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The Hennepin Lawyer
A Publication of the Hennepin County Bar Association
February 2001, Vol. 70 No. 2

Will Counsel Please Take the Stand?

THE CONFLICT OF INTEREST/FIDUCIARY EXCEPTION TO THE ATTORNEY-CLIENT PRIVILEGE IN MINNESOTA

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Every lawyer dislikes to take the witness stand and will do so only for grave reasons . . . He regrets it; the profession discourages it.

Justice Robert H. Jackson
Hickman v. Taylor, 329 U.S. 495, 517 (1947)

Attorneys loath testifying, especially against clients. To avoid testifying, attorneys helped create rules that often preclude their testimony. A recent order issued by the Minnesota Court of Appeals, however, reminds attorneys to heed caution. That caution is especially important in a dispute among shareholders in a closely held Minnesota corporation, where courts have long recognized that the controlling shareholders owe the noncontrolling shareholders a fiduciary duty.[1]

After 13 years of silence,[2] in *Miller Waste Mills v. Mackay*, the Minnesota Court of Appeals addressed the attorney-client privilege as it applies to minority shareholders involved in shareholder litigation.[3]

In *Miller Waste Mills*, apparently relying on the fiduciary exception to the attorney-client privilege, the court held that such a minority shareholder can discover legal advice on corporate matters given to management by corporate counsel.[4] Arguably, this order significantly erodes the corporate attorney-client privilege as provided by Minnesota law.

The Fiduciary Exception in Minnesota

There exists considerable uncertainty regarding the scope and the appropriate application of the fiduciary exception in Minnesota. While the exception has been amply employed among the various jurisdictions, particularly in federal courts, its application in Minnesota has been infrequent. Moreover, Minnesota courts that have applied the exception have done so with limited comment.

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I. EVANS V. *BLESI*

The corporation's attorneys were consulted by the majority shareholder about issues surrounding a minority shareholder.[5] Attorneys for the corporation's law firm provided advice and prepared documents to be used by the majority shareholder for obtaining the minority shareholder's resignation and taking corporate actions to eliminate the minority shareholder's rights.

In the trial of the claims brought by the minority shareholder against the majority shareholder and the corporation, the minority shareholder called as witnesses the attorneys who advised the majority shareholder. The trial court compelled the attorneys to testify.

The Court of Appeals, citing a Minnesota Supreme Court decision,[6] acknowledged that under Minnesota law a shareholder in a closely held corporation has a "fiduciary duty to deal openly, honestly and fairly with other shareholders."[7] Further, the Court of Appeals endorsed the trial court's determination that when attorneys represent both the corporation and the majority shareholder a conflict of interest exists.[8] Accordingly, the court held that the attorney's communications with a majority shareholder regarding advice on corporate matters were not privileged from the minority shareholder.[9]

The appellate court thus affirmed the trial court's ruling and noted that "[w]e agree with the trial court and view with disapproval and some concern the practice of an attorney representing a client at trial, knowing his partners will be called as witnesses, particularly where calling them is not a mere stratagem by opposing counsel to seize unfair advantage."[10]

II. MILLER WASTE MILLS, INC. V. MACKAY

The corporation brought suit against a minority shareholder, who also served as a corporate director. During the course of discovery, the minority shareholder sought to discover communications between the majority shareholders and corporate counsel. Corporate counsel refused to comply with the discovery request claiming the communications were protected under the attorney-client privilege and, alternatively, under the work product doctrine.[11]

The trial court granted the minority shareholder's motion to compel discovery. In response, the majority shareholder sought a writ of prohibition from the Minnesota Court of Appeals, which was denied. The Court of Appeals determined that the attorney's communications were not protected by the attorney-client privilege.[12] The court, quoting *Blesi*, held that "an attorney representing majority shareholders and the corporation has a duty to advise the minority shareholders regarding corporate matters."[13]

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Wigmore's Balancing Approach to Evidentiary Privileges

The substance and application of the attorney-client privilege and its exceptions digress considerably among the various jurisdictions. Defined generally, the privilege proscribes from discovery certain communications between an attorney and client. In *Upjohn v. United States*,[14] the U.S. Supreme Court extended privilege to communications between a corporation and corporate counsel.

Customarily, the corporate privilege exists where (1) a client (2) makes a communication (3) in confidence (4) to an attorney (5) for the purpose of seeking legal counsel.

