604 Regulators at the Gates: Managing & Protecting Attorney-Client Privilege in the Age of Disclosure

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Faculty Biographies

Jonathan Anschell

Jonathan Anschell is executive vice president and general counsel of CBS Television, in Los Angeles, and oversees the legal affairs of the CBS television network and its related production and distribution entities.

Previously, Mr. Anschell was a partner in White O'Connor Curry LLP, a Los Angeles-based law firm, where he maintained a trial and litigation practice with particular emphasis on media and entertainment-related matters.

Mr. Anschell has appeared on CNN and CourtTV, and teaches media and copyright law for the student media program at the University of California, Los Angeles.

David R. Byers

David R. Byers is head of the Toronto litigation department of Stikeman Elliott, co-chair of the firm's litigation practice nationally, and is a member of the Toronto management committee. He maintains a general civil litigation practice with emphasis on corporate commercial, arbitration, securities, and insolvency.

Mr. Byers has extensive advocacy experience, appearing before both the trial and appellate levels of courts in Ontario. He has acted as counsel on a wide range of commercial litigation matters both in court and through arbitration. He has acted for both lenders and debtors in several court supervised restructurings.

Mr. Byers is a member of the Metropolitan Toronto Lawyers' Association and a past-director of The Advocates' Society. He has participated in numerous panels and conferences as a speaker on a number of diverse topics.

He received his B.A., with honors, from the University of Western Ontario and his LL.B from Osgoode Hall.

Peter Godby

Peter Godby is a senior lawyer at the head office of British American Tobacco (BAT) in London, where he works within the strategic litigation group in the legal department. His current work includes defending BAT against claims involving allegations of smuggling and price fixing in the U.S. and elsewhere, as well as product liability smoking and health recoupment actions in Canada.

In previous roles at BAT he has covered a full range of company and commercial matters. His responsibilities have included head of the trademark department and company secretary for the publicly listed company. He has worked overseas for BAT at Brown & Williamson Tobacco Corporation in Louisville, Kentucky, and in Kuala Lumpur, Malaysia where he was the regional counsel for the BAT operations in Asia Pacific. Prior to joining BAT he worked in private practice in London on corporate work, principally mergers and acquisitions.

Mr. Godby graduated in law from Cambridge University.

Stanley Keller

Stanley Keller is a partner with Edwards Angell Palmer & Dodge LLP in their Boston office and is a nationally recognized corporate and securities lawyer. During his lengthy career, Mr. Keller has advised clients ranging from emerging companies to industry leaders. His practice has encompassed most areas of corporate and securities laws, focusing on (i) public and private securities offerings and other corporate financings, (ii) advising publicly traded companies on compliance with SEC rules, disclosure requirements and the Sarbanes-Oxley Act, (iii) mergers and acquisitions, and (iv) corporate governance, including advising on best practices and acting as special counsel to boards of directors and their committees.

In addition to his client work, Mr. Keller has had an active role in the development of corporate and securities laws through leadership positions in the ABA and other professional organizations, and through his writings and frequent speaking engagements. He chaired the ABA's committee on federal regulation of securities during the height of the Sarbanes-Oxley era, and in that capacity had responsibility for interacting on behalf of the private bar with the SEC, other governmental officials and the stock exchanges. He currently is a member of the ABA Presidential Task Force on attorney-client privilege. Mr. Keller is co-chair of the task force that drafted the new Massachusetts Business Corporation Law, and chaired the Boston Bar Association's Business Law Section and Corporation Law Committee.

Mr. Keller is a graduate of Harvard Law School and Columbia University.

Internal Investigations: Privilege Considerations

Presented By Jonathan H. Anschell
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Pros and Cons . . .

Pros:

- Visible and organized response to alleged wrongdoing
- Prompt gathering of information
- Public relations and compliance policies

Cons:

- Expense and disruption
- Jeopardizing privilege
- Creation of damaging evidence
- Allegations of bias or preordained result

Staffing the investigation

In-house counsel

- Offers familiarity with facts and players
- Cost-effective and efficient
- But may jeopardize privilege, jeopardize relationships and appear less than independent

Outside counsel

- Independent
- Minimal disruption and diversion of internal resources
- Less ambiguity or risk to privilege
- But more costly, less efficient and familiar with facts and players

Privilege: Attorney-Client

Elements of attorney-client privilege:

- A communication
- Between client and attorney
- Made in confidence
- For purpose of seeking, obtaining or providing legal advice

Privilege: Work Product Doctrine

- Can protect otherwise non-privileged material that is prepared in anticipation of litigation
  - United States v. Aldman, 68 F.3d 1495 (2d Cir. 1995): To trigger work product protection, it is sufficient that document was created "because of litigation." Need not be "primarily" for litigation.
  - But work product protection is qualified - - may be overcome by showing of substantial need, such as interview notes of witness who later becomes unavailable.
  - Highest protection applies to "opinion work product" - - mental impressions of an attorney.

Privilege - - In-house Counsel

- Privilege applies to corporation, acting through executives and other employees. Upjohn v. United States, 499 U.S. 383 (1981) (expanding privilege beyond corporation's "control group."
- But courts subject claims of privilege in the in-house context to a heightened level of scrunity:

  " [I]n-house counsel are frequently involved in the business decisions of a company. While an attorney's status as in-house counsel does not dilute the attorney-client privilege, the corporation must make a *clear showing* that in-house counsel's advice was given in a professional legal capacity."

  United States v. Chevron Corporation,

  N.D. Cal. 1996 (unpublished)

More scrutiny of the privilege as applied in-house . . .

"In that the privilege obstructs the truth-finding process and its scope is limited to that which is necessary to achieve its purpose, the need to apply it cautiously and narrowly is heightened in the case of corporate staff counsel, lest the mere participation of an attorney be used to seal off disclosure."

Georgia-Pacific Corporation v. GAF Roofing Manufacturing Corporation,
S.D.N.Y. 1996 (unpublished)

More scrutiny of the privilege as applied in-house . . .

"[T]o minimize the threat of corporations cloaking information with the attorney-client privilege in order to avoid discovery, claims of the privilege in the corporate context will be subjected to a heightened level of scrutiny."

Southern Bell Telegraph and Telephone Co. v. Deason, 632 So. 2d 1377 (Fla. 1994)

ACC's 2006 Annual Meeting: The Road to Effective Leadership October 23-25, Manchester Grand Hyatt

Some criteria for application of privilege

- Was communication clearly confidential and internal?
- Did communication occur in a litigation context?
- Did communication concern the client's legal rights and obligations?
- Was the attorney called upon to use training as an attorney?
- Could a non-lawyer have performed the same function?

Preserving the Privilege

- Frame investigation around potential litigation or other legal issues
- Clarify that in-house counsel is acting as an attorney
- Where possible, avoid involving dual-role in-house counsel (such as attorneys who handle business negotiations) in the investigation
- Mark all written communications with attorney-client privilege legend
- Involve outside counsel where circumstances warrant

Witnesses: Avoiding a conflict of interest

- The client of an in-house attorney is the corporation.
- Absent an express agreement to dual representation, individuals - - such as officers, directors or employees - - are not clients of the in-house counsel.
- Explanation and clarification is important.
  - e.g. New York State Disciplinary Rule 5-109:

"[When] the organization's interests may differ from those of the constituents with whom the lawyer is dealing, the lawyer shall explain that the lawyer is the lawyer for the organization and not for any of the constituents."

Explaining the role of in-house counsel

- "Company management has asked me to conduct this investigation. I represent the company; I don't represent any particular information. I don't represent you personally."
- "What we discuss is confidential and protected by the attorney-client privilege. But the privilege belongs to the company, not to you personally. That means that what we discuss will be disclosed to company management, and that the company may or may not decide to disclose anything you say to me."
- "You are free to consult with your own lawyer if you would like to. The company expects everyone to cooperate fully in this investigation, and it is important to us that you feel comfortable doing so."

STIKEMAN ELLIOTT

Recent Developments in the Law of Privilege

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Recent Developments in the Law of Privilege

By Neil Guthrie, Stikeman Elliott LLP

This article examines two areas in the law of privilege where there have been significant recent developments. Both relate to solicitor-client privilege – or, as it is known elsewhere in the Commonwealth – legal professional or legal advice privilege, which protects communications between solicitor and client, irrespective of pending or anticipated litigation.

The first section of this article concerns privilege over advice provided by in-house counsel, which may or may not attach depending on the nature of the advice that is given, the purpose of the recipient in asking for it and the way in which it is disseminated within the organisation. A recent decision of the House of Lords offers support for the view that privilege may protect advice provided by internal lawyers, even where it is somewhere on the borderline between 'pure' legal advice and advice which is strategic or 'reputational' in nature.[1]

The second section considers whether disclosure of privileged documents to auditors or regulators may be waiver of privilege for a limited purpose only, and not waiver in general. Important decisions of the Privy Council in a New Zealand appeal and, closer to home, of the Divisional Court of Ontario suggest that courts may, in appropriate circumstances, recognise the principle that privilege can be waived for a limited purpose only, with the result that the documents in question will retain the protection of privilege for purposes unrelated to that limited disclosure.[2]

LEGAL ADVICE PROVIDED BY INTERNAL COUNSEL

The Traditional View

It has long been recognised that legal opinions provided by in-house counsel in the performance of their duties to the employer are afforded the same solicitor-client privilege as opinions prepared by external counsel. The leading case on this point is *Alfred Crompton Amusement Machines Ltd* v. *Customs and Excise Commissioners (No. 2)*, where Denning L.J. (as he then was) held that in-house counsel were in all respects in the same legal position as lawyers in private practice:

Many barristers and solicitors are employed as legal advisers, whole time, by a single employer. Sometimes the employer is a great commercial concern. At other times it is a

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[1] *Three Rivers District Council* v. *Governor and Company of the Bank of England*, [2004] UKHL 48 ('*Three Rivers*').

[2] *B.* v. *Auckland District Law Society*, [2003] 2 A.C. 736 (P.C. (N.Z.)) ('*Auckland District Law Society*'); *Philip Services Corp. (Receiver of)* v. *Ontario Securities Commission*, [2005] O.J. No. 4418 (Div. Ct) ('*Philip Services*').

government department or a local authority. It may even be the government itself, like the Treasury Solicitor and his staff. In every case these legal advisers are paid, not by fees for each piece of work, but by a fixed annual salary. They are, no doubt, agents or servants of the employer. For that reason, Forbes J. [in the trial court] thought they were in a different position from other legal advisers who are in private practice. I do no think this is correct. They are regarded by the law as in every respect in the same position as those who practise on their own account. The only difference is that they act for one client only, and not for several clients. They must uphold the same standards of honour and of etiquette. They are subject to the same duties to their client and to the court. They must respect the same confidences. They and their clients have the same privileges.[3]

This view has also been endorsed in Canada: see, for example, *Canary v. Vested Estate Ltd.*4

What the cases make clear is that solicitor-client privilege extends only so far in the in-house context, namely to communications made in the capacity of a legal adviser and not in a business capacity. In the *Alfred Crompton* case, Lord Justice Denning went on to say, directly after the excerpt quoted previously:

> I speak, of course, of their communications [*i.e.*, those of in-house counsel] in the capacity of legal advisers. It does sometimes happen that such a legal adviser does work for his employer in another capacity, perhaps of an executive nature. Their communications in that capacity would not be the subject of legal professional privilege. So the legal adviser must be scrupulous to make the distinction.[5]

The *Canary* case also dealt with a situation where the internal lawyer's advice was given not exclusively in a legal capacity, where he negotiated a particular business transaction on his employer's behalf. The communications involved were not subject to privilege as a result.

This principle has been re-stated in a number of more recent Canadian cases. In *Re Ontario Securities Commission and Greymac Credit Corp.*, it was held that the president of the corporation, who was also a lawyer, could not assert solicitor-client privilege in respect of information he had acquired in the performance of functions that could have been performed by a non-lawyer employee or agent of the company.[6] In their text on solicitor-client privilege, Ronald D. Manes and Michael P. Silver note, however, that 'where a document is entrusted to a solicitor in a capacity other than as a solicitor, and the solicitor subsequently acquires knowledge of its contents in a professional capacity, the document is privileged'.[7]

The net result is that in determining whether or not solicitor-client privilege will apply to communications between in-house counsel and a corporation or its employees, it will be necessary to know in what capacity the solicitor was acting. A communication will be protected by privilege if it is made in the context of a solicitor-client relationship – that is, in the course of a request for or the provision of legal advice, and not for some other purpose. There is, as a result, a 'need to know' component to the analysis: privilege will attach if the requester needs the advice in order to understand the requester's own legal position; where the advice merely fulfils a general, informational purpose, privilege will not attach. Where the precise nature of the purpose behind the furnishing of advice is not obvious, it will be up to the court to decide, based upon the particular facts. Lord Denning's 'scrupulous distinction' may prove elusive. It is therefore important for in-house lawyers to delineate clearly when they are acting in their capacity as legal counsel, to indicate clearly that legal advice is both privileged and confidential, and to segregate in separate documents and files any material which is not privileged.

Grey Areas

A case illustrating the difficulty of characterising the work-product of in-house counsel is *Toronto-Dominion Bank* v. *Leigh Instruments Ltd (Trustee of)*.[8] TD's legal department maintained a general file containing precedents on the subject of comfort letters. The parent corporation of Leigh Instruments had provided comfort letters to TD. The bank relied on them in approving a loan to Leigh Instruments. In a subsequent civil action in which the comfort letters were in issue, Peat Marwick sought access to the TD legal department's general file. The court rejected the bank's claim that the contents of the file were privileged and ordered production of certain documents. The principle that solicitor-client privilege *could* attach to the contents of the file was accepted, but Winkler J. held that privilege did not attach to all of the contents of the file. He found that an internal memorandum on comfort letters was not privileged because it had been widely circulated within the bank in the form of a head office circular (not a legal department memorandum), was not marked as being privileged and confidential and was written by the bank's general counsel in an executive, not a legal, capacity on a matter of corporate policy. A second memorandum addressed to the credit division of the corporate banking group and 13 senior vice-presidents *was* privileged, because it was prepared by an internal lawyer at the request of general counsel and was clearly in the nature of legal advice (even though it was not marked 'confidential'). Privilege was also claimed by TD over a newspaper article on comfort letters from a British publication and a newsletter from an Australian law firm on the same subject that was circulated to TD's corporate customers, on the grounds that these were attorney work-product, selected and retained through the exercise of a lawyer's professional skill and judgment. Winkler J. rejected this contention, on the grounds that these documents were collected *ad hoc* or randomly, and could be privileged only in the context of contemplated or pending litigation.[9] Winkler J. held that

> a communication will be protected by the rubric of solicitor-client privilege if it is made in the context of a solicitor-client relationship, in the course of either requesting or providing legal advice, and if it is intended to remain confidential. Where a lawyer is employed as in-house counsel by a corporation, the privilege will still apply to communications passing between the lawyer and the corporation, as long as they meet the criteria above.[10]

What this means is that if the communication is made outside the context of seeking or providing legal advice, it will not be subject to solicitor-client privilege. Privileged communications should therefore be shared within an organisation only as widely as is

[3] [1972] 2 Q.B. 102 (C.A.) ('*Alfred Crompton*') at 129.

[4] [1930] W.W.R. 996 (B.C.S.C.) ('Canary').

[5] *Supra* note 3 at 129.

[6] (1983), 41 O.R. (2d) 328 (Div. Ct).

[7] *Solicitor-Client Privilege in Canadian Law* (Toronto & Vancouver: Butterworths, 1993) ('Manes & Silver'), at 41. See also *Mutual Life Assurance Co. of Canada* v. *Canada (Deputy Attorney-General)* (1998), 28 C.P.C. (2d) 101 (Ont. H.C.); *Crown Zellerbach Canada Ltd* v. *Canada (Deputy Attorney-General)*, [1982] C.T.C. 121 (B.C.S.C.).

[8] (1997), 32 O.R. (3d) 575 (Gen. Div.) ('*TD*').

[9] See also *Husky Oil Operations Ltd* v. *MacKimmie Matthews* (1999), A.R. 115 (Q.B.); Ken B. Mills, 'Privilege and the In-House Counsel' (2003), 41 Alta L.R. 79; Deborah MacNair, 'Solicitor-Client Privilege and the Crown: When is a Privilege a Privilege?' (2003), 82 Can. Bar Rev. 213.

[10] *Supra* note 8 at 582.

necessary for the provision of specific legal advice. A more circumscribed view of privilege is also espoused in *General Accident Assurance Co.* v. *Chrusz*, where Doherty J.A. (dissenting in the result, but not on this point) rejected the notion that solicitor-client (or, as he preferred to call it, client-solicitor) privilege protects 'all communications or other material deemed useful by the lawyer to properly advise his client'.[11]

Recent developments: broadening the scope of legal advice

Recent English jurisprudence (although not specifically in the in-house context) offers signs of a countervailing trend. In two decisions from 2003 and 2004, the English Court of Appeal appeared to narrow the definition of legal advice, although the House of Lords overruled one of these judgments in November 2004 in a decision which could have significant implications in Canada. The decision appears not, however, to have been cited in Canada to date on the issue of privilege.

Three Rivers District Council v. *Governor and Company of the Bank of England* concerned advice prepared in connection with allegations of misfeasance in public office against the Bank of England by creditors of BCCI, as a result of the controversial failure of the latter institution.[12] In that case, the Court of Appeal found that documents prepared by a special internal unit of the Bank of England for the purposes of the public inquiry into the BCCI collapse were not protected by privilege and had to be produced at the request of the BCCI creditors. It was held that the public inquiry, not the Bank of England, was the client in the case, and the communications were not produced in contemplation of litigation. The documents in question were 'presentational' – that is, they were prepared by the special unit within the Bank and given to its counsel for the purpose of preparing submissions to the official inquiry and giving advice on the nature, presentation, timing and content of those submissions.

The Court of Appeal found that these documents were not protected by 'legal advice' (*i.e.*, solicitor-client) privilege, because they were not prepared with the dominant purpose of seeking or giving advice on the legal rights and liabilities of the client. Privilege was held to apply only to communications prepared for the specific task of seeking and obtaining legal advice. The Court of Appeal took the view that parties within an organisation who are not charged with that specific task ought to be treated as third parties, and privilege would therefore not attach to documents provided to them by internal counsel. Lord Phillips MR held that legal advice is not merely 'advice given by a lawyer', but 'advice given in relation to law' – that is, with respect to the legal rights and liabilities of the client. To similar effect is *United States of America* v. *Philip Morris Inc.*, where privilege was held by the English Court of Appeal not necessarily to extend to advice from solicitors on the defendant's policy for the management and retention of documents, where litigation was not reasonably in prospect.[13]

The result of *Three Rivers* in the Court of Appeal appeared to represent a significant departure from the traditional position on privilege in English law. On appeal to the House of Lords, a panel of five law lords rejected the decision of the Court of Appeal in concurring judgments.[14] The House of Lords adopted the broader of definition of 'legal advice' that is articulated in *Balabel* v. *Air India*, *per* Taylor L.J.: 'legal advice is not confined to telling the client the law; it must include advice as to what should prudently and sensibly be done in the relevant legal context.'[15] Some of the speeches of the law lords in *Three Rivers* lend support to the proposition that privilege could, on this analysis, extend to matters which would on a stricter view be outside the confines of 'legal advice'. Lord Scott of Foscote observes in his judgment in *Three Rivers* that the cases on privilege 'recognise that in the complex world in which we live there are a multitude of reasons why individuals, whether humble or powerful, or corporations, whether large or small, may need to seek the advice or assistance of lawyers in connection with their affairs'.[16] This is arguably broad enough to encompass matters related to reputation and risk management, which have legal aspects but which may not be directly concerned with legal liability in the narrower sense. Lord Scott later suggests that privilege should attach to '[p]resentational advice or assistance given by lawyers to parties whose conduct may be the subject of criticism by the inquiry', because it is advice or assistance which may help the client in avoiding the invocation of public law remedies.[17] Towards the end of his speech, Lord Scott says, 'The defence of personal reputation and integrity is at least as important to many individuals and companies as the pursuit or defence of legal rights whether private law or public law'.[18] In the view of Lord Rodger of Earlsferry, privilege ought to attach to presentational documents prepared for the inquiry because counsel were being asked 'to put on legal spectacles when reading, considering and commenting on the drafts'.[19] In other words, the lawyers were being asked to 'consider, as lawyers, how the Bank's evidence could be most effectively presented' to the official inquiry; privilege should attach because the role of counsel to 'carry out a function which involved the use of their legal skills if it was to be performed properly'.[20] Lord Carswell appears to disagree with the Court of Appeal's view that privilege should not extend to the documents at issue because they addressed 'the possibility of damage to the Bank's reputation'.[21] Later in his speech, Lord Carswell relies on a line of nineteenth-century cases which suggest that 'privilege extends to all communications between a solicitor, as such, and his client, relating to matters within the ordinary scope of a solicitor's duty', concluding that the presentational documents at issue should be protected by privilege:

> … all communications between a solicitor and his client relating to a transaction in which the solicitor has been instructed for the purpose of obtaining legal advice will be privileged, notwithstanding that they do not contain advice on matters of law or construction, provided that they are

[11] (1999), 45 O.R. (3d) 321 (C.A.) ('*General Accident*') at 358. Other recent cases which have considered the sometimes uneasy relationship between legal and non-legal advice in the in-house context include: *Gower* v. *Tolko* (2001), D.L.R. (4th) 716 (Man. C.A.) (counsel retained to investigate facts of sexual harassment complaint; report of fact-finding not privileged *per se*, unless for the purpose of enabling counsel to provide legal advice); *Hydro One Network Services Inc.* v. *Ontario (Ministry of Labour)*, [2002] O.J. No. 4370 (S.C.J.) (report prepared by non-lawyer at request of counsel privileged because purpose was to enable provision of legal advice; statement to this effect and fact of marking it 'Privileged & Confidential' appeared to be significant); *Re Prosperine* (2002), 37 C.B.R. (4th) 135 (Ont. S.C.J.) (report of consultant retained by in-house counsel to investigate potential fraud not privileged; was not prepared to assist counsel with the provision of legal advice); *College of Physicians & Surgeons (British Columbia)* v. *British Columbia (Information & Privacy Commissioner)*, [2003] 2 W.W.R. 279 (B.C.C.A.), leave to appeal refused [2003] 2 W.W.R. 279 (experts' reports obtained by in-house counsel not privileged because incidental to the provision of legal advice).

