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Access to Internal Investigation Records by Shareholders

Mary C. Gill & Courtney Quirós*

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I. Introduction

In the current environment, it is not uncommon for a company, its executives, or directors to be presented with allegations of wrongdoing. Whether the issues are raised by a concerned or disgruntled employee, the Securities Exchange Commission, or the Department of Justice, the company should be prepared to promptly determine the nature and severity of the potential problem. Generally, the appropriate course in these situations is for the board of directors of the company to appoint an independent committee to oversee an internal investigation into the allegations. Through an internal investigation, the company can determine the factual nature and scope of the alleged misconduct and analyze the legal implications of the situation, which will allow the company's board of directors to take appropriate remedial action if necessary. The investigation should be conducted in such a way to achieve maximum credibility, integrity, and accuracy, while at the same time preserving all applicable privileges and legal defenses for the company to the greatest extent possible. A recent Delaware Supreme Court decision serves as a reminder that even where companies and their counsel take care to protect the confidentiality of an internal investigation, there is no guarantee against shareholders' access to these records.

* Mary C. Gill is a partner and Courtney Quirós is an associate in the Securities Litigation Group at Alston & Bird LLP in Atlanta, GA.

II. Protection of Internal Investigation Records

In most instances, an internal investigation will be conducted confidentially and under the guidance of counsel, with the expectation that the attendant privileges will protect its content. Over thirty years ago, the United States Supreme Court held that the attorney-client privilege applies to internal investigations and protects the confidential communications conducted by counsel in the course of the investigation. *Upjohn Co. v. United States*, 449 U.S. 383 (1981). The *Upjohn* principles continue to protect properly developed and maintained records of internal investigations in most instances. *See, e.g.*, *In re General Motors LLC Ignition Switch Litigation*, 80 F. Supp. 3d 521 (S.D.N.Y. 2015) (applying *Upjohn* to protect internal investigation records, including witnesses communications); *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754 (D.C. Cir. 2014) (finding *Upjohn* protects internal investigation interviews by non-attorneys at the direction of company's legal department conducted for the purpose of rendering legal advice).

Extreme care and deliberate consideration must be given to each step of the internal investigation to protect confidentiality and preserve all applicable privileges. There are myriad situations where courts have found that the attorney-client privilege or attorney work product doctrine has either been waived or failed to attach in the first instance. For example, in *U.S. v. Ruehle*, 583 F.3d 600, 612 (9th Cir. 2009), the Ninth Circuit held that the company's expressed intention to disclose the substance

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of interviews and the results of an internal investigation to outside auditors eliminated the expectation of confidentiality and deprived the materials of the protection of attorney-client privilege. *See also DeFrees v. Kirkland*, No. CV 11-4272 GAF SPX, 2012 WL 1356495, at *1 (C.D. Cal. Apr. 11, 2012) *aff'd*, 579 F. App'x 538 (9th Cir. 2014) (finding that attorney-client privilege had been waived when the chief executive officer, who had retained independent outside counsel to conduct an internal investigation into actions of the general counsel and certain directors, disclosed the report of investigation to the full board of directors, the general counsel, former executive officer and the Securities Exchange Commission); *In re OM Sec. Litig.*, 226 F.R.D. 579, 591 (N.D. Ohio 2005) (finding that defendant company's production of the audit committee's PowerPoint presentation of investigation to plaintiff shareholders resulted in full subject matter waiver of the attorney-client privilege); *Gruss v. Zwirn*, No. 09 Civ. 6441, 2013 WL 3481350, at *13 (S.D.N.Y. July 10, 2013) (holding attorney-client privilege and work-product protection were waived where company voluntarily provided to the Securities Exchange Commission the content of interview notes and summaries prepared by counsel); *but see SEC v. Berry*, No. C-07-04431 RMW, 2011 WL 825742, *3–6 (N.D. Cal. Mar. 7, 2011) (finding that although the company's audit committee waived work product protection of interview memoranda by discussing the contents of interviews with certain government officials, production of the attorneys' underlying notes and draft interview memoranda was not warranted); *SEC v. Schroeder*, No. C-07-03798 JW, 2009 WL 1125579, at *7 (N.D. Cal. Apr. 27, 2009) (concluding that sharing final interview memoranda with the Securities Exchange Commission did not result in subject matter waiver of the work product privilege and, thus, underlying internal notes and draft memoranda were protected).[1]

