

DELAWARE BUSINESS COURT INSIDER

Director's Access to Company's Privileged Information Upheld Despite Proxy Contest

Where two halves of a deadlocked board are competing in a proxy contest, can one half assert the corporation's privilege against the other?

By **Barry M. Klayman** and **Mark E. Felger** | June 01, 2022



Barry M. Klayman, left, and Mark E. Felger, right. Courtesy photos

Where two halves of a deadlocked board are competing in a proxy contest, can one half assert the corporation's privilege against the other? In *In re Aerojet Rocketdyne Holdings*, C.A. No. 2022-0127-LWW, (Del. Ch. May 5, 2022), Vice Chancellor Lori Will concluded that it could not. The even division of the board meant that neither side could benefit from the company's resources, including its privilege, to the exclusion of the other.

The background of the dispute was somewhat unusual. Disagreements among members of the board had developed over a potential merger agreement with Lockheed Martin. Defendant Drake, a board member and CEO, accused another board member, plaintiff Lichtenstein, the company's executive chairman, of plotting to remove her so the Company could solicit other bidders allegedly to benefit Lichtenstein financially. To address the accusations, the board appointed a nonmanagement committee to investigate. Meantime, the FTC sued to block the Lockheed merger. The board, fearing that the merger would not close and cognizant of the

approaching deadline for submitting director nominations, tried to agree on a slate of nominees but was unsuccessful.

A proxy contest ensued with four incumbent directors including Lichtenstein among the challengers to a slate headed by Drake. The challengers' slate was sponsored by Steel Partners, which held roughly 5.5% of the company's outstanding common stock through an indirect subsidiary. Lichtenstein was the executive chairman of Steel's general partner. On the same day that Steel's affiliate filed an amended Schedule 13D to announce its slate, the defendant board members, without consulting the rest of the board, caused the company to issue a press release and public filings which disclosed the nonmanagement committee's investigation of Lichtenstein and expressed disappointment with his decision to launch a "disruptive" proxy contest. At the same time, the company's longtime outside counsel, Gibson, Dunn & Crutcher, in its capacity as counsel for the company, advised plaintiffs that their actions in connection with the proxy contest breached their fiduciary duty.

Lichtenstein and his fellow directors on the opposition slate instituted suit against the other members of the board. Seeking to maintain the company's neutrality with respect to the proxy contest, they sought to prohibit the company's officers, directors and employees from acting on the company's behalf without board authorization, and to prohibit anyone from acting on the company's behalf to support either slate of nominees so long as the board remained split. Following the commencement of the litigation, the defendants engaged Gibson Dunn to jointly represent them and the company in the dispute with the plaintiffs.

The vice chancellor granted the plaintiffs' motions to expedite and for a temporary restraining order. The TRO required the company and its advisers to remain neutral on issues over which the board was divided, and required Gibson Dunn (and its local Delaware counsel) to withdraw as counsel to the company in the litigation.

The plaintiffs then served document requests on the defendants and a subpoena duces tecum on Gibson Dunn. After the defendants and Gibson Dunn served written responses and objections to the requests, Lichtenstein sought confirmation from the defendants that they would not invoke the company's attorney-client privilege against him (except to protect confidential communications regarding the substance of the investigation by the nonmanagement committee). The defendants refused, and Gibson Dunn said that it believed the subpoena sought documents protected by the attorney-client privilege which it could not waive.

Lichtenstein filed a motion to compel seeking an order requiring defendants and Gibson Dunn to produce documents withheld on the basis of the company's privilege and the company to direct its advisors to produce any information they were withholding on the basis of the company's privilege. He argued that, as a sitting director, he had an equal right to the company's privileged information as did the rest of the board. The defendants argued that the plaintiffs were not entitled to the company's privileged information because they sought it in furtherance of the proxy contest rather than their fiduciary duties, and that the plaintiffs had become adverse to the company. The defendants also argued that the plaintiffs were not entitled to communications subject to a joint privilege between the defendants and the company.

The vice chancellor rejected the defendants' arguments. Under Delaware law, a corporation generally cannot assert the attorney-client privilege to deny a director access to legal advice furnished to the board during the director's tenure. She identified three recognized exceptions to a director's right of access to board information: First, the director can enter into an *ex ante* agreement limiting the director's access to board information; second, the board can form a special committee that excludes a director, retains separate legal counsel, and engages in privileged communications with its counsel to the extent necessary for the committee's ongoing work; and third, privileged information can be withheld from a director once sufficient adversity exists between the director and the corporation such that the director no longer has a reasonable expectation that he is a client of the board's counsel.

At issue in the case was the adversity exception. According to the defendants, the plaintiffs could not have reasonably expected to remain clients of the company's counsel after announcing their intention to be part of a slate challenging some of the current board members. They become adverse to the company because of their alignment with Steel, which the defendants characterized as an activist investor engaged in a takeover attempt. However, the vice chancellor noted that both factions included incumbent directors. It made no sense to treat one faction as hostile to the company and the other as friendly. Both sets of directors were entitled to rely on the company's in-house and outside counsel for legal advice as joint clients.

The vice chancellor found that the defendants' alignment with the company's management did not afford them a greater claim to the company's privilege than the plaintiffs. It would undermine the directors' duty to manage the corporation if one board faction could rely on its association with management to benefit from the protections of the company's legal advice to the exclusion of their fellow directors.

The defendants also argued that the plaintiffs were not entitled to discovery related to Gibson Dunn's joint representation of the company and the defendants in connection with the pending litigation. However, the vice chancellor found a serious question regarding whether the joint defense agreement was validly authorized on the company's behalf given the absence of Board approval. The Delaware Rules of Professional Conduct require that an organization's consent to dual representation had to come from an appropriate official of the organization *other than* the person to be represented or by the stockholders.

The defendants had no greater claim to the company's privilege than the plaintiffs, all of whom were joint clients of the company's counsel. While the plaintiffs and defendants may be adverse to one another in the context of the proxy contest, it did not follow that one faction of the board was adverse to the company because the other was aligned with management. As a result, neither side should benefit from the company's resources, including its privilege, to the exclusion of the other, and plaintiffs were entitled to access the legal advice delivered jointly to the company and the defendants.

A key factor in the result appears to be that the defendants could not convince the vice chancellor that the plaintiffs were adverse to the company as opposed to being adverse only to a faction of the board. It seems equally important that outside counsel aligned itself with one faction of the board, but purported to jointly represent both that faction and the company. The opinion is important not only for what it says about a director's access to a company's privileged

information, but also for what it says about the role of outside company counsel faced with a divided board.

Barry M. Klayman *is a member in the commercial litigation group and the bankruptcy, insolvency and restructuring practice group at Cozen O'Connor. He regularly appears in Chancery Court.*

Mark E. Felger *is co-chair of the bankruptcy, insolvency and restructuring practice group at the firm.*

Page printed from: <https://www.law.com/delbizcourt/2022/06/01/directors-access-to-companys-privileged-information-upheld-despite-proxy-contest/>

Copyright 2022. ALM Global, LLC. All Rights Reserved.