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No Good Deed Goes Unpunished? Establishing a Self-evaluating Privilege for Corporate Internal Investigations

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NOTES

NO GOOD DEED GOES UNPUNISHED? ESTABLISHING A SELF-EVALUATIVE PRIVILEGE FOR CORPORATE INTERNAL INVESTIGATIONS

"Great corporations exist only because they are created and safeguarded by our institutions; and it is therefore our right and our duty to see that they work in harmony with these institutions.... The first requisite is knowledge, full and complete."[1]

INTRODUCTION

The public image of corporate America has taken a beating.[2] Arguably, no period of history has seen corporations struggle through such a widespread range of civil and criminal enforcement activities at the hands of government agencies.[3] On any given day

1. Theodore Roosevelt, State of the Union Message (Dec. 3, 1901), http://www.presidency.ucsb.edu/showdoc.php?id=744&type=1&president=26 (last visited Nov. 23, 2004).

2. In fact, "[t]he rising criticism of the large corporation has in the last decade reached such a pitch that it seems quite reasonable to believe that we are witnessing what will prove to be a radical discontinuity in the institution's historical development." RUSSELL B. STEVENSON, JR., CORPORATIONS AND INFORMATION: SECRECY, ACCESS AND DISCLOSURE 4 (1980).

3. According to one author:

> Like so many of humankind's major technological developments ... the large business corporation has brought ... no small number of serious problems. Indeed, so closely linked has the corporation become in the popular mind with the inevitable malfunctions of our enormous and enormously complex economic system that today's common parlance refers more often to the evils and misdeeds of the "corporation" than to those of "big business" or the "malefactors of great wealth" as was the case not so many years ago. Whether fairly or not, the "corporation," rather than the business system of which it is a part, is increasingly being singled out as the villain in the controversies surrounding many, if not most, of the more important problems confronting the society.

the business sections of the country's newspapers are full of grand jury testimony, indictments, and settlement agreements between federal enforcement agencies and high-profile corporations or their boards of directors. According to the *Washington Post*, "[a] former top mutual fund executive pleaded guilty ... to tampering with evidence to thwart a probe of illegal trading and agreed to pay $400,000 to the Securities and Exchange Commission to settle allegations that he cut deals giving special trading privileges to certain wealthy customers."[4] On the same day, "[t]he New York Stock Exchange ... found evidence that the five largest of seven 'specialist' firms that control trading on the exchange regularly engaged in abusive practices .... [that] have cost investors as much as $150 million,"[5] and "[a] former executive with the McKesson Corporation pleaded guilty ... to securities fraud charges in connection with an accounting scandal that cost shareholders of the company $9 billion."[6] While the *New York Times* affirmed that "Richard M. Scrushy, the founder and ousted chief executive of HealthSouth, refused to answer lawmakers' questions ... about his knowledge of a fraud scheme at the company,"[7] the *Wall Street Journal* reported that "[j]ury deliberations in the fraud trial of a former Rite Aid Corp executive headed into a third day, after jurors failed to reach a verdict yesterday."[8] Although shockingly extensive, perhaps the most troubling aspect of these headlines is that they represent only one day in the life of corporate America.

In response to the increased pressure resulting from these public embarrassments, corporations have turned to internal investigations as a way of placating federal investigators and fulfilling their fiduciary responsibilities to their shareholders.[9] At the most basic

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Id. at 3-4.

4. Brooke A. Masters, *Ex-Executive Pleads Guilty in Fund Probe: Former Alger Worker Settles with SEC*, WASH. POST, Oct. 17, 2003, at E1.

5. Kathleen Day & Ben White, *NYSE Finds Proof of Trading Abuses: Exchange to Fine Firms Responsible*, WASH. POST, Oct. 17, 2003, at E1.

6. *Former Executive Pleads Guilty*, N.Y. TIMES, Oct. 17, 2003, at C6.

7. Milt Freudenheim, *Former Chief of HealthSouth Refuses to Respond at Hearing*, N.Y. TIMES, Oct. 17, 2003, at C7.

8. *Rite Aid Jurors Still Meeting*, WALL ST. J., Oct. 17, 2003, at C9.

9. In fact, "[i]nternal corporate investigations have become an established response to allegations of improprieties on the part of the corporation, its officers, or its employees." Thomas R. Mulroy & Eric J. Muñoz, *The Internal Corporate Investigation*, 1 DEPAUL BUS. &

level, internal investigations involve an extensive fact-finding effort on the part of either a corporation's general counsel or an independent legal professional.[10] Corporations may initiate an internal investigation "in response to an ongoing government investigation or agency subpoena, pursuant to a consent decree with the Securities and Exchange Commission (SEC), the Internal Revenue Service (IRS), or another government agency,"[11] or "[a]n investigation may ... be prompted internally, through either a complaint or grievance from an employee or group of employees."[12] Once a threat to a corporation's stability becomes apparent, both directors and managers may hold an affirmative duty to investigate any potential irregularities.[13] Accordingly, the decision to conduct an internal investigation can have far-reaching impacts, both positive and negative.[14]

Regardless of the immediate motivation, a corporation may realize some important benefits from conducting an internal investigation.[15] First, a corporation that releases the results of an internal investigation to government regulators may be able to secure more lenient civil or criminal penalties.[16] Second, conducting

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COM. L.J. 49, 49 (Fall 2002).

10. Brad D. Brian & Barry F. McNeil, *Overview: Initiating an Internal Investigation and Assembling the Investigative Team*, *in* AMERICAN BAR ASSOCIATION, SECTION OF LITIGATION, INTERNAL CORPORATE INVESTIGATIONS 2, 6-13 (Brad D. Brian & Barry F. McNeil eds., 2d ed. 2003).

11. Mulroy & Muñoz, *supra* note 9, at 49.

12. *Id.* At any rate,

> the need for an investigation usually becomes known because: (1) management has received internal information of suspected wrongdoing from employees or agents of the company; (2) management has been alerted to a government investigation through receiving a grand jury subpoena or learning that government investigators have been conducting interviews; or (3) the company has been threatened with civil litigation that raises questions of serious improprieties.

DAN K. WEBB ET AL., CORPORATE INTERNAL INVESTIGATIONS 4-2 (Release 19 2003).

13. *Id.* (footnote omitted). As such, "management must obtain a command of the facts and applicable law" in order to fulfill their fiduciary duty to act in the corporation's best interest. *Id.* In fact, the "[f]ailure to do so may increase the likelihood that the company will face criminal, administrative, or civil liability, jeopardize government contracts, threaten customer and supplier relationships, and crush employee and managerial morale." *Id.*

14. *See* Brian & McNeil, *supra* note 10, at 6-8.

15. *See id.*

16. *See id.* at 7. Although some practitioners argue that "the benefits of voluntary disclosure are greatly overstated," voluntary disclosure can present a number of benefits to

an internal investigation allows a corporation to respond proactively to any potential litigation by controlling the flow of relevant information.[17] Third, even in the absence of litigation, an internal investigation may help improve corporate performance.[18] At the very least an internal investigation is concrete evidence that a corporation's directors have fulfilled their fiduciary duties to their shareholders.[19]

As with any business decision, corporate directors must balance these benefits against the potential risks of conducting an internal investigation. By definition, conducting an internal investigation presents the probability of discovering damaging information.[20] In addition, a corporation may be inviting a federal enforcement action by sharing the results of an internal investigation with government regulators in the absence of an immunity or confidentiality agreement.[21] Finally, and perhaps most importantly, a corporation that prepares an internal investigation always runs the risk that the final product may be discoverable in subsequent civil litigation.[22] In other words, even if an investigation is prepared in cooperation with an enforcement agency, potential plaintiffs may be able to gain access to a corporation's most sensitive information. In this scenario a corporation that has acted in good faith to discover evidence of its own wrongdoing, in essence, has created a litigation roadmap for any disgruntled shareholder or employee looking for a potential payday.[23]

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a corporation. Thomas E. Holliday & Charles J. Stevens, *Disclosure of Results of Internal Investigations to the Government or Other Third Parties*, *in* AMERICAN BAR ASSOCIATION, SECTION OF LITIGATION, INTERNAL CORPORATE INVESTIGATIONS 279, 287 (Brad D. Brian & Barry F. McNeil eds., 2d ed. 2003).

17. *See* Brian & McNeil, *supra* note 10, at 7-8.

18. *See id.* at 8.

19. *See* WEBB ET AL., *supra* note 12, at 4-3. By fulfilling this basic obligation, corporate directors may take great strides towards restoring public trust and confidence. *See id.*

20. Although not a problem in theory, internal investigations may lead to a range of additional questions that a corporation's directors must address.

21. *See* Holliday & Stevens, *supra* note 16, at 291-92. Significantly, a corporation that is the subject of an enforcement action is exposing itself to potentially ruinous civil and financial penalties.

22. *See id.* at 291.

23. *See* Sue Reisinger, *Corporate Privilege in Fraud Cases Is at Stake: Much Rides on a 9th Circuit Decision*, NAT'L L.J., Apr. 21, 2003, at A1.

Historically, courts have developed a number of mechanisms for keeping sensitive information confidential during the litigation process, including the attorney-client and work product privileges. There is a surprising lack of consensus, however, as to which theory, if any, is most effective for a corporation in the context of an internal investigation. Essentially, the problem boils down to whether a corporation waives its ability to keep an internal investigation confidential after voluntarily turning over the results to government enforcement agencies.[24] Considered in the contemporary context of increased public scrutiny and oversight, this question is more pressing than ever.[25] This Note will argue that, in light of the increasing pressure on corporations to cooperate with government agencies, as well as the significant expansion in investigative agencies and tactics, federal courts should give greater protections to the results of internal investigations that corporations disclose to a government agency voluntarily. In fact, the public's interest in holding corporations accountable for keeping their shops in order will be better served by establishing proactive incentives for internal investigations through the creation of a formal self-evaluative privilege for corporations that disclose the results of their investigation voluntarily.

This Note will address the arguments both for and against establishing a formal self-evaluative privilege in this context. Through the lens of *United States v. Bergonzi*,[26] Section I examines the federal courts' traditional approach to the confidentiality of internal investigations that are disclosed voluntarily. This Part relies on the facts of an ongoing criminal fraud prosecution to demonstrate both the shortcomings and consequences of the prevailing judicial treatment of corporations that disclose the results of an internal investigation to a government agency. Part II assesses the motivations, risks, and benefits of corporate internal investigations. Part III considers two recognized evidentiary privileges, namely, the attorney-client and work product privileges, that corporations often invoke in an attempt to protect the results of internal investigations. As this Part demonstrates, neither

24. *See id.*
25. *See id.* at A7.
26. 216 F.R.D. 487 (N.D. Cal. 2003).

privilege provides sufficient protection for an internal investigation that a corporation discloses voluntarily to a government agency. Finally, Part IV introduces the concept of the self-evaluative privilege as a more appropriate response to this issue. As this Part demonstrates, the self-evaluative privilege, although controversial and not widely recognized, strikes the perfect balance between protecting the confidentiality of sensitive corporate information and promoting the public interest in full and fair disclosure of the information required for effective government oversight.

