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## Pa. Supreme Court Refuses to Narrow Attorney-Client Privilege in Derivative Cases

*Court says adoption of "good cause" inquiry into exceptions would lead to impermissible uncertainty of the rule*

The Pennsylvania Supreme Court has refused to join several other jurisdictions in accepting a "good cause" inquiry to provide exceptions to the basic rule of attorney-client privilege in derivative action cases. It has held that providing such a "conditional privilege" would reduce the certainty of the attorney-client privilege.

The question has arisen in a derivative action brought by several former directors of a pair of Pittsburgh nonprofits who claimed that they were removed for attempting to challenge the management of the organization's president. They claimed that the others on the board breached their fiduciary duty to the organization by improperly removing those questioning management in a corporate reorganization. They sought to bring a derivative action in the name of the corporation against remaining officers and directors.

Pennsylvania had provided a paradigm for addressing derivative litigation by adopting Sections 7.02-7.10 and 7.13 of the American Law Institute's Principles of Corporate Governance in a 1997 case called *Cuker v. Mikalauskas*. Under that ruling, plaintiffs should present a "demand" to the corporation that it pursue litigation on behalf of the corporation, often against current management. In response, the corporation may establish for an independent committee to investigate the claims and determine whether litigation is appropriate. If it declines and the plaintiffs pursue their own case, the corporation can file a motion to dismiss and the court will review the determination with substantial deference to the business judgment rule.

When the current management in this case filed a motion to dismiss, the plaintiffs sought discovery, including all materials involving the corporations and the corporate counsel that were used in reaching the decision that litigation was not appropriate. The corporation withheld some items, asserting the attorney-client privilege.

The trial court ordered the corporation to provide "all materials provided to or generated by the [Committee], including all related legal opinions and communications." On appeal, the state's Commonwealth Court, the intermediate appellate court, unanimously vacated the trial court decision and remanded for consideration pursuant to a 1970 Fifth Circuit case known as *Garner v. Wolfinbarger*. The Fifth Circuit had set forth nine criteria by which to determine whether the

attorney-client privilege should be withheld. The principles and procedure have been adopted by several other states.

In a lengthy opinion and review, the Supreme Court rejected the position. The Court said that although the ALI Principles mentioned the Garner case in its comments, the ALI had not adopted the Garner principles as its own. The Court refused to adopt the Garner policy, holding “it is inconsistent with the attorney-client privilege under Pennsylvania jurisprudence because it eliminates the necessary predictability of the privilege.”

“Rather than providing clarity and certainty,” the Court wrote, “the Garner test requires attorneys and clients to speculate how a court in the future will weigh the nine subjective and amorphous factors in an attempt to discern whether a derivative plaintiff has brought a sufficient claim to allow the abrogation of the current management’s assertion of the attorney-client privilege in regard to legal advice provided by the corporation’s lawyers. The reality is that this weighing of the factors would result in current managers and the corporation’s attorneys having no meaningful way of determining whether their otherwise privileged communications would be later divulged in derivative litigation discovery. As a result, corporate management would be less willing to discuss issues with corporate counsel, and corporate counsel would caution corporate management not to speak with her candidly. As a matter of simple logic, this will result in corporate managers being forced to act without necessary legal guidance in an already complicated legal environment. We conclude that this is inconsistent with the revered nature of the attorney-client privilege in Pennsylvania, and the clarity of it, which has been codified by our legislature and applied continuously by our courts.”

The Court also rejected the plaintiffs’ attempted use of the fiduciary and co-client exceptions to the privilege. Under the fiduciary exception, the privilege cannot be asserted by a trustee against a trust’s beneficiaries for advice regarding the management of a trust. The Commonwealth Court had rejected that claim on the ground that this case did not involve an actual trust and that a derivative action involving a corporation did not present the same issues.

The co-client exception applies where a single attorney represents multiple clients. The Commonwealth Court said that only the current management should be considered to hold the privilege for the corporation.

The Supreme Court agreed that “the derivative relationship involved in this case does not fit within the construct of either exception.”

It vacated both the trial court and Commonwealth Court opinions and remanded the case to the trial court to reconsider in light of its opinion.

Two “concurring and dissenting” justices argued that the decision was premature on a motion to dismiss. (*Pittsburgh History and Landmarks Foundation v. Ziegler*, Supreme Ct., PA, No. 53 WAP 2017, 1/23/19.)

## **YOU NEED TO KNOW**

This is a mind-numbing issue of relatively narrow import, but the decision should eliminate some confusion in Pennsylvania.