EVIDENCE: "GOOD CAUSE" HELD TO DEFEAT THE ATTORNEY-CLIENT PRIVILEGE WHEN A CORPORATION IS SUED BY ITS SHAREHOLDERS

In *Garner v. Wolfinbarger*[1] the Court of Appeals for the Fifth Circuit held that in a suit against a corporation by its shareholders the attorney-client privilege was available to the corporate client on a limited basis, subject to being overcome by a showing of "good cause."[2] Several stockholders of the First American Life Insurance Company of Alabama (FAL), initiated a class action alleging violations of the Securities Act of 1933,[3] the Securities Exchange Act of 1934,[4] SEC rule 10b-5,[5] the Investment Company Act of 1940,[6] the Alabama Securities Act,[7] and common law fraud, seeking to recover the purchase price paid for FAL stock from FAL and its officers and directors. In addition, the stockholders, claiming injury to the corporation itself resulting from alleged fraud in the purchase and sale of securities, brought a derivative action against various individual defendants on behalf of the corporation. The shareholders attempted by deposition to obtain information concerning advice given by FAL's attorney, Richard Schweitzer,[8] related to the issuance and sale of stock. The corporation and Schweitzer himself claimed that the attorney-client privilege barred the divulgence of both the advice given to the corporation by Schweitzer and the communications received by him from FAL. The privilege was also claimed with respect to certain documents in Schweitzer's possession, which were sought under a subpoena duces tecum. In granting the motion for an order requiring Schweitzer to answer the interrogatories and to produce the requested documents,[9] the district court held that the privilege was unavailable

1. 430 F.2d 1093 (5th Cir. 1970).
2. *Id.* at 1104.
3. 15 U.S.C. §§ 77a *et seq.* (1964).
4. 15 U.S.C. §§ 78a *et seq.* (1964).
5. 17 C.F.R. § 240.10b-5 (1970).
6. 15 U.S.C. §§ 80a-1 *et seq.* (1964).
7. ALA. CODE tit. 53 §§ 28-65 (Cum. Supp. 1969).
8. R. Richard Schweitzer served as attorney for the corporation in connection with the issuance of the FAL stock here involved. After the transactions sued upon were complete he became its president. The case concerns Schweitzer's activities only during the period he acted as attorney for FAL.
9. The latter motion was treated by the district court as a motion to produce under FED. R. CIV. P. 34.

when asserted by a corporation against plaintiff stockholders.[10] The court of appeals vacated the district court's order[11] and remanded for further proceedings to determine whether the plaintiffs could make the requisite showing of "good cause" in conformity with its opinion.[12]

The attorney-client privilege dates back to English law during the reign of Elizabeth I.[13] The privilege was originally based on the oath and honor of the attorney to keep his client's secrets and was therefore vested solely in the attorney. As the law became more complex, it was recognized that legal advice was essential and that one should be free to seek such advice confidentially. To encourage free communications, the privilege was extended to the client.[14] Although subjected to periodic attack by commentators,[15] the privilege is strongly entrenched in comtemporary legal practice. The requirements of the privilege as it exists today are enumerated by Dean Wigmore:

> (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his legal 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.[16]

This attorney-client communications privilege is not coterminous with the attorney's work product privilege. The latter, although in some respects more inclusive than the attorney-client communications privilege, is limitcd in that it is qualified rather than absolute and can be overcome by a showing of "necessity or justification."[17]

For many years the privilege was assumed to be available to the corporate client. In fact, both the American Law Institute's Model Code of Evidence[18] and the Uniform Rules of Evidence[19] included

10. Garner v. Wolfinbarger, 280 F. Supp. 1018 (N.D. Ala. 1968). This opinion by District Judge Grooms was criticized in Comment, *The Attorney-Client Privilege in Shareholders' Suits*, 69 COLUM. L. REV. 309 (1969).

11. 430 F.2d at 1104. The defendants appealed from the district court order under the interlocutory appeals statute, 28 U.S.C. § 1292(b) (1964).

12. 430 F.2d at 1104.

13. *See, e.g.*, Comment, *The Lawyer-Client Privilege: Its Application to Corporations, the Role of Ethics, and Its Possible Curtailment*, 56 NW. U.L. REV. 235 (1961).

14. *Id.*

15. *E.g.*, J. BENTHAM, *Rationale of Judicial Evidence*, bk. IX pt. IV, c. 5, in VII WORKS OF JEREMY BENTHAM 474 *et seq.* (J. Bowering ed. 1840) *reproduced in part in* 8 J. WIGMORE, EVIDENCE § 2291 at 549-51 (McNaughton rev. 1961); Morgan, *Foreword* to the MODEL CODE OF EVIDENCE 22-31 (Am. L. Inst. 1942); Radin, *The Privilege of Confidential Communication Between Lawyer and Client*, 16 CALIF. L. REV. 487 (1928).

16. 8 J. WIGMORE, *supra* note 15, § 2292.

