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The Corporate Attorney-Client Privilege: Loss of Predictability Does Not Justify Crying Wolfinbarger

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*By Paul R. Rice**

INTRODUCTION

Recently, Jack Friedman examined the U.S. Court of Appeals for the Fifth Circuit's landmark decision of *Garner v. Wolfinbarger*[1] and the subsequent expansion of the *Garner* exception to the attorney-client privilege.[2] This exception recognized a shareholder's right to examine privileged communications between corporate officers or directors and corporate legal counsel in the context of shareholder derivative actions.

This right was premised on the fiduciary duty that corporate management owes to shareholders.[3] The court held that when shareholders are pursuing the interests of the corporation in a derivative action, they are entitled to access to privileged communications if these communications are important to establishing the validity of their claims.[4] To obtain this

*Mr. Rice is a Professor of Law at the American University Washington College of Law where he has taught evidence for a quarter of a century. He is the author of two leading treatises on the attorney-client privilege. *See* PAUL R. RICE, ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES (2d ed. 1999) [hereinafter RICE, ATTORNEY-CLIENT PRIVILEGE]; PAUL R. RICE, ATTORNEY-CLIENT PRIVILEGE: STATE LAW (2000).

1. 430 F.2d 1093 (5th Cir. 1970).

2. *See* Jack P. Friedman, *Is the* Garner *Qualification of the Corporate Attorney-Client Privilege Viable After* Jaffee v. Redmond?, 55 BUS. LAW. 243 (1999).

3. Describing this fiduciary duty the *Garner* court explained that

> in assessing management assertions of injury to the corporation it must be borne in mind that management does not manage for itself and that the beneficiaries of its action are the stockholders. Conceptualistic phrases describing the corporation as an entity separate from its stockholders are not useful tools of analysis. They serve only to obscure the fact that management has duties which run to the benefit ultimately of the stockholders.

Garner, 430 F.2d at 1101.

4. In so holding, the court

> reject[ed] the idea that the prospective decision of the client on whether to abide by advice or disregard it, or the guarantee of a veil of secrecy, either establishes or narrows the attorney's obligation in the giving of advice. And to grant to corporate management

right the shareholders must demonstrate "good cause."[5] Mr. Friedman correctly characterized this "good cause" determination as nothing more than a balancing test—balancing the bona fides of the shareholders' claims and their need for the information against the corporate managers' need for confidentiality in their own legal consultations.[6]

This "fiduciary duty exception"[7] to the attorney-client privilege has gained wide acceptance in both federal and state courts.[8] The exception also has been radically expanded.[9] From shareholder derivative actions (which are brought by one or more shareholders for the benefit of the corporate entity and of all shareholders) it has been expanded to non-derivative actions (in which the shareholder's action is primarily for her own individual financial benefit).[10]

Outside the corporate context, the exception has been recognized in many instances where a fiduciary duty has been owed to non-shareholders.

> Examples include a suit by the Secretary of Labor against former officials of a pension fund for their violation of their fiduciary duties [to contributors to the fund;[11]] a suit between a limited partner and

> plenary assurance of secrecy for opinions received is to encourage it to disregard with impunity the advice sought.

Id. at 1102 (footnote omitted).

5. The court listed a number of factors that should be considered in deciding whether "good cause" has been shown:

> the number of shareholders and the percentage of stock they represent; the bona fides of the shareholders; the nature of the shareholders' claim and whether it is obviously colorable; the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources; 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; whether the communication related to past or to prospective actions; whether the communication is of advice concerning the litigation itself; the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing; the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.

Id. at 1104.

6. "The *Garner* rule is a balancing test that determines whether the shareholders' need to discover the communications outweighs the importance of protecting its confidentiality." Friedman, *supra* note 2, at 243 (footnote omitted).

7. *See* 1 RICE, ATTORNEY-CLIENT PRIVILEGE, *supra* note *, §§ 8:17-8:25, at 107-38 (discussing the "fiduciary duty exception" to the attorney-client privilege).

8. *See id.*

9. *See id.* § 8:23, at 130.

