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SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

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Directors and Waiver of the Attorney-Client Privilege

Individuals who sit on boards of directors often wear several hats at the same time, whether sitting on more than one board or holding fiduciary positions with multiple entities. The operation of the attorney-client privilege in the landscape of these varying and sometimes shifting relationships between directors and their boards is complex and fraught with risks of inadvertent waiver and ancillary litigation. This is especially the case when the multiple entities served by the same individual become adverse.

In an opinion filed in September 2005 in *American Steamship Owners Mutual Protection & Indemnity Ass'n, Inc. v. Alcoa Steamship Co.*,[1] Magistrate Judge James C. Francis IV of the U.S. District Court for the Southern District of New York examines a number of importan questions relating to the application of the attorney-client privilege when a director has conflicting loyalties, including who precisely enjoys the attorney-client relationship and who controls the application of the privilege.

The Disputed Insurance Claims

American Steamship involved a dispute between a mutual insurance association of ship owners (the Club) and its members, over the extent of the Club's insurance obligations for certain claims asserted against members related to asbestos exposure aboard their vessels. No reserves had been set aside for the claims at issue because of a significant lag in time between when the claims were incurred and when they were reported to the members and to the Club.

As a mutual indemnity association, the Club members insured each other against most liability claims. Until 1989, the Club's practice was to close each insurance year approximately 10 years after the actual end of the year. When it closed an insurance year, the Club would establish reserves for claims that had been reported but not yet resolved. No provision was made, however, for claims that had been

incurred but not reported (IBNR) by the time a given year was closed (IBNR claims). When members of the Club began receiving claims from seamen arising from exposure to asbestos as much as four decades earlier, the Club initially paid those claims from its general reserves, despite the fact that these IBNR claims were not covered by any specific reserves.

The board discontinued this practice in May 2004, announcing that IBNR claims arising in closed policy years prior to 1989 would no longer be covered. When some of the members objected to this change, the Club brought a declaratory judgment action seeking a determination that it was not obligated to pay the IBNR claims, or alternatively, that it be permitted to reopen closed years for the purpose of levying additional assessments to pay such claims.

Privilege Disputes

Two distinct attorney-client privilege disputes arose during discovery, both of which grew out of the fact that individuals who either currently or formerly served on the Club's board of directors also served as officers or employees for individual companies that were constituent members of the Club.

The first dispute concerned two opinion letters authored by the Club's legal counsel around the time that the Club's board voted to discontinue payment of the IBNR claims. Both letters were circulated to the entire board, including to an individual who was also an officer of Farrell Lines, one of the Club members that was adversely affected by the vote and that ultimately became a defendant in the Club's declaratory judgment lawsuit.[2] Although counsel for the Club notified Farrell Lines that the two letters were privileged attorney-client communications and demanded their return, Farrell Lines mistakenly circulated both letters to its co-defendants during the course of discovery. The Club brought a motion for a protective order seeking to bar the defendants' use of these documents because they were privileged. At the same time, it also moved to compel discovery concerning the opinions of counsel for certain member defendants on questions related to the liability for the IBNR claims.

The Client

• ***Who Is the Client—the Entity or Its Board Members?*** Magistrate Judge Francis rejected the defendants' argument that the opinion letters provided to the Club were not subject to the attorney-client privilege, but ultimately found that although the documents were, in fact, privileged, that privilege had been waived with respect to one of the two letters. His rulings on both questions—the existence of the privilege as well as its waiver—turned on his determination that the client enjoying the privilege was the entity rather than the individuals comprising its board of directors.

