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Practising Law Institute
1177 Avenue of the Americas
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Three's Company or Three's a Crowd? Working with Third Parties during an Internal Investigation

Laura G. Hoey
David E. Rhinesmith
Lauren M. Modelski
Ropes & Gray LLP

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I. INTRODUCTION

During the course of an internal investigation, a client or counsel may encounter a number of third parties either as part of the investigation or in the normal course of business. In some cases, such as those where the relationship is driven by investigative concerns, the sharing of information with this party will be valuable to the internal investigation. In others, a third party relationship may present a hurdle to the investigation or raise previously unforeseen challenges.

One of the critical considerations with such relationships concerns the information investigation counsel should disclose to a third party. In particular, should counsel disclose information that may be otherwise protected by the attorney-client privilege or work product doctrine? It is vital that both the client and counsel carefully consider the appropriate level of disclosure, taking into account potential privilege waiver. In some instances, particularly where a series of outside parties may play a significant role in the investigation, a company and its counsel may benefit from setting up initial parameters concerning how to deal with such entities. In others, flexibility will be essential as the company's needs and the third party's role evolve.

This outline discusses the interaction of legal counsel and third parties, with a specific eye toward the privilege issues that may be involved when considering disclosure. Though certainly not an exhaustive list, this outline will specifically highlight such categories of third parties as auditors, banks, and public relations firms. As discussed below the purpose of the relationship and the manner in which the parties actually interact are among the relevant considerations, and may be pivotal in how the privilege is scrutinized.

II. THE KOVEL DOCTRINE

A. The Decision in *Kovel*

1. The *Kovel* doctrine, set forth in *United States v. Kovel,* 296 F.2d 918 (2d Cir. 1961), describes the parameters for the extension of the attorney-client privilege to non-attorney third parties. The approach has been adopted by most circuits and has been applied, beyond the factual context of *Kovel* (accountants in tax cases). *Kovel* now regularly informs how courts evaluate the privilege for third party disclosures.

2. *Kovel* held that the privilege could extend to communications between a client and a non-attorney third party if "the communication [is] made in confidence for the purpose of obtaining legal advice from the lawyer." *Id.* at 922. In applying this rule, the court found that the privilege could reasonably extend to an accountant assisting a law firm in an investigation into an alleged federal income tax violation.

   (a) The court explained that the privilege could be extended to protect communications which were "necessary, or at least highly useful," to discussions between the client and the attorney, which is the very relationship that "the privilege is designed to permit."

   (b) The privilege may therefore be extended to cover communication with an expert who plays a "translating or interpreting function" because such communications help the attorney better understand and convey information, and may be used in providing legal advice. *Id*. In short, the extension of the privilege heavily depends on the purpose of the advice conveyed.

B. Application

1. To determine whether the protection of the privilege may extend to a third party requires scrutinizing whether the communication is actually necessary to the rendering of legal advice. In practice, however, it may be difficult for courts to determine the necessity or purpose of a third party relationship—particularly as a court may be asked to evaluate communications years after the fact.

2. Courts considering this question have therefore looked to facts that may demonstrate the necessity or purpose of the relationship, primarily (a) the nature of the advice given (*i.e.*, what information was conveyed), and (b) the structure of the relationship (*i.e.,* how the advice was conveyed and to whom it was conveyed).

   (a) In considering the nature of the advice given, courts look to whether the advice was legal in nature and/or its necessity to the legal representation.

   (b) In considering the structure of the relationship, courts have looked at the facts surrounding the parties' communications, for example, scrutinizing the retention agreement between a client and a third party advisor, particularly whether legal

purposes were described within. *See, e.g.*, *Louisiana Mun. Police Emps. Retirement Sys. v. Sealed Air Corp.*, 253 F.R.D. 300 (D.N.J. 2008).

