

Securities Litigation Update

Must A Corporation Disclose Privileged Information To Avoid Prosecution, And If It Does So, Will It Be At The Mercy Of The Plaintiffs' Bar? – Recent Developments In DOJ Policy And Case Law

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Many boards and executives of corporations subject to criminal and civil regulatory investigations have grappled with the highly charged decision of whether to provide the government with privileged communications and attorney work product. By providing the government with information that is protected by either the attorney-client privilege or attorney work product doctrine, the corporation hopes to receive credit for cooperating with the government and thereby avoid criminal prosecution or civil regulatory action. However, there may be significant downstream consequences for the corporation choosing to disclose privileged information to the government. In particular, providing the government with privileged information could seriously imperil any later attempt to reassert privilege as to other parties, including civil litigants who are seeking to recover monetary damages from the corporation. That risk, in turn, needs to be offset against the potential impact on civil litigation – including rights to insurance and indemnification – of criminal or regulatory charges against the corporation.

The last year has seen a number of significant developments in both the U.S. Department of Justice's official policy that applies to corporate prosecutions and in the case law that addresses whether a corporation can continue to assert the attorney-client and work product privileges over documents and information it has provided to the government:

- On August 28, 2008, the U.S. Department of Justice announced that it was revising its Principles of Federal Prosecution of Business Organizations, also known as the McNulty Memorandum and (previously) the Thompson Memorandum. The revised guidelines state that credit for cooperation will not depend on a corporation's waiver of the attorney-client privilege or work product protection, but rather on the corporation's willingness to disclose "relevant facts." However, by emphasizing that a corporation must disclose "relevant facts" to obtain credit for cooperation – and thus avoid prosecution on the basis of such cooperation – the

revised guidelines allow a prosecutor to punish a corporation for failing to disclose "relevant facts" that are protected by either the attorney-client privilege or attorney work product doctrine. Thus, although the revised guidelines prohibit a prosecutor from requesting that a corporation waive its attorney-client privilege and work product protection, they nonetheless require a corporation that wishes to cooperate with the government to provide "relevant facts" irrespective of the applicability of such privileges.

- Recent federal and state court decisions have also taken up the debate over the extent to which disclosure of privileged materials to the government constitutes comprehensive waiver. For instance, in *S.E.C. v. Roberts*, 2008 WL 3925451 (N.D. Cal. Aug. 22, 2008), counsel for a Special Committee of McAfee's Board was ordered to turn over certain documents and other factual information it had provided or otherwise made available to the government. By contrast, in a case of first impression for the California appellate courts, *Regents of Univ. of California v. Superior Court*, 165 Cal. App. 4th 672 (Cal. Ct. App. 2008), the court upheld selective waiver, citing coercive government policies as a basis for finding that waiver during the course of a regulatory investigation was not waiver as to third-party litigants.

A. Recent Changes In DOJ Policy.

The DOJ recently announced the third version in five years of the guidelines a prosecutor must consider when deciding whether to charge a corporation for wrongdoing. The DOJ's new policy expressly acknowledges criticism of the prior policies: "a wide range of commentators and members of the American legal community and criminal justice system have asserted that the Department's policies have been used, either wittingly or unwittingly, to coerce business entities into waiving attorney-client

privilege and work-product privilege.” *Principles of Federal Prosecution of Business Organizations* (hereinafter “Filip Memorandum”), reprinted in *United States Attorneys’ Manual*, tit. 9 ch. 9-28.710. However, although expressly adopted to appease critics and avert possible Congressional legislation curtailing prosecutorial discretion, the latest version is unlikely to satisfy those critics or change the basic calculus that a corporation considers when deciding whether to provide the government with privileged communications and attorney work product.

The controversy began in January 2003 when then-Deputy Attorney General Larry Thompson issued a memorandum listing the principles prosecutors must consider before charging a corporation with wrongdoing. The so-called Thompson Memorandum expressly directed prosecutors to consider whether a corporation had “disclos[ed] the complete results of its internal investigation” and “waived attorney-client and work product protection” when deciding whether to charge a corporation with a crime for an act committed by one of its agents. After the Thompson Memorandum, corporations often provided prosecutors with the complete results of an internal investigation into misconduct by a corporate agent, including detailed interview notes from employee interviews prepared by lawyers retained by the company to investigate the conduct at issue and any privileged documents relating to the underlying conduct.

