

ETHICALLY SPEAKING

A Tale of Two Privilege Rules



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by *Scott B. Garner*

Under California law, the attorney-client privilege is nearly sacrosanct, to be circumvented only under narrow, statutorily expressed circumstances. But how can a lawyer—even one practicing in California—be confident that California’s privilege rules even will apply? Suppose, for example, that a lawyer is in a federal, or even a state, court in Orange County, litigating both federal and state law issues. Will the court apply state privilege laws or federal common law, and does it matter?

While the answer to the first question will depend on the issues underlying the dispute, the answer to the second question likely is a resounding “yes.” That was made clear recently in the case of *United States v. Rueble*, 583 F.3d 600, 608 (9th Cir. 2009), where the Ninth Circuit reversed the District Court on an important privilege issue because the District Court committed a “fundamental flaw” by applying state privilege law rather than federal common law. As the court pointed out, in contrast to California state law, which aggressively protects privileged communications between a lawyer and his client, under federal common law,

“[t]he attorney-client privilege is strictly construed.” *Id.* at 607. Moreover, “[t]he party asserting the privilege bears the burden” of proof. *Id.* at 608.

Indeed, a recent Fourth Appellate District case bluntly captured the federal common law attitude toward the attorney-client privilege through the following quote from a Fourth Circuit federal case: “[T]he privilege remains an exception to the general duty to disclose. Its benefits are all indirect and speculative; its obstruction is plain and concrete. It is worth preserving for the sake of a general policy, but it is nonetheless an obstacle to the investigation of the truth. It ought to be strictly confined within the narrowest possible limits consistent with the logic of its principle.” *Regents of Univ. of Cal. v. Super. Ct.*, 165 Cal.App.4th 672, 680 n.5 (2008) (internal citations omitted). With this summary of the attitude taken by some federal courts toward the attorney-client privilege, it would be difficult to argue that a determination of whether a communication is privileged would not be impacted by whether state or federal law were applied.

One area where these important differences between state and federal privilege laws have played out is shareholder derivative actions.

In the corporate setting, a lawyer’s client is the corporation itself, and not the shareholders. In the case of a shareholder derivative action, however, a shareholder is seen as standing in the shoes of the corporation, seeking recovery on the corporation’s behalf. For that reason, federal courts generally have found that the attorney-client privilege may not be asserted by a corporation or its lawyer to block disclosure to a shareholder asserting a derivative claim.

The seminal federal case on this issue is *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970). Although a Fifth Circuit case decided over 40 years ago, *Garner* remains good law and is cited approvingly by federal courts throughout the country. In *Garner*, applying federal law, the court held that a shareholder asserting a derivative claim against a corporation or its lawyer could gain access to otherwise privileged communications upon a showing of good cause. *Id.* at 1103–04. *Garner* has been applied by many courts in a number of different contexts to overcome the attorney-client privilege. See, e.g., *Arcuri v. Trump Taj Majal Assocs.*, 154 F.R.D. 97, 105–06 (D.N.J. 1994); *Addington v. US Airline Pilots Ass’n*, No. CV08-1633-PHX-NVW, 2009 U.S. Dist. LEXIS 14939, at **3–4 (D.Az.

Feb.11, 2009). It has been flatly rejected, however, by California state courts.

Most recently, a state court reaffirmed California’s rejection of the *Garner* doctrine in *Favila v. Katten Muchin Rosenman LLP*, 188 Cal.App.4th 189 (2010). In *Favila*, the estate of a corporation’s founder and shareholder sued, among others, the corporations’ outside corporate counsel for professional malpractice and related causes of action. Unlike in *Garner* and similar federal decisions, the attorney-client privilege between the lawyer and the corporation could not be waived by the shareholder-plaintiff; thus, absent a waiver by the corporate client itself—which was not given—the lawyer-defendant could not disclose his confidential advice to his client (the corporation) as part of his defense of the malpractice action. *Id.* at 218. (“The corporation, not the shareholder, is the holder of the privilege and the only party that can waive the privilege. Thus, the filing of a derivative action against outside counsel does not result in a waiver of the corporation’s attorney-client privilege.”) (internal citation omitted). This left the lawyer without the ability to testify about advice he gave to the corporation, which he claimed was central to his defense in the malpractice action.

Faced with this dilemma—that is, a defendant potentially unable to defend himself without disclosing attorney-client privileged communications—the court sided with preservation of the privilege, disallowing a claim of waiver based on the filing of the derivative action. *Id.* at 221–22. The result, however, turned out to be not so bad for the lawyer. In ruling on the lawyer’s demurrer, the court conditionally stayed the action against him until the shareholder-plaintiff could demonstrate that the attorney-client privilege had been waived by some other means (e.g., by the crime-fraud exception). *Id.* If the shareholder could not establish a waiver, he could not proceed in his lawsuit against the corporation’s counsel. *Id.*

This seemingly harsh result is hardly an outlier, but rather is consistent with California precedent. In *McDermott, Will & Emery v. Super. Ct.*, 83 Cal.App.4th 378 (2000), for example, the court issued a peremptory writ of mandate directing the trial court to grant judgment on the pleadings in favor of the law firm defendant because, absent a waiver of the attorney-client privilege by the law firm’s corporate

client, the law firm could not fairly defend itself against a shareholder derivative action. *Id.* at 383–85. The court expressly rejected *Garner* and similar federal cases that have created judicial exceptions to the attorney-client privilege, stating that, “[u]nlike some courts, California courts have refused to carve out a shareholder exception to the attorney-client privilege, even in a derivative action.” *Id.* at 385; see also *Dickerson v. Super. Ct.*, 135 Cal.App.3d 93, 99 (1982) (rejecting *Garner* rule because that court was empowered by Federal Rule of Evidence 501, whereas California courts may not create new privileges or exceptions).

The shareholder derivative lawsuit context is just one of many in which state and federal law differs significantly on application of the attorney-client privilege. Lawyers and clients alike need to be aware of which set of rules is likely to be applied in a given case, as the choice of law very well could be determinative of whether a confidential attorney-client communication ultimately is kept confidential, or disclosed for the world to hear.



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