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When Your "Client" Is Your Company's Investor - The "Fiduciary Exception" to the Attorney-Client Privilege

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In the corporate context, the attorney-client privilege's application is rarely straightforward. When tested in court, the privilege's very existence often turns on crucial questions that may not have been considered at the time of the communication. Was the advice primarily business or legal?[1] Which employees qualify as "clients"?[2] Was the advice rendered to assist in the commission of a transaction that might later be viewed as fraudulent?[3]

Now let's add another question: is management seeking legal advice to advance the best interests of the company? If not, an investor may be able to pierce the attorney-client privilege in a litigation against the company.[4] This exception to the privilege is known as the "fiduciary exception," but is also referred to as the "good cause" exception and, in the corporate context, as the "Garner Doctrine."[5]

THE GARNER DOCTRINE

The Garner Doctrine arises from the Fifth Circuit's decision in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971), which extended the "fiduciary exception" to the attorney-client privilege from the traditional trustee context to corporations. *See also Wachtel v. Health Net, Inc.*, 482 F.3d 225 (3d Cir. 2007) (discussing origins of "fiduciary exception").

Recently, New York's influential intermediate appellate court, the Appellate Division, First Department, adopted *Garner's* formulation of the factors for the "fiduciary exception" in *NAMA Holdings, LLC v. Greenberg Traurig LLP*, __ A.D.3d __, 2015 N.Y. Slip. Op. 07346 (N.Y. App. Div. Oct. 8, 2015). Corporate lawyers should take note.

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[1] *United States v. United Show Mach. Corp.*, 89 F. Supp. 357, 359-61 (D. Mass. 1950) (Wyzanski, J.).
[2] *Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981).
[3] *United States v. Zolin*, 491 U.S. 554, 562-63 (1989).
[4] In rare cases, the privilege can also been pierced based on the "fiduciary exception" in connection with a third-party subpoena to the company.
[5] The Garner Doctrine does not apply to work-product. *See In re Int'l Sys., & Controls Corp.*, 693 F.2d 1235, 1239 (5th Cir. 1982).

The “fiduciary exception” to the attorney-client privilege originated in the law of trusts. [6] But it now can come into play in any litigation by investors against a company (or its agents) where the claim is that management had acted in a manner inimical to investor interests, *e.g.*, for breach of fiduciary duty or similar wrongdoing. The doctrine has been applied in derivative actions, class actions, and individual direct claims, *In re Pfizer Inc. Secs. Litig.*, No. 90 Civ. 1260 (SS), 1993 WL 561125, at *11 (S.D.N.Y. Dec. 23, 1993) (collecting cases); *but see Weil v. Investments/Indicators, Research & Mgmt.*, 647 F.2d 18 (9th Cir. 1981) (limiting the “fiduciary exception” in the corporate context to derivate actions), and is well established in federal and state courts around the country. *Solis v. Food Employers Labor Relations Ass'n*, 644 F.3d 221 (4th Cir. 2011). The doctrine also potentially applies in any case where fiduciary relationships exist, including, for example, between union negotiators and union members, *Cox v. Adm’r U.S. Steel & Carnegie,* 17 F.3d 1386 (11th Cir. 1994), and controlling shareholders and creditors, where the company is insolvent, *In re Teleglobe Commc’ns Corp.,* 493 F.3d 345 (3d Cir. 2007); *see, generally, Matter of Stenovich v. Wachtell, Lipton, Rosen & Katz*, 195 Misc.2d 99, 112, 756 N.Y.S.2d 367, 380-381 (Sup. Ct. N.Y. County 2003) (collecting cases).

The “fiduciary exception” involves a balancing of important interests. *See Sandberg v. Virginia Bankshares, Inc.*, 979 F.2d 332, 351 (4th Cir. 1992). On the one hand, society has an interest in having company managers and directors consult candidly with lawyers to obtain legal advice for the company, which requires an assurance of confidentiality. *Id.* at 351, 352; *see also Upjohn,* 449 U.S. at 389-90. On the other hand, management is required to “exercise the privilege in a manner consistent with their fiduciary duty to act in the best interests of the corporation and not of themselves as individuals.” *Id.* (quoting *Commodity Futures Trading Comm’n v. Weintraub*, 471 U.S. 343, 348 (1985)). As such, where the corporation’s officers or directors have acted inimically to shareholder interests, the shareholders may show “good cause” why the corporation or its officers should not be permitted to invoke the attorney-client privilege. *Garner*, 430 F.2d at 1103-04.