As an initial matter, the defendants argued that the Club could not assert the privilege to bar its own director from providing the opinion letters to Farrell Lines, arguing that an entity may not invoke the privilege against an individual who was a director at the time the document in question was created. That argument is supported by a line of cases that cast board members as the actual clients of the corporate attorney, and reason that the privilege thus cannot be invoked against those board members. For example, in *Kirby v. Kirby*,[3] the Delaware Chancery Court found that no privilege barred a director from attorney-client documents created during his tenure, because "the directors, collectively, were the client at the time the legal advice was given…[and] consistent with their joint obligations… [should] be treated as the 'joint client' when legal advice is rendered to the corporation through one of its officers or directors." Similarly, in *Gottlieb v. Wiles*,[4] the U.S. District

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Court for the District of Colorado held that a corporation and its directors were analogous to jointly represented parties with a common interest, and that "[w]hen they later become adverse, neither is permitted to assert the attorney-client privilege as to communications occurring during the period of common interest."

Magistrate Judge Francis rejected this joint representation approach, stressing that the "distinction between a board member's personal role and his role as a director is critical in this case." He noted that several cases have rejected the "common interest paradigm," because a board constitutes a single unitary client made up of board members acting in a collective, rather than in an individual capacity,[5] where the individual members enjoy no personal attorney-client relationship or privilege with the corporation's attorneys.[6] Magistrate Judge Francis reasoned that a director may have a legal right of access to communications between a corporation and its attorneys, but with that right comes the obligation to protect the confidentiality of those communications.

In this case, he held that a director of the Club, when acting on behalf of a constituent member could "neither disseminate confidential information he [] received as a Board member nor pierce the privilege to obtain additional information."[7] He concluded that the fact that certain Club directors also had roles in the member entities did not undermine the Club's privilege claim because that information "was provided to them in their capacities as fiduciaries [to the Club]."

Waiver

Magistrate Judge Francis went on to find, however, that the Club had waived the privilege with respect to the earlier of the two letters at issue by disclosing multiple other legal opinions related to the subject matter of that communication. He explained that under the "fairness doctrine," waiver of the attorney-client privilege will occur when a party makes selective disclosures of related communications in a way that renders the disclosure incomplete and misleading.[8] He pointed to the fact that the Club had produced in discovery 16 different opinions of counsel relating to: the closing of insurance years and the Club's ability to assess additional premiums against members for closed years; the coverage of occupational disease claims; the use of the Club's reserves; and the application of deductibles—opinions he found related to one of the letters the Club was seeking to withhold.

He went on to stress that the Club had not only revealed these opinion letters to the defendants, but had made active use of them at the depositions of three former directors of the Club's board. Specifically, counsel for the Club questioned the former board members about apparent inconsistencies between their understandings and opinions and those expressed in the opinion letters they had received as Club board members. Magistrate Judge Francis rejected the Club's attempt to distinguish between legal opinions authored before and after the Club's relationship with the defendant members became adversarial, concluding that its piecemeal disclosure of the opinions was "precisely the type of selectivity that constitutes a waiver."

Magistrate Judge Francis declined to weigh in on the open question of whether such selectivity is itself sufficient to constitute a waiver, or whether some showing that the selectivity was tactical or unfair is also required-before waiver will be found.[9] He held that the Club's selective disclosure was "plainly tactical" and put the defendants at a disadvantage. Specifically, he noted that although the Club had been able to suggest certain inconsistencies between the deponents' testimony and the legal advice received by the board—and with the positions they may have taken while members of the board, "the defendants have been deprived of information about the extent to which that legal advice remained uniform over time." He concluded the defendants were entitled to know all of the legal opinions expressed by the Club's counsel to the extent that the Club was arguing that those board members did follow or should have followed that legal advice.

In 'American Steamship,' the judge examined questions relating to the application of the attorney-client privilege when a director has conflicting loyalties.

Southern District Judge Lewis A. Kaplan affirmed this ruling over the plaintiff's objection.[10] Stressing that the client in this matter was the Club rather than the individual directors, he held that when the Club elected to disclose and use some of its counsel's legal opinions in the litigation it made a "fateful decision," the consequence of which included a waiver of the privilege with respect to one of the two withheld opinion letters.