Nevertheless, taking care to preserve and avoid waiving any applicable privileges may not fully insulate internal investigation records from shareholders' access. For example, in a noteworthy decision, the Delaware Chancery Court allowed shareholders in a derivative action to obtain the confidential and privileged report of an internal investigation that had been prepared by independent counsel to the company's special committee. *Ryan v. Gifford*, No. 2213-CC, 2007 WL 4259557, *3–4 (Del. Ch. Nov. 30, 2007), *on motion for interlocutory appeal,* 2008 WL 43699, at *2 (Del. Ch. Jan. 2, 2008). In *Ryan,* the court recognized that the attorney-client privilege generally protected communications between the special committee and its counsel, but nonetheless found that the attorney-client privilege had been waived, *inter alia*, through the communication of the special committee's findings to the board of directors, members of which were named defendants in the derivative litigation and whose outside counsel also attended the board meeting. As a result, the court concluded that those directors were participating in the board meeting in their individual capacities, rather than in their fiduciary capacities, which resulted in a waiver of the privileges.

As an alternative ground for ordering that the report be produced, the *Ryan* court held that the shareholders had shown "good cause" to justify production of the report and the supporting documents, under *Garner v. Wolfinbarger*, 430 F.2d 1093, Fed. Sec. L. Rep. (CCH) ¶92759, Fed. Sec. L. Rep. (CCH) ¶92819, 14 Fed. R. Serv. 2d 490 (5th Cir. 1970).

A. *Garner:* The Fiduciary Exception

Well before the Supreme Court decision in *Upjohn,* the Court of Appeals for the Fifth Circuit recognized that the attorney-client privilege may be asserted by a corporation in the context of shareholders demand for information, but recognized a "fiduciary exception" to the attorney-client privilege. *Garner,* 430 F. 2d 1093. The exception arises "where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests," such that "the stockholders be permitted to show cause why the privilege should not be invoked in the particular instance." *Id.* at 1103-04. The Fifth Circuit suggested several factors to be considered in determining whether shareholders had "good cause" to invoke the fiduciary exception under the particular circumstances, including:

(1) [T]he number of shareholders and the percentage of stock they represent;

[1] Rule 502 of the Federal Rules of Evidence governs the circumstances in which an intentional waiver of privileged information to a federal office or agency will result in a waiver of undisclosed information.

(2) the bona fides of the shareholders;

(3) the nature of the shareholders' claim and whether it is obviously colorable;

(4) the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources;

(5) whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality;

(6) whether the communication related to past or to prospective actions;

(7) whether the communication is of advice concerning the litigation itself;

(8) the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing;

(9) the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.

Id. at 1104.

In the four decades since the Fifth Circuit decision, shareholder litigants have sought to use *Garner* to gain access to a variety of privileged corporate records, with limited success. *See, e.g*., Benjamin Cooper, "An Uncertain Privilege: Reexamining Garner v. Wolfinbarger and Its Effect on Attorney-Client Privilege," 35 CARDOZO L. REV. (2014). A recent decision by the Delaware Supreme Court in *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*, 95 A.3d 1264 (Del. 2014), however, may encourage more frequent attempts by shareholders to gain access to internal investigation materials and other privileged corporate records.

B. *Wal-Mart:* The Fiduciary Exception in Section 220 Actions

In the *Wal-Mart* decision, the Delaware Supreme Court for the first time expressly held that the *Garner* exception can be applied in both plenary actions and in books and records actions under Delaware's Section 220, with the caveat that the exception is one that "is narrow, exacting, and intended to be very difficult to satisfy." *Id*. at 1278. As the *Ryan* court noted, the Court of Chancery had applied *Garner* in a variety of situations to permit shareholder access to privileged corporate records, therefore the Supreme Court's recognition of the fiduciary exception in plenary actions was not entirely unexpected. The court's holding that shareholders may also gain access to privileged corporate records through a books and records action however is particularly noteworthy.

