UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Bank of Montreal,

Plaintiff,

v.

Avalon Capital Group, Inc., et al.,

Defendants.

Civil No. 10-591 MJD/AJB

ORDER ON PLAINTIFF'S MOTION TO COMPEL PRODUCTION AND DEFENDANTS' MOTION TO STRIKE AND FOR PROTECTIVE ORDER

This matter is before the Court, Chief Magistrate Judge Arthur J. Boylan, on plaintiff Bank of Montreal's ("BMO") Motion to Compel Production of Certain Documents Withheld on Claim of Privilege, but Previously Voluntarily Provided to Third Persons [Docket No. 164] and defendant Avalon Capital Group, Inc.'s ("Avalon") Motion to Strike Privileged Communications in Plaintiff's Third Amended Complaint and for a Protective Order [Docket No. 170]. Hearing was held on June 23, 2012, 2011, at the U.S. Courthouse, 300 South Fourth Street, Minneapolis, Minnesota 55415. Plaintiff was represented at the hearing by Jeffrey G. Close, Esq., and Christopher R. Morris, Esq. Defendant was represented by David M. Schiffman, Esq., and Richard D. Anderson, Esq.

Based upon the file and documents contained therein, including memorandums, affidavits, and exhibits, and in consideration of arguments presented at hearing, the magistrate judge makes the following:

ORDER

1. Plaintiff Bank of Montreal's Motion to Compel Production of Certain Documents Withheld on Claim of Privilege, but Previously Voluntarily Provided to Third Persons is **granted** as provided herein [Docket No. 164].
2. Defendant Avalon Capital Group, Inc.'s Motion to Strike Privileged Communications in Plaintiff's Third Amended Complaint and for a Protective Order is **denied** [Docket No. 170].

Dated: July 10, 2012

s/ Arthur J. Boylan
Arthur J. Boylan
United States Chief Magistrate Judge

MEMORANDUM

Background and Motion Claims

Plaintiff Bank of Montreal ("BMO") alleges that between 2005 and 2008 Defendant Avalon Capital Group, Inc. ("Avalon") engaged in a pattern of misrepresentations and fraudulent omissions in its business dealings with BMO, and that BMO suffered harm as a result. During the time period in question, Joseph Burke served as Chief Executive Officer of Lakeland Construction Finance, LLC ("Lakeland") a wholly owned subsidiary of Avalon. (Pl.'s Mem. Supp. Mot. to Compel Produc. 2) Burke played a key role in creating and implementing a transition plan that would allow Lakeland to remove a difficult employee, Robert Machacek, without triggering specific disclosure requirements and covenants it had with BMO. (Pl.'s Mem. Supp. Mot. to Compel Produc. 3.)

BMO alleges that Lakeland's plan to terminate Machacek, referred to as the "*Burke Plan*," contains evidence of Avalon's misrepresentations to BMO regarding Machacek's termination and Avalon's intention to "cash out" its investment in Lakeland, to the detriment of BMO. Burke left Lakeland in October 2008, taking with him at least 3 file boxes of documents, as well as the company laptop from which he'd worked remotely. (Pl.'s Mem. Supp. Mot. to Compel Produc. 4.) Lakeland was aware that Burke took these documents with him and made no effort to extract information from the laptop or to prevent Burke from leaving with the documents. In fact, Lakeland apparently made a mirror image of the laptop before relinquishing it to Burke. (Pl.'s Mem. Supp. Mot. to Compel Produc. 4.) Avalon made no inquiries or demands regarding the status of the laptop or the documents at the time of Burke's departure. Nicole Blakely, in-house counsel for Avalon, was included in correspondence stating that Burke was leaving and taking the laptop with him. (Burke Correspondence, Counsel Aff. at Ex. 7, Oct. 29, 2008.)

In February 2011, two-and-a-half years after Burke left Lakeland, BMO subpoenaed from Burke, among other documents, all records related to Lakeland and Avalon. (Pl.'s Mem. Supp. Mot. to Compel Produc. 5.) Avalon was served with notice of the subpoena. (Subpoena and Cert. of Service, Counsel Aff. at Ex. 4, Feb. 9, 2011.) Avalon took no effort at that time to prevent Burke from producing information to BMO, or to assert that any of the documents in Burke's position were privileged. Burke produced documents in response to the subpoena on April 20, 2011 (henceforth referred to as the "*Burke Production*"). Avalon had notice of this production but at the time did not attempt to assert privilege or to recover any of the documents produced.