In response to a steady drum beat of criticism that federal prosecutors were using the threat of criminal prosecution to coerce a waiver of the attorney-client privilege and work product protections, then-Deputy Attorney General Paul McNulty announced a revised set of guidelines in December 2006. Under the so-called McNulty Memorandum, prosecutors were required to establish a legitimate need for privileged information before seeking a waiver. The revised policy created a two-tier system for categorizing privileged information, and adopted different procedures for seeking access to each. Category I privileged materials were factual in nature (e.g., key documents, witness statements, factual interview memoranda). Category II materials represented core privileged communications and non-factual work

product (e.g., attorney notes, reports of counsel’s conclusions, legal determinations reached in internal investigations).

Prior to seeking items in Category I, the McNulty Memorandum required prosecutors to obtain the approval of a U.S. Attorney. With regard to information in Category II, the McNulty Memorandum cautioned that waiver as to those materials should be rarely sought and would require prior written approval by the Deputy Attorney General. The most significant policy shift was a prohibition on considering a corporation’s decision to decline waiver of Category II materials in making charging decisions. However, prosecutors remained free to view the decision to waive as to Category I “fact” materials as a plus factor demonstrating the corporation’s cooperation. Thus, under the McNulty Memorandum, a prosecutor could give a corporation “extra credit” when deciding whether to charge that corporation with a crime if the corporation decided to waive applicable privileges and provide the prosecutor with so-called Category I information.

The McNulty Memorandum proved to be relatively short lived. On August 28, 2008, Deputy Attorney General Mark Filip did away with the “two tier approval” rule of the McNulty Memorandum in favor of a “don’t ask” rule. The Filip Memorandum expressly states that “prosecutors should not ask for such waivers [of the attorney-client privilege and work protect protections] and are directed not to do so.” See Filip Memorandum at ch. 9-28.710. The Filip Memorandum also expressly states that “[e]ligibility for cooperation credit is not predicated upon the waiver of attorney-client privilege or work product protection.” *Id.* at ch. 9-28.720. According to the new policy, “the cooperation that is most valuable to resolving allegations of misconduct by a corporation and its officers, directors, employees, or agents is disclosure of the relevant *facts* concerning such misconduct.” *Id.* (emphasis in original). In other words, the DOJ will not judge a corporation’s cooperation by whether the corporation decides to waive the attorney-client privilege or work product

protection, but rather by whether it provides the “relevant facts” relating to the conduct at issue. In practical effect, however, this may prove a distinction without a difference.

The Filip Memorandum’s solution to the waiver issue begs the question: what should a corporation do if the “relevant facts” are either protected by the attorney-client privilege or constitute attorney work product? For example, when a corporation discovers evidence of fraud by an executive, the corporation’s board will retain experienced counsel (often a former prosecutor) to conduct an internal investigation. Through counsel, the board will interview the executive at issue and even interview the lawyers who advised the corporation during the time period of the conduct at issue. If the executive at issue makes incriminating statements to counsel for the board, should the corporation waive the attorney-client privilege and work product protection and allow the board’s lawyer to turn state evidence and testify in the government’s case regarding those statements? Likewise, what should the corporation do if the executive claims that he or she did not know that the conduct at issue was improper, but a lawyer for the corporation claims to have told the executive that the conduct would violate the law and that the executive hid the conduct from the lawyer? Should the corporation waive the attorney-client privilege and allow the lawyer for the company to testify in the government’s case?

Under the Filip Memorandum, most corporations will likely decide to provide such evidence for fear of being charged with a crime. The evidence plainly constitutes “relevant facts” as that term is used in the Filip Memorandum. To be sure, it is exactly the type of “smoking gun” evidence that prosecutors can use to secure a conviction. Moreover, the Filip Memorandum expressly states that a prosecutor must consider whether a corporation fails to disclose such “relevant facts” when evaluating whether the corporation should be given a pass because of its cooperation or whether it should be charged because of its lack of cooperation. Indeed, when discussing the application of the attorney-client privilege and work product protection to the results of an internal investigation, the Filip Memorandum states that a corporation that does not disclose the relevant facts to the government **“for whatever reason”** – which necessarily includes

the assertion of the attorney-client privilege or attorney work product protection – “should not be entitled to receive credit for cooperation.” See Filip Memorandum at ch. 9-28.270(a).

