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The Attorney-Client Privilege Has Viability for the Corporate Client in a Suit Brought against It by Its Stockholders - The Privilege, However, Is Subject to the Right of the Stockholders to Show Good Cause Why It Should Not Be Invoked in the Particular Instance.

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states have enacted statutes similar to Article 7519a, but most of them require a comparatively short number of years of non-use before there is a forfeiture of the appropriative right.[65] The *Wright* case[66] appears to be a correct step in Texas' stride to preserve its natural resources and meet its future needs.

Richard Gary Thomas

ATTORNEY-CLIENT PRIVILEGE—CORPORATIONS—THE ATTORNEY-CLIENT PRIVILEGE HAS VIABILITY FOR THE CORPORATE CLIENT IN A SUIT BROUGHT AGAINST IT BY ITS STOCKHOLDERS. THE PRIVILEGE, HOWEVER, IS SUBJECT TO THE RIGHT OF THE STOCKHOLDERS TO SHOW GOOD CAUSE WHY IT SHOULD NOT BE INVOKED IN THE PARTICULAR INSTANCE. *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).

The stockholders of First American Life Insurance Company, an Alabama corporation, brought a class action against their corporation. They alleged violations of the Securities Act of 1933,[1] the Securities Exchange Act of 1934,[2] the Securities Exchange Rule 10(b)(5),[3] the Investment Company Act of 1940,[4] the Alabama Securities Act,[5] and common law fraud. Plaintiff-stockholders sought to recover the purchase price which they and the other members of the class paid for their stock in the corporation.

Defendant, R. Richard Schweitzer, served as attorney for the corporation in connection with the issuance of the stock involved. He became the president of the corporation after the litigated transactions were completed. On deposition, Schweitzer was asked several questions concerning the advice given to the corporation by him concerning the

65 N.MEX. STATUTES ANN. 75-5-26 (1953); IDAHO CODE 42-222 I.C. (1948).
66 Texas Water Rights Comm'n v. Wright, 464 S.W.2d 642 (Tex. Sup. 1971).

1 15 U.S.C.A. §§ 77a-77aa (1963). This section, which is too lengthy to reproduce here, is concerned primarily with the initial distribution of securities rather than subsequent trading.
2 15 U.S.C.A. §§ 78a-78hh-1 (1963). This section deals with post distribution tradings.
3 17 C.F.R. § 240.10b-5 (1970).
4 15 U.S.C.A. §§ 80a-(1)-80d-(52) (1963). This section deals with eliminating conditions which adversely affect the national public interest and the interest of investors.
5 CODE OF ALA. TIT. 53 §§ 28 (Supp. 1969) Securities—Fraudulent and other prohibited practices—
(a) It is unlawful for any person, in connection with the offer, sale or purchase of any securities, directly or indirectly
(1) to employ any device, scheme, or artifice to defraud,
(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they are made, not misleading, or
(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

issuance and sale of the stock and questions concerning the information furnished to him by the corporation. The questions all related to acts performed by Schweitzer while acting solely as an attorney and before he became an officer of the corporation.

The Federal District Court ordered the production of certain documents in the possession of the corporation and required Schweitzer to answer all oral interrogatories propounded on deposition.[6] Held—*Order vacated and cause remanded.* The attorney-client privilege has viability for the corporate client in a suit brought against it by its stockholders. The privilege, however, is subject to the right of the stockholders to show good cause why it should not be invoked in the particular instance.

There exists a fundamental principle of evidence that the public has a right to everyman's evidence and exemptions from the general duty to give testimony are exceptional.[7]

> An exception is justified if and only if, policy requires it be recognized when measured against the fundamental responsibility of every person to give testimony.[8]

There are certain confidential relationships which by their existence create a privilege not to disclose confidences made between the parties. Such a privilege is the attorney-client privilege which forbids an attorney from disclosing communications that have been made to him by the client or advice which the attorney may have given to the client, unless the client consents to the disclosure.[9] The attorney-client privilege is concerned with promoting freedom of consultation with attorneys to facilitate the workings of justice. The theory behind the privilege is that it secures for the client a subjective freedom of mind when he seeks legal advice, thereby encouraging him to make a full disclosure to his attorney of all matters in litigation. The privilege protects communications made in confidence and only the client can invoke the privilege.[10] The privilege extends only to communications

[6] On November 8, 1967, the Federal Judge of the Northern District of Alabama, ordered the production of certain documents in the possession of the corporation, and required Schweitzer to answer all oral interrogatories propounded on deposition. The November 8 order required production of:

> [A]ll correspondence and memoranda of discussions between you (Schweitzer) or other attorneys with your firm and the officers or directors of First American Life.

