Selective Waiver: Can a Corporation have its Cake and Eat it, Too?

~ *Stanley A. Twardy, Jr. and Doreen Klein*[*]

In the last several years, numerous events have turned the spotlight on the issue of corporate waiver of attorney-client privilege and work product protections. To name some of the most noteworthy, in April 2006, after months of hearings, the U.S. Sentencing Commission unanimously voted to strike language from the Federal Sentencing Guidelines that suggested that waiver of these privileges was a necessary prerequisite in order for corporations to receive credit for their cooperation. In December 2006, after Judge Lewis Kaplan condemned the Department of Justice ("DOJ") for pressuring KPMG to deny employees the advancement of attorneys' fees in a tax fraud prosecution,[1] the DOJ issued the so-called McNulty Memorandum which, in addition to changing DOJ policy regarding the advancement of attorneys' fees, outlined a new step-by-step process that a federal prosecutor must follow before requesting a corporation to waive attorney-client or work product privileges.[2] In 2007, the Senate and the House each considered identical bills designed to preserve the attorney-client privilege and work product protections by limiting a federal agency's power to pressure a corporation to waive these protections during the course of an investigation.[3] Although the Senate bill is still in committee, in July 2007 the House passed the bill. In February 2008, the U.S. Senate approved, by unanimous consent, a bill adding new Evidence Rule 502, which limits the scope of waiver, protects against inadvertent waiver, and extends the federal protections against waiver to state proceedings in certain circumstances.[4]

While each of these steps are designed to protect against compelled or inadvertent waiver of these protections, a vexing problem nonetheless persists for the corporation that determines it is in its best interests to "voluntarily" deliver otherwise protected material to government agencies. A serious issue arising from this decision is the concern that disclosure will result in waiver of the privileges to third parties, most notably plaintiffs who may be targeting the corporation for potential civil litigation. One solution that has been widely discussed but has endured a largely cold reception from the courts is that of selective waiver.

Selective waiver contemplates a limited waiver of the attorney-client privilege and work product protections, in which the corporation and the government agency agree that disclosure of otherwise protected material is limited to the government agency and that the protections are preserved with respect to any other party. The concept has its origins in the Eighth Circuit decision of *Diversified Industries, Inc. v. Meredith*.[5] In Diversified Industries, the corporation voluntarily produced to the SEC materials otherwise protected by the attorney-client privilege. In subsequent civil litigation against the corporation, the plaintiff sought production of the materials claiming, inter alia, that any privilege was waived when the corporation produced the materials to the SEC. An en banc panel of the Eighth Circuit held that disclosure of the materials to the SEC pursuant to subpoena did not waive the privilege. The court reasoned that the disclosure was in a "separate and nonpublic SEC investigation" and therefore only a limited waiver occurred. To conclude otherwise would "thwart[] the developing procedure of corporations to employ independent outside counsel to investigate and advise them in order to protect stockholders, potential stockholders and customers."[6]

Efforts to codify the selective waiver principle have met with mixed results. During the drafting process for new Evidence Rule 502, the Advisory Committee on Evidence Rules considered but then dropped a "selective waiver" provision, deeming it too controversial for inclusion.[7] However, in the Financial Services Regulatory Relief

Act of 2006, the proposition was added to the Federal Deposit Insurance Act to apply in the narrow context of disclosure to banking regulators.[8]

Absent statutory support for the selective waiver concept, corporations have tried to gain protection by cloaking their production to the government with an agreement that any waiver is a limited one. Yet, the mere fact that the corporation and the government agree that protections are not waived as to third parties is not necessarily sufficient to protect the disclosed material. Careful analysis of the law of the jurisdiction is vital before any prediction can be made as to the ramifications of a selective waiver agreement. While that analysis is necessarily fact specific as well as dependent upon the jurisdiction, certain themes have developed – at least within the Second Circuit – that a corporation should consider in an effort to best position itself to argue that the waiver of its attorney-client and work product protections is a limited one.

Absent statutory support for the selective waiver concept, corporations have tried to gain protection by cloaking their production to the government with an agreement that any waiver is a limited one.

