

The SEC & Limited Waiver Of the Attorney-Client Privilege

BY ROY SIMON

May one of your corporate clients give government investigators the results of your law firm's privileged internal investigations into the client's possible violations of the federal securities laws without waiving the attorney-client privilege as to third parties?

Suppose that while gathering information for a corporate client's Form 10K, you come across evidence of a material violation of the securities laws. You comply with the new SEC Standards of Professional Conduct for Attorneys (which took effect on August 5, 2003) by reporting the evidence to the CEO or Chief Legal Officer of the client, who responds by asking your firm to conduct a through internal investigation to get to the bottom of things. Somehow the SEC gets wind of the problem (maybe the stock price declines 60% within a month after insiders sell off most of their holdings), and the SEC requests the results of your firm's internal investigation into the alleged wrongdoing. The SEC is willing to enter into a strict confidentiality agreement stating that the SEC will use the information for its purposes only and will not share the information with any third parties.

Meanwhile, the United States Attorney is conducting a parallel criminal investigation, and also asks for the results of your internal investigation. The AUSA handling the matter points out to you that on January 20, 2003 the DOJ released a new set of prosecutorial guidelines for business organizations, which state:

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. [Emphasis added.]

This guideline, and others issued along with it, trace their origin to principles set down in the so-called "Holder Memorandum," issued by then-Deputy Attorney General Eric Holder in the late 1990s. "It's phrased as a carrot," says Robert Anello, a partner at Morvillo Abramowitz Grand Iason & Silberberg, "but it's really a stick." If your client won't agree to turn over the results of the internal investigation and waive the attorney-client privilege as to other information, the DOJ will take a harder line against your client and will seek harsher penalties if it eventually obtains a conviction. See, Tamar Loomis, *Justice Encourages Waiving Attorney-Client Privilege*, N.Y.L.J. Feb. 20, 2003.

So you're between a rock and a hard place. Will you advise your client to provide the results of the internal investigation and other privileged information to the SEC and the United States Attorney? The results of the investigation are clearly protected by the attorney-client privilege (and by the work product doctrine as well). If you provide those results to the SEC and the U.S. Attorney, will that waive the attorney-client privilege with respect to third parties, such as the plaintiffs in private securities fraud

litigation? In other words, by turning over privileged information to the SEC and the United States Attorney, are you in effect handing the same information on a silver platter to private securities law plaintiffs?

The answer, unfortunately, is far from clear. This article tries to predict how New York federal courts will rule when third parties argue that a corporation has waived the attorney-client privilege by disclosing privileged information to the SEC, the United States Attorney, and other government agencies.

Background

When the SEC first issued proposed Standards of Professional Conduct for Attorneys pursuant to the Sarbanes-Oxley Act in November of 2002, a proposed § 205.3(e)(3) provided:

Where an issuer, through its attorney, shares with the Commission, pursuant to a confidentiality agreement, information related to a material violation, such sharing of information shall not constitute a waiver of any otherwise applicable privilege or protection as to other persons.

In its own commentary introducing the proposed §205.3(e)(3), the SEC said:

This paragraph would set forth the Commission's position on an unsettled question: whether an issuer waives attorney-client privilege and/or other protection (such as work-product protection) by sharing with the Commission, pursuant to a confidentiality agreement, confidential information regarding misconduct by the issuer's employees or officers?

