

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

FELIX NEDLER, FRIDA VAYSMAN,	:	CIVIL ACTION
INNA PROSHAK, Individually and	:	
Derivatively on behalf of CIRCLE OF	:	
FRIENDS ADHC, INC., and STEVEN	:	NO. 05-6113
PROSHAK, Individually and Derivatively	:	
on behalf of ODESSA PARTNERS, LLC,	:	
Plaintiffs,	:	
	:	
v.	:	
	:	
VICTORIA and ALAN VAISBERG,	:	
JOSEPH AND LANA MANDALE,	:	
MICHAEL and ELINA ZAVERUKHA,	:	
MIKHAIL SLOBODSKOI,	:	
GRACE ADULT DAY HEALTHCARE,	:	
INC., LJ CAB CO., INC.,	:	
METROPOLITAN TRANSPORTATION,	:	
CO., LLC. , TWO STAR CAB CO.,	:	
and ODESSA PARTNERS, LLC.	:	
Defendants.	:	

ORDER & MEMORANDUM

ORDER

AND NOW, this 22nd day of August, 2006, upon consideration of Defendants' Motion for Protective Order to Quash Subpoena (Document No. 39, filed June 23, 2006), Plaintiffs' Response to Defendants' Motion for Protective Order to Quash Subpoena (Document No. 40, filed July 6, 2006), and the Reply Memorandum in Further Support of the Motion to Quash Subpoena Directed to Spector Gadon & Rosen, P.C. (Document No. 44, filed August 4, 2006), following a telephone conference with counsel on July 25, 2006 and oral argument on August 11, 2006, for the reasons set forth below, **IT IS ORDERED** that Defendants' Motion for Protective Order to Quash Subpoena (Document No. 39, filed June 23, 2006) is **GRANTED** on the present state of the record.

MEMORANDUM

I. INTRODUCTION

Plaintiff Steven Proshak alleges that he is a shareholder of Odessa Partners, LLC (“Odessa”). Compl. at ¶ 4. Plaintiffs Felix Nedler, Frida Vaysman, and Inna Proshak allege that, at all times relevant to this action, they have been, and continue to be, shareholders of Circle of Friends ADHC, Inc. (“Circle of Friends”). Id. at ¶¶ 1-3.¹ On June 12, 2006, plaintiffs served a far-reaching subpoena on the law firm of Spector, Gadon & Rosen, P.C., which is counsel to all defendants in this case, as well as Circle of Friends and Enso Holdings, Inc.

Presently before the Court is defendants’ motion for a protective order to quash the subpoena of June 12, 2006. The Court conducted a telephone conference with counsel on July 25, 2006 and oral argument on August 11, 2006.

For the reasons set forth in this Memorandum, the motion is granted. To the extent that this Memorandum differs, albeit slightly, from the opinions expressed by the Court at the hearing on August 11, 2006, this Memorandum reflects the Court’s analysis and conclusions and supercedes anything said to the contrary at oral argument.

II. DISCUSSION

A. Subpoena At Issue

The plaintiff’s subpoena of June 12, 2006 requires Spector, Gadon & Rosen, P.C. to:

[D]esignate and produce for deposition the person(s) with the most information pertaining to the following matters:

¹ The relationships among plaintiffs, defendants, and Circle of Friends is outlined in the “Background” section of this Court’s Memorandum dated April 18, 2006, which denied defendants’ Motion to Dismiss.

1. All non privileged communications and documents pertaining to Circle of Friends (ADHC) Inc., as well as any and all of the following entities:
 - a. Grace Adult Day Healthcare, Inc.
 - b. LJ Cab Co., Inc.
 - c. Metropolitan Transportation Cab Co., LLC
 - d. Two Starr Cab Co.
 - e. Odessa Partners, LLC

2. All non privileged communications and documents pertaining to Circle of Friends (ADHC) Inc. as well as any and all of the following people/entities:
 - a. Victoria Vaisberg
 - b. Alan Vaisberg
 - c. Joseph Mandale
 - d. Lana Mandale
 - e. Michael Zaverukha
 - f. Elina Zaverukha
 - g. Michael Slobodskoi
 - h. Restaurant Langeron and/or Esno Holdings, Inc.

3. Invoices for legal services rendered by Mr. Epstein and/or Spector, Gadon submitted to any of the above entities or persons set forth in No. 2 and No. 3 within the last four years.

See Def. Mot. Protective Order to Quash Subpoena, Ex. A. The subpoena further requires

Spector, Gadon & Rosen, P.C. to:

[P]roduce at the time of the deposition the following documents and tangible things:

1. All non privileged documentation relating to any of the above individuals and/or entities including invoices for services rendered by Mr. Epstein and/or Spector Gadon as set forth in No. 3 above.