I. THE DILEMMA OF DISCLOSURE: *UNITED STATES V. BERGONZI*

Perhaps more notably than any case in recent memory, the order from the United States District Court for the Northern District of California in *United States v. Bergonzi*[27] highlights the pervasive problems with maintaining the confidentiality of corporate internal investigations that are submitted to government agencies voluntarily. Described as a "corporate fraud case that has everything—federal indictments of corporate officers, a securities investigation, federal and state class actions, individual shareholder suits, employee suits and derivative suits,"[28] *Bergonzi* illustrates the prevailing judicial response to the question of whether a corporation waives the protections of the attorney-client and work product privileges if it voluntarily turns over the results of an internal investigation to government investigators who signed a confidentiality agreement.[29] According to Judge Martin J. Jenkins, the answer, quite simply, is yes.[30]

In order to realize the full implication of this decision, it is necessary to understand the case's convoluted background.[31] Although the immediate controversy stems from the Department of

27. *See* id. at 493 (finding that "communications between client and attorney for the purpose of relaying communication to a third party is [sic] not confidential and not protected by the attorney-client privilege").

28. Reisinger, *supra* note 23, at A1.

29. *See Bergonzi*, 216 F.R.D. at 495; *see also* Reisinger, *supra* note 23, at A1.

30. *See Bergonzi*, 216 F.R.D. at 502 (granting Defendant's motion for the production of a corporation's internal investigation report); Reisinger, *supra* note 23, at A1.

31. For an extensive factual account of the accounting irregularities and proposed merger, see Ash v. McCall, No. 17132, 2000 Del. Ch. LEXIS 144, at *7-*8 (Del. Ch. Sept. 15, 2000).

Justice's (DOJ) indictment of two HBO & Company (HBOC) executives for securities fraud, mail fraud, and wire fraud,[32] the full story begins with the McKesson Corporation's (McKesson) decision to acquire HBOC.[33]

On October 17, 1998, McKesson entered into a stock-for-stock merger agreement with HBOC.[34] The agreement eventually grew into a flat-out acquisition, with HBOC emerging as McKesson's wholly-owned subsidiary.[35] Beginning on April 28, 1999, the newly created corporation[36] announced a series of financial restatements due to pervasive accounting irregularities on the part of HBOC.[37] Initially, the corporation identified $42 million in improperly recorded revenue.[38] As its audits continued through July 1999, McKesson HBOC reduced its revenues by $327.4 million for the three fiscal years prior to the merger.[39] In response to this announcement, the value of McKesson HBOC's shares fell from $65 to $34 within twenty-four hours, and the company's market value decreased by almost $9 billion.[40]

The legal response to McKesson HBOC's financial restatement was nothing short of staggering. In addition to the initiation of

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32. Reisinger, *supra* note 23, at A7; *see Bergonzi*, 216 F.R.D. at 490.

33. *See Bergonzi*, 216 F.R.D. at 490; *Ash*, 2000 Del. Ch. LEXIS 144, at *4-*5. According to a pending lawsuit, "HBOC, a Delaware corporation headquartered in Atlanta before the merger, provides computer software and technology solutions to the healthcare industry. McKesson, a Delaware corporation headquartered in San Francisco, is primarily engaged in the business of healthcare supply management." *Id.*

34. *See* Saito v. McKesson HBOC, Inc., 806 A.2d 113, 115 (Del. 2002). Specifically, the terms provided that

> McKesson would acquire HBOC in a tax-free, stock-for-stock merger then-valued at approximately $14 billion. Under the terms of the agreement, HBOC would merge with a McKesson acquisition subsidiary and HBOC shareholders would receive 0.37 shares of McKesson common stock in exchange for each share of HBOC common stock.

Ash, 2000 Del. Ch. LEXIS 144, at *5.

35. *In re* McKesson HBOC, Inc. Sec. Litig., 126 F. Supp. 2d 1248, 1253 (N.D. Cal. 2000); *Saito*, 806 A.2d at 115.

36. Under the terms of the agreement, "McKesson's name was changed to McKesson HBOC and HBOC, now a wholly owned subsidiary of McKesson HBOC, became the combined Company's health care information technology division." *Ash*, 2000 Del. Ch. LEXIS 144, at *6.

37. *See Bergonzi*, 216 F.R.D. at 490; *Saito*, 806 A.2d at 115.

38. *See* In re *McKesson HBOC*, 126 F. Supp. 2d at 1253.

39. *See id.* In total, "McKesson HBOC had to disallow $327.4 million of revenue and $191.5 million of operating income." *Ash*, 2000 Del. Ch. LEXIS 144, at *7.

40. *See* In re *McKesson HBOC*, 126 F. Supp. 2d at 1253.

investigations by the Securities and Exchange Commission (SEC) and the DOJ, McKesson was forced to address numerous allegations of securities fraud.[41] Although the full scope and impact of these complaints remains to be determined, it is clear that they were strong external incentives for McKesson HBOC to find out the reasons behind their potentially ruinous restatements.

Accordingly, McKesson HBOC's Board of Directors took immediate steps to review the circumstances surrounding HBOC's actions.[42] In May 1999, McKesson HBOC hired the law firm of Skadden, Arps, Slate, Meagher & Flom to conduct an internal investigation,[43] and entered into confidentiality agreements with the SEC and the United States Attorneys' Offices (USAO).[44] In July 1999, McKesson HBOC voluntarily disclosed the results of its investigation to both the SEC and USAO, including a memorandum on fifty-five interviews conducted with thirty-seven present and former employees.[45] After receiving the report, a federal grand jury "indicted the two former co-presidents of HBOC on 17 counts of securities, mail and wire fraud."[46] In addition, the SEC filed securities fraud charges against HBOC's former General Counsel, Senior Vice President of Finance, Chief Financial Officer, Senior Vice President of Sales and two other financial officers.[47] In light of McKesson HBOC's complete and extensive cooperation, both agencies declined to bring civil or criminal actions against the corporation.[48] In fact, "[i]n its 2001 policy statement, the SEC cited McKesson as an example of a company that cooperated"[49] with federal agencies.

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41. *Bergonzi*, 216 F.R.D. at 490. In fact, "over seventy-five class action, derivative, and individual lawsuits have been filed in connection with these events at McKesson HBOC." *Ash*, 2000 Del. Ch. LEXIS 144, at *9.

42. *Bergonzi*, 216 F.R.D. at 490.

43. *See id.*

44. *See id.* at 490-91.

45. *See id.* at 491.

46. Reisinger, *supra* note 23, at A7; *see also Bergonzi*, 216 F.R.D. at 490.

47. Reisinger, *supra* note 23, at A7.

48. *See id.*

49. *Id.* Significantly, the SEC filed an amicus brief in *Bergonzi* on behalf of McKesson HBOC. *See Bergonzi*, 216 F.R.D 487. According to one attorney involved in the case, "[w]hat the United States cares about is the next case.... [and] being able to go to the next McKesson and say, 'Look, if you give us this report ... we are not going to give it to the plaintiff's class action lawyers who want it.'" *See* Reisinger, *supra* note 23, at A7 (quoting John H. Hemann, the assistant U.S. attorney prosecuting the former HBOC executives).

HBOC's former officers did not find McKesson HBOC's cooperation to be such a positive development.[50] Not surprisingly, both co-defendants in the DOJ's criminal prosecution, as well as all of the former directors still under investigation by the SEC, have requested access to the internal investigation.[51] After hearing oral arguments, the trial court ordered McKesson HBOC to release the results of its investigation.[52] Specifically, the court held that "[a]lthough McKesson entered into what it fashions to be confidentiality agreements with the Government entities involved ... the production of the [internal investigation report] to ... the SEC constituted waiver of the [work product] privilege."[53] The court disposed of McKesson HBOC's claim of attorney-client privilege by ruling that "[b]y giving the Government, whether the SEC or the USAO, full discretion to disclose the [internal investigation report] in certain circumstances, the terms of the Agreements run counter to the Company's assertion the communication was intended to remain confidential."[54]

Unfortunately, McKesson HBOC's concerns with handing the results of its internal investigation over to the defendants in *Bergonzi* turned out to be appropriate. As a result of its ill-fated acquisition, the company has been named as a defendant in more than seventy-five private lawsuits.[55] In addition, McKesson HBOC is facing a federal class action lawsuit spearheaded by the New York State Common Retirement Fund.[56] Finally, McKesson HBOC has also been targeted in a series of state lawsuits.[57] If the decision in *Bergonzi* is upheld, McKesson HBOC's alleged waiver of its attorney-client and work product privileges could allow any number of plaintiffs to access the results of its internal investigation. The

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50. According to one attorney familiar with the case, McKesson HBOC's internal investigation is "a clear-sailing road map as to exactly what happened and where the evidence is and who the bad guys are." *See id.* (quoting Robert S. Plotkin, a partner with the Washington office of Paul, Hastings, Janofsky & Walker).

51. *See Bergonzi*, 216 F.R.D. at 493; Reisinger, *supra* note 23, at A1.

52. *See Bergonzi*, 216 F.R.D. at 502.

53. *Id.* at 496-97.

54. *Id.* at 494.

55. Ash v. McCall, No. 17132, 2000 Del. Ch. LEXIS 144, at *9 (Del. Ch. Sept. 15, 2000).

56. *See generally In re* McKesson HBOC Inc., Sec. Litig., 126 F. Supp. 2d 1248 (N.D. Cal. 2000).

57. *See* Reisinger, *supra* note 23, at A7.

impact of this decision on McKesson HBOC's market capitalization, financial stability, and public reputation could be nothing short of devastating.[58] As a result, it is not surprising that the fallout from this case has resonated throughout the corporate environment. As the following Part demonstrates, the events surrounding the decision in *Bergonzi* are emblematic of the difficult questions that many corporations face when deciding to conduct an internal investigation.

II. CORPORATE INTERNAL INVESTIGATIONS: ASKING THE DIFFICULT QUESTIONS

The pressure on a corporation to conduct an internal investigation can come from many different sources.[59] For example, reactive internal investigations are motivated in response to a discrete action by a government agency, such as a grand jury subpoena, document request, administrative audit, or law enforcement activity.[60] In contrast, proactive internal investigations are remedial in nature and are organized in an attempt to avoid future administrative or law enforcement action.[61] Regardless of the immediate motivation, the prospect of an internal investigation presents a corporation's directors with a number of difficult questions.