[12] [2002] E.W.H.C. 2730 (Comm.); [2003] E.W.C.A. Civ. 474; [2003] E.W.H.C. 2565 (Q.B. & C.A.); [2004] E.W.C.A. Civ. 218 (C.A.).

[13] [2004] E.W.C.A. Civ. 330 (C.A.).

[14] *Three Rivers*, *supra* note 1.

[15] [1988] Ch. 317 (C.A.) ('*Balabel*') at 330.

[16] *Supra* note 1 at para. 34.

[17] *Ibid.* at para. 37.

[18] *Ibid.* at para. 44.

[19] *Ibid.* at para. 60.

[20] *Ibid.*

[21] *Ibid.* at para. 77.

> directly related to the performance by the solicitor of his professional duty as legal adviser of the client.[22]

At this stage, the precise boundaries of what is 'directly related' to the performance of the lawyer's duty as counsel have not been delineated in the English jurisprudence, and it remains to be seen how courts in Canada will respond to the *Three Rivers* decision.

The *Balabel* analysis, upon which the House of the Lords relied in *Three Rivers,* was recently applied by Linhares de Sousa J. in *Ministry of Community and Social Services* v. *Cropley*.[23] The Information and Privacy Commissioner, whose determination was under review by the Divisional Court in that case, had concluded that the documents at issue were not subject to the protection of privilege on the grounds that, while prepared by internal counsel at the Ministry, they were disseminated to enforcement staff as manuals, guidelines, procedures and instructions of 'general application' and were thus outside the ambit of privilege.[24] Linhares de Sousa J. disagreed, saying that the Commissioner had made too much of the characterisation of the documents as manuals and guidelines for general consumption. The judge took a more expansive view of the phrase 'particular legal context' from the English decision, refusing to confine privilege to documents prepared for the purposes of a 'single discrete transaction or particular litigation'.[25] Citing *Balabel*, Madam Justice Linhares de Sousa held:

> The legal advice covered by solicitor-client privilege is not confined to a solicitor telling his or her client the law. The type of communication that is protected must be construed as broad in nature, including advice on what should be done, both legally and practically.[26]

Although Justice Linhares de Sousa was at pains in her reasons for judgment not to reveal the confidential contents of the documents in question (which limits the usefulness of the judgment as a practical guide for in-house counsel), she was satisfied that they fell within the definition of legal advice:

> In essence, through the medium of these documents, the agents of the Director [of the Family Responsibility Office] are receiving the instructions of the Director with respect to how s. 41 default proceedings [under the *Family Responsibility and Support Arrears Enforcement Act*] are to be conducted in the name of the Director, as the Director has been so instructed by its legal counsel. There is no basis for terminating the solicitor-client privilege on these facts.[27]

It is fairly clear from this that the documents contained a significant element of legal advice, but the judgment might presumably have been otherwise if the facts had been closer to those in the *TD* case discussed in the previous section of this article, where privilege did not attach to the documents setting out general corporate policy rather than the specific advice of the bank's internal counsel. *Dicta* in the judgment of Justice Linhares de Sousa suggest, for example, that 'training and instructional records designed for general application' would not be subject to solicitor-client privilege.[28]

The Supreme Court of Canada considered similar issues in *Pritchard* v. *Ontario (Human Rights Commission)*, where a document was informed both by the purpose of obtaining legal advice and by policy considerations.[29] In that case, the Court considered whether privilege attached to an opinion prepared by in-house counsel at the Ontario Human Rights Commission with respect to a sexual harassment and discrimination complaint against a third-party employer. Major J., writing for the Court, compared government lawyers to in-house corporate counsel, recognising that both are frequently required to 'give advice in an executive or non-legal capacity'.[30] While privilege would not generally attach to non-legal advice, it is sometimes necessary to take a broader view:

> Owing to the nature of the work of in-house counsel, often having both legal and non-legal responsibilities, each situation must be assessed on a case-by-case basis to determine if the circumstances were such that the [solicitor-client] privilege arose. Whether or not the privilege will attach depends on the nature of the relationship, the subject matter of the advice, and the circumstances in which it is sought and rendered…[31]

On the facts before the Court, the legal opinion was in essence 'a *legal opinion*', albeit one that appeared to be informed by policy considerations.[32]

Three Rivers and *Pritchard* offer authority of considerable weight for the proposition that the protection of solicitor-client privilege may extend to a wider range of documents than is suggested in Canadian cases like *TD* and *General Accident*. The House of Lords' disposition of the appeal in *Three Rivers* also provides arguments against the narrowing of the scope of privilege that had been suggested in the English Court of Appeal, which may help to forestall a more restrictive approach to the issue on the part of Canadian courts.

DISCLOSURE OF PRIVILEGED DOCUMENTS TO AUDITORS AND REGULATORS

Significant issues arise when privileged documents (legal opinions, for example) are disclosed by a company to its auditors or in the course of a regulatory investigation. The problem is the extent to which such disclosure constitutes waiver of privilege for all purposes, not solely for the purpose of the audit or regulatory inquiry.

Privilege can be waived by voluntary act, by implication or through inadvertence.[33] Privilege generally belongs to the client rather than the solicitor, and is thus the client's to

[22] *Ibid.* at para. 91, 111; relying on *Carpmael* v. *Powis* (1846), 1 Ph. 687, *per* Lord Lyndhurst.

[23] (2004), 70 O.R. (3d) 680 (Div. Ct).

[24] *Ibid.* at 686

[25] *Ibid.* at 690.

[26] *Ibid.* at 688.

[27] *Ibid.* at 689.

[28] *Ibid.* at 687.

[29] [2004] 1 S.C.R. 809 ('*Pritchard*').

[30] *Ibid.* at para. 19.

[31] *Ibid.* at para. 20.

[32] *Ibid.* at para. 28 (emphasis in original).

[33] Manes & Silver, at 187-205.

waive, although it is clear from the case law that waiver can also be effected by a solicitor as agent of the client.[34]

The traditional position in Canada has been that privilege cannot be partially waived, unless the portion of the communication which is disclosed can be said to be severable from the undisclosed portion because it deals with different subject matter. The rationale for this is that the party to whom disclosure is made should be able to assess the whole of the legal advice in question, and not just a selection; '[t]o allow an individual item to be plucked out of context would be to risk injustice through its real weight or meaning being misunderstood'.[35]

In the in-house context, waiver would not occur simply by virtue of sharing a legal opinion with employees in addition to those for whom the opinion was initially prepared – subject to the caveats discussed in section 0 of this article. Although the issue appears not to have been the subject of judicial consideration in Canada, it has been suggested that a Canadian court would probably accept the reasoning in *Upjohn Co.* v. *United States*, which rejected the theory that privilege is lost when in-house legal opinions are shared with lower level employees who are not part of senior management.[36] Provided work product is generated by in-house counsel for the purposes of giving legal advice within the entity and shared for that same purpose, it should be protected by solicitor-client privilege.

Loss of privilege is an obvious issue where documents prepared by counsel are required by a corporation's auditors for the purposes of their audit, or where a regulator requires the production of privileged documents as part of an investigation. Until recently it was relatively clear that privilege over such documents is lost once they are disclosed to an auditor or regulator. Recent jurisprudence necessitates revisiting that assumption.

Disclosure to Auditors

External auditors have wide-ranging rights to obtain information. For example, the *Business Corporations Act* (Ontario), provides in s. 153(5) as follows:

> Upon the demand of an auditor of a corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such,
>
> (a) information and explanations; and
>
> (b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries,
>
> as are, in the opinion of the auditor, necessary to enable the auditor to make the examination and report required under this section and that the directors, officers, employees or agents are reasonably able to furnish.

The *Canada Business Corporations Act* contains analogous provisions.[37] Note that the statutory language confers upon the auditors, rather than on the company that is being audited, the discretion to determine what information is reasonably necessary for the performance of the audit function. The audit function is itself broad, and is not necessarily confined to the balance sheet in the strict sense.

There is clearly the potential that an auditor's request may extend to privileged documents, if in the view of the auditors this information is relevant for the purposes of the audit. Auditors would, in appropriate circumstances, be entitled to request production of privileged communications. As Haley J. notes in *Cineplex Odeon Corp.* v. *Canada (A.G.)*:

> auditors will often request privileged documents from clients or their attorneys in the course of an audit. To the extent that these disclosures are necessary to permit the independent auditor to fulfil his obligations the client will be required to waive the privilege.[38]

Haley J. refers in this passage to auditors in the United States, but appears to conclude that the answer would be no different in Canada if auditors were to request and be provided with privileged material. Disclosure in these circumstances should be confined wherever possible to non-privileged, factual matters but, as the passage from *Cineplex* suggests, there may be situations in which the disclosure of privileged information will be unavoidable. It might be possible for a company to adopt a general policy of not disclosing legal opinions to its auditors and to consider whether separate board minutes could be maintained, in order to segregate privileged from non-privileged information, limiting disclosure to the latter wherever possible. While the auditors might be satisfied to know that legal advice was obtained, without the need to see the substance of that advice, the statute ultimately gives them – and not the company – the discretion to determine what is necessary for the purposes of the audit. In instances where legal advice is an integral part of the accounting treatment, disclosure will be unavoidable.

Auditors are under both a professional and a contractual duty to maintain the confidentiality of information entrusted to them for the purposes of an audit, which offers additional protection for sensitive information. Where disclosure to auditors involves third-party information, the corporation may nevertheless wish to provide its auditors only with a sufficient amount of information and level of detail in order to allow a meaningful audit, but without revealing the specifics of the third-party information. The disclosure of the names of customers of the company that is being audited is to be avoided. It should be noted, however, that while limiting the amount of information provided to auditors would help to minimise business risk to customer relationships, it has been the prevailing view that this will not insulate the provider of the information from waiving its privilege over legal advice disclosed to the auditors. This position appears to have changed, as a result of the recent *Philip Services* decision discussed in section 0, below.[39]

As a general proposition, privilege is waived over documents provided to an accountant for the purposes of an audit (or any other accounting purpose), unless the audit is being conducted for use in conjunction with litigation[40] Similarly, communication or material prepared by an accountant for a client is not privileged unless it is prepared by the accountant for the client at the request of the client's lawyer for the purposes of contemplated litigation. When an accountant prepares work or material for a client and

[34] *Ibid.* at 205.

[35] Nea Karteria Maritime Co. Ltd v. Great Lakes Steamship Corp. (No 2), [1981] Comm. L.R. 138 (Q.B.) at 139, per Mustill J.; also Great Atlantic Insurance Co. v. Home Insurance Co., [1981] 2 All E.R. 485 (C.A.) at 491-2.

[36] Manes & Silver, supra note 7 at 55; Upjohn Co. v. United States (1981), 449 U.S. 383 (6th Cir. 1981).

[37] Business Corporations Act, R.S.O. 1990, c. B.16, as amended (the 'OBCA'), s. 153(5); Canada Business Corporations Act, R.S.C. 1985, c. C-44, as amended (the 'CBCA'), s. 170 (1)-(2).

[38] (1994), 114 D.L.R. (4th) 141 (Ont. Gen. Div.) ('*Cineplex*'), at para. 30.

[39] *Philip Services*, *supra* n. 2.

[40] See *Professional Institute of the Public Service of Canada v. Canada (Director of the Canadian Museum of Nature)*, [1995] 3 F.C. 643 (T.D.) ('*Professional Institute*'), where the Auditor General of Canada was treated in the same way as an external, third-party auditor in a commercial setting.

gives it to the client directly, it can be privileged only if it falls within the boundaries of solicitor-client or litigation privilege. In this case the material must have been prepared for the client to be given to the solicitor for the dominant purpose of litigation.[41] The general position that communications to or from an accountant for the purposes of an audit will not be privileged (unless the communications are made with litigation in mind), has been upheld consistently in Canadian case law. The leading case in Canada is *Susan Hosiery Ltd* v. *Minister of National Revenue*, where it was held that communications made or prepared by an accountant would not be subject to privilege, except in two circumstances:

> (1) where the communications arose as a result of a request by the client's lawyer to be used in connection with litigation, either existing or apprehended, or
>
> (2) where the accountant was acting as the representative of the client in obtaining legal advice.[42]

On the facts of *Susan Hosiery*, privilege was held to exist because the accountants had acted as the client's agent in obtaining legal advice.[43]

In *Cineplex*, the court dealt specifically with the privileged status of documents delivered pursuant to an audit. In this case, a firm of chartered accountants were both tax accountants and external auditors of a company.[44] Certain correspondence and meeting notes between Cineplex's solicitors and its in-house counsel were provided to the company's accountants, Peat Marwick, for the purpose of giving legal advice regarding a transaction. In the hands of Peat Marwick acting in this capacity, the communications were clearly privileged. Certain documents had been disclosed, however, by the accounting partner at Peat Marwick to members of the audit team without the consent of the company. The question was whether this resulted in a loss of privilege.

Haley J. reiterated the general principle, relying on *Susan Hosiery*:

> The general principle of law is clear that information or advice given in confidence between accountant and client is not the subject of privilege. The only exception is where information is given to or by the accountant as agent for the client for the purpose of obtaining legal advice for the client.[45]

With respect to the disclosure to the separate audit team within Peat Marwick, Haley J. believed that there was no distinction between this and disclosure to an auditor from a different firm.[46] As for disclosure made pursuant to an audit, Haley J. held:

> If such an audit were conducted by another firm of chartered accountants there would be no question that they would be third parties in relation to the corporation and disclosures to those auditors would constitute waiver of privilege …[47]

And later in the judgment (in a passage quoted previously):

> auditors will often request privileged documents from clients or their attorneys in the course of an audit. To the extent that these disclosures are necessary to permit the independent auditor to fulfil his obligations the client will be required to waive the privilege.[48]

Despite the disclosure to the audit team in *Cineplex,* the court agreed with the company's argument that the privilege should not be lost because the tax accountant had no authority to waive privilege on its behalf; only the client can waive the privilege.[49]

Possible Privilege Attaching to Accountant-Client Communications

There is some support, however, in *AGT Limited* v. *A.-G. (Canada)* for the proposition that the 'Wigmore rules' for privileged communications could apply to accountant-client communications, including documents provided pursuant to an audit.[50] Qualified privilege will arise under the Wigmore rules where:

a) the communications arise in a confidence that they will not be disclosed,

b) this element of confidentiality is essential to the full and satisfactory maintenance of the relation between the parties,

c) the relation is one which in the opinion of the community ought to be sedulously fostered, and

d) injury to the relation by disclosure of the communications would be greater than the benefits to be derived from disclosure.

The case involved materials filed by AGT, a regulated telephone company, with the CRTC. These materials were intended to be confidential, but were subsequently requested by the Minister of National Revenue pursuant to sub-section 231.2(1) of the *Income Tax Act*. AGT resisted the request, claiming among other things that the documents were covered by common law privilege, based on the Wigmore rules, and were accordingly exempt from seizure. In assessing this claim, Rothstein J. agreed that common law privilege was defined by the Wigmore rules, as outlined in cases such as *Slavutych* v. *Baker* and *R.* v. *Gruenke*.[51] Rothstein J. proceeded to apply the four-part Wigmore test, beginning with the first requirement that the documents originate in a confidence that they will not be disclosed.

Aside from the request for confidentiality by AGT, Rothstein J. noted:

> There is no evidence of any other reason supporting the argument that [the documents] originated in the confidence that they would not be disclosed. Undoubtedly, AGT hoped the CRTC would rule that the documents not be

[41] See Manes & Silver at 60-2, 76-7; and also Ronald Manes & Michael Silver, *The Law of Confidentiality in Canada* (Toronto & Vancouver: Butterworths, 1996), at 43-7.

[42] [1969] 2 Ex. C.R. 27 (Ex. Ct) ('*Susan Hosiery*').

[43] See also *Long Tractors Inc.* v. *Canada* (*Deputy Attorney-General*), [1998] 3 C.T.C. 1; *Brunner & Lay (Can.) Ltd* v. *Canada* (*Deputy Attorney-General*), [1984] C.T.C. 534.

[44] *Supra* note 38.

[45] *Ibid.* at para. 7. This view was upheld in a recent decision of the Federal Court of Australia, *Commissioner of Taxation* v. *Pratt Holdings Pty Ltd*, [2005] FCA 1247.

[46] *Ibid.* at para. 12-14.

[47] *Ibid.* at para. 12.

[48] *Ibdi.* at para. 30.

[49] See also *Canbook Distribution Corp.* v. *Borins* (1999), 7 C.B.R. (4th) 121 (Ont. Ct. (Gen. Div.)) at para. 12; *Belgravia Investments Ltd* v. *The Queen*, [2002] D.T.C. 7133 (F.C.T.D.) ('*Belgravia*') at para. 50.

[50] 96 D.T.C. 6388 (F.C.T.D.), aff'd 97 D.T.C. 5189 (F.C.A.) ('*AGT*').

[51] [1976] 1 S.C.R. 254; [1991] 3 S.C.R. 263 ('*Gruenke*').

> disclosed; but in making their submissions, they left themselves in the hands of the CRTC. […] This inevitably leads to the conclusion that AGT could not have originated the documents it submitted to the CRTC in the confidence they would not be disclosed.[52]

Because of a lack of evidence that the communications originated in the confidence that they would not be disclosed, AGT had failed to satisfy the first branch of the Wigmore test. Rothstein J. found it unnecessary, therefore, to consider the remaining three branches of the Wigmore test, and concluded that common law privilege was 'simply not applicable in this case'.[53] On appeal, the Federal Court of Appeal was satisfied that the motions judge did not err on this point, making it unnecessary consider the privilege argument further.