On February 19, 1968, upon motion to reconsider the order of November 8, the trial judge affirmed the previous order. Again in Garner v. Wolfinbarger, 280 F. Supp. 1018 (N.D. Ala. 1968), the judge affirmed the previous orders.

[7] 8 WIGMORE, EVIDENCE § 2192 (3d ed. 1940).

[8] Garner v. Wolfinbarger, 430 F.2d 1093, 1100 (5th Cir. 1970).

[9] 3 JONES ON EVIDENCE, PRIVILEGES § 827 (5th ed. 1958). *See also* Alexander v. United States, 138 U.S. 353, 11 S. Ct. 350, 34 L. Ed. 954 (1891); Phillips v. Chase, 87 N.E. 755 (Mass. 1909).

[10] Schwimmer v. United States, 232 F.2d 855 (8th Cir. 1956), *cert. denied*, 352 U.S. 833, 77 S. Ct. 48, 1 L. Ed.2d 52 (1956); *Ex parte* Lipscomb, 111 Tex. 409, 239 S.W. 1101 (1922).

made by the client to his lawyer while acting as such. Accordingly, it does not protect disclosures made to a person who is a lawyer but not acting in that capacity.[11]

There are two traditional exceptions to the established rule of attorney-client privilege: (1) communications made in the contemplation of a crime or fraud;[12] and (2) communications made to joint clients.[13] Communications made between an attorney and his client before or during the commission of a crime or fraud are not privileged, if made with the purpose of guiding or assisting in the commission of the crime or fraud.[14] Where the same attorney acts for more than one client under the joint-client exception neither party may exercise the privilege in a subsequent controversy with the other.[15]

A corporation can assert the attorney-client privilege as can an individual.[16] For a corporation to claim the privilege, the person making the communication must be competent and authorized to do so. The directors and officers will generally be regarded as competent to seek legal advice.[17] Regular employees, clerks, managers, *etc.* are authorized to speak on matters concerning their immediate jobs only, however, and their unrelated corporate statements will not be privileged.[18]

In deciding the instant case, the Fifth Circuit Court of Appeals had to balance the opposing principles of the right of disclosure of all material facts on one hand, and the right of privilege against disclosure of confidential communications on the other.[19] The stockholders-

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See also McCORMICK ON EVIDENCE, *The Client's Privilege: Communications Between Client and Lawyer* § 98 (1954).

11 8 WIGMORE, EVIDENCE § 2296, 2300 (3d ed. 1940).

12 *See* 58 AM. JUR., *Witness* § 515 (1948).

13 8 WIGMORE, EVIDENCE § 2312 (3d ed. 1940).

14 Clark v. State, 159 Tex. Crim. 187, 261 S.W.2d 339 (1953); United States v. Bob, 106 F.2d 37 (2d Cir. 1939), *cert. denied*, 308 U.S. 589, 60 S. Ct. 120, 84 L. Ed. 493 (1939); *In Re* Sawyer's Petition, 229 F.2d 805 (7th Cir. 1956).

15 Grand Trunk Western R.R. v. H.W. Nelson Co., 116 F.2d 823 (6th Cir. 1941); Hoffman v. Labritzbe, 289 N.W. 652 (Wis. 1940).

16 United States v. Louisville & Nashville R.R., 236 U.S. 318, 35 S. Ct. 363, 59 L. Ed. 598 (1915); Schwimmer v. United States, 232 F.2d 855 (8th Cir. 1956), *cert. denied*, 352 U.S. 833, 77 S. Ct. 48, 1 L. Ed.2d 52 (1956); Civil Aeronautics Board v. Air Transport Association of America, 201 F. Supp. 318 (D.D.C. 1961). *See also* 98 A.L.R.2d 241 (1964).

