Negotiating Contracts for the Corporate Client: Does the Attorney-Client Privilege Apply?

You are inside corporate counsel for a large chemical manufacturer that has sold property to a commercial real estate company. As in-house counsel for the chemical company/seller, you participated in negotiating and drafting the terms of the sales contract. The real estate company filed a breach of contract action against your company, alleging that your employer failed to comply with the provisions of the contract dealing with environmental issues, thereby imposing on the purchaser the cost of making the property compliant with federal and state environmental laws. Discovery in the case has begun, and counsel for the real estate company has issued a notice to depose you concerning your role in negotiating the contract provisions at issue. Does the attorney-client privilege insulate you from discovery? Although a lawyer in a private law firm could reasonably expect to be protected by the privilege in analogous instances, an inside lawyer may face a much more searching inquiry.

By John K. Villa

Author of *Corporate Counsel Guidelines*, published by ACCA and West Group

The answer to this question is governed by the unfortunate truth that courts have historically been, and to varying degrees remain, skeptical of invocations of the privilege by in-house counsel in many areas where law and business advice meet. This wariness is prompted by a concern that corporations may structure their business operations to have the inside lawyers, who often understand business operations nearly as well as the business executives that they advise, handle a wide range of business activities to shield the conduct from discovery.[1] This strategy can leave an adversary with no one from whom substantive information can be discovered. The reaction of many courts, therefore, is a stricter and more searching application of the rules of privilege, sometimes with a different result.

To begin, let's briefly review the basic elements of the attorney-client privilege. The privilege requires a communication, made in confidence, from a client to a lawyer that discloses a fact for the purpose of securing primarily either a legal opinion, legal services, or assistance in a legal proceeding.[2] When these elements are satisfied and there is no waiver, the privilege applies.[3] Although the classic rules of privilege apply only to statements from clients to lawyers for purposes of obtaining advice, the jurisprudence now generally recognizes that the lawyer's advice is also privileged as it either explicitly or implicitly reveals the substance of the client's communication.[4]

The same elements must be established in order for the privilege to apply to communications between in-house counsel and the corporate client, but greater scrutiny has been given to assertions of the privilege in this scenario, particularly with respect to claims regarding the purpose of the communication. Specifically, when the fact of an attorney-client relationship is established in any other situation, including between outside counsel and a corporate client, the communications between them are generally pre-

John K. Villa is a partner with Williams & Connolly LLP in Washington, DC. He specializes in corporate litigation (civil and criminal) involving financial services, directors', officers', and lawyers' liabilities, and related issues. He is an adjunct professor at Georgetown Law School and a regular lecturer for ACCA. He is also the author of *Corporate Counsel Guidelines*, published by ACCA and West Group.

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sumed to be for the purpose of obtaining legal advice.[5] Because of the various roles that in-house counsel may play within a corporation, the same presumption does not exist.[6] As explained by one court:

> [S]taff attorneys may serve as company officers with mixed business-legal responsibility; whether or not officers, their day-to-day involvement may blur the line between legal and nonlegal communications; and their advice may originate not in response to the client's consultation about a particular problem but with them, as part of an on-going, permanent relationship with the organization. In that the privilege obstructs the truth-finding process and its scope is limited to that which is necessary to achieve its purpose . . . the need to apply it cautiously and narrowly is heightened in the case of corporate staff counsel, lest the mere participation of an attorney be used to seal off disclosure[.][7]

"[T]he decisive factor in deciding the question of privilege" for inside counsel is often the purpose of the communication.[8]

These abstract principles are admittedly difficult to apply to the everyday practice of in-house corporate counsel. At one end of the jurisprudential spectrum, it is clear that, when the functions performed by counsel require the exercise of counsel's professional skill and training, such as providing legal opinions, preparing legal documents, or litigating claims, the purpose is legal.[9] The water becomes mirky, however, when in-house counsel provide both legal and business advice, such as in the negotiation of a contract. The states have adopted varying formulations of the rules on this issue, but the upshot is that the privilege still applies as long as the primary[10] or predominant[11] purpose of the client's consultation with in-house counsel is the obtaining of legal advice or legal assistance.[12]

The question at bar is how these principles have been applied to in-house counsel who conduct contract negotiations on behalf of the corporation. Although there are relatively few reported cases on this point, those that have addressed the issue have, in general, found the privilege inapplicable,[13] even in cases in which counsel also incidentally perform the purely legal function of interpreting a contract provision.[14] These courts reason that acting as a negotiator on behalf of management constitutes a business function that eclipses the legal knowledge or skill applied to the negotiations.[15] Other courts, however, have adopted a more balanced approach: even in cases in which the communications involve references to financial issues and issues of commercial strategy and tactics, the privilege will still apply if it is "evident that the attorney is presenting the issues and analyzing the choices on the basis of his legal expertise and with an obvious eye to the constraints imposed by applicable law."[16] Moreover, although the Restatement does not expressly address this question, its approach in resolving the general question of whether a communication is made for the purpose of obtaining or providing legal assistance is consistent with this more balanced approach. While noting that "communications with a person who is a lawyer but who performs a predominantly business function within an organization" are not protected by the privilege, the Restatement recognizes that the privilege will apply "[w]hen a person in such a role performs legal services for the client organization."[17] And under the Restatement's view, "[a] lawyer's assistance is legal in nature if the lawyer's professional skill and training would have value in the matter."[18]

The answer to the question posed at the outset is that the in-house lawyer

may well be deposed as to his or her role in the negotiations process and be required to establish the legal nature of the work performed. Of course, it will be easier to defend the privilege if the lawyer was working with a business person who is available to be questioned on the substantive negotiations.

What steps can corporations take to protect the privilege?