Under Professor Wigmore's analysis of evidentiary privileges, withholding relevant evidence from the factfinder creates costs to the legal system.[15] Wigmore argues that evidentiary privileges should be adopted only when the benefit created by the privilege outweighs the cost associated with the loss of evidence.[16]

In favor of adopting a broad corporate privilege is the predication that the privilege provides considerable social utility by encouraging frank and open communication between management and counsel. Such communication, it is argued, is necessary to survive in the "complicated array of regulatory legislation confronting modern corporations."[17]

In favor of a narrow privilege is the belief that the cost of lost evidence, in the corporate context, is heightened because management can use the privilege as a shield against shareholder inquiry. By strategically channeling sensitive information through corporate counsel, management can effectively maximize the quantity of privileged material to the detriment of shareholders.[18]

The *Garner* Rule

In the landmark case *Garner v. Wolfinbarger*,[19] the Fifth Circuit Court of Appeals carved out a qualified attorney-client privilege within the context of shareholder derivative suits from what was previously thought to be an absolute privilege.

The case involved a class action suit brought by shareholders. The complaint alleged violations of federal securities laws, common law fraud, and a derivative claim brought on behalf of the corporation. During the course of discovery, the plaintiffs sought to discover the contents of communications between the corporation and corporate counsel concerning the issuance and sale of stock. After the corporation refused to comply with the request, the plaintiffs sought and obtained an order to compel discovery. The trial court's order was appealed.

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The Fifth Circuit began its analysis with Wigmore's traditional balancing approach.[20] The court weighed the benefits connected to granting attorney-client privilege protection to communications between the corporation and corporate counsel against the shareholders' interest in obtaining vital evidence of corporate improprieties. The court acknowledged the advantage gained by protecting the communications, stating "corporate management must manage . . . Part of the managerial task is to seek legal counsel when desirable, and, obviously, management prefers that it confer with counsel without the risk of having the communications revealed at the instance of one or more dissatisfied stockholders."[21] Nonetheless, the court was moved by the awareness that "management has duties which run to the benefit ultimately of the stockholders"[22] and therefore concluded that any advantage created by granting the privilege is surpassed by the shareholder's interest of ensuring that "management judgment . . . stand on its merits, not behind an ironclad veil of secrecy which under all circumstances preserves it from being questioned by those from whom it is, at least in part, exercised."[23]

While the *Garner* court rejected a broad application of the attorney-client in the context of shareholder disputes, it also disfavored a complete abrogation of the privilege in this context. Accordingly, the court announced a qualified privilege whereby a shareholder must satisfy a two-prong test to overcome the corporation's assertion of privilege.

Under *Garner*, the shareholder must first show that a fiduciary duty exists.[24] Then, the shareholder must demonstrate that the facts support a showing of "good cause" sufficient to overcome the assertion of the privilege.[25] The court revealed several factors that would determine the presence or absence of good cause: (1) the number of shareholders (plaintiffs) and the percentage of stock they represent; (2) the legitimacy of the claim; (3) the apparent necessity and availability of the information; (4) whether the alleged conduct is illegal; (5) whether the communication related to past or prospective actions; (6) whether the communication is for advice concerning the litigation itself; (7) the extent to which the communication is identifiable and not a fishing expedition; and (8) the risk of revealing trade secrets or information that is necessary to keep confidential for other reasons.[26]

Applying this test, the Fifth Circuit determined that the first prong was satisfied because a fiduciary duty between the corporation and the plaintiff shareholders did exist. The case was remanded for a determination under the second prong, whether the plaintiff could demonstrate good cause to overcome the assertion of privilege.

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After *Garner*

The *Garner* exception has procured substantial support in both federal and state courts. While a few courts have limited the circumstances in which the exception is available,[27] generally, it is applied broadly.

The frequent use of the exception has not resolved the uncertainty associated with it. Consistently, courts and commentators struggle with determining to whom the exception should apply.

