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Attorney-Client Privilege

U.S. District Court Rules on Whether Attorney Interview Notes and Summaries Produced in Connection with Hedge Fund Manager D.B. Zwirn's Internal Investigation of Financial Irregularities Are Protected from Disclosure by Attorney-Client Privilege

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In early 2006, now-defunct hedge fund managers D.B. Zwirn & Co., L.P. and D.B. Zwirn Partners, LLC (Zwirn) learned of certain financial irregularities in their operations, including unauthorized early payment of management fees and the purchase of a Gulfstream jet for use by their founder and principal, Daniel B. Zwirn. See "Ten Steps That Hedge Fund Managers Can Take to Avoid Improper Transfers among Funds and Accounts," Hedge Fund Law Report, Vol. 4, No. 13 (April 21, 2011). The Zwirn companies retained the services of three different law firms – Schulte, Roth & Zabel, LLP (SRZ); Gibson, Dunn & Crutcher, LLP (GDC); and Fried, Frank, Harris, Shriver & Jacobson LLP – to investigate the irregularities and defend any legal actions arising from them. The investigations placed blame on plaintiff Perry A. Gruss (Gruss), who was Chief Financial Officer and a partner of certain Zwirn entities. Gruss resigned. Zwirn then communicated its attorneys' findings to its investors and to the Securities and Exchange Commission (SEC). In response, Gruss sued Zwirn for defamation in U.S. District Court. During discovery, Gruss moved to compel disclosure of the interview notes and summaries prepared by SRZ and GDC attorneys in the course of their investigations. For the reasons set forth below, the District Court ruled that those interview notes and summaries are protected by the attorney-client privilege and the related work product doctrine and that Zwirn had not waived that privilege. *Perry A. Gruss v. Daniel B. Zwirn, et al.*, No. 09-Civ.-6441, U.S. District Court, Southern District of New York, decided July 14, 2011 (Magistrate Michael H. Dolinger). For a summary of Gruss' complaint, see "Former CFO of Highbridge/Zwirn Special Opportunity Fund Sues Ex-Partner Daniel B. Zwirn for Defamation and Breach of Contract," Hedge Fund Law Report, Vol. 2, No. 30 (July 29, 2009).

Background

Defendants in this action are hedge fund founder Daniel B. Zwirn, and two of the hedge fund management companies he founded and controlled, D.B. Zwirn & Co., L.P. and D.B. Zwirn

Partners, LLC (collectively, Zwirn). Plaintiff in this action is Perry A. Gruss (Gruss), who worked for Zwirn from 2002 through 2006 as Chief Financial Officer. He eventually became a partner in certain Zwirn entities.

In early 2006, Zwirn discovered that certain Zwirn companies had collected management fees before they were entitled to do so and had purchased a Gulfstream jet for Daniel B. Zwirn's personal use. To investigate and deal with the consequences of those financial irregularities, Zwirn retained the services of three different law firms. In early 2006, SRZ conducted the initial internal investigation, which apparently found Gruss responsible for the irregularities. In the Fall of 2006, Zwirn retained GDC to conduct a second internal investigation and assist in notifying the SEC of the irregularities. Finally, Zwirn retained Fried, Frank, Harris, Shriver & Jacobson LLP to coordinate the defense of any SEC charges relating to the irregularities. For a discussion of the utility of internal investigations to hedge fund managers faced with SEC investigations, see "For Hedge Fund Managers in a Heightened Enforcement Environment, Internal Investigations Can Help Prevent or Mitigate Criminal and Civil Charges" Hedge Fund Law Report, Vol. 2, No. 47 (Nov. 25, 2009).

Gruss resigned after he was blamed for the irregularities. This lawsuit arose when, according to the Court, "[Daniel] Zwirn made several statements absolving himself and blaming Gruss for his companies' problems." Gruss claimed that Zwirn's statements were defamatory. Gruss claimed in part that Zwirn failed to disclose that the "investigation [had] concluded that Harold Kahn, the Chief Operating Officer of the Zwirn Entities, was at a minimum willfully blind to both the use of investor funds for Zwirn's private jet and the early taking of management fees[.]" Zwirn interposed counterclaims for breach of contract and breach of fiduciary duty and sought to recover the costs of its internal investigations.