In September 2011, three years after Burke left Lakeland with documents and seven months after Burke was subpoenaed by BMO, Avalon objected to portions of BMO's Second Amended Complaint that made reference to the Burke Plan. At that time, Avalon asserted that those documents and any related emails and attachments were privileged. Avalon currently refuses to produce its own documents related to the Burke Plan. BMO moves to Compel Production of Certain Documents Withheld on Claim of Privilege but Previously Voluntarily Provided to Third Persons. Avalon moves to Strike Privileged Communications in Plaintiff's Third Amended Complaint and seeks a Protective Order.

Avalon has refused to independently produce any documents relating to the Burke Plan and is now asserting that the documents BMO received from Burke are protected by attorney-client privilege and must be returned. BMO contends that the documents were created for business rather than legal purposes and are therefore not privileged. BMO also argues that regardless of whether the documents were created for business or legal purposes, Avalon waived its privilege by failing to protect document confidentiality upon Burke's separation from Lakeland and for nearly three years thereafter, and by failing to timely object to the subpoena of Burke or Burke's subsequent production. In response, Avalon offers the following arguments: (1) even if Lakeland waived privilege by disclosing to Burke, Avalon did not; (2) any disclosure of privileged materials was inadvertent and therefore did not waive privilege; or (3) Avalon was joined with Lakeland by a common interest and that this interest provides an exception to the rule that disclosure to a third party waives privilege. Each of these arguments is addressed in turn below.

In its own motion Avalon moves to strike portions of Paragraphs 185 and 191 of BMO's Third Amended Complaint which it claims directly references privileged

communications. Avalon also moves for a protective order precluding discovery relating to certain communications for which privilege is being asserted, even though BMO may already possess those communications.

DISCUSSION

Attorney-Client Privilege. "In a civil case, state law governs privilege regarding a claim or defense for which state law supplies the rule of decision." *See* Fed. R. Evid. 501. This court has already determined that with regard to the matter at hand, California law and Minnesota law do not appear to conflict any meaningful way. For consistency and ease of analysis, Minnesota law will be cited.

Privilege for attorney-client communications is found within Minnesota Statutes § 595.02(1)(b). Minnesota law provides that for a communication to be protected by attorney-client privilege, it must be confidential and must be made for the purpose of seeking or providing legal advice. *Marvin Lumber and Cedar Co. v. PPG Ind. Inc.*, 168 F.R.D. 641, 644 (D. Minn. 1996). The party claiming privilege has the burden of demonstrating that each of these elements has been satisfied. *Marvin Lumber,* 168 F.R.D. at 644. Because attorney client privilege operates to exclude potentially truthful evidence, it must be narrowly construed. *Id.* Avalon asserts that its privilege claims are limited to communications regarding legal advice and are therefore protected by attorney-client privilege. BMO argues that the documents at issue are not legal documents at all, but rather, are communications pertaining to business matters to which attorney-client privilege does not apply. The court finds that in this matter, the legal or business nature of the communications is not determinative, as both Avalon and Lakeland failed to maintain the confidentiality required to enjoy privilege.

Failure to Maintain Confidentiality. Despite knowledge of Burke's departure, Avalon did not inquire as to the whereabouts of the contested communications nor did it attempt to implement any nondisclosure agreements or policies for exiting employees. Avalon made no attempt to assert that the Burke Plan was privileged or that it was to be kept confidential. "Failure to take reasonable precautions to preserve confidentiality may be considered as bearing on intent to preserve confidentiality and, consequently, the privilege." *O'Leary v. Purcell Co., Inc.*, 108 F.R.D. 641 (M.D.N.C. 1985). *See also In re Grand Jury Proceedings*, 727 F.2d 1352, 1355 (4th Cir. 1984). Avalon, in its capacity as sole manager of Lakeland, did not even attempt to assert that these communications were privileged until they were referenced in BMO's Second Amended Complaint some three years after Burke left Lakeland. It cannot establish the ongoing intent necessary to preserve the confidentiality or privilege of these materials.