10. *See, e.g.*, Fausek v. White, 965 F.2d 126, 130-31 (6th Cir. 1992); Ward v. Succession of Freeman, 854 F.2d 780, 786 (5th Cir. 1988); Gerrits v. Brannen Banks of Florida, Inc., 138 F.R.D. 574, 578-79 (D. Colo. 1991); Burghart v. Landau, No. 82 Civ. 2181, 1985 WL 209, at *5-*6 (S.D.N.Y. Jan. 23, 1985); Cohen v. Uniroyal, Inc., 80 F.R.D. 480, 484 n.4 (E.D. Pa. 1978) (citation omitted); Bailey v. Meister Brau, Inc., 55 F.R.D. 211, 213 (N.D. Ill. 1972). *But see* Weil v. Investment/Indicators, Research & Management, Inc., 647 F.2d 18, 23 (9th Cir. 1981).

11. *See* Donovan v. Fitzsimmons, 90 F.R.D. 583, 586 (N.D. Ill. 1981).

> a general partner in the same general partnership;[[12]] actions by union members against union officers;[[13]] an action by trust beneficiaries against the trust and its trustee;[[14]] an action by an excess insurer against the primary insurer;[[15]] an action by creditors against a bankruptcy creditor's committee;[[16]] actions by minority shareholders against majority shareholders;[[17]] an action by a corporation against a former executive who, while employed by the plaintiff, formed a competing corporation;[[18]] and an action on behalf of a corporation against the law firm that represented the corporation.[[19]][20]

As a few courts have done,[21] Mr. Friedman does not simply want to limit *Garner* to the facts of that case—namely shareholder derivative actions. He proposes that *Garner* be abolished and corporate shareholders in derivative actions be given an absolute right to access the privileged communications of corporate management. He would equate shareholders bringing derivative actions with the management of the corporation protecting and preserving the interests of the corporate entity.[22]

The linchpin of Mr. Friedman's proposal is that predictability in the application of the privilege protection is critical to its effectiveness and success: Openness and candor by the client can only be encouraged if the client *knows* that his communications with legal counsel are, and will remain, confidential and protected.[23] Thus, Mr. Friedman concludes that because uncertainty is created by the "fiduciary duty" exception and because its application depends on subsequent developments that are unpredictable, the exception itself should be eliminated.

12. *See* Fortson v. Winstead, McGuire, Sechrest & Minick, 961 F.2d 469, 475-76 n.5 (4th Cir. 1992).

13. *See* Mallick v. International Bhd. of Elec. Workers, 749 F.2d 771, 783-85 (D.C. Cir. 1984).

14. *See* Wildbur v. ARCO Chem. Co., 974 F.2d 631, 645 (5th Cir. 1992).

15. *See* Central Nat'l Ins. Co. v. Medical Protective Co., 107 F.R.D. 393, 394-95 (E.D. Mo. 1985) (mem.).

16. *See In re* Baldwin-United Corp., 38 B.R. 802, 805 (Bankr. S.D. Ohio 1984).

17. *See In re* Transocean Tender Offer Sec. Litig., 78 F.R.D. 692, 694-97 (N.D. Ill. 1978).

18. *See* J.H. Chapman Group, Ltd. v. Chapman, No. 95 C 7716, 1996 WL 238863, at *1-*2 (N.D. Ill. May 2, 1996).

19. *See In re* Sunrise Sec. Litig., 130 F.R.D. 560, 597 (E.D. Pa. 1989) (mem.).

20. 1 RICE, ATTORNEY-CLIENT PRIVILEGE, *supra* note *, § 8:23, at 130-32.

21. *See, e.g.*, Weil v. Investment/Indicators, Research & Management, Inc., 647 F.2d 18, 23 (9th Cir. 1981).

22. "[P]laintiff shareholders who are litigating a derivative suit on its merits should have an unconditional right to discover corporate attorney-client communications, because such shareholders are acting in the role of management during the course of the derivative litigation on its merits." Friedman, *supra* note 2, at 281.

23. This observation reflects the U.S. Supreme Court's statement that "[a]n uncertain privilege . . . is little better than no privilege at all." Upjohn Co. v. United States, 449 U.S. 383, 393 (1981).