Public comments on the SEC's limited waiver proposal praised the SEC's idea but questioned whether the regulation would be valid. The Association of the Bar of the City of New York, for example, noted formidable problems under Rule 501 of the Federal Rules of Evidence, which provides: "Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness [or] person ...shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience." (Emphasis added.) "For any rule affecting privilege to bind litigants in subsequent federal court proceedings," the City Bar said, "the rule must pass muster under Rule 501 of the Federal Rules of Evidence." But the proposed limited waiver rule lacked an "Congressional imprimatur" because § 307 of the Sarbanes-Oxley Act of 2002 (which mandated the new SEC rules) did not address selective waiver. Indeed, in 1984 Congress had rejected an SEC proposal to amend the Securities and Exchange Act of 1934 by establishing a selective waiver rule regarding documents disclosed to the SEC. Thus, the SEC's proposed regulation regarding limited waiver was not "provided by Act of Congress" and could not alter the "principles of the common law" as interpreted by the federal courts in light of reason and experience. The common law, however, was in disarray. The federal cases on limited waiver were sharply conflicting, and the City Bar's review of the relevant authorities suggested that "only a minority view upholds the doctrine of limited waiver, even in the presence of a confidentiality agreement." Others also doubted that the SEC could dictate the law on attorney-client privilege. In the end, the SEC apparently agreed with the critics. When the SEC's final rules were issued on January 29, 2003 (effective August 5, 2003), the SEC withdrew proposed §205.3(e)(3).

But the issue is far from dead. With or without that regulation, the SEC (and other government agencies) continue to ask companies to hand over privileged information - especially the results of costly and damaging internal investigations into alleged fraud. And private parties, in turn, continue to demand the very same information in discovery, arguing that disclosure to the SEC has waived the attorney-client privilege. What is the law in New York federal courts?

The inconclusive New York case law

When the New York City Bar commented on the SEC's proposed limited waiver rule last year, the Bar cited only three New York cases addressing whether voluntary disclosure of privileged information waives the attorney-client privilege: *Bowne of New York City, Inc. v. AmBase Corp.*, 150 F.R.D. 465 (S.D.N.Y. 1993); *In re Leslie Fay Co., Inc. Sec. Litig.*, 161 F.R.D. 274 (S.D.N.Y. 1995); and *In re Steinhardt Partners L.P.*, 9 F.3d 230 (2d Cir. 1993). I will analyze those three cases and draw what conclusions I can.

The first case cited by the City Bar, *Bowne of New York City, Inc. v. AmBase Corp.*, 150 F.R.D. 465 (S.D.N.Y. 1993), arose when AmBase missed a deadline for a proxy mailing, which in turn delayed the closing on AmBase's sale of one of its subsidiaries, the Home Insurance Company, thereby allegedly causing \$23 million in damages to AmBase. During the litigation, Bowne and Chemical Bank sought to compel AmBase to produce more than 1,500 documents that AmBase and its former counsel (Cravath Swaine & Moore) had withheld on grounds of attorney-client privilege and work-product immunity. The same parties sought answers to numerous deposition questions that AmBase instructed its witnesses not to answer on the basis of privilege or work-product.

Meantime, in the course of discovery in a related litigation called the *Robitaille* case. AmBase had initially asserted both the attorney-client privilege and the work-product rule to fend off certain document requests and deposition questions concerning communications with or analysis by the attorneys who had worked for AmBase in connection with the sale of the Home. But later, AmBase agreed with the *Robitaille* plaintiffs to a limited waiver of all privilege and work-product claims in connection with the depositions of three AmBase witnesses, including its former General Counsel. Specifically, AmBase agreed to permit its witness to testify fully "with respect to privileged communications," provided that plaintiffs "not claim that the provision of such testimony entitles them to all other communications relating to that subject...." As understood by AmBase's attorney in connection with the deposition of AmBase's former General Counsel, AmBase agreed to allow plaintiffs to elicit "[a]ny testimony ... [a]s to any conversation or subject matter ... pertaining to this lawsuit" as long as the communication had occurred before the plaintiffs' departure from AmBase. In exchange, the *Robitaille* plaintiffs agreed not to argue to the court that such testimony waived the privilege of AmBase as to matters that plaintiffs did not actually inquire into. In other words, the *Robitaille* plaintiffs agreed not to argue for a "subject matter" waiver. The agreement encompassed only answers to deposition questions and not the production of documents.

