Internal Investigations 2009:

How to Protect Your Clients or Company

Co-Chairs

Nancy Kestenbaum
Richard J. Morvillo
David B. Bayless
Sheila Finnegan

Practising Law Institute

5

COMMENCING THE INTERNAL INVESTIGATION

Douglas R. Young
Jessica K. Nall
Paul A. Alsdorf
Ann-Catherine Padian
Farella Braun + Martel LLP

Prepared March 27, 2009

BIOGRAPHICAL INFORMATION

Douglas R. Young is a senior litigation partner in the San Francisco law firm of Farella Braun + Martel LLP, where he concentrates his practice in the areas of complex commercial litigation and white collar criminal defense. He is a Fellow of the American College of Trial Lawyers, the International Academy of Trial Lawyers, and of the American Academy of Appellate Lawyers. Mr. Young has also served as President of the Bar Association of San Francisco and as an officer or board member for several public-interest organizations. Mr. Young has regularly accepted court appointments under the Federal Criminal Justice Act or on a pro bono basis for individuals and institutions. He is a recipient of the ABA Pro Bono Public Award and of the Criminal Justice Achievement Award from the Criminal Trial Lawyers Association of Northern California. Mr. Young is listed in *The Best Lawyers in America* and in the *Chambers USA Guide to America's Leading Business Lawyers*. Mr. Young can be reached at 415-954-4438, or by e-mail at *dyoung@fbm.com*.

Jessica K. Nall is a partner in the white collar criminal defense group in the San Francisco law firm of Farella Braun + Martel LLP. Ms. Nall's white collar criminal defense practice focuses on the representation of executives facing SEC enforcement actions and criminal prosecution as well as internal corporate investigations relating to accounting and securities issues. Ms. Nall is on the Board of Women Defenders, an organization serving the needs of female criminal defense attorneys in the San Francisco Bay Area. Ms. Nall can be reached at 415-954-4468 or at jnall@fbm.com.

Paul A. Alsdorf is a litigation associate at Farella Braun + Martel with a practice emphasizing white collar criminal defense. In his criminal defense practice, Mr. Alsdorf has represented companies and individuals during criminal antitrust proceedings, stock option backdating investigations, and corporate internal investigations involving allegations of accounting improprieties and off-label pharmaceutical promotion. During law school he served as the Executive Director of the Harvard Prison Legal Assistance Project. Mr. Alsdorf can be reached at 415-954-4494 or palsdorf@fbm.com.

Ann-Catherine Padian is an associate in the white collar criminal defense group at Farella Braun + Martel LLP. Ms. Padian's white collar criminal defense practice has included antitrust investigations, shareholder derivative actions, and back-dating cases. Ms. Padian can be reached at 415-954-4966 or at apadian@fbm.com.

I. WHEN IS AN INTERNAL INVESTIGATION NEEDED?

1. **The need for an investigation typically arises from credible allegations or suspicions of significant or material misconduct, legal or ethical violations, or other wrongdoing.** The wrongdoing may be of many kinds:

   a. Suspicion of misleading reporting, improper manipulations of funds or shares, insider trading, or other offenses may prompt securities fraud or other fraud-related investigations.

   b. Bribery, whether domestic or foreign. Foreign bribery could be a violation of the Foreign Corrupt Practices Act ("FCPA").

   c. Antitrust violations (for example, illegal agreements or collusion – particularly in the international context). These may be independent cause for concern as well as being indicative of potential FCPA violations.

   d. Other areas may include:

      i. Misappropriation of trade secrets or other intellectual property;

      ii. Theft, self-dealing, or diversion of goods or funds;

      iii. Violation of state or federal False Claims acts;

      iv. Accounting irregularities such as backdating of stock options;

      v. Immigration violations (for example, employing undocumented workers);

      vi. Labor violations (for example, discrimination);

      vii. Environmental violations (for example, unlawful pollution or inaccurate reporting);

      viii. Tax violations (for example, sales tax evasion);

      ix. Other statutory or regulatory violations.

2. **Upon a report of suspected wrongdoing, the responsible course for a corporate decision-maker or counsel is to evaluate the source of the report and, in many cases, to investigate.**

   a. The decision to begin an internal investigation may lie with the corporation or be statutorily prescribed. § 10A of the Securities and Exchange Act requires auditors who become

aware of an illegal act to determine that act's effect on the company's financial statements. In such situations, auditors will look to the company to investigate any possible illegal acts and take "timely and appropriate remedial actions."[2] *See* David M. Brodsky et al., RECOMMENDED PRACTICES FOR COMPANIES AND THEIR COUNSEL IN CONDUCTING INTERNAL INVESTIGATIONS (American College of Trial Lawyers February 2008), *available at* www.actl.com/AM/Template.cfm?Section=All_Publications &Template=/CM/ContentDisplay.cfm&ContentID=3390.