2. . . . [A] privilege log for any document withheld from production or redacted and the privilege log must identify with sufficient particularity the documents which claim to be privileged and the nature of the specific privilege being claimed.

See Def. Mot. Protective Order to Quash Subpoena, Ex. A. The subpoena concludes by reserving plaintiffs' "right to inquire into other matters." See Def. Mot. Protective Order to Quash

Subpoena, Ex. A.

B. Overview of Parties' Arguments

On June 23, 2006, defendants filed a motion for a protective order to quash the plaintiffs' subpoena of June 12, 2006. In that motion, defendants argue that the subpoenaed communications and documents are protected under the work-product doctrine and the attorney-client privilege. Defendants also complain that the subpoena inappropriately seeks duplicative information from a nonparty – i.e., Spector, Gadon & Rosen, P.C. – which places an unnecessary burden on the law firm and creates unnecessary expenses during the discovery process.

On July 6, 2006, plaintiffs responded, arguing that in their capacity as shareholders of Circle of Friends and Odessa, they are entitled to discover all communications and documents pertaining to Spector, Gadon & Rosen's representation of Circle of Friends and Odessa. Relying on Gregory v. Correction Connection, Inc., 1990 U.S. Dist. Lexis 15804 (E.D. Pa. Nov. 20, 1990), plaintiffs contend that the attorney-client privilege and the work-product doctrine do not protect from disclosure the communications between counsel for a closely held business and the shareholders of that business. To bolster their position, plaintiffs point to Section 85 of The Restatement 3d of the Law Governing Lawyers, which provides guidelines on "Communications Involving a Fiduciary Within an Organization."² In addition, plaintiffs argue that the crime-fraud

² Section 85 states:

In a proceeding involving a dispute between an organizational client and shareholders, members, or other constituents of the organization toward whom the directors, officers, or similar persons managing the organization bear fiduciary responsibilities, the attorney-client privilege of the organization may be withheld from a communication otherwise within § 68 if the tribunal finds that: (a) those managing the organization are charged with breach of their obligations toward the shareholders, members, or other constituents or toward the organization itself; (b) the communication occurred prior to the assertion of

exception to the attorney-client privilege applies to discovery regarding Enso Holdings, Inc., so communications involving that corporation must be disclosed during discovery.

In their reply, filed on August 4, 2006, defendants argue that under Pennsylvania law, the shareholder plaintiffs are not clients of Spector, Gadon & Rosen because they did not exercise managerial control over Circle of Friends or Odessa. Defendants' position is based on Agster v. Barmada, 43 Pa. D. & C. 4th 353 (Com. Pleas Ct. Allegheny Co., 1999). Agster was the first – and, apparently, only – Pennsylvania court to address “whether, in a shareholder suit against [a closely held] corporation, a corporation may assert the attorney-client privilege to protect communications with corporate counsel.” Id. at 354. The Agster Court reasoned that “an arrangement whereby the communications between corporate counsel and the dominant shareholders are confidential is consistent with the reasonable expectations of those minority shareholders who do not anticipate having any relationship with corporate counsel.” Id. at 369. On this ground, Agster held that those exercising managerial control over a closely held corporation are considered clients of corporate counsel, whereas those who do not exercise managerial control are not clients of corporate counsel and, accordingly, are not entitled to abrogate the attorney-client privilege claimed by the corporation. Id. at 370-372.

Defendants in the instant case argue that the Agster rule controls the analysis in this case. Relying on Agster, defendants take the position that the shareholder plaintiffs in Circle of Friends and Odessa are not entitled to abrogate the attorney-client privilege that protects Circle of Friends

the charges and relates directly to those charges; and (c) the need of the requesting party to discover or introduce the communication is sufficiently compelling and the threat to confidentiality sufficiently confined to justify setting the privilege aside.

and Odessa's communications with Spector, Gadon & Rosen, P.C. because they did not exercise managerial control over either corporation. Defendants further argue that plaintiffs mistakenly rely on Section 85 of the Restatement 3d of the Law Governing Lawyers because Agster rejected the case on which it was based, Garner v. Wolfenbarger, 430 F.2d 1093 (5th Cir. 1970). The Garner Court held that a corporation may assert the attorney-client privilege in a dispute with minority shareholders who exercise no managerial control, but the privilege is conditional and gives way upon a showing of good cause by the minority shareholders. In rejecting the Garner rule, Agster concluded it "is inconsistent with Pennsylvania case law's application of the attorney-client privilege" because "the purpose of the privilege is to guarantee the confidentiality of an attorney-client privilege." 43 Pa. D. & C. 4th 353, 363, 371.