Based on these agreements, three AmBase witnesses answered the plaintiff' questions, including questions about investigations of the incident by AmBase counsel and the attorneys' evaluation as to whether shareholder approval was needed at all. (If AmBase did not require shareholder approval, then the late mailing could have damaged AmBase because AmBase could have sold its subsidiary without a proxy mailing.) Moreover, other AmBase employees answered deposition questions about the same subjects without claiming privilege or work-product objections and without citing the original limited waiver agreement.

In the Bowne case, Bowne and Chemical argued that AmBase had waived the attorney-client privilege and work-product protection by disclosing privileged information in the *Robitaille* litigation. AmBase argued that a disclosure of privileged matter to another party in one case does not constitute a waiver for purposes of a later case if the waiver is clearly limited. Alternatively, AmBase argued that if the disclosure in *Robitaille* did effect a waiver in this case, the waiver should be construed narrowly, limited to the disclosure and use solely of the information actually contained in the answers permitted at the *Robitaille* depositions. Magistrate Judge Dobriner rejected AmBase's arguments, stating:

AmBase's assertion that it has not waived the privilege and work-product rule cannot be sustained. By its agreement to disclosure in the *Robitaille* lawsuit and its actual disclosure to the plaintiffs in that action, AmBase has lost the ability to preclude Bowne and Chemical from inquiry into those matters. Moreover, the scope of the waiver is properly defined more broadly than AmBase suggests. ...

... AmBase chose, for its own tactical reasons, to waive the privilege as to any matters relevant to the counterclaims in the *Robitaille* case. That disclosure was not in furtherance of the purpose of the privilege, which is to permit candid discussions between client and counsel so as to facilitate the attorney's rendition of legal advice. Although AmBase entered into this arrangement in another litigation and with another set of parties, that does not avert an implied waiver here.

Quoting the leading case of *Permian Corp. v. United States*, 665 F.2d 1214, 1221 (D.C. Cir.1981),, the *Bowne* court said:

The client cannot be permitted to pick and choose among his opponents, waiving the privilege for some and resurrecting the claim of confidentiality to obstruct others, or to invoke the privilege as to communications whose confidentiality he has already compromised for his own benefit.... The attorney client privilege is not designed for such tactical employment.

The court expressly rejected AmBase's reliance on *Teachers Ins. and Annuity Ass'n of America v. Shamrock Broadcasting Co.*, 521 F. Supp. 638 (S.D.N.Y.1981). That case, the court noted, had involved disclosure to a government agency, not another private party - and in any event the Shamrock case was not necessarily still good law. The court went on to find a full subject matter waiver - a devastating holding for AmBase.

The second case cited by the City Bar, *In re Steinhardt Partners L.P.*, 9 F.3d 230 (2d Cir. 1993), was a class action suit alleging manipulation of the market for two-year Treasury notes during the Spring and Summer of 1991. In answer to a discovery request in the class action suit, Steinhardt identified as responsive a memorandum prepared by its attorneys and previously submitted to the SEC, but Steinhardt refused to produce the memorandum, claiming that the memorandum was attorney work product. Plaintiffs moved to compel production. The district court granted the motion to compel, holding that the prior disclosure of the memorandum to the SEC waived the claim for work product protection.

Steinhardt filed a petition with the Second Circuit for a writ of mandamus to prevent discovery of the document. Relying heavily on *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 606 (8th Cir.1977) (en banc), Steinhardt argued that voluntary disclosure of privileged material to an investigatory government agency

does not waive the privilege as to subsequent private litigants. The *Diversified* opinion had based its "selective waiver" theory on the policy consideration that if voluntary disclosure to the SEC waives privilege as to subsequent private litigants, parties might be discouraged from cooperating with governmental investigations, and might even hesitate before initiating an independent investigation of wrongdoing within the corporation. (The Second Circuit noted that *Diversified* had addressed this question in the context of the attorney-client privilege rather than work product, but said this did not damage Steinhardt's argument because "much of the reasoning in *Diversified* has equal, if not greater, applicability in the context of the work product doctrine.")

