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Denial of the Attorney-Client Privilege in Shareholders' Suits Against Corporations

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CASE NOTED

DENIAL OF THE ATTORNEY-CLIENT PRIVILEGE IN SHAREHOLDERS' SUITS AGAINST CORPORATIONS

Shareholders of the First American Life Insurance Company of Alabama brought a class action against First American and some of its directors, officers, and controlling persons, alleging violations of the 1933 and 1934 federal securities acts, including SEC rule 10b-5. Violations of the Alabama blue-sky laws, and common law fraud were also alleged. Additionally, the plaintiff shareholders claimed that the corporation itself was damaged by various fraudulent purchases and sales of securities. Thus, they asserted a derivative action on behalf of the company against the individual corporate officers, directors, and control persons. Both the corporation's attorney and the president of the corporation, Schweitzer, who had acted as First American's attorney in connection with the issue of the stock involved in the suit, objected to certain questions put to Schweitzer on deposition. It was contended that the attorney-client privilege, claimed by the corporation through its lawyer, did not permit Schweitzer to answer questions regarding his advice to the corporation as its attorney. The Alabama Federal District Court ordered Schweitzer to answer, holding that the attorney-client privilege was unavailable as against the plaintiff shareholders. On appeal to the Fifth Circuit; *held*: In a shareholders' suit against their corporation[1] where good cause has been shown, the corporation may not claim the attorney-client privilege to avoid discovery by shareholders of corporate records, which might otherwise be privileged. *Garner v. Wolfinbarger*, 430 F.2d 193 (5th Cir. 1970), *aff'g* 280 F. Supp. 1018 (N.D. Ala. 1968).

Generally, every person owes a duty to the state to aid in the administration of justice by testifying and otherwise giving evidence. In the absence of a privilege, such as the attorney-client privilege, "the public has a right to every man's evidence," which is a right that has existed for more than three centuries.[2]

The history of the attorney-client privilege goes back to 16th Century England.[3] According to Wigmore, it is the oldest of the privileges for confidential communications.[4] Originally, the privilege "belonged" to the

1. Apparently, whether the suit is a derivative suit, which is an action brought on behalf of the corporation as plaintiff, or simply a suit by stockholders against the corporation as defendant is not a basis upon which this case can be distinguished. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970).

2. 8 J. WIGMORE, EVIDENCE § 2192 (J. McNaughton ed. 1961); 58 AM. JUR., *Witnesses* § 29 (1948).

3. J. WIGMORE, EVIDENCE § 2290 n.1 (J. McNaughton ed. 1961); Pye, *Fundamentals of the Attorney-Client Privilege*, 15 PRAC. LAW. 15, 16 (Nov. 1969).

4. 8 J. WIGMORE, EVIDENCE § 2290 (J. McNaughton ed. 1961).

attorney and was based upon the attorney's honor to keep the secrets of his clients. However, by the end of the 1700's, the voluntary pledge of secrecy or "point of honor" basis for the privilege was repudiated by the courts. It was replaced by a new theory which "looked to the necessity of providing subjectively for the client's freedom of apprehension in consulting his legal adviser."[5] The purpose of the privilege's maintenance today has been explained by McCormick:

> [Lawyers] can act effectively only if they are fully advised of the facts by the parties whom they represent. Such full disclosure will be promoted if the client knows that what he tells his lawyer cannot, over his objection, be extorted in court from the lawyer's lips. The proposition is that the detriment to justice from a power to shut off inquiry to pertinent facts in court will be outweighed by the benefits to justice (not to the client) from a franker disclosure in the lawyer's office.[6]

The privilege became, and still is, the client's—not the lawyer's.[7] Wigmore, in an often-quoted summary, has itemized the essential requirements of the privilege as follows:

> (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.[8]

Although a Federal District Court in Illinois once held that a corporation could not avail itself of the attorney-client privilege, reasoning that the corporation did not fall within the definition of "client,"[9] that decision was reversed by the Seventh Circuit,[10] and today, there seems little doubt that a corporation is entitled to the same treatment as any other client and may assert the privilege.[11] The Fifth Circuit, in *Garner v. Wolfinbarger*, recognized the general availability of the privilege to corporate

5. *Id.*

6. C. McCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 91 (1954). *See also* ALI, MODEL CODE OF EVIDENCE, rule 210, comment *a* (1942).

7. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970). *See also* 8 J. WIGMORE, EVIDENCE §§ 2290, 2320 (J. McNaughton ed. 1961); 58 AM. JUR., *Witnesses* §§ 460-62 (1948); Annot., 98 A.L.R.2d 241 (1964).

8. 8 J. WIGMORE, EVIDENCE § 2292 (J. McNaughton ed. 1961).

9. Radiant Burners, Inc. v. American Gas Ass'n, 209 F. Supp. 321 (N.D. Ill. 1962); Radiant Burners, Inc. v. American Gas Ass'n, 207 F. Supp. 771 (N.D. Ill. 1962).

10. 320 F.2d 314 (7th Cir. 1963).

11. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970). *See also* United States v. Louisville & N.R.R., 236 U.S. 318 (1915); Radiant Burners, Inc. v. American Gas Ass'n, 320 F.2d 314 (7th Cir. 1963), *rev'g* 207 F. Supp. 771 (N.D. Ill. 1962); Schwimmer v. United States, 232 F.2d 855 (8th Cir. 1956); Belanger v. Alton Box Board Co., 180 F.2d 87 (7th Cir. 1950); Lalance & Grosjean Mfgr. Co. v. Haberman Mfgr. Co., 87 F. 563 (2d Cir. 1898); Robertson v. Commonwealth, 181 Va. 520, 25 S.E.2d 352 (1943); Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 953 (1956).

entities; however, under the facts of the case before them, they denied First American's claim of privilege upon the following grounds:

> 1. that there are certain obligations or duties that run from the corporation to the stockholder;
> 2. that the privilege has never been absolute, and there have been traditional exceptions for
> a. communications in contemplation of a crime or fraud, and
> b. communications to a joint attorney.[12]

In reaching the decision noted herein, both the Fifth Circuit and the district court cited two English cases—*Gourrand v. Edison Gower Bell Telephone Co.*[13] and *W. Dennis & Sons, Ltd. v. West Norfolk Farmers' Manure & Chemical Co.*[14] Both cases analogized the duty of the corporation to its stockholders to the duty of a trustee to the *cestui que trust.*[15] In the *Gourrand* case, the chancery court held that the corporation could not refuse to produce documents which had been purchased with money belonging to the party applying for their production.[16]

The District Court's reliance upon these two cases has been criticized by a number of legal writers who claim that the trust analogy fails in application to the modern corporation.[17] Cases which permit management to spend corporate funds in proxy contests with groups of shareholders have been cited by these critics to illustrate the point that the corporation and the stockholders are not one and are unlike trustee and beneficiary.[18]

In the instant case, the Fifth Circuit simply avoided the controversy concerning the validity of the trust analogy. Although the court stated that "the responsibility of officers and directors toward the shareholders of a corporation . . . is an important factor in our decision,"[19] it declined to categorize or analogize that responsibility. Instead, the court relied only to a limited degree on the English authorities in the following manner.

> Both [English] cases treat the relationship between the shareholder and company as analogous to that between beneficiaries and trustees, a basis which the defendants in the present case say has no viability for American corporations. Though not binding precedents, these English cases are persuasive recognition that there are obligations, *however characterized*, that run

12. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970).
13. 57 L.T. Ch. 498, 59 L.T. 813 (1888).
14. 2 All E.R. 94, 112 L.J. Ch. 239, 169 L.T. 74, 59 T.L.R. 298, 87 Sol. Jo. 211 (1943).
15. *Contra, In re* Prudence Bonds Corp., 76 F. Supp. 643 (E.D.N.Y. 1948).
16. Gourrand v. Edison Gower Bell Tel. Co., 57 L.T. Ch. 498, 59 L.T. 813 (1888).
17. Comment, *The Attorney-Client Privilege in Shareholder's Suits*, 69 COLUM. L. REV. 309, 315 (1969); Burnham, *The Attorney-Client Privilege in the Corporate Arena*, 24 BUS. LAW. 901, 908 (1969); Brereton, *Abrogation of the Corporate Privilege in Stockholder Suits*, 15 PRAC. LAW. 24, 25 (Nov. 1969).
18. Comment, *The Attorney-Client Privilege in Shareholder's Suits*, 69 COLUM. L. REV. 309, 318 & n.40 (1969).
19. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970).

> from corporation to shareholder and must be given recognition in determining the applicability of the privilege.[20]

Traditionally, communications made by a client to his attorney during or before the commission of a crime or a fraud for the purpose of being guided in its commission have not been privileged.[21] In *Garner v. Wolfinbarger*, the case noted herein, the plaintiff shareholders alleged, among other things, common law fraud and violations of SEC rule 10b-5 and therefore this exception to the attorney-client privilege was the second ground for the court's decision. Of course the court recognized that legal advice secured in aid of a defense of *past* misconduct is distinguishable from that sought during or before the act, the former being privileged.[22] However, the court saw no distinction between criminal transactions and fraudulent actions or acts of questionable legality—the differences between these, the court said, are of degree, not of principle.[23]

The third ground upon which the *Garner* decision was based was the "joint-attorney" exception to the attorney-client privilege. When the same attorney acts for two or more persons with a common interest, neither party may exercise the privilege against the other.[24] According to one legal writer, who criticized the lower court's decision in this case, "the only possible reason for denying the privilege to a corporation as against its shareholders would be based on the traditional 'joint attorney' exception. . . ."[25] However, the author said that it would be difficult to apply this exception to management and shareholders because the two so often have adverse interests.[26]

It cannot be said, therefore, that the court looked to any one ground in making this far-reaching determination; instead it balanced and combined a number of factors.[27] With a brief note, the court also passed upon two other issues of some importance.[28] First, the court saw no distinction

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20. *Id.* at 19 (emphasis added).