17 Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 956 (1956).

18 *Id.* at 958.

19 Garner v. Wolfinbarger, 430 F.2d 1093, 1101 (5th Cir. 1970). *In addition*, the instant case posed several issues. *First*, it is a consolidation of cases: Garner v. Wolfinbarger, Garner v. Grooms, #26168, which dealt with the availability or non-availability of the privilege and an order of transfer from the Northern District of Alabama to the Southern District, and First American Life Insurance Co. v. Garner, #26266. *Second*, the court had to determine if federal or state law was to be applied. With respect to the orders of transfer, the court determined that the issue shall be determined in a separate proceeding; and a separate opinion would be rendered.

The Fifth Circuit Court then determined that the question involved presented a federal question with state aspects and stated:

> The order of the District Court appears to treat Alabama standards as controlling.
>
> We conclude that the choice of law cannot be settled by reference to any simple

plaintiffs contend that a corporation may claim the privilege except in a suit between the stockholders of a corporation and the management.[20] They contend that a corporate counsel represents the corporation in its entirety, and:

> [P]ermitting the privilege to be invoked by the corporation against its own stockholders would permit the concealment of communications with attorneys from the very person paying for the attorney's services.[21]

The corporation contends that management and stockholders are separate, and in actual practice the attorney represents the corporate management. The privilege therefore, is absolute and always exists, regardless of the circumstances.[22]

In reaching its decision that the privilege did not exist in a suit between stockholders and corporate management, the district court, using Alabama's Reception statute,[23] relied upon two English cases, *W. Dennis & Sons v. West Norfolk Farmer's Manure and Chem. Co-Operative Co.*,[24] and *Gourund v. Edison Gower Bell Telephone Co.*[25]

The Fifth Circuit took note of the district court's reliance on these cases by stating that there are obligations running between a corporation and its shareholders which must be taken into consideration when viewing the attorney-client privilege.[26]

The American Bar Association, appearing as *Amicus Curiae*,[27] sup-

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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.

The court went on to state that:

> Such actions are predicated on Federal law embodying federal policies. Enforcement of those policies demands that the federal courts apply their own rules of privilege where substantial state interests are not infringed.

20 Garner v. Wolfinbarger, 430 F.2d 1093, 1097 (5th Cir. 1970).

21 *See* Reply Brief for Appellants-Petitioners and Cross-Appellees, A. L. Garner, *et al.* p. 12.

22 Garner v. Wolfinbarger, 430 F.2d 1093, 1097 (5th Cir. 1970).

23 CODE OF ALA. TIT. 1 § 3 (1940) which provides:

> The common law of England, so far as is not inconsistent with the constitution, laws and institutions of this state, shall, together with such instructions and laws, be the rule of decisions, and shall continue in force, except as from time it may be altered or repealed by the legislature.

24 [1943] Ch. 220. Here, discovery was sought of a report prepared by an accounting firm for a corporate client. The English court allowed the discovery, treating the relationship between the company and the shareholders as being analogous to that which exists between beneficiaries and trustees.

25 57 L.J. Ch. 498, 59 L.T. 813 (1888). Here the plaintiff-stockholders wanted to inspect documents prepared by attorneys for the corporation. The court granted the stockholders the right to inspect.

26 Garner v. Wolfinbarger, 430 F.2d 1093, 1102 (5th Cir. 1970).

27 The A.B.A. filed an *Amicus Curiae* brief in support of the corporation-appellants. They rely upon *In Re* Prudence-Bonds Corp., 76 F. Supp. 643 (E.D. N.Y. 1948) where certain bondholders brought an action for an accounting against the Guaranty Trust Co., acting trustee of the bondholders. The court held that opinions of counsel which had been rendered to the trustee would not be disclosed to the bondholders, stating that if the privilege were unavailable to the trustee, both attorney and bondholders might ultimately be harmed.

ports the view of absolute privilege. The A.B.A. urges when a confidential communication between attorney and client is involved, the policy of encouraging corporate officials to speak freely with their lawyers outweighs the stockholders' need to know corporate affairs. They allege that the harm done to both attorney and client outweighs the benefits of disclosure.