During the course of discovery, Zwirn delivered to Gruss the following documents: (i) an SRZ memo of 9/11/06 detailing the findings of its investigation, (ii) SRZ "talking points" prepared around 10/4/06 for use by Zwirn in communicating with investors, (iii) GDC Power Point presentations made to the SEC, (iv) additional SRZ "talking points" prepared after GDC's SEC submissions, and (v) a Zwirn memorandum to investors detailing the GDC findings. However, Gruss also moved to compel "production of certain supporting documents created by SRZ and GDC in the course of their investigations, specifically, the SRZ and GDC attorneys' notes on, and summaries of, all interviews conducted in the course of their investigations." Zwirn opposed the motion on the ground that the attorney notes and summaries were protected by the attorney-client privilege and the related "work product" doctrine. For the reasons set forth below, the District Court refused to require disclosure.

Attorney-Client Privilege

As a general matter, "[i]nterviews of a corporation's employees by its attorneys as part of an internal investigation into wrongdoing and potentially illegal conduct have been repeatedly found to be protected by the attorney-client privilege." (Citations omitted.) The privilege applies to communications with all employees, not just high-level employees, and encompasses attorneys' notes. The Court stated: "It is clear to us, therefore, that the notes and summaries of interviews by the law firms in the course of their internal investigations are protected by the attorney-client privilege."

Gruss argued that the privilege did not apply because the notes allegedly "were prepared for the business purpose of communicating with investors and other interested business parties, rather than legal purposes[.]" In support of that argument Gruss pointed out that the attorneys'

conclusions were communicated to the SEC and to Zwirn investors in a "widespread public dissemination." Had the advice been "legal," Zwirn would have kept the results confidential.

Zwirn argued strenuously that it was seeking legal advice from SRZ and GDC regarding what disclosure was legally required and on possible legal action by the SEC. That advice continued even after Gruss left the company and included additional investigations into financial irregularities. That advice included, in Zwirn's words:

> whether the accounting irregularities were material to investors . . . whether disclosures about the irregularities were required . . . whether anyone responsible for the irregularities should remain at [the Zwirn Entities] and the possibility of related employment litigation . . . whether the accounting irregularities exposed [the Zwirn Entities] to possible regulatory issues, [and] investor lawsuits, and what should be [the Zwirn Entities'] strategy respecting possible litigation.

Gruss' argument failed because he was unable to prove that the predominant purpose of the communications with SRZ and GDC was for business, as opposed to legal, advice. The mere fact that attorneys provide both business and legal advice does not eliminate the privilege: "So long as the communication is primarily or predominantly of a legal character, the privilege is not lost merely by reason of the fact that it also refers to certain nonlegal matters." (Citations omitted.) Gruss had no way to challenge the attorneys' sworn statements that they had been retained to give legal advice to Zwirn.

The Court noted that the advice from SRZ and GDC was not limited to how to communicate with investors. In addition, it encompassed "the legal ramifications of the accounting irregularities within the heavily-regulated world of investment contracts, the decision as to which employees should be held responsible and how those employees should be disciplined – advice with clear legal implications when the employee in question was party to a partnership agreement, as was Gruss . . . and both the possibility of and strategies for, future litigation. . . . The fact that some of this advice resides in the gray area where legal advice shades into business advice does not change that conclusion." The Court concluded that "the attorney-client privilege protects documents created by defendants' outside counsel in the course of their investigation into accounting irregularities."

Work Product Doctrine

To qualify as protected work product, "[t]he material must (1) be a document or a tangible thing, (2) that was prepared in anticipation of litigation, and (3) was prepared by or for a party, or by his representative." Even if material prepared by attorneys is "work-product," a person can nevertheless obtain production of that material by showing "substantial need" and the inability to obtain the information from other sources without "undue hardship." (Citations omitted.) A distinction is drawn between work product relating to factual matters and work product containing attorneys' opinions. The latter is entitled to greater protection. Like the attorney-client privilege, as long as work product is created because of the prospect of litigation, it is entitled to protection even if it also assists with business.