b. Whether necessary or discretionary, prompt investigation and correction can be a mitigating factor at almost every level of enforcement, and delay or indifference can be seen as an aggravating factor.

c. The scope and nature of an internal investigation may determine the degree to which an organization may be able to mitigate or avoid the negative consequences of a potential violation.

   i. "If a corporation effectively investigates its own misconduct, the corporation may persuade the government to forego conducting a separate investigation, reduce the scope of its investigation, or allow the corporation to guide the government's investigation. The government may also agree that if the results of its own investigation conform with the results identified by the corporation, the penalty will be no more than a specified sanction. Thus, a credible internal investigation can prevent a wide-ranging government investigation into the corporation's affairs and give the corporation more control over the nature and focus of the government investigation." Mark D. Pollack & Erin R. Schrantz, CONDUCTING INTERNAL INVESTIGATIONS AFTER SARBANES-OXLEY: BEST PRACTICES, SH083 ALI-ABA 87, 91 (2003).

   ii. Former Securities and Exchange Commission Director of Enforcement, Linda Chatman Thomas noted: "From

---

2. Securities Exchange Act § 10A, 15 U.S.C. § 78j (2006).

my perspective, the evolution of the internal investigation has been an overwhelmingly positive development for shareholders and for our enforcement program. More than 30 years after the initiation of the Commission's voluntary disclosure program, the internal investigation continues to play a key role in our enforcement efforts. We continue to encourage and reward cooperation from the business community for very important reasons." Linda Chatman Thomsen, SEC DIRECTOR OF ENFORCEMENT, REMARKS BEFORE THE STANFORD LAW SCHOOL DIRECTORS' COLLEGE, June 26, 2007, *available at www.sec.gov/news/speech/2007/spch062607lct.htm.*

iii. "The fines [for an FCPA violation] are most severe where the company is a repeat offender or where the conduct is egregious. In contrast, the DOJ and SEC impose lower fines where the company conducts an internal investigation after discovering a potential violation, voluntarily discloses the results of that investigation to the regulators, and remedies the violation through improved internal controls." Christopher J. Steskal, THE FOREIGN CORRUPT PRACTICES ACT: THE NEXT CORPORATE SCANDAL? January 28, 2008, available at http://www.fenwick.com/docstore/Publications/Litigation/sec/Sec_Litigation_Alert_01-28-08.pdf.

II. WHO SHOULD CONDUCT THE INTERNAL INVESTIGATION?

1. Who in a company should initiate the investigation, and to whom the investigator should report, will depend on circumstances.

a. The Audit Committee is sometimes a likely choice, especially if the investigation concerns the company's financial activity or internal controls.

b. A special Board committee, perhaps limited to independent directors, might be appointed to oversee the investigation. Alternatively, the Board might appoint an outside panel.

c. More routine investigations can potentially be overseen by in-house counsel.

2. **When should outside counsel conduct the investigation?**

a. In-house counsel, and a company's internal audit function, will have an in-depth understanding of the nature of the company's business, its culture, and corporate organization. They may also understand the personalities and dynamics underlying any alleged wrongdoing. This background knowledge can be invaluable in immediately beginning an investigation with little or no start up time. These factors may also make in-house counsel better able to assess the importance of documents and data uncovered during the investigation itself.

b. Outside counsel will typically be more expensive and require more startup time and initial investment to begin an investigation in earnest. However, outside counsel can provide several advantages over in-house functions, especially in more serious and complex matters.

i. In-house counsel, as well as regular corporate counsel, may be viewed negatively (or at least with caution) by regulators or the company's independent auditors, given their perceived dependence on corporate management and officers for employment and/or business.

ii. Outside counsel can bring general experience with conducting investigations as well as in-depth subject matter expertise to bear and will be familiar with the technological and logistical challenges of an investigation. Outside counsel should also have significant experience reporting to and managing the expectations of regulators and outside auditors.

iii. In-house counsel often provide business as well as legal advice. Communications with outside counsel will therefore receive a stronger presumption of privilege than those with in-house counsel. *See* United States v. Chevron Texaco Corp., 241 F. Supp. 2d 1065, 1076 (N.D. Cal. 2002) ("[C]ommunications between a corporation and its outside counsel are presumed to be made for the purpose of seeking legal advice... [but] because in-house counsel may operate in a purely or primarily business capacity... the presumption that

attaches to communications with outside counsel does not extend to communications with in-house counsel.").