No Discovery

• ***No Discovery of Opinion Letters From Members' Counsel.*** In the second discovery dispute, the Club sought to pierce the attorney-client privilege and gain access to opinions provided to certain member defendants by their counsel. It argued, in reliance on the U.S. Court of Appeals for the Fifth Circuit's decision in *Garner v. Wolfinbarger*,[11] that because those members had officers and employees who had also once been directors of the Club, the attorney-client privilege could not be invoked to block the Club's access to documents obtained during the course of its fiduciary relationships with those directors.

Magistrate Judge Francis recognized that the fiduciary exception to the attorney-client privilege established in *Garner* has been applied to prevent a broad array of fiduciaries from obscuring the reasons for their actions by relying on the attorney-client privilege.[12] He found, nevertheless, that the *Garner* doctrine was inapplicable in this case because there was no fiduciary relationship between the Club and the parties asserting the privilege. He noted that while the directors owed a duty to the Club, the Club was not seeking documents from the directors, but rather from the members, who stood in a contractual instead of a fiduciary relationship to the Club. Accordingly, he found no basis for piercing the attorney-client privilege, and denied the Club's motion to compel production of the legal opinions provided to its members.

Conclusion

Both of the discovery motions in *American Steamship* revolved around the fact that by virtue of their positions with multiple entities, certain individuals had obtained access to confidential information from both sides of this litigation. Although their insider status may have given them access to privileged information from both sides, their dual status resulted in the erection of significant barriers across which such information could not pass. For the Club, failure to perceive these barriers resulted in a broad subject matter waiver when it used privileged information in the depositions of its former directors. Similarly, its unsuccessful efforts to obtain privileged information from members by invoking the fiduciary exception to the attorney-client privilege resulted from a blurring of the lines between those entities and their officers and directors.

1. 232 FRD 191 (SDNY 2005).
2. The second letter was not supposed to be circulated to the board member who was also an officer of Farrell Lines, but was distributed to him inadvertently. This circumstance did not play a role in the court's resolution of the dispute over access to these documents.
3. 1987 WL 14862, at *7 (Del. Ch. July 29, 1987).
4. 143 F.R.D. 241, 247 (D. Colo. 1992).
5. *Moore Business Forms, Inc. v. Cordant Holdings Corp.*, 1996 WL 307444, at *4 n.4 (Del. Ch. June 4, 1996).
6. *Dexia Credit Local v. Rogan*, 231 F.R.D. 268, 278 (N.D. Ill. 2004).
7. 232 F.R.D. at 198 (citing *Genova v. Longs Peak Emergency Physicians, P.C.*, 72 P.3d 454, 463 (Colo. Ct. App. 2003); *Milroy v. Hanson*, 875 F. Supp. 646, 650 (D. Neb. 1995)).
8. 232 F.R.D. at 199 (citing, inter alia, *In re Von Bulow*, 828 F.2d 94, 101 (2d Cir. 1987)).
9. Compare, e.g., *United States v. Bernard*, 877 F.2d 1463, 1465 (10th Cir. 1989) (selective disclosure alone triggers broad subject matter waiver); *Bowne of New York City, Inc. v. AmBase Corp.*, 150 F.R.D. 465, 485 (S.D.N.Y. 1993) (same) with *Falise v. American Tobacco Co.*, 193 F.R.D. 73, 85 (E.D.N.Y. 2000) (unfairness required for waiver).
10. *Am. S.S. Owners Mut. Prot. & Indem. Ass'n, Inc. v. Alcoa S.S. Co.*, No. 04 Civ. 4309 (S.D.N.Y. Nov. 1, 2005).
11. 430 F.2d 1093 (5th Cir. 1970).
12. 232 F.R.D. at 201-02 (citing, inter alia, *RMED Int'l, Inc. v. Sloan's Supermarkets, Inc.*, 2003 WL 41996, at *4 (S.D.N.Y. Jan. 6, 2003)).