In *Wal-Mart,* the shareholder, Electrical Workers Pension Fund IBEW ("IBEW"), made a demand upon Wal-Mart to inspect books and records relating to an alleged bribery scheme involving WalMart's Mexican subsidiary, WalMex, and Wal-Mart's subsequent investigation and response to the alleged misconduct. The books and records demand came on the heels of a provocative *New York Times* article in April 2012 describing a scheme of illegal bribes made to Mexican officials at the direction of the senior executives of WalMex. Shortly after the *New York Times* article ran, IBEW's counsel received an anonymous package containing confidential Wal-Mart documents that had been referenced in the *New York Times* article.

The *New York Times* article indicated that Wal-Mart executives had reported the misconduct to the company's general counsel, who initiated an investigation and retained independent outside counsel to conduct it. According to the article, Wal-Mart executives rejected the outside counsel's plan for an extensive independent investigation and, instead, directed a more limited internal investigation. The preliminary findings of the internal investigation identified evidence of illicit conduct and concluded that there was "a reasonable suspicion to believe that Mexican and USA laws had been violated." *Id*. at 1268. According to IBEW, Wal-Mart failed to heed this warning and instead turned the investigation over to be conducted by the general counsel of WalMex, the subsidiary under investigation, who concluded that there was no evidence of any bribes.

Section 220 of the Delaware General Corporation Law permits any stockholder of a Delaware corporation to make a demand to inspect the corporation's books and records, including the stock ledger, stockholder list, and other books and records. Del. Code Ann. § 220(b). The statute requires, however, that the shareholder attest to having a "proper purpose" for the request to inspect the ma-

terials. *Id*. Moreover, in a books and records action, the court must first determine whether the records at issue are "necessary and essential" for the shareholders' stated purpose for inspection. *Wal-Mart*, 95 A.3d at 1271.

In its books and records demand letter, IBEW stated that the purpose of the request was to investigate alleged mismanagement in connection with the investigation of the bribery allegations and possible breaches of duty by WalMex or Wal-Mart executives related to the alleged bribery, and to determine whether a pre-suit demand on the Wal-Mart board would be futile as part of a derivative action. Wal-Mart complied with the request and produced documents, but redacted or otherwise withheld documents it considered either not "necessary or essential" to IBEW's stated purposes or protected by the attorney-client privilege or work product doctrine. The *Wal-Mart* shareholders sought to enforce the request to inspect the full range of documents and brought a Section 220 action in the Delaware Court of Chancery to do so, which resulted in an order requiring Wal-Mart to produce the contested documents, including documents subject to attorney-client privilege and the work product doctrine.

On appeal, the Delaware Supreme Court held for the first time that the *Garner* doctrine is applicable in plenary stockholder/corporation proceedings, as well as in a Section 220 action. In a Section 220 action, however, before considering the applicability of *Garner, s*hareholders must first establish that the request is "necessary and essential" for the stated purpose. The court held that documents are "necessary and essential" to a Section 220 demand if they address the "crux of the shareholder's purpose" and if that information "is unavailable from another source." *Id*. The court emphasized that whether the documents are necessary and essential is fact specific inquiry and will necessarily depend on the context in which the shareholder's demand for inspection arises. *Id*.

Applying these principles in *Wal-Mart,* the Delaware Supreme Court found that the requested documents, including the privileged communications relating to the internal investigation, were "necessary and essential" to the shareholders' stated purpose because IBEW sought information about the underlying bribery allegations, the manner in which the investigations were conducted, and whether demand on the board would be futile. *Id*. at 1283.

Turning to the *Garner* factors, the Delaware Supreme Court concluded that "good cause" existed to order the privileged documents to be produced. *Id*. at 1280. Specifically, the shareholder had demonstrated a colorable claim, based in part upon Wal-Mart's public statements concerning potential illegal conduct in Mexico and the extensive *New York Times* article. In addition, the claim related to how the investigation itself was conducted and the information was not available from alternative sources. The fact that the shareholder was able to identify specific documents, as disclosed in the *New York Times* article, demonstrated that they were not "blindly fishing." *Id*. Moreover, the shareholder claims involved allegations of criminal or otherwise illegal conduct, which is one of the *Garner* factors to be considered in deciding whether to permit disclosure of privileged documents. *Id*.