2. **What is the proper role of in-house counsel in the investigation?**

   a. Even when an in-house lawyer does not conduct the investigation, he or she still plays an important role (assuming the investigation does not involve issues concerning in-house attorneys or the functioning of the legal department) in ensuring the investigation goes smoothly and efficiently.

      i. In-house counsel should request frequent updates from the investigative team to ensure the investigation is progressing and to keep expenses and costs in check.

      ii. In-house counsel can also provide appropriate informal updates to management and board members on the progression of the investigation, where such information sharing is appropriate and will not compromise the investigation's independence or leak information to potential targets of an investigation.

   b. In-house counsel often acts as a liaison between the investigative team and the company, facilitating the collection of documents and scheduling interviews. The presence of outside counsel can often be unfamiliar and unsettling for many employees. Due to familiarity with the individuals involved, and to minimize disruption, in-house counsel often initiates document requests and contact witnesses to schedule interviews.

III. DEFINING THE APPROPRIATE SCOPE OF THE INVESTIGATION

1. **Establish scope, budget, and timeline at the beginning.**

   a. All three are important for budgetary purposes, especially with outside counsel.

      i. Expect that use of accountants, consultants and other experts will increase the cost.

      ii. Plan and budget for follow-up investigation to see that reforms decided on in response to the problem have actually been implemented and are working.

iii. Recognize that the scope of the investigation, and the resources devoted to it, may be viewed by the government as evidence – pro or con – of the degree to which the company has taken appropriate steps to respond.

b. Initial scope or budget should not be allowed to thwart thorough investigation if broader wrongdoing is revealed than was initially suspected.

c. The original timeline should aim for prompt resolution. But as with scope and budget, this too must be extended if more appears than was originally expected.

d. Clear communications between the investigation team and appropriate company management (i.e., persons who are not targets or subjects of the investigation) is essential.

i. An engagement letter outlining the scope of the inquiry is often a useful charter for the investigation. It can be formally amended if changes are needed.

ii. Clear procedures on interim reporting and other aspects of management interface are helpful.

2. **Communicate regularly with outside auditors.**

a. A crucial constituency of many internal investigations is the company's outside auditors. Especially when investigations relate to a company's financial statements or public filings, auditors can delay resolution by refusing to provide an unqualified audit report or approve a restatement until the investigation has progressed to their satisfaction.

b. It is therefore crucial to keep outside auditors appraised of an investigation's progress and to share information with them on a regular basis to ensure that they can quickly sign off on investigative work once the company and counsel believe it is completed.

c. Failure to provide such regular disclosure risks unanticipated delays if the auditors insist upon further investigation or follow on work beyond the original scope of the investigation.

d. Any information or document sharing should be carefully conducted as such disclosures risk waiver of attorney-client and/or work product privilege. See *infra* at § V(2).

3. **Give the Investigator Adequate Resources.**

a. "[W]e have come to see investigations in which companies did not provide sufficient authority or resources to the lawyers and other professionals conducting an investigation. In other cases, companies have unduly circumscribed the scope of their inquiry. Sometimes lawyers do not have the ability to ask questions of all relevant persons; sometimes accountants are asked to offer opinions based on limited factual presentations. The injury to a company from a poorly structured or executed investigation can be substantial: when regulators or enforcement authorities ultimately develop the full story, the company's credibility is injured, its attempts to claim credit for cooperation will be jeopardized, and the surprise to shareholders and others can further damage the company's reputation." Giovanni P. Prezioso, SEC GENERAL COUNSEL, REMARKS TO THE VANDERBILT DIRECTOR'S COLLEGE, September 23, 2004, *available at www.sec.gov/news/speech/spch092304gpp.htm.*

b. *See supra* at § I(2) regarding promptness of the investigation.

IV. DOCUMENT AND EVIDENCE COLLECTION, PRESERVATION, AND DISCLOSURE

1. **Preservation of Evidence.**

a. This is of critical importance, and must begin immediately. At the outset of any investigation, counsel should identify which documents and electronic data must be preserved – a pool of data that will likely be ultimately larger than the amount collected and/or reviewed.

i. Counsel should identify relevant employees who may know where documents and data are stored and conduct preliminary interviews of those employees.

ii. Relevant employees should receive a "litigation hold" notice to preserve evidence from an in-house official, whether or not the investigation is being run in-house: this usually enhances the likelihood that the order will be obeyed and also reflects the company's commitment to the process.

iii. The investigator should then review the documents provided to identify other document custodians who may have relevant information and who should receive a "litigation hold" notice from in-house counsel.

c. If there is a document retention policy in effect, prescribing destruction or records after a given time, the investigator should insist that this be suspended where appropriate, and management must cooperate by giving the necessary orders.

i. The investigator should also take care to identify and secure any electronic backup resources immediately, as these are often deleted and/or recycled on a regular basis. Especially where the investigation concerns years-old conduct, these backups may be the only source of documents that may have been deleted from computers in regular use during the normal course of business.

ii. Destroying documents (whether paper or electronic) can be an indicator of guilt in a later government investigation, can give risk to adverse presumptions about what the destroyed documents contained, and perhaps even ground a charge of obstruction of justice.

