

Corporate Litigation:

Directors' Exercise of the Corporate Privilege

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APRIL 11, 2013

Directors need access to basic information about the corporation they manage in order to fulfill their fiduciary duties. Current directors of a corporation have a near-absolute right to inspect the corporation's books and records, including the privileged legal advice the corporation seeks and obtains. Recent case law exploring the boundaries of this right illustrates that in practice the analysis is more nuanced. The Appellate Division, First Department, ruled last month in [*Barasch v. Williams Real Estate*](#),¹ that a corporate director and shareholder whose interests are adverse to those of the corporation is not entitled to obtain the corporation's attorney-client privileged communications concerning that director's rights. Relatedly, courts continue to debate whether former directors are entitled to obtain privileged communications between the corporation and its lawyers made during their tenure on the board in order to support a post-tenure claim or defense.

Background

A lawyer representing a corporation generally owes professional duties to the entity and not to any officer, director, employee, shareholder or other corporate constituency. Legal constructs are notoriously difficult to reach on the phone, however, and unreliable about appearing at meetings. Like other corporate decisions made day-to-day, decisions about privilege must be made by individuals empowered to act on behalf of the corporation. State corporation laws generally vest management authority in the corporation's board of directors. Outside the bankruptcy context, corporate management therefore controls the corporate attorney-client privilege, which is normally exercised by its officers and directors. The managers must, of course, exercise the privilege in accordance with their

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fiduciary duty to act in the best interests of the corporation and not influenced by their individual interests.² Consequently, directors and officers generally have no right to assert an individual interest in the confidentiality of their communications made on behalf of the corporation.

A corporate representative may be able to assert an individual privilege and prevent the corporation from waiving privilege, however, if the representative can demonstrate that corporate counsel jointly represented the representative individually alongside the corporation.³ Former directors and officers may not assert corporate privilege against the instructions of the current managers, even as to communications that they made to corporate counsel concerning matters within the scope of their corporate duties.⁴

Former Directors

Courts disagree on whether former directors are entitled to obtain privileged communications between the corporation they served and corporate counsel dating from the period of their board service. The majority view is that the corporate entity is the sole client of a lawyer representing a corporation. These courts reason that individuals through which corporations act, including directors, are only representatives of the corporation, not clients by extension of the corporation. A corporation may through its authorized representatives (and over the objection of individual directors or officers) waive the corporation's privilege. Conversely, because privilege belongs to the corporation, not to individual managers, a majority of the board can assert the attorney-client privilege over the objection of the minority.

As a federal court stated in the seminal [*Milroy v. Hanson*](#),⁵ "an individual director is bound by the majority decision and cannot unilaterally waive or otherwise frustrate the corporation's attorney-client privilege if such action conflicts with the majority decision of the board of directors." In *Milroy*, a dissident director and minority shareholder of a closely held corporation sued the remaining directors on the corporation's board. Michael Milroy continued to serve on the board during the lawsuit and sought production of the corporation's privileged documents, over which the majority of the directors asserted the corporation's attorney-client privilege. The court denied Milroy access to the privileged documents, holding that Milroy, "as a dissident director, has no right to waive or otherwise pierce [the corporation's] attorney-client privilege because he is not the 'management' of the

corporation and 'management' of the corporation, as it has a right to do, asserts the privilege against him."

Adopting *Milroy's* reasoning, numerous federal courts have determined that "[o]nce a director leaves his corporate position, his obligations in this respect cease, and hence there is no logical reason why at that point he would need, and should be expected, to be able to access or have any control over corporate communications, including documents embodying privileged communications made in the past while he served the corporation."⁶

A competing line of cases, chiefly in New York and Delaware state courts, holds that a corporation's board of directors is a "joint client" with the corporation, so that the corporation cannot assert privilege against former directors as to corporate communications made during their tenure, even if their interests have become adverse to the corporation. The leading case adopting the "joint client" approach is the Delaware Court of Chancery's *Kirby v. Kirby*,⁷ in which the defendants, including the corporation and its then-current directors, sought to withhold from plaintiffs—former board members—privileged documents created when the plaintiffs were members of the board.

The court held that privilege as to these documents could not be asserted against the former directors because "the directors, collectively, were the client at the time the legal advice was given." That is, "[t]he directors are all responsible for the proper management of the corporation, and it seems consistent with their joint obligations that they be treated as the 'joint client' when legal advice is rendered to the corporation through one of its officers or directors." The court acknowledged that a director's statutory right to examine corporate books and records ends when the director leaves office, but regarded that event irrelevant to whether privilege may be asserted against a former director's request for discovery in support of a colorable claim or defense. *Kirby* also held that upon departure from the board, it would "be a 'fiction' to say that [former directors] were the clients to whom the legal advice was rendered" and declined to order production of post-board service documents on the "joint client" theory.

