Delaware's Adoption of Garner — and Practical Ways to Respond

This article was originally published in *Law360* on August 27, 2014.

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On July 23, 2014, the Delaware Supreme Court in Wal-Mart Stores Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW held that plaintiff stockholders, who make a showing of good cause, can inspect documents concerning a corporation's internal investigation even if those documents were otherwise covered by the attorney-client privilege and even if the plaintiffs' inspection demands are made in Section 220 litigation.[1] In so ruling, the Supreme Court expressly adopted the "fiduciary" exception to the attorney-client privilege first announced in a Fifth Circuit appellate decision dating from 1970, Garner v. Wolfinbarger.[2] The court also ruled that Garner does not apply to efforts to protect nonopinion work product, which should be analyzed under Court of Chancery Rule 26(b)(3).

The Garner Exception to the Attorney-Client Privilege

Over 40 years ago, the Fifth Circuit in Garner held that a stockholder, upon a showing of good cause, could overcome a corporation's attorney-client privilege when suing the corporation for acting "inimically" to the stockholder's interests.[3] The plaintiffs in Garner had asserted class claims (under the Securities Act of 1933 and the Securities Exchange Act of 1934, among other statutes), all arising out of a corporation's allegedly fraudulent public offering of stock; the corporation, in turn, had asserted derivative cross-claims against various of its directors, officers and control persons.

Discovery quickly focused on the corporation's president, who at the time of the offering had served as its lawyer. The plaintiffs sought, and the defendants resisted, discovery aimed at the legal advice the then-lawyer had given the corporation about the securities offering. The district court held that the corporation could not invoke the attorney-client privilege. On an interlocutory appeal, the Fifth Circuit vacated the order and remanded, holding that while the corporation could invoke the privilege, the privilege was neither "inflexibly absolute" nor "totally unavailable."[4]

The Garner court aimed to develop a rule between these two extreme positions, balancing the injury resulting from disclosure against the benefit gained in the "correct disposal of litigation." Reasoning that corporate "management has duties which run to the benefit ultimately of the stockholders," the court noted that corporate management, much like the trustee of a trust, often should act "wholly or partly in the interests of others," namely, the shareholders.

Having so ruled, the Garner court remanded, providing a list of

factors that should be considered in determining the presence or absence of good cause, including "the number of shareholders and the percentage of stock they represent ... the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources ... whether the communication is of advice concerning the litigation itself ... [and] the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons."

The court also commended the use of in-camera inspection, oral examination and protective orders, presumably to ensure that the wrong materials are not produced, and that the materials that are produced do not fall into the wrong hands.[5]

Often cited but less often followed, the Garner decision has met with a mixed response. At last check, it has been cited in 373 opinions, of which 41 disapprove it or limit its application.[6] New York courts, for example, apply Garner in both derivative and nonderivative suits.[7] By contrast, California courts "do not recognize Garner" and do not "permit shareholders to discover privileged communications upon a showing of good cause,"[8] on the ground that they "are not free to create new privileges as a matter of judicial policy and must apply only those which have been created by statute."[9]

Academic criticism of the result began even before the Fifth Circuit ruled[10] and has continued to date.[11] As recently as February 2014, a law review article stated that "many commentators are highly critical of Garner, noting that the inconsistencies in applying the exception have often made it difficult for parties to discern whether or not the attorney-client privilege will attach to communications between corporate management and counsel."[12]

Wal-Mart: The Delaware Supreme Court Expressly Adopts the Garner Doctrine

In 2012, the New York Times ran a front-page expose on what it deemed a massive scheme by officers of Wal-Mart's Mexican subsidiary to bribe Mexican government officials, followed by what was said to be a whitewash of an internal investigation that had been stifled by one of the alleged targets of the investigation.[13] In response, the Indiana Electrical Workers Pension Trust Fund IBEW, a Wal-Mart shareholder, requested to inspect corporate documents related to the alleged bribery and its alleged cover-up.

