# THERANOS RULING SERVES AS AN IMPORTANT REMINDER OF THE LIMITS OF THE ATTORNEY-CLIENT PRIVILEGE AND INDIVIDUAL ACCOUNTABILITY IN CORPORATE WRONGDOING

The story of the rise and fall of the once multi-billion dollar health care company Theranos, Inc. ("Theranos") and its founder, Elizabeth Holmes, no longer serves merely as a bingeworthy weekend watch but rather yet another cautionary tale for corporations and their counsel. In 2015, Holmes touted a $9-billion dollar valuation of Theranos after she claimed to have revolutionized blood testing by running 200 different diagnostic tests through just a fingerpick of blood. But, by 2018, following a series of journalistic and regulatory investigations, the United States Securities and Exchange Commission charged Theranos and Holmes with defrauding investors through false claims about the technology behind Theranos' blood-testing capabilities.

Early last month, a federal judge in California ruled in favor of the U.S. government that emails from Holmes to her company's lawyers were not privileged and, therefore, were admissible in her criminal trial for fraud. Contrary to Holmes's assertion, the U.S. District Court for the Northern District of California held the attorney-client privilege did not extend to her emails with Theranos' attorney. The Court's reason for its decision: Holmes failed to show she made it clear she was seeking legal advice in her personal capacity when she approached her company's attorney.

The government's criminal case against Holmes for defrauding Theranos investors highlights both (1) the importance for corporations and their individual officers to understand the limits of the attorney-client privilege; and (2) the U.S. government's continued efforts to hold individuals accountable for corporate wrongdoing (U.S. v. Holmes, 5:18-CR-00258-EJD, U.S. District Court, Northern District of California).

### THE ATTORNEY-CLIENT PRIVILEGE

The attorney-client privilege protects the communications made in confidence between an attorney and a client when the attorney is acting in the capacity as a legal advisor. Theranos' attorneys began representing the company in 2011 in an intellectual property dispute. The Court's decision regarding Holmes' emails largely hinged on the fact Holmes failed to demonstrate Theranos' attorney jointly represented both her company and herself individually.

To determine whether individual privilege exists, the Court applied the Ninth Circuit's *Graf* test (*See U.S. v. Graf*, 610 F.3d 1148, 1161 (9th Cir. 2010)), which requires an individual to satisfy certain factors that demonstrate joint representation. In short, a person needs to show that when they approached counsel for legal advice, they did so in a way that made clear they were seeking legal advice in their individual capacity, rather than just in their representative capacity for the corporation.

After an *in camera* review of the emails, the Court determined Holmes failed to satisfy the *Graf* test. Important factors in the Court's analysis include the absence of engagement letters or formal writings describing representation beyond the original purpose of representing Theranos in an intellectual property dispute, lack of financial records showing she paid the attorneys from her own accounts rather than Theranos' accounts and failure to show her communications with the attorneys were confidential and exclusively between her and the attorney.

Although the *Graf* case was the first time the Ninth Circuit addressed a standard to determine whether a corporate employee holds a joint privilege over communications with corporate counsel, other state and federal courts apply similar tests. For example, in reaching its decision, the *Graf* Court adopted the Third Circuit's *Bevill* test, joining the First, Second, Sixth and Tenth Circuit in the use of this sort of privilege test. Moreover, state courts, including the Supreme Court of Alabama, have explicitly relied on the *Bevill* test when determining whether an individual corporate officer can assert attorney-client privilege regarding communications with corporate counsel (*Ex parte Smith*, 942 So. 2d 356, 359-361 (Ala. 2006)).

### INDIVIDUAL ACCOUNTABILITY AND RISK

The 2015 memorandum titled "Individual Accountability for Corporate Wrongdoing" from former Deputy Attorney General Sally Yates (the "Yates Memo") first signaled the U.S. government's shift in focus to hold the individuals accountable for behavior that perpetrated corporate

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wrongdoing. The Yates Memo also changed the nature of corporate wrongdoing investigations because now, prosecutors will investigate both the corporation and the individuals simultaneously from the outset.

The effect of the Yates Memo on the health care industry is evidenced by the myriad of cases, settlements and exclusions brought against not only health care entities but their C-Suites as well. For example, in August of 2018, the Department of Justice announced a settlement with a relatively large health system and the health system's founder and CEO regarding allegations of submitting false claims to Medicare through a practice known as "up-coding," where patients were admitted to the hospital when they only required less costly outpatient care. In that settlement, the health system paid $61,750,000, and the CEO paid $3,250,000 individually.

A more recent example, in March of 2021, a former CEO of a Texas-based hospice agency plead guilty to defrauding federal government programs by billing for Medicare and Medicaid hospice services that were not given or were not proper, including fatally overdosing patients for profit. The CEO admitted to writing pain prescriptions without physician input and generating a $60 million scheme with two physician co-conspirators. The CEO faces up to 14 years in prison for his individual wrongdoing in the company's scheme.

**PRACTICAL TAKEAWAYS**

- The effects of the Yates Memo are seen through continued efforts of the U.S. government to hold individuals accountable for corporate wrongdoing, especially for allegations of defrauding government health care programs.
- It is important for individuals to consult early with federal prosecutors and obtain separate counsel once an individual is identified as a subject in a criminal investigation.
- The U.S. District Court's decision regarding Holmes' emails to her company's attorney is an important reminder that not every communication to an attorney is protected under the attorney-client privilege.
- The attorney-client privilege protects the communications made in confidence between an attorney and a client when the attorney is acting in the capacity as a legal advisor. Engagement letters and other formal writings are important for determining when an attorney acts in its capacity as a legal advisor.

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