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58. Currently, McKesson HBOC is the sixteenth largest corporation in the United States, *Fortune 500 Largest U.S. Corporations*, FORTUNE, Apr. 5, 2004, at F1, with 2004 revenues of $69.5 billion. Press Release, McKesson HBOC, McKesson Reports Fiscal 2004 Fourth Quarter and Full Year Results (Apr. 29, 2004), *at* http://www.mckesson.com/releases/2004/042904_241205923.htm. In a quarterly report filed with the SEC on February 13, 2003, McKesson HBOC reported that it could not

> predict or determine the outcome or resolution of the accounting litigation proceedings, or to estimate the amounts of, or potential range of, loss with respect to those proceedings.... The range of possible resolutions of these proceedings could include judgments against the Company or settlements that could require substantial payments by the Company, which could have a material adverse impact on McKesson's financial position, results of operations and cash flows.

McKesson HBOC, Form 10-Q, Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, For Quarter Ended December 31, 2002 (Feb. 13, 2003), *available at* http://www.sec.gov/Archives/edgar/data/927653/000095014903000297/f87627e10vq.htm (last visited Sept. 7, 2004).

59. *See* Brian & McNeil, *supra* note 10, at 6-8.

60. *See id.* at 5; Mulroy & Muñoz, *supra* note 9, at 49.

61. *See* Brian & McNeil, *supra* note 10, at 5; Mulroy & Muñoz, *supra* note 9, at 49.

A. Deciding to Conduct an Internal Investigation

Initially, the most difficult choice facing a corporation's directors is whether to undertake an internal investigation at all.[62] Understandably, directors have no liberty to avoid undertaking an investigation if an enforcement agency requests information.[63] In contrast, proactive investigations always present a corporation with the temptation to avoid asking challenging questions.[64]

B. Deciding to Disclose the Results of an Internal Investigation

Once a corporation addresses the threshold question of whether to conduct an internal investigation, its directors must then decide if it should disclose the results.[65] As a general matter, corporations lack an affirmative duty to report evidence of wrongdoing.[66] Despite this fact, however, corporations are still faced with significant regulatory and policy incentives to disclose the results of an internal investigation. For example, corporations in highly regulated industries might have a duty to submit an investigative report as part of their statutory reporting requirements.[67]

Even if a corporation is not under a statutory obligation to disclose, voluntary disclosure to a federal enforcement agency can

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62. *See* Brian & McNeil, *supra* note 10, at 6.

63. *See id.*

64. *See id.* at 6-7.

65. Holliday & Stevens, *supra* note 16, at 281.

66. Although a corporation is not required "to report knowledge of criminal conduct ... or to disclose evidence of that conduct voluntarily," it may not make a partial or misleading disclosure of any improper activity discovered by an internal investigation. *Id.* (footnote omitted).

67. *See* WEBB ET AL., *supra* note 12, at 11-4; Holliday & Stevens, *supra* note 16, at 283. Although the full range of federal reporting requirements is beyond the scope of this Note, a few examples might prove informative. The Anti-Kickback Enforcement Act of 1986 "requires government contractors to report in writing to the Inspector General of the contracting agency whenever there are 'reasonable grounds' to believe that a kickback may have occurred between upper- and lower-tier government contractors." Holliday & Stevens, *supra* note 16, at 283 (quoting 41 U.S.C. § 57 (2000)). Also, "states may impose broad disclosure obligations upon government contractors." *Id.* at 283. In addition, federally insured banks are obligated to submit written reports to the Office of the Comptroller of the Currency if "there is cause to believe that the bank has been defrauded." *Id.* Furthermore, public corporations "are subject to the disclosure requirements of the federal securities statutes and rules." *Id.* at 283-84.

produce significant positive results as a matter of corporate policy. As an initial matter, the duty to investigate, and potentially to report, allegations of corporate wrongdoing stems from the directors' fiduciary duty to the shareholders and their implied duty to inform themselves of corporate activities.[68] Accordingly, the primary benefit that a corporation's directors may realize from an internal investigation is to prevent a breach of their fiduciary duty.[69] At the same time, internal investigations can allow corporations to improve their financial performance by deterring future misconduct[70] and to restore the public's trust by demonstrating the company's integrity.[71] In addition, reporting the results of an internal investigation may convince the government not to prosecute or may demonstrate that federal allegations of impropriety may be unfounded.[72] Finally, corporations that prepare an internal investigation will, at a minimum, have a chance to undertake proactive preparation for litigation,[73] to control access to information, and to create a formal response strategy.[74]

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68. *See* WEBB ET AL., *supra* note 12, at 11-3.

69. *See generally* Joy v. North, 692 F.2d 880 (2d Cir. 1982); *In re* Par Pharm., Inc. Derivative Litig., 750 F. Supp. 641 (S.D.N.Y. 1990). Directors who ignore the responsibility to investigate potential wrongdoing risk exposing themselves to shareholder derivative actions attacking their decision. *See* WEBB ET AL., *supra* note 12, at 11-4. The fact that, "[i]n the context of a derivative action, a written report [of an internal investigation] may be used as evidence in support of a motion by the board of directors to terminate a lawsuit," illustrates the protection that directors can afford themselves and their corporation simply by initiating an internal investigation. Edwin G. Schallert & Natalie R. Williams, *Report of the Investigation*, *in* INTERNAL CORPORATE INVESTIGATIONS, *supra* note 10, at 337.

70. *See* Holliday & Stevens, *supra* note 16, at 292.

71. *Id.* at 287.

72. *See* Schallert & Williams, *supra* note 69, at 337. In other words, reporting the results of an internal investigation provides "tangible evidence that ... corrective action is under way," which "may forestall a more intrusive government investigation." *Id.* Initially, this reporting includes "bring[ing] exculpatory evidence to the prosecutor's attention, ... articulat[ing] the corresponding legal defenses, and ... correct[ing] errors or misunderstandings on the part of the investigators reporting to the prosecutor." Holliday & Stevens, *supra* note 16, at 288. In truth, there is still considerable disagreement about the real benefits to be ralized in this area. According to one group of practitioners, "[t]his theory ... is articulated by government lawyers more often than it is proven correct," and "any pre-indictment presentation that implicitly concedes guilt serves only to convince the prosecutor that prosecution is warranted." *Id.* at 287-88.

73. *See* Holliday & Stevens, *supra* note 16, at 288.

74. *See* Brian & McNeil, *supra* note 10, at 7.

There are, however, significant risks in conducting an internal investigation. Initially, disclosing the results of an internal investigation to federal enforcement agencies may produce a wide variety of unintended consequences.[75] Accordingly, "the results of an investigation conducted as part of a good faith effort to respond to, investigate, and resolve an internal company problem could ... establish civil or criminal liability of the corporation, its officers, or its directors."[76] In addition, disclosure of an internal investigation's results may produce a "chilling effect" on employees who would otherwise be willing to participate in an investigation stemming from a fear of personal criminal liability or a threat to their permanent employment.[77]

The most serious consideration, however, involves the corporation's ultimate ability to keep the results privileged in subsequent litigation. The question of whether a corporation waives its ability to keep an internal investigation confidential after turning over the results to government enforcement agencies is one that federal courts are not doctrinally equipped to address. Although some courts have displayed a willingness to keep the results of an internal investigation confidential,[78] a corporation that decides to undertake an internal investigation faces the real possibility that the "[p]roduction of a report to a government agency may result in the loss of all legal privileges associated with preparing the report."[79] The following Part will discuss the extent to which courts have struggled with this issue of confidentiality. Unfortunately, the mix of approaches taken by the federal courts has not provided adequate guidance for corporations trying to decide whether to disclose the results of an internal investigation.

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75. *See* Mulroy & Muñoz, *supra* note 9, at 49. Specifically, this decision "can lead to unforeseen and undesirable third-party actions, criminal prosecutions, or civil enforcement actions by government agencies against the corporation." *Id.*

76. *Id.* According to one assessment, "[e]ven if not used directly, the information may provide the government or opposing parties with a virtual road map of leads, such as names of witnesses and the existence of documents containing relevant information" or, at the very least, compromise a corporation's ultimate litigation strategy. *See* Holliday & Stevens, *supra* note 16, at 291.

77. *See* Holliday & Stevens, *supra* note 16, at 291.

78. *See infra* notes 129-34 and accompanying text.

79. *See* Schallert & Williams, *supra* note 69, at 337.

III. TRADITIONAL APPROACHES TO PROTECTING THE CONFIDENTIALITY OF INTERNAL INVESTIGATIONS: THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT PRIVILEGE

As *Bergonzi* demonstrates, corporations that volunteer the results of an internal investigation to a federal agency face the bleak prospect of waiving the report's confidentiality in all future proceedings.[80] At present, corporations are generally limited to relying on the protections offered by the attorney-client privilege and work product privilege in order to keep the results of their internal investigations confidential. Although these established privileges generally serve the same purpose, there is a difference in the scope of their applicability, which stems from their divergent policy goals.[81] Initially, the attorney-client privilege developed as an attempt to promote justice by protecting the attorney-client relationship.[82] At the same time, the work product privilege developed as a means of maintaining an adversarial system of justice.[83] As the following sections demonstrate, courts have applied both privileges extensively in the context of corporate internal investigations, often with mixed results.

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80. *See supra* notes 29-30 and accompanying text.

81. As stated by one court,

> [t]he purpose of the attorney-client privilege is to encourage full disclosure of information between an attorney and his client by guarantying the inviolability of their confidential communications. The "work product of the attorney," on the other hand, is accorded protection for the purpose of preserving our adversary system of litigation by assuring an attorney that his private files shall, except in unusual circumstances, remain free from the encroachments of opposing counsel.

Scourtes v. Fred W. Albrecht Grocery Co., 15 F.R.D. 55, 58 (N.D. Ohio 1953).

82. *See* Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

83. *See* Hickman v. Taylor, 329 U.S. 495, 512 (1947). Specifically,

> the general policy against invading the privacy of an attorney's course of preparation is so well recognized and so essential to an orderly working of our system of legal procedure that a burden rests on the one who would invade that privacy to establish adequate reasons to justify production through a subpoena or court order.

Id.