The decision in *AGT* at least left open the possibility that common law privilege could be found to apply in appropriate circumstances, although it did not do so on the facts of the case. The *AGT* decision may therefore weigh against a blanket assertion that there is no accountant-client privilege in Canada. Such an argument would appear to have been effectively forestalled by the subsequent decision in *Tower* v. *Minister of National Revenue*.[54]

It may still be possible to argue from *AGT* that disclosure to auditors does not waive privilege *vis-à-vis* other parties, and that privilege could exist with respect to documents that are already subject to a solicitor-client privilege. While it has always been understood that privilege is waived when documents are provided to an accountant for the purposes of an audit, this traditional view has recently been rejected by the Ontario Divisional Court in *Philip Services*, as is discussed below.[55]

Disclosure of Privileged Documents to a Regulator

With respect to information provided to a regulator, there may be an argument that privilege is not lost through disclosure if it can be said that that disclosure is not the result of a voluntary act, but instead results from compliance with a compulsory order of the regulator. Voluntary disclosure to third parties will have the effect of waiving privilege: see *Supercom of California Ltd* v. *Sovereign General Insurance Co.*, where it was accepted as 'an established principle that generally, disclosure to outsiders of privileged information constitutes waiver of privilege.'[56] Voluntary compliance in response to the request of a regulator is treated no differently: see *Professional Institute*, where privilege was lost when an otherwise privileged forensic audit was disclosed to the Auditor General, but not pursuant to any power of compulsion.[57] Two decisions of the Competition tribunal emphasise, however, that where an individual is *compelled* (rather than requested) to produce documents, a claim for privilege over those documents may be asserted.[58] See also *S & K Processors Ltd* v. *Campbell Ave. Herring Producers Ltd*, where McLachlin J. (as she then was) held that an implied waiver of privilege must be based on 'some manifestation of a voluntary intention to waive the privilege at least to a limited extent'.[59] Waiver will be deemed to occur where it can be inferred from conduct, based on considerations of fairness and consistency.[60]

It may be possible to argue that disclosure of privileged material for the limited purpose of fulfilling obligations to an auditor or regulator does not constitute a waiver of privilege. This was the argument in *British Coal Corp.* v. *Dennis Rye Ltd (No. 2)*, where the disclosure of privileged documents for the purposes of assisting in a criminal investigation did not have the effect of waiving a party's rights as they related to a concurrent civil action for fraud arising on the same facts.[61]

This reasoning has been applied in *Interprovincial Pipe Line Inc.* v. *Minister of National Revenue*, where disclosure to auditors that was required under the CBCA did not constitute waiver for other purposes (including an audit by Revenue Canada).[62] In that case, Gibson J. held that legal opinions were disclosed 'for a limited purpose only, namely to assist in the conduct of the audit and examination of the financial statements'.[63] In his judgment, Gibson J. relied on Alberta authority for the concept of limited waiver, noting that the matter before him had originally arisen in that province.[64] Gibson J. acknowledged, however, that his conclusion on this point runs counter to case law in Ontario and the United States.[65]

One of the Ontario cases referred to by Gibson J. in *Interprovincial Pipe Line* is *Air Canada* v. *McDonnell Douglas Corp.*, where the decision in *British Coal* was read more narrowly as establishing that disclosure arising out of a duty to assist in the conduct of *criminal proceedings* does not constitute a waiver of privilege, on the grounds of public policy, but leaving it unclear whether this exception could apply more generally.[66]

Recent Developments: Limited Waiver

The argument in favour of the concept of limited waiver has been strengthened by the recent decision of the Judicial Committee of the Privy Council in an appeal from New Zealand involving disclosure of documents by a firm of solicitors to their governing body. In *Auckland District Law Society*, the firm disclosed documents to the law society's counsel in connection with a complaint against the firm and some of its current and former partners arising from the formation of partnerships for the purposes of an investment scheme.[67] The documents were subject to solicitor-client privilege and were disclosed to the Law Society on the express condition that they would not be distributed further and that privilege over

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[52] *AGT*, *supra* note 50 at 6395.

[53] *Ibid.*

[54] (2003), 231 D.L.R. (4th) 318 (Fed. C.A.).

[55] *Philip Services*, *supra* n. 2, discussed in section 0 of this article.

[56] (1998), 37 O.R. (3d) 597 (Gen. Div.) at 611.

[57] See *Professional Institute*, *supra* note 40. See also *British Columbia (Securities Commission)* v. *B.D.S.*, [2000] B.C.J. No. 2111 (B.C.S.C.), aff'd (2003) 226 D.L.R. (4th) 393 (B.C.C.A.), leave to appeal denied [2003] S.C.C.A. No. 341. One might ask whether compliance with a regulator is truly voluntary if the consequences of non-compliance are so unpalatable as to leave the regulated party effectively with no choice but to comply.

[58] See *Canada (Director of Investigation and Research)* v. *Air Canada* (1993), 46 C.P.R. (3d) 312 (Comp. Trib.); *Canada (Director of Investigation and Research)* v. *Washington*, [1995] C.C.T.D. No. 22 (Comp. Trib.).

[59] (1983), 35 C.P.C. 146 (B.C.S.C.) ('*S&K*') at 150; also *Re Director of Investigation and Research and Shell Canada Ltd* (1975), 55 D.L.R. (3d) 713 (Fed. C.A.).

[60] *S&K*, *supra* note 59 at 150.

[61] [1988] 3 All E.R. 816 (C.A.) ('*British Coal*'). See also *Bourns Inc.* v. *Raychem Corp.*, [1999] 3 All E.R. 154 (C.A.).

[62] (1995), D.T.C. 5642 (F.C.T.D.) ('*Interprovincial Pipe Line*').

[63] *Ibid.* at para. 18.

[64] See *Ed Miller Sales & Rentals Ltd* v. *Caterpillar Tractor Co.* (1988), 61 Alta L.R. (2d) 319 (C.A.), at para. 24). The principle in *Interprovincial Pipe Line* has been extended in a subsequent Alberta decision: see *Anderson Exploration Ltd* v. *Pan-Alberta Gas* (1998), 61 Alta L.R. (3d) 38 at para. 28-30.

[65] See *Air Canada* v. *McDonnell Douglas Corp.* (1994), 19 O.R. (3d) 537 (Gen. Div. Master), cited in *Interprovincial Pipe Line* at para. 19-20.

[66] (1994), 19 O.R. (3d) 537 (Gen. Div.).

[67] *Supra* note 2.

them was not being waived. This was acknowledged by the Society's counsel. A new lawyer for the Society was subsequently appointed, but he was not informed of the conditions and the documents were disclosed to the Law Society in connection with other complaints made against the firm. The Privy Council considered whether the legislation empowering the Law Society to investigate complaints against solicitors overrode the common law of privilege, concluding that it did not, and then went on to consider the issue of whether solicitor-client privilege was waived because a privileged document had been disclosed for a limited purpose only. Lord Millett gave judgment for the Judicial Committee:

> The Society's argument, put colloquially, is that privilege entitles one to refuse to let the cat out of the bag; once it is out of the bag, however, privilege cannot help to put it back. Their Lordships observe that this arises from the nature of privilege; it has nothing to do with waiver. It does not follow that privilege is waived generally because a privileged document has been disclosed for a limited purpose only…
>
> The question is not whether privilege has been waived, but whether it has been lost. It would be unfortunate if it were. It must often be in the interests of the administration of justice that a partial or limited waiver of privilege should be made by a party who would not contemplate anything which might cause privilege to be lost, and it would be most undesirable if the law could not accommodate it.[68]

Later in the judgment, Lord Millett stated:

> A lawyer must be able to give his client an unqualified assurance, not only that what passes between them shall never be revealed without his consent in any circumstances, but that should he consent in future to disclosure for a limited purpose those limits will be respected…[69]

The *Auckland District Law Society* case would presumably be of assistance to an appellate court here in making sense of the inconsistent Canadian authority on point and, as a Privy Council judgment, would carry some weight. On this basis, there would certainly be an argument that the intention to share privileged documents with an auditor or regulator is to disclose them for the limited purpose of complying with the requirements of the party to whom they are disclosed, not to waive privilege over them for other, wider purposes. In such circumstances it would be helpful to indicate the continued assertion of privilege and the confidential nature of the documents (as was the case in *Auckland District Law Society)*, in order to make the argument that any waiver of privilege applied only for a limited purpose.

The concept of limited waiver, at least in the context of client-auditor communications, was given significant endorsement by the Ontario Divisional Court in the recent *Philip Services* decision.[70] In *Philip Services*, the company's auditors attended a meeting of the audit committee, at which in-house counsel provided an overview of legal advice concerning the company's disclosure obligations with respect to a senior officer's admissions that he had fraudulently diverted company funds. The auditors participated in further deliberations on the disclosure issue and were provided with a previous legal opinion. The Ontario Securities Commission commenced proceedings against Philip Services for failing to make proper disclosure and ultimately found that the auditor was a third party to Philip, and that privilege over the legal opinion had therefore been waived for all purposes by virtue of the discussion at the audit committee meeting, on *Cineplex* principles.[71] On appeal to the Divisional Court (composed of Lane, Linhares de Sousa and O'Driscoll JJ), the receiver of Philip Services argued that

> where the right of an auditor to demand information from the audited company and its officers and directors is exercised in relation to documents which are privileged, the resulting disclosure must be treated as limited to the purpose for which the statute grants the right to obtain disclosure. [72]

Lane J., for the Court, reviewed the *Cineplex* case, as well as *Professional Institute* and *Interprovincial Pipe Line*. In the submission of the OSC, the *Cineplex* line of cases supported 'the view that the voluntary giving of a privileged document to the auditor by the person possessing the privilege must be understood to be a complete waiver of the privilege'.[73] Justice Lane's response was as follows:

> I am not so sure that they go that far. Noel J's comments [in *Professional Institute*] that auditors are "bound to disclose otherwise privileged information", can equally be read as confined to the waiver for the purposes of the audit, if one limits the duty to disclose to the requirements of the law and auditing standards, as I think it must be. There is no free-standing duty on auditors to make public disclosure of everything they learn that might interest the criminal or tax authorities; their duties arise from their role as auditors as governed by law and professional obligations.[74]

If the right of auditors to request documents and the purposes for which they may use them are limited, then it would appear that waiver of privilege over anything disclosed to auditors will be similarly limited. Lane J. interpreted *Interprovincial Pipe Line* as authority for the proposition that

> disclosure to the auditors for their purposes is not properly disclosure to the world, because of the great importance of the solicitor-client privilege to the proper functioning of the legal system.[75]

Given the overriding importance of privilege to the administration of justice, Lane J. adopted the 'minimal impairment test' which has been applied in criminal cases involving privileged documents:

> While the present case does not involve a *Charter* challenge, the message from the Supreme Court is clear: restrictions on solicitor-client privilege to attain other important societal objectives are to be closely scrutinized and restricted to what is absolutely necessary for the competing objective so as to achieve the minimal necessary impairment of solicitor-client privilege.[76]

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[68] *Ibid.* at para. 68.

[69] *Ibid.* at para. 71.

[70] *Supra* n. 2.

[71] *Supra* n. 38.

[72] *Supra* n. 2 at para. 31.

[73] *Ibid.* at para. 41.

[74] *Ibid.* at para. 42.

[75] *Ibid.* at para. 47. *British Coal*, *supra* n. 61, while not directly relevant to the issue at hand, was 'of interest' with respect to limited waiver (*Philip Services* at para. 49).

[76] Supra n. 2 at para. 51, citing *Descoteaux* v. *Mierwinski*, [1982] 1 S.C.R. 860; *Lavallee, Rackel & Heintz* v. *Canada (A.-G.)*, [2002] 3 S.C.R. 209 at 241.

As a result, s. 153 of the OBCA could not be read as authorising the auditor to ignore the solicitor-client privilege which attached to the legal opinions it had received from Philip Services, or the limited use to which the auditors could put these documents.[77] In Justice Lane's view this leaves auditors with a meaningful ability to 'use the [privileged] document across the full range of auditor responsibilities', but does not justify further disclosure by the auditors of the privileged material.[78] Privilege over the legal opinions provided by Philip Services to its auditors, Justice Lane concluded, had been waived for the limited purpose of allowing the auditors to discharge their statutory and professional duties, but not for any wider purpose.[79] The OSC served a notice of motion for leave to appeal, but subsequently abandoned the appeal. The decision in *Philip Services* may therefore be treated as final.

Although the recognition of limited waiver of privilege in *Philip Services* is confined to the context of disclosure to an auditor for the purposes of the audit function, the decision may suggest that Canadian courts will be prepared to recognise limited waiver in other circumstances as well – perhaps including disclosure of privileged documents that is requested or required by a regulator. Counsel making arguments on this issue would presumably also wish to make reference to the *Auckland District Law Society* case, which offers support for the concept of limited waiver from no less than the Judicial Committee of the Privy Council.

It would be reasonable to conclude that the law of solicitor-client privilege continues to develop on a number of fronts, although where this will all lead is a matter of speculation. The decision of the House of Lords in *Three Rivers* provides the basis for an argument that the courts ought to reject a narrower view of legal advice that is confined – perhaps artificially – to advice 'in relation to law' (as the English Court of Appeal expressed it in *Three Rivers*), and to extend the protection of privilege to a wider range of documents prepared by in-house counsel.

The *Philips Services* case is a remarkable development in the law of privilege, representing the first clear recognition in Ontario of the concept of limited waiver in the context of disclosure to an auditor.[80] While that context is itself limited, the principles enunciated by the Privy Council in *Auckland District Law Society* strongly suggest that the courts should be prepared to recognise limited waiver in other contexts as well, including that of disclosure by the regulated to the regulator.

If, as Chief Justice Lamer held in *Gruenke*,[81] the law of privilege is not closed to the admission of new classes of privilege on a principled basis, it is clear that the boundaries of existing classes are also subject to continual development.

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[77] *Ibid.* For the OBCA provisions, see *supra* n. 37.

[78] *Ibid.* at para. 56.

[79] *Ibid.* at para. 57-8.

[80] It is unfortunate, then, that the US District Court for the Southern District of New York rejected the assertion of privilege on the basis of limited waiver that was made by the receiver of Philip Services over the same documents that had been in issue in the Ontario proceedings: 2005 US Dist. LEXIS 22998 (S.D.N.Y., 6 October 2005). Freedman J. made only brief mention of the adjudication of the privilege claim in Ontario, found that the legal opinions had sufficient connections to the United States and simply applied US federal law.

[81] *Supra* n. 51 at para. 47.

Protecting Privilege in Multi-Jurisdictional Litigation

In cases where a claim to privilege is challenged, having already been challenged (successfully) in another jurisdiction, and the onus is on the party claiming privilege to justify upholding the privilege, the court will need to be persuaded that the factors causing the document to be deprivileged in other jurisdictions do not exist or should not apply to the challenge in this particular case. This will involve satisfying the court that:

(i) privilege potentially exists;

(ii) even if privilege doesn't exist under that court's rules, the court should accept that the document is privileged under the law of the party claiming privilege and the law of that document;

(iii) even if deprivileged by order of another court or treated as waived in another jurisdiction, this does not mean that the privilege has been lost or waived in the particular forum and/or to this particular litigant;

(iv) even if confidentiality has been lost (e.g. because posted by another person on their website and thereby generally accessible on the Internet), privilege has not been lost or waived as against the particular litigant now challenging the claim to privilege.

Success in maintaining privilege under such circumstances will require the local law to recognise the principle of applying foreign law and practice, and for judges to be willing to adopt a rather technical and academic approach. Judges' willingness to do so will vary, particularly where there is already a hard-fought history of procedural disputes between the parties.

For a UK company, involved in overseas litigation, this may mean relying on UK privilege law in addition to or as part of the protection afforded by the overseas law. UK privilege has two basic categories:

1) legal advice privilege; and

2) litigation privilege.

Legal advice privilege covers confidential communications between lawyer and client for the purpose of seeking or giving legal advice. It exists separately to and independently of litigation. It is the privilege that applies whether the legal advice is given in the context of litigation or otherwise. It will protect documents evidencing such communications from disclosure, and so would protect, for example, fax transmittal sheets from or to lawyers and legal bills. In that respect UK privilege is wider than US privilege.

Another example of UK privilege being wider than US privilege is where the documents are part of a "continuum of communications" between the lawyer

and client. If so, then otherwise non-privileged documents that are part of this "continuum" will also be treated as privileged. The "continuum" occurs where the overall context for the non-legal advice documents is clearly one of obtaining and communicating on legal advice. On this basis documents, such as agendas for and invitations to meetings of or with lawyers, which typically are not privileged under US law, would be treated as part of a "continuum of communications", and hence themselves privileged, even though the particular document itself does not contain legal advice.

Recent cases in the UK (known as the "Three Rivers" cases[1]) have explored what constitutes legal advice. Lower court decisions in Three Rivers had confined and restricted legal advice privilege so as to apply it only to transactions involving legal rights and obligations capable of becoming the subject matter of litigation. The House of Lords, the ultimate appeal court in the UK, overturned these decisions. The House of Lords took a broader view (and more in line with lawyers' previous expectations and assumptions), and held that legal advice privilege covered not only legal advice per se, on matters of law and construction, but also advice to the client on drafting answers to inquiries or presenting evidence in a favourable light. Although not technically legal advice, and not for litigation purposes, the House of Lords saw this as within the ordinary scope of a lawyer's business, and so entitled to privilege and protection from disclosure. For the House of Lords a lawyer's business included advice as to what can sensibly and prudently be done, and giving advice with his "legal spectacles on", and using his special professional knowledge and skills. The House of Lords saw this arising if there could be criticism of the client or damage to its reputation.

The Three Rivers decisions have also narrowed the definition of "client". In the UK the decisions mean that the client does not include a corporate entity, or even all of its officers and employees, but only the person or team of people charged with obtaining legal advice for the corporation on a particular matter. Legal advice privilege will not apply to communications passing between lawyers and other employees of the corporation, no matter how senior. It would be surprising if this narrower definition is not contested in future litigation.

Litigation privilege applies to communications which are created for the dominant purpose of being used in actual or anticipated litigation. The litigation must have started, or be a real likelihood or reasonably in prospect; a general apprehension or mere possibility of future litigation is insufficient.

Litigation privilege applies to protect third party documents created for the purpose of litigation and to communications between client or lawyer and a third party, such as an expert witness. However, unsolicited communications from a third party will not be protected. Also, importantly, unless there is litigation, or a reasonable prospect of it, which would give litigation privilege protection, third party documents and communications, even if they were prepared and sent for the purpose of enabling the client to obtain legal advice, will not be privileged because UK law does not apply legal advice privilege to such third party documents and communications. Hence the significance of the narrower definition of "client" in the Three Rivers Case. The documents in question were not in the context of litigation, and so there was no litigation privilege, but were prepared in relation to an official enquiry into the notorious collapse of the BCCI bank. The narrower definition resulted in many in-house communications by employees, including to outside counsel, and even if seeking legal advice, being deemed not to be privileged as the particular employees were not on the "legal team", and so not deemed to be "the client", and thus the documents had to be disclosed in subsequent litigation.

Litigation privilege can make pre-existing, and otherwise non-privileged, third party documents privileged. If non-privileged documents have been selected for the purpose of litigation, and if the disclosure of that selection of documents would betray the lawyer's impressions and the trend of the legal advice or argument, then UK privilege will apply. However, this will only apply if the selection is from pre-existing third party documents; pre-existing client unprivileged documents are excluded from the "trend of advice" litigation privilege.

In-house lawyer – legal advice privilege and litigation privilege will usually apply to an in-house lawyer provided he/she is performing legal functions as compared to other purposes, such as when acting in an administrative, compliance or company secretarial capacity or if offering business advice or opinions (heaven forbid!). However, somewhat controversially, an in-house lawyer's internal legal correspondence is not protected in the context of a European Commission investigation into alleged breaches of Article 81 and 82 of the EC treaty (anti-competitive behaviour such as price fixing and abuse of dominant position).

Loss of privilege – privilege may be lost if it is waived or if confidentiality is otherwise lost. The waiver may be express (e.g. if a privileged document is exhibited as part of an affidavit) or implied (e.g. if a document is voluntarily waived as to part but the court rules that fairness demands that the rest of the document or related documents be disclosed). It can also happen if a privileged document is inadvertently disclosed to the other side on discovery as it may then be treated as waived. However, the court may order that the document cannot be used if the court determines that the other side knew that a mistake had been made or that a reasonable lawyer would have realised that a mistake had been made by the disclosing side, and that therefore it was clear that no waiver had been intended.

Also privilege may be lost if confidentiality has been lost because of action by a third party, (e.g. publication on the Internet), even if that disclosure was unlawful (if the document was stolen or there was a breach of confidence). Disclosure to a limited number of third parties for a limited purpose does not necessarily mean that confidentiality has been lost.

