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# Outside Disclosure of Internal Investigations: Federal Court Rules Disclosure Does Not Destroy Corporate Privileges

In light of new whistleblower rules and increased regulation, internal investigations are an increasingly important way for companies of all sizes to promptly investigate allegations or suspicions of misconduct in their organizations. Some internal investigations involve large-scale mismanagement at the highest level, while others concern more routine malfeasance by mid-level managers or lower-level employees. Whatever the precise circumstances, internal investigations are, by their very nature, confidential.

As a recent case in the Southern District of New York (S.D.N.Y.) demonstrates, there are times when a company may find it necessary to go beyond uncovering misconduct and taking corrective action, to revealing the findings of an investigation to an external audience. Typically, this is done in an effort to protect the firm's brand and reputation, and regulatory standing. These disclosures might be made to a government agency or regulator, the public and media, other employees not involved in the misconduct, or investors and the financial markets.

## BACKGROUND ON *GRUSS V. ZWIRN*

In a defamation case, *Gruss v. Zwirn*, the Court recently denied a former employee's attempt to force his former employer to disclose supporting documents about its internal investigation in his lawsuit against the employer. The Court held that the documents sought were protected by the attorney-client and work-product privileges, despite the employer's fairly extensive outside disclosures in court filings and statements to investors and the SEC about the findings of its investigation. The Court thus permitted the company to make significant—and more nuanced—outside use of its internal investigation and yet maintain its legal protections.[1]

In *Gruss*, the plaintiff was the former CFO of several hedge funds and their management company. Financial irregularities arose concerning improper management fees and the use of a corporate jet by the funds' principal, Daniel Zwirn. The funds hired two law firms. One firm investigated who was responsible for the improprieties and how to best remedy them. The second firm investigated the irregularities and notified the SEC. Once informed, the SEC started its own investigation. Zwirn used written talking points drafted by one law firm to inform investors about the improprieties and the CFO's resulting departure. He also disclosed the

issues and investigation to his investors in several telephone calls and a memorandum that detailed the second law firm's findings. Zwirn made several statements that cleared himself of responsibility and placed the blame on the former CFO.

The former CFO sued for defamation and breach of contract stemming from the internal investigations. The funds and Zwirn defended the defamation claim based on their good faith reliance on counsels' conclusions in the internal investigations. They also asserted affirmative counterclaims in which they made "extensive and specific allegations . . . to the findings of the two internal investigations." The findings were contained in one law firm's legal memorandum, the talking points, a Q&A document used by Zwirn with investors, and two PowerPoint presentations that the second law firm used (including summaries of employee interviews) when it reported the problems to the SEC. The funds' disclosures to the SEC were under a written confidentiality agreement they had with the SEC. The funds produced all of those documents to the former CFO, but he sought the undisclosed attorney notes and summaries of witness interviews.

The Court declined to order further disclosure. *First*, it held that the attorney notes and summaries of interviews by the law firms were clearly protected by the attorney-client privilege and had predominantly a legal purpose, although there may have been a business purpose, a "gray area where legal advice shades into business advice." Work-product protection also applied, even if the documents were created to assist with a business decision, because litigation on the securities and accounting issues was anticipated.

*Second*, while the Court noted that privilege had been waived as to the documents the funds had already voluntarily produced in discovery, that did not necessarily mean that the supporting attorney notes and counsel's summaries of interviews had to be disclosed. The Court found that there was no waiver by putting the findings and documents at issue because the defendants did not intend to prove their defenses and counterclaims by using the withheld documents and assured the Court they would not, and they did not, rely on the notes and witness summaries (as opposed to the investigatory documents already disclosed) in challenging the defamation claim.

*Third*, the defendants' "selective use" of the documents with investors, in pleadings, and to the SEC, also did not require further disclosure. The funds disclosed the facts, not privileged communications, in documents that had already been produced in discovery, so no unfairness to the former CFO resulted in not having the attorney notes and witness summaries. On disclosure to the SEC, the Court acknowledged that disclosure to a government agency can waive privileges as to private litigants, but not in this case because the funds signed a confidentiality agreement with the SEC and there was no evidence that they disclosed the notes and witness summaries to the SEC.

### LESSONS LEARNED FROM *GRUSS*

While each case is different and must be analyzed in its own context, as seen in *Gruss*, the outside disclosure of the results of an internal investigation carries potential risks, including the following:

- Companies should carefully limit, and narrowly tailor, their outside use of reports or findings of the investigation because there will always be the risk of unwanted disclosure by selective use, and the corresponding risk of litigation, such as defamation lawsuits by the accused.
- Business advice and purpose may be intermingled with legal and litigation advice, as long as the predominant purpose of the communication was legal advice.
- In preparing documents for outside use and disclosure, a company should take care to

use information and statements that are publicly available, or non-privileged factual information, or documents that the company may (or plans to) reveal anyway.

- Repeated defensive use of investigative reports may be allowed, as in *Gruss*, without compromising attorney-client and work-product privileges. But, some proactive use of the internal investigation materials was also permitted because the defendants produced all documents they disclosed to investors and the SEC, and the funds assured the Court they would not make use of the undisclosed documents in proving their counterclaims.
- While most courts have not allowed companies to "selectively disclose" the results of an internal investigation to a regulator like the SEC and yet withhold them from a private litigant (invoking privilege both as a "sword and a shield"), the Court permitted it because the funds entered into a written confidentiality agreement with the SEC and there was no unfairness otherwise present in the circumstances.

## CONCLUSION

When considering external disclosure of the results of an internal investigation, a company must strike a delicate balance between the need to closely protect sensitive and potentially damaging information with the need to defend the company's welfare and reputation in the marketplace and court of public opinion. Selective outside disclosure can have the unintended consequence of unwanted disclosure about details of the investigation, thus lifting the veil of secrecy that otherwise surrounds the company's internal investigation. Seeking guidance from experienced legal counsel can help an organization determine a sound course and strategy to navigate the regulatory and litigation landscape without unnecessarily jeopardizing its legal protections.

To read the decision, please see *Gruss v. Zwirn*.

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## CONTACT US

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1 *Gruss v. Zwirn*, et al., Case No. 1:09-cv-06441, (S.D.N.Y., July 14, 2011).

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