Dissatisfied by Wal-Mart's response, IBEW brought a books-and-records action against Wal-Mart under Delaware General Corporation Law Section 220. Such an action entitles shareholders to review the corporation's books and records for a "proper purpose," often articulated as an investigation of alleged breaches of fiduciary duty, if those documents are "necessary and essential" to accomplish that purpose and "unavailable from another source." IBEW said it sought documents to probe whether there had been a cover-up, to see what Wal-Mart's board had been told, and to ascertain whether, should a derivative action be brought, demand on the board would be futile.

The Delaware Court of Chancery, citing Garner, ruled that the IBEW was entitled to certain documents "known to exist by ... the Office of the General Counsel of Wal-Mart" and otherwise protected by the attorney-client privilege. Affirming the lower court's decision, the Delaware Supreme Court expressly adopted the Garner doctrine, engaging in an analysis of the Wal-Mart facts in the framework of the Garner good-cause factors.

Specifically, the Wal-Mart court held that "the Garner doctrine should be applied in plenary stockholder/corporation proceedings ... [and] Section 220 proceedings," once the plaintiff has established, as a threshold issue, that it is entitled to the scope of document production under Section 220.[14] The court also held that work-product claims should not be judged under Garner but under Court of Chancery Rule 26(b)(3), although the court noted that the two sets of factors "overlap."[15]

The Wal-Mart decision marks the first express adoption by Delaware's Supreme Court of the Garner doctrine, although the court noted that, in the 40 years since Garner, it had twice "tacitly endorsed" the Garner doctrine,[16] and the Court of Chancery had expressly adopted it.[17]

Implications of Delaware's Adoption of Garner — And Practical Ways to Respond

Coming as it does from an influential court in an important state, the Wal-Mart decision may breathe new life into a doctrine that has had less influence and practical consequences than the number of citations to the Garner case might suggest. Although

Wal-Mart involved extraordinary facts unlikely to occur very often, it nonetheless serves as a reminder of the fragility of the attorney-client privilege, at least where the defendant arguably owes, and allegedly has breached, fiduciary duties to the plaintiff.

Many of the Garner good-cause factors examine issues beyond what the defendant can control, such as the number of shareholders suing and the percentage of stock they represent. Certain Garner factors,[18] however, suggest some guidance for those seeking to protect legal advice rendered to corporate clients.

- "the availability of [the information] from other sources ..."

If the plaintiffs can and should conduct their own discovery, courts are unlikely to order the production of privileged material or work product. But where, by spoliation or inadvertence, all nonprivileged sources of the information disappear, the balance may be tipped in favor of production. Put another way, the internal investigation should leave the evidence in place, unless there are very strong reasons to do otherwise. In Section 220 litigation, if the information is available from another source, the court should not even reach the Garner issue.[19]

- "whether the communication is of advice concerning the litigation itself ..."

Wal-Mart suggests that advice about the litigation itself will be protected even if advice about the underlying conduct is not protected.[20] This underscores the advice, often given but often ignored, that one be slow to reduce to writing the results of an internal investigation, at least prelitigation. Sometimes a writing is unavoidable, but if the only rationale for a written report is that the client expects a big book in return for big fees, the temptation to reduce everything to writing should be resisted.

- "the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons."

The point here is double-edged: including trade secrets or other confidential business information in documents may lessen the risk that disclosure will be ordered, but increase the harm if disclosure is ordered.

- "The court can freely use in-camera inspection or oral examination and freely avail itself of protective orders"

Courts rarely relish conducting in-camera inspections, but in an appropriate case nothing demonstrates more concretely the interests at risk if privileged material is ordered to be produced. And if production is ordered, a protective order, and perhaps a stipulation and order that the production, being involuntary, is not a waiver, may help keep the documents from falling into the wrong hands — for example, other plaintiffs or government agencies who could not by themselves properly invoke Garner.