A. The Corporate Attorney-Client Privilege

In practice, the attorney-client privilege is still the primary evidentiary tool for maintaining the confidentiality of privileged documents.[84] Some commentators have argued that this privilege should be disfavored, because it creates unnecessary costs for the judicial system without producing any additional candor between attorneys and clients.[85] The Supreme Court, however, has recognized the attorney-client privilege as "the oldest of the privileges for confidential communications known to the common law."[86] In theory, the attorney-client privilege appears to be an enticingly simple tool to protect the confidentiality of an internal investigation. In practice, however, its application in a corporate setting presents a number of difficult issues.

1. Identifying the Corporate Client

As an initial matter, courts have established that corporations may enjoy the benefits of the attorney-client relationship with its retained legal counsel.[87] Although corporations receive the same confidentiality guarantees as individuals,[88] the privilege protects

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84. Dennis J. Block & Nancy E. Barton, *Implications of the Attorney-Client Privilege and Work-Product Doctrine*, *in* INTERNAL CORPORATE INVESTIGATIONS, *supra* note 10, at 20. Traditionally, the attorney-client privilege attaches to a communication if

> (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made ... in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed ... for the purpose of securing primarily either (i) an opinion on law or (ii) legal services ... and (4) the privilege has been (a) claimed and (b) not waived by the client.

Id. (quoting United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 358-59 (D. Mass. 1950)); *see also* WEBB ET AL., *supra* note 12, at 6-3.

85. *See* Elizabeth G. Thornburg, *Sanctifying Secrecy: The Mythology of the Corporate Attorney-Client Privilege*, 69 NOTRE DAME L. REV. 157, 218 (1993); *see also* William H. Simon, *Solving Problems vs. Claiming Rights: The Pragmatist Challenge to Legal Liberalism*, 46 WM. & MARY L. REV. 127, 142-45 (2004).

86. *Upjohn*, 449 U.S. at 389. As such, the privilege serves a critical purpose, "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Id.*

87. *See, e.g.*, *id.* at 389-90.

88. Mulroy & Muñoz, *supra* note 9, at 51.

only *communications* between an attorney and his client.[89] In addition, there is still considerable disagreement as to which agents represent the corporation in a sufficient capacity to have their communication protected.[90] As there is no *per se* rule, the existence of the corporate attorney-client privilege must be determined on a case-by-case basis.[91]

In light of this discretionary approach, *Upjohn v. United States* has become the gold standard for identifying the client in the corporation-attorney relationship.[92] In *Upjohn*, the Court rejected a restrictive "control group"[93] test that would limit the attorney-client privilege to "communications between counsel and upper-echelon ... management."[94] Apparently, the Court's reasoning rested upon the assumption that, in the context of corporate internal investigations,

> it will frequently be employees beyond ... "officers and agents ... responsible for directing [the company's] actions in response to legal advice" ... who will possess the information needed by the corporation's lawyers. Middle-level—and indeed lower-level—employees can, by actions within the scope of their employment, embroil the corporation in serious legal difficulties, and it is only natural that these employees would have the relevant information needed by corporate counsel if he is adequately to advise the client with respect to such actual or potential difficulties.[95]

Accordingly, *Upjohn* protects communication between an employee and a corporation's attorney when the communication takes place

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89. *See Upjohn*, 449 U.S. at 395-96. In the context of corporate internal investigations, this protection does not extend to any facts or other information uncovered during the course of the investigation. *See id.*

90. *See id.* at 391-92.

91. *See id.* at 396.

92. *See* Mulroy & Muñoz, *supra* note 9, at 51. This decision is even more notable as it evaluated the "applicability of the attorney-client privilege in connection with an internal corporate investigation." *Id.* at 51-52.

93. *See Upjohn*, 449 U.S. at 397.

94. Mulroy & Muñoz, *supra* note 9, at 52.

95. *Upjohn*, 449 U.S. at 391. In light of the purpose behind the attorney-client privilege, the control group test "cannot, consistent with 'the principles of the common law as ... interpreted ... in the light of reason and experience,' govern the development of the law in this area." *Id.* at 397 (citation omitted) (quoting FED. R. EV. 501).

during an internal investigation.[96] Although *Upjohn* appears to shield a corporation's internal investigations, lower courts have not followed the decision universally, and it remains the subject of considerable interpretation.[97]

2. Defining Corporate Legal Services

In addition to the difficulties with identifying the corporate client, courts have also struggled with questions relating to the appropriate definition of corporate legal services. In general, a qualified attorney acting principally as a lawyer must perform the legal services in question in order for the attorney-client privilege to attach.[98] In the corporate context, however, internal investigations raise questions as to whether an attorney has been employed to perform legal or business services.[99] As the privilege's protection does not apply to non-legal communications,[100] the fact that corporations commonly employ attorneys to provide a mixed product of theoretical legal doctrine and pragmatic business advice can present a conceptual

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96. Mulroy & Muñoz, *supra* note 9, at 53. The Court looked to a variety of factors to determine whether the attorney-client privilege applied, including whether

> (1) the interviews occurred at the direction of corporate counsel; (2) employee communications were made to corporate counsel acting as such; (3) the information sought was not available from "control group" management; (4) the communications were within the scope of the employees' duties; and (5) the employees were aware that they were being questioned in order for the corporation to secure legal advice.

Id. In general, lower federal courts have determined that the attorney-client privilege exists without finding the presence of all of the *Upjohn* factors. *See id.* at 49.

97. *See id.* at 53. Significantly, "*Upjohn* may not necessarily apply in diversity proceedings where the federal court ... is obligated to use state privilege law, which could vary from state to state." *Id.* at 54. In addition,

> *Upjohn* is not binding upon state courts. In fact, according to one recent survey, only fourteen states (either through judicial decision or legislative enactment) have adopted *Upjohn*'s rule on corporate attorney-client privilege, eight states have adopted the 'control group' test, and the remaining states have not definitively decided on a particular approach.

Id. For a specific listing of *Upjohn*'s treatment at the state level, see *id.* at 54 n.34.

98. *See id.* at 56. In other words, an attorney must "be involved not only in investigating the facts, but also in formulating and rendering legal advice and opinion." *Id.*

99. *See* Block & Barton, *supra* note 84, at 29.

100. *See id.*

conflict.[101] Accordingly, courts will only protect this mixed communication if it is predominately legal in nature.[102]

The leading authority on corporate legal services remains *Diversified Industries, Inc. v. Meredith*.[103] In *Meredith*, the Court stated that "[i]t is not easy to frame a definite test for distinguishing *legal from nonlegal advice*."[104] They continued to find, however, that

> a matter committed to a professional legal adviser *is prima facie so committed for the sake of the legal advice* which may be more or less desirable for some aspect of the matter, and is therefore within the privilege unless it clearly appears to be lacking in aspects requiring legal advice.[105]

In the context of an internal investigation, this standard has been applied to mean that referring the matter to a professional legal advisor is *prima facie* evidence that the matter was committed for the purpose of securing legal advice.[106] This restriction, however, can be problematic for attorneys retained for their participation in "advising and assisting the corporation with financial, business, technical, or human resource issues."[107] Some commentators have argued that a corporation should not have to forfeit the attorney-client privilege because its attorneys will invariably have additional business-related obligations.[108] This debate highlights the persistent

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101. *See id.* at 30.

102. *See id.*

103. 572 F.2d 596 (8th Cir. 1977). For an extensive discussion of *Meredith*, see Schallert & Williams, *supra* note 69, at 341-42.

104. *Meredith*, 572 F.2d at 610 (quoting 8 WIGMORE, EVIDENCE § 2296 (McNaughton rev. 1961)).

105. *Id.*

106. *Id.* As stated in *Meredith*,

> [i]n applying this standard, the Court stated that the matter was committed to Wilmer, Cutler & Pickering, a professional legal adviser. Thus, it was *prima facie* committed for the sake of legal advice and was, therefore, within the privilege absent a clear showing to the contrary. No such showing was made. Rather, the December report contained communications which were uniquely legal.

Id. (emphasis added).

107. Mulroy & Muñoz, *supra* note 9, at 57.

108. *Id.* A few courts have endorsed this position, finding that

> [t]he modern lawyer almost invariably advises his client upon not only what is permissible but also what is desirable. And it is in the public interest that the lawyer should regard himself as more than predicter of legal consequences. His

questions about the scope of protections offered by the attorney-client privilege in maintaining an internal investigation's confidentiality.

B. The Corporate Work Product Privilege

In addition to the attorney-client privilege, corporations frequently invoke the work product privilege in an attempt to keep the results of an internal investigation confidential.[109] Significantly, this privilege protects all materials prepared in anticipation of litigation, whether prepared by an attorney, a party to the litigation, or a party's agent.[110] In general, the work product privilege focuses primarily on protecting an attorney's opinions and legal theories, as opposed to the underlying facts.[111] Regardless of whether the material is ordinary work product or opinion work product, however, it must be prepared in anticipation of litigation in order to remain privileged.[112]

Although the privilege is firmly established, courts are cognizant of the special considerations that an internal corporate investigation presents. In fact, "[m]ost courts have recognized that once the suspicion of wrongdoing rises to the level where an internal investigation is commissioned, litigation is virtually inevitable,

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> duty to society as well as to his client involves many relevant social, economic, political and philosophical considerations. And the privilege of nondisclosure is not lost merely because relevant nonlegal considerations are expressly stated in a communication which also includes legal advice.

United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 359 (D. Mass. 1950).

109. The work product privilege is a common law evidentiary rule codified in federal procedural rules. *See* Hickman v. Taylor, 329 U.S. 495, 511 (1947); *see also* FED. R. CIV. P. 26(b)(3).

110. *See* FED. R. CIV. P. 26(b)(3).

111. *See* Block & Barton, *supra* note 84, at 49. This differential protection provides that "[i]n ordering discovery of [work product] materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation." FED. R. CIV. P. 26(b)(3). On the other hand, "ordinary work product, inherently factual in nature" receives less protection. Schallert & Williams, *supra* note 69, at 345.

