Family Office

NEWSLETTER

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Attorney-Client Privilege and the Family Office

Communications between lawyers and family offices — or the family members they serve — often contain highly sensitive information about a family's financial activities, tax strategies and personal planning that could be very damaging if disclosed in a litigation or a regulatory matter. Preserving attorney-client privilege in these communications is critical. This article reviews the application of the attorney-client privilege in contexts that are common to family offices and suggests some important steps family offices can take to increase the likelihood that the attorney-client privilege will protect legal communications involving the family office and their family member clients.

For a family office, the benefits of protecting legal communications from production based on the attorney-client privilege may arise in several contexts. The most common are:

- Government investigations or proceedings involving family members or trusts for their benefit, such as audits by the IRS or state and local tax authorities;
- Lawsuits, arbitrations and similar legal proceedings between or among family members and/or trustees of family trusts; and
- Lawsuits, arbitrations and similar legal proceedings involving family members, trustees of family trusts and/or the family office, on the one hand, and third parties on the other (e.g., vendors, transaction parties, landlords and employees).

Fundamentals of the Attorney-Client Privilege

To assert the attorney-client privilege, and protect communications from disclosure, requires the following:

- A communication between a client (a person or an entity)
- and a lawyer acting in his or her capacity as a lawyer
- that is made to seek, obtain or provide legal advice
- and that is made and kept in confidence.

Not all communications with a lawyer are privileged. To be protected, a communication must be made for the express purpose of securing legal, not business, advice. Business communications are not protected merely because they are sent to or received from an attorney. Further, the attorney-client privilege does not protect legal communications when the attorney is engaged in, or is assisting the client to engage in, criminal or fraudulent activity. In short, while it may be good practice to copy a lawyer on sensitive and confidential communications to try to protect the communications as privileged, that alone does not guarantee that a communication will ultimately be protected from disclosure.

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Who's the Client?

Because the attorney-client privilege protects communications only between a client and his or her lawyer, it is important to identify the client to whom the privilege applies in any given communication. In the family office context, lawyers may be asked for advice on legal issues affecting one or more family members, trustees of family trusts, the family office itself and/or separate investment entities, any one of which may be the client as to a particular matter.

Some matters may affect multiple family members and entities, in which case it may be desirable to extend the scope of the attorney-client privilege to protect confidential communications among all the clients and their counsel. This may arise, for example, if a government agency is investigating an entire family's financial activities, if someone has sued the family office and is seeking discovery of communications among family members, or if someone has sued a family member or trustee and is seeking communications between the defendant(s) and the family office. Methods of extending the scope of the attorney-client privilege exist for these situations and ideally should be implemented as early in a matter as possible — even before an IRS investigation or lawsuit is on the horizon. Assuming the family members, trustees and family entities share a lawyer or law firm, each individual, trust and entity should consider signing a separate engagement agreement with the law firm so that each is considered a "client." These engagement agreements should recite that the firm must withdraw from the legal representation if a conflict of interest someday arises between the various clients, but that at present, no conflict exists, and to the contrary, the clients are all working together and desire that the firm work for their joint benefit. If a litigation arises or is anticipated, the various clients could also enter into what is referred to as a common interest agreement, which memorializes their desire that legal counsel work for their joint benefit and to keep privileged any communications with counsel.

Sometimes the family office may be the sole client with legal interests in a particular matter — for example, the termination of a family office employee or the negotiation of a lease for the family office space. In that case, legal communications between the family office's counsel and its various officers, directors and employees would be protected as privileged. If the family office is a closely held entity — such as an LLC — that is owned by family members, communications between a family member-owner and the family office's lawyer about the family office's legal concerns arguably should be privileged, regardless of whether the family member is an officer or director of the family office or a client in his or her individual capacity. Where the relationship between the family member and the family office is more attenuated — for example, the family office is owned by multiple trusts of which the family member is a beneficiary, or the family member is a mere client of the family office with no direct or indirect ownership interest — the privilege may not apply.

More challenging are situations where a family member is the client, and in the course of representing the family member the lawyer communicates with an officer or employee of the family office. In such cases, it may be difficult to assert privilege because the communications involve a third party, but, as discussed below, there are ways to try to do so.

Maintaining the Attorney-Client Privilege When Communications Involve Third Parties

Privilege protection may be compromised when a third party, such as an adviser or professional other than legal counsel, is included on a legal communication. The law provides for extending the attorney-client privilege to communications with third parties when they are kept confidential and when they help further the lawyer's ability to provide legal advice. This is the core feature of the so-called *Kovel* doctrine, named for the seminal 1961 case in this area, *United States v. Kovel*. *Kovel* drew an analogy between a translator who was helping an attorney

who did not understand a foreign language and an accountant who was helping an attorney who did not understand unfamiliar accounting concepts. In both situations, the purpose of the communications was to provide the attorney with a fluency in the underlying facts and concepts that would enable the attorney to better render legal advice. If the purpose of the communication between the attorney and the third party is to provide purely financial or business — not legal — advice, however, the privilege will not apply. Although *Kovel* was decided by the New York-based Second Circuit, its ruling has been accepted in numerous other jurisdictions, including California (*United States v. Judson* (9th Cir. 1963)) and Illinois (*United States v. Seale* (7th Cir. 1972)).