Salomon Brothers Treasury Litigation v. Steinhardt Partners, L.P. (In re Steinhardt Partners, L.P.)[9] remains the benchmark in the Second Circuit, but its implications are more significant than its holding. In *Steinhardt*, the Court held that the defendant had waived its work product privilege when it disclosed a privileged memorandum to the SEC pursuant to subpoena but without entering into a confidentiality agreement. The Court rejected a per se rule that all voluntary disclosures to the government waive work product protection.[10] Rather, the Court held that rules relating to privilege in government investigations must be done on a case by case basis. The Court reasoned that a "rigid rule would fail to anticipate situations in which the disclosing party and the government may share a common interest in developing legal theories and analyzing information, or situations in which the SEC and the disclosing party have entered into an explicit agreement that the SEC will maintain the confidentiality of the disclosed materials."[11]

Given this broad hint, it is perhaps not surprising that courts within the Second Circuit seized upon the dual themes of common interest and confidentiality agreements to inform their analyses in cases where third parties claimed that a corporation's disclosure to government agencies of otherwise privileged material waived those protections. Initially, the courts focused upon the existence of a confidentiality agreement, in virtually any form. However, with the benefit of a developing body of case law, the courts in the Second Circuit appear to be engaging in a more nuanced analysis that considers the "common interest" factor in a fashion that makes it far more difficult to determine how a court will resolve the issue of waiver.

Thus, in *Maruzen Co., Ltd. v. HSBC USA, Inc.*,[12] the plaintiff moved to compel documents from the defendants' internal investigation that the defendants had produced to federal regulatory and law enforcement authorities. The court construed the "main issue" to be whether the defendants had confidentiality agreements with the various agencies. Finding that the defendants had such agreements – albeit in oral form – the court denied the motion to compel.

In re Natural Gas Commodity Litigation,[13] a decision rendered by a magistrate judge, the corporation produced documents to federal regulators in the course of settlement discussions, pursuant to an explicit confidentiality agreement providing that (i) the disclosure was not a waiver of any privilege as to the agency's staff with respect to anything other than what was in the documents; (ii) the disclosure was not a waiver of privilege at all as to third parties; and (iii) requesting the return of the documents. The corporation produced the documents to other federal agencies in cooperation with their ongoing investigations of the corporation and, in lieu of an explicit confidentiality agreement, requested confidentiality under FOIL and did not request the return of the documents. In holding that there was no waiver of the attorney-client and work product protections, the magistrate judge held that the confidentiality agreements were an important factor under *Steinhardt*. Noting that *Steinhardt* provided no further guidance on other factors to consider, the magistrate judge also determined on his own to consider that the corporation had provided to the civil plaintiff factual documents underlying the work product analyses disclosed to the government agencies. The magistrate judge reasoned that the plaintiff therefore could not demonstrate any need for the privileged material. In affirming the ruling, the district court noted both that voluntary disclosure to government agencies pursuant to explicit non-waiver agreements did not waive attorney-client or work product privilege and that, absent any explicit list of considerations established by *Steinhardt*, the magistrate judge did not err in considering whether the plaintiff had need of the document.[14]

In *United States v. Wilson*,[15] the defendant turned over medical records to state and federal prosecutors under cover of a letter stating that the sole purpose of disclosure was to aid prosecutors in determining whether to seek the death penalty, and that it "will not act as a waiver of [the defendant's] privileges or rights of privacy or confidentiality."[16] In rejecting the prosecution's contention that the defendant thereby waived any privileges and that they should therefore be permitted to turn the material over to their expert in the death penalty phase of the trial, the court relied upon *Steinhardt* in finding that the existence of an express non-waiver agreement was a critical element of the analysis.

More recently, in In re *Cardinal Health, Inc. Securities Litigation*,[17] the court considered the claim of waiver where outside counsel was retained by the corporation's Audit Committee to conduct an internal investigation after the corporation learned that the SEC and the U.S. Attorney's Office ("USAO") were investigating the corporation's accounting practices. The agencies invited the Audit Committee to share the results of the internal investigation, including whether wrongdoing had occurred, the identities of the wrongdoers, and proposed remedial measures. Outside counsel obtained permission from the Audit Committee to disclose its work product to the SEC pursuant to a confidentiality agreement, and then provided the documents to the USAO without a confidentiality agreement but was subsequently advised by the USAO that it had maintained the confidentiality of the documents. The plaintiffs in a securities litigation then subpoenaed the documents.