Subsequent to *Kirby*, Delaware decisions have reiterated that a corporation cannot assert privilege to deny a former director access to legal advice furnished to the board during the director's tenure, but have refined the analysis, saying that "a more accurate description of the relationship is that there was a single 'client,'

namely, the entire board, which includes all its members. That is, a director seeking information furnished to the board that is the subject of the privilege claim is a 'client' not in his or her individual capacity, but as a member of the collective body (the board) of which the director is one member."⁸

In *Spitzer v. Greenberg*,⁹ the First Department similarly ruled that under New York and Delaware law former directors are within the circle of persons entitled to view privileged materials created during their tenure without causing waiver of the attorney-client privilege, as long as the former directors participated in the relevant legal consultations while they were directors. There, two former directors and officers of American International Group who were defendants in government proceedings subpoenaed the company to obtain legal memoranda created during their tenure at the company in order to seek to develop an advice of counsel defense. The trial court sustained the company's refusal to produce the memoranda on the ground that former directors were not entitled to information subject to the company's attorney-client privilege and work product protection.

The First Department reversed, concluding that although former directors generally are not entitled to inspect corporate records, "a former director may still have a qualified right to inspect the books and records covering a period of his directorship whenever in the discretion of the trial court he can make a proper showing by appropriate evidence that such inspection is necessary to protect his personal responsibility interest as well as the interest of the stockholders." The former directors were within the circle of persons entitled to view privileged materials without causing a waiver of the attorney-client privilege, the court determined, because "while directors and officers of AIG, [they] were privy to, and on many occasions actively participated in, legal consultations" regarding relevant transactions and they had made a sufficient showing that the information was critical to their defense.

In an important limitation, the First Department emphasized that the privilege (i) belongs to the corporation, and can be asserted or waived only by the corporation, and (ii) the corporation has no obligation to waive its privilege at the request of a former director or officer. Thus *Greenberg* stands for the proposition only that former directors may be entitled to obtain privileged communications created during their tenure but, as Justice David Friedman wrote in a separate concurrence, "[w]hat use, if any, the former directors may make of such documents, or of the

legal advice reflected therein, in defending this action, is a question for another day."

The "joint client" approach has been criticized by several federal courts as "(1) fundamentally inconsistent with the rationale for the privilege, (2) ignor[ing] the unique and limited role of corporate representatives in communicating with counsel on behalf of the corporation, and (3) allow[ing] the fiduciary's termination of his responsibilities to trigger his ability to use the access previously granted to him for fiduciary purposes as a weapon to advance his own interests at the expense of the corporation."¹⁰ In *Fitzpatrick v. American Intern. Group*, for example, U.S. Magistrate Judge Michael H. Dolinger held that in federal court federal common law controls privilege questions, and ruled that a former director and officer of an AIG subsidiary asserting claims against his former company and its parent company was not entitled to obtain documents from the period of his board service subject to the companies' privilege.

The court closely examined *Kirby*, and deemed it "fundamentally at odds with basic principles" of privilege in the corporate context. First, by "identifying the collective (or individual) board members as the client—rather than treating them as the representatives of the client, though empowered to speak for the client—the Chancery Court's analysis is contrary to settled federal law, which insists that the corporation is the client and the directors and officers are only its representatives." In addition, because a director's fiduciary duties and ability "to speak for it last only so long as the director remains in that official position," upon departure there is no longer any "logical reason why at that point he would need, and should be expected, to be able to access or have any control over corporate communications, including documents embodying privileged communications made in the past while he served the corporation."

And granting former directors access to privileged corporate documents "as a matter of course would have seemingly perverse implications," i.e., the "sabotaging of the policy underlying the privilege would be a product of the former director's earlier assumption of his own set of obligations to the corporation and would be in the service of that former director's personal interests even though his interests would now, by definition, be adverse to those of the corporation."

Current Director Adversity

In [*Barasch*](#), the First Department last month ruled that a corporate director-shareholder is not entitled to obtain privileged communications between company counsel and company representatives that were made at a time when the director's interests were adverse to the corporation and her fellow directors. Candace Carmel Barasch was a director and shareholder of Williams Real Estate, and sued the company in a stock appraisal proceeding after the company sold a 65 percent interest in the business to a third party in an October 2008 transaction to which Barasch had objected.