Taking several steps may help ensure that communications with an accountant, appraiser or other professional advisor are protected under the *Kovel* doctrine. First, the law firm should retain the third-party professional to assist it on behalf of its client rather than the client hiring the professional directly. The engagement agreement, or a similar letter setting forth the details of the relationship (frequently referred to as a *Kovel* letter), should explicitly explain the third-party professional's role in assisting the law firm. Obtaining the benefits of *Kovel* may be difficult in situations where the law firm "hires" the same professional advisor who has already advised a client for years. For example, if a family member or a family office retains an accounting firm that the lawyer consults from time to time about the family member's tax or estate planning, courts may be skeptical of the notion that the lawyer truly "hired" that firm. Protection will more likely be available in situations where the lawyer engages the professional to assist with a specific transaction, audit, litigation or other legal matter. The key question will generally be whether the parties' substantive communications reflect their understanding that the accountant is acting confidentially and for the purpose of assisting the lawyer and enabling the lawyer to better give legal advice. In any event, if the accountant or other professional is one who has advised the client in the past, the protection will be prospective only and will not cover communications before the engagement by the lawyer.

Frequently a family member, or a member of the family office, and legal counsel may wish to discuss a matter with an outside advisor such as a banker or consultant to the family office. In these situations, the *Kovel* doctrine won't apply. Generally, in non-*Kovel* situations, the presence of a non-client to a communication waives the protection of the attorney-client privilege. There are, however, important exceptions. One such exception is the "agency" doctrine, where (1) the outsider (i.e., agent) and the client have a reasonable expectation of confidentiality under the circumstances, and (2) the disclosure to the agent is "necessary" for the client to obtain informed legal advice, not simply useful or convenient for the client. The courts have taken a very narrow view as to whether a third party is necessary for purposes of communications sought to be protected by the attorney-client privilege. The case law on this issue, especially with regard to family office-type situations, is sparse, but it is clear that for this exception to apply, the non-client third party must be necessary to the communications with the lawyer. For example, communications involving family friends, insurance brokers and investment bankers have all been found not to be protected under the agency doctrine because the third parties involved were not essential to the subject communications. The courts have repeatedly said that a third party's involvement for mere convenience is not sufficient to protect the communications under the attorney-client privilege. In short, in order for the agency doctrine to apply, the third-party agent must be "nearly indispensable or serve some specialized purpose in facilitating the attorney-client communications." *See Narayann v. Sutherland Global Holdings, Inc.*(applying New York law). (Note that Delaware courts apply a somewhat looser standard which allows a third party to be treated as an agent where the third party

"shares responsibility for the subject matter" of the communication. *See, e.g., In Re Lululemon Athletica Inc. 220 Litigation.*)

It is unclear whether a court applying the necessary standard would treat officers and employees of a family office as agents for purposes of the attorney-client privilege when it comes to communications between a lawyer and a family office relating to a family member's personal legal matters. Individuals served by a family office may view the family office as indispensable in managing their assets and finances. Some may also rely on the family office to manage their estate and tax planning, including reviewing strategies proposed by their lawyers or accountants and reviewing drafts of estate planning documents. The necessary standard, however, is an objective standard, not one based on the client's subjective views. It is possible that the standard may be met where, for example, a client cannot make an informed decision about an estate plan or a particular tax strategy without information about assets and entities that is in the possession of the family office (and the family office's guidance to understand the same). If the client's decision — say, whether or not to disinherit a child — does not depend on information possessed by the family office, the standard most likely will not be met, and communications between the client and the lawyer on the subject should not include family office employees.

Finally, courts have recognized what is referred to as the "functional equivalent" doctrine when it comes to an entity's attorney-client privilege and disclosure of communications to third parties. In this scenario, the entity's privilege will be protected where the third party to whom disclosure of the confidential communication is made is the functional equivalent of an employee of the entity. Courts weigh a number of factors in determining whether a third party should be considered the functional equivalent of an employee. In situations where the family office is the client, these factors would include:

- Whether the third party (such as a consultant) had the primary responsibility for a key family office function.

- Whether there was a continuous and close working relationship between the third party and the family office's principals on matters critical to the family office's position on legal matters or in litigation.

- Whether the third party is likely to possess information possessed by no one else in the family office.

In other words, the third party needs to be totally integrated into the family office.

Conclusion and Best Practices

Protecting the attorney-client privilege is important for a family office and the family members it serves. It enables the family office and family members to have open and candid discussions with their legal counsel about sensitive matters. Maintaining privilege in the family office context can be challenging, however. Below is a non-exhaustive list of suggestions to help each family office minimize the risk that the attorney-client privilege will be inadvertently waived:

- Mark communications with counsel about legal matters relating to the family office or a family member with a legend such as **"Attorney-Client Privileged/Highly Confidential."** The use of such a legend won't guarantee that the privilege will apply, but it may serve to remind family members and family office employees of the importance of the attorney-client privilege and the need to consider the implications before communicating in writing about sensitive matters.

- Avoid using text messages, personal emails or personal devices when communicating with legal counsel or about legal advice. Use business email addresses and business devices only, if possible. Take reasonable precautions to restrict access to attorney-client emails.

- State in email communications that you are requesting legal advice.
- Segregate business information from legal advice in each communication, or document business advice in separate communications.
- Limit legal communications to a "need to know" group, and do not forward emails regarding legal matters to outsiders. The need-to-know group should be strictly limited to those individuals who are clients (keeping in mind whether the client in each situation is a family member or the family office), agents of the clients with indispensable information or an individual who is the functional equivalent of an employee who has extensive continuing involvement in the subject matter of the legal advice.
- Discuss legal matters in person or by telephone rather than in written communications, especially emails, when possible.
- Use *Kovel* letters where appropriate, and have outside counsel retain and communicate with experts and consultants during litigation to the extent possible.
- Make sure family members and employees in the family office are aware of the family office protocols regarding communications relating to legal matters.

Given that family office structures vary greatly, each family office's particular organizational structure and operation should be reviewed in order to determine what steps it should take to protect the attorney-client privilege in its unique situation.

Please feel free to contact a member of our team for more information.

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