The Second Circuit disagreed. Citing *Permian Corp. v. United States*, 665 F.2d 1214 (D.C. Cir.1981) (which was quoted in Bowne), the Second Circuit said that "selective assertion of privilege should not be merely another brush on an attorney's palette, utilized and manipulated to gain tactical or strategic advantage." The basis for the attorney-client privilege is that confidentiality will foster frank communication between attorney and client, so the privilege ceases when the client no longer desires secrecy. Voluntary cooperation with government investigations may be a laudable activity, but "[w]hen a corporation elects to participate in a voluntary disclosure program like the SEC's, it necessarily decides that the benefits of participation outweigh the benefits of confidentiality." The court noted that the D.C. and Third Circuits had applied similar reasoning to work product in *In re Sealed Case*, 676 F.2d 793 (D.C.Cir.1982), and *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414 (3rd Cir.1991).

Moreover, the court said, corporations generally make voluntary disclosures because they believe there is some benefit to be gained from disclosure. For example, voluntary cooperation offers a corporation "an opportunity to avoid extended formal investigation and enforcement litigation by the SEC, the possibility of leniency for prior misdeeds, and an opportunity to narrow the issues in any resulting litigation." These incentives exist whether private third party litigants have access to attorney work product disclosed to the SEC or not. The court was also persuaded by the SEC's amicus brief that "the protection of privilege is not required to encourage compliance with SEC requests for cooperation with investigations." The SEC pointed to empirical evidence: it was continuing to receive voluntary cooperation from subjects of investigations, "notwithstanding the rejection of the selective waiver doctrine by two circuits and public statements from Directors of the Enforcement Division that the SEC considers voluntary disclosures to be discoverable and admissible." The court thus rejected Steinhardt's argument that ordering Steinhardt to produce the report would present similarly situated parties with a Hobson's choice between waiving work product protection through cooperation with investigatory authorities, or not cooperating with the authorities. "Whether characterized as forcing a party in between a Scylla and Charybdis, a rock and a hard place, or some other tired but equally evocative metaphoric cliché," the court said, the "Hobson's choice" argument was unpersuasive. "An allegation that a party facing a federal investigation and the prospect of a civil fraud suit must make difficult choices is insufficient justification for carving a substantial exception to the waiver doctrine."

Nevertheless, perhaps the most important feature of the Steinhardt opinion is that the court expressly declined to adopt a per se rule that all voluntary disclosures to the government waive work product protection. "Crafting rules relating to privilege in matters of governmental investigations must be done on a case-by-case basis," the court said. "Establishing 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."

The third case cited by the City Bar, *In re Leslie Fay Co., Inc. Sec. Litig.*, 161 F.R.D. 274 (S.D.N.Y. 1995), is more closely on point. By way of background, early in 1993, Leslie Fay had publicly announced that it had commenced an Audit Committee Investigation and that the results might cause the Company to restate its earnings for 1991 and eliminate any profit for 1992. On the same day, the first of thirteen shareholder class-action lawsuits was filed against the Company, its officers and directors, and its outside auditors, BDO Seidman (BDO). Soon afterwards, Leslie Fay was informed by the SEC, the United States Attorney's Office for the Middle District of Pennsylvania (the "USAO/MDPA"), and the United States Attorney's Office for the Southern District of New York ("USAO/SDNY") that they had all commenced investigations into Leslie Fay's accounting irregularities. At the outset of these government investigations, Leslie Fay's Audit Committee agreed to provide the SEC and both U.S. Attorneys with copies of the Audit Committee Report upon completion of the investigation.