The Wal-Mart court acknowledged that the Garner doctrine fiduciary exception "is narrow, exacting, and intended to be very difficult to satisfy," providing some hope that the doctrine's application in Delaware will be appropriately limited.[21] But no matter how it may be applied in future cases, corporate counsel should consider taking several precautionary steps now: providing written legal advice on an as-needed basis only; diligently marking such writings as attorney-client privileged; where applicable, also marking such writings as attorney work product; and avoiding situations in which the only evidence of an unprivileged fact is a privileged writing.

Endnotes

1 ___ A.3d ___, 2014 WL 3638848 (Del. July 23, 2014). "Section 220 litigation" refers to litigation brought pursuant to Section 220 of the Delaware General Corporation Law, 8 Del. Code § 220, by a stockholder seeking to inspect a corporation's books and records. Such actions often precede shareholder litigation

2 430 F.2d 1093 (5th Cir. 1970)

3 Id. at 1100-04 ("[W]here the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of 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 cause why it should not be invoked in the particular instance.").

4 Id. at 1097.

5 Id. at 1097, 1101, 1104.

6 KeyCite, WestlawNext, last accessed Aug. 11, 2014.

7 Stenovich v. Wachtell Lipton Rosen & Katz, 195 Misc. 2d 99, 756 N.Y.S.2d 367 (N.Y. Sup. Ct. 2003); Hoopes v. Carota, 142 A.D.2d 906, 531 N.Y.S.2d 407 (1988), aff'd,, 74 N.Y.2d 716, 543 N.E.2d 73 (1989).

8 Swortwood v. Tenedora de Empresas SA de C.V., 13CV362-BTM (BLM), 2014 WL 895456 (S.D. Cal. Mar. 6, 2014).

9 Id.; Hoiles v. Superior Court, 157 Cal. App. 3d 1192, 1199, 204 Cal. Rptr. 111 (1984) (California does not afford an "extraordinary avenue … to petitioners to pierce the privilege in their capacity as shareholders.").

10 The Attorney-Client Privilege in Shareholders' Suits, 69 Colum. L. Rev. 309, 319 (1969).

11 Stephen A. Saltzburg, Corporate Attorney-Client Privilege in Shareholder Litigation and Similar Cases: Garner Revisited, 12 Hofstra L. Rev. 817, 828, 841-43 (1984); Robert R. Summerhays, The Problematic Expansion of the Garner v. Wolfinbarger Exception to the Corporate Attorney-Client Privilege, 31 Tulsa L.J. 275, 279 (1995); Is the Garner Qualification of the Corporate Attorney-Client Privilege Viable After Jaffee v. Redmond?, 55 Bus. Law. 243, 266 (1999); Craig C. Martin & Matthew H. Metcalf, The Fiduciary Exception to the Attorney-Client Privilege, 34 Tort & Ins. L.J. 827, 844, 846 (1999).

12 Benjamin Cooper, An Uncertain Privilege: Reexamining Garner v. Wolfinbarger and Its Effect on Attorney-Client Privilege, 35 Cardozo L. Rev. 1217, 1220 (2014).

13 "Vast Mexico Bribery Case Hushed Up by Wal–Mart After Top–Level Struggle," N.Y. Times, Apr. 21, 2012.

14 Wal-Mart Stores Inc., 2014 WL 3638848, at *3, *5, *13 (citations omitted).

15 Id. at *13-*14. Though not identically worded, Chancery Rule 26(b)(3) is similar to Fed. R. Civ. P. 26(b)(3).

16 Zirn v. VLI Corp., 621 A.2d 773 (Del. 1993) (decided on grounds other than the Garner doctrine, specifically waiver through partial disclosure); Espinoza v. Hewlett–Packard Co., 32 A.3d 365 (Del. 2011) (the court did not reach the issue of applicability of the Garner doctrine).

17 Grimes v. DSC Commc'ns Corp., 724 A.2d 561 (Del. Ch. 1998).

18 The following bullets all quote from Garner, 430 F.2d at 1104.

19 Wal-Mart Stores, Inc., 2014 WL 3638848, at *11, *13.

20 Id. at *13.

21 Id. at *11.