The court first analyzed the status of the documents as work product. In holding that they were entitled to work product

To view back issues of our Newsletter, visit our Committee Website:

www.abanet.org/litigation/committees/criminal

protection, the court reasoned that: (i) the corporation hired outside counsel after it learned it was under investigation, so it anticipated litigation; (ii) the documents, consisting of interview memoranda and exhibits, would reveal the principle issues with which counsel were concerned;[18] (iii) accounting work papers, prepared by an expert retained by outside counsel, would reflect counsel's impressions as to the important issues, since counsel had established the agenda for the accounting firm; and (iv) materials received from attorneys for individual witness would reflect counsel's thought processes because the material was delivered in response to counsel's specific requests.

The court next considered the issue of waiver. In holding that the Audit Committee had not waived the work privilege, the court reasoned that its purpose in authorizing the investigation "in the face of almost certain litigation between [the corporation] and the SEC or USAO – as well as in sharing the results with the SEC and USAO – was [to ensure that the corporation's] accounting practices be 'clean as a hounds' tooth.'"[19] The court construed this as an "interest in common" with the government agencies. Because of that common interest, the court found that counsel's failure to obtain a confidentiality agreement with the USAO did not waive the work product protection.[20]

Shortly after *Cardinal Health*, another court in the district reached a contrary result on similar facts in *In re Initial Public Offering Securities Litigation*.[21] Significantly, in In re Initial Public Offering, outside counsel was retained by the corporation, rather than the Audit Committee as in Cardinal Health. Outside counsel created interview memoranda and produced them to the USAO and the SEC pursuant to confidentiality agreements. Counsel also discussed the contents of some of the memoranda with a regulatory agency, produced them in an arbitration pursuant to a motion to compel, and then produced them voluntarily to the remaining plaintiff in the arbitration pursuant to a joint stipulation and confidentiality order. Plaintiffs in a separate securities litigation moved to compel disclosure of the memoranda.

The court first examined and then concluded that the memoranda constituted work product. However, the court held that the corporation had waived the work product protection. The court analyzed the cases and arguments pertaining to the concept of selective waiver and, in sweeping policy language, concluded that "selective waiver is not in the long-term best interests of the government, the adversarial system, or litigants."[22] In a result diametrically opposite that of *Cardinal Health*, the court then found that the corporation did not have a common interest with the USAO or the SEC. Rather, the court reasoned that the government was investigating the possibility of wrongdoing and the corporation disclosed the memoranda to escape or limit its liability. The court found that it was not enough that there was a common interest in disclosing the memoranda when the adversarial relationship nonetheless continued. The court also noted that the mere existence of a confidentiality agreement was not enough to support the finding of selective waiver.

The court also noted that the mere existence of a confidentiality agreement was not enough to support the finding of selective waiver.

The case law in the Second Circuit therefore yields few certainties except for the proposition that the selective waiver analysis is highly fact specific. However, the decisions reveal certain factors that can guide a corporation in positioning itself to argue that the disclosure of privileged material to the government is only a limited waiver.

First, the execution of an agreement preserving the confidentiality of the materials is a vital component of the claim. In order to ensure clarity of intent, the agreement should be explicit and in writing, the government agency should expressly agree to its terms, and the document should be executed prior to disclosing any privileged material.

Second – and the true challenge for the disclosing corporation – is the need to establish that there is a common interest with the government agency. The corporation should be aware that the timing of disclosure may factor into the court's analysis of whether the parties share a common interest. Thus, if the corporation discloses privileged material after learning that it is the target of a government investigation, the court may conclude that the parties in fact have an adversarial relationship that defeats the claim of common interest. In contrast, if the corporation discloses privileged material prior to learning that it is a target of an investigation, the court may conclude that the material is not entitled to work product protection at all, because it was not created in anticipation of litigation.[23] Given this paradoxical bind, the lesson of *Cardinal Health* may well be that, in today's Sarbanes-Oxley world, charging the Audit Committee with the responsibility to conduct an internal investigation will bolster the claim of "common interest," for the mandate of the Audit Committee in these circumstances arguably parallels the obligations of federal regulatory and law enforcement agencies.