On September 29, 1993, Leslie Fay issued a press release announcing that the Audit Committee had completed its report. Leslie Fay then voluntarily provided copies of the report to the SEC and both U.S. Attorneys. Leslie Fay asked the SEC to keep the report confidential but did not enter into a formal confidentiality agreement. BDO later served a document request seeking the Audit Committee report and eventually moved to compel production of the report. The court said the situation was governed by the Second Circuit's decision in *Steinhardt*. As in *Steinhardt*, Leslie Fay had produced its report to the SEC voluntarily, without entering into a confidentiality agreement with the SEC. Indeed, the SEC expressly declined the Audit Committee's invitation to enter into a confidentiality agreement concerning the report. Rather, just as in *Steinhardt*, the SEC merely stamped the report with a notice reading "FOIA Confidential Treatment Requested." The fact that the SEC agreed not to assert that disclosure of the report constituted a waiver was "inconsequential" because "the SEC is not in a position to decide what constitutes a waiver." Thus, the court ruled that producing the report to the SEC waived any work product immunity, attorney-client privilege, or self-analysis privilege the report may have had. See *In re Leslie Fay Companies, Inc. Securities Lit.*, 152 F.R.D. 42 (S.D.N.Y.1993).

In addition, in response to grand jury subpoenas from the U.S. Attorney in Philadelphia, Leslie Fay had produced certain materials that Arthur Anderson had prepared at the direction of Leslie Fay's counsel, Weil, Gotshal & Manges ("Weil"), in connection with the Audit Committee's investigation. In a November 1993 letter, the U.S. Attorney agreed to keep the materials confidential and to limit disclosure to the furtherance of law enforcement objectives. Specifically, in a letter agreement, the parties stated that the production was made pursuant to the "common interests of the USAO and the Audit Committee" and was not meant to waive any attorney-client privilege or work-product protection to which those documents may be entitled. In 1995, however, BDO served a subpoena on Weil seeking four classes of documents: "1) memorandum and notes regarding interviews of Company personnel conducted by Weil and AA in the course of preparing the ACR; 2) Weil and AA work product relating to the discovery, mechanics and scope of Leslie Fay's accounting irregularities; 3) Weil and AA work product relating to the other matters discussed in the ACR, including their analysis of materials reviewed by senior management and the outside directors; and 4) communications with the Audit Committee about the investigation," including drafts of the Audit Committee Report. When Weil refused to comply with the subpoena, BDO moved to compel. Among other things, BDO argued that Weil waived any work product protection and/or attorney-client privilege associated with the documents by producing them and/or revealing their contents to the SEC and the U.S. Attorney in Philadelphia.

The court accepted BDO's argument with respect to the SEC because it would be unfair to BDO to deny access to the documents underlying the report. Attempting to shield the documents underlying the Audit Committee report from discovery while at the same time urging the court to award it damages in reliance, at least in part, on that report's conclusions, the court said, would make the Audit Committee "guilty of the exact conduct that the subject matter waiver doctrine was formulated to address." But the court rejected BDO's argument regarding disclosure to the U.S. Attorney's Office because Leslie Fay had provided the materials to the U.S. Attorney under a confidentiality agreement. In *Steinhardt*, the district court noted, the Second Circuit had indicated that "the disclosure of privileged information to the government may not constitute a waiver if the government agrees to maintain the confidentiality of the disclosed materials." The court was satisfied that Leslie Fay's agreement with the U.S. Attorney satisfied the standard articulated in *Steinhardt*.

Conclusion

Unfortunately, the case-by-case approach taken by the Second Circuit in *Steinhardt* and the split-the-baby approach taken by the court in *Leslie Fay* give little guidance to attorneys facing the dilemma laid out at the beginning of this article. A confidentiality agreement with the SEC or the U.S. Attorney will weigh in favor of preserving the privilege, but such an agreement will not be dispositive. The best that an attorney can do is to weigh the costs and benefits to the corporation of disclosing to the government, negotiate the strongest confidentiality agreement the government will accept, and hope that persuasive advocacy will defeat the claims of waiver by plaintiffs who will inevitably bring civil actions in the wake of a government investigation. Until either the Second Circuit or the United States Supreme Court issues a definitive ruling, however, the law governing selective waiver in New York courts will remain unsettled and uncertain.

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