What Happens When Something Goes Wrong: Conducting Internal Investigations and How They May Impact the Attorney-Client Privilege

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I. Introduction

Internal investigations are of increasing importance in corporate America. Corporations frequently are required to investigate a wide range of complaints, including: employment claims, accounting irregularities, product defect claims, unfair trade practices, executive misconduct, insider trading, bribery, violations of the Foreign Corrupt Practices Act, antitrust violations, misappropriation of trade secrets and intellectual property, environmental violations, immigration violations, claims related to lawsuits of any nature and state and federal statutory and regulatory violations. An investigation of each of these matters requires careful consideration with regard to the purpose of the investigation, who conducts the investigation, who is made aware of the investigation, who will learn about the results of the investigation and whether the results of the investigation will remain confidential.

The importance of investigations has escalated due to the accounting and option backdating scandals that became prevalent in 2003, such as the collapse of Enron. As a result of the numerous scandals involving corporate and securities fraud, federal and state governments and lawyers representing shareholders have escalated their attacks on corporations. Indeed, since July 2002, the U.S. Department of Justice ("DOJ") has obtained nearly 1,500 corporate fraud convictions, including convictions of more than 200 chief executive officers and corporate presidents, more than 120 corporate vice presidents and more than 50 chief financial officers.[1] In addition, from 2003 to 2007, the Federal Bureau of Investigation has opened an average of 505 new corporate and securities fraud cases each year, resulting in an average of 531 indictments and an average of 438 convictions.[2] As part of these government investigations, government regulators and prosecutors have required target corporations to turn over privileged documents in exchange for the prospect of leniency for the corporation, a practice condemned by Congressional leaders and prominent legal organizations. While recent changes in position by the DOJ will likely eliminate much of this "forced waiver" practice, the continuing trend in the law cutting back on the attorney-client privilege for corporations and, in particular, corporate counsel, indicates that corporations and corporate counsel need to take extra precautions when proceeding with internal investigations.

[1] Report to the President, Corporate Fraud Task Force, 2008, Letter from the Chairman, p. iii.

[2] *Id.* at 1.19.

II. Internal Investigations

A. Importance of Internal Investigations

Conducting internal investigations is an integral part of good corporate governance. A timely, thorough and carefully planned internal investigation can result in many benefits to a corporation, including early detection of culpable conduct, evaluating and preparing for the risk of exposure related to the culpable conduct and taking appropriate remedial measures to address culpable conduct. Other benefits may include dissuading the government from conducting its own investigation, convincing the government to reduce its investigation's scope and shaping media scrutiny by showing a corporation's good faith.[3] Government regulations encourage internal investigations. Indeed, some agencies have programs that encourage early detection and reporting of wrongful conduct, such as the Corporate Leniency Program of the Antitrust Division of the DOJ. Furthermore, the DOJ identifies the following criteria in assessing how to treat a corporate target in a criminal investigation:

- Existence and adequacy of a corporation's compliance program
- The corporation's remedial actions
- The audit committee's and board's role in the investigation[4]

On the other hand, a poorly planned and executed internal investigation will cause the corporation to fail to realize possible benefits and potentially subject the corporation to further sanctions or monetary damages. The corporation may also waive or compromise communications and documents normally protected by the attorney-client or work product privileges. Most importantly, the corporation will fail to detect and remedy the culpable conduct.

B. How to Conduct an Internal Investigation

Each internal investigation requires its own format depending on the purpose and scope of the investigation. To be effective, any investigation should include:

(1) A determination of the severity of the charges and the investigative measures that should be implemented, including whether an independent outside law firm should conduct the investigation;

(2) Identification of who will be provided the results of the investigation, including whether the results will be revealed to government agencies;

(3) A carefully designed scope and purpose;

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[3] Paul R. Bessette et al., *External Consequences: Internal Investigations After Sarbanes-Oxley*, METROPOLITAN CORP. COUNSEL, Sept. 2004, at 8.

[4] *Id.*

(4) Identification of the witnesses;

(5) Prompt action to preserve and secure all evidence, including relevant documents and electronic data;

(6) Clear communication to employees that investigating counsel does not represent them;

(7) Controls to prevent the investigation or details thereof from being disclosed to the media;

(8) An evaluation of the necessity and format of a written report of the investigation, assuming that any written report may ultimately be released to the public;

(9) Clear identification of who is and is not the client, such as the board of directors, audit committee or special committee appointed by the board; and

(10) A plan to ensure that the remedial measures identified as a result of the investigation are implemented to prevent recurrence of the problem(s) that led to the investigation.[5]

This section will elaborate on these suggestions and provide practical advice on how to conduct investigations. It will also provide insight concerning possible ramifications of a poorly designed internal investigation.

1. Compliance System and Initial Assessment

A corporation should be proactive in its approach to internal investigations. Corporate counsel should work with the board of directors to ensure that the proper systems are in place before any wrongdoing actually occurs. Simply put, it is too late to carefully plan an internal investigation after a crisis has been identified. Developing a compliance system for monitoring complaints, therefore, is the first step a corporation should take in the area of internal investigations.

In developing a compliance system, a key component is to identify the players who will be involved in an internal investigation. Consequently, the corporation should identify and create a crisis team that includes corporate counsel, outside counsel, auditors, information services personnel and experts grouped by their expertise to respond to complaints in different areas. Investigations frequently are unexpected and extremely time consuming, making it difficult to require a potential team member to drop what she is doing to dedicate her time exclusively to the investigation for the next several months or years. As a result, the team identified should have some depth. To provide this depth, the corporation should identify more

[5] *See* Robert W. Tarun, *Ten Tips for Handling Sensitive Investigations: Practical Advice You Need in the Sarbanes-Oxley Era*, 10 BUS. CRIMES BULL. 1, Nov. 2003.

than one individual or entity for each discipline that may be called upon to participate in the investigation.