Next, defendants explain that the shareholder plaintiffs' "mere non-managerial ownership interests," Def. Reply Mem.8, in Circle of Friends and Odessa distinguish this case from Gregory v. Correction Connection, Inc., 1990 U.S. Dist. Lexis 15804 (E.D. Pa. Nov. 20, 1990) (McGlynn, J.), on which plaintiffs rely. In Gregory, the plaintiff was a majority shareholder, the director of the defendant corporation, the chairman of the Board of Directors, and the Chief Executive Officer. Because the Gregory plaintiff exercised managerial control over the defendant corporation, Judge McGlynn rejected the defendant corporation's claim of attorney-client privilege. Defendants argue that the Gregory rule is inapposite to the instant case.

Finally, defendants argue that plaintiffs have offered no evidence to show that the "crime-fraud" exception applies to Enso Holdings, Inc.'s communications with Spector, Gadon & Rosen, P.C. For all of these reasons, defendants request that the Court grant the motion for a protective order to quash the plaintiffs' subpoena.

The Court held oral argument on August 11, 2006, at which counsel amplified the arguments in their briefs. In addition, plaintiff's counsel provided citations to the following three Eastern District of Pennsylvania opinions in support of plaintiffs' position that the Garner rule and Section 85 of the Restatement 3d of the Law Governing Lawyers should be adopted by this Court: Orovitz v. Schilling, 1995 U.S. Dist. Lexis 9372, *6 (E.D. Pa. July 6, 1995) (Ludwig, J.) (applying the Garner rule, but concluding that "plaintiff has not established good cause to abrogate the [attorney-client] privilege, a la Garner."); Cohen v. Uniroyal, Inc., 80 F.R.D. 480 (E.D. Pa. 1978) (Van Artsdalen, J.) (applying the Garner rule and concluding, inter alia, that "there is good cause to override the [attorney-client] privilege" with respect to the disclosure of information requested in the interrogatories at issue); and, In re Sunrise Securities Litigation, 130 F.R.D. 560, 596 n.9, 597 n.10 (E.D. Pa. 1989) (O'Neill, J.) (discussing the Garner principles in passing). This Court notes that all of these cases were decided before Agster.

C. Analysis

Two issues are before the Court. The first issue is whether plaintiffs can succeed on the claim that they are entitled to abrogate the attorney-client privilege invoked by Circle of Friends and Odessa with respect to those corporations' communications with Spector, Gadon & Rosen, P.C. The second issue is whether plaintiffs have presented sufficient evidence to invoke the crime-fraud exception to attorney-client privilege with respect to Enso Holdings, Inc.'s communications with Spector, Gadon & Rosen, P.C.

For the reasons set for the below, the Court concludes that, on the present state of the record, plaintiffs are not entitled to (1) abrogate attorney-client privilege with respect to Circle of Friends and Odessa, or (2) invoke the crime-fraud exception with respect to Enso Holdings, Inc.

Accordingly, the Court grants Defendants' Motion for Protective Order to Quash Subpoena.

1. On the present state of the record, plaintiffs are not entitled to abrogate the attorney-client privilege.

On the present state of the record, the Court concludes that plaintiffs are not entitled to abrogate the attorney-client privilege claimed by Circle of Friends and Odessa with respect to those corporations' communications with Spector, Gadon & Rosen, P.C. The Court reaches this conclusion under both the Agster rule and the Garner rule, and thus, the Court does not resolve the question of whether Agster or Garner is controlling.

First, under the Garner rule, the Court concludes that plaintiffs do not succeed in abrogating the attorney-client privilege. The Garner rule allows the attorney-client privilege to be abrogated by shareholders filing a derivative suit only if those shareholders make a showing of good cause.³ On the present state of the record, the Court concludes that plaintiffs have failed to make a showing of good cause that warrants abrogating Circle of Friends and Odessa's claims of

³ The Garner Court explained:

There are many indicia that may contribute to a decision of presence or absence of good cause, among them the number of shareholders and the percentage of stock they represent; the bona fides of the shareholders; the nature of the shareholders' claim and whether it is obviously colorable; the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources; whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality; whether the communication related to past or to prospective actions; whether the communication is of advice concerning the litigation itself; the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing; the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.