Within the corporate context, it is unclear whether the exception applies to non-derivative suits or whether it is limited to derivative actions. The *Garner* court did not distinguish whether a fiduciary duty is owed to the shareholders collectively or individually. On this issue, courts are split. On the one hand, some courts follow the Ninth Circuit's lead subscribing to a narrow view of when the exception is available and will not apply it to non-derivative actions.[28] On the other hand, endorsing the Fifth Circuit view, some courts apply the privilege to non-derivative actions arguing that the presence of good cause, rather than the nature of the claim, should control the inquiry.[29] Finally, adopting a middle-ground approach, some courts do not rigidly preclude the use of the exception in non-derivative actions, but will use the non-derivative status as a factor in the good cause determination.[30]

It is also unclear whether the exception should be limited to shareholder lawsuits. Notably, it is recognized that while the *Garner* court expressly based its decision on the unique relationship and obligations that run between the corporation and its shareholders, the court did not use the term "fiduciary." Notwithstanding, it is clear that the logic underlying the *Garner* exception is equally germane to analogous fiduciary relationships outside the shareholder context. Thus, if the *Garner* exception is premised on the existence of a fiduciary relationship, it might be applied in all instances where either a statutory or a common law fiduciary duty exists. To this end, courts adopting a broad application of the *Garner* exception have created a broad fiduciary exception that applies in a wide range of contexts.[31]

The Work Product Protection

Separate from the attorney-client privilege, the work product protection exists to protect the work and the mental impressions of the attorney where the work was prepared primarily for the purpose of litigation. In Minnesota, the work product doctrine has been codified in Minn. R. Civ. P. 26.02(c).

This rule protects against discovery of "documents and tangible things" which are "prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative." *Id.*; *see also* Hickman v. Taylor, 329 U.S. 495 (1947). The work product doctrine does not extend to hide facts or communications. Mead Corp. v. Riverwood Natural Resources Corp., 145 F.R.D. 512, 518 (D. Minn. 1992); Eoppolo v. National R.R. Passenger Corp., 108 F.R.D. 292, 294 (E.D. Pa 1985). For documents to be considered work product, they must be prepared in anticipation of litigation. Minn. R. Civ. P. 26.02(c). If a party fails to meet its burden to establish that the documents were not prepared in anticipation of litigation, courts will find that the work product doctrine does not protect the documents. *See* Sandberg, 979 F.2d at 355-56; Gregory v. Correction Connection, Inc., 1990 WL 182130 (E.D. Pa. Nov. 20, 1990).

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To meet its burden of showing the documents were prepared in anticipation of litigation, a party claiming work product protection must show "[t]he document was prepared *because* of the prospect of litigation when the preparer faces an actual claim or a potential claim following an actual event or series of events that reasonable could result in litigation." *See* Sandberg, 979 F.2d at 356 (quoting National Union Fire Ins. Co. v. Murray Sheet Metal Co., 967 F.2d 980, 984 (4th Cir. 1992). Documents prepared in the ordinary course of business or for other non-litigation purposes do not meet this test. *Id.* For example, the defendant corporation in *Sandberg* did not meet its burden to show that its general counsel's notes taken at a meeting with corporate officers to discuss an upcoming merger were prepared in anticipation of litigation. *Id*. at 356. The court noted that "[t]he mere fact that a lawsuit was pending does not transform an attorney's notes into material prepared in anticipation of litigation." *Id*.

In *Miller Waste Mills v. Mackay*, the court addressed the availability of the work product protection where the attorney-client privilege was lost due to the conflict of interest/fiduciary exception.

The court stated that it was unaware of any "controlling authority that precludes a corporation or majority shareholders engaged in litigation with a minority shareholder director from asserting work product privilege as to materials prepared in anticipation of litigation or materials that reveal opinions, legal theories, and strategies of counsel regarding pending litigation."[32] The matter was remanded for consideration and a decision on the assertion of the work production privilege.

Present State of the Law in Minnesota

At present, the proper application and scope of the conflict of interest/fiduciary exception to the attorney-client privilege in Minnesota is unsettled. Application of the exception without commentary that establishes definitive limitations arguably creates an inference that Minnesota has adopted a broad application.

Because neither *Blesi* nor *Miller Waste Mills* involved derivative claims, the exception may not be restricted to derivative claims in Minnesota. Minnesota state courts have not expressly adopted or rejected *Garner*.

It could be argued that Minnesota rejected the *Garner* limitations. Neither the *Blesi* court nor the *Miller Waste Mills* court cited *Garner* and neither court applied *Garner's* "good cause" analysis. Instead, both courts seem to have based their determinations on the existence of a conflict of interest coupled with a fiduciary relationship between the clients. In the absence of the limitations, one could conclude that in Minnesota corporations are per se precluded from asserting privilege against shareholders with respect to communications involving corporate majority/controlling shareholders to have their own lawyers—separate from the corporation's lawyers—from whom they can communicate under the unquestioned protection of the attorney-client privilege.

