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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.

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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.

SEC v. Microtune, Inc.

A recent Texas case — *SEC v. Microtune, Inc.*, 2009 WL 1574872 (N.D.Tex 2009) — reflects this trend and suggests it will be very difficult for a cooperating company to retain the privilege. The *Microtune* court held that disclosing portions or conclusions of an internal investigation to a government agency constitutes a subject-matter waiver of the attorney-client privilege over the entire internal investigation. Further, the court held that the work product doctrine only applies where litigation is the primary purpose behind the document's creation. The result is that even if a company claims that fear of litigation was the driving purpose for the internal investigation, a court may still conduct its own factual assessment and come to the opposite conclusion.

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 lessened charges for corporations that conducted their 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. Docket 220, 2001 WL 1301408 (Oct. 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 —s pecifically, 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 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.

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