2. **Documents.**

a. "No internal investigation would be complete (or considered credible) without a thorough review of all relevant documents. Document review will assist the investigator in the gathering and analysis of all relevant factual material. Documents in this context mean documents and materials created at or about the time of the incident(s) in question – documents that are made and kept by the corporation in the ordinary course of its business generally will not be privileged." Joseph T. McLaughlin, CORPORATE INTERNAL INVESTIGATIONS – BOON OR BANE?, 1367 PLI/Corp 981, 1010 (2003).

b. "[C]are needs to be taken with respect to documents created by counsel or at the direction of counsel during the course of the investigation. All such documents reflecting or containing attorney-client communications or work product must be clearly marked as such." McLaughlin, *supra*, 1367 PLI/Corp at 1010-11. The potential consequences of a later waiver of

privilege as to such documents should also be considered, even before such documents are created.

3. **Interviews.**

a. Some believe it is best to review available documents before scheduling interviews, as the better the situation is understood, the more productive interviews will be.

i. In many investigations, relevant witnesses should be interviewed at a preliminary stage to provide a broad overview of the issues under investigation and help locate relevant documents and information. Those witnesses may then be interviewed again with targeted follow-up questions once document review has taken place.

ii. Investigators should be wary of interviewing potential targets of an investigation prior to completing a comprehensive document review or preliminary interviews, as potential targets may refuse to participate in follow-up interviews if preliminary questions reveal that they are exposed to potential liability.

b. It is advisable to have only one note-taker in the room to avoid conflicting written records of what was said. To preserve work-product protection for written records of interviews, a note-taking attorney should memorialize the interview (non-verbatim notes), including mental impressions, legal theories, and other relevant observations. Shortly after the interview, the attorney should use the notes to create a memorandum documenting the interview, which will receive greater work product protection than a purely factual transcript of questions and answers.

c. "Sometimes, senior managers seek to participate in, or attend, interviews of various witnesses. In some cases, employees may feel more comfortable with someone they know being in the room while they are being interviewed. In other cases, an employee may feel intimidated by the presence of someone from senior management. As a general proposition, it is always best to conduct the interviews of employees without the presence of senior management." Jay G. Martin, STRATEGIES FOR BOARDS OF DIRECTORS CONDUCTING INTERNAL INVESTIGATIONS, 1479 PLI/Corp 473, 483 (2005).

d. *Upjohn* warnings: At the outset of the interview, employees should be informed that (1) counsel represents the company (or committee of the board of directors); (2) counsel does not represent the employee individually; (3) the conversation is covered by the attorney-client privilege, but that the company holds the privilege; and (4) that the company therefore determines whether and when to waive privilege and disclose the employee's statements to external parties such as auditors or governmental agencies.[3]

i. If the Company has already determined to disclose the contents and results of its investigation (including witness interviews) to the government, it is a good practice to advise the employee witness in advance of the interview.

ii. Although responses may be less candid, if the warning is not given, a confidential relationship may be implied by a witness's expectation, which can lead to conflicts. See, e.g., United States v. Hart, No. 92-219, 1992 WL 348425 (E.D. La. Nov. 17, 1992) (communications held privileged based on employee expectation) (cited with apparent approval in In re Grand Jury Subpoena Duces Tecum, 112 F.3d 910 (8th Cir. 1997). *See also infra* at V(6)(e).

iii. In some circumstances, witnesses should have separate counsel.

e. Employees should be assured that there will be no retaliation for truthful statements (although confessing does not imply amnesty for substantive wrongdoing). At the same time, however, they should be made aware that false statements, or failure to cooperate, will result in appropriate internal penalties and other possible consequences.

i. Lying to internal investigators can even lead to a charge of obstruction of justice, as it has in several recent cases,

---

3. For a thorough discussion of what warnings corporate counsel should give when interviewing employees during internal investigations, see UPJOHN WARNINGS: RECOMMENDED BEST PRACTICES WHEN CORPORATE COUNSEL INTERACTS WITH CORPORATE EMPLOYEES (ABA WCCC Group, draft as of Nov. 3, 2008).

including the Computer Associates case, which saw two former executives indicted for such alleged conduct. See *www.usdoj.gov/opa/pr/2004/September/04_crm_642.htm.*

V. COMMUNICATIONS WITH AUDITORS AND REGULATORS

1. Sharing within the company

a. Privilege in a communication bearing on an internal investigation can be vitiated, as with any other privileged communication, by disclosing it more widely than is necessary. Thus, it is important, even before considering external disclosure, to keep internal communications asking or supplying legal advice fairly closely held.