21. Union Camp Corp. v. Lewis, 385 F.2d 143 (4th Cir. 1967); Pollock v. United States, 202 F.2d 281 (5th Cir. 1953); United States v. Bob, 106 F.2d 37 (2d Cir. 1939); United States v. United Shoe Mach. Corp., 89 F. Supp. 357 (D. Mass. 1950); Annot., 16 A.L.R.3d 1029 (1967); C. MCCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 99 (1954).

22. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970). *See generally* J. MCCORMICK, HANDBOOK ON THE LAW OF EVIDENCE § 99 (1954).

23. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970).

24. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970); Grand Trunk W.R.R. v. H.W. Nelson Co., 116 F.2d 823 (6th Cir. 1941); C. MCCORMICK, HANDBOOK ON THE LAW OF EVIDENCE § 95 (1954); 8 J. WIGMORE, EVIDENCE § 2312 (J. McNaughton ed. 1961).

25. Comment, *The Attorney-Client Privilege in Shareholder's Suits*, 69 COLUM. L. REV. 309, 317 (1969).

26. *Id.* at 317-18.

27. A second important issue in this case is the conflicts of law problem. The court used the balancing approach to this issue as well. In a federal question case, to what law does the federal court refer for a solution to an evidentiary problem? *See generally*, Annot., 95 A.L.R.2d 320 (1964) (federal courts follow the law of the forum state with respect to privileged communications).

28. Garner v. Wolfinbarger, 430 F.2d 193 (5th Cir. 1970).

between the way in which house counsel and outside counsel should be regarded for purposes of the privilege. This has, apparently, been an issue in the past.[29] Second, regardless of who pays the attorney's fees—the corporation or management on its own behalf—the privilege may still be unavailable. This expands the exception to the privilege even further, and may be contrary to *W. Dennis & Sons*, which permitted shareholders to discover documents relating to company affairs *unless* the documents came into existence as a part of the defense to the litigation and after the initiation of the litigation.[30] Furthermore, the district court decision, from which this appeal arose, apparently applied only to communications between lawyer and corporation prior to the filing of the suit.[31]

Although this was a case of first impression on the federal appellate level, a number of decisions other than the two English cases cited have been rendered subsequent to the district court's opinion.[32] All have followed the lower court's opinion, denying the privilege when shareholders of the corporation have sued the corporation. In *Fischer v. Wolfinbarger*, the court stated absolutely:

> A corporate entity acts only for its shareholders, and they are entitled to see written communications and to inquire concerning oral communications between their corporation and its attorneys.[33]

In *Pattie Lea, Inc. v. District Court of Denver*, the Colorado Supreme Court denied the accountant-client privilege to the corporation, where it was sued by some of its shareholders. It based its holding on the "joint-attorney" exception and upon the fact that "a corporation entity acts only for its stockholders. . . ."[34]

It has been said that the law relating to the attorney-client privilege is "one of the most hazy frontiers of the discovery process."[35] Although there are few reported cases on the privilege when claimed by the corporation in a shareholder's suit, the trend is very clear—the shield cannot be used to forestall shareholder discovery of otherwise privileged corporate documents and oral communications between the attorney and the corpora-

29. Wise v. Western Union Tel. Co., 39 Del. 456, 178 A. 640 (1935); Annot., 98 A.L.R.2d 241 (1964); Pye, *Fundamentals of the Attorney-Client Privilege*, 15 PRAC. LAW. 15 (Nov. 1969).

30. W. Dennis & Sons, Ltd. v. West Norfolk Farmers' Manure & Chem. Co-op Co., Ltd., 2 All E.R. 94, 112 L.J Ch. 239, 169 L.T. 74, 59 T.L.R. 298, 87 Sol. Jo. 211 (1943).

31. Garner v. Wolfinbarger, 280 F. Supp. 1018, 1019 (N.D. Ala. 1968).

32. Fischer v. Wolfinbarger, Nos. 5911 and 5919 (M.D. Tenn. Aug. 29, 1969); Fischer v. Wolfinbarger, 45 F.R.D. 510 (W.D. Ky. 1968); Dahlke v. Morrison, No. 69-497 (N.D. Ala. Oct. 3, 1967); Pattie Lea, Inc. v. District Court of Denver, 161 Colo. 493, 423 P.2d 27 (1967).

33. 45 F.R.D. 510, 511 (W.D. Ky. 1968).

34. 161 Colo. 493, 496, 423 P.2d 27, 30 (1967).

35. Stone v. Grayson Shops, 8 F.R.D. 101, 102 (S.D.N.Y. 1948).

tion. With this decision, the stockholder has been put a little more on a parity with the management, whom he pays, who is supposed to be working for him, any yet whose interests, according to one legal writer, are so often adverse to his.[36]

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36. Comment, *The Attorney-Client Privilege in Shareholder's Suits*, 69 COLUM. L. REV. 309 (1969).