WILMERHALE

Privilege Standing Committee Update

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Third Circuit Declines to Apply the Fiduciary Exception to Certain Health Insurance Providers

As an issue of first impression, the Third Circuit recently considered whether beneficiaries of an employer-sponsored health care plan can discover otherwise privileged legal advice communicated to the plan's external administrators. The decision in *Wachtel v. Health Net,* Nos. 06-3031/3031, slip op. at 1 (3d Cir. Apr. 2, 2007), implicates the "fiduciary exception" to the attorney-client privilege which, although often overlooked, can greatly impact the confidentiality of legal advice provided to trustees, corporations, and other fiduciary clients.

The Fiduciary Exception

The fiduciary exception to the attorney-client privilege can make otherwise protected communication between a fiduciary and its attorney discoverable by beneficiaries the fiduciary serves.[1] Although the exception has its origin in the English common law of trusts, its adoption by American courts is relatively recent.

The exception is grounded in a trustee's duty to provide a beneficiary with complete information.[2] In an early decision, the Delaware Chancery Court concluded that, as a result of the underlying fiduciary relationship, legal advice sought by a trustee flowed to the trust's beneficiary who became the attorney's "real" client. *Riggs Nat'l Bank of Wash, D.C. v. Zimmer*, 355 A.2d 709, 712-13 (Del. Ch. 1976). The Court reasoned that even though it was the trustee who solicited the legal advice, the beneficiary was entitled to access it because: (1) the content of the advice was for the benefit of the trust, not the trustee; (2) the attorney's fees were paid from the trust's assets, not the trustee's personal funds; and (3) there were "no adversarial proceedings"[3] between the trustee and the trust, so there was no need for the trustee to seek out independent legal advice. *Wachtel*, Nos. 06-3031/3032 at 17 (summarizing *Riggs*). In essence, the privilege was the beneficiary's to assert. *Id*.

U.S. courts have expanded the exception to reach other kinds of fiduciary relationships. In what is commonly referred to as the *Garner* rule,[4] the fiduciary exception is regularly applied to assertions of privilege made by corporate counsel when discovery is sought by shareholders. Courts have also applied the exception to legal advice provided to a partnership, to a union's assertion of privilege against its members, and to claims of privilege made by administrators of employee pensions

funds and health care plans. In the context of employee benefits, the common law fiduciary exception has collided with the statutory definition of "fiduciary," as promulgated by the Employee Retirement Income Security Act (ERISA). The intersection of these two regimes is addressed by the Third Circuit's opinion in *Wachtel v. Health Net, Inc*., below.

The Third Circuit's Decision

Petitioner Health Net asked the Court to vacate a district court order requiring it to produce otherwise privileged attorney-client communications under the fiduciary exception. *Id*. at 5. Health Net was a provider of medical benefits to participants in certain employer-sponsored benefit plans, but it did not serve as a plan administrator or trustee; rather, Health Net processed claims and made determinations on how much to pay, based on various factors, including whether the medical services were provided in- or out-of-network. *Id*. at 5-6. Plan beneficiaries brought suit against Health Net charging that these determinations were based on outdated data ascribing a "customary" cost for covered medical procedures, and sought to bolster their claim by obtaining privileged communications between Health Net and its counsel. The district court upheld a Special Master's determination that, if given the chance, the Third Circuit would adopt the fiduciary exception, and would apply the exception to the communications at issue; petitioners appealed. *Id*. at 7-8.

The Court (Roth, C.J.), noted that many courts have adopted the fiduciary exception, but refused to decide whether, or to what extent, the exception applied in the Third Circuit. *Id*. at 11. However, the court held that even if the fiduciary exception did apply in the Third Circuit it would not apply to Health Net in this instance. *Id*. at 5. While acknowledging that Health Net was an ERISA fiduciary "to the extent that [Health Net] has discretion to determine claims," id. at 12, the Court recognized that "ERISA fiduciaries … come in many shapes and sizes," and that the fiduciary exception does not apply with equal force to all. *Id*. at 20-21. When plan beneficiaries "are not the 'real' clients obtaining legal representation," such as when the interests of the fiduciary and the beneficiaries diverge, the exception will not apply. *Id*. at 21.