b. Guard privilege carefully. People become careless about this when the likelihood of litigation seems remote. Litigation about the subject of an internal investigation is always a present possibility.

c. The decision as to whether the investigation report should be oral or written should be made carefully.

   i. An oral report has flexibility and is less vulnerable to a leak; but writing fixes the content permanently, requires clarity of findings and communication, and restricts responsibility for the report to its authors.

   ii. Promising a written report enhances credibility and commitment to completeness of investigation, and producing one suggests that the problem is now understood and full correction has at least begun.

   iii. But despite recent changes in government internal guidance, the government (or other agencies such as the Audit Committee) may require a written report, or condition leniency on producing one.

   iv. "Oral reports have the benefit of being less susceptible to discovery in any useful way, can be delivered and digested more expeditiously by the client, and can involve significantly less expense to the client. For example, if a litigation pre-assessment is the objective, an oral report may be desirable. At the same time, oral reports are usually less precise and more subject to

miscommunication or misunderstanding than written materials. By contrast, written reports are more precise and, in the eyes of many clients, more useful because of their permanence and accessibility. Clients who think they may want to rely on the [investigation] for some purpose in the future (for example, to voluntarily share with a government agency, dismiss derivative litigation or serve as affirmative evidence of due care) may favor written reports. Nevertheless, written reports are clearly much more useful to government investigators and opposing private litigants." Martin, *supra*, 1479 PLI/Corp at 486.

d. The decision as to who should see or hear any report is also important. Possible recipients include the Audit Committee, the entire board, company auditors, top management, all affected management, participants in events, the whole company, press, government authorities, and perhaps even plaintiffs in related litigation.

e. It is increasingly the case that production of the report to the government may result in a finding that any privileges that otherwise would have protected it have been waived. *See infra* at § V(3) for further discussion.

2. **Sharing with outside auditors**: The courts are split on whether disclosing investigation results to the company's outside auditors waives work-product protection.

a. For example, in Medinol, Ltd. v. Boston Scientific Corp., 214 F.R.D. 113 (S.D.N.Y. 2002), Medinol provided information regarding an internal investigation to its outside auditors in connection with their audit of the company's litigation exposures. The court found that to be a waiver of the attorney-client and work product protections. However, many courts have rejected Medinol as finding a waiver too readily. See, e.g., Vacco v. Harrah's Oper. Co., No. 1:07-CV-0663, 2008 U.S. Dist. LEXIS 88158 (N.D.N.Y. Oct. 29, 2008) (stating that "Medinol has been almost uniformly rejected" and citing long list of district court cases criticizing Medinol).

b. Thus, for example, in Merrill Lynch & Co, Inc. v. Allegheny Energy, Inc., 2004 WL 2389822 (S.D.N.Y. 2004), the court found no waiver in a similar situation, because Merrill

Lynch's outside auditors were not "adversaries" as contemplated by the work product doctrine, and because Merrill Lynch was ethically bound to maintain the confidence of the internal investigation report.

c. Likewise, in Laguna Beach County Water District v. Superior Court, 124 Cal. App. 4th 1453 (2004), a lawyer responded to audit inquiries about pending or threatened litigation. Such letters are routinely sent by lawyers to auditors preparing financial statements on behalf of a mutual client. The court found no waiver, as the "disclosure did not contravene the purpose of the work product doctrine" and the attorney "did not intend to waive protection."

   i. The documents held protected in the Laguna Beach case were headed "attorney-client and attorney work product communication."

   ii. The court found "[d]isclosure of the information was not casual, unthinking, or even voluntary. Nothing in the record shows [the attorney] would have sent these letters without defendant's request and a requirement imposed by at least good faith, if not a more stringent duty, to comply with the request . . . There is no evidence that [the accounting firm] did not intend to or in fact maintain the confidentiality of the information. Nothing in the record shows that any of the contents of the two letters would be or were disclosed in the audits." Id., 124 Cal. App. 4th at 1459.

   iii. Moreover, as the court noted, disclosure operates as a waiver only when otherwise protected information is divulged to a third party "who has no interest in maintaining the confidentiality . . . of a significant part of the work product," which was not the case with these auditors."

d. In United States v. Textron, Inc., 507 F. Supp. 2d 138 (D.R.I. 2007), the court held that disclosure to an outside auditor waived the attorney-client privilege, because the auditors were not clients, but did not waive the work-product protection, because the communications to the auditors did "not substantially increase the opportunity for potential adversaries to obtain the information." See Gregory P. Joseph,

PRIVILEGE DEVELOPMENTS IN THE CORPORATE CONTEXT – 2008, *available at www.josephnyc.com/articles/ viewarticle.php?54*. However, on appeal, the First Circuit vacated the decision that the work-product protection had not been waived pending a determination of whether disclosure of the auditor's papers would reveal the content of the corporation's work product. United States v. Textron, Inc., No. 07-2631, 2009 U.S. App. LEXIS 1538 (1st Cir. Jan. 21, 2009).

