

PRESERVING PRIVILEGE WHEN UNDERTAKING INTERNAL INVESTIGATIONS

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Like it or not, corporate boards and in-house counsel are in the era of the internal investigation. Indeed, the internal investigation seemingly has evolved into its own distinct body of law. This phenomenon is most notably attributable to 1. the dictates of the Sarbanes-Oxley (SOX) Act, which requires companies to implement procedures to sift out accounting improprieties and requires in-house and outside counsel and auditors to investigate and report *indicia* of fraud; 2. Securities and Exchange Commission pronouncements targeting directors, auditors and attorneys who fail to exercise these fiduciary responsibilities; and 3. class-action settlements in which outside directors and professionals were required to kick in money out of pocket.

Since SOX's enactment in 2002, more than 2,500 public companies have retained outside counsel to conduct internal investigations into suspected wrongdoing, according to a February 2008 paper by the American College of Trial Lawyers, "Recommended Practices for Companies and Their Counsel in Conducting Internal Investigations." That is a sign that many companies are taking their obligations seriously.

In an effort to uncover and remediate wrongdoing, however, counsel inevitably will create a road map that, in the hands of plaintiffs counsel, could lead to huge damages in shareholder suits.

But companies can be assured that the attorney-client privilege and work-product doctrine will insulate investigative work from discovery in shareholder litigation, right? Not so fast. There are a number of land mines waiting to cause privilege to be forever waived. Here are five important rules for companies to keep in mind.

1. *A lawyer must be involved to receive any protection.* While this may seem elementary, companies often use nonlawyers, such as internal auditors, to conduct investigations or at least to do an initial assessment of the allegations. None of that investigative work will be protected unless directed or conducted by counsel.

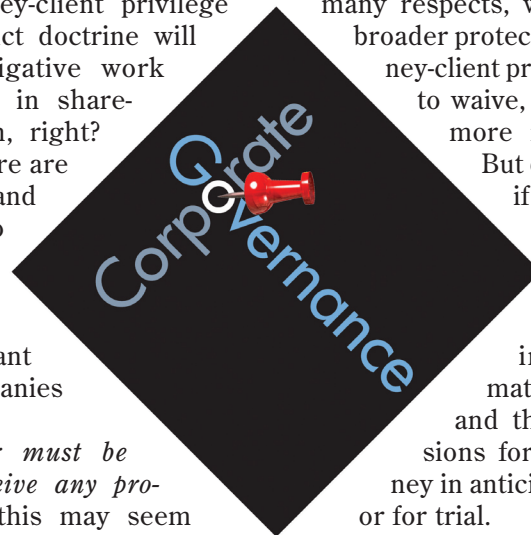
2. *Clarify the goal of the investigation to obtain attorney-client privilege.* For communications between a client and investigative counsel to be protected, they must be made for the purpose of facilitating legal services. The company, therefore, should ensure that

the engagement agreement clearly indicates that it is retaining counsel to develop factual information for the purpose of providing legal advice to the client.

3. *Position the investigation for maximum work-product protection.* In many respects, work product is a broader protection than the attorney-client privilege. It is harder to waive, and any waiver is more narrow in scope. But determining when, if at all, the work-product doctrine applies often is difficult. Work product only immunizes the material prepared by, and the mental impressions formed by, an attorney in anticipation of litigation or for trial.

A party must reasonably anticipate litigation before triggering work-product protection. But, because the purpose of an investigation usually is to determine whether any wrongdoing occurred, the triggering event may not arise until later in the investigation, if at all.

To best position the investigation for work-product protection, the company promptly should retain outside counsel to conduct the inquiry. The company and its counsel continually should analyze the prospect of future



litigation and document the company's determination that it anticipates litigation, including the existence of any ongoing government investigation or other basis for the company's belief. When the company makes that determination, it should send an appropriate document-hold notice to, at least, all persons who might hold relevant information, including the company's IT professionals.

4. *Ensure lawyers oversee outside consultants.* To protect outside consultants' work product and the confidentiality of communications between counsel and consultants, outside counsel, rather than the client, should retain and direct the consultants' activities. Additionally, it is not advisable to retain consultants who already perform similar services for the company.

5. *Limit disclosure of any part of the investigation.* Entire articles have been devoted to this subject. But, to be sure, disclosure of any part of the investigation to any third party involves potential peril for attorney-client privilege or work-product immunity. That includes disclosure to the company's own directors, officers and auditors.

First, the general assumption should be that when a company chooses to provide investigatory information to a government agency, it is waiving, as to any person and purpose, any protection associated with that information. Most courts have rejected the selective-waiver concept, in which parties attempted to argue that the waiver only applied to the government agency.

Second, disclosure to the company's auditors is fraught with danger of waiver. Generally, in the context of

the attorney-client privilege, an auditor will not be considered a representative of the client or the lawyer. Therefore, any disclosure of privileged information to the auditor will waive the privilege.


Disclosure of work product is a more difficult question since waiver results only when disclosure is made to an adversary or in a manner that substantially increases the likelihood of disclosure to an adversary. Whether disclosure to an auditor meets this waiver standard will be a fact-specific analysis and usually will only be settled well after disclosure to auditors has occurred; predicting what an unknown judge will later decide cannot be done with any level of certainty. While there are benefits to disclosure of information to auditors, lawyers and their clients must weigh that benefit in the context of the potential waiver of the information provided.

Third, the persons implicated in the potential wrongdoing are sometimes high-ranking company officers or members of the board — people frequently within the group to whom the investigation status and conclusions are normally provided. But, based on the investigation, these same people may later become adverse to the company, either because their employment is terminated or they are targets of shareholder derivative suits, and disclosure of protected information to them could result in a waiver. Analyze this fact-intensive issue throughout the investigation to prevent unintended waiver.

Similarly, a lawyer's communications with lower-level employees may not be protected from disclosure as

attorney-client communications. Some courts have limited the privilege to communications with senior management and employees who advise senior management on final decisions.

Even if a lawyer's interviews with certain employees are outside the attorney-client privilege, his notes could be protected as attorney work product. To enhance this likelihood, lawyers should avoid taking down verbatim statements or putting statements in quotation marks in interview notes and summaries. In addition, they should not ask employees to review the notes or summaries.

Readers can find extensive discussion of waiver when disclosures are made to certain directors in *Ryan v. Gifford*, a 2008 decision by the Delaware Chancery Court. 

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