Because the need for an internal investigation may originate from a variety of sources, including an independent audit, whistleblowers, a government subpoena or a lawsuit, the crisis team should be capable of responding to each.[6] The crisis team should ensure that the board is immediately informed of alleged wrongdoing by senior management or other issues that may create a conflict of interest if resolved by management.[7] The compliance system, however, should make certain that the board does not have to deal with "less consequential" complaints.[8]

Once assembled, the crisis team should identify the purpose, scope and goals of an investigation. To determine the scope of the investigation, some preliminary inquiry may be essential. Corporate counsel customarily are responsible for conducting this preliminary inquiry, but should be aware and make their boards aware that their participation in the inquiry may compromise the attorney-client privilege as to the inquiry's subject matter.

2. Securing and preserving the evidence

At the outset of an investigation, the investigator, with the assistance of corporate counsel, management and information services personnel, must identify the relevant documents and electronic media and take prompt measures to secure the evidence. To do so, the investigator must identify employees, board members and third-party service providers who may have evidence relevant to the investigation. The investigator may be required to retain the services of a forensic computer expert to restore lost or intentionally destroyed data. Further, the investigator may be required to retain a forensic accountant to review financial data to assist in identifying missing data. In fact, a thorough understanding of the documentation by the investigator is necessary before she proceeds further in the investigation and a forensic accountant frequently assists in helping the investigator to understand the data.

In addition to gathering relevant evidence, the corporation also must take prompt action to preserve all evidence by suspending its document retention policy. (If your company does not have a document retention policy and a method of suspending the document retention policy, your company should consider putting these measures into place.) Corporations are required to preserve documents when they receive notice that documents in their possession are relevant to actual or possible litigation or a government investigation.[9] Suspending the corporation's document retention policy protects the corporation from potentially destroying crucial evidence and the resulting harsh sanctions that can result from such spoliation.

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[6] Lee M. Dewey and Peter C. Spring, *In Readiness for an Internal Investigation*, DIRECTORS & BOARDS, Jan. 1, 2005, at 39.

[7] *Id.*

[8] *Id.*

[9] *Thompson Co. v. General Nutrition Corp.*, 593 F.Supp. 1443, 1455 (D.C. Cal. 1984).

The importance of preserving evidence is demonstrated by the proceedings involving the collapse of Enron and the resulting prosecution of Arthur Andersen, LLP. There, a jury found Arthur Andersen, LLP guilty of knowingly, intentionally, and corruptly persuading employees to withhold documents from a regulatory proceeding, and the 5th Circuit affirmed the decision. A partner at Arthur Andersen had urged employees to comply with the firm's document retention policy regarding Enron documents even after the SEC made Enron aware that it had opened an investigation into its accounting practices. Although the United States Supreme Court reversed the conviction in *Arthur Andersen LLP v. U.S.*,[10] the prosecution itself demonstrates the ramifications of improper document destruction.[11]

Another instructive case is *Arndt v. First Union National Bank*.[12] There, the North Carolina Appeals Court upheld a jury instruction that provided an adverse inference against a corporation for its failure to stop destroying pertinent documents even after receiving notice of a former employee's claim for breach of contract and other violations. The instruction said that the jury could infer that the destroyed documents, e-mails and profit and loss statements, would be damaging to the defendant. The jury ultimately found the corporation liable on the breach claim and awarded the employee over $800,000.

Finally, in *In re Prudential Insurance Co. of America Sales Practices Litigation*[13] the court sanctioned Prudential Insurance Company for improperly destroying documents by ordering it to pay a $1 million fine plus attorney's fees, to provide the court with a written document retention policy, and to start a telephone "hotline" devoted to reporting document destruction.

3. Who Participates in an Investigation

The success or failure of an investigation largely depends upon the credibility, integrity and capabilities of the investigator. If the board, management, the public or a government agency, all of whom may be expected to accept the findings of the investigation, does not have confidence in the independence and integrity of the investigation and the accuracy of its findings, the entire investigation will be rendered meaningless. Consequently, selecting the investigator often is the most important decision the corporation makes after deciding to undertake an investigation.

Assuming the complaint that triggered the compliance system is important enough to necessitate an internal investigation, the board must determine who will oversee the investigation and whether to appoint a committee of the board or form a special investigation committee to

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[10] 544 U.S. 696 (2005).

[11] Following the reversal by the Supreme Court, the DOJ announced that it would not re-prosecute Arthur Andersen, LLP. *See Arthur Andersen avoids criminal rap,* http://money.cnn.com/2005/11/23/news/midcaps/arthur_andersen/index.htm.

[12] 613 S.E.2d 274 (N.C. Ct. App. 2005).

[13] 169 F.R.D. 598 (D.N.J. 1997).

supervise the investigation. The persons responsible for overseeing the investigation should immediately decide whether to retain an independent law firm or use corporate counsel to conduct the investigation. Because courts closely scrutinize a claim of privilege when it relates to communications by or with corporate counsel, the corporation should retain outside counsel if the investigation surrounds a sensitive matter that the corporation would like to keep confidential.