Statute – in the UK there is legislation which expressly denies and revokes privilege so that, under certain conditions, their privileged status is lost (i.e. section 328 of the Proceeds of Crime Act 2002, and section 291 of the Insolvency Act 1986).

[1] Three Rivers DC & Ors v Governor and Company of the Bank of England (No. 5) [2002] EWCA Civ 474: [2003] QB 1556 (CA): Three Rivers DC & Ors v Governor and Company of the Bank of England (No. 6) [2004] EWCA Civ 218: [2004] QB 916 (CA) [2004] QB 916 (CA) [2004] UKHL 48 [2005] 1 AC 610 (HL).

Joint privilege – this applies where a lawyer is jointly retained by more than one client and enables the sharing of information and documents. No written agreement is required.

Common interest privilege - this applies to a document, which is privileged in the hands of the sender, and which is sent to another party who has a "community of interest" with the sender in the subject matter of that document. The recipient can then also claim privilege over the document. No written agreement is required. The community of interest must exist at the time the document is sent or, arguably, at the time the document is disclosed.

Both joint privilege and common interest privilege can only arise if there is a legal advice or litigation privilege context.

Best Practice

Best practice in relation to the creation and subsequent treatment of privileged materials will vary from jurisdiction to jurisdiction. From a UK perspective the following practices can be recommended:

- At the outset clarify in writing who the client is. This will mean identifying the individuals from within a corporation who are tasked with obtaining the legal advice. The client team should include everyone who will need to provide information to lawyers or use information provided by lawyers.

- In-house lawyers in particular should specify in each communication what the context of the communication is. This will later assist a Court in determining whether litigation privilege or legal advice privilege apply (i.e. "this email is sent in connection with the provision of legal advice in relation to the ACC Inquiry").

- Take steps to resist production of privileged documents.

- If you do have to provide privileged material to a third party, clarify in writing that privilege is claimed, and has not been waived, and that the document is being provided for a specified limited purpose and on the condition that it be kept confidential.

AMERICAN BAR ASSOCIATION

TASK FORCE ON ATTORNEY-CLIENT PRIVILEGE
NEW YORK STATE BAR ASSOCIATION
SECTION OF BUSINESS LAW
SECTION OF CRIMINAL JUSTICE
SECTION OF LITIGATION
SECTION OF INDIVIDUAL RIGHTS AND RESPONSIBILITIES
GENERAL PRACTICE, SOLO AND SMALL FIRM DIVISION
SECTION OF LABOR AND EMPLOYMENT LAW
SECTION OF HEALTH LAW
SECTION OF INTELLECTUAL PROPERTY LAW
SECTION OF TORT TRIAL AND INSURANCE PRACTICE
SECTION OF STATE AND LOCAL GOVERNMENT LAW
SECTION OF ANTITRUST LAW
YOUNG LAWYERS DIVISION

REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED, that the American Bar Association opposes government policies, practices and procedures that have the effect of eroding the constitutional and other legal rights of current or former employees, officers, directors or agents ("Employees") by requiring, encouraging or permitting prosecutors or other enforcement authorities to take into consideration any of the following factors in making a determination of whether an organization has been cooperative in the context of a government investigation:

(1) that the organization provided counsel to, or advanced, reimbursed or indemnified the legal fees and expenses of, an Employee;

(2) that the organization entered into or continues to operate under a joint defense, information sharing and common interest agreement with an Employee or other represented party with whom the organization believes it has a common interest in defending against the investigation;

(3) that the organization shared its records or other historical information relating to the matter under investigation with an Employee; or

(4) that the organization chose to retain or otherwise declined to sanction an Employee who exercised his or her Fifth Amendment right against self-incrimination in response to a government request for an interview, testimony, or other information.

REPORT

I. BACKGROUND

In early 2004, the U.S. Sentencing Commission amended the Commentary to the Federal Sentencing Guidelines to state that an organization's willingness to waive the attorney-client privilege or work-product doctrine could be relevant to a determination that the entity was cooperating with the government and therefore eligible for a reduced penalty. In August of 2004, the ABA House of Delegates adopted a resolution opposing that amendment ("Recommendation 303").[1] Two months later, then-ABA President Robert Grey created a new Presidential Task Force on Attorney-Client Privilege.

The Task Force has reviewed scholarly articles and applicable law, conducted meetings, held public hearings, and received oral and written testimony from interested persons.[2] After gathering and analyzing this information, the Task Force submitted a proposed resolution last year to the ABA House of Delegates that expressed support for the privilege and opposition to governmental policies that erode it ("Recommendation 111").[3] The ABA House of Delegates approved the recommendation in August 2005 without dissent. In addition to Recommendation 111, the Task Force also provided the ABA House of Delegates with a detailed Report discussing and analyzing the importance of the attorney-client privilege and the work product doctrine, as well as the various ways in which these protections have been eroded in recent years.[4]

In order to carry out the policy positions outlined in Recommendations 303 and 111, the ABA has worked closely with a broad coalition of legal and business groups in an effort to persuade the U.S. Sentencing Commission to amend its organizational Sentencing Guidelines in a manner consistent with those resolutions.[5] After receiving extensive written comments and testimony from the ABA, the coalition, and numerous former senior Justice Department officials, the Sentencing Commission voted unanimously on April 5, 2006, to reverse the 2004 privilege waiver amendment to the Sentencing Guidelines. Unless Congress acts to modify or reverse the change, it will become effective on November 1, 2006.

Since the approval of Recommendation 111, the ABA also has engaged the Department of Justice in an effort to persuade it to modify its "Thompson Memorandum,"[6] which makes an organization's willingness to waive its attorney-client privilege and work product protections a key factor in determining whether the organization has been "cooperative." The Task Force has developed a proposed amendment to the Thompson Memorandum to prohibit this practice, and on May 2, 2006, ABA President Michael Greco submitted this proposed amendment to Attorney General Alberto Gonzales.[7]

In implementing its charge, the Task Force also has focused its attention on other aspects of the Thompson Memorandum and its implementation. Of particular concern is a provision that provides:

> [W]hile cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the

[1] Recommendation 303 supported five specific changes to the then-proposed amendments to the Federal Sentencing Guidelines for Organizations, including amending the Commentary to Section 8C2.5 to state affirmatively that waiver of attorney-client and work product protections "should not be a factor in determining whether a sentencing reduction is warranted for cooperation with the government." Recommendation 303 and the related Report are available at http://www.abanet.org/poladv/report303.pdf.

[2] These and other useful materials on the topic of privilege waiver are posted on the Task Force's website, which is located at http://www.abanet.org/buslaw/attorneyclient/.

[3] Recommendation 111 states as follows:

> RESOLVED, that the American Bar Association strongly supports the preservation of the attorney-client privilege and work product doctrine as essential to maintaining the confidential relationship between client and attorney required to encourage clients to discuss their legal matters fully and candidly with their counsel so as to (1) promote compliance with law through effective counseling, (2) ensure effective advocacy for the client, (3) ensure access to justice and (4) promote the proper and efficient functioning of the American adversary system of justice; and
>
> FURTHER RESOLVED, that the American Bar Association opposes policies, practices and procedures of governmental bodies that have the effect of eroding the attorney-client privilege and work product doctrine and favors policies, practices and procedures that recognize the value of those protections.
>
> FURTHER RESOLVED, that the American Bar Association opposes the routine practice by government officials of seeking to obtain a waiver of the attorney-client privilege or work product doctrine through the granting or denial of any benefit or advantage.

[4] Recommendation 111 and the related Report are available on the Task Force's website at http://www.abanet.org/buslaw/attorneyclient/. The Recommendation, but not the Report, constitutes official ABA policy.

[5] The members of the coalition include the American Chemistry Council, the American Civil Liberties Union, the Association of Corporate Counsel, Business Civil Liberties, Inc., the Business Roundtable, the Financial Services Roundtable, Frontiers of Freedom, the National Association of Criminal Defense Lawyers, the National Association of Manufacturers, the National Defense Industrial Association, the Retail Industry Leaders Association, the U.S. Chamber of Commerce and the Washington Legal Foundation. The ABA is not formally a part of the coalition but has worked closely with the coalition to achieve the common goals outlined in Recommendations 303 and 111. Other organizations that have taken steps to confront encroachment on the attorney-client relationship include the Securities Industry Association, the Bond Market Association, and a number of state and local bar associations.

[6] Memorandum from Larry D. Thompson, Deputy Attorney General, to Heads of Department Components and United States Attorneys on *Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003), *available at* http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

[7] Available at http://www.abanet.org/poladv/acprivgonz5206.pdf.

> employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.[8]

The Task Force has concluded that the implementation of this provision threatens to undermine fundamental values that have long been recognized by the ABA. In particular, the ABA has recognized the critical importance of access to competent representation in criminal cases (and, indeed, in all legal matters). Competent representation in a criminal case requires that counsel investigate and uncover relevant information,[9] and that, subject to limited exceptions, lawyers should not interfere with an opposing party's access to such information.[10] The ABA has further recognized the importance of protecting an individual's ability to assert his or her constitutional rights. The Task Force has concluded that practices instituted by federal and state prosecutors pursuant to the Thompson Memorandum and its principles, as well as similar practices instituted by civil enforcement authorities, have contributed to an erosion of these individual rights.

The particular policies and practices addressed by the Task Force in this Report, as in its previous Report, relate to actions that organizations have been expected to take or to refrain from taking as aspects of cooperation justifying leniency. As discussed below, it is inconsistent with ABA principles, good corporate governance, the role of lawyers in our adversarial system of justice and individual Constitutional rights, for government lawyers to consider any of the following factors in making a determination of whether an organization has been cooperative in the context of a government investigation : (1) that the organization provided counsel to an employee or agreed to pay an employee's legal fees and expenses; (2) that the organization entered into or continues to operate under a joint defense, information sharing and common interest agreement with an employee or other represented party with whom the organization believes it has a common interest in defending against the investigation; (3) that the organization shared its records or other historical information relating to the matter under investigation with an employee or other represented party; or (4) that the organization chose to retain or otherwise declined to sanction an employee who exercised his or her Fifth Amendment right against self-incrimination in response to a government request for an interview, testimony, or other information.

The Task Force believes the ABA should express its opposition to these government policies, practices and procedures, as they undermine access to effective representation and the preservation of constitutional rights.

II. CORPORATE COOPERATION IN CRIMINAL INVESTIGATIONS

Criminal prosecutors have traditionally used the threat of prosecution to secure cooperation by parties whom they believe to be criminally culpable. Many regard this practice as objectionable, because it results in providing leniency to parties who would otherwise deserve harsher treatment or because it creates incentives for parties to fabricate evidence to secure leniency. Nonetheless, the practice is by now well-established, particularly in the context of investigations and prosecutions of individuals.[11]

The practice of securing cooperation is now employed not only by prosecutors but also by civil enforcement authorities in dealing with organizations. As this Task Force observed in its earlier Report: "Prosecutors have traditionally recognized that criminal charges ought to be pursued rarely against corporations, but prosecutors nevertheless employ the threat of criminal prosecution to secure corporations' assistance in their criminal investigations and prosecutions of individuals."[12] As a general matter, as the Task Force further observed, this is a legitimate practice: "At one time, this assistance primarily included providing relevant documents and information other than privileged communications and attorneys' litigation work product. Demands for this level of corporate assistance do not, in particular, present concerns from the perspective of the public interest in an effective corporate client-lawyer relationship." As it does when measuring and rewarding cooperation by culpable individuals, the government may fairly consider the extent to which a cooperating organization assists it by providing information in its possession that is not otherwise easily accessible to investigators. Further, the government may consider whether the organization has taken steps to remedy whatever wrongdoing may have occurred and to prevent its recurrence, including by sending a strong message to officers and employees that future wrongdoing will not be tolerated.

While acknowledging the legitimacy of government investigative practices generally, the Task Force's earlier Report in support of Recommendation 111 identified one practice of particular concern: "the perceived prosecutorial expectation that in order to persuade the prosecution that the corporation has not engaged in conduct deserving of prosecution, or as an aspect of cooperation with the criminal investigation, corporations will provide material that is subject to the protection of the attorney-client privilege or

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[8] Memorandum from Larry D. Thompson, *supra* note 6, at 7-8.

[9] *See, e.g.*, ABA Standards Relating to the Administration of Criminal Justice, The Defense Function, Standard 4-4.1(a) (3d ed. 1992) ("Defense counsel should conduct a prompt investigation of the circumstances of the case and to explore all avenues leading to facts relevant to the merits of the case and the penalty in the event of conviction.").

[10] *See, e.g.*, ABA Standards Relating to the Administration of Criminal Justice, The Prosecution Function, Standard 3-3.1(d) (3d ed. 1992) ("A prosecutor should not discourage or obstruct communication between prospective witnesses and defense counsel. A prosecutor should not advise any person or cause any person to be advised to decline to give to the defense information which such person has a right to give."); *id.*, The Defense Function, Standard 4-4.3(d) ("Defense counsel should not discourage or obstruct communication between prospective witnesses and the prosecutor. It is unprofessional conduct to advise any person other than a client, or cause such person to decline to give to the prosecutor or defense counsel for codefendants information which such person has a right to give."); ABA Model Rules of Professional Conduct, Rule 3.4(f) ("A lawyer shall not . . . request a person other than the client [or a relative or employee of the client] to refrain from voluntarily giving relevant information to another party. . . .").

[11] *See, e.g., United States v. Singleton*, 165 F.3d 1297 (10th Cir. 1999) (en banc).

[12] Report in Support of Recommendation 111, at 14. Unless otherwise indicated, all quotations from that Report are on that page.

work-product doctrine." The Report noted that, "[a]s a practical matter, corporations rarely can resist prosecutorial requests for disclosure, because of the harsh consequences of having to defend against criminal charges, and because, in cases where criminal charges are brought and sustained, corporations depend on the leniency in sentencing that results from providing assistance satisfactory to the prosecution."[13] The Task Force proposed Resolutions, subsequently adopted without dissent by the ABA House of Delegates, directed at this practice.

As acknowledged in the Thompson Memorandum, the government's job is made easier when it can obtain the results of company counsel's investigation, including statements of the organization's employees. As Resolution 111 and accompanying Report set forth, companies are entitled to the benefit of counsel without intrusion of the government into confidential communications and information gathered under the privilege and work product doctrine. Additionally, the Task Force has become concerned by evidence of government practices under cooperation policies that, in addition to intruding on the relationship between the organization and its counsel, also adversely affect the right and ability of the organization to assure that employees are given adequate protections of the client-attorney relationship. By first encouraging an organization to obtain statements of employees and then requiring or encouraging it to waive attorney-client privilege and work product protections that would ordinarily shield such statements from discovery, the government is benefited, since "[s]uch waivers permit the government to obtain statements of possible witnesses, subjects, and targets without having to negotiate individual cooperation or immunity agreements."[14] However, as discussed below, such practices are violative of the rights of employees and unfairly intrude on the rights of organizations to deal fairly with their employees.[15]

[13] *Id*. at 15.

[14] Memorandum from Larry D. Thompson, *supra* note 6, at 7.

[15] Since the Thompson Memorandum encourages the organization to disclose privileged and confidential memoranda of interviews conducted by the organization's lawyers as part of an internal investigation, the organization is oftentimes placed in the position of either waiving the confidentiality inherent in attorney-client privilege and work product protections, thereby undermining the rights of its employees, or facing punishment for not having done so. The Task Force believes this harms effective corporate governance while both undermining the role of attorneys as counselors and advocates for their clients, and damaging the relationship of trust and confidence between an organization and its employees.

Moreover, the government has taken the position that false statements by employees to the private lawyers conducting the organization's internal investigation into alleged wrongdoing can be prosecuted under 18 U.S.C. § 1512(c)(2) for impeding an "official proceeding." *See United States v. Singleton*, Criminal No. H-04-514-SS (S.D. Tex. superseding indictment of March 8, 2006). A similar theory was applied in the recent prosecutions involving Computer Associates. In that case three former executives of the company pleaded guilty to charges of federal obstruction of justice for lying to outside counsel retained by the company to investigate possible improprieties. The guilty pleas were based on the same theory, namely, that by lying to the outside law firm, the employees had sought to obstruct the government's investigation and mislead federal officials. *See* Alex Berenson, *Case Expands Type of Lies Prosecutors Will Pursue*, N.Y. Times, May 17, 2004, at C1.

Other government policies and practices relating to cooperation by organizations have come under criticism[16] and have been called to the Task Force's attention in the course of its work. Among other things, concerns have been raised that, in seeking complete cooperation from corporations that are subject to criminal prosecution or civil enforcement actions, the government has unintentionally undermined corporate compliance with the law by "giv[ing] company personnel an incentive not to speak to internal counsel, the person from whom they would normally seek advice in helping the company obey the law."[17] The Task Force has identified several government policies, procedures and practices relating to cooperation by organizations that it considers to be contrary to the public interest, not only because they are inconsistent with good corporate governance, but also because they erode individuals' fundamental rights.[18]

III. GOVERNMENT POLICY AND PRACTICES REGARDING INDEMNIFICATION OR ADVANCEMENT OF ATTORNEYS' FEES

When confronted by a government investigation, organizations routinely face the question of providing lawyers for individual directors, officers, employees and agents (collectively "Employees"). Actual or potential conflicts of interest prevent the organization's lawyers from representing all affected Employees. If the investigation focuses on actions taken by the affected Employees in the course and scope of their duties, it is not uncommon for these Employees to retain separate counsel to protect their individual interests. Often the employer will pay the legal fees for Employees up to the point where they are determined to be innocent or are found guilty of wrongdoing. These steps are taken pursuant to well established corporate governance practices. Typically, articles of incorporation or corporate by-laws authorize companies to enter into such

[16] *See, e.g.*, John S. Baker, Jr., *Reforming Corporations Through Threats of Federal Prosecution*, 89 CORNELL L. REV. 310 (2004); John Hasnas, *Ethics and the Problem of White Collar Crime*, 54 AM. U.L. REV. 579 (2005); Peter J. Henning, *Targeting Legal Advice*, 54 AM. U.L. REV. 669 (2005). For contrasting views, *see, e.g.*, Mary Beth Buchanan, *Effective Cooperation by Business Organizations and the Impact of Privilege Waivers*, 39 WAKE FOREST L. REV. 587 (2004); Barry W. Rashkover, *Reforming Corporations Through Prosecution: Perspectives From an SEC Enforcement Lawyer*, 89 CORNELL L. REV. 535 (2004).

[17] George Ellard, Essay, *Making the Silent Speak and the Informed Wary*, 42 AM. CRIM. L. REV. 985, 993 (2005) (discussing Computer Associates prosecution, in which corporate officers were charged with obstruction of justice for allegedly making false statements to corporate counsel knowing that corporate counsel would convey them to government investigators); *see also* Laurie P. Cohen, *In the Crossfire: Prosecutors' Tough New Tactics Turn Firms Against Employees*, WALL ST. J., June 4, 2004, at A1 (quoting white-collar defense attorney Stanley Arkin: "the discretionary tools by which the government has come to define cooperation diminish the sense of professional trust in the workplace and degrade the basic relationship between lawyers and employees of a firm.").

[18] *See also* "The Decline of the Attorney-Client Privilege in the Corporate Context, March 2006 Survey Results," presented to Congress and the Sentencing Commission by the coalition referred to in note 5, *supra*. This detailed survey, containing responses from over 1,200 in-house and outside corporate counsel, documents the manner in which the government has frequently pressured organizations under investigation to waive the attorney-client privilege and work product protections, and the impact these practices have had, *inter alia*, on the ability of organizations to conduct effective self-governance programs. It is available online at http://www.acca.com/Surveys/attyclient2.pdf.

agreements pursuant to authority to do so provided by state laws. This system is designed to insure that the best interests of the organization are advanced and protected, and that the rights of Employees are maintained, by providing the board of directors with standards to guide its decisions. This system has worked well and it is inappropriate for the enforcement community to interfere with the decision-making of organizations through pressures exerted under cooperation policies.

Under the Thompson Memorandum, however, in assessing the extent of an organization's cooperation with the government, prosecutors are instructed to consider whether an organization is supporting "culpable employees and agents . . . through the advancing of attorney's fees."[19] In addition, in carrying out these dictates, prosecutors on occasion encourage the organization to make these determinations at an early stage of the investigation, often before the organization has completed its own internal investigation into the matters at hand. This may cause the organization to make these determinations prematurely and without a proper factual basis, in order to be seen as fully cooperating with the government. Such decisions not only harm the organization, they deprive Employees of the support and resources they need to defend themselves, even though they have neither admitted nor been convicted of wrongdoing. This in turn damages the rights of these individuals to effective representation and undermines the relationship of trust and confidence that should exist between an organization and its Employees.