> If counsel can render an unqualifiedly favorable opinion, such an opinion can be written without significant fear of harm or embarrassment to the client if later made public. But when counsel believes, in good faith, that a particular transaction is not lawful, the cause of justice is best served by allowing counsel to state his opinion as fully and forthrightly as possible, without fear of later disclosure to parties seeking to attack the transaction in the event that counsel's advice is not followed or is followed only in part.[28]

A case supporting the A.B.A. position but not relied on by the Fifth Circuit is *Graham v. Allis-Chalmers Manufacturing Co.*[29] This was a derivative action on behalf of the corporation by shareholders against directors and four non-director managers for damages allegedly sustained by the corporation by reason of anti-trust violations. Shareholders urged as error, refusal of the Vice Chancellor to order production of statements taken from the defendants by an attorney in an investigation to determine if the acts were anti-trust violations. The court denied production on the ground that it would violate the attorney-client privilege.

In reaching its decision, the circuit court relied upon the Colorado decision of *Pattie Lea, Inc. v. District Court.*[30] This proceeding was brought by several corporations for a writ of prohibition to prevent the taking of depositions of their C.P.A. and corporate director. The corporation claimed that these depositions violated the accountant-client privilege. The court held that the statutory privilege against disclosing confidential communications made between a corporate client and its accountant[31] did not protect the corporations from being required to disclose those communications to its own stockholders in a good faith derivative suit brought by them against the corporation.

The Fifth Circuit summarized its holding by stating:

> [W]here the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of

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28 *See* Brief of A.B.A. as *Amicus Curiae*, at p. 17.
29 188 A.2d 125 (Del. 1963).
30 423 P.2d 27 (Colo. 1967) en banc.
31 7 C.R.S. 154-1-7(7) (1963).
A certified public accountant shall not be examined without the consent of his client as to any communications made by the client, to him in person or through the media of books of account and financial records, or his advice, reports or working papers given or made thereon in the course of professional employment. . . .

> those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show *good cause* why it should not be invoked in the particular instance.[32]

The court then established nine indicia to aid the trial court in determining the presence or absence of *good cause:*

> 1) the number of shareholders and the percentage of stock they represent;
> 2) the bonafides 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, or it is of action criminal, or illegal but not criminal, or of doubtful legality;
> 6) whether the communications 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;
> 9) (and) the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.[33]

This holding appears to have created a new exception to the attorney-client privilege in addition to the traditional exceptions of communications made in contemplation of fraud or crime, and communications made by joint-clients. The new exception applies to corporations and will deny them the right to claim the privilege where the shareholders can show *good cause* why the privilege should not exist. The A.B.A. apparently felt that good cause was not sufficient grounds for a new exception. Possibly, the A.B.A. felt that this would weaken the attorney-client privilege and start a trend of exceptions which would soon render the privilege meaningless.

The ruling of the instant case has also left several issues unanswered. All written communications of attorney are not protected, for if they were, this could provide a sanctuary for all business records of the corporate client. The privilege should apply to the extent that communications are related to legal advice but not where they touch primarily on matters of business.[34] The court in the instant case did not

32 Garner v. Wolfinbarger, 430 F.2d 1093, 1103 (5th Cir. 1970) (emphasis added).
33 *Id.* at 1104.
34 United States v. Vehicular Parking, Ltd., 52 F. Supp. 751 (D. Del. 1943).

distinguish the communications of Schweitzer as business related or purely legal. Such a determination would be essential to the question of the corporate-attorney privilege. Neither does the court distinguish between the different types of shareholders' actions. These actions may be divided into three general categories: (1) derivative actions, (2) individual actions, and (3) representative actions.[35] A shareholder's derivative action is an action brought by one or more shareholders of a corporation to enforce a corporate right or to prevent or remedy a wrong to a corporation in cases where the corporation refuses or fails to take appropriate action, because it is controlled by the wrongdoers or for other reasons.[36] An individual action results where one or more shareholders sue the corporation for their own benefit, after they have sustained a loss separate from other shareholders. A representative action is based upon a primary or personal right belonging to the plaintiff-stockholders and those of their class.[37] Shareholders may maintain an action in their own names for an injury directly affecting them, even though the corporation may also have a cause of action growing out of the same wrong, where it appears that a violation of some special duty owed the stockholders resulted in the harm.[38] Would the attorney-client privilege be subject to different tests depending on the type of shareholder-actions brought against the corporation? If the privilege is subjective, then it would seem to have less reason to exist, if any, in a shareholder's derivative suit brought strictly for the benefit of the corporation; and a greater reason to exist if the suit were strictly for the sole benefit of one or more shareholders. In *Weck v. District Court of 2nd Judicial District*,[39] the court held that communications made by a corporation to its C.P.A. were privileged in a class action brought by some of its shareholders in their *own right*, and not in the *right of the corporation.*