In selecting outside counsel to conduct the investigation, a corporation may want to retain a completely independent outside firm if the firm's normal outside counsel has a close financial relationship with the corporation, which would call into question the independence of the outside counsel. For example, in the Enron investigation, Enron used its usual outside counsel, who had collected over $100 million in legal fees from Enron, to investigate transactions that its partners had facilitated. The law firm's self-interest called into question the credibility of its investigation of these transactions.[14]

4. Identifying the client and who is entitled to the results of the investigation

Equally important to identifying the investigator is identifying the client. If the audit committee is responsible for the investigation or a special litigation committee is formed to supervise the investigation, the corporation and its board must understand the limits on the extent of the disclosure of the results of the investigation, i.e., who may, and more importantly, may not, receive the results of the investigation.

The importance of this concept is demonstrated by the recent decision in *Ryan v. Gifford*.[15] *Ryan* involved a derivative action in which several of the directors were sued and related to stock option backdating. The board formed a special committee to oversee outside counsel's internal investigation. The special committee, the outside counsel's client, then presented its final oral report to the entire board, including board members who were under investigation for alleged wrongdoing and their counsel. The court concluded that the special committee waived any claim to attorney-client privilege by disclosing the results of the investigation to individual defendant board members and their counsel. The court concluded that the relationship between the special committee and the individual defendant board members was adversarial and, thus, the privilege had been waived, not only to the oral presentation, but the entire subject matter of the investigation.[16] In a later opinion, the court explained that the

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[14] Tarun, *supra* note 5.

[15] *Ryan v. Gifford*, 2007 WL 4259557 (Del. Ch. Nov. 30, 2007)

[16] *Id*., 2007 WL 4259557 at *3. The court further explained that any confusion as to whether the directors attended as fiduciaries or in their individual capacities was resolved when the individual defendant board members relied upon the findings for exculpation as individual defendants. *Id.; see also Securities Exch. Comm'n v. Roberts*, 2008 WL 3925451 *6, n. 4 (N.D. Cal. Aug. 22, 2008) (in finding a waiver of attorney-client and work product privileges that might apply to an internal investigation, the court concluded that the special committee, not the board, was the law firm's client and, to the extent the special committee was mandated to investigate the misconduct of the members of the board, the board and the special committee did not share a common interest.)

individual defendant board members and their counsel attended the board meeting not as fiduciaries, but in their individual capacities.[17]

Although the court's opinion is *Ryan* is limited to its specific facts, it demonstrates that the corporation must carefully monitor how the results of the investigation are disseminated, the circumstances under which they are disseminated and to whom they are disseminated. The more widely the results of an investigation are disseminated, the more likely courts will find that there has been a waiver of the attorney-client and work product privileges.

5. Communicating with employees and witnesses

The interviews conducted as part of an investigation obviously play a integral role in the accuracy of its results. Employees must understand the confidential nature of the communications and understand the investigator's relationship with them when she conducts her interview. To accurately document the interview, the investigator should have someone available to take notes of the interview.

The corporation should take special precautions in how it communicates with its employees, especially those who are witnesses. First, the corporation should advise the employees involved of the investigation and ask for their full cooperation with the investigators. Second, the corporation should instruct the employees to not discuss the investigation with anyone other than the investigators. This prevents potential collaboration and fabrication among the employees and also preserves the confidential nature of the investigation. The employees, however, should not be led to believe that the results of the interview will be privileged or remain confidential. Indeed, if the corporation has already determined that it will disclose the investigation to the government, the employee should be so advised and not misled to believe that the results of the interview will remain confidential.

Third, the investigator, whether corporate or independent counsel, should give employees interviewed as part of the investigation an *Upjohn* warning, so called because it is premised on the United States Supreme Court's landmark opinion involving attorney-client privilege in *Upjohn v. U.S.*[18] To provide the warning, the investigator must explain to employees that discussions with corporate counsel are privileged, but that the privilege belongs solely to the company and may be waived at any time by the company.[19] As a result of this warning, "[e]mployees are left with the accurate understanding that anything they say may be disclosed to third parties, including law enforcement, government regulators, and plaintiff's counsel."[20] The investigator must balance the *Upjohn* warning with the requirement of Model Rule 4.4, which

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[17] *Ryan v. Gifford*, 2008 WL 43699 (Del. Ch. Jan. 2, 2008)

[18] *Upjohn v. U.S*, 449 U.S. 383 (1981).

[19] *White Collar Crime Enforcement Issues: Hearing Before the House Judiciary Subcommittee on Crime, Terrorism, and Homeland Sec.*, 109th Cong. 2006 WLNR 3887189 [hereinafter *Hearings*] (statement of William M. Sullivan, Jr., Litigation Partner at Winston and Strawn).

[20] *Id.*

provides, "In representing a client, a lawyer shall not use methods of obtaining evidence that violate the legal rights of third persons."[21]

Fourth, if the employee is a potential criminal defendant, the employee should be advised of her right to obtain independent counsel. This is extremely important because, on the one hand, the employee is being required to provide evidence with the fear that she will lose her job if she does not not cooperate, and on the other hand, the very evidence the employee provides may be used against her in a subsequent criminal prosecution.

Finally, employees should be reminded of the possible consequences of being untruthful, including the potential that the employee might later suffer internal penalties or be charged with obstruction of justice if the results of the investigation are revealed to the government as part of its investigation.

