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Internal Inquiry Results: The Disclosure Quandary

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Special to the Legal

Corporations faced with a government investigation often must make a Hobson's choice: whether or not to disclose the results of an internal probe.

As the 6th U.S. Circuit Court of Appeals has stated in this context, "[A]ll litigation-related tactical decisions have an upside and a downside."

When confronted with notice that a government agency is commencing an investigation, typically the company and its counsel will have only limited knowledge of the facts underlying the subject matter of the probe.

As a result, counsel will often advise the company to conduct an internal investigation. This will usually result in a written report and other documentation of the facts discovered for the company board of directors' use in formulating its response to the government investigation.

Invariably, the facts giving rise to the government's investigation will also give rise to — and likely already have spawned — a number of private lawsuits against the company and its representatives by its shareholders and others. The same facts might also give rise to civil and criminal actions by the government against the company and some of its officers, directors and representatives.

To protect the company's internal investigation from disclosure to those plaintiffs and other parties, outside counsel will usually be retained to conduct the internal investigation and to draft the investigation report to the board. In so doing, the company can assert that the report and other documents created during the investigation are protected from disclosure by the attorney-client privilege and attorney work-product doctrine.

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At the same time, the corporation's exposure to liability, as contrasted to the liability of its agents, may turn on the company's cooperation with the government's investigation. The company may enhance its chances either for avoiding liability or for leniency by sharing the results of its internal investigation with the government.

AVOIDING WAIVER OF PRIVILEGES

Disclosing the company's internal investigation report and backup materials to the government, however, raises the possibility of waiver of the attorney-client and the work-product protections. Faced with this Hobson's choice, what should counsel do under these circumstances?

The McKesson Corp. and its outside counsel, Skadden Arps Slate Meagher & Flom, found itself in just this situation. On April 28, 1999, McKesson publicly disclosed that its auditors had discovered massive accounting irregularities in the financial statements of McKesson's newly acquired subsidiary, HBO & Co. (HBOC). As a result of those irregularities, McKesson wrote off several hundred thousand dollars of revenue and its stock price plummeted.

Following its public announcement, McKesson was quickly besieged by numerous lawsuits by private litigants. The Securities and Exchange Commission and the U.S. Attorney's Office also confronted it with investigations. Over the next several months, the SEC commenced civil enforcement actions against several former HBOC and McKesson officers and employees and employees of HBOC's outside auditors, and some of those same individuals were indicted by the USAO for federal securities fraud.

McKesson retained Skadden to represent it in the shareholder lawsuits, to conduct an internal investigation and to represent it in connection with the SEC and USAO investigations. Skadden's internal investigation resulted in the preparation by Skadden of numerous memoranda of interviews with various McKesson employees and a written report to McKesson's audit committee.

Prior to completion of its report to the audit committee and faced with the USAO and SEC investigations into McKesson's conduct, Skadden negotiated confidentiality agreements with both entities and then later produced the privileged audit committee report and interview memoranda for them. The confidentiality agreement with the SEC provided that the SEC would maintain confidentiality of the information provided to it by McKesson, except to the extent required for the SEC to carry out its duties and responsibilities or to the extent that the SEC determined that federal law required that disclosure.

The USAO also agreed in its agreement

to keep the information confidential, but could, in its discretion, disclose the documents to a federal grand jury and could use the documents in any resulting criminal proceeding, including prosecution of McKesson.

DON'T BET ON CONFIDENTIALITY

Two recent decisions in cases arising out of the McKesson accounting irregularities in the federal and state courts of California suggest that the chances of successfully blocking disclosure of a corporation's privileged documents to its adversaries and other parties in private party litigation, following disclosure of those documents to the government, are not good — despite the existence of a confidentiality agreement with the government agency.

In both cases, the courts rejected the selective waiver doctrine and ruled that production by McKesson of its attorney-client-privileged and work-product protected protected materials to the USAO and the SEC waived those protections as to other parties seeking production of those documents.

In *United States v. Bergonzi*, the court ordered Skadden's report to McKesson's board's audit committee and other related documents produced to criminal defendants fighting charges brought by the USAO, which grew out of the transactions that formed the subject of McKesson's internal investigation. The court held that the attorney-client privilege never attached to the requested documents because McKesson had agreed to produce the documents to the government before they had ever been created and because McKesson had given the SEC and USAO full discretion to disclose the documents under the terms of the confidentiality agreements.

The court also held that although the documents were originally protected by the work-product doctrine, McKesson had waived that protection by producing the documents to an adversary. In reaching this conclusion, the court found that McKesson and the SEC and USAO did not share a common interest because the government entities had not agreed to unconditional confidentiality of the documents. The court also rejected the selective waiver doctrine, finding it inherently unfair that a party could disclose documents to one outsider but not another.

Finally, the court concluded that the government entities in this case were adversaries of McKesson and that waiver of the work-product protection as to one adversary constituted waiver as to all adversaries. The ruling is on appeal to the 9th Circuit, and the criminal prosecution has been stayed pending that decision.