Wal-Mart had also sought protection of the documents under the work-product doctrine. The Supreme Court of Delaware acknowledged that *Garner* was limited to information protected by the attorney client privilege. *Id*. However, the court concluded that the *Garner* factors overlap with the required showing under Chancery Rule 26(b)(3). *Id*. at 1280-81. Chancery Rule 26(b)(3) allows a party to obtain access to non-opinion work product "upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain, the substantial equivalent of the materials by other means." *Id*. As a result, the court concluded that the Court of Chancery had properly used the *Garner* analysis in determining that the work-product doctrine should yield to allow the shareholders access to the documents. *Id*. at 1281.

III. Books and Records Demands Post-*Wal-Mart*

Recent decisions from the Court of Chancery affirm that the stringent requirements of Section 220 are not easily met. *See, e.g., Southeastern Pennsylvania Transportation Authority v. AbbVie, Inc*., C.A. No. 10374–VCG, 2015 WL 1753033, at *13 (Del. Ch. Apr. 15, 2015) (finding that although investigating corporate wrongdoing is a proper purpose, demand for books and records under Section

220 is limited to investigating nonexculpated corporate wrongdoing); *Fuchs Family Trust v. Parker Drilling Company*, C.A. No. 9986-VCN, 2015 WL 1036106, at *7 (Del. Ch. March 4, 2015) (rejecting a stockholder request for documents that would reveal identities of those who allegedly violated the Foreign Corrupt Practices Act, finding that inspection for a proper purpose is limited to those documents that are necessary, essential and sufficient to that purpose).

In another notable decision, *In re Lululemon Athletica 220 Litigation*, No. CV 9039-VCP, 2015 WL 1957196 (Del. Ch. April 30, 2015), the Court of Chancery considered a Section 220 demand for documents, which included a request for privileged attorney-corporate client communications. In *Lululemon*, shareholders filed a Section 220 request seeking to investigate potential insider trading by the company's founder and then-chairman of the board, as well as potential mismanagement by the board in connection with his trades. Following a Section 220 hearing, Vice Chancellor Parsons found there was a credible basis to infer wrongdoing by the former chairman and board mismanagement, and ordered production of a number of documents including all documents concerning any investigation of the trades by the board. Pursuant to the order, the company produced documents but withheld email correspondence on various grounds, including attorney-client privilege. Plaintiffs filed a motion to enforce the court's order, both as to communications sent or received by independent board members about the trades located on personal, non-company email accounts, and privileged communication between the company's in-house counsel and a director that included a legal analysis of the trading activity.

In considering the non-privileged corporate documents, the Court of Chancery emphasized:

> [E]ven if the shareholder has expressed a proper purpose, Section 220 does not open the door to the wide ranging discovery that would be available in support of litigation, because the stockholder's inspection right is a qualified one. Determining the appropriate scope of inspection under Section 220 is fact specific and will necessarily depend on the content. This Court must circumscribe orders granting inspection with *rifled precision* and the relevant inquiry in confining the scope of such an order is whether or not a particular document is *essential* to a given inspection purpose.

Id. at *5 (internal quotations and citations omitted). Applying this rigorous test, the court determined that searching independent directors' non-company emails was unwarranted. Turning to the privileged communications of the company's in-house counsel, the court ruled that "the necessary and essential prong for Section 220 to be similar, if not identical, to this aspect of the *Garner* analysis," in reliance upon *Wal-Mart*. *Id*. at *12. The court determined that the privileged communication between the company's in-house counsel and a director regarding legal analysis of the trading activity were necessary and essential, which the court found to be directly related to shareholder's proper purpose. On balance, the court concluded that the *Garner* factors weighed in favor of allowing shareholder access to the privileged communication.

IV. Conclusion

Companies and their executives and boards of directors must be vigilant in protecting confidential and privileged corporate records developed during internal investigations. The *Wal-Mart* decision potentially opens the door for shareholders to seek pre-litigation confidential and privileged corporate records, including materials relating to internal investigations. Nevertheless, the threshold requirements of Section 220, coupled with the "narrow and exacting" *Garner* factors, should continue to limit the situations in which shareholders succeed in gaining access to privileged corporate records.

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