6. The report of the findings of the investigation

The determination of whether to issue a written or an oral report of the investigation is driven by the facts and purpose of each investigation.[22] In the post-Enron world, a written report may be the better choice in that it assures stockholders and government agencies that the corporation will take remedial action. As *Ryan* demonstrates, however, the potential waiver of privilege is not dependent on whether the report is oral or written.[23]

In preparing a report, corporations should assume that the report will be requested and prepare for its confidentiality to be challenged. As a result, the report should separate factual findings from legal conclusions, or perhaps the corporation should prepare two separate reports so as to protect the legal conclusions under the attorney-client privilege in the event a government agency or other third party subsequently subpoenas the report. Damaging legal conclusions expressed in conjunction with the factual findings of an investigation could not only be potentially devastating in future litigation, but could also hurt public perception of the corporation. The authors of the report should carefully choose the wording of their factual findings and conclusions and should include and highlight the positive evidence, not just point out the potentially damaging evidence. These measures are important because the report, whether accurate or not, becomes critical evidence once it is disclosed.

The report should include:

- the identity of the client;
- the events or circumstances necessitating the investigation;

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[21] *Id.*

[22] Tarun, *supra* note 5.

[23] *Ryan*, *supra* note 15.

- the method of investigation, including the persons interviewed, the documents reviewed, and whether the document retention plan was suspended;
- any impediments to completing the investigation, such as a witness invoking her rights under the Fifth Amendment;
- the identity of the participants and confirmation that the investigator informed the witnesses that she was independent;
- confirmation that the *Upjohn* warning was provided to employees and they were notified of their right to seek counsel;
- an accurate and thorough factual finding;
- conclusions as to culpability, both positive and negative;
- remedial measures to be implemented and an action plan for implementing; and
- additional investigation that may be necessary.

Even though all investigations are different, including these elements are necessary for any report.

7. Executing the remedial measures

Once a corporation completes the investigation, it must implement the remedial measures identified in the report or be prepared to explain why it did not implement them. Prosecutors and regulators in subsequent investigations will review the company's response to prior incidents when they make enforcement decisions. A corporation should also follow through on its own recommendations because such actions will get a positive response from the public. Moreover, corporations have a responsibility to be good public citizens and, therefore, should follow through on their recommendations so as to have institutional integrity regardless of any positive externalities.

In addition, the corporation should be aware of whether any regulatory requirements have been triggered and whether any disclosure needs to be made to auditors, regulators, or law enforcement officials.[24] Many federal agencies have policies that offer amnesty or lenience to a corporation for self-reporting potential violations.

The corporation should also notify the corporation's insurance carrier of the investigation and its conclusions, without waiving privilege, in a timely manner. By doing so, corporations meet disclosure requirements and can enlist the help of the insurance carrier if litigation ensues.

[24] Dewey and Spring, *supra* note 6.

8. Ethical Considerations for Corporate Counsel in the Aftermath of Wrongdoing

Both the Model Rules of Professional Conduct and Tennessee Rules of Professional Conduct require lawyers representing corporations to take additional steps after discovering wrongdoing. The Tennessee Rules of Professional Conduct provide in pertinent part:

> (b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization has engaged or is engaged in action, has refused or refuses to act, or intends to act or refrain from acting in a matter related to the representation that is or will be a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:
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> > (1) asking reconsideration of the matter;
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> > (2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
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> > (3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act on behalf of the organization as determined by applicable law.
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> (c) If, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may withdraw in accordance with Rule 1.16 and may make such disclosures of information relating to the organization's representation only to the extent permitted to do so by Rules 1.6 and 4.1.[25]

[25] TENN. RULES OF PROF'L CONDUCT R. 1.13.

As a result of this rule, corporate counsel "shall" report both criminal and civil wrongdoing that an investigation uncovers upon discovering it if the offense violates a legal obligation to the corporation or is a violation of the law that might be imputed to the organization and is likely to cause the corporation substantial injury. The lawyer has discretion in deciding where to report the offense and can go to the board if she deems it necessary. It is important to note that if, after reporting the offense, the corporation fails to remedy the offense, the lawyer "may" withdraw or make permissible disclosures outside the corporation but the rule does not force her to do either.

C. Federal Investigations and Their Impact on Internal Investigations

As the number of investigations of corporations by federal agencies and the DOJ has increased, federal agencies and the DOJ have become increasingly aggressive in demanding from corporations information that results from their internal investigations. Both the SEC and the DOJ have guidelines that set forth criteria for determining how aggressively to pursue criminal charges against the corporation for misconduct and consider a corporation's cooperation as part of this criteria. Prosecutors and regulators increasingly request that, in exchange for the mere prospect of leniency, referred to by the DOJ as charging guidelines, corporations both investigate themselves and submit reports documenting the extent of the inquiry and the basis of the inquiry's conclusions, a practice commonly referred to as "forced waiver".[26] Officials may "request" the identities of those involved, their acts and any documentation.[27]

The position of the DOJ has evolved and recently, in response to concern expressed by Congressional leaders and other legal organizations, the DOJ implemented new policies that are designed to protect the attorney-client privilege. By way of background, in 2003, following the Enron and WorldCom accounting scandals, the DOJ implemented a policy to encourage corporations to waive attorney-client privileged investigative findings in exchange for leniency through the Principles of Federal Prosecution of Business Organizations, more commonly known as the Thompson Memorandum.[28] This policy was revised in 2006 by the McNulty Memorandum.[29] The McNulty Memorandum restricted the ability of the government to seek privileged information by requiring that there be a "legitimate need" for the privileged information and approval of the Deputy Attorney General before seeking privileged information. The McNulty Memorandum further states that "[w]aiver of attorney-client and work product protections is not a prerequisite to a finding that the company has cooperated in the government's investigation," but explains that "a company's disclosure of privileged information may permit the government to expedite its investigation." The principles set forth in the Thompson Memorandum and the McNulty Memorandum were incorporated into the United

[26] *Hearings*, *supra* note 19.

