Bloomberg BNA that this loss may lead the ACC's members to consider a change of strategy—one that shifts the battlefield from the courts to the boardroom negotiations where corporations and the firms they hire hammer out engagement terms.

Attacking Privilege Contractually

Sarwal said that while ACC hopes New York's highest court will reverse this ruling, ''in the interim we're going to be working with our members on appropriate language to put in retainer agreements'' that may prospectively waive a firm's right to invoke the intrafirm privilege against a client.

Sarwal said many ACC members ''looked at New York as a bellwether jurisdiction'' and believed that ''if we didn't prevail [there] it was time to go in a different direction in terms of responding to this issue.''

That new tack, Sarwal said, may involve using ''outside counsel guidelines'' to require firms to give up the right to shield internal communications that would be privileged under this New York ruling and a string of recent cases from courts in other states.

That suggestion didn't sit well with some lawyers who are designated as their firms' general counsel or have acted in that capacity on an informal basis.

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"If that's really what they plan to do that will be very disappointing," said Brian S. Faughnan, a partner in the Memphis office of Lewis Thomason.

"It's a bit wrong-headed to insist that firms, if they're going to get your business, would have to waive the privilege," Faughnan told Bloomberg BNA.

Faughnan said the ACC's suggested approach could be myopic because the availability of the privilege often inures to the benefit of clients. "There is reason, if you're a client of a law firm, to want the lawyers who are representing you to feel free to communicate with a properly designated in-house counsel about how to comply with their ethical obligations," he said.

The appellate panel in this case echoed those sentiments. "The protection afforded by the attorney-client privilege encourages lawyers to seek advice concerning their ethical responsibilities and potential liabilities in a timely manner so as to minimize any damage to the client from any conflict or error," Justice David Friedman wrote for the unanimous court.

'It's Going to be a Battle'

Sarwal was confident corporate counsel will be successful in convincing the firms they hire to prospectively waive the right to invoke the intrafirm privilege.

Refusing to do so "is going to be seen as a liability" when firms compete for corporate work, Sarwal said. And big companies will be well-positioned to obtain such waivers because "at the end of the day, corporate coffers fund these firms," he added.

Ronald C. Minkoff, a New York lawyer who heads the professional responsibility group at Frankfurt Kurnit Klein + Selz, was less convinced.

"Law firms are going to be loath to give this up," said Minkoff, whose firm joined the amicus brief supporting the privilege. "And it's going to be a battle if [companies] are going to throw [privilege waivers] into outside counsel guidelines along with the hundreds of other things they have in there," he said.

"It may work to the advantage of the ACC's membership—big corporations that have economic clout in a marketplace that has changed to being a buyer's market instead of a seller's market," Minkoff said.

But waivers will be harder to come by "for most other clients who aren't that sophisticated," Minkoff said, "and they're the ones who are more likely to need it."

Hiding Evidence?

The appellate panel's determination that New York recognizes the intrafirm privilege resolved a contentious discovery fight in a malpractice case that finance executive Keith Stock filed against attorney M. Christine Carty and her New York law firm, Schnader Harrison Segal & Lewis LLP (SHSL).

Stock hired Carty to negotiate the terms of his separation from MasterCard. The malpractice complaint said Carty failed to advise Stock that his termination accelerated the expiration of certain stock options, causing him to lose approximately $5 million.

Stock said Carty and SHSL then "attempted to cover up their wrongdoing" by urging him to pursue a "costly, time-consuming and ultimately wasteful" lawsuit against MasterCard, and an equally fruitless arbitration claim against Morgan Stanley Smith Barney, the administrator of the stock options program.

Morgan Stanley gave notice of its intent to call Carty as a fact witness in the arbitration, and Carty then consulted with SHSL's general counsel and with lawyers at the firm who were handling the arbitration.

That triggered a discovery request asking SHSL to turn over those communications.

A trial court ordered the defendants to disclose their internal communications. It did so by relying on what some courts have dubbed the "fiduciary duty exception" to the attorney-client privilege.

That exception emerged from a line of cases that began with *In re Sunrise Sec. Litig.*, 130 F.R.D. 560 (E.D. Pa. 1989).

The *Sunrise* court said law firms, like corporations, are generally entitled to assert the privilege. But it said law firms ability to do so against their own clients must be more circumscribed because "a law firm's consultation with in house counsel may cause problems of conflicting fiduciary duties which seldom arise in corporations or other professional associations."

"When a law firm seeks legal advice from its in house counsel, the law firm's representation of itself (through in house counsel) might be directly adverse to, or materially limit, the law firm's representation of another client, thus creating a prohibited conflict of interest," the *Sunrise* court said.

Accordingly, the *Stock* trial court said the "fiduciary duty exception" precludes firms from asserting the privilege to shield internal communication that create "a conflict between the law firm's fiduciary duties to itself and its duties to the client seeking to discover the communication."

