Corporate Internal Investigations

Do Privileged Investigations Stay Privileged?

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According to the American College of Trial Lawyers, more than 2500 companies conducted internal investigations with the assistance of outside counsel between 2001 and 2008. The recent options backdating scandal alone accounted for 143 internal investigations at public companies. In the wake of the current economic crisis, there will likely be an even greater surge in the number of these investigations.

While companies conduct internal investigations for many reasons, the results of these investigations are often shared with the government. Under guidance from both the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC), such cooperation can lead to reduced charges or fines. But the disclosure required by that cooperation with the government leaves open the real possibility that the attorney-client privilege and the work product doctrine may be waived.

As we discuss below, recent court decisions have been finding that these investigations are either not covered by the attorney-client privilege and the work product doctrine or that those privileges have been waived. The consequence of these findings is that third parties — plaintiffs' attorneys in class action litigation, former employees, and others — can potentially gain access to all of the material collected, analyzed, or prepared in the investigation.

In light of Microtune, counsel for public companies should be aware of the potential privilege issues before an internal investigation is launched. We discuss these below.

**INTERNAL INVESTIGATIONS AND COOPERATION WITH THE GOVERNMENT**

Internal investigations serve a number of important purposes for public companies. They are often a vehicle to allow boards to fulfill their corporate governance mandate by investigating claims of wrongdoing directed at management. Internal investigations allow companies to obtain the facts so that it can quickly formulate appropriate legal and litigation strategy.

These investigations are also important to outside auditors. Often, outside auditors are reluctant to proceed with their issuance of an audit opinion if significant questions have been raised about the company's accounting or internal controls. Indeed, with increasing frequency, outside auditors are requiring companies to perform so-called 10A investigations into allegations of fraud or impropriety before the auditors will issue their audit opinions. See Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

Finally, and often most significantly, internal investigations can be very
important for corporations that hope
to receive cooperation credit from the
DOJ and SEC. Both agencies
have repeatedly offered reduced
penalties, amnesty from criminal
liabilities, and lessenened charges for
corporationsthatconductedtheir
own internal investigations. See Report
of Investigation Pursuant to Section
21(a) of the Securities Exchange Act
of 1934 and Commission Statement
on the Relationship of Cooperation
to Agency Enforcement Decisions,
Release No. 34-44969, 76 S.E.C.
23, 2001).

Privilege Implications
While cooperating with the
government and conducting
internal investigations are often
overwhelmingly beneficial to the
corporation as a whole, there
are costs associated with that
cooperation. Namely, corporations
run a very real risk that their
cooperation will be construed by the
courts as a waiver of the attorney-
client and work product privileges
for the pending matter as well as any
subsequent litigation.

At the outset of an investigation,
the documents compiled are
clearly privileged as attorney-client
communication, attorney work
product, or both. However, after
information is revealed to third
parties, including the government,
the clear majority of courts take a
categorical approach to the privilege:
once it is waived, it is waived. Even
proactive attempts by corporations
to protect the privilege, including
signed non-waiver agreements
between the corporation and the
government investigators, have thus
far been rejected by most courts.

One of the leading cases applying
this view is the Sixth Circuit’s
decision in In re Columbia/HCA
Healthcare Corp. Billing Practices,
293 F.3d 289, 302 (6th Cir. 2002).
In that case, Columbia, a health
care provider, disclosed results
of its internal audits to the Justice
Department in exchange for lenient
treatment. After settling the case
with the government, Columbia/
HCA was sued by numerous third
parties that sought to compel the
internal audit results. Columbia/
HCA claimed that the documents
were privileged and refused to
comply. The Sixth Circuit disagreed
and ordered production of the
documents. While recognizing the
importance of corporate cooperation
with government agencies, the court
primarily focused on the purpose
and significance of the attorney-
client privilege. According to the
court, the privilege was designed
to protect conversations between
client and attorney, and not the
government.

A minority of courts are more
protective of the privilege and
sympathetic to companies that
attempt to cooperate with the
government without waiving all
claims to the privilege. This protection
is seen most clearly in the Eighth
Circuit, which has long-recognized a
“selective waiver” doctrine. See, e.g.,
Diversified Industries v. Meredith,
572 F.2d 596, 611 (8th Cir. 1977).
Under this doctrine, the courts look
to the extent of the disclosure as
well as the intent of the corporation
regarding future disclosure. Where
a company voluntarily surrenders
limited privileged information in a
non-public investigation, the court
may find that a selective waiver
has occurred, and the remaining
privilege stays intact.

The Majority and Minority View
In SEC v. Microtune, the lines
between the majority and minority
view became more defined, and it is
clear that case law is lining up more
and more firmly behind the majority
waiver position. In that case, a Texas
federal district court rejected multiple
claims of privilege and considered
the corporation’s cooperation to be
a complete waiver.