FACTORS TO SHOW “GOOD CAUSE”

The “fiduciary exception” does not automatically apply to every dispute between investors and the companies they own. Indeed, once the privilege is established by the company, it is presumptively enforceable, unless the party seeking disclosure (*i.e.*, the investors) can show “good cause”; in other words, the burden is on the investors to show that the “fiduciary exception” applies.

Garner identified the following nine non-exclusive factors relevant for showing “good cause”:

[1] the number of shareholders and the percentage of stock they represent;

[2] the bona fides of the shareholders;

[3] the nature of the shareholders' claim and whether it is obviously colorable;

[4] the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources;

[5] whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality;

[6] whether the communication related to past or to prospective actions;

[7] whether the communication is of advice concerning the litigation itself;

[8] the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing;

[9] the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.

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[6] In the trust context, the “fiduciary exception” is somewhat more clear cut. First, a trustee has a duty of disclosure to a beneficiary; and second, the “real” client for purposes of the attorney-client relationship is the beneficiary, at least during the time when “no adversarial proceeding against the trustees was pending.” *Wachtel*, 482 F.3d at 232. By contrast, in the corporate context, the “real” client is not the investors, who are seeking to break the privilege, but the corporation.

Garner, 430 F.2d at 1104.[7]

No one factor determines "good cause," but the first carries significant weight, and can be a threshold issue. Whereas a court will look favorably on the exception when virtually all stockholders seek the information, the reverse is also true; a tiny minority is unlikely to succeed. Compare *Cox*, 17 F.3d at 1415 (refusing to apply "good cause" exception where "only a tiny percentage" of union membership seeks the information), with *Garner*, 430 F.2d at 1101 (commenting on the difficulty of "rationally defend[ing] the assertion of the privilege if all, or substantially all, of the stockholders desire to inquire into the attorney's communications with corporate representatives"). However, a majority is not required, and in the class action context, aggregation of the class's interest may apply. *See*, *e.g.*, *Sandberg*, 979 F.2d at 353 (finding that the first factor weighed in favor of applying fiduciary exception because plaintiff and class being represented owned 15% of the company).

To a similar point, while, in most jurisdictions, it is not a necessary condition to the Garner Doctrine that the shareholder plaintiff acts derivatively—*i.e.*, on behalf of the company against management—courts are more likely to find "good cause" in the derivative context than in a direct claim against the company, which requires more scrutiny as to the "shareholder's motivations." *NAMA*, *supra* at *10. This makes sense. A plaintiff suing directly is seeking to profit at the expense of the other shareholders. Those other shareholders also have a stake in the privilege, and may well favor non-disclosure.

The third, fourth, and fifth factors go to the nature and merits of the plaintiff's claim and the necessity of obtaining the information. The court will consider whether the claim alleges a breach of trust or fiduciary duty, whether disclosure is necessary and if it would be detrimental to the company's interests, and whether the alleged misconduct of the relevant officers or directors is of significant gravity to justify the exception. Collectively, these factors underscore the point that the Garner Doctrine is an *exception*, and does not apply unless important interests are at stake.

The sixth factor as formulated by *Garner* is somewhat ambiguous: why does it matter that the legal advice applies to "past" or "prospective" actions? The answer may lie by analogizing the "fiduciary exception" to the "crime-fraud exception." *See Sandberg*, 979 F.2d at 352. Generally, the "crime-fraud exception" applies to prospective advice only, in other words, advice that the attorney renders to help with the future commission of a wrongful action, but not to advice about prior completed acts. According to the Fourth Circuit, the same logic applies to the "fiduciary exception," as *Sandberg* explained:

> The past/prospective distinction in this case is analogous to the past and prospective portion of the crime/fraud exception. This case is not a criminal action and the civil lawsuit does not expressly state a cause of action for fraud. Nevertheless, the improprieties, breaches of fiduciary duties, and violations of securities laws alleged (and proved) by Plaintiffs encompass conduct of a magnitude that should be accorded significant weight in the balance between society's interests in enforcing fiduciary duties and the corporation's interest in confidential communications with its attorney.