112. *See* FED. R. CIV. P. 26(b)(3); *see also, e.g.*, *Hickman*, 329 U.S. at 512 (stating that "the general policy against invading the privacy of an attorney's course of preparation is so well recognized and so essential to an orderly working of our system of legal procedure that a burden rests on the one who would invade that privacy to establish adequate reasons to justify production through a subpoena or court order").

particularly where the investigation confirms wrongdoing."[113] In spite of this unique realization, maintaining the confidentiality of sensitive corporate information under the work product privilege remains far from guaranteed. As *Bergonzi* demonstrates, the protections that the attorney-client privilege and work product privilege offer have not held up in the highly specialized context of internal investigations submitted voluntarily to government agencies.[114]

C. Waiver of the Traditional Privileges

On the surface, it appears that corporations may be able to secure some degree of protection from these established evidentiary privileges. The benefits to be realized from the collective application of these privileges, however, may be more appealing in theory than in practice. As applied, it remains unclear whether either privilege can keep confidential the results of an internal investigation that a corporation has submitted voluntarily to a federal enforcement agency.[115] According to the doctrine espoused in *Bergonzi*, once the material in an internal investigation has been submitted voluntarily to a government agency, then the protections offered by the attorney-client and work product privileges may be waived as to other potential litigants.[116]

1. Waiver of the Attorney-Client Privilege

Although a corporation can waive an investigation's privileged status in a number of ways,[117] one specific scenario is particularly problematic for corporations attempting to cooperate with government agencies. Initially, a voluntary disclosure of confidential information to a third party generally waives the attorney-client

113. Schallert & Williams, *supra* note 69, at 344. For cases that follow this view of internal investigations, see *id.* at 344 n.24.

114. *See supra* Part I.

115. *See supra* notes 55-58 and accompanying text.

116. *See* Block & Barton, *supra* note 84, at 63-64.

117. *See generally id.* at 63-81 (discussing scenarios in which a corporation can waive the privileged status of an internal investigation).

and work product privileges as to all other parties.[118] Accordingly, the disclosure of confidential information to a federal agency will usually waive the privilege for all future cases regarding communication on the same subjects, especially if the disclosure took place during the course of an investigation or administrative proceeding.[119] Although this precedent is firmly established, several federal circuits have declined to adopt a *per se* rule that every voluntary production by a corporate client waives the attorney-client and work product privileges.[120] Significantly, courts have split about the impact of inadvertent disclosure on an internal investigation's privileged status.[121] Although some courts find that the simple act of disclosure waives the privilege,[122] others hold that the privilege is not waived absent some intention to waive on the part of the corporation.[123]

2. Waiver of the Work Product Privilege

The issues with respect to waiver of a corporation's work product privilege are significantly different than those involving waiver of the attorney-client privilege.[124] In general, courts have held that not all voluntary disclosures waive the work product privilege.[125] Courts look to a variety of factors in determining when a corporation has waived its work product privilege, including whether

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118. *See* PaineWebber Group, Inc. v. Zinsmeyer Trusts P'ship, 187 F.3d 988, 992 (8th Cir. 1999).

119. Block & Barton, *supra* note 84, at 64. For a representative listing of judicial treatment of this issue, see *id.* at 64 n.194. Although voluntary disclosure by corporate clients is limited to those individuals with sufficient authority to bind the corporation through their actions, it is still clearly established that corporations may lose the protections of the attorney-client and work product privileges. *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 348-49 (1985).

120. *See, e.g., In re* Steinhardt Partners, L.P., 9 F.3d 230, 236 (2d Cir. 1993).

121. *See* Block & Barton, *supra* note 84, at 74.

122. *See, e.g., In re* Grand Jury Investigation of Ocean Transp., 604 F.2d 672, 675 (D.C. Cir. 1979), *cert. denied*, 444 U.S. 915 (1979) (finding that "[a]n intent to waive one's privilege is not necessary for such a waiver to occur").

123. *See, e.g.*, United States v. United Techs. Corp., 979 F. Supp. 108, 116 (D. Conn. 1997) (considering a number of factors in determining whether inadvertent disclosure should be a waiver of privilege).

124. *See* Holliday & Stevens, *supra* note 16, at 294.

125. *See In re* Subpoenas Duces Tecum, 738 F.2d 1367, 1372 (D.C. Cir. 1984).

> (1) "the party claiming the privilege seeks to use it in a way that is not consistent with the purpose of the privilege," (2) appellants had no reasonable basis for believing that the disclosed materials would be kept confidential ... and (3) waiver of the privilege in these circumstances would not trench on any policy elements now inherent in this privilege.[126]

At first blush, it appears that the work product privilege may offer corporations a substantial degree of protection against waiving the confidentiality of an internal investigation. It is important to remember, however, that this privilege applies only if the material is prepared in anticipation of litigation.[127] Although many courts have shown a willingness to assume that all internal investigations are prepared in anticipation of litigation,[128] there is still considerable debate on this subject.

3. Extent of a Corporation's Waiver

Once a corporation waives the privileged status of an internal investigation, courts face significant questions about the extent of the waiver.[129] In general, voluntary disclosure of a communication to one party means an absolute and complete waiver to all parties.[130] In contrast, some courts are willing to recognize a limited waiver of confidentiality.[131] Under this approach courts have been willing to

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126. *See id.* (citation omitted) (quoting *In re* Sealed Case, 676 F.2d 793, 818 (D.C. Cir. 1982)). The factors for finding a waiver of the work product privilege have also been described as

> whether the party claiming the privilege seeks to use it in a way that is not consistent with the purpose of the privilege[;] ... whether waiver of the privilege in the circumstances would tread on policy elements inherent in the privilege; whether the party had a reasonable basis for believing that the disclosed materials would be kept confidential by the governmental agency to which disclosure was made; and whether the disclosure was voluntary or involuntary.

Holliday & Stevens, *supra* note 16, at 294.

127. *See supra* note 112 and accompanying text.

128. *See supra* note 113 and accompanying text.

129. Accordingly, "[g]iven the uncertainty in the law and the flexibility of tests that courts have applied to waiver issues, it is impossible for company counsel to guarantee that the company's investigation report and materials will remain privileged." Holliday & Stevens, *supra* note 16, at 294.

130. *Id.* at 292-93.

131. *See, e.g.*, Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 611 (8th Cir. 1977).

disclose specific parts of an internal investigation while protecting any information not actually disclosed.[132] Although courts have recognized this type of waiver only in limited situations, those that do so have based their decision on important public policy considerations, "such as facilitating the settlement of litigation, permitting full cooperation among joint defendants, expediting discovery and encouraging voluntary disclosure to regulatory agencies."[133] In essence, the selective waiver approach recognizes the potential negative effect that "a doctrine of total waiver [of privilege] would have on corporate cooperation in voluntary disclosure programs."[134]

IV. NO TIME LIKE THE PRESENT: A SELF-EVALUATIVE PRIVILEGE FOR CORPORATE INTERNAL INVESTIGATIONS

As demonstrated by the dilemma facing McKesson HBOC, the importance of maintaining an internal investigation's confidentiality can hardly be overstated.[135] At the same time, the protections offered by the traditional attorney-client and work product privileges have not held up under judicial review.[136] When faced with the competing priorities of cooperating with federal enforcement agencies and protecting the corporation from the untimely disclosure of sensitive information, directors and managers confront significant disincentives to adopting proactive, self-evaluative governance strategies. The prominent corporate scandals over the past several years clearly demonstrate that this environment is unsatisfactory for regulators and unsettling for investors.

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132. *See, e.g., id.*

133. *In re* Martin Marietta Corp. v. United States, 856 F.2d 619, 623 (4th Cir. 1988).

134. *See* Schallert & Williams, *supra* note 69, at 353. Although selective waiver would seem particularly well-suited in the context of a corporate internal investigation, "[t]he weight of authority indicates that such cases are fairly rare exceptions to the general rule of waiver." Holliday & Stevens, *supra* note 16, at 293. Accordingly, most courts reject the doctrine, because it creates "risks of encouraging tactical selective disclosure by corporations while offering speculative benefits." Schallert & Williams, *supra* note 69, at 353. For a complete listing of the differential treatment of selective waiver by federal courts, see Block & Barton, *supra* note 84, at 66 n.203.

135. As asserted by one author, "it is through this Scylla of huge damage awards and Charybdis of governmental regulatory schemes that companies must navigate to avoid devastating financial losses or criminal inquiries." Donald P. Vandegrift, Jr., *The Privilege of Self-Critical Analysis: A Survey of the Law*, 60 ALB. L. REV. 171, 172 (1996).

136. *See, e.g., supra* Part III.

A. A Nascent Solution: Development of the Self-Evaluative Privilege

Unfortunately, federal courts have failed to embrace conclusively a developing privilege that serves the important public interests of promoting responsible corporate "self-policing" while protecting corporations from the financial impacts of continuous litigation.[137] The self-evaluative privilege[138] has developed in order to protect "documents that reflect an organization's internal self-analysis or self-evaluation"[139] from public disclosure. In addition,

> [t]he privilege protects an organization or individual from the Hobson's choice of aggressively investigating accidents or possible regulatory violations, ascertaining the causes and results, and correcting any violations or dangerous conditions, but thereby creating a self-incriminating record that may be evidence of liability, or deliberately avoiding making a record on the subject (and possibly leaving the public exposed to danger) in order to lessen the risk of civil liability.[140]

Although the self-evaluative privilege extends only to "subjective opinions, impressions and recommendations," it still presents a workable and preferable alternative to the use of existing privileges.[141]

As with the historical development of other recognized privileges,[142] the self-evaluative privilege stems from a desire to further the important public interests in "encouraging institutional self-policing"[143] and to avoid "the chilling effect ... from complete

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137. Schallert & Williams, *supra* note 69, at 343.

138. This privilege is also known as the privilege of self-critical evaluation, self-evaluation privilege, or privilege of critical self-evaluation. *See* JEROME G. SNIDER & HOWARD A. ELLINS, CORPORATE PRIVILEGES AND CONFIDENTIAL INFORMATION 6-1 n.1 (Release 7, 2003).

139. *Id.*; *see also, e.g.*, Todd v. S. Jersey Hosp. Sys., 152 F.R.D. 676, 682 (D.N.J. 1993).

140. Vandegrift, *supra* note 135, at 176 (quoting Reichhold Chem., Inc. v. Textron, Inc., 157 F.R.D. 522, 524 (N.D. Fla. 1994)).

141. SNIDER & ELLINS, *supra* note 138, at 6-5.

142. "Privileges have historically been recognized when, as is true in the case of self-critical analysis, the public interest weighs heavily in favor of confidentiality." Note, *The Privilege of Self-Critical Analysis*, 96 HARV. L. REV. 1083, 1084 (1983).

143. Schallert & Williams, *supra* note 69, at 346.

disclosure."[144] This nascent privilege is based on the assumption that disclosing an organization's self-evaluation will create incentives that are contrary to society's interests in promoting greater compliance with the law.[145] Since its initial recognition in 1970,[146] lower federal courts have upheld the privilege in a variety of contexts, including internal reviews of hiring policies,[147] products liability,[148] employment safety,[149] environmental audits,[150] libel,[151] and securities litigation.[152] In addition, commentators have argued for expanding the privilege to NCAA investigative files,[153] affirmative action plans,[154] and health care fraud and abuse investigations.[155]

Despite these persuasive arguments, most state and federal courts do not recognize the self-evaluative privilege as an independent means for protecting confidential information.[156] As a common law privilege without statutory underpinnings, courts have

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144. SNIDER & ELLINS, *supra* note 138, at 6-2 (quoting Todd v. S. Jersey Hosp. Sys., 152 F.R.D. 676, 682 (D.N.J. 1993)). The "self-evaluation privilege is designed to encourage parties to 'engage in candid self-evaluation without fear that such criticism will later be used against them.'" Mulroy & Muñoz, *supra* note 9, at 59 (quoting Reich v. Hercules, Inc., 857 F. Supp. 367, 371 (D.N.J. 1994).