The practical impact of this language in the Thompson Memorandum can be enormous. In one current example, allegedly in response to pressure from the government, KPMG refused to pay the legal fees of thirty-two of its partners and employees unless they talked to prosecutors.[20] KPMG evidently perceived that it *had to* impose this condition to convince the government it was cooperating fully with the investigation and thereby enabling it to avoid indictment by entering into a deferred prosecution agreement with the government.[21]

The former KPMG defendants moved to dismiss their indictments, and District Judge Lewis A. Kaplan ordered limited discovery and held a hearing on whether "the Thompson memorandum, insofar as it deals with advancement of defense costs as a factor relevant to whether a prospective corporate defendant will be prosecuted, is an improper interference with [individual employee] defendants' rights to obtain counsel of their choice and to mount a defense consistent with their means."[22] Based on that record, on June 26 of this year the court issued an extensive opinion holding that the Thompson Memorandum, and the government's implementation of it in the KMPG case, violated both the Fifth and Sixth Amendments to the Constitution.[23]

The court found that KMPG would have paid the individuals' legal expenses had the government not "held the proverbial gun to its head."[24] It concluded that the Thompson Memorandum, by its reference to "the advancing of attorneys fees" as a factor to assess cooperation, violated the individuals' substantive due process rights under the Fifth Amendment to be free from government interference with their ability to defend themselves.[25] In particular, the court declared that "it simply cannot be said that the payment of legal fees for the benefit of employees and former employees necessarily or even usually is indicative of an unwillingness to cooperate fully."[26]

As to the Sixth Amendment, the court first concluded that, while the Amendment's protections typically attach at the time of indictment, the government cannot take actions pre-indictment that it intends or knows will likely have an unconstitutional effect on those rights.[27] The court then held that the Thompson Memorandum unconstitutionally interfered with the defendants' right to counsel of their choice because it "discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves."[28]

The Court also conducted a hearing on whether proffer statements made to government attorneys by certain KPMG employees were improperly coerced in violation of the privilege against self-incrimination, as a result of KPMG's insistence that the employees cooperate with the government as a condition of continued employment and payment of legal fees. The Court concluded that the government was responsible for the pressure KPMG put on the employees to waive their constitutional rights, and it suppressed certain of the statements and the fruits of those statements. After noting that companies facing allegations of wrongdoing are under intense pressure to avoid indictment, the Court stated:

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[19] Memorandum from Larry D. Thompson, *supra* note 6, at 7-8. The Thompson Memorandum does not provide any measure by which an organization is expected to determine whether an Employee is "culpable" for purposes of the government's assessment of cooperation and, in part as a consequence, an organization may feel compelled either to defer to the government investigators' initial judgment or to err on the side of caution.

[20] *See* Cohen; *supra* note 17, at A1.

[21] *Id.*

[22] *United States v. Stein*, No. S1 05 Crim. 0888 (LAK) (April 12, 2006), slip op. at 1-2.

[23] *United States v. Stein*, No. S1 05 Crim. 0888 (LAK) (June 26, 2006).

[24] *Id*., slip op. at 2.

[25] *Id.* at 48-54.

[26] *Id*. at 52.

[27] *Id*. at 56.

[28] *Id*. at 59. The court declined to dismiss the defendants' indictments based on the foregoing. Instead, it opened a new civil docket under which the defendants could sue KPMG for provision of their legal fees, *id*. at 77-78, and it noted that, if any statements they made to the government as a result of KPMG's insistence that the employees submit to government interviews as a condition of continued employment or payment of any legal fees were therefore improperly coerced, those statements could potentially be suppressed, *id*. at 67-68.

> The DOJ and other federal agencies have capitalized on this, in part by altering the manner in which suspected corporate crime has been investigated, prosecuted, and, when proven, punished. The Thompson Memorandum is a part of this change. In cases involving vulnerable companies, the pressure exerted by it and by the prosecutors who apply it inevitably sets in motion precisely what occurred here – the exertion of enormous economic power by the employer upon its employees to sacrifice their constitutional rights.[29]

For those Employees who cannot afford to hire their own defense counsel,[30] the government's policy of discouraging organizations from advancing their Employees' legal fees may have the effect of depriving these individuals of counsel altogether during the critical stages prior to indictment. Even for those Employees who can afford a lawyer, it will often be difficult if not impossible to afford a lawyer with special expertise in white-collar criminal investigations and prosecutions and to finance the extensive legal work typically demanded to receive fully informed advice or to wage an effective defense to white-collar criminal allegations. This policy thus effectively denies individuals the benefits of representation to which, in many cases, they typically would otherwise be entitled under their employment contracts, under state law, under the corporation's articles of incorporation or by-laws, or under the doctrine of implied contract.

As a matter of good corporate governance, organizations may contract with Employees or otherwise decide to make legal representation available in matters relating to the Employee's responsibilities, including in criminal investigations and prosecutions. Organizations legitimately may conclude that such agreements enable them to attract and retain highly qualified officers and Employees. Indeed, individuals employed by the organization may justifiably expect their employer to support them in connection with lawful actions they have taken on the organization's behalf, rather than abandoning them at the first suspicion of wrongdoing. As a general rule, criminal prosecutors have no legitimate interest in pressuring organizations to refuse to carry out such agreements. Further, the effect of abrogating such agreements is to impede or prevent these individuals from retaining qualified lawyers to render a competent defense in highly complex white-collar criminal investigations and prosecutions. This strikes at the core of our adversarial system of justice. It has long been recognized that our system functions best when persons with legal needs are represented by competent counsel.[31]

IV. GOVERNMENT POLICY AND PRACTICES REGARDING JOINT DEFENSE, INFORMATION SHARING AND COMMON INTEREST AGREEMENTS

The Thompson Memorandum provides that, in deciding whether to reward an organization for its cooperation with a criminal investigation, the Department will view with disfavor an organization's decision to "provide[e] information to [its] employees about the government's investigation pursuant to a joint defense agreement."[32] In practice, some government prosecutors and civil enforcement authorities have interpreted this language broadly, with the result that organizations have been discouraged from entering into agreements of this sort, which are commonly referred to as "joint defense and information-sharing agreements" or "common interest agreements" (referred to hereafter as "common interest agreements"). An organization would typically seek to enter into such an agreement with Employees and other represented parties with whom it shares a common interest in defending against the investigation. Implementing the Thompson Memorandum in this manner undermines the legitimate interests of both the organization and the Employee in access to information necessary to effective representation.

The issues raised by the implementation of the Thompson Memorandum in this manner can only be understood if the effects are discussed in a real world context. Upon learning of alleged wrongdoing by its personnel, an organization typically retains counsel to conduct an internal investigation and advise the organization how to respond. At this preliminary stage, the organization has a legitimate interest in obtaining access to all relevant information available to it. In some cases, to facilitate its own investigation, the organization may want to exchange information and act cooperatively with lawyers for individual Employees or other parties involved in the matter and with whom it has a common interest in defending against the investigation. In such cases, to maintain the confidentiality of attorney-client privileged information and work product protected materials, the lawyers and their clients may consider entering into a common interest agreement pursuant to which each party will preserve the confidentiality of information obtained from the other. Indeed, in the absence of such an agreement, the organization may not have access to such information.

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[29] *United States v. Stein*, No. S1 05 Crim. 0888 (LAK) (July 25, 2006), slip op. at 36-37. The Court went on to say:

> In this case, the pressure that was exerted on the Moving Defendants was a product of intentional government action. The government brandished a big stick – it threatened to indict KPMG. And it held out a very large carrot. It offered KPMG the hope of avoiding the fate of Arthur Andersen if KPMG could deliver to the [United States Attorney's Office] employees who would talk, notwithstanding their constitutional right to remain silent, and strip those employees of economic means of defending themselves. In two instances, that pressure resulted in statements that otherwise would not have been made…. The coerced statements and their fruits must be suppressed.
>
> It is no answer for the government to say that these aspects of the Thompson Memorandum are needed to fight corporate crime. Those responsible should be prosecuted and, if convicted, punished. But the end does not justify the means. *Id*. at 37.

[30] The costs associated with defending a government investigation involving complex corporate and financial transactions can often run into the hundreds of thousands of dollars. Therefore, if the government succeeds in pressuring a company not to pay for the Employee's legal defense, the Employee typically may be unable to afford effective legal representation.

[31] Not only does this policy interfere with the establishment of an effective attorney-client relationship, but it also runs counter to the Department of Justice's own internal regulations, which permit the Department to pay for a prosecutor's outside counsel if the prosecutor is a subject of a federal criminal investigation. 28 C.F.R. §§ 50.15(a) (7), 50.16.

[32] Memorandum from Larry D. Thompson, *supra* note 6, at 7-8.

The law has long recognized that, because the interest in access to effective representation may be promoted by the sharing of pertinent information, including privileged information, among parties to a legal matter who are allied in interest, the privilege is not waived when otherwise privileged information is shared pursuant to such an agreement: "The joint defense agreement, or common interest rule, is an extension of the attorney-client privilege which 'serves to protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel."[33] An organization may well choose to be involved in such an agreement with current and former Employees, and other represented parties, including other organizations under investigation in the same matter.

At some point in the investigation, the organization may determine -- whether or not it believes wrongdoing has occurred -- that it wishes to cooperate with the government. At that point, as a result of the implementation of the Thompson Memorandum in many cases, the organization faces impediments resulting from three different approaches by the government. First, the government may take the position that the organization has already demonstrated a lack of cooperation by previously entering into a common interest agreement with some of its Employees during the course of its internal investigation or the government's investigation. Second, the government may take the position that no meaningful cooperation can be demonstrated, if the organization continues to operate under such an agreement with those the government alleges are wrongdoers. Third, the government may require or encourage the organization to make determinations of wrongdoing prematurely, even at the outset of the organization's own internal investigation or the government's investigation.

The difficulty presented by the first approach is that it has a chilling effect on an organization pursuing what is otherwise a perfectly legitimate, even necessary, practice in pursuing an effective internal investigation. The government should not be able to measure cooperation based on the fact that an organization entered into a common interest agreement at the beginning or during the course of its internal investigation.

The difficulty presented by the second approach is that, at the time the organization determines it wants to cooperate, many legitimate reasons may still exist as to why the organization would want to maintain common interest arrangements with some, if not all, of its Employees and others. This may be because the organization, in attempting to discharge its obligations in good faith, has not yet determined the extent or significance of these parties' conduct; because the organization disagrees with the government over the nature, extent or seriousness of the allegations; or for a myriad of other legitimate reasons. A desire to cooperate does not mean that the organization is prepared to agree with the government's position in the matter in any, let alone all, respects.

[33] *United States v. Schwimmer*, 892 F.2d 237, 243 (2d. Cir. 1989); *see also In re: Grand Jury Subpoenas, 89-3 and 89-4*, 902 F.2d 244 (4th Cir. 1990); *see generally* Deborah Stavile Bartel, *Reconceptualizing the Joint Defense Doctrine*, 65 FORDHAM L. REV. 871 (1996).

The difficulty presented by the third approach is that the Thompson Memorandum has at times been implemented in a manner that encourages organizations to make a determination of wrongdoing by Employees far in advance of the matter being adjudicated, sometimes at the outset of the organization's internal investigation into what happened and who did it. As a result, the organization may feel compelled to make a premature determination as to the "culpability"[34] of its Employees, so as not to displease government attorneys by appearing to be uncooperative. This in turn may lead the organization to decline to enter into common interest agreements with affected Employees, and to cut off the affected Employees from access to the organization's records and other historical information concerning the matter under investigation, as well as to deprive these Employees of financial support and a capable legal defense. These decisions are often made at a time when the Employees have neither been accused nor convicted of any wrongdoing. Such practices inhibit the organization's ability to conduct a thorough internal investigation and do serious damage to the relationship of trust and confidence that must exist between an organization and its Employees.[35]

Culpability can only be determined with certainty once an admission is made or a verdict is returned. It is the prerogative of the organization to reach the proper balance in providing fairness to its Employees while also evaluating their conduct in a timely fashion. The organization's thorough investigation of the facts may lead to a determination as to whether the Employees and others have acted in a manner that would prevent the organization from having a common interest with them. The organization's determination of culpability should not be done prematurely or in haste, or for reasons other than those based on an evaluation of the conduct of the individual in question. Indeed, the Constitution and statutory law impose heavy procedural and substantive burdens on the government if it seeks to prove culpability, including in criminal cases the need to overcome the presumption of innocence by proof beyond a reasonable doubt.

Since the Thompson Memorandum also empowers federal prosecutors to grant to or withhold benefits from the organization seeking cooperation credit as a result of these critical determinations, the organization is placed in an unenviable position. Given the potentially severe consequences to the "uncooperative" organization and the potential harm to individuals prematurely designated "culpable," the final decision in this regard must reside with the organization. It is inappropriate for the government to pressure the

[34] As that term is used in the Thompson Memorandum, *supra* note 6, at 7-8.

[35] The Thompson Memorandum does not provide guidance by which the organization is expected to determine if an employee is "culpable" for purposes of the government's cooperation guidelines. Nor does the Thompson Memorandum define what constitutes "support." As a consequence, an organization may feel compelled either to defer to government investigators' initial judgments or to err on the side of caution by broadly designating involved employees as culpable. The organization may thus make a premature decision to regard an employee as "culpable" when it might have reached a different conclusion after a thorough internal investigation. Besides depriving otherwise eligible Employees of legal representation and pertinent information, this response to the Thompson Memorandum may have the unintended consequence of impeding the organization's internal investigation by requiring the organization to adopt an unnecessarily adversarial relationship with certain of its Employees who may or may not have engaged in misconduct.

timing or merits of such a critical decision.[36] The Task Force believes that the sole judge of when to terminate a common interest agreement should be the organization itself. That decision should be made by the organization on the basis of what the organization, in its sole discretion, determines to be lawful, appropriate and consistent with good corporate governance.

On the other hand, the government will undoubtedly insist that an organization seeking leniency for cooperation assist the government in its investigation and prosecution, not thwart or impede it. Under these circumstances, the government may look unfavorably on the organization's continued sharing of information concerning the government's investigation with other parties whose interests in defending against the investigations are inconsistent with those of the organization[37] Under these limited circumstances, the government should be entitled to consider as a factor in determining the extent of an organization's cooperation its continued participation in a common interest agreement with parties the organization no longer believes share a common interest in defending against the investigation.

When an organization that is seeking credit for cooperation reaches the conclusion that it no longer has a common interest in defending against the investigation with a fellow member of a common interest agreement, it may well withdraw from that agreement. Prior to reaching such a conclusion, however, counsel for the organization, Employees and other represented parties must be able to effectively represent their respective clients by having the ability to share information and strategy liberally and without prejudicing a determination by the government as to whether the organization is deemed cooperative under applicable policies. Common interest agreements are not invariably against public policy – on the contrary, the evidence law reflects just the opposite – and therefore the government has no legitimate interest in categorically discouraging organizations from participating in them.[38]

V. GOVERNMENT POLICY AND PRACTICES REGARDING THE SHARING OF INFORMATION WITH PARTIES OUTSIDE THE CONTEXT OF COMMON INTEREST AND INFORMATION SHARING AGREEMENTS

Wholly apart from whether an organization shared information with others pursuant to a common interest agreement, some federal prosecutors implementing the Thompson Memorandum have taken the position that, in order to receive credit for cooperation, an organization should not provide any information – even the organization's own records relating to the purported wrongdoing and other historical information – to counsel for current or former Employees who are possible subjects or targets of the criminal or enforcement investigation, or who are under indictment. However, a categorical restriction on the sharing of information interferes with the individual's ability to gather the facts necessary for an attorney to prepare an adequate defense and may adversely impact the organization's ability to conduct a thorough internal investigation.[39]

For the government to influence organizations to adopt such a restriction is contrary to the public interest because, as noted, effective representation is essential to the just resolution of disputes in criminal cases no less than in civil cases. Indeed, the ABA is on record as being against lawyers' interference with witnesses' providing information to the opposing party's counsel. Rule 3.4(g) of the ABA Model Rules of Professional Conduct makes it improper for a lawyer to "request a person other than the client [or a relative or employee of the client] to refrain from voluntarily giving relevant information to another party."[40] In criminal cases in particular, courts have sometimes found it to be improper for the prosecution to pressure witnesses not to give information to defendants and their counsel.[41]

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[36] The U.S. Securities and Exchange Commission has seemingly taken a similar approach. In 2004, for instance, the Commission added a $25 million penalty to its settlement with Lucent Technologies for failing to "cooperate" with the Commission's investigation of its accounting measures. Phyllis Diamond, *SEC Demand for 'Cooperation' Seen Raising Due Process Concerns*, 36 SEC REGULATION & LAW REPORT 1070 (No. 24; June 14, 2004), *available at* http://corplawcenter.bna.com/pic2/clb.nsf/id/BNAP-5ZUQH2. One component of Lucent's failure to cooperate included the company's decision to expand "the scope of employees that could be indemnified against the consequences of the enforcement action after an agreement in principle had been reached with the SEC staff." *Id.* At the time, Paul Berger, the Associate Director of the Commission's Enforcement Division, stated that "'[a]nyone who settles with us is going to agree not to be indemnified.' He also said the Commission 'may well ask [a company] not to indemnify an individual' employee who has incurred costs and penalties." *Id.* The SEC has no apparent statutory authority to impose penalties for non-cooperation with its investigations. The Staff of the SEC has taken a similar view toward indemnification of attorneys' fees.

[37] By way of example, after an organization seeking leniency has concluded that certain Employees acted unlawfully in connection with the matter under investigation, the government may properly conclude that it is inconsistent with the organization's pledge of cooperation with the government for the organization to provide those Employees with information concerning the government's investigation. This information might include insights into the way in which the government's investigation is being conducted, information about individuals targeted for prosecution and disclosure of the organization's internal work product from its own investigation. Presumably, as it sought lenient treatment through cooperation, the organization itself would have concluded that, under those circumstances, it no longer had a common interest with those Employees in the context of the government's investigation and thus would have terminated or withdrawn from such a common interest agreement with those employees.

[38] To be sure, the government in criminal or civil enforcement proceedings may measure the value of an organization's cooperation as it measures that of individuals, by the amount of information provided to the government and the usefulness of the information. But the fact of having entered into a joint defense agreement should not in itself be viewed as a factor diminishing the value or sincerity of the organization's assistance.

[39] Insofar as it impedes reciprocal exchanges of information between the organization and certain of its Employees, this policy also undermines the organization's ability thoroughly to investigate matters of concern to both the organization and the government. *See* note 13, *supra*.

[40] *See also* note 10, *supra*.

[41] *See, e.g.*, *United States v. Morrison*, 535 F.2d 223 (3d Cir. 1976); *United States v. Leung*, 351 F. Supp. 2d 992 (C.D. Ca. 2005); *see also United States v. Narciso*, 446 F. Supp. 252, 316 (E.D. Mich. 1977) (concluding that letter implying that prospective witnesses should not speak with defense counsel and explicitly requesting that witnesses contact the government attorneys before consenting to any such interview was "improper and ill-advised"; and observing: "Witnesses do not belong to any party to a lawsuit and this is

While an organization may decide for its own purposes to deny information to parties adverse to the government, it should not be pressured by the government to do so. Therefore, the organization should not be deemed "uncooperative" by government attorneys if it provides its own pertinent records and other historical information relating to the matter under investigation to Employees and other represented parties who are attempting to defend themselves. Unlike material that may be shared under a common interest agreement, some of which may be protected by privilege or the work product doctrine, or which may involve information about the government's ongoing investigation, an organization's records created at or about the time of the suspected wrongdoing and its other historical information relating to the matter under investigation are evidentiary in nature. With some limitations, such records are ordinarily subject to subpoena and will undoubtedly be sought by prosecutors, investigators and other enforcement authorities. Providing such materials to Employees and other represented parties, even those suspected or accused of wrongdoing, simply enables these parties and their attorneys to prepare an adequate defense.