In support of his thesis, Friedman discusses two cases in which the U.S. Supreme Court has voiced the need for predictability—*Jaffee v. Redmond*[24] and *In re Sealed Case*.[25] In each of these cases the balancing away of an individual's privilege protection was rejected because it would make the privilege unpredictable, and therefore, ineffective. In *Jaffee*, the Court recognized a psychotherapist-patient privilege and insisted that it cannot be subject to an after-the-fact balancing test because that would destroy the effectiveness of the privilege. "Making the promise of confidentiality contingent upon a trial judge's later evaluation of the relative importance of the patient's interest in privacy and the evidentiary need for disclosure would eviscerate the effectiveness of the privilege."[26]

In *In re Sealed Case* the decision of the D.C. Circuit that was discussed by Mr. Friedman was reversed by the Supreme Court in *Swidler & Berlin v. United States*.[27] The reversal, however, also supports Mr. Friedman's thesis that predictability is fundamental to privileges designed to encourage open and candid communications. *Swidler & Berlin* involved the survival of an individual's attorney-client privilege after the client's death. In *Swidler*, a lawyer, who had been consulted by White House Counsel Vincent Foster, had been subpoenaed by the Kenneth Starr grand jury investigating President Clinton and directed to produce the notes of his interview with Mr. Foster, who had committed suicide. The Court held that if the privilege were posthumously balanced away based on a subsequently developing need, it could adversely affect the client's willingness to be candid with his attorney about his testamentary interests and desires. "Posthumous disclosure of such communications may be as feared as disclosure during the client's lifetime."[28]

Crucial to these and the other decisions cited by Mr. Friedman was the fact that the privileges were being discussed in the context of an *individual* being encouraged to communicate with another by being given the protection of a privilege. The logic of those decisions has too little relevance in the context of an *entity* client, like a corporation, to justify the action Mr. Friedman proposes.

Unlike the individual client, who is encouraged to be more open and candid by his knowledge that the privilege will prevent *him* from being injured by his own words, predictability is not the driving force behind the corporate attorney-client privilege because of (i) the manner in which the privilege is applied—to a fictitious legal entity that cannot speak—and (ii) the legal environment that requires corporate managers to seek legal

24. 518 U.S. 1, 17-18 (1996).

25. 124 F.3d 230, 234 (D.C. Cir. 1997), *rev'd sub nom.* Swidler & Berlin v. United States, 524 U.S. 399, 411 (1998).

26. *Jaffee*, 518 U.S. at 17.

27. 524 U.S. at 399.

28. *Swidler & Berlin*, 524 U.S. at 407.

assistance, regardless of its confidential nature, in order to avoid personal liability for their negligent mismanagement of corporate assets.

THE ATTORNEY-CLIENT PRIVILEGE IN THE CORPORATE CONTEXT

THE LOGIC OF THE PRIVILEGE PROTECTION

The logic of the attorney-client privilege is that a client knowing that he cannot be injured by his own words will reveal incriminating facts that he otherwise might have suppressed. With this enhanced disclosure, the lawyer will have more facts at his disposal that may be important to the legal assistance he has been asked to render. This, in turn, will result in more informed legal advice, which, it is believed, translates into greater compliance with the requirements of the law.[29] This same type of logic justifies the psychotherapist-patient privilege addressed in *Jaffee*. The client or patient must be encouraged to talk to facilitate the professional services that further a societal goal.

THE SAME LOGIC IS NOT APPLICABLE IN THE CORPORATE CONTEXT

There is a problem with this logic in the corporate context, however, because the attorney-client privilege *protects only* the corporate *entity*,[30] not the individual officers, directors, and employees, who speak for the entity on matters within the scope of their corporate responsibilities.[31] The privilege *provides no direct protection* to employees who create a risk of self-incrimination by speaking candidly with corporate counsel.[32] This was a reality

29. *See* 1 RICE, ATTORNEY-CLIENT PRIVILEGE, *supra* note *, § 2:3, at 14-15.

30. *See* Upjohn Co. v. United States, 449 U.S. 383, 389-90 (1981) (citation omitted).