The court did not specify whether Schweitzer was a "house" or retained counsel. Corporate attorneys are often employees, directors or officers of their client-corporations. They often participate in business decisions, and usually do not confine themselves to purely legal matters. A corporate attorney may be a "house" counsel. This is a common arrangement where a corporation hires an attorney, who receives a salary, uses corporation facilities and works only for the corporation. He deals with the company's legal problems wherever

35 19 AM. JUR. 2d, *Corporations* § 523 (1965).
36 Schreiber v. Butte Copper and Zinc Co., 98 F. Supp. 106 (S.D. N.Y. 1951).
37 Schultz v. Mountain Telephone Co., 72 A.2d 287 (Pa. 1950).
38 Funk v. Spalding, 246 P.2d 184 (Ariz. 1952). This is the situation which exists in the present case. The stockholders brought suit against the corporation, for the benefit of themselves, although the harm allegedly resulted to not only them, but to the corporation and even the general public.
39 408 P.2d 987 (Colo. 1965).

they may arise. Numerous cases treat a "house" counsel the equivalent of a retained attorney for the purposes of the privilege.[40] A retained counsel is one whose services are sought as needed and who may be self-employed or employed by a law firm. It would seem that the shareholders' contention in the instant case, that the attorney works for both the management and the shareholders, would have more viability in situations where communications were made to a "house" counsel, rather than to a retained counsel. A "house" counsel would appear to be more of an "employee" than would a retained counsel. However, the court did not concern itself with this question.

A final issue which the court did not delve into is the difference of privileged communications versus "work product" of an attorney. Privilege pertains to communications between a client and an attorney with respect to legal advice and it cannot be waived except by consent of the client. Work product concerns file material of an attorney, concerning litigation, or pending litigation, and it may be compulsorily disclosed upon judicial order.[41] In *Ortiz v. H.L.H. Products Co.*,[42] plaintiffs entered a motion to compel production of photographs and statements made to attorneys of defendant corporation. The court held that plaintiffs in diversity action who established that defendants had facts in their possession which were unavailable to plaintiffs and who demonstrated *good cause* for production were entitled to an order requiring production and this information was not protected by a state doctrine protecting attorney work product. Thus it can be seen that the work product of a corporate attorney in preparation of a pending litigation can be produced upon *good cause* shown.[43]

The ruling of the instant case may effect a drastic change in the attorney-corporate client relationship, or it may prove to be of little consequence. The court held that the privilege still has viability. However, if *good cause* exists and can be shown, the privilege will be overcome. The courts seems to straddle the issue and come up with a holding which lies somewhere between absolute privilege and no privilege. The court laid out nine indicia which will *aid* the trial court in determining whether *good cause* exists to overcome the privilege. These general guidelines, although designed to aid the lower courts, lack that necessary degree of specificity essential to any judicial ruling.

William Palmer

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40 United States v. United Shoe Machinery Corp., 89 F. Supp. 357 (D. Mass. 1950); Georgia-Pac. Plywood Co. v. United States Plywood Co., 18 F.R.D. 463 (S.D. N.Y. 1956); Connecticut Mut. Life Ins. Co. v. Shields, 16 F.R.D. 5 (S.D. N.Y. 1954); Scourtes v. Fred W. Albrecht Grocery Co., 15 F.R.D. 55 (N.D. Ohio 1953).

41 Hickman v. Taylor, 329 U.S. 495, 67 S. Ct. 385, 91 L. Ed. 451 (1947).

42 39 F.R.D. 41 (D.C. Del. 1965).

43 Courteau v. Interlake S.S. Co. 1 F.R.D. 525 (N.D. Mich. 1941).