LJN LAW JOURNAL NEWSLETTERS

The Corporate Counselor®

Volume 18, Number 5 • October 2003

Confiding in the Government

Corporate Fraud Brings New Pressures to Provide Disclosure to the Government in Confidentiality and Non-waiver Agreements

By Andre G. Castaybert

In the wake of the headline-grabbing corporate fraud scandals starting with Enron, the Justice Department earlier this year issued revised guidelines making a corporation's waiver of the attorney-client and work-product protections a factor in determining whether to charge a corporation for criminal conduct, including fraud. Under these guidelines, prosecutors may "consider" a company's willingness to identify wrongdoers, make witnesses available, disclose the results of its internal investigation and waive the attorney-client and work-product protections. Memorandum from Deputy Attorney General Larry D. Thompson re: Principles of Federal Prosecution of Business Organizations, Jan. 20, 2003. (The pertinent section of the guidelines reads: "In determining whether to charge a corporation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection.) The SEC, Commodity Futures Trading Commission (CFTC) and NASD have similar policies. Following the adoption of these guidelines, government demands that corporations waive the privilege and work-product protection have become routine, even at the outset of investigations. *See, eg*, T. Loomis, "New DOJ Guidelines Encourage Waiving Attorney-Business Client Privilege," Broward Daily Business Review 8, February 26, 2003.

But the decision to waive these protections and share the results of an internal probe with the government should be taken only after carefully weighing the possible consequences. Voluntary disclosure may be used as a declaration against interest, or an admission of fact, with devastating effect in later litigation. While the purpose of voluntary disclosure is to avoid liability and mitigate damage, it is no guarantee against criminal prosecution.

And, as sure as night follows day, plaintiffs in subsequent actions, and defendants in related criminal cases, will demand copies of any reports and interview materials to use in their own cases. Courts generally agree that the information gathered by counsel in the course of an internal investigation is privileged or subject to work product protection. *See, eg, In re Int'l Sys. & Controls Corp. Sec. Litig.*, 693 F.2d 1235 (5th Cir. 1982). But disclosure of such information to a third party, including the government, is generally held to waive the privilege in litigations against other adversaries. Further, such disclosure may result in an even broader waiver for communications *related to the subject matter* of the disclosed communication. *See, In re Steinhardt Partners, L.P.*, 9 F.3d 230, 235 (2d Cir. 1993); *In re Subpoenas Duces Tecum*, 738 F.2d 1367, 1375 (D.C. Cir. 1984); *In re Sealed Case*, 676 F.2d 793, 823-824 (D.C. Cir. 1982); *Permian Corp. v. United States*, 665 F.2d 1214, 1218-19, 1222 (D.C. Cir. 1981); *Dellwood Farms, Inc. v. Cargill, Inc.*, 128 F.3d 1122d, 1126-27 (7th Cir. 1997).

So far, with the exception of the Eighth Circuit and, more recently, the Delaware Chancery, courts have been reluctant to expressly recognize the doctrine of "selective waiver" that would allow disclosure to the government while protecting the privilege *vis-à-vis* third parties, including civil plaintiffs in shareholder suits, for example. *See Diversified Industries v. Meredith*, 572 F.2d 596 (8th Cir. 1977) (*en banc*); *Saito v. McKesson HBOC, Inc.*, 2002 WL 31657622 (Del. Ch. Nov. 13, 2002).

In an attempt to reduce the risk of further waiver, corporations under investigation have sought to shield privileged material by entering into confidentiality agreements under which the government agrees that no waiver of any privilege will arise from the disclosure.

Indeed — with the notable exception of the Sixth Circuit, which recently

Andre G. Castaybert is an attorney in the Litigation and Dispute Resolution Department of the New York office of Proskauer Rose LLP. He may be reached at 212-969-3406 or acastaybert@proskauer.com.

adopted a bright-line rule of absolute waiver (over a strongly worded dissent) — case law in most Circuits has retreated from the bright-line waiver rule and, in dictum, has encouraged reliance on confidentiality and non-waiver agreements to shield the corporation from efforts to pierce the privilege. *Compare, eg, In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289 (6th Cir. 2002) and *Westinghouse Elec. Corp. v. Republic of Philippines*, 951 F.2d 1414 (3d Cir. 1991) with *Permian Corp. v. United States*, 665 F.2d 1214 (D.C. Cir. 1981) and *In re Steinhardt Partners, L.P.*, 9 F.3d 230 (2d Cir. 1993).