31. All courts that have considered the suggestion that individual corporate agents be permitted to assert the attorney-client privilege in their own behalf despite a waiver by the corporation have rejected it. *See* United States v. Walls, No. 90-50412, 1991 WL 261632, at **2-**3 (9th Cir. Dec. 10, 1991); *In re* Bevill, Bresler & Schulman Asset Management Corp., 805 F.2d 120, 125 (3rd Cir. 1986); Citibank, N.A. v. Andros, 666 F.2d 1192, 1195 (8th Cir. 1981) (citations omitted); United States v. Piccini, 412 F.2d 591, 593 (2d Cir. 1969); *In re* Braniff, Inc., 153 B.R. 941, 944-45 (Bankr. M.D. Fla. 1993); *In re* Cumberland Inv. Corp., 120 B.R. 627, 629 (Bankr. D.R.I. 1990) (citations omitted); *In re* Blier Cedar Co., 10 B.R. 993, 1000 (Bankr. D. Me. 1981); *In re* Grand Jury Proceedings, 434 F. Supp. 648, 650 (E.D. Mich. 1977), *aff'd*, 570 F.2d 562 (6th Cir. 1978); *In re* Grand Jury Subpoena Duces Tecum, 391 F. Supp. 1029, 1034 (S.D.N.Y. 1975).

32. "The corporation's attorney-client privilege protection for the communications between its agents and attorney does not personally protect the agents, even though they may have incurred personal liability from the actions on behalf of the corporation, and their communications with counsel served only to incriminate themselves." 1 RICE, ATTORNEY-CLIENT PRIVILEGE, *supra* note *, § 4:21, at 97 (citing United States v. Aramony, 88 F.3d 1369, 1388-92 (4th Cir. 1996), *cert. denied*, 520 U.S. 1239 (1997)). Similarly, officers and directors may not prevent a corporation from waiving its privilege by exercising it individually. *See*

that the U.S. Supreme Court never addressed in the *Upjohn* decision, in which it attempted to define whose communications with corporate counsel are protected by the corporation's privilege,[33] or previously when the Court extended the privilege protection to corporations.[34] Therefore, a privilege designed to encourage more open communications when legal assistance is sought by a business entity serves little, if any, purpose.

Every corporate employee who speaks with corporate counsel about matters that could give rise to personal liability, jeopardizes his personal wealth and freedom when he communicates with corporate counsel and acknowledges actionable conduct. Unlike the attorney-client privilege that was created for individuals, when extended to corporate entities, the individuals who are supposed to be encouraged to speak by the existence of the privilege have no control over it. Consequently, whether the privilege will later be asserted (for example, when communications are sought by a grand jury or in a shareholders' derivative action), which would indirectly protect, and thereby benefit, the individual employees, or will be waived for the greater good of the corporation and its shareholders (which could occur when a government agency like the U.S. Securities and Exchange Commission (SEC) demands disclosures before stock options are approved), is within the *exclusive* control of the corporate management—generally referred to as the "control group."[35]

UNPREDICTABILITY IS INHERENT WITH THE CORPORATE PRIVILEGE

While corporate management might be disposed to use the entity's privilege to protect its employees, this protection is indirect and quite fortuitous. Corporate management is precluded from doing this when waiver would be in the best interests of the corporation. This was true, for example, in *Upjohn* and *Diversified Industries, Inc. v. Meredith*,[36] where privileged

Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 349 (1985); *In re* Lancaster Factoring Co., Ltd. v. Mangone, No. M12-329, 1996 WL 706925, at *2 (S.D.N.Y. Dec. 9, 1996); Polycast Tech. Corp. v. Uniroyal, Inc., 125 F.R.D. 47, 49 (S.D.N.Y. 1989); *Grand Jury Subpoena Duces Tecum*, 391 F. Supp. at 1034.

33. While denying that it had adopted a specific test for who personifies the corporate client, the Court employed all of the factors important to the "subject matter" test. Under this test, when any employee communicates with corporate counsel on matters within the scope of his corporate responsibilities and the communications are in confidence and for the purpose of obtaining legal advice or assistance, they will be protected by the corporation's privilege. *See Upjohn*, 449 U.S. at 394-95.

34. *See* United States v. Louisville & Nashville R.R. Co., 236 U.S. 318, 336-38 (1915).

35. *See* 1 RICE, ATTORNEY-CLIENT PRIVILEGE, *supra* note *, § 4:20, at 93.

36. 572 F.2d 596 (8th Cir. 1977). Limited waiver was approved in *Diversified Industries*, which permitted the corporation to make disclosures to a government agency, thereby waiving the privilege protection, but the waiver was limited to that disclosure. *See id.* at 611. This result gave additional indirect protection to individuals whose communications were disclosed, most courts have rejected the limited waiver concept because it is inconsistent with

communications were revealed to the SEC in order to resolve bribery claims and gain agency approval of a stock option. Under management's fiduciary duty to the shareholders, they are obligated to put the interests of the entity first. If they fail to do so, they can expose themselves to personal liability.