430 F.2d at 1104.

attorney-client privilege.⁴

Likewise, under the Agster rule, the plaintiffs' attempt to abrogate attorney-client privilege fails. The Agster Court held that, even if shareholders in non-managerial capacities show good cause to abrogate the privilege in the context of a derivative suit, the defendant corporation is entitled to claim the protection of the attorney-client privilege. At the hearing, plaintiffs' counsel conceded that plaintiff shareholders did not exercise managerial control over Circle of Friends and Odessa. In view of this concession, the Agster rule would preclude plaintiffs from overcoming Circle of Friends and Odessa's claims of attorney-client privilege.

At this juncture, the Court does not resolve whether Agster or Garner controls this case because plaintiffs cannot prevail under either decision.⁵ If plaintiffs reach a point where they believe they have sufficient evidence to establish good cause under Garner, the Court will entertain a renewed motion and will consider whether Agster or Garner governs the issue of whether the plaintiff shareholders in Circle of Friends and Odessa may access the communications between those corporations and Spector, Gadon & Rosen, P.C.

2. On the present state of the record, plaintiffs are not entitled to invoke the crime-fraud exception with respect to Enso Holdings, Inc.

On the present state of the record, the Court concludes that plaintiffs are not entitled to invoke the crime-fraud exception with respect to Enso Holdings, Inc.'s communications with

⁴ The Court notes that this case is still in the early stages of discovery, and plaintiffs have not taken the steps necessary to amass the evidence needed for a showing of good cause under Garner.

⁵ This conclusion supercedes any observations to the contrary that the Court may have made at the hearing on August 11, 2006, including the statement that the Court found the Agster rule more persuasive than the Garner rule.

Spector, Gadon & Rosen, P.C. because plaintiffs have offered no evidence in support of that claim.

The “crime-fraud” exception is an exception to the attorney-client privilege on the ground that the communications between an attorney and her client further future illegal conduct. In United States v. Zolin, 491 U.S. 554, 564 (1989), the Supreme Court discussed the crime-fraud exception at length. The Zolin Court instructed district courts faced with a claim of the crime-fraud exception as follows: “Before engaging in in camera review to determine the applicability of the crime-fraud exception, the judge should require a showing of a factual basis adequate to support a good faith belief by a reasonable person.” Id. at 572. Accordingly, this Court undertakes the preliminary step of determining whether plaintiffs have shown a factual basis adequate to support a good faith belief by a reasonable person that the crime-fraud exception applies to Enso Holding, Inc.’s communications with Spector, Gadon & Rosen, P.C. If plaintiffs meet their burden, then the Court “may engage in in camera review” to determine whether the exception in fact applies. Id. at 574. If plaintiffs fail to meet their burden, the inquiry ends.

The plaintiffs claim that the crime fraud exception applies to discovery regarding Enso Holdings, Inc. because Alan Vaisberg, allegedly with the advice of Spector, Gadon & Rosen, fraudulently terminated the business operations of Odessa, a corporation in which Steven Proshak was a 50 percent owner. In support of this allegation, plaintiffs point out the following: First, Spector Gadon & Rosen represents Enso Holdings, Inc. Second, Alan Vaisberg terminated Odessa’s lease with its landlord with the promise that a new entity, Enso Holdings, Inc., would take over the lease and sign a replacement lease. Plaintiffs offer an excerpt from the deposition testimony of Arthur Dorfman in support of the second point. Based on this scant evidence,

plaintiffs believe and aver that “SGR [Spector Gadon & Rosen] and [counsel Alan] Epstein gave Vaisberg advice on how to defraud Steven Proshak.”

Defendants argue that plaintiffs have not met their burden of showing that the crime-fraud exception applies because plaintiffs have offered no evidence to support application of the crime-fraud exception. The Court agrees. On the present state of the record, plaintiffs have not even come close to “showing . . . a factual basis adequate to support a good faith belief by a reasonable person” that the crime-fraud exception applies to Enso Holdings, Inc.’s communications with Spector, Gadon, & Rosen, P.C. Zolin, 491 U.S. at 572.

IV. CONCLUSION

For the foregoing reasons, and on the present state of the record, the Court concludes that plaintiffs are not entitled to abrogate the attorney-client privilege claimed by Circle of Friends and Odessa with respect to those corporations’ communications with Spector, Gadon & Rosen, P.C. The Court further concludes that plaintiffs have not presented sufficient evidence to invoke the crime-fraud exception with respect to Enso Holdings, Inc.’s communications with Spector, Gadon & Rosen, P.C. Accordingly, the Court grants the Defendants’ Motion for Protective Order to Quash Subpoena.

BY THE COURT:

/s/ Honorable Jan E. DuBois

JAN E. DUBOIS, J.