The decision about whether or not to provide such records and historical information to Employees and other represented parties should be made by the organization based upon the best interests of the organization and that of the individuals in question.[42] Government attorneys and investigators should not require or encourage organizations to withhold such material, nor should they grant or deny benefits to organizations based on the sharing of such materials. Whatever interest the government may claim in preventing the organization from sharing such information is outweighed by the need to allow organizations to exercise their prerogatives in evaluating Employee conduct while ensuring that represented parties receive adequate representation and have access to relevant evidence.

VI. GOVERNMENT POLICY AND PRACTICES REGARDING TERMINATION OR SANCTIONING OF OFFICERS AND EMPLOYEES FOR ASSERTING CONSTITUTIONAL RIGHTS

In assessing the extent of an organization's cooperation with the government, the Thompson Memorandum encourages prosecutors to consider whether an organization is supporting "culpable employees and agents . . . through retaining the employees without sanction for their misconduct."[43] In implementing this provision, prosecutors and civil enforcement authorities have sometimes made it known that, as a condition of complete cooperation, an organization will be expected to discharge Employees who assert their right against self-incrimination when requested to provide interviews or other information by the government's criminal or civil enforcement investigators.[44]

The organization is, of course, free to take whatever personnel actions it deems appropriate, lawful and consistent with good corporate governance. Nonetheless, the Task Force believes that government prosecutors and enforcement authorities should not require or encourage organizations to threaten their Employees with loss of employment or with other sanctions, in order to pressure them to waive their Fifth Amendment right to remain silent in response to government questioning. This practice may in some circumstances be viewed as coercive and may lead Employees to provide statements to government attorneys and investigators against their will. This practice can also result in the organization's Employees being unfairly deprived of their Constitutional rights to decline to be interviewed by government investigators and to seek the assistance of counsel before speaking with the government. As such, this practice undermines our adversary system of justice. The government could not properly discharge its own public employees merely for asserting a constitutionally protected right not to testify.[45]

Policies setting standards for evaluating cooperation in the context of government investigations should not require or encourage organizations to conclude that Employees who assert the right against self-incrimination when questioned by the government are per se uncooperative or have culpability for malfeasance. As noted, this may cause an organization to make a premature assessment of wrongdoing by individual Employees.[46] Because an organization's cooperation often begins before anyone has been tried or even charged, and sometimes even before all the facts are known, the manner in which the Thompson Memorandum has at times been implemented conflicts with the most basic American legal principle that defendants (and potential defendants) are innocent until proven guilty. The mere assertion of the privilege in response to a government inquiry should not be taken by the government as evidence of non-cooperation, much less proof of guilt.[47] Nor should government lawyers be permitted to consider as a factor indicating lack

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particularly so in a criminal case where a defendant is forced to compete with the vast resources of federal investigatory agencies and must necessarily overcome a natural reluctance of a witness to speak to the defense after an indictment has issued charging a criminal offense.").

[42] An organization should be free to make whatever decision it deems appropriate, lawful and consistent with good corporate governance, free from government pressure. Some organizations may well decide that such materials will not be shared with parties determined by the organization to have engaged in wrongful conduct. As in the case of participation in common interest agreements discussed in the Section IV of this Report, the timing and substance of this determination are up to the organization.

[43] Memorandum from Larry D. Thompson, *supra* note 6, at 7-8.

[44] As previously noted *supra* at page 7, the Task Force believes it is both unfair and inconsistent with the rights of Employees for Department of Justice prosecutors to require or encourage an organization, often at the outset of an investigation, to make a determination as to which of its Employees are "culpable" before all of the facts are known to the organization. It is likewise inappropriate for the government to encourage an organization to make a premature determination as to what actions constitute "misconduct."

[45] *See Gardner v. Broderick*, 392 U.S. 273 (1968) (finding that state may not discharge its employee solely for refusing to waive constitutional right against self-incrimination); *see also Garrity v. New Jersey*, 385 U.S. 493 (1967). *See* note 31, *supra*, regarding Department of Justice policy permitting payment of legal fees for outside counsel for prosecutors accused of criminal conduct.

[46] Of course, an organization will often have a legitimate interest in disciplining or discharging Employees based on its independent conclusion that they have engaged in wrongdoing or, for that matter, based on their unwillingness to cooperate with the organization's own investigation of alleged wrongdoing.

[47] Moreover, as the Supreme Court has recognized, individuals assert the right against self-incrimination for many reasons other than because they are in fact guilty of a crime. *Griffin v. California*, 380 U.S. 609, 613

of cooperation the fact that an organization chose not to impose sanctions on Employees who asserted their Constitutional rights in response to government requests for information.

VII. CONCLUSION

The government is entitled to conduct thorough investigations of possible wrongdoing and to grant leniency to those organizations that provide genuine cooperation. However, the government's investigative and prosecutorial interests must be balanced against the public interest in ensuring that organizations have the ability to conduct thorough internal investigations of possible wrongdoing, and that individuals receive effective representation and are able to assert their Constitutional rights without fear of punishment.

In the context of responding to government inquiries into possible wrongdoing on the part of its personnel, it is legitimate and in the public interest for an organization seeking leniency as a result of its cooperation with the government's investigation to choose to do any or all of the following: (1) provide counsel to an Employee or agree to pay an Employee's legal fees and expenses; (2) enter into or continue to operate under a joint defense, information sharing and common interest agreement with an Employee or other represented party with whom the organization believes it has a common interest in defending against the investigation; (3) share its records or other historical information relating to the matter under investigation with an Employee; or (4) choose to retain or otherwise decline to sanction an Employee who exercised his or her Fifth Amendment right against self-incrimination in response to a government request for an interview, testimony, or other information. Policies and practices of prosecutorial and civil enforcement agencies that discourage organizations from taking these steps erode individuals' constitutional and other legal rights, undermine the role of lawyers in our adversary system of justice, damage relations between individual Employees and their organizations, and impede the ability of organizations to conduct thorough investigations of suspected wrongdoing.

Respectfully submitted,

R. William Ide, III, Chair

ABA Task Force on Attorney-Client Privilege

August 2006

(1965). Oftentimes, defense counsel advise some clients whom they believe to be innocent to do so, recognizing that their testimony may be used against them, even unfairly, to draw unwarranted inferences.

AMERICAN BAR ASSOCIATION

TASK FORCE ON ATTORNEY-CLIENT PRIVILEGE
TENNESSEE BAR ASSOCIATION
SECTION OF STATE AND LOCAL GOVERNMENT LAW
BAR ASSOCIATION OF SAN FRANCISCO
SECTION OF BUSINESS LAW
TORT TRIAL AND INSURANCE PRACTICE SECTION
GENERAL PRACTICE, SOLO AND SMALL FIRM DIVISION
SECTION OF HEALTH LAW
SECTION OF LITIGATION
SECTION OF TAXATION
NEW YORK STATE BAR ASSOCIATION
SECTION OF LABOR AND EMPLOYMENT LAW
SECTION OF INDIVIDUAL RIGHTS AND RESPONSIBILITIES
YOUNG LAWYER FORUM DIVISION

REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED that the American Bar Association supports the preservation of the attorney-client privilege and work product doctrine in connection with audits of company financial statements.

FURTHER RESOLVED that the American Bar Association urges the Securities and Exchange Commission, the Public Company Accounting Oversight Board, the American Institute of Certified Public Accountants, the legal and accounting professions, and other relevant organizations to adopt standards, policies, practices and procedures and take other appropriate steps to ensure that attorney-client privilege and work product protections are preserved throughout the audit process.

REPORT

I. BACKGROUND OF THE TASK FORCE

The American Bar Association established its Task Force on the Attorney-Client Privilege in September 2004, to evaluate issues and recommend policy related to the attorney-client privilege and work-product doctrine.[1] The Task Force has been examining current developments regarding the privilege and work-product doctrine, the circumstances in which governmental agencies and others are asserting the need for privileged and work product protected information, and the extent to which preserving the privilege and work product protections or disclosing privileged information or attorneys' litigation work product in such circumstances harms the public interest. By examining and reporting on these and related issues, the Task Force hopes to inform the public and the legal profession of the importance of the privilege and work-product doctrine, relate each of these principles to the competing demands for access to protected information, and assist the ABA in developing policies that strike the right balance given these competing demands.

The Task Force began its work by identifying a variety of contemporary contexts in which attorney-client confidentiality has come under serious pressure, in light of changes in the law and changes in institutional practices by government agencies and others. The Task Force recognized that initially it would focus on the areas that seem to be producing the greatest tensions on the privilege and work-product doctrine. In light of its charge and its determination regarding the most pressing issues, the Task Force gave notice to the professional community that it would begin by focusing its attention on two substantial practices: (1) requests by prosecutors and government regulators for the production of material protected by the attorney-client privilege and work-product doctrine, and (2) requests by auditors of public companies for the production of material protected by the attorney-client privilege and work-product doctrine.

As part of its ongoing charge, the Task Force has reviewed scholarly articles and applicable law, conducted meetings, held public hearings, and received oral and written testimony from interested persons. These meetings and hearings have produced varied views and considerable information, some of which is noted in this Report and all of which is posted on the Task Force's website, which is located at http://www.abanet.org/buslaw/attorneyclient.[2]

1 Information about the Task Force and relevant materials assembled by it can be found on the Task Force's website: http://www.abanet.org/buslaw/attorneyclient/home.shtml.

2 The following is a list of the individuals and groups providing written or oral testimony to the Task Force on February 11, 2005: The American College of Trial Lawyers; David M. Brodsky, Corporate Counsel Consortium; Kenneth W. Gideon, ABA Section of Taxation; Steven K. Hazen, State Bar of California, Business Law Section, Corporations Committee; James W. Conrad, Jr., American Chemistry Council; Paul Rosenzweig, The Heritage Foundation; John Gamino, TXU Corporation; Ursula Weingold, University of St. Thomas School of Law (Minnesota); Brad Brian, ABA Section of Litigation; United States Chamber of Commerce; The Law Society of Upper Canada; Steven R. Schell, Black Helterling LLP; Paul Rice, American University Washington College of Law; ABA Section of State and Local Government Law; Randolph Braccialarghe, NSU Law Center; and State Bar of California, Standing Committee on Professional Responsibility & Conduct. The following is a list of the individuals and groups providing written or oral testimony to the Task Force on April 21, 2005: Stephen A. Saltzburg, The George Washington School of Law; Susan Hackett, Association of Corporate Counsel; John Beccia III, The Financial Services Roundtable; Jonathan Bach, New York Council of Defense

(footnote continued on following page)

After gathering and analyzing this information, the Task Force submitted a proposed resolution last year to the ABA House of Delegates, known as "Recommendation 111," which expresses support for the privilege and work product doctrine and opposition to governmental policies that erode these protections. The resolution, which the ABA House of Delegates approved unanimously in August 2005, states as follows:

> RESOLVED, that the American Bar Association strongly supports the preservation of the attorney-client privilege and work-product doctrine as essential to maintaining the confidential relationship between client and attorney required to encourage clients to discuss their legal matters fully and candidly with their counsel so as to (1) promote compliance with law through effective counseling, (2) ensure effective advocacy for the client, (3) ensure access to justice and (4) promote the proper and efficient functioning of the American adversary system of justice; and
>
> FURTHER RESOLVED, that the American Bar Association opposes policies, practices and procedures of governmental bodies that have the effect of eroding the attorney-client privilege and work product doctrine and favors policies, practices and procedures that recognize the value of those protections.
>
> FURTHER RESOLVED, that the American Bar Association opposes the routine practice by government officials of seeking to obtain a waiver of the attorney-client privilege or work product doctrine through the grant or denial of any benefit or advantage.

In addition to Recommendation 111, the Task Force also provided the ABA House of Delegates with a detailed Report discussing and analyzing the importance of the attorney-client privilege and the work product doctrine, as well as the various ways in which these protections have been eroded in recent years.[3] In the Report, the Task Force detailed the reasons behind the Recommendation. Among other things, the Report demonstrated the overriding public benefit resulting from preservation of client confidentiality, including in the organizational context, and the way such benefit is attained through faithful application of the attorney-client privilege and the attorney work-product doctrine. The key benefits of these protections identified in the Report can be summarized as follows:

- the protections foster the attorney-client relationship
- the protections encourage client candor

(footnote continued from preceding page)

Lawyers; Elizabeth J. Cabraser, Lieff, Cabraser, Heimann & Bernstein; Gerald B. Lefcourt, National Association of Criminal Defense Lawyers; Martin S. Kaufman, Atlantic Legal Foundation; W. Wayne Withers, Emerson; State Bar of California, Business Law Section, Corporations Committee; Federation of Defense & Corporate Counsel; and Section of International Law, Ad Hoc Task Force on Money Laundering and Professional Responsibilities.

3 Recommendation 111 and the related Report are available on the Task Force's website at http://www.abanet.org/buslaw/attorneyclient/. The Recommendation, but not the Report, constitutes official ABA policy.

- the protections foster voluntary legal compliance
- the protections promote efficiency in the legal system
- the protections enhance the constitutional right to effective assistance of counsel

While those benefits focus on the role of the attorney, the direct beneficiary is the client. Furthermore, the failure to achieve those benefits has an adverse impact on society in general and the administration of justice in particular.

Recommendation 111 is consistent with a narrower policy adopted by the ABA House of Delegates in August 2004 opposing recent amendments to the Federal Sentencing Guidelines that encourage prosecutors to pressure companies to waive their attorney-client privilege and work product protections during investigations.[4]

Since August 2005, the Task Force has continued its efforts. For example, in an effort to help implement the ABA's August 2005 recommendations, the Task Force prepared a memorandum (the "Revised Memorandum") earlier this year suggesting specific changes to the Justice Department's privilege waiver policy as stated in its 1999 "Holder Memorandum," 2003 "Thompson Memorandum," and 2005 "McCallum Memorandum." The Task Force's "Revised Memorandum" recommends that the Department's policies be modified to (1) prohibit federal prosecutors from demanding, requesting, or encouraging, directly or indirectly, that companies waive their attorney-client privilege or work product protections during investigations, (2) specify the types of factual, non-privileged information that prosecutors may request from companies during investigations as a sign of cooperation, and (3) clarify that any voluntary decision by a company to waive the attorney-client privilege and the work product doctrine shall not be considered when assessing whether the entity provided effective cooperation. Subsequently, on May 2, 2006, ABA President Michael Greco sent a letter to Attorney General Alberto Gonzales urging the Department to revise its waiver policies in accordance with the principles outlined in the Task Force's Revised Memorandum.

The Task Force expects to continue its work to develop specific measures in furtherance of the resolutions adopted by the ABA House of Delegates in August 2005. Discussions are underway with representatives of various regulators, which will help guide the Task Force in determining potential solutions to the issues. It has been very gratifying to see lawyers from corporations, the private sector and government all working together in a constructive manner on these critical issues for our justice system.

4 In August 2004, the ABA adopted Recommendation 303, supporting five specific changes to the then-proposed amendments to the Federal Sentencing Guidelines for Organizations, including amending the Commentary to Section 8C2.5 to state affirmatively that waiver of attorney-client and work product protections "should not be a factor in determining whether a sentencing reduction is warranted for cooperation with the government." Recommendation 303 and the related Report are available at http://www.abanet.org/poladv/report303.pdf. The Recommendation, but not the Report, constitutes official ABA policy. After receiving extensive written comments and testimony from the ABA, other organizations, and numerous former senior Justice Department officials, the Sentencing Commission voted unanimously on April 5, 2006, to reverse the 2004 privilege waiver amendment to the Sentencing Guidelines. Unless Congress acts to modify or reverse the change, it will become effective on November 1, 2006.

II. NEED FOR ABA POLICY ON THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE IN THE AUDIT CONTEXT

The policy adopted by the ABA in August 2005 that is contained in Recommendation 111 focused mainly on the need to preserve attorney-client privilege and work product protections in the context of federal law enforcement and prosecution, with special emphasis on the practice of certain federal agencies requiring companies to waive these protections during investigations. The policy did not directly address the status of the attorney-client privilege in the audit area. In fact, Section VIII of the Report accompanying Recommendation 111 specifically stated that the Task Force had not yet gathered sufficient information to make recommendations to the House of Delegates in the audit area and would seek to do so in the future. For these reasons, the Task Force believes it is both appropriate and necessary for the ABA to adopt a new resolution that directly addresses erosion of the privilege and the work product doctrine in the context of audits of financial statements. Unless the ABA adopts such a policy, it will be unable to effectively pursue its dialogue and advocacy efforts with federal regulators and the accounting profession.

The current proposed Recommendation and Report were prepared by the Task Force to address issues surrounding the tension between preservation of the fundamental protections of the attorney-client privilege and work product doctrine and the need for reliable financial reporting and effective audits.[5] The goal of the ABA should be to balance and reconcile these important competing public policies with a view to maintaining these fundamental protections while enabling effective audits of company financial statements. We believe this can be accomplished by defining auditing standards that identify information auditors need to obtain and retain for purposes of the audit in a manner that is entirely consistent with preserving these protections.

The importance of preserving attorney-client privilege and work product protections in the organizational context, as fundamental to our democratic values and system of justice, has been historically recognized in the accounting literature as part of generally accepted auditing standards. The ABA remains staunchly committed to preserving these fundamental values because they help protect the confidentiality of the attorney-client relationship and the essential candor of communications between client and counsel that are dependent on confidentiality. It is this confidentiality and the resulting candor of communications that permit lawyers to play a crucial role in encouraging legal compliance. The Task Force also is sensitive to the need for auditors to receive the information they reasonably need to conduct an effective audit and provide the reliable and transparent financial reporting upon which the credibility of our financial markets is based. This Report seeks to identify ways in which both goals might be achieved. It does so by identifying the information that we believe may properly be required in connection with an audit without undermining attorney-client and work product protections. It also addresses issues surrounding the extent to which information provided as part of the audit might be protected from further disclosure should that be considered a desirable outcome.

5 Not all members of the Task Force endorse every view expressed in this Report, but the Report taken as a whole reflects a consensus of the members of the Task Force. The views expressed in this Report have not been approved by the House of Delegates or Board of Governors of the American Bar Association and, accordingly, should not be considered as representing the policy of the American Bar Association.

In furtherance of the foregoing objectives, the Task Force believes that it is advantageous for the ABA to adopt current policy that expresses its support for the preservation of the attorney-client privilege and work product doctrine in the audit context and encourages relevant regulatory and industry groups to take steps to ensure that these protections are preserved throughout the audit process. Accordingly, it is submitting the Recommendation and providing this Report to amplify the reasons for the Recommendation and actions the Task Force could take to implement it in cooperation with regulatory authorities and industry groups.

III. EXISTING ABA POLICY ON AUDIT DISCLOSURES

During the period 1975-76, the ABA and the American Institute of Certified Public Accountants ("AICPA") adopted a policy endorsing a "Statement of Policy" regarding the appropriate scope of the lawyer's response to the auditor's request for certain privileged materials during the course of audits, including requests for disclosure of "contingent liabilities" that would violate the attorney-client privilege.[6] This policy, which is commonly referred to as the "Treaty," strikes a delicate balance between preserving the benefits arising from attorney-client and work product protections and other potentially competing policy considerations. Preserving this balance has been a hallmark of the interaction between the legal and accounting professions for over 30 years, and rationale for the Treaty remain valid today.

The Preamble to the Treaty explains these important policy considerations in pertinent part as follows:

> The public interest in protecting the confidentiality of lawyer-client communications is fundamental. The American legal, political and economic systems depend heavily upon voluntary compliance with the law and upon ready access to a respected body of professionals able to interpret and advise on the law. The expanding complexity of our laws and governmental regulations increases the need for prompt, specific and unhampered lawyer-client communication. The benefits of such communication and early consultation underlie the strict statutory and ethical obligations of the lawyer to preserve the confidences and secrets of the client, as well as the long-recognized testimonial privilege for lawyer-client communication.
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> * * * * *
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> It is also recognized that our legal, political and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and encouraging its readiness to seek advice of counsel and to act in accordance with counsel's advice.[7]

IV. AUDITING PRACTICES AFFECTING THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE

The collapse of Enron in late 2001 and the disclosure of other corporate and financial irregularities in early 2002 led to enactment of the Sarbanes-Oxley Act of 2002 ("SOX"). Shortly thereafter, the government caused an indictment to be filed against Arthur Andersen, a prominent accounting firm, in connection with the Enron matter and that firm ultimately ceased providing professional services. SOX created the PCAOB and charged it with authority, among other things, to inspect the performance of auditors and issue reports on those inspections. At the same time, civil liability claims against auditing firms and resulting settlements and judgments have continued to escalate. The combination of these factors has had a direct impact on the relationship between corporations and their auditors and, in turn, on the attorney-client relationship and related protections in a number of ways regularly identified by corporations and their internal and external counsel, including the following:

- auditor requests for a much broader range of documents in the possession of the audited company, often in the view of the client with limited relevance of the requested documents to the audit;
- auditor requests for documents covered by the protections notwithstanding other possible sources of the relevant information or other potential ways of satisfying audit needs;
- departures from the Treaty and an increase in non-standard requests;
- expansive treatment of documents in the files of an audited company as being "audit documentation"/"work papers" even though it is not clear that they actually document the audit process; and
- efforts to review protected materials not necessary for the audit of the financial statements in order to provide the internal controls certification required under SOX Section 404.

