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December 2009

# *Privilege Protects Attorney Audit Reports, California Supreme Court Rules*

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Businesses can audit themselves for legal compliance with less risk of creating adverse evidence for a litigation opponent following the California Supreme Court's unanimous ruling in *Costco Wholesale Corp. v. Superior Court of Los Angeles* (Nov. 30, 2009, Case No. S163335).

## I. Overview

The Supreme Court held that an attorney-client communication is privileged in its entirety, even purely factual material in it, and even though the factual material contained in the communication may be discoverable by other means. A trial court had ordered Costco to disclose portions of an opinion letter issued by outside counsel. The Supreme Court found error in three aspects of the lower court proceedings: (1) the court's attempt to draw a distinction between privileged legal advice and non-privileged factual material; (2) an in camera review of the communication to determine whether it was privileged; and (3) the finding that the letter's partial disclosure would not irreparably harm Costco.

Although *Costco* is favorable, it expressly declined to address a related question: When an attorney communicates with a client's employees, gather facts upon which to form a legal opinion, are those "factual" communications also covered by the attorney-client privilege? Employers therefore should take precautions to make privileged the investigatory communications between employees and counsel.

## II. Facts and Procedural History

Costco had asked its outside counsel to opine on the company's classification of certain managers as exempt from California's overtime pay rules. The attorney based her opinion on factual information gathered in interviews of managers made available by Costco for purposes of the investigation. Years later, a plaintiff sued Costco in a class action alleging misclassification of the same managers. Thus, the letter was responsive to the plaintiffs' discovery requests. When Costco cited the attorney-client privilege as a defense to production, the plaintiffs moved to compel.

The trial court ordered a discovery referee to review the opinion letter in camera. The referee concluded that portions of the letter were privileged, but that other portions were neither privileged nor protected as attorney work product. The referee created a redacted version of the letter that hid what she considered to be "attorney client communications and/or the type of attorney observations,

impressions and opinions plainly protected as work product," but left unredacted "factual information about various employees' job responsibilities." The trial court agreed, finding that Costco's attorney had acted, not as an attorney, but merely as a "fact-finder" when she interviewed the managers. The court then ordered Costco to produce the redacted version.

Costco unsuccessfully petitioned the Second District Court of Appeal, for a writ of mandate vacating the trial court's order. The Supreme Court, however, granted Costco's petition for review.

## III. The Supreme Court's Decision

The Supreme Court stated its holding plainly: "The attorney-client privilege attaches to a confidential communication between the attorney and the client and bars discovery of the communication irrespective of whether it includes unprivileged material." (Emphasis added.) Even the transmission of publicly available documents to a client by an attorney is privileged, the Court held. "Neither the statutes articulating the attorney-client privilege nor the cases which have interpreted it make any differentiation between 'factual' and 'legal' information." The Court explained, that "because the privilege protects the transmission of information, if the communication is privileged, it does not become unprivileged simply because it contains material that could be discovered by some other means." (Emphasis in original) Although *D.I. Chadbourne v. Superior Court*, 60 Cal. 2d 723 (1964), would be relevant to determining whether the underlying statements by Costco's managers to its outside counsel were themselves privileged, *Chadbourne* did not undermine the privilege that attached to counsel's letter to Costco, even where the letter quoted or summarized the managers' statements. Because the entirety of the letter was attorney-client privileged, the Court did not need to address whether the attorney work-product doctrine applies.

The Court also held that it was error for the trial court to order an in camera review of the opinion letter. Section 915 of the Evidence Code expressly prohibits review of material claimed to be privileged and is subject to only those exceptions specifically listed in Section 915(b), none of which applied here. The Court overruled two lower-court cases that suggested a different result, *Martin v. Workers Comp. Appeals Bd.* and *2,022 Ranch v. Superior Court*. (On the other hand, in dictum, the Court noted that a party can request review of material that the party asserts is privileged, to establish the communication's dominant purpose, presumably without waiving the privilege.)

Finally, the Court rejected the lower court's decision that Costco had not shown irreparable harm warranting a writ of mandate. The injury caused by an order requiring disclosure of privileged information is not "the risk the party seeking disclosure will obtain information to which it is not entitled," but rather the threat to the confidential relationship between attorney and client.

Chief Justice George wrote a concurring opinion emphasizing the importance of establishing the prima facie elements of privilege, including the requirement that a privileged communication be made in the course of an attorney-client relationship and thus for the purpose of the legal representation. The plaintiffs in Costco had not challenged these elements and so they were not at issue in the case or considered in the Court's opinion.

## IV. Practical Implications for Employers

*Costco* ruled as business groups had hoped – as far as it went. It now is clear that trial courts may not parse opinion letters and other attorney-client communications and determine whether portions may be disclosed to opposing counsel in litigation. The opinion, however, leaves open a separate and

perhaps equally important question: whether the factual communications between a corporation's employees and the corporation's outside counsel are themselves independently privileged. If not, the employee might then be forced in deposition to answer questions such as "What questions were you asked by outside counsel" and "What did you tell outside counsel in response?"

While leaving this question open, the Supreme Court hinted that its previous decision in *D.I. Chadbourne v. Superior Court* would control the analysis. *Chadbourne* articulated 11 principles that determine whether a corporate employee's statement to the corporation's counsel is privileged. In *Costco*, the Court summarized these principles and commented that, as long as the employer's dominant purpose in requiring an employee's cooperation in an investigation was "the confidential transmittal to the corporation's attorney of information emanating from the corporation," the communication is privileged.

To maximize the privilege protection, an employer should consider establishing a clear, documented protocol for any audit or investigation. While *Chadbourne* does not hold that such a protocol is required, prudence suggests its value. For example, a documented protocol could provide that (1) the employer intends to gather information under the attorney-client privilege and attorney work-product protection so that outside counsel can provide legal advice to the company; (2) communications between employees and outside counsel are attorney-client privileged; (3) as such, employees should not forward or discuss with others their communications with attorneys; and (4) information transmitted to outside counsel must be packaged and transmitted confidentially. Where an internal team will assist with the audit or investigation, the protocol could outline concrete steps to preserve the privilege by storing related documents and e-mails apart from other files, securing such files or e-mail folders if possible, marking related documents as "DRAFT" and "Attorney-Client Privileged," and naming a single member of the team responsible for deciding who else within the company may be included in the circle of privilege.

## V. Conclusion

*Costco* solved one set of problems without addressing another. We now know that opinion letters are not subject to in camera review or partial disclosure. We do not know for certain, however, the extent to which privilege attaches in an attorney's fact-gathering. Developing a clear, written privilege protocol for such investigations will maximize the case for privilege.

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*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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