III. WORKING WITH THIRD PARTIES IN PRACTICE

The standard set forth in *Kovel* has since been applied in a number of cases addressing various types of experts, including:

A. "Traditional" Experts: Accountants and Patent Agents

1. The most accepted and well-understood application of *Kovel* is to accountants in tax cases, the context in which *Kovel* was originally decided.
2. The privilege has also been readily extended to third parties who courts have easily recognized as "translating" experts, such as accountants in fraud cases or patent agents in patent cases.
   (a) *See*, *e.g.*, *Liggett Grp., Inc. v. Brown & Williamson Tobacco Corp.*, 116 F.R.D. 205, 210-11 (M.D.N.C. 1986) (using a case involving an accountant and a case involving a patent agent as prime examples of how to extend the privilege);
   (b) *Foseco Int'l Ltd. v. Fireline, Inc.*, 546 F. Supp. 22 (N.D. Ohio 1982) (patent agent).

B. Auditors

1. When working with third parties where the relationship is less easily couched in these terms, the extension of the privilege may pose additional risks as courts may be more reticent to apply the *Kovel* doctrine. This is evident even in the doctrine's application to auditors, a third party that companies and their counsel may initially assume are essentially the same as other accountants.
2. In considering privilege waiver, courts differentiate between those situations where the interests of auditors and the company are aligned and those where such interests may be disparate. Whether disclosure to an auditor waives privilege may depend on an analysis using the general considerations set forth in *Kovel* and related cases, starting with the role of the auditor and the nature of the advice sought.

(a) Where auditors are operating in the normal course of business, and were not retained for the purpose of seeking legal advice, courts have generally found that the privilege has been is waived.

(i) *See*, *e.g.*, *In re Honeywell Int'l, Inc. Secs. Litig*., 230 F.R.D. 293 (S.D.N.Y. 2003) (privilege did not extend to communications between client and non-party accountants or auditors);

(ii) *First Fed. Savs. Bank v. United States*, 55 Fed. Cl. 263, 269-70 (2003) (disclosure of board minutes for the business purpose of performing annual audits constituted a waiver of the privilege for all such disclosed minutes);

(iii) *But see SEC v. Berry*, No. C07-04431 RMW (HRL), 2011 WL 825742 (N.D. Cal. Mar. 7, 2011) (information shared with auditors for the purpose of an independent audit was protected due to this limited alliance with the corporation for the purpose of rooting out fraud).

(b) Conversely, privilege is not waived where an auditor is retained for the purpose of seeking legal advice, a situation closely analogous to *Kovel*. *See*, *e.g.*, *United States ex rel. Robinson v. Northrup Grumman Corp.*, No. 89 C 6111, 2003 WL 21439871 (N.D. Ill. June 20, 2003).

3. In practice, counsel using auditors in the course of an investigation should define the purpose of the retention and should ensure that such auditors not exceed those bounds. Additionally, counsel should be wary of disclosing legal advice or investigative findings to auditors retained in the client's ordinary course of business.

C. Banks and Financial Advisors

1. When considering disclosures to banks and other financial advisors, courts have again looked to the third party's role, both the advice sought and the purpose of the retention, in deciding whether the privilege extends to information disclosed to the third party.

2. Regardless of the third party's potential expertise, one of the key questions remains whether these financial advisors are offering

advice relevant to the litigation or investigation. Courts may scrutinize whether the banks or financial advisors are acting to further the business interests of the company or to assist the lawyer by playing a "translating" role.

(a) Accordingly, in looking to *Kovel*, various courts have rejected the extension of the privilege to communications with third party banks or financial advisors where these entities were hired in the ordinary course of the company's business.

(i) For example, in *Urban Box Office Network, Inc. v. Interfase Managers, L.P.,* No. 01 Civ. 8854(LTS)(THK), 2006 WL 1004472, at *4 (S.D.N.Y. Apr. 17, 2006), the court explained that "simply because financial consultants are employed to assist a company in a restructuring transaction does not mean that their communications with the attorneys were made in confidence for the purpose of the client obtaining legal advice from its counsel." Looking to the underlying business purpose of the retention, the court found the privilege did not extend to counsel's communications with these parties.