In *O'Leary v. Purcell Co., Inc.*, 108 F.R.D. 641 (M.D.N.C. 1985) a former employee left a company with information that might have otherwise been confidential and privileged. Much like the present situation, that company's parent corporation claimed that it had not permitted the employee to take the information with him and had therefore not waived its right to assert privilege. The court in that case held that regardless of whether the parent corporation had permitted the employee to take the documents, both the parent company and subsidiary had handled the documents "so loosely that they should not be considered 'confidential' for the purposes of the attorney-client privilege." *O'Leary*, 108 F.R.D. at 645. The court in *O'Leary* gives considerable weight to the fact that neither the parent company nor its subsidiary took reasonable steps to ensure the confidentiality of its communications. The court notes that, "attorney client privilege may be lost when parties fail to take reasonable precautions to insure and maintain the confidentiality of attorney client documents." *Id* at 646. The *O'Leary* court is

careful to delineate between waiver of attorney-client privilege and failure to maintain confidentiality, which can result in loss of privilege. This too is a case where such distinction is important. Regardless of whether Lakeland or Avalon waived attorney-client privilege by disclosure, both companies failed to implement policies or procedures, or to take any reasonable precautions with regard to confidentiality of the documents taken by Burke. This failure to maintain confidentiality has resulted in a loss of privilege for Avalon.

Disclosure. Generally, voluntary disclosure of confidential materials to a third party waives any applicable attorney-client privilege. *United States v. Workman,* 138 F.3d 1261, 1263 (8th Cir. 1998). *See also Imation Corp. v. Koninklijk Philips Elect. N.V.,* No. 07-CV-3668 (DWF/AJB) (D. Minn. slip.op. Aug. 07, 2008) (upon finding that disclosure was voluntary rather than inadvertent, court ruled that privileged documents directly related to disclosed information be produced.) Avalon attempts to argue that no disclosure occurred when Burke took documents with him. It claims that because Burke did not show the documents to others, the documents remained privileged until Burke was subpoenaed. Because this court finds that the failure to maintain confidentiality now bars Avalon from asserting privilege, it is not necessary to determine whether or not attorney-client privilege was waived by disclosure to a third party. However, this court does find that such waiver occurred, first when Burke was permitted to leave with the documents,[1] and again when Burke produced the documents in response to subpoena. Avalon makes several arguments regarding disclosure. In addition to insisting that no disclosure occurred, it claims that if disclosure occurred it was Lakeland and not Avalon who disclosed and

[1] At the time Burke's employment was terminated, he became a third party with no obligations to Lakeland or to Avalon. Neither company required Burke enter a formal agreement regarding the confidentiality of the communications in his possession; neither took any steps to assert that the information was privileged. Therefore, the release to Burke, particularly without any accompanying effort to assert that the documents were privileged or to ensure Burke maintained confidentiality, constitutes disclosure.

that Avalon's privilege therefore remains intact. Avalon also asserts that if Avalon did disclose, the disclosure was inadvertent and cannot be found to waive Avalon's privilege. Avalon also claims that it is protected from waiver by the common interest it shares with Lakeland. These arguments are not compelling for the reasons discussed below.

Inadvertent Disclosure. Avalon insists that it knew nothing of Lakeland's disclosure to Burke and that this is therefore an inadvertent, rather than a voluntary, disclosure. The difference is significant as "a voluntary disclosure of information which is inconsistent with the confidential nature of the attorney-client relationship waives the privilege."[2] *Gray v. Bicknell,* 86 F.3d 1472, 1482 (8th Cir. 1996). Voluntary disclosure waives privilege of not only disclosed documents but also "any information directly related to that which was actually disclosed." *United States v. Workman*, 138 F.3d 1261, 1263 (8th Cir. 1998). Inadvertent disclosures do not necessarily waive privilege.

As discussed above, Avalon lost any claims of privilege when it failed to maintain confidentiality of the communications at issue. However, this court will provide a brief discussion of inadvertent disclosure if only to demonstrate that as per an inadvertent disclosure analysis, the documents in question cannot be returned. The federal court generally chooses one of three approaches regarding documents that have been "mistakenly" produced. Briefly, these approaches can be characterized as lenient, strict, and middle of the road. *Starway v. Indep. Sch. Dist. No. 625*, 187 F.R.D. 595 (D. Minn, 1999). In determining whether communications should be returned after an inadvertent disclosure, this court employs the middle of the road *Hydraflow* test. *Starway,* 187 F.R.D. at 596. That test considers (1) the reasonableness of precautions to prevent disclosure; (2) the number of disclosures; (3) the extent of the disclosures; (4) the

[2] This case is based upon Missouri, not Minnesota, law but the Eight Circuit has offered an in-depth discussion of the analysis applied here and its relevance to claims of inadvertent disclosure.

promptness of measures taken to remedy the problem; and (5) whether justice would be served by relieving the party of its error. *Starway,* 187 F.R.D. at 597. *See also Hydraflow, Inc. v. Enidine Inc*., 145 F.R.D. 626, 637 (W.D.N.Y. 1993) and *Gray v. Bicknell*, 86 F.3d 1472, 1482 (8th Cir. 1996).