17. Hickman v. Taylor, 329 U.S. 495, 512 (1947).

18. A.L.I. MODEL CODE OF EVIDENCE rule 209 (1942).

19. UNIFORM RULES OF EVIDENCE rule 26(3) (1953).

corporations among the clients who could assert the privilege. It was not until 1962, in *Radiant Burners, Inc. v. American Gas Association*,[20] that the general assumption of its applicability to the corporate client was questioned. Finding no express holding on the issue, the district court reasoned that the privilege is not unlike the privilege against self-incrimination which can only be invoked by natural persons[21] and that the degree of confidentiality required was not present in the corporate setting; therefore, a corporation could not invoke the privilege. This decision was promptly reversed by the Court of Appeals for the Seventh Circuit, which held that "the attorney-client privilege in its broad sense is available to corporations. . . ."[22] The court indicated that the privilege applies to corporations for the same reasons it applies to individuals:

> The purpose of the privilege is to facilitate the administration of justice by encouraging full disclosure by the client to the attorney . . . [There is a] right and absolute necessity for confidential disclosure of information by the client to the attorney to gain the legal advice sought thereby. . . .[23]

The court declined to decide under what circumstances, if any, the privilege would be inapplicable to the corporate client, stating that the nature and extent of the privilege should be developed "on a case by case basis."[24] A great deal of litigation has occurred in the wake of *Radiant Burners* to determine the parameters of the corporate attorney-client privilege. Much of this has dealt with the term "client" as applied to corporations to determine which individuals can speak for the corporate entity in its capacity as a client. In *Zenith Radio Corp. v. Radio Corp. of America*,[25] the privilege was held to be available to those "affiliated with the corporation as employees, officers, directors, or 'outside counsel.' "[26] A similar view was taken in *United States v. United Shoe Machinery Corp.*,[27] where it was said that the privilege would attach to communications from any officer or employee of the corporation. The *United Shoe* case also held that the privilege applies to legal communications to house counsel as well as to outside counsel.[28]

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20. 207 F. Supp. 771 (N.D. Ill. 1962).
21. 8 J. WIGMORE, *supra* note 15, § 2259a.
22. Radiant Burners, Inc. v. American Gas Ass'n, 320 F.2d 314, 323 (7th Cir. 1963).
23. *Id.* at 322, 324.
24. *Id.* at 324.
25. 121 F. Supp. 792 (D. Del. 1954).
26. *Id.* at 795.
27. 89 F. Supp. 357 (D. Mass. 1950).
28. *Id.* at 360.

As to the precise question in *Garner*, whether the privilege is available to a corporation when the disclosure is sought by its stockholders, there was no American precedent. Two English cases, cited by the district court,[29] *Gouraud v. Edison Gower Bell Telephone Co. of Europe*,[30] and *W. Dennis and Sons, Ltd. v. West Norfolk Farmers' Manure and Chemical Co-operative Co.*,[31] held that the privilege was not available to a corporation sued by its stockholders. The *Dennis* case involved discovery of an independent accountant's report in the possession of counsel,[32] while *Gouraud* concerned discovery of documents prepared by an attorney for the corporation.[33]

In arriving at its decision in *Garner* the court of appeals attempted to strike a balance between the policies of confidentiality and disclosure.[34] The stockholder plaintiffs, who prevailed below, claimed the privilege was totally unavailable to the defendants. The corporate defendants, on the other hand, asserted an absolute right to claim the privilege.[35] The Fifth Circuit Court of Appeals rejected both contentions, holding instead that the privilege was neither inflexibly absolute nor totally unavailable. The court found that the privilege was not absolutely available to the corporation because of the continuing validity of traditional exceptions to the privilege for communications in contemplation of a crime or fraud and for communications to a joint attorney.[36] The court indicated that the first exception might be extended beyond its normal limitation to prospective criminal transactions,[37] stating that "[t]he differences

29. 280 F. Supp. at 1019.

30. 57 L.T. Ch. 489 (1888).

31. [1943] 2 All E.R. 94 (Ch.).

32. *Id.* at 96.

33. 57 L.T. Ch. at 500.

34. The availability of the privilege involves a complex problem of choice of law. The order of the district court appeared to treat the Alabama standards as controlling. The Court of Appeals for the Fifth Circuit disagreed, stating that "the choice of law cannot be settled by reference to any simple talisman, but can be arrived at only after a consideration of state and federal interests that are inseparable from the factors bearing on the availability of the privilege itself." 430 F.2d at 1097. Since the case was based primarily on a federal question claim, the court felt free independently to weigh the issues.

35. The corporate defendants were supported by the American Bar Association, which appeared as amicus curiae arguing in favor of the absolute privilege.

36. The privilege and its traditional exceptions would be given federal statutory underpinnings according to proposed rule 5-03 of the Rules of Evidence for the United States District Courts and Magistrates. *See* 46 F.R.D. 161, 249-51 (1969). There are three other exceptions relating to claims throngh a deceased client, breach of a lawyer's duty to his client, and documents attested by a lawyer. *Id.* at 251.