Finally, if Minnesota courts have premised the exception on the existence of a fiduciary relationship, it is reasonable to assume that it may be applied outside the corporate context. This means that the attorney-client privilege may be eviscerated in any context where a statutory or common law fiduciary duty exists.

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Closing

Corporate counsel should, where the interests of the minority and the majority differ, consider whether to represent both the majority shareholders and the corporation.

Counsel who determines to represent both the controlling shareholders and the corporation should be mindful that he or she may hear these words: "May counsel please take the stand."

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[1] Evans v. Blesi, 345 N.W.2d775 (Minn. Ct. App. 1983). A recent Minnesota case has held that the fiduciary obligation does not necessarily flow the other way. However, in Advanced Communicut Design, Inc. v. Follet, __N.W.2d__ (Minn. Aug. 3, 2000) C1-99-778, the Minnesota Supreme Court held that a shareholder owning only non-voting shares in a closely held corporation does not owe a fiduciary duty to the corporation or the other shareholders; 601 N.W.2d 707 (Minn. App., 1999), review granted Jan. 18, 2000. The Minnesota Court of Appeals ruled that a noncontrolling shareholder does not owe a fiduciary duty to the controlling shareholders.

[2] In Minnesota, the fiduciary exception to the attorney-client privilege was first recognized in Evans v. Blesi, 345 N.W.2d 775, (Minn. Ct. App. 1983). No subsequent published opinions address the exception.

[3] *Miller Waste Mills v. Mackay*, C4-97-1354 (Minn. Ct. App. 1997).

[4] *Id*.

[5] *See* Evans v. Blesi, 345 N.W.2d at 778.

[6] *See* Fewel v. Tappan, 27 N.W.2d 648, 645 (Minn. 1947); *see also* Minn. Stat. 302A.751.

[7] *See* Blesi, 345 N.W.2d at 779.

[8] *Id*. at 780-81.

[9] *Id*.

[10] *Id*. at 781.

[11] *See* Minn. R. Civ. P. 26.02(c).

[12] Mackay, C4-91-1354 (Minn. Ct. App. 1997).

[13] *Id*.

[14] *Upjohn v. United States*, 449 U.S. 383, 389 (1981).

[15] J. Wigmore, *Evidence in Trials at Common Laws*. 2192, at 73 (1961).

[16] *Id*. s. 2285, at 571.

[17] *Upjohn*, 449 U.S. at 389.

[18] *See* 24 Charles Alan Wright & Kenneth A. Graham, Jr., *Federal Practice and Procedure* 5472 (1986).

[19] *See* Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970).

[20] *Id*. at 1101.

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[21] *Id*.

[22] *Id*.

[23] *Id*.

[24] *Id*. at 1102 (recognizing that "there are obligations, however characterized, that run from corporation to shareholder that must be given recognition determining the applicability of the privilege").

[25] *Id*. at 1103-04.

[26] *Id*. at 1104.

[27] *See* e.g. Weil v. Inv., Indust. Research & Mgt., 647 F.2d 18 (9th Cir. 1981).

[28] *Id*.

[29] *See* Ward v. Succession of Freeman, 854 F.2d 780 (5th Cir. 1988).

[30] *See* Fausek v. White, 965 F.2d 126 (6th Cir. 1992).

[31] *See* Petz v. Ethan Allen, Inc., 113 F.R.D. 494 (D. Conn. 1985) (applying the fiduciary exception to pension plan beneficiary context); Fortson v. Winstead, McGuire Sechrest & Minnik, 961 F.2d 469 (4th Cir. 1991) (limited partnership context); Nellis v. Air Line Pilots Ass'n, 144 F.R.D. 68 (E.D. Va. 1992) (union membership context); Kush & Assoc., Ltd. v. Wein Geroff Ent., Inc., No. 85C493, 1986 WL 15120 (N.D. Ill. Dec. 31, 1986) (insurer/insured context); Western Gas Processors, Ltd. v. Enron Gas Processing Co., No. 87-A-1427, 1989 WL 20529 (D. Colo. Mar. 6, 1989) (joint venture relationship context); Quintel Corp. v. Citibank, 567 F.Supp. 1357 (S.D.N.Y. 1983) (contractual context).

[32] *Id*. Several courts have held that the exception does not apply to work product materials. *See In re* International Systems, 693 F.2d 1235 (5th Cir. 1982).

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Disclaimer: The article was first published in the February 2001, Vol. 70 No. 2 issue of *The Hennepin Lawyer*, a publication of the Hennepin County Bar Association.

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