SAME FACTS, DIFFERENT CASE

In a separate case arising out of the same facts, the California Superior Court similarly ordered the same documents produced to private-party plaintiffs suing McKesson and others in California state court under the California securities laws. Relying heavily on the policies supporting the attorney-client-privilege and work-product doctrines in California, the California Court of Appeals affirmed the decision that McKesson had waived both the attorney-client privilege and the work-product protection by producing the documents to the government.

McKesson recently petitioned the California Supreme Court to review this affirmance.

In both opinions, the courts rejected McKesson's request to recognize a selective waiver doctrine that would have allowed disclosure of the documents to one adverse party without waiving the privilege as to other adverse parties. In so ruling, the courts rejected the two principal arguments advanced by McKesson.

First, both courts found that McKesson and the government were adversaries at the time of the disclosure — contrary to McKesson's argument that it and the government were cooperating to get to the root of the fraud, and despite that both the SEC and the USAO eventually decided not to pursue claims against McKesson.

For this reason, the courts held that McKesson was not entitled to the protection from waiver of the privileges similar to that afforded to participants in a joint defense agreement. Because McKesson's production was to an adversary, despite the existence of the confidentiality agreement, the courts held that the privilege was waived.

Second, both courts rejected the argument advanced by McKesson — and also by the SEC and the Securities Industry Association as amicus curiae in both cases — that recognizing a selective waiver exception under these circumstances would further an important public policy by encouraging companies to cooperate with government investigations.

The courts reasoned that the policies underlying the attorney-client privilege and work-product doctrine were not fostered by permitting disclosure of otherwise protected material to the government.

BEWARE COOPERATION

Since it appears that McKesson's and Skadden's attempt to cooperate fully with the government while protecting its privilege has failed, unless both decisions are reversed on appeal, what do these recent decisions mean to counsel faced with this Hobson's choice? They certainly mean that counsel must face the possibility that if the company decides to produce the results of its internal investigation to the government — even according to the terms of a confidentiality agreement — it is quite possible, maybe even likely, that the audit report and the underlying documentation will later be subject to discovery in suits filed against the corporation by private individuals.

Several factors will affect the likelihood that a court will enforce the attorney-client and work-product privileges despite the corporation's production of its privileged documents to the government. First, counsel must recognize whether or not its corporation is an adversary of the government. Barring unusual circumstances, if your company is being investigated, regardless of whether it is a "target" of the investigation, courts will probably consider it an adversary of the government.

If, on the other hand, the company is truly assisting the government in an investigation into, say, the behavior of another entity, it will probably not be viewed by a court as being adverse to the government. For example, in *In re M&L Business Machine Co. Inc.*, the court found no waiver of privilege by a bank where the bank provided information regarding M&L Business Machine Co. to USAO pursuant to a confidentiality agreement.

Of course, the stronger the confidentiality agreement, the more persuasive it will be in the final determination of whether the privileges apply. As counsel for the company, you will want the confidentiality agreement to provide that the government agency will maintain the confidentiality of the documents as broadly as possible under the circumstances, including refusing to produce them in litigation.

Although the government agency may agree to negotiate such a confidentiality agreement with you, it will, unfortunately, almost certainly not agree to the blanket pro-

tection for your documents that you would prefer. At a minimum, the government agency will probably insist that it be entitled to use your documents for any purpose in the conduct of its own investigation — which may entail revealing the formerly privileged documents to experts, fact witnesses, the grand jury and others — and in any civil or criminal actions that follow from the investigation.

In addition, it may also maintain the right to share the documents and their contents with other government agencies. On the other hand, the government may actually be willing to assist you in subsequent litigation opposing attempts by third parties to discover the disclosed documents by filing an amicus brief in support of your argument that policy reasons require recognition of a selective waiver exception.

The timing of its disclosure to a government agency may also be a factor affecting the eventual outcome. For example, in *Bergonzi*, the Northern District of California found it significant that McKesson had agreed to disclose its findings and reports even before the reports had been created. Although other courts have found the timing of the disclosure irrelevant, you might have a better chance of protecting your company's privilege if you commence your negotiation with the government after you have completed your investigation, drafted your report and produced it to your board.

Finally, as part of the negotiations with the investigating agency, special attention should be paid to defining exactly what information will satisfy the agency's needs. By negotiating carefully, you might not have to produce the actual investigation report to the government. Rather, you might be able to get the same benefits from cooperating with the government by producing, for example, a summary of the facts learned in your investigation, without disclosing your mental impressions and legal advice to the board.

In the final analysis, any decision you make to provide any information to a government agency, whether written or oral, will expose your company to the possibility that a court will later rule that it has waived its attorney-client privilege and work-product protection as to the information disclosed.

Nonetheless, by thinking carefully about the benefits and risks involved in cooperating with the government's investigation, you can help the company make decisions to maximize benefits while minimizing risk.

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