In that case, after Microtune’s
management discovered possible
evidence of stock option backdating,
the company’s Audit Committee
initiated an internal investigation
and retained the law firm of Andrews
Kurth to conduct the investigation.
Throughout the investigation,
Andrews Kurth periodically updated
the SEC on the investigation’s status
and the firm’s preliminary findings,
and at the conclusion of the
investigation, the firm presented its
formal findings to the SEC; in total,
Andrews Kurth produced more than
30,000 pages of documents to the
SEC. Subsequently, the SEC filed
charges against Microtune and two
of its former officers. After Microtune
settled the case, the former officers
sought discovery of the Andrews
Kurth investigation documents
from Microtune. The latter asserted
attorney-client communication and
work product privileges, and refused
to produce the documents.

The Northern District of Texas
rejected both claims of privilege. The
court held that even if the attorney-
client communication privilege did
apply, the firm’s disclosures to third
parties — specifically, disclosures
regarding aspects of the investigation
to an outside auditing firm, the
Nasdaq Listing Qualifications Panel,
and the SEC itself — constituted a
subject matter waiver.

The court also rejected Microtune’s
assertion of the work product
doctrine. In construing the privilege
strictly, the court held that the work
product doctrine only applies when
litigation concerns are the “primary
motivating purpose” behind the
creation of the document. Despite the
Audit Committee Chair’s declaration
that the company anticipated
government investigations and
possible civil litigation at the start
of the investigation, the court
dismissed the rationale as “self-
serving testimony.” Instead, the
court focused on the testimony
of an Andrews Kurth attorney — testimony that described the purpose of the investigation without mentioning potential litigation — and the apparent business purposes underlying the documents’ creation.

The ease and certainty with which the Texas court rejected the claims of privilege in *Microtune* are striking and indicate, that courts are hesitant to entertain claims of privilege following disclosures related to internal corporate investigations.

**Observations**

Given the trend of cases such as *Microtune* and *In re Columbia/HCA Healthcare Corp. Billing Practices*, corporations should conduct their investigations under the assumption that disclosure to the SEC or another third party will result in a waiver of the privilege over the entire investigation. While it is best to plan for the worst case scenario, counsel should still consider a number of steps to maximize the potential that a court will uphold some or all of the attorney-client privilege and work product doctrine.

Those steps include:

1. **Think about privilege issues at the very start of any investigation.** Some of the privilege claims in *Microtune* (at least those related to work product) suffered from a lack of contemporaneous support that potential litigation was one of the main drivers behind the launch of the investigation. Board or committee resolutions or minutes should reflect the reasons for the investigation.

2. **When reporting to the board, counsel should provide it with an analysis of legal claims.** Of course, corporations should not claim that they expect litigation when they in fact do not, and corporations that conduct investigations for business purposes should not be afforded the protections of the work product doctrine unnecessarily. However, where a corporation genuinely anticipates litigation, and where the investigation is spurred by a fear of legal corporate liability, the corporation should proactively identify and record that concern to avoid jeopardizing the privilege claim.

3. **If documents are to be produced to the SEC or other parties, a corporation should enter into a non-disclosure agreement with the government.** While certainly not dispositive or binding on courts, it may offer some protection if a court were sympathetic to finding a limited waiver. Even if the courts are unwilling to categorically recognize non-waiver agreements, an agreement itself is a useful record that the corporation is actively seeking to protect the privilege as strongly as possible.

4. **Despite the existence of a non-waiver agreement, productions of documents to the government should include a privilege review and the creation of a privilege log for withheld documents.** While the *Microtune* opinion is not entirely clear, it seems as though counsel produced significant amounts of privileged documents to the government. The better course of action is to first produce non-privileged documents and information along with a privilege log. To the extent the government then requests privileged materials, the corporation should attempt to find ways outside of a production or disclosure of privileged material to satisfy the government’s need for information and remain cooperative.

5. **Produce only non-privileged documents.** As a general matter, facts and documents created before the investigation was commenced are not privileged. Those are the documents that should be produced to the government. Production of schedules or charts created for the investigation should generally be withheld from the government.

Similarly, privileged board or committee presentations should not be produced.

6. **Limit the disclosure of privileged information to as few people as possible.** Put simply, the more people that have access, the more likely the court will be to reject the privilege claim. As discussed above, this is especially true in cases where privileged material is shared with those that may have culpability in the matters under investigation. If there are board members or executive officers with potential culpability, they should be excluded from all discussions of the investigation.

**Conclusion**

The number of corporate internal investigations has been increasing rapidly and the importance of these investigations to demonstrate cooperation with the government has been never been more significant. Yet the price of cooperation is often a waiver of the attorney client privilege and work product doctrine. As a result, corporations and their counsel should consider privilege issues at the start of any internal investigations and plan accordingly.