3. **Attorneys having to testify as to attorney-client communications**. "It is . . . increasingly common for attorneys who have conducted [internal corporate investigations] to be called as witnesses in governmental and civil proceedings concerning their ICI [internal corporate investigation]. In such proceedings, the attorneys may need to describe the substance of the ICI they conducted, the processes they followed, and the advice they rendered to the client. Attorneys who have conducted an ICI may be used to provide affirmative evidence of 'admissions' made by witnesses during interviews, and to impeach witnesses who have altered their stories from what they said during ICI interviews." Jay G. Martin, STRATEGIES FOR BOARDS OF DIRECTORS CONDUCTING INTERNAL INVESTIGATIONS, 1479 PLI/Corp 473, 486 (2005).

   a. It may seem unlikely that a lawyer would be required to testify to the legal advice he gave a client. But unlike work product protection, which the lawyer may herself invoke, the privilege is the client's. If the client waives (or is found to have waived) the privilege, the lawyer must answer.

   b. For a recent opinion on the issue, see the decision by Judge Charles Breyer in U.S. v. Reyes, 2006 U.S. Dist. LEXIS 94457 (N.D. Cal. Dec. 22, 2006), as well as SEC v. Roberts, 254 F.R.D. 371 (N.D. Cal. 2008) (following the reasoning in Reyes).

4. **DOJ position on waiver of privilege for cooperation credit:**

   a. In January 2003, then-United States Deputy Attorney General Larry D. Thompson issued a memorandum entitled "Principles of Federal Prosecution of Business Organizations" (see text on the web at *www.usdof.gov/dag/cftf/corporate guidelines.htm*). The "Thompson Memo" suggested that target corporations should waive their attorney-client and work-product protections or risk being charged criminally, in part

because they did not do so. Here are two significant excerpts from the memo:

i. "One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements." Id.

ii. "Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation." Id.

iii. Demands for waivers following promulgation of the Thompson Memo became more common. The investigatory climate became more intimidating, and reliance on either attorney-client privilege or work-product protection became burdened and perceived and risky.

b. In response to criticism from the defense bar and members of Congress, the DOJ proffered a new memorandum, entitled the McNulty Memorandum, which instituted new procedures for DOJ requests for privilege waivers during the course of criminal investigations (see text on the web at *www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf*). The McNulty Memo was designed to respond to criticism regarding the increasing level of investigators' demands to

waive privilege in order to get cooperation credit, and represents a departure from the Thompson Memo.

i. As the Deputy Assistant Attorney General explained in a March 2007 speech: "The tone of the McNulty Memorandum is critical to an understanding of the Department's approach to corporate criminal charging policies. It is a tone of respect for the importance and long-standing nature of the attorney-client privilege." (See text on the web at *www.usdoj.gov/criminal/pr/testimony/2007/03/ 2007_5048_03-08-07 bmsabin-statement. pdf.*)

ii. However, the McNulty Memo did not entirely do away with the DOJ's consideration of voluntary privilege waivers as a factor in the charging decision: "A corporation's cooperation is just one of the nine factors a prosecutor must consider in determining whether to charge a corporation, and a company's willingness to waive the attorney client privilege is just one sub-factor in gauging cooperation." Id.

iii. In fact, there was significant doubt as to whether the McNulty Memo in fact changed the DOJ's practices. This issue was the subject of a hearing by the Senate Judiciary Committee in September 2007. (See BNA White Collar Crime Report, Vol 2, No. 18, at p. 555-557.) Recent surveys of defense practitioners suggest that the DOJ's demands for privilege waivers under the McNulty Memo might have been continuing at the same or a similar rate as under the prior Thompson Memo. Id.

c. On August 28, 2008, the DOJ announced revisions to its rules to replace the McNulty Memorandum. Rather than issuing a new memorandum, the DOJ simply incorporated its changes into the United States Attorneys' Manual. The new policy will determine corporate cooperation based on "facts the corporation discloses," not on waiver of the attorney-client privilege or the work product doctrine. James M. Keneally and Conor S. Harris, REVISIONS TO THE DOJ'S GUIDELINES ON CORPORATE PROSECUTIONS: THE LAST WORD?, White-Collar Crime, at 3-7 (October 2008).

i. The revision states that, while "waiving the attorney-client and work product protections has never been a prerequisite under the department's prosecution guidelines for a corporation to be viewed as cooperative," "[e]veryone agrees that a corporation may freely waive its own privileges if it chooses to do so" and "such waivers occur routinely." Id.