(ii) Relatedly, in *United States v. Ackert*, 169 F.3d 136 (1999), the court held attorney-client privilege could not extend to a communication between an attorney and a third party simply because the communication may have been important to the attorney's advising of the client. Instead, *Ackert* stressed the underlying nature of the relationship and the advice given—here, because counsel was looking to advise the client on a transaction and disclosed information to an investment bank for the purpose of better understanding the tax consequences of a transaction, the protection of the privilege would not cover these communications. The *Ackert* court determined that the investment bank at hand was not acting in a translating capacity, that *Kovel* did not apply, and thus the documents shared with the investment bank were not protected from disclosure. Among the many issues involved here, this case demonstrates that disclosing information to a third party financial advisor does *not* mean that the third party served in the type of translating role protected by *Kovel.*

(b) Where a court determines that an investment bank is lending its expertise and providing guidance that directly informs a law firm's legal advice to the client, on the other hand, communications between a law firm and an investment bank relating to a potential transaction may be held privileged. *See Calvin Klein Trademark Trust v. Wachner*, 124 F. Supp. 2d 207 (2000).

(i) Here, the court found that counsel was seeking insight from an investment bank as to what was "material," and thus legally required to be disclosed to potential buyers. In such circumstances, the court found that the bank was serving in an interpretive function akin to the accountant in *Kovel*, and thus, that attorney-client privilege would shield such communications.

(ii) This approach has been adopted by the Seventh Circuit as demonstrated in *Stafford Trading, Inc. v. Lovely*, No. 05-C-4868, 2007 WL 611252 (N.D. Ill. Feb. 22, 2007) (holding that certain communications with an investment bank were privileged where the communications had been confidentially communicated with counsel for the purpose of obtaining legal advice).

3. The structure of the relationship between the parties may be viewed as critical, even conclusive, where courts are seeking to assess the nature of the relationship, and accordingly whether or not the protection of the privilege will apply.

(a) In *Louisiana Mun. Police Employees*, 253 F.R.D. 300 (2008), the court relied heavily on the retainer agreement between a client and investment bank in evaluating whether the advice given was legal in nature. The court explained that if the advice sought from the investment bank had been legal in nature, the legal purpose of the services would have been set forth in the retainer agreement. In rejecting the extension of the privilege, the court noted that there was no mention of legal services in the agreement and further that the agreement did not even provide for information being shared with the company's counsel. *Id.* at 313.

4. Attorneys should be cautious when dealing with third party banks and financial advisors in light of the matter-specific inquiry as to the nature and structure of the relationship and each disclosure.

(a) As the purpose for which such financial advisors were retained may be conclusive, the company and/or its counsel should take care to make this purpose clear, for example, by including this purpose in the retention agreement.

D. Public Relations Firms

1. Under *Kovel*, courts have been less likely to extend the privilege to communications with public relations firms. Courts have held that such relationships did not evidence that the public relations firm provided expertise or input relevant to the legal matter.

   (a) For example, in *Calvin Klein Trademark Trust v. Wachner*, 198 F.R.D. 53, 54 (S.D.N.Y. 2000), the court rejected privilege claims for communications with a public relations firm, finding insufficient evidence that the public relations firm was actually involved in legal strategy or helped facilitate the attorneys' provision of legal advice, as it was not apparent that the third party provided anything significantly different from ordinary public relations advice.

      (i) The Court also found the structure of the relationship—specifically, that the public relations firm had a prior relationship with the client—to be significant evidence that the firm was providing ordinary public relations services.

      (ii) Note that this decision is different from the previously cited case of the same name, *Calvin Klein Trademark Trust v. Wachner*, 124 F. Supp.2d 207 (2000), above.

   (b) Similarly, *Burke v. Lakin Law Firm, PC*, No. 07-CV-0076-MJR, 2008 WL 117838, at *3 (S.D. Ill. Jan. 7, 2008), held that the work product protection would not extend to documents "merely prepared for one's defense in the court of public opinion," rather than for the purpose of providing advice as part of the legal defense.

2. A few courts have, in light of the nature of the advice given and the structure of the relationship, extended the privilege to public relations firms, viewing such third parties as providing consulting services relevant to the legal matter. *See In re Grand Jury Subpoenas Dated Mar. 24, 2003*, 265 F. Supp. 2d 321 (S.D.N.Y. 2003).

(a) *In re Grand Jury Subpoenas* held that, in a case involving an extraordinary media frenzy surrounding a grand jury investigation, public relations and media strategy were an integral part of providing legal advice, and that the realities of these parties' management of the relationship demonstrated that this was the purpose and actual use of the advice of the public relations firm.