Application of the *Hydraflow* analysis demonstrates the following: with regard to reasonable precautions, Avalon has failed to prove that it took steps to assert privilege or to maintain confidentiality of the documents in question. Additionally, the number and extent of the disclosures in this instance is far from minimal; Avalon estimates that some 2000 pages were released to Burke, who held them for nearly 3 years before Avalon demanded their return. As noted above, Avalon was anything but prompt in its response to the Burke production. Avalon did not respond to notice of the subpoena, did not protest at the time of production, and did not assert privilege until portions of the contested communications appeared in BMO's Second Amended Complaint. Finally, this court finds that allowing Avalon to enjoy privilege over documents without properly asserting privilege or maintaining confidentiality will not serve justice but will quite possibly encourage irresponsible behavior.

Joint Client and Community of Interest Privilege. Avalon argues that it was joined with Lakeland by a common interest and that this interest protects it from waiver of privilege. The question of the precise relationship between Lakeland and Avalon has been addressed by this court before. In *Bartholomew v. Avalon Capital Group*, Inc., 278 F.R.D. 441 (D. Minn, 2011), this court analyzed the relationship between Lakeland and Avalon as determined by their communications with Avalon's counsel Nicole Blakely. The court in that matter found that, "Lakeland and Avalon were clients who consulted Blakely upon matters of common interest." 278 F.R.D. 441 at 450. The court cited the following reasons for its decision:

> First, the voluminous communications that this Court reviewed do not in any way comport with Blakely's assertions that she informed Lakeland's officers that the scope of her representation was limited. Second, Blakely, Avalon and Lakeland failed to adhere to any of the formalities that would suggest that the scope of Blakely's representation was limited… Third, the communications produced by Plaintiff support that Blakely represented herself to third parties as working on behalf of both Avalon and Lakeland's common interests. *Id*.

Avalon's reliance upon the common interest doctrine is misplaced. While Avalon correctly asserts a common interest, it mischaracterizes the privilege provided by this interest. It is true that "[t]he common interest doctrine is an exception to the rule that voluntary disclosure of confidential, privileged material to a third party waives the privilege. *Pucket v. Hot Springs School Dist. No. 23–2*, 239 F.R.D. 572, 582 (D.S.D.2006) (citing *In re Grand Jury Subpoena Duces Tecum*, 112 F.3d 910, 922 (8th Cir.1997)). However, the exception cannot be applied uniformly to all third party disclosures. Specifically, "the attorney-client privilege may extend to communications with third parties who have been engaged to assist the attorney in providing legal advice." *United States v. Richey*, 632 F.3d 559, 566 (9th Cir. 2011). It does not, however, extend to communications with *any* third parties. Disclosure to Burke is not vitiated by Avalon's common interest with Lakeland. Burke does not have a common interest in the present litigation. In attempting to address all of Avalon's arguments regarding disclosure, the court notes that if the only relevant question was whether Burke's production in response to subpoena constituted inadvertent disclosure, the answer is no. Avalon's failure to timely respond to notice of the subpoena or to the production itself is enough to convince this court Avalon failed to assert and protect its own privilege in a reasonable manner.

***In camera* Review.** Because the court has granted BMO's motion to compel, its motion asking the court to conduct an *in camera* review is moot. Additionally, this court finds that there is no basis for such a review under the crime-fraud exception to privilege. BMO's motion to conduct an in camera review is denied.

Strike Paragraphs 185 and 191 of BMO's Third Amended Complaint. For the reasons discussed above, the communications referenced in Paragraphs 185 and 191 of BMO's complaint are not privileged and Avalon's motion to strike is denied.

Protective Order. As the communications in question are not privileged, Avalon's motion for a protective order is denied.

CONCLUSION

Avalon offers several arguments as to why it cannot be compelled to produce documents relating to the Burke production. None of these are persuasive. The question before the court is quite easily reduced to an examination of the precautions taken by Avalon and its subsidiary, Lakeland, with regard to confidentiality of purportedly privileged communications. This court finds that despite multiple opportunities, Avalon failed to maintain the confidentiality of the communications in question and in so doing lost any privilege that may have applied. Avalon did not inquire as to the location of the documents, did not demand the return of the documents, and did not assert the privileged nature of these documents until long after they had been produced. For these reasons and for those reasons discussed herein, Avalon is hereby Ordered to Produce the Documents Withheld on Claim of Privilege, but Previously Voluntarily Provided to Third Persons. For the same reasons, Avalon's Motion to Strike Privileged Communications in Paragraphs 185 and 191 of Plaintiff's Third Amended Complaint and for a Protective Order is denied.