37. 8 J. WIGMORE, *supra* note 15, § 2298.

between prospective crime and prospective action of questionable legality, or prospective fraud, are differences of degree, not of principle."[38] The joint attorney exception, which applies whenever an attorney acts for two or more persons who have become adversaries in a lawsuit,[39] was found to be relevant in disputes between the corporate entity and its shareholders. Citing *Pattie Lea, Inc. v. District Court*,[40] where because of the joint attorney exception the statutory privilege for communications between a public accountant and his corporate-client did not prevent discovery in a derivative action brought by stockholders, the court noted that an attorney is usually employed by the corporation for the benefit of all stockholders. Nevertheless, considering the compelling interests which surround the privilege, the Fifth Circuit held that a corporation should not be absolutely barred from asserting the privilege merely because the suit is instigated by some stockholders but that the privilege should be available to the corporation "subject to the right of the stockholders to show cause why it should not be invoked in the particular instance."[41] The court suggested that an *in camera* inspection be used in ruling on the availability of the privilege and outlined several factors which might be considered in determining whether "good cause" is present, including the number of shareholders and the percentage of stock they represent; the nature of the shareholders' claim; the apparent necessity of the information and its availability from other sources; and whether the communication related to past or prospective actions which were either criminal, illegal, or of doubtful legality.[42]

The *Garner* decision is likely to produce a great deal of litigation. Derivative actions and suits by stockholders against the corporation will often raise the issue of the discoverability of corporation-attorney communications. If the availability of the privilege ultimately rests on a finding of good cause as defined in *Garner*, litigation may be expected similar to that which followed the Supreme Court's ruling in *Hickman v. Taylor*[43] requiring a showing of "necessity" for discovery of an attorney's work product. The new discovery rules, however, evidence a desire to reduce the number of cases in which a showing of

38. 430 F.2d at 1103.
39. 8 J. WIGMORE, *supra* note 15, § 2312.
40. 161 Colo. 493, 423 P.2d 27 (1967) (en banc).
41. 430 F.2d at 1103-04.
42. *Id.* at 1104.
43. 329 U.S. 495 (1947). *See* C. WRIGHT, FEDERAL COURTS § 82, at 363 (2d ed. 1970).

good cause will be required[44] in order to remove some of the confusion which necessarily surrounds a good cause requirement. Perhaps the court in *Garner* could have reached a more workable result if the claim of absolute privilege were sustained with its traditional exceptions. If the communications concerned prospective criminal or fraudulent activities, discovery would be permitted under the existing exception.[45] Whether the materials sought fall within the exception could be determined by the judge through an *in camera* inspection. Interrogatories would be permitted only if directed toward communications which originally concerned prospective criminal or fraudulent activities. The joint attorney exception poses the greatest problem, and its applicability is difficult to determine in stockholders' suits. In cases where the corporate counsel is obviously working for the benefit of the stockholders as well as the corporate management and where the two interests are not adverse, the exception should apply to permit discovery. In theory the corporate attorney should always be working in behalf of the stockholders. However, in the modern corporate world there are many instances where the interests of the stockholders and management are adverse, such as when management consults counsel for legal advice aimed at avoiding or minimizing actual or potential shareholder complaints. When the attorney acts on behalf of the corporate management to the detriment of some or even all stockholders, the rationale behind the joint attorney exception fails, and it should not apply.[46] By adhering to the

44. The good cause requirement has been stricken from FED. R. CIV. P. 34 (motion to produce), as amended in 1970. Prior to 1970 the rule read "Upon motion of any party showing good cause therefore . . ."; the amended rule simply states "Any party may . . . ." The Advisory Committee's note (a) to then proposed rule 34 states that: "Good cause is eliminated because it has furnished an uncertain and erratic protection to the parties from which production is sought and is now rendered unnecessary . . . ." *Preliminary Draft of Proposed Amendments to Rules of Civil Procedure*, 43 F.R.D. 211, 256 (1967).

45. See note 37 *supra* and aecompanying text.

46. The judge should consider applicability of the joint attoruey exception in lignt of the surrounding circumstances, focusing his attention on the nature and content of the information sought through discovery. The issue will normally arise when the privilege has been asserted in lieu of responding to oral or written interrogatories or as an excuse for failing to produce requested documents. The party seeking discovery will apply to the court for an order compelling an answer under FED. R. CIV. P. 37(a). *See generally* C. WRIGHT, *supra* note 43, §§ 84, 87, 90. At this point in the proceeding the scope of discovery will no longer be a matter of speculation, and the judge can rule on the applicability of the privilege in the light of the interrogatories to which it has been asserted. When the privilege is claimed with respect to the production of documents, the judge may utilize an *in camera* examination of the materials in formulating his decision.

absolute privilege as limited by its exceptions, the court could have avoided the litigation and confusion which accompanies a good cause requirement while providing for the same ultimate result in the vast majority of cases.