ii. The new policy also prohibits prosecutors from considering whether a corporation is advancing attorney fees or counsel for its employees or requesting that they not do so. Id.

iii. The policy states that cooperation credit will not be withheld based only on a corporation's participation in a joint defense agreement. However, the policy notes that such an agreement may prevent a corporation from being unable to disclose a fact that might help it receive cooperation credit. Id.

d. A proposed congressional bill, the "Attorney-Client Privilege Protection Act," would impose a bar on federal investigators requesting companies to waive privilege or to refuse to advance defense fees. (See Attorney-Client Privilege Protection Act of 2007, S. 186, 110th Cong. 1st Sess. (2007)). This measure is opposed by the Department of Justice and, even if passed, would not prevent investigators from accepting voluntary privilege waivers by companies under investigation. Id.

i. The legislation, originally introduced in December 2006 by Senator Arlen Specter, was reintroduced again in the same form in January 2007 after Congress reconvened, in spite of the promulgation of the McNulty Memo of December 2006. Upon reintroducing the Bill, Senator Specter commented: "There is no need to wait to see how the McNulty memorandum will operate in practice. The flaws in that memorandum are already apparent." (See 153 Cong. Rec. S42-01, at S181-183 (Jan. 4, 2007) (statement of Sen. Specter).); see also Ann Graham, NEW MEMO WON'T EASE ATTORNEY-CLIENT PRIVILEGE CONCERNS, February 11, 2008, at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id= 1202469642951.

ii. The legislation was re-introduced again on June 26, 2008, but was not voted on in either house of Congress. It appears to have been abandoned for now. See "S.3217: Attorney-Client Privilege Protection Act of 2008" on www.govtrack.us, available at http://www.govtrack.us/congress/bill.xpd?bill=s110-3217.

5. SEC position on waiver of privilege for cooperation credit:

a. Like the DOJ's Thompson and McNulty Memos, the SEC's policy statement, entitled the "Seaboard Report," sets forth a statement of the factors the SEC will consider when determining whether to afford cooperation credit. Among the factors to be considered is factor 11, the provision of internal investigation materials to the SEC. Waiver of attorney-client privilege is implied, as such materials would in most cases be privileged.

b. In response to criticism from the defense bar, Congress, and others, SEC officials have stated that privilege waivers are not required in order to establish cooperation on the part of a company under investigation. (See text of the ABA letter to the SEC requesting revision to the policy regarding privilege waivers on the web at *www.abanet.org/poladv/letters/attyclient/2007feb05_privwaivsec_1.pdf.*) In a recent speech in response to the criticism, Commissioner Paul Atkins disavowed the Commission's practice of encouraging privilege waivers for cooperation credit: "I strongly believe that the Commission should not view a company's waiver of privilege as a factor that will afford cooperation credit, and I personally refuse to consider for 'credit' purposes whether a respondent has waived when I decide how to vote on a recommendation." (See *www.sec.gov/news/speech/2007/spch020907psa.htm#foot2.*) It remains unclear, however, whether the SEC will in fact change its formal policy absent intervention from Congress.

c. The SEC recently released an enforcement manual for the first time. The manual sets forth standards for opening an inquiry and ranks investigations in order of importance as "critically important," "significant," or simply "matters under investigation" (MUI). The SEC will open an MUI when "a sufficiently credible source or set of facts suggests that a MUI could lead to an enforcement action that would address a

violation of the federal securities laws." The manual also notes that SEC policy is to notify corporations and individuals as soon as the SEC decides not to recommend an enforcement action. *See* "Gibson Dunn Partner John Sturc on SEC's New Enforcement Manual," Corporate Crime Reporter, at 1 (October 20, 2008).

i. The new manual also prohibits the SEC from asking companies to waive attorney-client privilege, although timely and relevant disclosure are still important factors in determining cooperation. Criminal Law Reporter, "Waiver of Attorney-Client Privilege Still a Gray Area, DOJ Official Says" (Vol. 84, No. 9, Nov. 26, 2008).

d. In In re BP Prods. No. Am., 263 S.W.3d 106 (2006), the court held that both the attorney-client privilege and the work product doctrine protected documentation underlying the company's report to the SEC that it had reserved $700 million to resolve litigation claims, where the reserve number was set by an in-house attorney. The Court explained that, in part, the privilege was not waived because the documentation had not been disclosed to auditors. *See* Joseph, supra.