[27] *Id.*

[28] See Principles of Federal Prosecution of Business Organizations at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

[29] http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf

States Attorneys Manual ("USAM"), which is binding on all DOJ prosecutors. Under both memoranda, the DOJ could consider the corporation's response to the government's request for privileged information in determining whether the corporation cooperated with the government's investigation, a key criteria under both memoranda in determining whether to bring criminal charges against the corporation. Under both memoranda, corporations were, in effect, forced to waive the attorney-client privilege relating to their investigations in hopes that the government would not bring charges against them, earning the well-deserved label "forced waiver."

Over the last several years, Congressional leaders, including Senators Arlen Specter and Patrick Leahy, leaders on the Senate's Judiciary Committee, began to closely scrutinize the DOJ's policies. Indeed, a bill titled The Attorney-Client Privilege Protection Act of 2008 (S. 3217, 110th Congress) is currently pending in the United States Senate.

In response to this close scrutiny and to prevent the passage of The Attorney-Client Privilege Protection Act of 2008, the DOJ re-evaluated and revised its position. In a letter to Senators Patrick Leahy and Arlen Specter dated July 9, 2008, attached hereto as Exhibit A, Deputy Attorney General Mark Filip described the DOJ's revised policy and changes to the Principles of Prosecution of Business Organizations. Mr. Filip outlined the following points, which appear to abrogate the forced waiver principles previously followed by the DOJ:

- Cooperation will be measured by the extent to which a corporation discloses relevant facts and evidence, not its waiver of privileges
- Federal prosecutors will not demand the disclosure of "Category II" information [non-factual attorney work product and core attorney-client privileged communications] as a condition for cooperation credit
- Federal prosecutors will not consider whether the corporation has advanced attorneys' fees to its employees in evaluating cooperation[30]
- Federal prosecutors will not consider whether the corporation has entered into a joint defense agreement in evaluating cooperation

The DOJ announced that it had adopted these policies on August 28, 2008, stating that they are effective immediately and will be incorporated into the USAM.

While the adoption of the new policies is a step in the right direction, corporations are not entirely in the clear. The DOJ's new guidelines do not apply to other federal agencies, including the SEC, which consider disclosure of privileged information as part of their evaluation of a

[30] This revision is consistent with the recent opinion the Court of Appeals for the Second Circuit upholding the dismissal of charges against of several former partners and employees of KPMG accounting firm on the ground that federal prosecutors deprived the defendants of their Sixth Amendment right to counsel by forcing KMPG into not paying their legal fees. *See United States v. Stein,* 2008 WL 3982104 (2nd Cir. Aug. 28, 2008). In *Stein*, the court criticized the federal prosecutors for using the DOJ's Thompson Memorandum policy of permitting prosecutors to view a company's payment of legal fees as an indication that the company is not cooperating with a criminal investigation.

corporation's cooperation. If enacted, however, The Attorney-Client Privilege Protection Act of 2008 would prohibit all federal agencies from requesting companies to waive privilege or advance defense fees to employees. It would not prevent the federal agencies from accepting volutary waivers of privilege by companies they investigate.

Going forward, corporations should be careful in analyzing the information they disclose to the government because any disclosures made to the government could result in a broad waiver of the attorney-client and work product privileges for the underlying subject matter.[31] Such a waiver would be applicable to law enforcement officials and all future third parties, including plaintiffs' attorneys.[32]

To date, courts have been reluctant to endorse a practice known as selective waiver, under which the corporation could cooperate with the investigating agency by providing information concerning its investigation and still assert privilege when the same documents are sought in other proceedings, such as civil claims arising from the subject matter of the investigation. In attempting to cooperate with the government and protect privilege, corporations negotiate with the investigating agency in an effort to provide the document to the agency but preserve the privilege as to any other entity. These agreements frequently are documented in writing. Corporations, however, should be aware that the enforceability of such documents is within the discretion of the court reviewing the assertion of privilege.[33] Accordingly, until courts allow for a limited selective waiver of the attorney-client and work product privileges, corporate counsel should be very careful in deciding to cooperate with federal regulators in exchange for leniency.[34]

Several recent cases demonstrate the potential impact of providing documents concerning an investigation to the government in exchange for potential leniency. Most recently, in *Securities Exch. Comm'n v. Roberts*,[35] the court ruled that communications shared with the SEC were not privileged. *Roberts* involved an action against the former executive vice president of McAfee, Inc. for securities law violations in conjunction with stock option backdating. During

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[31] *Hearings*, *supra* note 19.

[32] *Id.*

[33] A proposed amendment to Rule 502 of the Federal Rules of Evidence recently passed in Congress and now awaits the President's signature. The amendment specifically states that "An agreement on the effect of disclosure in a federal proceeding is binding only on the parties to the agreement, unless it is incorporated into a court order." Proposed New Evidence Rule 502, attached to Letter to Patrick J. Leahy and Arlen Specter dated September 26, 2007, available at http://www.uscourts.gov/rules/Hill_Letter_re_EV_502.pdf, at 16.