Therefore, when employees communicate with corporate counsel, they can never know what circumstances will subsequently develop that will make it beneficial for the corporation to waive its privilege protection (and through that waiver, destroy any protection from which the employee might benefit). That is, unpredictability is already inherent in the fabric of the corporate privilege, regardless of whether the fiduciary duty exception is restricted to shareholder derivative claims, and thus does not create a sufficient basis for eliminating the exception.

LACK OF PREDICTABILITY IS OF LITTLE CONSEQUENCE

Advocates of greater predictability for the corporate privilege may argue that as the level of unpredictability increases (for example, by the extension of the *Garner* exception to nonderivative shareholder actions), corporate officers and directors will stop seeking legal assistance. This argument, of course, has been proven wrong in the current judicial environment in which *Garner* has been vastly expanded. Despite this increased unpredictability, the sky has not fallen: Legal advice must always be sought by corporate management in order to avoid *personal* liability for the consequences that might flow from that failure. Corporate officers are not going to disregard the corporation's welfare and their personal financial security simply because the privilege (which gives them no direct protection) can no longer be maintained.

Why then has the corporate privilege been successful? Why do corporate employees who implicate themselves in financial misdealings continue to speak openly with corporate counsel? The question, of course, is loaded. It assumes an unproven fact—that corporate employees are candid about their own misdeeds. In a study of Fortune One-Hundred Corporations by the Evidence Project at the American University Washington College of Law, it was discovered that when employees know that they may be subject to personal liability for their misdeeds, almost 30% of them are not candid with corporate counsel.[37] The 70% that continues to be candid expressed the mistaken belief that the corporation would protect them.

the concept of confidentiality. *See* 2 RICE, ATTORNEY-CLIENT PRIVILEGE, *supra* note *, §§ 9:87-9:88, at 390-405.

37. *See* Professor Paul R. Rice, Director, Evidence Project American University Washington School of Law, Attorney-Client Privilege: Perceptions and Implications in the Corporate Setting (April 1998) (unpublished survey) (on file with *The Business Lawyer*, University of Maryland School of Law). In the study, hundreds of questionnaires were sent to agents of each participating corporation—both executive and non-executive level employees. Because

To whatever degree the corporate attorney-client privilege has been successful in encouraging candid communications from corporate employees, the most significant reasons appears to be the mistaken beliefs about the privilege.[38] Even when they know they are not represented, many employees speak with corporate legal counsel because of the economic power that the corporation holds over them—they either candidly speak with counsel or are fired, the "talk or walk" ultimatum.

CONCLUSION

The attorney-client privilege is an exception to the principle that the law is entitled to every man's evidence. It is an exception that courts profess to strictly limit in its application to communications that are necessary to achieve its goal of candor. When courts begin to appreciate that economic pressure is the dynamic that compels what the privilege is mistakenly believed to accomplish in the corporate context, they may begin to realize that the corporate privilege has survived by smoke and mirrors. As a consequence, the corporate privilege itself, rather than the "fiduciary duty" exception that Mr. Friedman is concerned about, may be the victim of the reevaluation he proposes.

these questionnaires were sent by in-house counsel, there was a high response rate. Question eight of the survey asked:

> If I knew that I was not personally protected when I communicate with corporate counsel about corporate matters that could expose me to civil or criminal liability, I would:
> a. Speak less candidly with corporate counsel;
> b. Not speak with corporate counsel until I had spoken with an attorney who personally represents me;
> c. Speak candidly with corporate counsel, because I want the corporation to obtain the most informed legal services;
> d. Speak candidly with corporate counsel on the assumption that my interests and the corporation's interests would be sufficiently identical so that the corporation would protect me from exposure to liability by maintaining the confidentiality the communication.

"50% would continue to speak openly on the belief that the corporation would protect them because their interests are sufficiently identical." *Id.* at 5. "50% would not speak with corporate counsel until they had spoken with an attorney who personally represented them." *Id.* "28% would speak less candidly with corporate counsel." *Id.* The less candid 28% represented half of those who indicated that they would not speak with corporate counsel until consulting their own counsel.

38. Fifty-five percent of all corporate executives erroneously believed that corporate counsel personally represented them when consulting on corporate matters that could lead to personal liability. *See id.* at 4.