The Court described four factors to evaluate in order to determine whether the beneficiaries are the "real" clients of legal advice given to an ERISA fiduciary: (1) ownership of the assets (i.e. whether the fiduciary holds legal title to or has a legitimate personal interest in the property); (2) whether a structural conflict of interest exists between the fiduciary and the beneficiaries with regard to the property; (3) whether the carrier serves many different customers to which it owes varied and distinct duties (as is the case when a carrier handles multiple plans at once, and services other, non-ERISA regulated customers); and (4) whether the company paid for legal advice using its own assets or the assets of the beneficiaries. *Id*. at 22-25. Because Health Net (1) had legal ownership of the assets at issue, (2) had a profit motive which created an inherent structural conflict of interest, (3) serviced multiple plans in addition to non-ERISA regulated customers, and (4) paid for legal advice from its own funds, Health Net was the true recipient of the legal advice at issue, not the beneficiaries. *Id*. at 25-26 ("[T]hese four factors … indicate that an insurer which sells insurance contracts to ERISA-regulated benefit plans is itself the sole and direct client of counsel retained by the insurer, not the mere representative of client-beneficiaries, and not a joint client with its

beneficiaries.")

The Court also considered whether Health Net, as a fiduciary, had a "duty of disclosure" to the plan beneficiaries, derived from the common law of trusts, which would encompass the privileged communications at issue. *Id*. at 26. While some courts have suggested that ERISA fiduciaries do owe a general duty of disclosure, the Court refused to expand the fiduciary exception in this way, noting that "Congress did not intend to expand the full panoply of trustees' obligations to every entity which might be designated a fiduciary under ERISA" and generally that "the disclosure obligations of an insurer-fiduciary cannot be defined through rote application of the common law of trusts." *Id*. at 27.

While providing some guidelines for examination of the novel question of "whether the fiduciary exception to the federal attorney client privilege applies with equal force to all fiduciaries under ERISA" (*id*. at 13), the Court warned against crafting bright line rules "that cause application of the privilege to turn on the answers to extremely difficult substantive legal questions," such as the extent of fiduciary obligations of insurers who contract with ERISA plans. *Id*. at 27-28. As the Court exhorted, "[t]he need for the attorney-client privilege is at its height where the law with which the client seeks to comply is complicated and the penalties for noncompliance are great." *Id*. at 28.

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[1] The Third Circuit described the fiduciary exception as one of several exceptions to attorney-client privilege necessary to balance the competing goals of facilitating "full and frank communication between attorneys and their clients" (*id.* at 14), with the need for fact-finders to have access to "every man's evidence" when deliberating. *Id.* at 15. As the Court described, this balance is best maintained by the recognition of certain exceptions to the privilege; namely, the "exception" for (1) non-legal advice; (2) non-confidential advice; (3) advice to further crime or fraud; and (4) advice rendered to a fiduciary to help that fiduciary fulfill his or her obligations to the beneficiary. *Id.* at 15-16.

[2] For this reason, some courts have opined that the fiduciary "exception" is a misnomer, arguing that it is not an exception to the attorney-client privilege, but instead stems from the notion that the trust, not the fiduciary, is really the lawyer's client. *See*, *e.g*., *Coffman v. Metropolitan Life Ins. Co.*, 204 F.R.D. 296, 299 (S.D.W.Va. 2001) (citing *United States v. Mett,* 178 F.3d 1058, 1063 (9th Cir. 1999).

[3] The United States District Court for the Southern District of New York recently confronted this issue. It looked to the following factors to determine whether the fiduciary-attorney communications concerned adversarial proceedings: (1) whether the trustee's communication with the attorney occurred after litigation commenced with the beneficiary and (2) whether the privileged communication concerned the issue being litigated. *Black v. Piney Bowes,* 2006 WL 3771097, *2-*3 (S.D.N.Y. Dec. 21, 2006) ("[w]hen an administrator is required to justify or to defend against a beneficiary's claims made because of an act of plan administration, the administrator does not act directly in the interests of the disappointed beneficiary but in his own interests or in the interests of the rest of the beneficiaries.") (citation omitted).

[4] *See Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970) (in applying a balancing test to determine

whether shareholders showed good cause to access the corporation's privileged materials, the Court considered: 1. the number of shareholders seeking the privileged materials; 2. the percent of stock held by the seeking shareholders; 3. the *bono fides* of the shareholders; 4. the merits of the shareholders claim; 5. the need of the shareholders to obtain the privileged information and its relation to the instant lawsuit; 6. the likelihood that the corporation acted criminally; whether the privileged material concerns the corporation's past or prospective actions; 7. whether the shareholder's request for privileged information is sufficiently focused; and 8. the danger of the corporation's trade secrets or other sensitive, proprietary information being publicly disclosed).