6 American Bar Association "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests," approved by the ABA Board of Governors in December, 1975, confirmed by the Board of Directors of the American Institute of Certified Public Accountants ("AICPA") in January, 1976, ratified by the ABA House of Delegates in August 1976, and incorporated by the AICPA in March 1977 into its "Standards of Fieldwork" as Exhibit II of AU Section 337 ("Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments") simultaneously with issuance of AU Section 9337 (Interpretations of Section 337). These standards and related interpretations have been adopted as interim auditing standards for public companies by the PCAOB in Rule 3200T. As noted below, there has been only one modification of these interpretations as it relates to tax opinions, and then the modification was carefully limited. A copy of the ABA/AICPA policy adopted in 1975-76 is available on the ABA Task Force's website at http://www.abanet.org/buslaw/attorneyclient/policies/aicpa.pdf.

7 Preamble to ABA "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests".

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Auditors have sometimes pointed to the regulatory requirements of the PCAOB and the SEC as justification for these actions; in the view of many knowledgeable observers, this claimed justification is unwarranted.

V. EXAMPLES OF POTENTIAL IMPLEMENTATION ACTIONS

The Task Force believes that adoption of the Recommendation as official policy of the ABA will facilitate efforts of the Task Force to initiate dialogues with appropriate regulatory authorities, including the SEC, the PCAOB and the AICPA, as well as with representatives of the accounting profession with a goal of resolving the issues associated with preservation of the protections in the audit context.

In the Task Force's view, these regulatory authorities could substantially alleviate those issues by making clear what information auditors need, and more importantly do not need, for the proper conduct of the audit. This clarification would reaffirm the importance of the fundamental policy of preserving attorney-client privilege and work product protections as a priority and outline carefully the information that can properly be sought and still be consistent with preservation of these protections. The clarification could consist of both general principles, such as reaffirmation of the primacy of the protections, and specific guidance. We identify several areas in this Section of the Report to illustrate how this might work, beginning with one that auditing standards have already addressed and can serve as a model if properly applied. These are provided solely as examples and not as positions adopted by the Task Force, much less recommended for adoption as specific policies of the ABA.[8]

The Task Force begins with the position, supported by several existing ABA policies, that preservation of the protections is vitally important. Thus, the circumstances for permitting information to be obtained that might implicate the attorney-client privilege or work product protections should be strictly limited to those where it is clearly necessary for purposes of the audit and not those where it merely would be convenient or would provide additional confirmation or comfort. In general terms, those circumstances should be limited to factual information that is not available from other sources or, solely when relied on by the client to justify its financial reporting position, applicable legal advice and opinions.

A. Tax Advice and Opinions

AICPA Standard of Field Work AU Section 9326.22 specifies that "*[i]f* the client's support for the tax accrual of matters affecting it, including tax contingencies, is based upon an opinion issued by an outside advisor with respect to a potentially material matter, the auditor *should* obtain access to the opinion, notwithstanding potential concerns regarding attorney-client or other forms of privilege."[9] In contrast to this measured approach, some accounting firms are reported to take the position that *all advice or opinions* received by the entity from outside tax advisors regarding the entity's tax accounts or matters affecting such accounts or the related financial statements disclosures should be reviewed and retained. As a result, in the view of many, these accounting firms are requesting protected information unnecessarily. At least one accounting firm justifies its position on the grounds that use of the word "should" in the quoted text "is to be interpreted consistently with its use in [PCAOB] Rule 3101," and that "it is mandatory that we obtain copies of opinions or advice provided by our client's outside tax advisors." Another firm justifies the position as required by AU Section 339 dealing with audit documentation.

In our judgment, that position is not supported by AU Section 9326.22 because it ignores its predicate condition that, before the opinion should be sought, the company must base its support for its tax position upon the opinion of counsel. It is only when the company seeks to justify its tax position on counsel's opinion that the standard calls for the auditor to have access to the opinion. Furthermore, the conclusion reached from use of the word "should" is not necessarily supported by Rule 3101, which actually provides that use of the word "should" means that the auditor must follow the procedure "*unless* the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objective of the standard."[10] Indeed, AU Section 9326.22 specifically provides that the "audit documentation" retained by the auditor "should include *either* the actual advice or opinions rendered by an outside advisor, *or other sufficient documentation or abstracts supporting both the transaction or facts addressed, as well as the analysis and conclusions reached by the client and advisor.*"[11] The interpretation goes on to state that "it may be possible to accept a client's analysis summarizing an outside adviser's opinion, but the client's analysis must provide sufficient competent evidential matter for the auditor to formulate his or her conclusion."[12] The term "evidential matter" refers to "underlying accounting data and all corroborating information available to the auditor."[13] The justification based on audit documentation is discussed further below in Section E.

Thus, in the area of tax advice and opinions of counsel, auditor's requests should be limited to those circumstances in which the opinion or advice is asserted by the company as the basis for its tax position. In most circumstances, however, we believe it will be possible for the company to produce materials satisfying audit requirements that disclose the factual and legal bases for the tax position taken by the company without the need for inquiry by the auditor into the advice or opinion of counsel.[14]

8 If adopted, only the Recommendation supported by this Report, not the Report itself and thus not the examples provided, will constitute official ABA policy.

9 Emphasis added. AU Section 9326 provides interpretations (in Q&A format) of AICPA AU 326. *See* note 18 and related text.

10 Rule 3101(A)(2).

11 Emphasis added.

12 *Id.*

13 AU Section 326.15.

14 Tax advice and tax opinions inherently involve legal analysis and determinations intended to be covered by the protections. These protections are essential to permit taxpayers to receive effective tax advice and to have the benefits of an adversarial system in controversies with the government. Moreover, tax matters are uniquely within the expertise of accounting firms, thus reducing their need to obtain protected analyses of counsel.

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B. Litigation Reserves

Litigation reserves represent the client's quantification for financial reporting purposes of its loss contingencies. The quantification may be based upon a number of factors, one of which may be advice or assessments from counsel. Loss contingencies are the subject matter of the Treaty, which addresses the information counsel is to provide to the auditor in a manner that does not impair the attorney-client privilege and work product protections. This carefully constructed framework should not be undermined by the auditor's seeking from the client protected information that, in conformity with the Treaty, is *not* to be obtained from counsel.

An exception to this principle could be made, similar to the tax opinion situation, if the client seeks to support its litigation reserve by reference to the opinion or assessment of counsel. That situation is not inconsistent with preserving the protections because, as has been recognized in other contexts, the client cannot both assert reliance on the advice of counsel and seek to protect that advice from disclosure.

It is important that all parties involved in the audit process recognize that factual information relevant to determining the proper amount of the reserve is not the subject of the protections and therefore should not be withheld by the company from its auditor, even if the factual information was compiled by counsel.

Furthermore, an auditor in appropriate circumstances may, if necessary, seek confirmation from the client that the client's position on the litigation reserve is not inconsistent with the advice of its counsel.

Under these procedures, we believe that auditors can effectively audit client litigation reserves without encroaching on the protections.

C. Environmental Contingencies/Conditional Asset Retirement

Environmental contingencies, including those involving the future obligation to retire assets covered by FAS No. 143 and Interpretation No. 47, may involve considerations similar to those with respect to tax matters. Questions relating to the proper accounting for environmental contingencies can involve legal determinations, such as whether environmental laws require remediation or taking an asset out of service and the expected timing of such actions.

Consistent with the treatment of tax opinions, counsel's assessment of these matters would properly be sought by the auditor only if the client justifies its position on the contingency by use of counsel's advice. Other sources of confirmation, such as engineering analysis and the like, may be available to support the position. Also, factual information, such as environmental, as opposed to legal, assessments should be available to the auditor. As with other situations, the auditor may seek confirmation from the client that its position is not inconsistent with the advice of counsel.

D. Internal Investigations

Internal investigations provide special problems, in part because of the responsibilities imposed on the auditor under Section 10A of the Exchange Act and in part because of the potential relevance to the adequacy of the client's internal controls. However, procedures among companies, counsel and auditors have evolved that enable the auditor to obtain the information it needs for verification while preserving the attorney-client privilege and work product protections. For example, auditors can be provided with summaries of the factual information that has been developed, including access to transcripts of interviews that are not otherwise protected. We do not believe, however, that the auditor should have access to the investigating counsel's notes of interviews, legal assessments or legal advice to the client. The requirement by auditors that any of those materials generated by counsel be shared with it would unnecessarily impede the ability of counsel fully to investigate, report and advise the corporate client and potentially would interfere with and weaken the ability of corporations to engage in self-policing. Instead, we suggest that the auditor can rely on investigating counsel's provision of non-protected materials and its assurance, as contemplated by the Treaty, that counsel fulfills its professional responsibility in advising the client with respect to its disclosure obligations.

We believe that recognition of these procedures in auditing standards would (i) provide comfort to the auditor that it is following proper procedures, (ii) confirm to users of financial statements that following these procedures does not constitute inadequate auditing, and (iii) assist companies in resisting unnecessary requests that could impair the protections and undermine the ability to conduct effective internal investigations.

E. Clarification of "Audit Documentation"

For the most part, issues concerning the attorney-client privilege and work product protections arise in audit-related matters in the context of furnishing documents to the auditor. Those documents might include letters, e-mails, faxes, legal opinions, and the like.

The PCAOB adopted Auditing Standard No. 3, "Audit Documentation," to address documentation requirements.[15] It subsequently adopted Rule 3101, providing definitions of certain terms used in Auditing Standard No. 3 and other auditing and related professional practice standards.[16] As the Board indicated in its press release announcing Auditing Standard No. 3, its principal objective was to require "that auditors document procedures performed, evidence obtained, and conclusions reached."[17] Unfortunately, some have interpreted Auditing Standard No. 3 to establish new substantive documentation requirements. The PCAOB should clarify that Auditing Standard No. 3 does not establish the information required for an audit, but rather addresses the need to document the audit process and preserve that documentation, in part to support the PCAOB's inspection process of audit work.

In this connection, documents evidencing advice of counsel to the audited company would not themselves appear to constitute "procedures performed, evidence obtained, and conclusions reached" by the auditor merely because they exist and may be used by the client in

15 Public Company Accounting Oversight Board Bylaws and Rules – Standards – AS No. 3, as approved in SEC Release No. 34-50253; File No. PCALB-2004-05, August 25, 2004.

16 Public Company Accounting Oversight Board Bylaws and Rules – Professional Standard, as approved pursuant to SEC Release No. 34-50031; File No. Board-2004-06, September 8, 2004.

17 Board Release No. 2004-006, at p. 4.

connection with the preparation of, as opposed to support for, its financial statements. Rather, the documents appear only to constitute "evidence obtained" to support the audit and, therefore, would be limited only to those appropriately obtained by the auditor as an integral part of the audit.

AICPA Standard of Field Work AU Section 326, Evidential Matter provides that "evidential matter supporting the financial statements consists of the underlying *accounting data* and all corroborating information *available* to the auditor."[18] In auditing literature, "audit documentation" is also frequently referred to as "audit work papers." The "evidence obtained" thus does not appear to include documents prepared by others that might be used by the company in connection with presenting the components of the financial statement unless it was needed by the auditor as "corroborating information." The PCAOB could appropriately clarify that the purpose of audit standards with respect to "audit documentation"/"audit work papers" is to preserve evidence of work done by the auditors, rather than to preserve the work of others that may have been used by the audited company but are not appropriately considered to be "corroborating information."

F. Confirmation of Continued Application of the Treaty

The Treaty has worked well for 30 years as a practical approach to preserving attorney-client privilege and work product protections in the context of communications between lawyers and auditors of companies. At the same time, the Treaty makes clear that it does not eliminate the professional responsibility of lawyers to advise their clients with respect to the client's disclosure obligations, which responsibility encompasses the client's disclosure to its auditors and through them to the investing public. This underpinning of the Treaty is even more valid today in the wake of SOX and the SEC's rules governing attorney professional conduct than it was when the Treaty was adopted. As such, the Treaty and the interpretations relating to it are key elements in recognizing the fundamental importance of the protections.

Because of the importance of the protections as a fundamental public policy matter, the PCAOB could issue a statement confirming the integrity and continuing application of the Treaty, including clarification that nothing contained in Auditing Standard No. 3 or Rule 3101 is intended to negate the provisions of the Treaty. The PCAOB also could issue a statement explicitly reaffirming that the principles of confidentiality recognized in the AICPA interpretations that have been adopted by the PCAOB as interim auditing standards are fundamental values entitled to respect.

G. Auditor Safe Harbor

Many have pointed to excessive exposure to extensive civil liability as a prime source of auditor requests for information beyond that necessary for the audit and as a significant impediment to restoring the proper balance in audit procedures to recognize the overriding importance of the attorney-client privilege and work product protections.

18 AU Section 326, issued August 1980, at par. 5.

The SEC's Advisory Committee on Smaller Public Companies in its final report dated April 23, 2006[19] noted the impact on smaller public companies of the diminished use of professional judgment by auditors due in part to fear of second-guessing by regulators and litigants. To combat this, it recommended development of a safe harbor protocol for accounting for transactions that would protect well-intentioned preparers of financial statements from regulatory or legal action when the process is appropriately followed and results in an accounting conclusion that has a reasonable basis.

The Task Force supports continued attention to this issue and a detailed examination of whether it would be appropriate to develop such a safe harbor as a means of enabling auditors to follow auditing procedures that recognize the overriding importance of the protections with confidence that their doing so will not be second guessed.

VI. CONFIDENTIALITY OF DISCLOSED INFORMATION

The foregoing approaches would define the limited circumstance under which information implicating the attorney-client privilege and work product protections could be requested by the auditor. That definition is essential to preserving the protections as historically recognized in the auditing standards. A separate question is the extent to which this information, as well as other information that a company may choose to share with the auditors in connection with the audit, will be protected from being accessible by third parties, such as governmental agencies and civil litigants, as a result of that disclosure.

Existing legal principles protect information disclosed to another party as attorney work product if there is a common legal interest between the parties.[20] There has been a difference among the courts in whether to recognize the company and the auditors as having a common legal interest so as to protect information shared by the company with its auditors in connection with the audit.[21] The argument for finding a common interest is stated by the court in *Merrill Lynch* as follows:

> [A]ny tension between an auditor and a corporation that arises from the auditor's need to scrutinize and investigate a corporation's records and book-keeping practices simply is not the equivalent of an adversarial relationship contemplated by the work product doctrine. Nor should it be. A business and its auditor can and should be aligned insofar as they both seek to prevent, detect, and root out corporate fraud. Indeed, this is precisely the type of limited alliance that courts should encourage. For example, here Merrill Lynch complied with Deloitte & Touche's request for copies of the internal investigation

19 Available at www.sec.gov/info/smallbns/acspc.shtml.

20 Another possible basis for protection, on which there is unsettled and conflicting authority, is "limited or selective waiver," especially when information is provided under a confidentiality agreement. For a discussion of these concepts, see Paper prepared by Latham & Watkins LLP on behalf of The Corporate Counsel Consortium (Dec. 22, 2004), available on the Task Force's website (*see* note 1).

21 Compare, e.g., *Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113 (SDNY 2002), with *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441 (SDNY 2004).

> reports so that the auditors could further assess Merrill Lynch's internal controls, both to inform its audit work and to notify the corporation if there was a deficiency.

Merrill Lynch at 448. The court further stated regarding an auditor's involvement with a company's internal investigation:

> [T]he aim should be for corporations to share information with their auditors to facilitate a meaningful review and, ultimately, the availability of more accurate information for the investing public. It is also important to encourage complete disclosure between a company and its auditor, so that auditors are not inadvertently shielded from complete frankness by corporate management, so that they can later claim that they had no knowledge of alleged malfeasance.

Id. at 449. It also noted that to find the auditor to be an adversary and thus for there to be a waiver of the work product protection "could very well discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry with the appropriate actors." *Id.*

The argument against finding a common interest, as stated by the court in *Medinol*, is primarily based upon the auditor assuming a public responsibility in providing an independent opinion on the fairness of the company's financial reports and thus not necessarily having interests that are aligned with those of the company.[22] The court also noted that the "common interest" protection normally applied only in the context of sharing work product in connection with litigation.

If there is to be reliable protection in place for information shared by a company with its auditors in connection with an audit, the differences among the courts would need to be resolved because "an uncertain privilege . . . is little better than no privilege at all."[23] The Task Force is not recommending at this time that the ABA take a position on the common interest issue. However, the Task Force believes that it would be useful for the SEC, the PCAOB, the AICPA and the accounting profession to examine whether those uncertainties should be eliminated in the audit context and ways in which that might be done while still maintaining the privilege and work product protections.

VII. CONCLUSION

For the reasons set forth in this Report, the Task Force respectfully requests the ABA House of Delegates to adopt the proposed resolutions included in the Recommendation.

Respectfully submitted,

R. William Ide, III, Chair
ABA Task Force on Attorney-Client Privilege

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22 *See United States v. Arthur Young & Co.*, 465 U.S. 805 (1984).

23 *See Upjohn Co. v. U.S.*, 449 U.S. 383, 393 (1981).

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ABA TASK FORCE ON ATTORNEY-CLIENT PRIVILEGE

RECOMMENDATION 111

RESOLVED, that the American Bar Association strongly supports the preservation of the attorney-client privilege and work product doctrine as essential to maintaining the confidential relationship between client and attorney required to encourage clients to discuss their legal matters fully and candidly with their counsel so as to (1) promote compliance with law through effective counseling, (2) ensure effective advocacy for the client, (3) ensure access to justice and (4) promote the proper and efficient functioning of the American adversary system of justice; and

FURTHER RESOLVED, that the American Bar Association opposes policies, practices and procedures of governmental bodies that have the effect of eroding the attorney-client privilege and work product doctrine and favors policies, practices and procedures that recognize the value of those protections.

FURTHER RESOLVED, that the American Bar Association opposes the routine practice by government officials of seeking to obtain a waiver of the attorney-client privilege or work product doctrine through the granting or denial of any benefit or advantage.

REPORT

I. Background of the Task Force

The American Bar Association established its Task Force on the Attorney-Client Privilege in September 2004, to evaluate issues and recommend policy related to the attorney-client privilege and work-product doctrine. The Task Force has been examining current developments regarding the privilege and work-product doctrine, the circumstances in which governmental agencies and others are asserting the need for privileged and work product protected information, and the extent to which preserving the privilege and work product protections or disclosing privileged information or attorneys' litigation work product in such circumstances impacts the public interest. By examining and reporting on these and related issues, the Task Force hopes to inform the public and the legal profession of the importance of the privilege and work-product doctrine, to relate each of these principles to the competing demands for access to protected information, and to assist the ABA in developing policies that strike the right balance given these competing demands. This Report is designed to review the progress of the Task Force, to project further activities, and to support three recommended resolutions for bedrock principles that should be ABA policy in this area.

