

New York Supreme Court Decision Clarifies Application of Fiduciary Exception to Attorney-Client Privilege

By: Jay Shapiro and Brian Oubre

Commercial Litigation Alert

10.15.15

Lawsuits filed by investors against corporations present significant discovery issues and it is not unusual that one area of contention focuses upon the efforts of investors to obtain sensitive communications, including those that are potentially covered by the attorney-client privilege. On October 8, 2015, the New York Supreme Court, Appellate Division, First Department, concluded that adversity is not a threshold issue in determining the applicability of the fiduciary exception to attorney-client privilege and, while examining this issue, adopted the "good cause" test in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert denied* 401 U.S. 974 (1971). In fact, the First Department observed that it had never before considered a standard applicable to the invocation of the fiduciary exception, and by ruling that adversity is but one of several factors to consider in making such a determination, adopted new precedent.

Specifically, the First Department determined that absent a more deliberate review and analysis of the fiduciary exception involving the consideration of several factors, the risk of disclosure of privileged materials is manifest.

Factual Background

The decision derives from a discovery dispute in which the managers of a limited liability company and corporate counsel invoked the attorney-client privilege to oppose the demand to produce documents made by one of the company's investors. Plaintiff NAMA Holdings, LLC ("NAMA") is the majority investor in The Alliance Network, LLC ("Alliance"), an entity created to build and develop commercial properties in Las Vegas, Nevada, specifically in what was to become the world's largest showroom facility known as the World Market Center (the "WMC Project"). Defendants Jack Kashani and Shawn Sampson are Alliance's managers.

In 2003, disputes arose between NAMA and members of Alliance regarding allegedly improper capital calls, NAMA's subsequent refusal to provide funding, and complaints that information was not being provided in accordance with Alliance's operating agreement. Alliance retained defendants Greenberg Traurig LLP and Robert Ivanhoe, the chair of Greenberg's global real estate practice (collectively "Greenberg"), and eventually entered into a settlement in April 2004 with NAMA and other parties to temporarily resolve these disputes. Related litigation and arbitrations took place in Delaware and California before this action was filed. NAMA asserts direct and derivative claims against Alliance's managers and Greenberg for breach of fiduciary duty and aiding and abetting that breach, tortious interference with prospective economic advantage, legal malpractice, unjust enrichment, breach of contract, and conversion. NAMA seeks declaratory and injunctive relief.

In response to NAMA's discovery requests, Greenberg produced a privilege log containing 3,000 entries and objected on the basis of attorney-client privilege. NAMA argued that there was no attorney-client privilege in light of the so-called fiduciary exception such that NAMA, as the investor, was a beneficiary of the attorney-client relationship that exists between the company's managers and corporate counsel. The managers and corporate counsel countered that NAMA has interests that are adverse to the company's interest, and therefore the fiduciary exception is inapplicable. The trial court considered this question, and determined that the parties were not adverse, and ordered the production of the privileged materials.

The First Department Ruling

The Appellate Division, First Department reversed the trial court's decision. The appellate court examined the attorney-client privilege in the corporate context, noting that where a shareholder – or, as here, an investor in a company – brings suit against corporate management for breach of fiduciary duty or similar wrongdoing, courts have carved out a "fiduciary exception" to the privilege that otherwise attached to communications between management and corporate counsel. The Appellate Division then observed that it had not yet previously defined the parameters of the fiduciary exception, and after a brief historical discussion of its origins, adopted the "good cause" test in *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert denied* 401 U.S. 974 (1971) – deeming it as striking "the appropriate balance between respect for the privilege and the need for disclosure...." These good cause factors are:

- (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; and
- (9) the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.

Garner, 430 F.2d at 1104.

The Appellate Division further determined that a court need not evaluate each factor listed in *Garner*. Instead, where a court finds that a shareholder has demonstrated good cause to apply the fiduciary exception and pierce the corporate attorney-client privilege, it must at least address those factors which support such a finding in its determination.

The Appellate Division then applied this standard to address Greenberg's argument that there is an "adversity limitation" to the fiduciary exception, such that if at some point NAMA's interests are adverse to those of Alliance, then the fiduciary exception is inapplicable from that point forward. In response, the Appellate Division noted that adversity is not one of the factors listed in *Garner*, and is thus not a threshold inquiry but rather a component of a broader "good cause" inquiry. The Appellate Division then examined the adversity argument under a number of the *Garner* factors, and determined that the question is not one of timing, but rather of the content of the communications themselves which can be determined by an *in camera* inspection. The court also specifically rejected the argument that if NAMA and Alliance became adverse at some point, *all* subsequent communications would be exempt from the fiduciary exception to attorney-client privilege.

Practice Pointer

125th
ANNIVERSARY

White and
Williams LLP

Given the previous lack of controlling authority in the First Department on the applicability of the fiduciary exception, fiduciaries and in-house counsel were providing services in a somewhat unsettled environment as to whether, and when, the attorney-client privilege could be pierced. However, the adoption of the *Garner* factors provides both clarity and defined parameters by which the fiduciary exception to attorney-client privilege can be applied in the event of litigation with a stockholder/investor, beneficiary, or other purported beneficiaries to the attorney-client relationship.

For further information on this matter, please contact Jay Shapiro (shapiroj@whiteandwilliams.com; 212.714.3063) or Brian Oubre (oubreb@whiteandwilliams.com; 212.631.4437).

This correspondence should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only and you are urged to consult a lawyer concerning your own situation and legal questions.

