

Delaware Chancery Court Orders Company and Board Committee Counsel to Provide Privileged Communications to Dissident Director

Court also Discusses Means by Which Communications Might be Screened from Specific Directors

By Michael G. O'Bryan

The Delaware Court of Chancery, in *Kalisman v. Friedman* (Apr. 17, 2013), ordered the respective counsels for a company and for a special committee of the company's board of directors to provide to a dissident director copies of their communications with the company's other directors, as well as internal law firm communications. The dissident director was a member of a large stockholder that had announced an intent to nominate a competing slate of directors at the company's next annual meeting, and was a member of the special committee as well as of the board. The communications related to actions taken by the board and the special committee that might otherwise be protected from disclosure to third parties by the attorney-client privilege or the work product doctrine.

BACKGROUND

The opinion arises from the proxy contest and related litigation over Morgans Hotel Group. The dissident director, Kalisman, is a member of a large stockholder, OTK, and was first appointed to the Morgans board early in 2011. Later that year, the board formed a special committee to evaluate strategic alternatives, and Kalisman was put on the committee. No significant alternative was adopted, however, and early this year OTK announced that it would nominate a competing slate of directors for the Morgans board.

The other members of the committee then began preparing for a recapitalization that would put a large voting bloc in new hands and dilute OTK. However, the other directors did not tell Kalisman about the recapitalization until the day before the committee was to meet to approve the recapitalization; prior to that time, when Kalisman asked for information, he was told "nothing was in the works." At the meeting for the approval of the recapitalization the committee formed a subcommittee that did not include Kalisman.

Kalisman sued, and, among other things, sought documents from counsel to the company and the committee. The defendants asserted that the information could be withheld from Kalisman on the basis of attorney-client privilege and the work product doctrine. The court disagreed, and ordered the company and committee counsel to provide the documents and communications (including internal law firm e-mails) to Kalisman, at least for the period until the other directors were able to establish more formally the requisite adversity that cut off his rights to such information.

COURT ANALYSIS

The court noted that a director of a Delaware corporation has an "essentially unfettered" right to information, including a right of "equal access" to information given to other directors. Communications from a company's counsel might be protected from disclosure to third parties by the attorney client privilege or the work product doctrine; however, each director is treated as a joint client of the counsel, reflecting the responsibility of each director for the proper management of the company, and thus should have access to those communications. The court rejected cases from other jurisdictions that purportedly allowed a board majority to invoke attorney-client privilege against a director.

The court noted two circumstances in which a director's access to privileged information might be restricted without the agreement of the director:

- *Special Committee*. Where the board "openly and with the knowledge of" the excluded director forms a special committee that does not include that director. While the communications between the members of the committee and its counsel would then be "properly protected," the extent to which the special committee might be required to update other directors, or provide information to other directors after the committee's work is completed, "has not been fully determined."
- *Adversity*. Where adversity exists between the director and the corporation "such that the director could no longer have a reasonable expectation that he was a client of the board's counsel."

Here, the other directors argued that adversity began after OTK announced that it would propose its own slate of directors. However, the court found that the adversity exception applied only from the date of the meetings of the committee and board at which the committee formed a subcommittee and the board approved the recapitalization, since the other directors had acted in secret and concealed their activities until the later meetings.

The court noted that a director might not have a right to access information if he or she planned to use it improperly. However, that limit did not apply unless the other directors could show that the director planned to use the information improperly, and the other directors did not make such showing.

The court likewise dismissed the claim that Kalisman would share the information with OTK, noting that Kalisman had undertaken not to share privileged information with OTK. Moreover, the court noted that "[w]hen a director serves as the designee of a stockholder on the board, and it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director," though given Kalisman's undertaking the court did not need to elaborate on this principle.

IMPLICATIONS

Directors, and their counsel, should not assume that communications produced by them can be withheld from other directors simply because the other directors are seen as "dissidents." If directors wish to screen specific directors from some communications, without the agreement of those directors, they should consider:

- Establishing an appropriate committee, in an "open" manner so that the other directors are aware of the creation of the committee and its purpose; or
- Relying on the adversity exception, but in that case they also should consider taking appropriate steps to show the adversity and make it clear to the affected directors that they are being so treated.

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