[34] In recent discussions concerning a proposal to amend Federal Rules of Evidence, Rule 502, the Judicial Conference of the United States considered adopting the concept of selective waiver as part of Rule 502. The Judicial Conference, however, ultimately decided to leave selective waiver out of the proposed amendment as a result of the controversy surrounding its adoption. Letter to Patrick J. Leahy and Arlen Specter dated September 26, 2007, available at http://www.uscourts.gov/rules/Hill_Letter_re_EV_502.pdf, at 6.

[35] *Securities Exch. Comm'n v. Roberts*, 2008 WL 3925451 (N.D. Cal. Aug. 22, 2008).

discovery, Roberts sought written notes held by an outside law firm hired by a special committee formed by the Board of Directors of McAfee. The law firm made presentations based upon its investigation to, among others, McAfee's board, the SEC and the DOJ. During the presentations, the law firm discussed some of its findings and answered questions it was asked about the individuals interviewed. Roberts sought the law firm's notes from its interviews, notes of the law firm's meetings with the government and notes of the law firm's communications with McAfee's management, Special Committee and Board. The court concluded that, to the extent that the law firm orally disclosed to the government factual information contained in any written material requested by Roberts, e.g, the law firm's interview notes, the law firm had waived the attorney-client and work product privilege with respect to that information.[36] The court further concluded that the law firm was required to produce notes of its meetings with the government, subject to redaction of the law firm's mental impressions and conclusions.

In *In re Columbia/HCA Healthcare Corporation*,[37] Columbia/HCA entered into an agreement with the federal government when it turned over documents regarding billing practices stating that the production did not constitute a waiver of attorney-client or work product privileges. Corporate counsel had created the documents after an internal audit. Judge Higgins of the U.S. District Court for the Middle District of Tennessee held that the voluntary disclosure of the privileged materials to an "adversary" constituted a waiver of the attorney-client and work product privileges. Columbia/HCA was therefore compelled to produce the documents to the plaintiffs in subsequent litigation.

Similarly, in *U.S. v. Hawkins*,[38] the McKesson Corporation ("McKesson") hired Skadden, Arps, Slate, Meagher, & Flom ("Skadden") to conduct an internal investigation of McKesson's accounting practices. McKesson and Skadden turned the internal report over to the SEC and other governmental entities in order to avoid criminal charges. Federal prosecutors did not charge McKesson itself, but did file criminal charges against McKesson's CFO, Richard Hawkins, and other executives. McKesson was also sued by shareholders in actions relating to the subject matter of the investigation. The prosecutors in the criminal trial of Hawkins sought to introduce the report in the criminal proceeding. McKesson intervened in Hawkins' trial in an attempt to close the portions of the trial in which the court would discuss the contents of the Skadden report, along with memos and interviews forming the basis of the report. McKesson argued that the attorney-client and work product privileges protected these documents. The court held that McKesson's interest in protecting privileged documents was not "sufficiently compelling" to outweigh the public's First Amendment right to access Hawkins' criminal trial thereby permitting the disclosure of otherwise privileged information.

Corporate counsel should pay close attention to these cases. The courts' decisions gave the public and plaintiffs' attorneys unfettered access to investigative findings for use in civil proceedings. Moreover, these cases demonstrate the position of a majority of courts, which do

[36] *Id.* at *5.

[37] 192 F.R.D. 575 (M.D.Tenn. 2000).

[38] 2005 WL 3234509, No. CR 04-106 (N.D.Cal. Jan. 10, 2005).

not honor selective waiver agreements made by corporations with the government. As a result, corporate counsel should carefully weigh the benefits of the potential disclosure with the potential risks in subsequent related proceedings.

III. Limits on the Attorney-Client and Work Product Privileges for Corporate Counsel

A. Attorney-Client Privilege

1. Basics

The attorney-client privilege is a common law privilege universally recognized by American courts. Its purpose is to encourage clients to communicate candidly with their attorneys, and it is strictly construed by courts. A commonly cited formulation of the privilege in Tennessee and other courts states that the privilege exists:

> (1) Where legal advice of any kind is sought, (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence, (5) by the client, (6) are at his instance permanently protected, (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.[39]

Tennessee has codified the privilege:

> No attorney, solicitor or counselor shall be permitted, in giving testimony against a client, or person who consulted an attorney, solicitor or counselor professionally, to disclose any communication made to the attorney, solicitor or counselor as such by such person, during the pendency of the suit, before or afterwards, to the person's injury.[40]

State law governs the application of the privilege in state courts.[41] Federal courts apply federal common law of privilege to federal claims and will apply state privilege law to diversity cases.[42] In situations in which the forum is different than the place of the communication or transaction, the forum court may not apply the privilege rules of the forum. Instead, these courts will often choose to apply the privilege rules of the state with the most significant contacts to the communication as a matter of policy.[43]

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[39] *Lewis v. U.S.*, 2004 WL 3203121 (W.D.Tenn. Dec. 7, 2004) (citing *U.S. v. Goldfarb*, 328 F.2d 280, 281 (6th Cir. 1964).

[40] TENN. CODE ANN. § 23-3-105 (2006).

[41] *See* Fed. R. Evid. 501 (stating that in civil actions and proceedings where state law supplies the rule of decision, state law determines the privilege).

[42] *Fleet Bus. Credit Corp. v. Hill City Oil Co.*, 2002 WL 31741282, No. 01-02417 (W.D. Tenn. Dec. 5, 2002).

[43] 1 KENNETH S. BROUN, MCCORMICK ON EVIDENCE § 73.2 (6th ed. 2006).