But as shown by the recent court experience of McKesson Corp., the medical supply company, a confidentiality or non-waiver agreement is no panacea.

McKesson's Experience with Confidentiality Agreements

McKesson's problems began when it acquired HBO & Co. (HBOC). (The facts concerning the McKesson case are based on of the SEC and McKesson submissions and the court opinions in the cases summarized and cited below and the earlier reports about the McKesson case. *See, eg,* S. Reisinger, "Much Rides On The Ninth Circuit's McKesson Decision," The Recorder (San Francisco) 3, April 24, 2003.) Only 4 months later, McKesson announced that its auditors had discovered serious financial irregularities. McKesson's stock price plunged and a flood of stockholder actions followed. The United States Attorneys Office (USAO) and the SEC started investigations that lead to the indictment of two HBOC officers for securities fraud.

Immediately after the announcement, McKesson's board launched an internal investigation conducted by outside counsel. In what turned out to be a successful effort to forestall an indictment, McKesson offered at the outset to share the results of its investigation with the government — provided the resulting report and underlying interviews be treated as confidential. The USAO and SEC agreed. The company's outside counsel then conducted more than 50 interviews and drafted a report of its findings, which it delivered to the company's audit committee along with the interview memoranda. McKesson then provided the report and interviews to the USAO and SEC.

The confidentiality agreement with the USAO stated that McKesson believed the investigation was privileged, that it had a common interest with the government, and that while it was agreeing to share information, it did not intend to waive privileges as to any other party. The confidentiality agreement with the SEC went further, stating that McKesson "has not waived, and does not intend to waive … any … privilege as to any third party." In each case, the government agreed not to assert that production would waive any of McKesson's privileges and agreed to maintain the confidentiality of the report and interviews.

Predictably, plaintiff shareholders and the criminal defendants (former HBOC officers) sought discovery of the report and interviews.

Based on the dictum in prior case law, McKesson had every reason to hope the courts would uphold its agreement with the government and protect the report and interviews from further disclosure: 1) McKesson itself had arguably been a *victim* of the fraud by HBOC's officers in the sale of their business to McKesson; 2) McKesson disclosed the accounting issues upon discovering them; 3) McKesson cooperated with the government from the outset, but only on condition that the government sign a confidentiality agreement; 4) both agencies agreed to maintain confidentiality, and McKesson only handed over its report and interviews after the confidentiality agreements were in place; and 5) under these circumstances, McKesson could reasonably believe it had a sufficient common interest with the government to persuade a court the common interest exception should apply.

So far, the discovery of the McKesson report and interviews has been litigated in four actions — but with very mixed results:

- In *McKesson HBOC, Inc. v. Adler*, a shareholder action in the Georgia, the state trial court held that the privilege had been waived by disclosure to the USAO. 562 S.E.2d 809, 812 (Ga. 2002). On appeal, the SEC argued in vain for the appeals court to overturn the ruling. Instead, the Georgia Court of Appeals upheld the privilege ruling, but recognizing that the work product protection is "not necessarily waived by disclosure to a third party," the court found that, in addition to the confidentiality agreement, there was evidence supporting McKesson's contention that the company and the SEC were not adversaries but instead "shared a common interest in developing legal theories and analyzing information." It remanded to the trial court to determine whether McKesson had waived its counsel work-product protection. *Id.* at 813. The parties settled the case promptly thereafter.
- In *Saito v. McKesson HBOC, Inc.*, the Delaware Chancery Court came to the exact opposite conclusion, holding that the very same materials were protected by the work-product doctrine, and that McKesson had not waived such protection. 2002 WL 31657622 (Del. Ch. Nov. 13, 2002). The court rejected the argument that McKesson's cooperation with the government aligned it with the government. But the court held that the materials were protected from disclosure nonetheless, because McKesson had a reasonable expectation of confidentiality in disclosing the information to the government. *Id.* at 11. The court accepted the SEC's argument that as a matter of public policy, corporations should be encouraged to disclose their investigations to the government without risking further disclosure to third parties. *Id.* at 9. It expressly recognized that selective waiver of the work-product privilege promotes cooperation with the govern-

ment and concluded that, "confidential disclosure of work-product during law enforcement investigations relinquishes the work-product privilege only as to that agency, not as to the client's other adversaries." *Id.* at 11. The court disputed the view that selective waiver doctrine permits litigants to "have their cake and eat it too", finding that "disclosures made to the SEC when the corporation is under investigation are not really akin to enjoying a dessert." *Id.* at 9. And finally, in a reminder that work-product is not absolutely protected, the court considered, but rejected, plaintiff's argument that it had a substantial need for the report and interview materials disclosed by McKesson. *Id.* at 11-12.