6. Recent developments in the law of waiver:

a. In U.S. v. Reyes, 2006 U.S. Dist. LEXIS 94457 (N.D. Cal. Dec. 22, 2006), U.S. District Judge Charles Breyer ruled that investigation counsel's oral report to the DOJ and SEC summarizing otherwise privileged internal investigation interviews created a waiver of privilege. The court also rejected the concept of "selective waiver." Id. At *24, *25.

b. Once the privilege has been waived, plaintiffs in shareholder suits and derivative actions may be able to gain access to the once-protected documents. For example, when McKesson HBOC shared the results of its internal investigation with the SEC, including interviews protected by the attorney-client privilege and investigation results protected by the attorney work product doctrine, it was then required to turn over the same documents to the plaintiffs in the shareholders' class action. McKesson HBOC, Inc. v. Superior Court, 115 Cal. App. 4th 1229 (2004).

i. In In re McKesson HBOC Securities Litigation, No. C-99-20743, 2005 WL 934331 (N.D. Cal. Mar. 31,

2005), the court held McKesson's internal investigation report and backup documentation not privileged because McKesson always intended that it would be turned over to the U.S. Attorney and the SEC. The communications at issue were therefore never confidential and privilege never attached. However, the court held the documents were protected attorney work product, on a selective waiver theory.

ii. At the Ninth Circuit level, the law regarding selective waiver remains unsettled. See Bittaker v. Woodford, 331 F.3d 715, 720 n.5 (9th Cir. 2003) (en banc); accord, In re McKesson, supra, at *8.

iii. A recent revision to the Federal Rules of Evidence, Rule 502, passed by Congress in late 2008, rejected a proposed selective waiver of privilege, protecting privileged materials disclosed in government investigations from disclosure to private litigants. (See Report of the Advisory Committee on Evidence Rules, Proposed Amendment of the Federal Rules of Evidence, FED. R. EVID. 502(c), at 12, *http://www.uscourts.gov/rules/Reports/EV05-2006.pdf.*) As Judge Breyer pointed out in U.S. v. Reyes, the majority of courts that have considered the issue have rejected selective waiver, so if passed, this provision in the Rule would have represented a significant shift from prior precedent. See Kristine L. Roberts and Mary S. Diemer, IMPACT ON PROTECTIVE ORDERS AND SUBJECT MATTER WAIVER, ABA Section of Litigation at 8-10 (Winter 2009).

c. If there is a final written internal investigation report, disclosure of that report may operate to waive privilege as to underlying and related documents. "Disclosure of the final report raises a significant risk that a court will hold that privilege with respect to some – if not all – of the underlying interview notes and memos have been waived. At the very least, disclosure of the final report is fairly likely to lead a court to conclude that underlying documents that were quoted from or paraphrased in the report are also now discoverable." Mary Beth Hogan, THE ATTORNEY-CLIENT PRIVILEGE AND INTERNAL INVESTIGATIONS: PRIVILEGE ISSUES IN

STRUCTURING AN INVESTIGATION AND INTERVIEWING WITNESSES, 145 PLI/NY 409, 417-18 (2004). See, e.g., Granite Partners, LP v. Bear Stearns & Co., Inc. 184 F.R.D. 49, 55 (S.D.N.Y. 1999).

d. In Ryan v. Gifford, 2008 Del. Ch. LEXIS 2 (Del. Ch. Jan. 2, 2008), following an earlier decision in the same case at 2007 WL 4259557 (Del. Ch. Nov. 30, 2007), the Court held that delivery of a report by a special investigative committee, set up following the filing of a derivative action, to a Board of Directors consisting of several directors who were also named as defendants in the derivative action, constituted a full waiver of the privilege as to all communications between the committee and its counsel, including all correspondence between the special committee and its counsel, the investigation report, and all correspondence between the company and counsel to the special committee. Several unusual factors contributed to the finding of waiver. For example, because the directors were present at the committee's report in their personal, not fiduciary, capacities, the Court found the privilege had been waived, particularly as their personal attorneys were present and they used the committee's findings in their individual defenses. Furthermore, the special committee lacked sufficient authority to take action independent of the other board members.

e. In an ongoing litigation where counsel intentionally disclosed privileged information to outside auditors, the battle over whether the privilege was waived as to later investigation is currently underway. Outside attorneys conducting an internal investigation intentionally provided information from interviews they conducted with the company's CFO (who they later represented in a related derivative action) and founder to outside auditors, and the judge stated he believed this action "loaded the gun" that led to the CFO's indictment. Whether the waiver will extend to the criminal indictment is yet to be decided. *See* Gabe Friedman, *Irell's Ties to Corporate Client Give Way to Tangles*, SAN FRANCISCO DAILY JOURNAL, Feb. 23, 2009, at 1; Gabe Friedman, *U.S. Judge Has Harsh Take on Irell's Role in Broadcom Case*, SAN FRANCISCO DAILY JOURNAL, Feb. 24, 2009, at 1.

NOTES