2. Attorney-Client Privilege and Corporations

Because courts consider corporations "clients," they have extended the attorney-client privilege to such corporations. In *Upjohn v. U.S*,[44] the U.S. Supreme Court clarified the scope of the privilege in the corporate context. There, Upjohn's general counsel sent a questionnaire to all of Upjohn's overseas managers as part of an internal investigation. The IRS subsequently requested the completed questionnaires when it started its own investigation of Upjohn. The Court rejected the widely used "control group" test, which held that the privilege only applied to corporate officers or employees in positions of substantial decision-making power. Instead, the Court used a case-by-case "functional" test with the following factors pointing toward a finding of privilege:

- the communications were made by employees to corporate counsel in order for the corporation to secure legal advice;
- the employees were cooperating with corporate counsel at the direction of corporate superiors;
- the communications concerned matters within the employees' scope of employment; and
- the information sought was not available from senior management who might have been part of Upjohn's control group.[45]

Part of the Court's rationale for extending the privilege beyond the control group was to encourage internal investigations so that corporate counsel could help "ensure their client's compliance with the law."[46] While Tennessee is not among the number of states whose courts have adopted the *Upjohn* test, no Tennessee decisions call the test into question. Additionally, a U.S. District Court in Tennessee cited to the test in *Royal Surplus Lines Ins. v. Sofamor Danek Group*,[47] a diversity case in which the court extended the privilege to communications between an insurance company's lawyer and a third-party broker. Because "Tennessee courts frequently look to state and federal common law when fashioning the contours of the attorney-client privilege,"[48] it is likely that the *Upjohn* functional test is the law in Tennessee.

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[44] 449 U.S. 383 (1981).

[45] *Id.* at 394-95.

[46] *Id.* at 392.

[47] 190 F.R.D. 463 (W.D. Tenn. 1998).

[48] *Id.* at 505.

3. Courts Limit the Extent of the Privilege for Communications with Corporate Counsel

Even though the Court in *Upjohn* explicitly protected the documents collected by corporate counsel in the course of internal investigations, since then courts have limited the privilege for corporate counsel. This presumption against the privilege for corporate counsel stems from the nature of the position. Corporate counsel often wear many hats within the corporations for whom they work. They often serve as members of the board of directors or company officers and therefore have a "mixed business-legal responsibility."[49] Even those corporate counsel who do not jointly serve in official management positions are routinely called upon to impart valuable guidance that frequently constitutes business advice. Courts are also biased against corporate counsel because of the concern that corporations will abuse the privilege by funneling unprotected information to corporate counsel in an attempt to shield it from discovery. Courts that have limited the attorney-client privilege for corporate counsel do so by taking a limited view as to what constitutes "legal advice." Corporate counsel should pay close attention to two Tennessee decisions in this regard.

In *Miller v. Federal Express Corp.*,[50] Magistrate Judge Vescovo ordered that documents relating to an EEOC charge, some of which were authored by Fed Ex's corporate counsel, were discoverable because they were not for the purposes of obtaining legal advice. The documents the court reviewed were e-mails from corporate counsel to several management level employees concerning instructions for the internal EEOC investigation. She ruled that the e-mails were not privileged because Fed Ex failed to make a showing that they were written to provide legal advice.

In *Royal Surplus Lines Ins. Co. v. Sofamor Danek Group, Inc.*,[51] Magistrate Judge Vescovo specifically reviewed, *in camera*, all of the documents that a non-party, Sedgwick James of Tennessee, produced. Sedgwick was the insurance broker who facilitated the sale of a Royal insurance policy to Sofamor Danek Group (SDG). The disputed communications included those between corporate counsel and employees of both Sedgwick and SDG. Among other findings, the court determined that the corporate counsel for Sedgwick was acting solely in an effort to procure a "particular business arrangement," namely the sale of the insurance policy, during a meeting with executives, and ordered the production of the meeting notes because the counsel gave no "legal advice". The court made this determination as part of a line-by-line review of documents, ordering that some lines be produced and others not.

Other jurisdictions have also tightened up the use of the privilege as applied to corporate counsel. In *Cardenas v. Prudential Insurance Co.*,[52] a Minnesota court held that a memorandum

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[49] Peter C. Buck et al., *Confidentiality of Communications by In-House Counsel for Financial Institutions*, 6 N.C. BANKING INST. 265, 289 (April 2002).

[50] 186 F.R.D. 376, 388 (W.D.Tenn. 1999).

[51] 190 F.R.D. 505 (W.D.Tenn. 1999).

[52] 2004 U.S. Dist. LEXIS 1778, No. 99-1421 (D. Minn. Jan. 30, 2004).

written by Prudential's corporate counsel to an executive level employee was not protected by the attorney-client privilege. The document detailed "goals of the Employment and Labor Law sector and was made for business purposes, rather than legal advice."

In *Borase v. M/A Com, Inc.*,[53] the court concluded that, if a corporate counsel has other non-legal job titles, the corporation has to make a "clear showing" that the corporate counsel was giving legal advice in order for a communication to be protected. There, the court held that the corporation failed to carry its burden of demonstrating that their corporate counsel, who also served as a Senior Vice-President and Corporate Secretary, was acting as an attorney, rather than a businessman, when he had certain conversations with management concerning the termination of an employee. At these meetings, the corporate counsel discussed reasons for the termination, the possibility that the employee might bring a discrimination claim, and other details of a separation agreement that the employee signed.