- Although not an answer that many inside counsel happily accept, the use of outside counsel unquestionably protects the corporation's privilege to a greater extent than using in-house counsel.
- If the corporation chooses not to use outside counsel, the negotiating team should consist of at least one operational executive in addition to the lawyer so that the court will not be placed in the difficult position of upholding the privilege at the expense of denying the adversary all discovery. It may also be helpful to have a memorandum or other memorialization of the roles of the two individuals. If memoranda are prepared by counsel in connection with the negotiations (and the author's advice is not to prepare unnecessary memoranda), then clearly identify the legal nature of the problems addressed.

NOTES

1. *See generally*, JOHN K. VILLA, CORPORATE COUNSEL GUIDELINES § 1.01 (ACCA and West Group 2001) (discussing the history of the privilege and the courts' reluctance to embrace wholeheartedly its application to in-house counsel).
2. United States v. United Shoe Machinery Corp., 89 F. Supp. 357, 358–359 (D. Mass. 1950); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 68 (2000).
3. See Villa, *supra* note 1.
4. I*n re* Six Grand Jury Witnesses, 979 F.2d 939, 943–944 (2d Cir. 1992); United States v. Amerada Hess Corp., 619 F.2d 980, 986 (3d Cir. 1980); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 69 cmt. i (2000) (favoring a broad application of the privilege to any confidential communications by a lawyer to a client).
5. *See* Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 610 (8th Cir. 1978) (communication made to outside counsel, as professional legal advisor to corporation, is prima facie made for the purpose of legal advice).
6. *See* Independent Petrochemical Corp. v. Aetna Cas. & Sur. Co., 672 F. Supp. 1, 5 (D.D.C. 1986) (refusing to hold that any communication by a corporate employee to in-house counsel is prima facie made to obtain legal advice and therefore falls within the privilege).
7. Rossi v. Blue Cross and Blue Shield of Greater New York, 73 N.Y.2d 588, 542 N.Y.S.2d 508, 510 (1989) (citations omitted).
8. Handguards, Inc. v. Johnson & Johnson, 69 F.R.D. 451, 453 (N.D. Cal. 1975) (relying on Zenith Radio Corp. v. Radio Corporation of America, 121 F. Supp. 792, 794 (D. Del. 1954); *see also* Diversified Indus., Inc. v. Meredith, 572 F.2d at 602 (8th Cir. 1978) (the attorney-client privilege applies to communications between in-house counsel and the corporate client when counsel has "been engaged or consulted by the client for the purpose of obtaining legal services or advice—services or advice that a lawyer may perform or give in his capacity as a lawyer, not in some other capacity").
9. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 72 cmt. b (2000).
10. *See* Status Time Corp. v. Sharp Electronics Corp., 95 F.R.D. 27, 31 (S.D.N.Y. 1982); *see also* Cooper-Rutter Associates, Inc. v. Anchor Nat'l Life Ins. Co., 168 A.2d 663, 563 N.Y.S.2d 491 (2d Dept. 1990) (documents not protected because not primarily of legal character).
11. Neuder v. Battelle Pacific Northwest Nat'l Laboratory, 194 F.R.D. 289 (D.D.C. 2000); *see also* Handguards, Inc. v. Johnson & Johnson, 69 F.R.D. at 453 (when acting as an advisor, in-house counsel "must give predominantly legal advice to retain his client's privilege of non-disclosure, not solely, or even largely, business advice").
12. Under the Restatement's test, the client's purpose in consulting counsel must be for obtaining legal assistance and not predominantly for another purpose. "Whether a purpose is significantly that of obtaining legal assistance or is for a nonlegal purpose depends upon the circumstances, including the extent to which the person performs legal and nonlegal work, the nature of the communication in question, and whether or not the person had previously provided legal assistance relating to the same matter." RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 72 cmt. c (2000).
13. *See* F.H. Krear & Co. v. 19 Named Trustees, 90 F.R.D. 102, 103 (S.D.N.Y. 1981); Georgia-Pacific Corp. v. GAF Roofing Manufacturing Corp., 1996 WL 29392, at *4 (S.D.N.Y. 1996); Cooper-Rutter Associates, Inc. v. Anchor Nat'l Life Ins. Co., 563 N.Y.S.2d at 491.
14. *See* Georgia-Pacific Corp. v. GAF Roofing Manufacturing Corp., 1996 WL 29392, at *4; Cooper-Rutter Associates, Inc. v. Anchor Nat'l Life Ins. Co., 563 N.Y.S.2d 491.
15. *See, e.g.*, Georgia-Pacific Corp. v. GAF Roofing Manufacturing Corp., 1996 WL 29392, at *4–*5 (noting that counsel's averment that he had rendered legal advice to management regarding the contract's environmental provisions, "although considered, does not overcome the nature of his role" as contract negotiator and therefore the conclusion that he was acting in a business capacity).
16. Note Funding Corp. v. Bobian Investment Co., 1995 WL 662402, at *3 (S.D.N.Y. 1995); *see also* Handguards, Inc. v. Johnson & Johnson, 69 F.R.D. at 454 (holding that documents relating to the negotiation and interpretation of a licensing agreement "fell within the ambit of the attorney-client privilege, [because the privilege] extends to communications calling for or expressing legal opinions or advice concerning business negotiations as well as documents prepared with an eye toward litigation"); *cf.* United States v. Wilson, 798 F.2d 509, 513 (1st Cir. 1986) (privilege inapplicable to memo sent by putative client to attorney with respect to buyout "where the role of the attorney was not to negotiate as an advocate or provide legal advice" on behalf of putative client, but was "merely to relay the settlement figures to the attorney's actual clients").
17. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 72 cmt. c (2000).
18. *Id*. at cmt. b.