(b) As the *In re Grand Jury Subpoenas* court reasoned: "In consequence, this Court holds that (1) confidential communications (2) between lawyers and public relations consultants (3) hired by the lawyers to assist them in dealing with the media in cases such as this (4) that are made for the purpose of giving or receiving advice (5) directed at handling the client's legal problems are protected by the attorney-client privilege." *Id.* at 331.

IV. STRUCTURING THIRD PARTY RELATIONSHIPS IN LIGHT OF *KOVEL*

Since the *Kovel* doctrine requires a fact-intensive inquiry, counsel should carefully craft and control third party relationships to demonstrate their legal necessity.

A. Factors Courts Consider

1. District courts have considered a number of factors in scrutinizing the relationship of counsel, clients, and third parties consulted in the course of a legal matter, including:

   (a) whether the third party was retained by counsel,

      (i) *See N.Y. Renu with Moistureloc Prod. Liab. Litig.*, No. 766,000/2007, MDL. 1785, 2:06-MN-77777-DC, 2009 WL 2842745, at *2 (D.S.C. July 6, 2009) ("under Kovel, retention by counsel rather than the client cuts in favor of a finding that the agent was necessary to the representation, and rightly so, because retention by the lawyer is an implicit conclusion of the lawyer that the consultant's expertise will maximize the lawyer's services");

(b) the purpose of retaining the third party,

(i) *See*, *e.g.*, *Carter v. Cornell Univ.*, 173 F.R.D. 92, 94 (S.D.N.Y. 1997) (applying privilege to a university human resources employee conducting interviews with university staff because the interviews were conducted at the request of counsel and for the exclusive use of counsel in rendering legal representation). *See also United States v. Jones*, 696 F.2d 1069, 1072-73 (4th Cir. 1982) (explaining that the court doubted the privilege should apply even for attorneys where it is apparent the client retained these attorneys for a specific and limited business purpose, rather than for the purpose of obtaining legal advice for their own guidance as clients);

(c) any pre-existing relationship between the third party and the client,

(i) even accountants (the experts in *Kovel*) claiming to be experts have been denied privilege for want of evidence that the firm was "working under a different arrangement from that which [ordinarily] governed the rest of its work for [the company]." *United States v. Adlman*, 68 F.3d 1495, 1500 (2d Cir. 1995);

(d) to whom the third party is directing advice,

(i) *See*, *e.g.*, *Black & Decker Corp. v. United States*, 219 F.R.D. 87, 90 (D. Md. 2003) *aff'd in part*, *rev'd in part on other grounds Black & Decker Corp. v. United States*, 436 F.3d 431 (4th Cir. 2006);

(e) the third party's involvement in a given communication; and

(f) who initiated, and ultimately received a given communication.

B. Practical Concerns for Counsel Engaging Third Parties

1. As a practical matter, when engaging a third party, lawyers should structure such arrangements in a manner consistent with the concerns outlined above. This may include:

(a) Counsel acting as the primary point of contact for any third party communications regarding the investigation;

(b) Counsel ensuring that any related communications from the third party are addressed to the lawyers and any

communications intended for the company should flow through and involve the lawyers, always making it clear that the third party's advice is merely that, advice, taken into consideration by the lawyer who serves as the primary point of contact;

(c) The parties carefully crafting the retention agreement of the third party, potentially structuring it such that the lawyer, rather than the client, retains the third party;

(d) The parties specifying the basis for the engagement of the third party in the engagement letter;

(e) The parties, if appropriate, creating and familiarizing the third party and client with engagement letter provisions that explain appropriate means and routes for communication;

(f) Counsel and client directing the third party to avoid discussion of the investigation without a lawyer present; and

(g) Counsel creating and controlling any written records of discussions or communications that occur pursuant to the investigation.

V. CONCLUSION

Third parties, whether auditors, banks, financial advisors, public relations firms, or other experts, may be a necessary part of working with a company's operations, whether such parties are consulted as part of an investigation or regularly work with the company in the normal course of business. As discussed, the way in which attorneys and clients interact with these third parties can raise significant risks of waiver of the attorney-client privilege or work product doctrine.

A pertinent part of any investigation is working with third parties in a manner that will either fall within the protective parameters of the *Kovel* doctrine, or structuring communications to avoid disclosing information that could put the privilege at risk.

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