- In *Green v. McKesson, Inc.*, another shareholder action in Georgia, the trial court ordered production of the report and interviews despite opposition from the SEC. The trial court has certified the order for immediate appeal and McKesson has sought review by the Georgia Court of Appeals.

Finally, in *United States v. Bergonzi*, the California federal district court held that the report and interviews constituted work-product, but that McKesson waived the protection by disclosing them to the government. 216 F.R.D. 487 (N.D. Cal. 2003). The court reasoned that the government was McKesson's adversary and the two did not share a common interest. *Id.* at 572. While conceding that the confidentiality agreements were "replete with language which would support a finding [that] the Company intended the documents now sought by Defendants to be confidential," the court held that the communication of the report and interviews was not made in confidence because McKesson knew they were created "for the purpose of relaying [the] communication to a third party," *ie,* the government. *Id.* at 569. The court also noted that the agreements gave the government discretion to use the materials in the criminal proceedings. *Id.* at 570 and 572. Finally, the court found that since no privilege barred production of the report, the information must be divulged to the criminal defendants under *Brady v. Maryland*, 373 U.S. 83 (1963) and the Federal Rules of Civil Procedure because it contained "exculpatory information that [was] either admissible or [would] reasonably likely to lead to admissible evidence." 216 F.R.D. at 499. McKesson's appeal to the Ninth Circuit is pending. The SEC has urged the Ninth Circuit to reverse the district court and uphold the terms of the confidentiality agreement.

THE LESSONS OF MCKESSON

As McKesson's experience shows, while the pressures on companies to cooperate are considerable, they should not automatically acquiesce in the government's demands for a waiver. Any waiver of the privilege and work-product protections must be carefully weighed and the consequences of possible disclosure to third parties factored in from the outset.

As shown above, the law governing the enforcement of these types of confidentiality agreements varies significantly from one jurisdiction to the next. Before offering such a waiver, then, the company must attempt to discern, to the extent possible, which jurisdiction's laws will govern the enforcement of the agreement.

In any event, the company should certainly consider offering narrower alternatives: requiring employees to speak to the government as a condition of continued employment, limiting disclosure to the extent possible to non privileged materials and disclosing information orally in the context of a proffer. Where feasible, the company should attempt to limit its disclosures to non-privileged materials.

And whether there is a waiver or not, any public statements or summaries of the findings of any report must be carefully crafted to avoid claims that the public statement itself waived the privilege or protection or the terms of any confidentiality agreement with the government.

If waiver is ultimately the only option, to protect its claims to the privilege, the corporation must seek a written and *unconditional* confidentiality agreement regarding the disclosure of any investigative report or supporting materials. Clearly, submitting the information to the government while "reserving" the company's confidentiality rights and protections is insufficient protection from waiver.

The precise terms and the timing of such an agreement are critical considerations. As shown in the McKesson case, the very fact that the agreement with the government was reached at the outset was a factor in finding that there was no expectation of confidentiality. Also, the government's attempt to carve out exceptions to confidentiality to allow it discretion to use the materials in other criminal cases and before a grand jury may undermine the agreement's protections *vis-a-vis* third parties. And any confidentiality agreement should be worded to prevent disclosure in response to Freedom of Information requests.

In addition, to the extent possible, the attorneys must make a record that the company's interests are consistent with those of the government in order to invoke the common interest exception.

As part of the agreement, the corporation should reserve the right to assert the privileges in later proceedings and seek the agency's agreement to make submissions supporting the company's privilege claims in later litigations.

But even with a confidentiality and non-waiver agreement, as shown by McKesson's experience, the investigation itself must be undertaken with the understanding that any report or interviews may ultimately have to be disclosed by the government.