145. SNIDER & ELLINS, *supra* note 138, at 6-5 (quoting Sheppard v. Consol. Edison Co., 893 F. Supp. 6, 7 (E.D.N.Y. 1995)).

146. For a complete listing of the contexts in which the self-evaluative privilege has been recognized, see SNIDER & ELLINS, *supra* note 138, at 6-2 nn.5-9.

147. *See* Banks v. Lockheed-Georgia Co., 53 F.R.D. 283, 284-85 (N.D. Ga. 1971).

148. *See* Bradley v. Melroe Co., 141 F.R.D. 1, 2-3 (D.D.C. 1992).

149. *See* Granger v. Nat'l R.R. Passenger Corp., 116 F.R.D. 507, 510 (E.D. Pa. 1987).

150. *See* Reichhold Chem., Inc. v. Textron, Inc., 157 F.R.D. 522, 527 (N.D. Fla. 1994).

151. *See* Lasky v. Am. Broad. Cos., Inc., 5 Fed. R. Serv. 3d (West) 1366, 1367 (S.D.N.Y. 1986).

152. *See In re* Crazy Eddie Sec. Litig., 792 F. Supp. 197, 205-06 (E.D.N.Y. 1992).

153. *See generally* Kevin MacGillivray, *The Confidentiality of NCAA Investigation Files: A Policy Worthy of Protection*, 8 SETON HALL J. SPORT L. 629 (1998) (arguing for the extension of the self-evaluative privilege to NCAA investigations of rules violations by student athletes).

154. *See generally* Note, *The Self-Critical Analysis Privilege and Discovery of Affirmative Action Plans in Title VII Suits*, 83 MICH. L. REV. 405 (1984) (demonstrating the need for a self-critical analysis privilege to protect affirmative action plans in employment discrimination suits).

155. *See generally* Gabriel L. Imperato, *Internal Investigations, Government Investigations, Whistleblower Concerns: Techniques to Protect Your Health Care Organization*, 51 ALA. L. REV. 205 (1999) (presenting the need for a self-evaluative privilege to protect health care providers during a fraud and abuse investigation).

156. SNIDER & ELLINS, *supra* note 138, at 6-3. For examples of the negative treatment afforded the self-evaluative privilege, see *id.* at 6-3 nn.11-12.

recognized self-evaluation, at best, on a case-by-case basis.[157] Whether due to "the suspicion that 'many internal probes are really velvet-coated cover-ups'"[158] or the general reluctance toward recognizing new evidentiary privileges,[159] most federal courts have failed to clarify the privilege's scope or contours.[160]

Courts faced with a claim of self-evaluative privilege have typically balanced the private interests of the party seeking protection against the "public interest in maintaining confidentiality."[161] In order to be protected by the self-evaluative privilege, the prevailing test requires that:

> (1) the information must result from a critical self-analysis undertaken by the party seeking protection; (2) the public must have a strong interest in preserving the free flow of the type of information sought; (3) the information must be of a type the flow of which would be curtailed if discovery were allowed; and (4) the information must have been prepared with the expectation that it would be kept confidential, and must have in fact been kept confidential.[162]

Perhaps more importantly, courts that have recognized this privilege acknowledge that it is grounded in the idea that "confidentiality is often essential to the free flow of information and that the free flow of information is essential to promote recognized public interests."[163]

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157. See Note, *supra* note 154, at 428-29.

158. Schallert & Williams, *supra* note 69, at 343 n.22 (quoting Fred Strasser, *Dicey Dilemmas: Corporate Probe Use Expanding*, NAT'L L.J., Jan. 9, 1989, at 1).

159. *See* Vandegrift, *supra* note 135, at 174. "Judicial apprehension about a broad self-criticism privilege may stem from the Supreme Court's admonitions against the expansion of existing, and the creation of new, privilege doctrines." Schallert & Williams, *supra* note 69, at 348.

160. *See* SNIDER & ELLINS, *supra* note 138, at 6-4.

161. *Id.* at 6-6.

162. *Id.*; *see also* Dowling v. Am. Haw. Cruises, Inc., 971 F.2d 423 (9th Cir. 1992) (establishing the most widely applied test for the recognition of a self-evaluative privilege).

163. Note, *supra* note 154, at 1087; *see also* Bredice v. Doctors Hosp., 50 F.R.D. 249 (D.D.C. 1970) (recognizing the existence of the self-evaluative privilege in protecting a hospital's internal risk management process). As stated by one commentator, the self-evaluative privilege is a reasonable alternative for situations in which "denying protection will stifle more information than will applying the privilege." Note, *supra* note 142, at 1088.

B. Making the Grade: Why Corporate Internal Investigations Satisfy the Test for a Self-Evaluative Privilege

Although no court has expressly recognized a claim of self-evaluative privilege for corporate internal investigations, some have discussed its applicability in this context.[164] In fact, corporate internal investigations, especially those that are motivated internally and provided proactively to federal enforcement agencies, satisfy the required elements of the self-evaluative privilege better than many of the situations in which courts have already recognized its applicability. First, the information to which the privilege would be applied is the result of a corporation's critical self-analysis. Regardless of the motivation, the focus of an internal investigation is, by definition, on a corporation's internal activities. Second, the public has a strong interest in maintaining the free flow of internal information from a corporation to the appropriate enforcement agencies, as well as in avoiding the "chilling effect" on employee cooperation that results from the strict disclosure approach.[165] Whether styled as self-policing, self-analysis, or self-governance, enabling federal enforcement agencies to obtain the confidential information they need to fulfill their oversight functions is an important public interest that meets the requirements for recognition of the self-evaluative privilege. Third, the information contained in internal investigations is, without a doubt, of a type that would be discouraged in the face of complete discovery. As demonstrated by McKesson HBOC's dilemma, the information contained in internal investigations can have extremely damaging and unforeseen consequences. Given the choice, it seems obvious that allowing greater public discovery of this information can serve only as a disincentive for corporations to conduct proactive fact-finding activities. Finally, in the absence of a government mandate, internal investigations are almost always prepared with the intention that they will be kept confidential. The difficulty, however, comes in satisfying the expectation that the investigation is actually kept confidential.

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164. Block & Barton, *supra* note 84, at 18-19 n.1.

165. Todd v. S. Jersey Hosp. Sys., 152 F.R.D. 676, 682 (D.N.J. 1993).

Courts have been reluctant to grant a self-evaluative privilege to corporations that share information with a government agency pursuant to a formal request or subpoena, due to the lack of confidentiality that such disclosure seems to entail.[166] In theory, the self-evaluative privilege is waived only "if there is disclosure of the results of the evaluation *in a manner that would allow an adversary to gain access to the information.*"[167] Under the facts in *Bergonzi*, McKesson HBOC provided the DOJ with the results of their internal investigation voluntarily and under the terms of a negotiated confidentiality agreement.[168] Accordingly, the corporation clearly conducted its investigation with the intention that the results would stay confidential and took voluntary steps to ensure that the information would in fact remain so. It is hard to imagine any other actions that McKesson HBOC could have taken to protect the confidentiality of its information, short of denying the DOJ and SEC access to the information and facing a formal investigation or subpoena.[169] As a result, it is counterproductive and counterintuitive for courts to deny the application of the self-evaluative privilege when a corporation discloses its internal investigation in such a confidential manner. In light of these arguments, it seems obvious that corporations that voluntarily submit the results of an internal investigation to a federal enforcement agency satisfy the elements necessary for courts to recognize the protections of the self-evaluative privilege.

C. No Time Like the Present: Why Corporations that Cooperate Should Be Protected by a Self-Evaluative Privilege

The application of the self-evaluative privilege to corporate internal investigations does more than merely satisfy a set of basic structural formalities. Specifically, there are strong pragmatic and policy arguments in favor of extending this privilege beyond its

166. *See, e.g.*, FTC v. TRW, Inc., 628 F.2d 207, 210-11 (D.C. Cir. 1980) (finding the self-evaluative privilege inapplicable to documents requested by a government agency, as opposed to a private party); *see also* SNIDER & ELLINS, *supra* note 138, at 6-9.

167. SNIDER & ELLINS, *supra* note 138, at 6-9 (emphasis added).

168. United States v. Bergonzi, 216 F.R.D. 487 (N.D. Cal. 2003).

169. Incidentally, either option would have waived the corporation's expectation of confidentiality and denied it any protection from the self-evaluative privilege.

traditional context. The following sections will examine these arguments in greater detail.

1. A Convergence of Opinions

The first argument in favor of extending the self-evaluative privilege to corporate internal investigations is that a surprising number of governmental actors and agencies have already reached an apparent convergence of opinion on this topic. For example, both the executive and legislative branches of the federal government have already recognized the desirability of this approach. In addition, Delaware's Court of Chancery has started to demonstrate a greater recognition of the benefits to be realized from a self-evaluative privilege for corporate internal investigations. Perhaps not surprisingly, it is the federal judiciary that remains out of step with the prevailing views on this topic. Several examples may help to further clarify these important developments.

