

Corporate Counsel Clarity: 9th Circuit Defines the Client

In the realm of corporations, sometimes it is a bit tricky to figure out who the client is — and who holds the attorney-client privilege. Fortunately for corporate counsel, the 9th U.S. Circuit Court of Appeals has just made that analysis much clearer. In *U.S. v Graf*, 2010 DJDAR 10510, Judge Richard C. Tallman affirmed a ruling made by Judge Margaret Morrow of the Central District that the corporate attorney-client privilege extends to outside consultants who are “functional employees,” and that it is only the corporation that holds that privilege and the entity can elect to waive it over any employee objection. The court further joined other circuits in articulating that if an individual seeks to claim a personal privilege with corporate counsel, he or she has a substantial burden and must prove a demanding five-part test.

Although this was a criminal case, the opinion articulates a standard that applies equally in the civil context. James Graf was apparently quite a scoundrel: he was indicted for fabricating an entirely fraudulent health care benefit plan. He, along with others, actually marketed the plan to insurance agents who sold the “policies” to unsuspecting victims and, through a complex set of manipulations of the corporation, Graf and his cronies pocketed the premiums. In the operation of this multi-million dollar

the corporations testified for the prosecution against Graf, who had to a large extent directed counsel. The company had been taken over by a receiver, so the receiver held the corporate attorney/client privilege and expressly waived it so that the prosecution could obtain the lawyers’ testimony. Graf objected to all the attorneys’ testimony based on attorney/client privilege, claiming that all the lawyers, including the in-house general counsel, had a direct duty to him as an individual to maintain his discussions with them confidential. The trial court overruled that objection and Graf was convicted based in part on the lawyers’ testimony. So while the matter was a criminal case, the opinion proceeded to create law to guide all corporate lawyers about when an employee or outside consultant can claim the privilege.

As an initial matter, the court held that although Graf was not technically an employee, based on an examination of his duties, he was ruled to be a so-called “functional employee,” since despite his “independent” status he performed tasks typical of a regular employee. The court determined that outside consultants who conduct the type of business that an ordinary company employee would perform can be deemed functional employees for the purpose of the corporation’s attorney/client privilege. Here Graf communicated with insurance brokers and agents, managed employees, and of course, discussed company business with corporate counsel, so based on this factual inquiry he met the test.

Next the court adopted a five-part test for determining when an individual corporate officer or employee can make a personal claim for attorney/client privilege — as Graf was doing here. Borrowing from the 3rd U.S. Circuit Court of Appeals, the new 9th Circuit rule is that an employee must show that: the employee approached corporate counsel to ask legal advice; the employee made it clear he or she was seeking legal advice as an individual; the corporate counsel “saw fit” to advise the employee as an individual, “knowing that a possible conflict could arise;” the conversations were confidential; and the substance of the privileged conversations “did not concern matters within the company or the general affairs of the company.”

Graf clearly could not satisfy at least three of these different requirements, although he certainly tried.

He testified that he believed his discussions were privileged and he was the holder of the privilege and no one said otherwise. Although he never paid the lawyers, Graf claimed he discussed personal issues with them. But he never made it sufficiently clear to the lawyers, who believed they were representing the corporation, and the subject matter of the discussions was about company matters. So Graf had no personal attorney-client privilege and off he went to jail.

Frankly, this is an extremely difficult test to meet. The onus is on the employee to make quite clear to the lawyer that he or she desires to create an attorney/client relationship, and a lawyer can easily avoid the relationship and privilege by promptly raising the conflict issue. Moreover, no relationship can even occur if the topic is about the company — again a good protection for the lawyer.

This wonderful rule does not make it less important for lawyers representing companies to be on their guard when the inevitable request comes in from an employee, officer or director for personal advice. Frequently the request will come from a senior member of management or even the person to whom the lawyer directly reports. And for in-house counsel, the challenges can be even greater, since he or she can be subject to that quick question in the hall that a good friend and fellow worker needs a bit of guidance on. That is why appropriate reference to the rules of professional conduct and related conflict rules may allow a lawyer to handle a delicate interpersonal situation without creating resentment. Fortunately, the 9th Circuit has made that task a little easier.



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criminal enterprise, Graf caused to be created several shell companies and did business with a number of legitimate businesses, including hiring both in-house and outside lawyers for the company. Graf himself was the architect but was careful not to be an officer, director, shareholder, or employee of these entities, likely because he had been “banned from insurance work by the state of California for misconduct in violation of state insurance laws.” The U.S. Dept. of Labor ultimately got wise to Graf’s fraud, but not before his scheme had bilked people out of \$14 million in premium payments and left over \$20 million of unpaid claims representing thousands of victims with unpaid medical bills. Judge Morrow sentenced him to 25 years in prison.

At trial, several lawyers who had represented