Gruss challenged whether the attorney notes he sought were prepared in anticipation of litigation. He also argued that the material fell within an exception to the doctrine for material that "would have been prepared in essentially similar form irrespective of litigation" or that is prepared in the ordinary course of business. (Citations omitted.) The Court distinguished the cases relied on by Gruss, noting that, in this case, the investigations were not announced in

advance, the results were not widely disseminated and, most important, the interviews were conducted by attorneys. The exception did not apply where, as here, attorneys' notes of witness interviews could reveal the attorney's thought processes and strategies. The Court ruled that the "essentially similar form" exception should not apply to opinion work product arising from attorney interviews: "[I]nsofar as the interview notes and summaries contain opinion work product, they are protected by the work-product privilege." On the other hand, the Court did not believe that Zwirn met its burden of showing that its attorneys' factual work product "would have been created in essentially similar form irrespective of the litigation" and, consequently, the work product doctrine would not apply. Nevertheless, because Zwirn employees were communicating with Zwirn's attorneys, the SRZ and GDC notes and summaries covering facts fell squarely within the protection of the attorney-client privilege.

Gruss also argued that he had "substantial need" for the attorneys' notes because several years had already passed since the investigations were conducted and witnesses' memories were likely to have faded. The Court was very skeptical that the mere passage of time, and the possibility of fading memories, would be sufficient to show "substantial need." In addition, all factual material contained in interview notes and summaries was already protected by the attorney-client privilege. There is no "substantial need" exception to the attorney-client privilege, only to the work-product doctrine. Consequently, it was immaterial whether Gruss had substantial need for the factual material in the SRZ and GDC notes.

Waiver

Gruss argued that, even if the attorney-client and/or work product privilege applied to the SRZ and GDC interview notes and summaries, Zwirn had waived the privilege in three ways.

"At Issue" Waiver

First, Zwirn allegedly relied on privileged material in asserting defenses against Gruss' defamation claims. Gruss claimed that those defenses gave rise to an "at issue" waiver, which derives from the principle that a litigant may not use the attorney-client privilege as both a shield and a sword. It is unfair for a party to use "an assertion of fact to influence the decision maker while denying its adversary access to privileged material potentially capable of rebutting the assertion." (Citations omitted.) The Court, however, pointed out that the Second Circuit has given a very restrictive reading to "at issue" waiver: "'[T]he essential element' in finding an at-issue waiver is 'reliance on privileged advice in the assertion of the claim or defense;' in other words, 'a party must rely on privileged advice from his counsel to make his claim or defense' before a waiver will be found." (Citations omitted.) This is similar to the New York standard for the privilege: Waiver occurs only "when the party has asserted a claim or defense that he intends to prove by use of privileged materials." (Citation omitted.)

Zwirn had asserted two "good faith" defenses to Gruss' defamation claims and asserted counterclaims for breach of contract and breach of fiduciary duty. The Court ruled that none of those defenses or counterclaims relied on the advice of Zwirn's counsel or would be proved using privileged material. Consequently, there was no "at issue" waiver.

- Zwirn's first defense was that "the allegedly defamatory statements are within the sphere of legitimate public concern and, in making the alleged statements, the [Zwirn Entities] acted reasonably, in good faith, and in reliance on the conclusions reached as a result of the review conducted by outside counsel [SRZ] and the independent internal investigation

conducted by [GDC]." Since Zwirn had already disclosed the investigators' reports to Gruss, Gruss needed to show that Zwirn relied on the interview notes that it sought to discover. However, there was no evidence that any Zwirn defendant had access to those notes. Because the Zwirn defendants did not see the notes that Gruss sought to discover, they could not possibly have relied on them in making the allegedly defamatory statements about Gruss.