As an initial matter, the final results of a corporation's internal investigation will be of significant interest and usefulness to a number of federal agencies. First, the SEC requires that all publicly traded corporations include a wide variety of internal governance information in their periodic filings.[170] This information includes, for example, whether any member of a corporation's officers or directors "is a named subject of a pending criminal proceeding"[171] and whether a corporation knows of any "trends or uncertainties that have had or that the [corporation] reasonably expects will have a material ... unfavorable impact" on its business.[172] Second, the DOJ can and will pursue formal investigations in order to ferret out suspected corporate wrongdoing.[173] Interestingly, the threat of harm to a publicly traded corporation's image, and therefore to the value of its shares, from a DOJ investigation may be as much of a motivation to perform an internal investigation as the issuance of a formal indictment. When taken in conjunction with the DOJ's shift to using search warrants and the attendant public spectacle,[174]

170. *See* Holliday & Stevens, *supra* note 16, at 284.
171. 17 C.F.R. § 229.401(f)(2) (2004).
172. 17 C.F.R. § 229.303(a)(3)(ii) (2004).
173. *See supra* text accompanying note 32.
174. Brian & McNeil, *supra* note 10, at 14.

corporations may face pressure to conduct an internal investigation from either formal or informal DOJ actions. Third, the Environmental Protection Agency (EPA) has well established reporting requirements and voluntary disclosure programs for corporations to use in investigating their environmental footprints.[175] Finally, the Department of Health and Human Services (DHHS) continues to increase the scope of its formal reporting requirements.[176]

A number of government agencies have already recognized the sensitive and privileged nature of the information generated by an internal investigation. Not surprisingly, many of these agencies have created formal voluntary disclosure programs that may effectively insulate a corporation from any additional criminal sanctions.[177] The DOJ, Department of Defense (DOD), EPA, and Internal Revenue Service (IRS) all have developed written guidelines for voluntary disclosure of a corporation's internal investigation.[178] Clearly, these programs signal a strong commitment by federal enforcement agencies to bypass prosecution for corporations whose disclosure is truly voluntary and not developed in the face of external pressure.[179]

Perhaps the most important example of this federal commitment to encouraging cooperation between corporations and enforcement agencies is that the voluntary disclosure of sensitive information at an early stage of government involvement will be taken into account during any subsequent sentencing phases.[180] As applied, the Federal Sentencing Guidelines for Organizations give considerable weight to a corporation's decision to cooperate with federal investigators.[181]

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175. *See, e.g.*, Envtl. Prot. Agency, Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations, *available at* http://www.epa.gov/compliance/resources/policies/incentives/auditing/auditpolicy.pdf (last visited Sept. 12, 2004).

176. *See, e.g.*, Department of Health and Human Services, Office of Inspector General, Provider Self-Disclosure Protocol, 63 Fed. Reg. 58,399 (Oct. 30, 1998), *available at* http://oig.hhs.gov/authorities/docs/selfdisclosure.pdf (last visited Sept. 12, 2004).

177. Holliday & Stevens, *supra* note 16, at 287.

178. For a representative listing of voluntary reporting programs developed by federal agencies, see *id.* at 290 n.31.

179. *Id.* at 290.

180. *See* Brian & McNeil, *supra* note 10, at 7.

181. For an extensive account of the approach taken by the Federal Sentencing Guidelines for Organizations toward a corporation's voluntary disclosure of its internal investigation, see Holliday & Stevens, *supra* note 16, at 288-89. The authors note that

> [a]n organization's voluntary disclosure of wrongdoing tends to reduce its

Specifically, if a corporation is actually guilty of the offense charged, cooperation with federal enforcement agencies may cut the fines by between eighty and ninety-five percent.[182] As such, "a decision not to disclose carries with it substantial economic risks in the form of a fine, as well as terms and conditions of probation."[183] At the most basic level, the potential to avoid severe financial liability and statutory penalties provides significant incentives for corporations to conduct and disclose the results of their internal investigations.[184] The existence of these voluntary disclosure programs already creates a limited protection for corporate internal investigations in practice, if not in theory. As demonstrated in *Bergonzi*, however, these programs do not go far enough toward ensuring the confidentiality of sensitive corporate information.

In addition to this movement by federal enforcement agencies toward recognizing a self-evaluative privilege, Congress appears to be following a similarly proactive approach to internal investigations. In fact, Congress's most recent legislation to address corporate governance in general, and internal investigations in particular, seems to favor a more tempered approach to corporate disclosure. Initially, the Sarbanes-Oxley Act[185] imposed a wide range of reporting and disclosure requirements on corporations and their directors.[186] At first blush these requirements may reflect nothing more than a punitive approach to enforcing basic standards of corporate governance. Recent legislation, however, moderates this

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culpability score, and thus its multiplier and actual fine. More specifically, if the organization: voluntarily discloses the offense to the government *before disclosure is threatened or a government investigation begins*, fully cooperates in the subsequent government investigation, and clearly recognizes and accepts responsibility for its conduct before trial (i.e., pleads guilty), then five points will be subtracted from the culpability score.

Id. (citation omitted) (quoting U.S. SENTENCING GUIDELINES MANUAL § 8C2.4(a) (1991)).

182. *See* WEBB ET AL., *supra* note 12, at 11-4.

183. *See* Holliday & Stevens, *supra* note 16, at 288.

184. *See* Brian & McNeil, *supra* note 10, at 7.

185. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002) (codified in scattered sections of 15 U.S.C. and 18 U.S.C.).

186. Brian & McNeil, *supra* note 10, at 2. For a discussion of the Sarbanes-Oxley Act's reporting and disclosure requirements, see *id.* at 2 n.2. Although the full scope of the Act's requirements is beyond this Note's boundaries, it is sufficient to state that Congress has become more involved in resolving policy questions on promoting ethical corporate governance.

standard by providing publicly traded corporations with a limited self-evaluative privilege.

Specifically, the Securities Fraud Deterrence and Investor Restitution Act of 2003 (SFDIRA)[187] would provide an unprecedented degree of statutory protection for corporations that disclose the results of an internal investigation to the SEC. As drafted, the legislation would prohibit the waiver of a document's confidentiality if a corporation shares information with the SEC.[188] The SFDIRA would amend section twenty-four of the Securities Exchange Act of 1934 by inserting the following language:

> Notwithstanding any other provision of law, whenever the Commission and any person agree in writing to terms pursuant to which such person will produce or disclose to the Commission any document or information that is subject to any Federal or State law privilege, or to the protection provided by the work product doctrine, such production or disclosure shall not constitute a waiver of the privilege or protection as to any person other than the Commission.[189]

According to one of its sponsors, Congressman Michael G. Oxley, the bill is designed "to strengthen the Securities and Exchange Commission to make it even more effective in deterring securities fraud and enforcing securities statutes."[190] Accordingly, the bill is intended not only to "act [as] a deterrent," but also "to restore some faith in the process for investors who have plenty of education in the school of hard knocks."[191]

Congressman Oxley's comments mirror the results of a report on the SFDIRA conducted by the House of Representatives Committee on Financial Services (Committee).[192] In their evaluation of the bill, the Committee determined that the SFDIRA "would give the [SEC] and banking regulators access to significant, otherwise unobtainable

187. The Securities Fraud Deterrence and Investor Restitution Act of 2003, H.R. 2179, 108th Cong. (2003).

188. *Id.* § 4.

189. *Id.*

190. Press Release, Congressman Richard H. Baker, Baker, Oxley Introduce Bill to Strengthen SEC Powers Against Securities Fraud, Return Funds to Defrauded Investors (May 21, 2003), *available at* http://www.baker.house.gov/html/release.cfm?id=59.

191. *Id.*

192. H.R. REP. NO. 108-475, pt. 1 (2004).

information by allowing . . . private parties to produce privileged or work-product protected documents . . . without waiving the privilege or protection as against any other party."[193] The Committee captured the crux of the arguments in favor of recognizing a self-evaluative privilege for corporations that share the results of an internal investigation with the SEC by stating:

> Voluntary production of information that is protected by the attorney-client privilege, other privileges, or the attorney work product doctrine greatly enhances the [SEC's] investigative efforts, and in some cases makes them more efficient. In many cases, private parties would be willing to share privileged information with the [SEC] if they could otherwise maintain the privileged and confidential nature of the document. For example, a company that retains outside counsel to conduct an internal investigation concerning possible violations may be willing to share the investigative report with the [SEC]. Under current law, however, a party who produces privileged or protected material to the [SEC] runs a very serious risk that a third party, such as an adversary in private litigation, could obtain that information by successfully arguing that production to the [SEC] waived the privilege or protection. This presents a substantial disincentive for anyone who might otherwise consider providing the [SEC] useful information that is subject to a privilege or protection.... [The SFDIRA] minimizes that disincentive. It does ... allow parties who choose to produce such materials to do so without fear that their production to the [SEC] will be deemed to waive the privilege or protection as to anyone else.[194]

The Committee continued to find that "[t]he protections of a clear rule ... will help ensure that ... Federal functional regulators receive necessary information about the respective financial services providers that they regulate and that there is a free flow of information between the regulated entity and the Federal regulator."[195]

193. *Id.* at 13.
194. *Id.* at 24.
195. *Id.* at 25.

Although the SFDIRA's current status remains unclear,[196] these statements from the Committee's evaluation demonstrate a strong legislative intent to promote voluntary disclosure of a corporation's internal information by protecting this privileged material from private third parties. Accordingly, this trend presents a strong intuitive argument in favor of aligning judicial corporate policy with current legislative sentiment by recognizing a self-evaluative privilege for corporate internal investigations.

Moreover, the policy goals and motivations behind the self-evaluative privilege are more faithful to those followed by Delaware's Court of Chancery, arguably the nation's leading venue for corporate litigation, than those represented by the current federal approach. Recently, these courts have demonstrated a willingness to move away from their historic reliance on the business judgment rule[197] in favor of a more flexible approach to evaluating corporate governance.[198] According to one of the court's leading members, "[t]he Delaware courts' traditional approach is to create incentives for good things to happen, not to punish except through public embarrassment and occasional money damages for egregious conduct."[199] Not only has Delaware been able to promote proactive corporate governance, but early indications suggest that they have

196. After its introduction in the House of Representatives on May 21, 2003, *see* United States Cong., Bill Summary & Status for the 108th Congress, *available at* http://thomas.loc.gov (last visited Sept. 12, 2004), the Committee on Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (Subcommittee) heard testimony regarding the SFDIRA. H.R. REP. NO. 108-475, pt. 1, at 15. Following its approval by both the Subcommittee and the Committee, *see id.*, the SFDIRA passed to the Committee on the Judiciary, and has since been placed on the Union calendar. *See* United States Cong., Bill Summary & Status for the 108th Congress, *available at* http://thomas.loc.gov (last visited Sept. 12, 2004).

197. Traditionally, the Delaware Court of Chancery has used the business judgment rule to dismiss shareholder litigation, which has led, in part, to Delaware's reputation as being a corporation-friendly venue. John Gibeaut, *Stock Responses*, A.B.A. J., Sept. 2003, at 38. As commonly stated, the business judgment rule stands for the proposition that

> the actions of disinterested and independent directors—who after reasonable investigation—adopt a course of action that they, in good faith, honestly and reasonably believe will benefit the corporation will not be "second guessed," on the merits of that decision.

Myron T. Steele, *Nonbinding Opinions: A Delaware Justice Writes on Judging Corporate Governance*, BUS. L. TODAY, Sept./Oct. 2003, at 17.

198. *See* Gibeaut, *supra* note 197, at 40.