B. Recent Case Law Addressing Selective Waiver

In the last year, several courts have weighed in on the selective waiver debate in a variety of decisions that help to illustrate, in a more concrete way, the real litigation ramifications of agreeing to cooperate with the government. Most recently, Judge Patel in the Northern District of California addressed whether lawyers for a Special Committee of McAfee’s Board waived the attorney-work product privilege when, after conducting an internal investigation of stock option backdating at McAfee, they disclosed the substance of certain employee interviews to the government. See generally *S.E.C. v. Roberts*, 2008 WL 3925451 (N.D. Cal. Aug. 22, 2008). In instances where the attorneys had revealed the substance of their mental impressions, opinions, and conclusions to the government, the court found waiver, holding that a party “may not selectively disclose information to third parties while continuing to maintain the privilege” against others. *Id.* at *6, 9-10. Similarly, the court held that where the attorneys disclosed factual information to the government, they have waived the attorney-client and work product privileges with respect that information. *Id.* at *5.

Although finding waiver, Judge Patel limited the scope of the waiver with respect to the notes taken by the attorneys for the Special Committee during witness interviews. The court held that even where the attorneys read their interview notes when providing factual information to the government, “the reference does not automatically constitute a waiver.” *Id.* at *9. The court reasoned that the corporation did not waive the privilege as to the interview notes because the “release of factual information from the meeting notes, when queried by the government, does not reveal mental impressions or conclusions.” *Id.* Notably, other courts have reached a different conclusion regarding the scope of the waiver. For example, in *U.S. v. Reyes*, 239 F.R.D. 591, 603 (N. D. Cal. 2006), the attorneys for Brocade’s Audit Committee referred to their interview notes when disclosing factual information from witness interviews to the government. However,

unlike Judge Patel in *Roberts*, Judge Breyer in *Reyes* held that such reference waived any privilege that attached to the interview notes without examining whether the attorneys conveyed their impressions of the witness' demeanor, credibility, or culpability to the government. *See id.* at 602 ("The Court holds . . . that [the attorneys] surrendered whatever privileges may have attached to the [interview notes] when they shared their contents with the government.").

The courts in *Roberts* and *Reyes* did not expressly address whether the disclosures at issue were effectively coerced by the government and thus did not constitute a voluntary waiver of the attorney-client and attorney work product privileges. That issue was, by contrast, squarely addressed in *Regents of Univ. of California v. Superior Court*, 165 Cal. App. 4th 672 (Cal. Ct. App. 2008). In *Regents*, the California Court of Appeals directly analyzed whether disclosure of privileged materials in the course of a criminal or civil investigation constitutes a narrow waiver as to the government alone (a "selective waiver") or is a far broader waiver of privilege as to all third parties. The *Regents* court concluded that the corporation's decision to selectively disclose privileged materials to the DOJ *did not* waive privilege as to third-party plaintiffs. *Id.* at 683-84. In reaching that result, the court noted that "the threat of regulatory action and indictment" and severe consequences and costs for declining to cooperate in a government investigation are a "means of coercion . . . more powerful than a court order." *Id.* at 675, 683.

At the heart of the *Regents* decision was the finding that well-publicized government policies (embodied in the Thompson Memorandum, which was controlling at the time) so strongly encourage waiver of privilege as to have a "coercive impact" that effectively makes it unreasonable "for the defendants to resist or otherwise challenge the government's requests" for privileged materials. *Id.* at 684. As such, the court held that the trial court had correctly determined that any resulting disclosure, compelled by the corporation's need to appear affirmatively cooperative with the government, did not waive attorney-client or work product privileges as to others. *Id.* Not all courts have agreed with this result and, to the extent that

the new Filip Memorandum alters the equation – a proposition that is, at the very least, debatable – the precedential value of the *Regents* decision is unclear.

C. Conclusion.

Despite recent changes to DOJ policy, corporations may still decide to provide privileged information to the government in an effort to avoid criminal prosecution. To date, the scope of waiver that may occur in connection with any such cooperation has been analyzed by the courts with varying results. As a consequence, corporations must continue to weigh the perceived advantages of assisting the government by providing it with privileged information against the risk that a court will compel disclosure of such privileged information in the context of civil litigation with third-parties. In most situations, a corporation will decide to provide the government with privileged information rather than risk criminal or regulatory charges. That is true because criminal or regulatory charges could have disastrous consequences for a corporation. Among other things, such charges might be used against the corporation in parallel civil litigation, significantly increasing settlement values, and potentially resulting in the loss of insurance coverage altogether.

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