Third, limiting disclosure of the privileged material to the government agency bound by the confidentiality agreement enhances the contention that any waiver of privilege is a limited one.

Fourth, consider the element of a third party's need for otherwise privileged work product material. To the extent that the documents underlying any disclosed work product analysis can be separated out and provided to a third party seeking to pierce the privilege protections, the corporation may contend that the party does not need the work product analysis, but instead can perform its own.

There are many factors that lead to a decision whether to make a production to the government or not. Ultimately, in deciding whether to waive the privilege and produce to the government, a critical component of that analysis requires weighing the anticipated benefits of production against the presumptive finding of a reviewing court that the production constitutes a waiver as to third parties.

*** Stanley A. Twardy, Jr.,** a former United States Attorney for the District of Connecticut, is a partner at Day Pitney LLP and

Doreen Klein, a former Assistant District Attorney in New York, is Counsel at the firm. Both are members of the firm's White Collar Defense Internal Investigations group.

Selective Waiver:
Can a Corporation have it's
Cake and Eat it, Too?

1. United States v. Stein, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).
2. The text of the McNulty Memorandum can be found at the following link: www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf.
3. S. 186 and H.R. 3013, 110th Cong. (2007), respectively.
4. S. 2450, 110th Cong. (2007).
5. 572 F.2d 596 (8th Cir. 1978) (en banc).
6. *Id*. at 611 (citations omitted).
7. The Advisory Committee's report to the Standing Rules Committee can be found by clicking on the link at http://www.uscourts.gov/rules/Reports/EV05-2007.pdf which is located on the Federal Rulemaking home page for the U.S. Courts.
8. See 12 U.S.C. § 1828(x) ("The submission by any person of any information to any Federal banking agency, State bank supervisor, or foreign banking authority for any purpose in the course of any supervisory or regulatory process of such agency, supervisor, or authority shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to such information under Federal or State law as to any person or entity other than such agency, supervisor, or authority.")
9. 9 F.3d 230 (2d Cir. 1993).
10. To be sure, the Second Circuit appears to be in the minority in declining to adopt a per se waiver approach. In re Initial Public Offering Securities Litigation, 2008 U.S. Dist. LEXIS 11058 (S.D.N.Y. Feb. 14, 2008), In re Natural Gas Commodity Litigation, 2005 U.S. Dist. LEXIS 11950 (S.D.N.Y. June 21, 2005) and In re Columbia/HCA Healthcare Corp. Billing Practices Litigation, 293 F.3d 289 (6th Cir. 2002) all provide overviews of the law in the various jurisdictions.
11. *Id*. at 236.
12. 2002 U.S. Dist. LEXIS 13288 (S.D.N.Y. July 18, 2002).
13. 2005 U.S. Dist. LEXIS 11950.
14. In re Natural Gas Commodities Litigation, 232 F.R.D. 208 (S.D.N.Y. 2005).
15. 493 F. Supp. 2d 348 (E.D.N.Y. 2006).
16. *Id*. at 360.
17. 2007 U.S. Dist. LEXIS 36000 (S.D.N.Y. Jan. 26, 2007).
18. The court noted specifically with respect to the interview memoranda that they were not in a verbatim question and answer format but, rather, involved discussions of the principle issues covered. *Id*. at *17-*18.
19. *Id*. at *28.
20. The court rejected the plaintiffs' reliance upon the case of In re Leslie Fay Cos. Securities Litigation, 161 F.R.D. 274 (S.D.N.Y. 1995), which also concerned an investigation conducted by a company's Audit Committee, based upon the timing of the internal investigation. In Leslie Fay, the Audit Committee commenced its investigation prior to being informed that the SEC had begun investigating accounting irregularities at the company. However, the cases are also distinguishable because Leslie Fay is pre-Sarbanes-Oxley and, accordingly, the mandate of the Audit Committee was not governed by the stringent financial oversight and reporting obligations required by the Act.
21. 2008 U.S. Dist. LEXIS 11058.
22. *Id*. at *24-*25.
23. With the enactment of the Sarbanes-Oxley Act of 2002, however, it is arguable that the enhanced corporate responsibility for implementing internal controls, and for detecting and reporting financial wrongdoing, make litigation an almost inevitable byproduct of the discovery of such wrongdoing.