This trend in the law calls into question a corporate counsel's ability to engage in investigative activities because these activities may not involve the giving of "legal advice".[54] The American Bar Association (ABA) denounced this line of decisions in 1997, arguing that courts should not subject corporate counsel to a stricter standard than outside counsel.[55] The ABA argued that applying different rules to corporate counsel discourages corporate communication with corporate counsel and, therefore, undermines a justification for the attorney-client privilege itself: fostering a client's law-abiding conduct.[56] These different judicial rules for inside and outside counsel seem even more unfair because, in many cases, outside counsel may give business advice more frequently than corporate counsel. In a study of New York lawyers, 47.8% of outside counsel said they give business advice frequently compared with only 46.7% of corporate counsel.[57]

4. Measures to Increase the Likelihood that Documents will be Privileged

Corporate lawyers may take certain measures in order to keep communications and documents privileged. These steps include:

(1) Marking files "privileged" and "confidential." Simply putting a stamp on a file will not protect an otherwise unprotected document. However, such a marking will make it less likely that legal advice will be considered non-legal

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[53] 171 F.R.D. 10 (D. Mass. 1997).

[54] In addition, the European Union and many countries around the world do not consider communications with corporate counsel to be privileged.

[55] Amy L. Weiss, *In-House Counsel Beware: Wearing the Business Hat Could Mean Losing the Privilege*, 11 GEO. J. LEGAL ETHICS 393, 403 (1998).

[56] *Id.* at 402.

[57] *Id.* at 399.

(2) Carefully choose who will attend meetings

(3) Limit the dissemination of confidential documents

(4) Refrain from handling matters normally handled by business executives

(5) Above all, strive to keep communications in their legal role separate from business-oriented communications[58]

Because some courts, like the Massachusetts court in *Borase*, are especially suspicious of corporate lawyers who are also officers or board members, shedding these extra duties is a way to increase the chances that the attorney-client privilege will attach to communications. The problem here, and with some of the above suggestions, is that corporations hire counsel for not only their legal skill, but also their overall wisdom, which normally includes business acumen. In addition, even if corporate counsel shed these other official roles, this is no assurance that their communications will be privileged. Courts have made it clear that even if a corporate lawyer does not wear another "hat" in the organization, they will engage in detailed privilege analysis regarding possibly privileged communications. As a result, corporate counsel should make their clients aware that communications during negotiations and any business-related communications may not be protected by the privilege.[59]

An additional problem is created by the increasing use of e-mail chains. A hypothetical often encountered by corporate counsel illustrates this point. The corporate counsel appropriately limits distribution of an e-mail opinion to a select group of managers who "need to know." However, those managers then forward the counsel's e-mail to a much broader group who have no responsibility for the subject matter addressed or, worse, use portions of that advice to inform unrelated business decisions. Aggressive plaintiff's counsel then argues that the wide dissemination of the initial privileged communication waives the privilege. To prevent disclosure of confidential communications based on this hypothetical, it is important not only that corporate counsel limit the distribution of privileged e-mail, but that she also caution the recipients against further distribution.

B. Work product Privilege

A separate form of privilege that may be waived if not protected, particularly when it is applied to corporate counsel is the work product privilege. The work product privilege is codified in the Federal Rules of Civil Procedure.

> [A] party may obtain discovery of documents and tangible things otherwise discoverable . . . and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative . . . only upon a showing that the party seeking discovery has substantial need of the materials in

[58] *Id.* at 409.

[59] *Id.*

> the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means. . . . the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.[60]

This protection differs from the attorney-client privilege in a few ways. First, the purpose behind the work product privilege is to allow parties to freely prepare documents for litigation, not to protect the attorney-client relationship. Second, certain aspects of the work product privilege are broader while some are narrower than the attorney-client privilege. The work product privilege is broader in that it protects all communications prepared in anticipation of litigation, not just those created by lawyers. It is narrower in that, for work product privilege to apply, there must be a reasonable likelihood that litigation is forthcoming; whereas, the attorney-client privilege is not litigation-specific. The work product privilege is also narrower in that an adverse party can overcome it by showing a substantial litigation need for the materials and the inability to obtain the materials without undue hardship.

The Supreme Court explicitly applied the work product privilege to corporate counsel in *Hickman v. Taylor*.[61] Courts, however, often refuse to extend work product privilege to documents for the same reasons that they do not extend attorney-client privilege. They do not want the corporation to funnel all documents through a lawyer solely to shield the documents from discovery. The most likely challenge to a claim of work product privilege is that the documents were not created in anticipation of litigation but in the normal course of business. For example, in *Miller v. Federal Express Corp.*,[62] the court refused to find communications protected by work product privilege because Fed Ex conducted EEOC investigations routinely and for a purpose other than preparing for litigation, e.g., to improve employee relations.

IV. Conclusion

Corporations must plan for problems before they occur. Consequently, corporations must be proactive in creating a system that investigates and addresses complaints and allegations in a timely and thorough manner. A corporation should strongly consider using an independent outside law firm to conduct the investigation in order to preserve the attorney-client privilege for the findings. In the post-Enron corporate world, the public, the government and courts will look more favorably on a corporation that conducts a thorough and independent investigation and demonstrates a commitment to implement recommended remedial measures and may provide benefits that prevent or reduce unnecessary losses to or criminal charges against the corporation.

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[60] Fed. R. Civ. P. 26(b)(3). Tennessee has an almost identical version codified at Tenn. R. Civ. P. 26.02(3).

[61] 329 U.S. 495 (1947).

[62] 186 F.R.D. 376, 388 (W.D.Tenn. 1999).