The appellate panel reversed, saying it "agree[d] with the weight of recent national decisional authority" endorsing the intrafirm privilege, and

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Corporate Counsel Weekly

BNA's Corporate Counsel Weekly (ISSN 0886-0475) is published weekly, except for the weeks of Memorial Day, Labor Day, and Christmas, at the annual subscription rate of $1,232 per year, for a single print copy by The Bureau of National Affairs, Inc., 1801 S Bell St, Arlington, VA 22202-4501. **Periodicals Postage Paid at** Arlington, VA and at additional mailing offices. **POSTMASTER:** Send address changes to BNA's Corporate Counsel Weekly, Bloomberg BNA Customer Contact Center, 3 Bethesda Metro Ctr Suite 250, Bethesda, MD 20814.

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with a 2013 ABA Resolution that urged courts to do so.

The appellate panel also borrowed from outside authorities in delineating the scope of the intrafirm privilege and the circumstances under which courts should recognize it.

The court said communications are more likely to fall under the privilege if they were prompted by requests for advice about a lawyer's ethical or legal obligations in a matter, and if the attorney offering that advice was not directly involved in the underlying representation.

The opinion said communications are also more likely to qualify for protection if the client isn't billed for time that a lawyer spends consulting with his or her firm's general counsel.

Formal Designation

Minkoff said that advice on invoking the privilege was sound, but he also suggested another risk management tip: formally designating somebody in the firm as general counsel.

''When this debate began over whether or not this privilege existed [about] 10 years ago I had to go to the powers-that-be in my firm and say, 'I need to be designated as the general counsel,' '' Minkoff said. ''Because the only way this privilege is going to work is if there is a person in a firm that has that role.''

''[I]nstitutionalizing the role became important for those of us who were starting to think about this privilege and whether or not it was going to withstand judicial scrutiny,'' Minkoff said.

Faughnan said that although he is not aware of any controlling appellate authority on the privilege in Tennessee, he thinks courts ''in most states that will tackle the issue for the first time will be more persuaded by [the] more recent case law,'' including this decision, than by the line of authority that followed *Sunrise*.

Jordan M. Kam of Roth Law Firm PLLC, New York, represented Stock. Frederick B. Warder III and Jesse A. Townsend of Patterson Belknap Webb & Tyler LLP, New York, represented the defendants.

By Samson Habte

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The ruling is available at http://src.bna.com/gVA.

Disclosure

SEC Disclosure Proposal Includes Line-by-Line Changes

In the SEC's latest effort to revamp its disclosure regime, it has taken the unusual step of offering the public a section-by-section comparison of what the proposed rule changes would look like.

The agency's ''demonstration version'' comprises nearly 200 pages of proposed additions and deletions to its disclosure rules, including Regulations S-K and S-X.

The Securities and Exchange Commission proposed changes and sought feedback on others July 13, to eliminate redundant and obsolete disclosure requirements as part of its review of the effectiveness of the overall set of regulations.

The sprawling release includes agency-suggested deletions across many subject areas, such as interim financial statements, equity compensation plans, dividends and derivative policies.

Further changes were proposed to income tax disclosures, real estate investment trust filings, cash flow statements, and auditing standards, among many others.

The agency also proposed that some definitions be referred to the Financial Accounting Standards Board to be potentially included in U.S. generally accepted accounting principles.

The comment period is 60 days.

By Rob Tricchinelli

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The comparison is available at http://src.bna.com/gT6.

SEC Enforcement

SEC Adds Longer Deadlines, Depositions to In-House Forum

The SEC unanimously voted to allow depositions and a longer amount of time between deadlines in its in-house court system, as the agency fights back litigation challenging both the constitutionality and fairness of the forum.

The Securities and Exchange Commission offered the changes in reaction to the lawsuits and other public comments, but the defense bar and other stakeholders have argued that they still don't match the procedural protections afforded by the federal courts. The Dodd-Frank Act expanded the agency's power to bring cases in-house.

The rule changes, which become effective in 60 days, were adopted largely as proposed in September. The agency agreed to the rule changes July 13 in a summary vote without public discussion.

Fairness Concerns

The new rules address some of the fairness concerns that administrative respondents have raised in lawsuits challenging the in-house court, brought in response to SEC enforcement actions.

Respondents in more complex cases will have as long 10 months to prepare for a hearing. They also may take up to three depositions in cases against one individual or entity, and five in cases with more than one respondent, which are unavailable to respondents in less complex cases.

The U.S. Chamber of Commerce has said the lack of depositions and short time frame are unfair to respondents compared to federal court and in July 2015 suggested its own series of changes, including a more consistent set of standards for choosing a venue.

''More due process reforms are needed in order for parties to have full discovery rights, including a right of removal to district courts and preservation of jury trials in complex cases,'' Thomas Quaadman, chairman of the Chamber's Center for Capital Markets Competitiveness, said in a July 13 blog post.

'Band-Aid on a wound'

Another congressional critic of the venue was also largely unmoved by the SEC action.

''While I appreciate the SEC acknowledging the serious due process concerns that have been raised because of their unfair use of in-house judges, the changes adopted today effectively put a Band-Aid on a wound that requires stitches,'' Rep. Scott Garrett (R-N.J.), said in a news release.

Garrett has been pushing a bill that would heighten the burden of proof for liability in the administra-