- Zwirn's second defense was that their statements were protected by self-interest and common interest "qualified" privileges: It was in Zwirn's interest to publicize its intent to discover the source of the financial irregularities. Similarly, Zwirn and its investors had a common interest in doing so. Gruss' claim of waiver failed because that defense was not based on the advice of counsel. It is not enough for the interview notes to be relevant to showing that the defense was not available: "Neither of the qualified privileges asserted by the defendant requires reliance upon the advice counsel. Instead, they require only that defendant either shares an interest in the subject with the recipient of the allegedly defamatory communication or that the recipient's knowledge of the allegedly defamatory matter serves a sufficiently important interest of the defendant."
- As for Zwirn's counterclaims, Gruss argued that "[b]y expressly relying on what the [SRZ] and [GDC] investigations concluded, the Zwirn Entities have placed the accuracy of those findings at issue, thereby waiving the privilege concerning the underlying [interview notes and summaries]." The mere fact that Zwirn may have learned of Gruss' misconduct as a result of the investigations did not change the privileged nature of the attorney-client communications. Here, Zwirn was not going to use the underlying notes and summaries to prove Gruss' alleged misconduct. It was going to rely on other facts and on Gruss' own testimony. Consequently, as Zwirn was not going to rely on those notes and summaries to prove its counterclaims at trial, there was no "at issue" waiver relating to them.

It is important to bear in mind that this case concerns only SRZ and GDC interview notes and summaries. The actual reports and power point presentations prepared by those attorneys had already been disclosed to Gruss. Had Zwirn asserted privilege with respect to the reports and power point presentations, the Court's conclusions would likely have been different, given the extent to which Zwirn used those reports as the basis for its defenses and counterclaims.

Waiver by Disclosure

Second, Zwirn allegedly waived the privilege by revealing to its investors and to the SEC the existence of the SRZ and GDC investigations and the conclusions reached in those investigations. However, Gruss provided no legal support for this "staggeringly broad proposition." The Court reiterated that "the attorney-client privilege applies to communications, not facts; even if certain facts were once the subject of a privileged attorney-client communication, disclosure of those facts does not waive the privilege in the communication."

Waiver by Selective Revelation

Finally, Zwirn allegedly waived the privilege by selectively revealing portions of privileged communications in its communications with investors and SEC filings. As for revelations to investors, the Court agreed that any privilege was waived with respect to the portions of privileged communications that Zwirn actually revealed to the investors. However, the

undisclosed portions of those communications remained privileged unless Zwirn placed those privileged portions "at issue" by relying on them in the lawsuit. As indicated above, the Court concluded that it had not done so.

Zwirn's disclosures of actual excerpts from interview notes and summaries to the SEC presented "a more difficult question" because a partial disclosure to the SEC is "by implication, a waiver of privilege with respect to the specific information necessary to confirm the disclosures." (Citation omitted.) One Second Circuit decision has held that a waiver of privilege with respect to the SEC constitutes a waiver of that privilege with respect to third parties. However, other cases have limited that waiver when disclosure is made to the SEC subject to a confidentiality agreement. In this case, Zwirn disclosed information to the SEC subject to "an express confidentiality agreement, which reserved the application of the attorney-client and work-product privileges." The information provided to the SEC was not revealed to any other person or party. Consequently, the Court ruled that the selective disclosures of interview notes to the SEC did not waive the privilege with respect to Gruss. In light of this decision, funds faced with revealing potentially privileged material to the SEC should consider seeking an appropriate confidentiality agreement that preserves the attorney-client and work product privileges.

For other litigation involving Zwirn, see "Federal District Judge in Texas Dismisses Former Executives' Employment Contract Dispute Against Hedge Fund Firm D.B. Zwirn & Co. Over Unpaid Bonuses," Hedge Fund Law Report, Vol. 3, No. 8 (Feb. 25, 2010); and "Federal District Court Finds that Affiliate of Hedge Fund D.B. Zwirn & Co. Failed to Prove Breach of Loan and Security Agreement by Borrower in that Agreement," Hedge Fund Law Report, Vol. 3, No. 12 (Mar. 25, 2010).