In discovery, Barasch sought all communications between the company and its transaction counsel concerning her stock holdings and the transaction. The company objected, arguing that even though she was a director, Barasch was not entitled to obtain privileged communications belonging to the company because she was now adverse to the company. Even though Barasch (who had retained separate counsel regarding the transaction) was indisputably adverse to the corporation and the other directors by September 2008, the trial court disagreed, reasoning that as a director of Williams, Barasch was a corporate insider and could not be adverse to the company for purposes of access to privileged information.

The First Department reversed, holding that a corporate director cannot invoke her corporate position to pierce the privilege that attaches to communications between the company and its counsel concerning matters in which that director is or may be adverse to the company. A rule permitting a sitting director to obtain all privileged corporate communications, irrespective of adversity between the company and director's interests, the court reasoned, "would prevent a corporation from freely consulting with counsel when dealing with a dispute involving a sitting director, or seeking advice regarding a director's suspected misconduct."

Distinguishing its *Greenberg* decision, the court stated that the critical difference between Barasch's attempt to access privileged communications and that of former directors in *Greenberg*, was that Barasch "was not privy to the legal consultations and communications between transaction counsel and [the corporation], but instead was the subject of those consultations, and was adverse to the corporation at the time." Earlier this year, the Massachusetts Supreme Judicial Court in *Chambers v. Gold Medal Bakery*¹¹ adopted a similar approach in the context of a closely held family corporation, holding that two board members' pursuit of a buy-out of their

equity created adversity sufficient to permit the corporation to withhold privileged and work product information from those sitting directors.

The custodians of the corporation's privilege must take care to preserve the privilege by ensuring confidential communications are not shared with insiders with interests adverse to the corporation. In *DeFrees v. Kirkland*,¹² upon learning that most of the members of the board and the company's former outside counsel were acting adversely to the interests of the company and its shareholders, the company CEO, acting on behalf of the company, retained a law firm to conduct an investigation into the matter. The law firm prepared and delivered to the CEO a detailed, privileged and confidential report summarizing its conclusions and recommendations.

The report described misconduct by outside counsel and certain members of the board, and recommended that all "responsible parties" be stripped of decision-making authority at the company. The CEO authorized the distribution of the report to the full board, including the members alleged to have acted against the company, a former board member (who provided it to the SEC) and the outside firm alleged to have acted against the company. A California federal court recently determined that the CEO had authority to waive the company's privilege and did so by voluntarily sharing the report with these third parties who had allegedly breached their fiduciary duties to the company.

Conclusion

Protection of the corporate attorney-client privilege requires careful evaluation of any disputes between one or more sitting corporate directors and the corporation to determine if any directors may have individual interests adverse to the corporation. The *Barasch* and *Chambers* decisions illustrate the fact-intensive analysis courts will undertake to determine if a sitting director has sufficiently adverse interests to justify denying access to privileged corporate information relevant to those interests. The ability of former directors to obtain in discovery privileged information created during their tenure at the corporation may depend on where the suit is pending, making the differences in judicial approaches a potentially important consideration in forum selection.

Endnotes:

1. 2013 WL 978789 (1st Dept. March 14, 2013).
2. *MacKenzie-Childs LLC v. MacKenzie-Childs*, 262 F.R.D. 241, 249 (W.D.N.Y. 2009).
3. *Fitzpatrick v. American Intern. Group*, 272 F.R.D. 100, 107 n.4 (S.D.N.Y. 2010).
4. *Escue v. Sequent*, 2012 WL 220204, *5 (S.D. Ohio 2012) ("Sequent can assert the attorney-client privilege with respect to [former director] even though he formerly had access to the information as an owner and director of Sequent. [Former director] was privy to the privileged information in his capacity as a corporate representative. As he no longer acts...as an owner or director, he can no longer exercise or waive the privilege on behalf of the corporation").
5. 875 F.Supp. 646, 648-50 (D. Neb. 1995).
6. *Fitzpatrick*, 272 F.R.D. at 107; see also *Davis v. PMA Companies*, 2012 WL 3922967, *6 (W.D. Okla. Sept. 7, 2012) ("Plaintiff's status as a former director and officer of PMA does not entitle him to production of otherwise privileged communications made during his tenure...").
7. 1987 WL 14862 (Del. Ch. July 29, 1987).
8. *Moore Business Forms v. Cordant Holdings*, 1996 WL 307444, *4 n.4 (Del. Ch. June 4, 1996).
9. 851 N.Y.S.2d 196 (1st Dept. 2008).
10. *Fitzpatrick*, 272 F.R.D. at 107.
11. 464 Mass. 383 (2013).
12. 2012 WL 1356495 (C.D. Cal. 2012).

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