Id. at 353-54. Put another way, under the sixth factor, a court is more likely to apply the "fiduciary exception" when the attorney's advice is in furtherance of a breach of fiduciary duty, rather than advising as to whether a breach occurred in the past.

The seventh factor, "whether the communication is of advice concerning the litigation itself," counsels against finding "good cause" once the investors are in litigation, or threatening litigation, against the corporation. *NAMA*, *supra* at *11. Although litigation adversity is important, *see, e.g., Stenovich*, 756 N.Y.S.2d at 115 (applying fiduciary exception up to date of transaction at issue, but before any disputes arose), it is *not* dispositive. In *NAMA,* for example, the corporate defendants argued that the "fiduciary exception" should be categorically unavailable once an adverse relationship arises between the company defendant and the investor plaintiffs. *Id.* at *10. As a

[7] To make them more manageable, the nine factors can be grouped into four categories: "(1) the discovering party's stake in the fiduciary relationship; (2) the apparent merit of the claim; (3) the need of the discovering party for the information; and (4) the nature of the communication itself." *Pfizer*, 1993 WL 561125, at *13.

matter of convenience, that test would streamline the Garner Doctrine by establishing a cut-off date from which no further waiver could occur. But the New York court was not persuaded. Though acknowledging that "adversity" could be highly relevant in analyzing the *Garner* factors, the First Department declined to adopt it as a "categorical adversity limitation." *Id.* at *10.

The eighth and ninth factors emphasize that a court should not apply the "fiduciary exception" overly broadly and without regard to the totality of circumstances. In *NAMA*, for example, the Appellate Court criticized the court below for ordering the production of 3,000 documents off of a privilege log, without conducting an in camera review or making any differentiations as to which documents the exception applied. *NAMA*, *supra* at *12 ("We recognize that this case presents the motion court with a difficult task, given the number of communications listed on the Privilege Log. However, it is uncontested that the special referee did not review a single document in camera, despite being instructed by the motion court to conduct an item-by-item review. Therefore, we cannot affirm an order directing the production of more than 3,000 purportedly privileged communications without a single one of those communications having been reviewed").

TAKEAWAYS

It is easy to dismiss casually any privilege exception that implies immorality. Most executives would reject out of hand any suggestion that they would ever engage in activities that are contrary to the best interests of the company or in furtherance of a crime or fraud. And that may well be so. But good intentions may not be enough. Exceptions to the privilege are often decided before trial during discovery, and are thus resolved on *plaintiff's allegations in pleadings* not *proven facts.*

The upshot is that *Garner* and *NAMA* serve as important reminders about the limits of the protections of the attorney-client privilege in the corporate context. First, the attorney-client privilege is not absolute. It is an exception to the general principle that the public has the right to "every man's evidence." (*U.S. v. Bryan*, 339 U.S. 323, 331 (1950)), and it can be pierced or waived under numerous circumstances. Second, the "client" of a company's in-house and outside lawyers is the company, not the individual officers and directors. (*See also Upjohn Co. v. United States,* 449 U.S. 383, 389-90 (1981)).[8] Third, officers and directors might take comfort in the fact that even though the privilege does not belong to them, they control the company that owns the privilege. Under the fiduciary exception, however, this protection is illusory; others may gain control on a showing of "good cause." These "others" include shareholders, investors, and even creditors in the case of insolvency. Finally, a company's attorney-client privilege as to communications with counsel by officers and directors extends only so far as they are acting in the interests of the company.

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[8] *Upjohn* gave rise to the so-called "Upjohn Warning," where corporate officers and directors are reminded that company counsel, often now engaging in an internal investigation, do not represent the individuals.