199. Steele, *supra* note 197, at 18.

done so without harming shareholders' access to the information necessary to protect their ownership rights.[200]

In light of these recent developments, it seems that certain judicial venues, as well as the federal executive and legislative branches, are beginning to recognize the privileged nature of information collected during an internal investigation. This concurrence of opinions demonstrates that federal courts should also recognize this reality when evaluating claims for a self-evaluative privilege.

2. Addressing the Agency Problem

Clearly, one of the motivating concerns behind the federal judiciary's approach to corporate governance is the recurring problem of ensuring that corporate directors and managers take actions that are in the best interests of the corporation and its shareholders.[201] Sometimes referred to as the agency problem in corporate law, the intractable questions related to aligning shareholder and management interests can and will be better addressed by the recognition of a self-evaluative privilege than by a continuation of the status quo. By recognizing a self-evaluative privilege, federal courts can remove the considerable disincentives for corporations to conduct proactive internal investigations. As discussed in the context of *Bergonzi*, losing an internal investigation's privileged status can have devastating financial and legal effects for a corporation.[202] The fact that corporate internal investigations frequently give rise to spin-off shareholder litigation makes

200. The trend toward increased shareholder activism demonstrates this new reality. For example, the 2003 Annual Meeting season produced 324 shareholder proposals related to executive compensation, as compared to 106 in 2002. Gibeaut, *supra* note 197, at 40. In addition, the fact that Delaware's Courts of Chancery have taken a proactive approach to corporate governance has not diminished their willingness to disclose corporate information that does not meet the tests for privileged status. In fact, since June 2002, Delaware's Supreme Court has reversed six decisions favoring directors, including decisions relating to shareholder attempts "to obtain documents supporting allegations of accounting irregularities." *Id.* at 41.

201. *See, e.g.*, Dodge v. Ford Motor Co., 204 Mich. 459, 507 (1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.").

202. *See supra* text accompanying notes 55-58.

the protections offered by a self-evaluative privilege even more valuable.[203]

Protecting the confidentiality of internal investigations is even more confusing in the context of shareholder or derivative litigation because of the general principle that "otherwise privileged communications between counsel and their corporate clients may be discovered by plaintiffs in shareholder actions upon a showing of good cause."[204] This general rule rests on the assumption that a corporation owes a fiduciary duty to shareholders that prevents it from invoking the attorney-client privilege against its beneficiaries.[205] Realistically, shareholder suits and derivative actions are no less damaging than government enforcement actions. The extensive consequences of disclosing an internal investigation under these circumstances will go a long way toward eliminating the free flow of information between managers and the board of directors, corporations and government agencies, and employees and managers.[206]

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203. Block & Barton, *supra* note 84, at 84.

204. *Id.* This general rule is laid out in *Garner v. Wolfinbarger*, 430 F.2d 1093, 1103-04 (5th Cir. 1970). In addition, *Garner* lays out specific indicia of good cause to which a court will look in determining whether a party can access internal investigations. *Id.* at 1104. Although the *Garner* rule is followed generally, in most cases where the rule is applied, courts usually deny discovery in practice for lack of good cause. *See* Block & Barton, *supra* note 84, at 85. Some courts have limited *Garner* "to discovery of the legal advice preceding the allegedly wrongful conduct." *Id.* at 86.

205. Block & Barton, *supra* note 84, at 84. As stated by one commentator,

> [s]hareholder suits ... present a conceptual dilemma for the attorney-client privilege due to the fiduciary relationship that exists between the corporation and its shareholders. Because the corporation exists for the benefit of the shareholders, allowing the corporation free rein to assert the privilege against these same shareholders appears anomalous. On the other hand, the corporation will need to seek legal advice free from fear of disclosure to individual shareholders who may not represent the best interests of the majority of stockholders.

Schallert & Williams, *supra* note 69, at 349.

206. In fact,

> [i]f discoverable by shareholders, the internal investigative report could provide damning evidence of corporate wrongdoing, thereby laying the foundation for shareholders' claims. Moreover, facts revealed in the internal investigative report could spawn lawsuits not previously contemplated. Given the threat of these consequences, corporations will be less likely to undertake internal investigations and to document those findings in a written report.

Id. at 350.

These arguments make it apparent that the self-evaluative privilege offers a more effective and proactive solution to the traditional agency problems of corporate governance than those presented by the evidentiary privileges currently recognized by federal courts.

3. Increasing Corporate Efficiency

In addition, there is an intuitive efficiency argument in favor of recognizing a self-evaluative privilege for corporate internal investigations. Ideally, corporations should appoint independent directors who are committed to their shareholders' best interests. Implicit in this idea of fiduciary duty is the directors' responsibility to stay informed about the corporation's internal workings.[207] Under the prevailing treatment of internal investigations, the possibility of universal disclosure serves as a judicial bar to corporate directors fulfilling their implied duty to stay informed. By recognizing a self-evaluative privilege, courts can remove this significant disincentive. As a result, directors may be able to use internal investigations as a tool to improve corporate performance as opposed to focusing on the risk management questions presented by the current system. Accordingly, by recognizing a self-evaluative privilege, courts can give corporate directors the benefits of another performance improvement tool, which, in turn, will ultimately benefit their shareholders.

4. Protecting the Public Interest

Finally, the public interest advanced by the self-evaluative privilege is consistent, if not identical, to those cited in defense of the existing attorney-client and work product privilege. The attorney-client privilege is grounded in protecting the free flow of information and full disclosure of material information between attorneys and clients.[208] In addition, the work product privilege has been codified as an attempt to ensure a robust adversarial system, as manifested in the complete discovery of information through the

207. *See supra* text accompanying note 68.

208. *See supra* note 81 and accompanying text.

process of litigation.[209] The lowest common denominator for both of these privileges is that the public's interest is served most effectively and efficiently by the complete and prompt disclosure of any information that is material to an ongoing dispute. Parties who have argued for applying the self-evaluative privilege to corporate internal investigations have advanced this theme consistently as the underlying public interest protected by this doctrine.[210] In other words, by preserving the confidentiality of internal investigations, courts can actually further the public's interest in full and fair disclosure of corporate information.

As in *Bergonzi*, assuring corporations that their internal investigations will not become a matter of public record facilitates this flow of information between corporations and the relevant oversight and enforcement agencies. At the same time, the public receives an added benefit when the government agencies charged with protecting shareholders' interests have access to accurate information collected by those closest to the daily corporate machinations. Accordingly, the self-evaluative privilege will be able to protect the public interest through complete and accurate disclosure of information while also providing government agencies with the necessary tools to fulfill their statutory mandates. Unfortunately, the federal courts have not been receptive to these public policy arguments. As the recent corporate scandals demonstrate,[211] these arguments have taken on new relevance and should be given a closer examination.

5. Arguments for Maintaining the Status Quo

Opponents of the self-evaluative privilege have advanced numerous arguments against it. As an initial matter, federal and state courts have precedent on their side. Accordingly, arguments for extending the self-evaluative privilege to corporate internal investigations have received a consistently hostile reception.[212] To a certain extent, this hostility can be attributed to an historical

209. *See supra* text accompanying note 83.

210. *See, e.g.*, Sheppard v. Consol. Edison Co., 893 F. Supp. 6, 7 (E.D.N.Y. 1995) (evaluating a corporation's analysis of the public policy goals supporting the self-evaluative privilege).

211. *See, e.g.*, *supra* notes 4-8 and accompanying text.

212. *See* SNIDER & ELLINS, *supra* note 138, at 6-3 nn.11-12.

unwillingness to recognize new evidentiary privileges without overwhelming public policy support.[213] The resistance to developing a self-evaluative privilege for corporations that cooperate with government agencies, however, seems not only outdated but downright harmful in light of recent corporate history.[214]

In addition, opponents of the self-evaluative privilege point to the increasing activism among corporate shareholders as further support for the position that new privileges are not necessary to promote responsible corporate governance.[215] In other words, the current policies in favor of disclosing the results of an internal investigation have achieved the intended effect of protecting the public's interest against abuses by corporate management. The flood of corporate misbehavior that splashes across the newspapers on almost a daily basis, however, stands in stark contrast to this bare assertion.[216] Regardless of the recent success realized by derivative lawsuits, corporate shareholders at-large still face the twin challenges of dispersion and disinterest. Accordingly, the investing public must have faith that the government enforcement agencies assigned to protect their interests will be able to achieve their mandate. By their own admission, the DOJ and other agencies have recognized that the self-evaluative privilege will only help them achieve this goal.[217]

Finally, critics of the self-evaluative privilege often argue that new privileges serve only to limit disclosure and restrict the range of information that is available to the adversarial judicial process.[218] Although this point raises important public policy concerns, it loses its thrust in this context for several reasons. First, extending the self-evaluative privilege to internal investigations would protect only the actual report itself. As with the work product and attorney-client privileges, an adversarial party can access any underlying information through discovery and deposition. If plaintiffs are allowed continued access to a corporation's report of their own internal investigations, courts are, in essence, forcing a corporation

213. *See* Note, *supra* note 142, at 1084.
214. *See, e.g.*, *supra* notes 4-8 and accompanying text.
215. *See supra* note 200 and accompanying text.
216. *See supra* text accompanying notes 4-8.
217. *See supra* notes 49, 170-84 and accompanying text..
218. *See, e.g.*, Simon, *supra* note 85, at 142-45.

to outline a litigation strategy against itself. Second, the self-evaluative privilege could only be extended to corporations claiming this protection in order to disclose sensitive information to a government enforcement agency. Accordingly, it seems nonsensical to argue that removing incentives for a corporation to cooperate with government agencies will be a more faithful attempt to promote the goals of full and fair disclosure. On the contrary, by guaranteeing that any information collected as part of an internal investigation will maintain its privileged status, courts can take great steps toward promoting full disclosure and protecting the public's interest.

CONCLUSION

As demonstrated by *Bergonzi*, the question of whether a corporation waives its attorney-client and work product privileges by sharing the results of an internal investigation with government agencies is more pressing than ever. Although strong arguments exist on both sides of this debate, the trend, both legislative and regulatory, is moving toward greater recognition of the privileged status of information collected during an internal investigation. Accordingly, it is time for the federal court system to recognize this movement and to bring its decisions in line with the prevailing public policy that favors protecting corporate internal investigations. In light of the increasing pressure on corporations to cooperate with government agencies, courts should abandon their traditional positions on the waiver of privileged information collected during internal investigations in favor of establishing a self-evaluative privilege for corporations that volunteer this information to government enforcement agencies. Clearly, the time has come for a change in the dominant ethics and practices of corporate governance. The question remains, however, whether the law will recognize the potential for change embodied in the self-evaluative privilege or continue to insist that no good deed goes unpunished.

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