While much work remains to be done, the Task Force believes that it has sufficient facts and insights on certain key principles to recommend action by the ABA. The three resolutions recommended for adoption by this Report are consistent with earlier ABA policy relating to the attorney-client privilege and work-product doctrine, including the ABA's August 2004 resolution opposing the Federal Sentencing Guidelines expectation that corporations waive privileges as an element of assisting government investigations. To a substantial extent, the recommended resolutions are implicit in the earlier one, as well as in the ABA's consistent commitment, in its rules of professional conduct and other positions, to the principle of attorney-client confidentiality. Although the work of the Task Force will continue with the objective of developing more specific policy, the Task Force believes it is important for the ABA to affirm bedrock principles that will be the foundation for its further work. Strong support for the preservation of the attorney-client privilege and work-product doctrine, opposition to policies, practices and procedures of governmental agencies that have the effect of eroding the attorney-client privilege and work-product doctrine, and favoring government endorsement of policies, practices and procedures that recognize the value of those protections are the objectives of these resolutions. Some of the more specific measures that have been suggested and are being considered by the Task Force and others, both inside and outside the ABA, are described in Sections VII and VIII of this Report. When more fully developed and considered, further policy and specific measures will be brought to the ABA House of Delegates for action.

The Task Force began its work by identifying a variety of contemporary contexts in which attorney-client confidentiality has come under serious pressure, in light of changes in the law and changes in institutional practices by government agencies and others. The Task Force recognized that initially it would focus on the areas that seem to be producing the greatest tensions on the privilege and work-product doctrine. In light of its charge and its determination regarding the most pressing issues, the Task Force gave notice to the professional community that it would begin by focusing its attention on two substantial practices: (1) requests by prosecutors and government regulators for the production of material protected by the attorney-client privilege and work-product doctrine, and (2) requests by auditors of public companies for the production of material protected by the attorney-client privilege and work-product doctrine. This report reviews the progress to date, and provides recommendations expressing the ABA's strong support for the preservation of the attorney-client privilege and work-product doctrine, its opposition to policies, practices and procedures of governmental agencies that have the effect of eroding the attorney-client privilege and work-product doctrine, and its endorsement of policies, practices and procedures that recognize the value of those protections.

The Task Force has reviewed scholarly articles and applicable law, conducted meetings, held two public hearings, and received oral and written testimony from interested persons. These meetings and hearings have produced varied views and considerable information, some of which is noted in this Report and all of which is posted on the Task Force's website, which is located at http://www.abanet.org/buslaw/attorneyclient.[1] The Task Force expects to continue its work to develop specific measures in furtherance of the recommendations to the ABA House of Delegates accompanying this Report, to flesh out recommendations on privilege and work product issues related to auditors, and to identify and address other issues not discussed herein. Discussions are underway with representatives of various regulators, which will help guide the Task Force in determining potential solutions to the issues. It has been very gratifying to see lawyers from corporations, the private sector and government all working together in a constructive manner on these critical issues for our justice system.

II. Overview of the Attorney-Client Privilege and Work-Product Doctrine

Lawyers have always been understood to play a critical role in preserving legal rights, compliance with the law, and ultimately, the rule of law. As the law becomes increasingly complex, the need for lawyers has become increasingly essential. Further, the confidentiality of the attorney-client relationship has historically been considered an essential aspect of legal representation, and one that is necessary to ensure the ability of lawyers to carry out their assigned role in the legal system. The confidential relationship is recognized and preserved not only in the common law regulating the lawyer-client relationship and in the rules of professional

[1] The following is a list of the individuals and groups providing written or oral testimony to the Task Force on February 11, 2005: The American College of Trial Lawyers; David M. Brodsky, Corporate Counsel Consortium; Kenneth W. Gideon, ABA Section of Taxation; Steven K. Hazen, State Bar of California, Business Law Section, Corporations Committee; James W. Conrad, Jr., American Chemistry Council; Paul Rosenzweig, The Heritage Foundation; John Gamino, TXU Corporation; Ursula Weingold, University of St. Thomas School of Law (Minnesota); Brad Brian, ABA Section of Litigation; United States Chamber of Commerce; The Law Society of Upper Canada; Steven R. Schell, Black Helterling LLP; Paul Rice, American University Washington College of Law; ABA Section of State and Local Government Law; Randolph Braccialarghe, NSU Law Center; and State Bar of California, Standing Committee on Professional Responsibility & Conduct. The following is a list of the individuals and groups providing written or oral testimony to the Task Force on April 21, 2005: Stephen A. Saltzburg, The George Washington School of Law; Susan Hackett, Association of Corporate Counsel; John Beccia III, The Financial Services Roundtable; Jonathan Bach, New York Council of Defense Lawyers; Elizabeth J. Cabraser, Lieff, Cabraser, Heimann & Bernstein; Gerald B. Lefcourt, National Association of Criminal Defense Lawyers; Martin S. Kaufman, Atlantic Legal Foundation; W. Wayne Withers, Emerson; State Bar of California, Business Law Section, Corporations Committee; Federation of Defense & Corporate Counsel; and Section of International Law, Ad Hoc Task Force on Money Laundering and Professional Responsibilities.

conduct, but in the attorney-client privilege and, with respect to the lawyer's role in litigation, the work-product doctrine.

The Attorney-Client Privilege. The attorney-client privilege is a rule of evidence that protects the confidentiality of communications between an attorney and client. Its underlying purpose is to encourage persons to seek legal advice freely and to communicate candidly during consultations with their attorneys without fear that the information will be revealed to others. This enables clients to receive the most competent legal advice from fully informed counsel so that the client can fulfill his or her responsibilities under the law and benefit from the law's protection. Given the ever-growing and increasingly complex body of public law, the client's better understanding of his or her legal obligations enhances the law's efficacy.[2]

Recognizing that the attorney-client privilege is an exception – albeit a very important exception – to the general principle that witnesses must provide relevant testimony in court proceedings, courts over the decades have sought to develop the parameters of the privilege toward several ends. Importantly, the privilege has been designed to apply only in the general class of cases where its purposes are strongly served. In general, attorney-client communications will only be privileged if the communication was between a lawyer and a client (or prospective client), was for the purpose of enabling the client to secure legal services or assistance (and not for the purpose of committing a crime), and was made in confidence (i.e., outside the presence of third parties). Thus, the mere fact that an individual communicates with an attorney does not make the communication privileged. Personal communications, business advice, and advice to aid in the commission of illegal activity that is carried out are not protected.[3] The client claiming the benefit of the privilege has the burden of proving its applicability,[4] and the privilege is lost if the client does not claim the privilege or waives it.[5]

The attorney-client privilege is subject to limited exceptions, [6] but importantly, it is *not* subject to an exception simply because a private litigant, government agency, or other third party claims an important need to know what the client discussed with an attorney. Such an exception has been rejected primarily because of the paramount importance of assuring clients in advance whether their communications will be privileged. If the protection were not assured, the client would be unable to rely on confidentiality when seeking legal advice, and hence might be hesitant to disclose adverse as well as favorable facts to the lawyer. Further, it is crucial to remember that the privilege does not shut off access to facts within a party's possession. A party can be asked, "what did you observe?" or "what did you do?" The only type of question that the privilege forecloses, is, "What was your conversation with your lawyer?"

[2] PAUL R. RICE, ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES §§ 1:1-1.3 at 6-14 (2nd ed. 1999).
[3] See Clark v. U.S., 289 U.S. 1, 15 (1933); U.S. v. Bob, 106 F.2d 37, 40 (C.C.A. 2d Cir. 1939); Haines v. Liggett Group Inc., 975 F.2d 81, 84, 36 Fed. R. Evid. Serv. (LCP) 782 (3rd Cir. 1992), as amended, (Sept. 17, 1992).
[4] See Federal Trade Commission v. Lukens Steel Company, 444 F.Supp. 803, 806 (D.D.C. 1977).
[5] See United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 358-59 (D. Mass. 1950).
[6] These exceptions, include, the crime-fraud exception, the joint-clients common interest exception and the shareholder derivative action exception. For a discussion of these and other exceptions to the privilege, please see EDNA EPSTEIN, THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE, 391-465 (4th ed. 2001).

So that lawyers and clients will know in advance what communications will and will not be protected, and can conform their conduct accordingly, courts have endeavored to draw the lines with some clarity. Of course, it is impossible to achieve absolute certainty. At the margins, the application of the privilege is not always clear, and indeed, treatises can and have been written on the privilege, its exceptions, its intricacies, and its areas of ambiguity.[7] Further uncertainty results from the fact that the relevant case decisions (and, in some states, statutes) differ from jurisdiction to jurisdiction. With respect to federal proceedings, Congress has not codified the attorney-client privilege but has authorized ongoing common law development of this and other privileges.[8] Pursuant to its authority under the Federal Rules of Evidence, the Supreme Court of the United States has consistently recognized and upheld the privilege.[9] But the Supreme Court has resolved only a limited number of questions concerning the boundaries of the privilege, and on the remaining questions, different districts and circuits – and even different judges within a given federal district – may take different approaches.

Critics of the privilege argue that because the privilege prevents the disclosure of a client's communications, it hinders the public's ability to discover the truth. This argument fails to account for the countervailing benefits associated with the privilege. As one writer has stated, "[T]he definition of the privilege [expresses] a value choice between protection of privacy and discovery of truth and the choice of either involves the acceptance of an evil—betrayal of confidence or suppression of truth."[10] The judiciary has recognized this choice and has consistently decided in favor of upholding and protecting the privilege.

The Work-Product Doctrine. The work-product doctrine is a protection afforded to the "work product" of attorneys that precludes adversaries from discovering "work product" developed in anticipation of litigation. The protection accorded "work product" is premised on the same belief underlying the attorney-client privilege—that an attorney cannot provide full and adequate legal representation unless certain client-attorney material is unavailable to adversaries. While these two doctrines rest on the same principles, the focus of each is different. The privilege strives to encourage clients to communicate openly with their attorneys; the work-product doctrine aims to allow the attorney to engage in careful and thorough preparation for litigation. Whereas the privilege protects attorney-client communications when related to the provision of legal advice in all circumstances, the work-product doctrine is applicable only to the actual work product of an attorney developed in preparation for litigation. [11] Additionally, the protection of the work-product doctrine may be claimed by both attorney and client, whereas the privilege belongs only to the client.[12]

[7] See, e.g., EDWARD J. IMWINKELRIED, THE NEW WIGMORE: EVIDENTIARY PRIVILEGES (2002).
[8] FED. R. EVID. 501.
[9] See Hunt v. Blackburn 128 U.S. 464, 470 (1888); Upjohn Co. v. U.S., 449 U.S. 383, 389 (1981); Swidler & Berlin v. United States, 524 U.S. 399, 403 (1997).
[10] Geoffrey C. Hazard, Jr., An Historical Perspective on the Attorney-Client Privilege, 66 CAL. L. REV. 1061, 1085 (1978).
[11] EPSTEIN at 477.
[12] Id. at 490.

The United States Supreme Court set forth the standard for evaluating the work-product doctrine in Hickman v. Taylor.[13] There the Court found that an attorney's mental processes "fall outside the arena of discovery and [revealing such information to an adversary] contravenes the public policy underlying the orderly prosecution and defense of legal claims."[14] In summary, Hickman set forth the following propositions used in the evaluation of the work-product doctrine: (1) material collected by an attorney during his or her preparation for litigation is protected in discovery, unless an adversary can demonstrate a sufficient need for the material, and (2) an attorney's mental processes, i.e., theories, analyses, beliefs, etc., are at the foundation of our legal system and will accordingly be protected from discovery to an almost absolute extent.[15] These propositions have also been, to a degree, codified by the Federal Rules of Civil Procedure and the Federal Rules of Criminal Procedure.[16]

While the privilege and the work-product doctrine will often overlap in their protection, they are by no means coextensive. The work-product doctrine offers a broader protection than the privilege in that it can encompass not only communications, but also an attorney's thoughts, impressions, beliefs and materials. Despite being broader than the privilege in that respect, the work-product doctrine is only applicable to "work product" prepared in anticipation of litigation.

The Attorney-Client Privilege and Work-Product Doctrine in the Context of the Corporate Client. The attorney-client privilege, unlike privileges such as the Fifth Amendment privilege against self-incrimination, extends to corporations and other business entities.[17] The corporate entity is, of course, an artificial being that exists only in the eyes of the law and can act only through its employees and agents. This anomaly creates a unique situation when evaluating how the privilege should apply in the context of communications to an attorney representing a corporate client.[18]

Some persons have argued that the privilege should not apply in the corporate context, but the United States Supreme Court has recognized the important role the privilege plays for corporations. The absence of the privilege would "not only make it difficult for corporate attorneys to formulate sound advice when their client is faced with a specific legal problems but also threaten to limit the valuable efforts of corporate counsel to ensure their client's compliance with the law."[19]

Generally, in the context of an individual client it is relatively easy to determine whether the privilege should apply because the client is a natural person and, more often than not, is the communicator, the privilege holder and the decision-maker. When the client is a corporation, however, it becomes more difficult to determine whether the privilege should attach to communications made by representatives of the corporation because the communicator, the privilege holder and the decision-maker necessarily never can be the same person or entity. The corporation is the privilege holder, but because the corporation is merely a legal fiction, it is incapable of communicating or making decisions except through the conduct of its employees and agents. This differentiation between individual and corporate clients creates a natural tension between the justification for the privilege, i.e., encouraging people to seek legal advice and communicate candidly with their attorney, and the application of that justification to a corporation.[20] It thus becomes more difficult to determine to which communications made on behalf of a corporation to an attorney the privilege should attach.[21] Courts have developed different tests to determine when the privilege should attach to communications from a corporation's representatives or agents to an attorney on behalf of the corporation. [22]

Upjohn Co. v. United States[23] is the seminal case regarding the attorney-client privilege in the corporate context. In Upjohn, accountants discovered that a subsidiary of the Upjohn Co. made payments to or for the benefit of foreign government officials for the purpose of obtaining business. In response, the company's counsel conducted an internal investigation to examine the alleged improper payments. As part of the investigation a letter containing a questionnaire prepared by counsel for Upjohn Co. was circulated to many of Upjohn Co.'s managers inquiring about the alleged improper payments. Additionally, Upjohn's in-house and outside counsel interviewed some of the same employees that received the questionnaire.[24] Following counsel's analysis of the facts and advice, the company voluntarily reported certain questionable payments to the SEC and the IRS, which it furnished with a list of all employees interviewed by Upjohn Co. and who had responded to the questionnaire. In response, the IRS launched an investigation and issued a summons for all questionnaires and notes of interviews conducted with Upjohn's employees and officers.[25]

The Supreme Court rejected the government's argument that the attorney-client privilege applied exclusively to corporate counsel's communications with the corporation's "control group," i.e., officers and employees responsible for directing the company's actions based on counsel's legal advice.[26] The Court determined that the control group test failed to take into account the need for attorneys to obtain information needed to give sound and informed legal advice, discouraged employees from communicating important information to a corporation's attorney, impaired the provision of competent legal advice to a corporation's employees who put into effect such corporation's policies, increased the difficulty of formulating legal advice for specific problems, and impaired the ability of counsel to help ensure a corporation's voluntary compliance with the law.[27] In so determining, the Court reasoned that "[t]he narrow scope given the attorney-client privilege by the [Sixth Circuit] not only makes it difficult for corporate attorneys to formulate sound advice when their client is faced with a specific legal problem but also threatens to limit the valuable efforts of corporate counsel to ensure their client's

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[13] Hickman v. Taylor, 329 U.S. 495 (1947).
[14] Id. at 510.
[15] EPSTEIN at 481.
[16] Id.
[17] EPSTEIN at 99.
[18] JOHN WILLIAM GERGACZ, ATTORNEY-CORPORATE CLIENT PRIVILEGE § 1.16, at 1-14 to 1-16
[19] Upjohn, 449 U.S. at 392.
[20] Id.
[21] EPSTEIN at 100.
[22] For a discussion of these tests, please see GERGACZ §§ 3.67 to 3.102, at 3-130 to 3-186.
[23] Upjohn, 449 U.S. at 383.
[24] Id. at 386-87.
[25] Id. at 387-88
[26] Id. at 396-97.
[27] EPSTEIN at 102.

compliance with the law."[28] Further, the Court stated that if "the purpose of the attorney-client privilege is to be served, the attorney and client must be able to predict with some degree of certainty whether particular discussions will be protected. An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all."[29] Despite the Court's decision in Upjohn, some state courts continue to apply the control group test, along with other tests, when determining who constitutes a privileged individual in the corporate client context.

Like the privilege, the work-product doctrine also applies to corporations. An issue of particular concern to corporations is whether internal investigations conducted by companies and the resulting materials are protected by the work-product doctrine. There is some case law that specifically addresses whether a company's internal investigation can be said to be "in anticipation of litigation." The cases draw a distinction between investigations into illegal activity and investigations into other matters. Most of the cases conclude that internal investigations of possible corporate illegal activity are performed with enough anticipation of litigation to qualify for work product protection.[30] In cases addressing investigations into other activities, the courts focus on whether the investigation was performed in the ordinary course of business or for litigation purposes.[31] Thus, the critical step is to distinguish investigations done as part of litigation preparation from investigations done for simple fact-finding or for a business motive.

III. Importance of the Attorney-Client Privilege to the American Justice System

The attorney-client privilege is a right held by the client, such that only the client and not the lawyer has the ultimate authority to waive the privilege. The protection afforded to the client by the privilege rests on the presumption that clients consult lawyers for the purpose of abiding by, rather than breaking, the law.[32] The privilege is an important and necessary part of our judicial system for many reasons. Among other things, the privilege has an important role in (i) fostering the attorney-client relationship, (ii) encouraging client candor, (iii) enhancing voluntary legal compliance, (v) increasing the efficiency of the justice system and (vi) enhancement of constitutional rights.

The Privilege Fosters the Attorney-Client Relationship. The legal system has developed into a complex and intricate maze not always easy to navigate. These complexities make it unlikely that clients are able to conduct their legal affairs without fully informed representation by an attorney; whether in litigation or in regard to counseling about legal consequences of their actions, competent legal representation is a requirement. The privilege helps to ensure that the representation will be competent and fully informed. The attorney-client relationship must encourage trust because full disclosure will not be fostered if the attorney is viewed as a potential threat to the client's interests.[33] It is in this context that the promise of confidentiality offered by the privilege becomes a vital part of our legal system.

The Privilege Encourages Client Candor. Another purpose of the privilege is to promote client candor by encouraging "full and frank communication between attorneys and their clients."[34] The privilege allows an attorney to avoid what would otherwise be a professional dilemma of cautioning a client against disclosure and rendering perhaps uninformed legal advice or of learning all the details of a situation and increasing the peril to the client that could result if such details could be disclosed.[35]

An attorney may give reasonably informed professional advice only when information is given in confidence to the attorney by the client. If a client fears that information revealed to his attorney will be made known to others, then the client will withhold information and the attorney will be left with less than all of the information needed to provide competent legal advice.[36] The existence of the privilege encourages clients to be completely truthful with their lawyers. Legal advice is of dubious value if it is not based on a full and free disclosure of all pertinent facts, without fear of disclosure to third parties.[37]

Additionally, if individuals' communications with attorneys could be revealed to unfriendly third parties, those individuals would be less likely to seek an attorney's advice. In a society as structurally and legally complex as ours, sound legal advice is essential, and such advice is often unattainable without unfettered disclosure of all relevant information by a client to his attorney. To induce clients to seek out and consult with lawyers, the privilege is a necessity.[38]

This same principle applies in the corporate context, albeit differently because of the corporate structure. Individuals communicating on behalf of a corporation are not afforded a personal privilege in their communications with corporate counsel because the privilege belongs to the client, i.e., the corporation. Because the exercise or waiver of the privilege is controlled by the corporation and not the individual communicator, the individual communicator has no incentive to be forthcoming with corporate counsel. Nonetheless, corporate employees communicating with a corporation's attorney usually do so at the behest of management, and but for the privilege, the revelation of communications to a corporation's attorney by its employees could be compelled, a scenario any member of corporate management would like to avoid. Thus, there exists a strong incentive to extend the privilege to corporations because without it, corporate management might discourage corporate employees from communicating with

[28] Upjohn, 449 U.S. at 392.
[29] Id. at 393.
[30] See In re International Sys., 693 F.2d 1235 (5th Cir. 1982); In re Grand Jury Investigation (Sun Co.), 599 F.2d at 1232 (3rd Cir. 1979).
[31] Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 604 (8th Cir. 1978) ("Law Firm's investigation was not made and its report was not prepared because of any prospect of litigation involving [the company] . . . . Board of Directors . . . wanted to frame policies and procedures that in the future would protect it against repetitions of prior misdeeds"); Miller v. Federal Express Corp., 186 F.R.D. 376 (W.D. Tenn. 1999) (concluding that an investigation was done for both employee relations and possible litigation purposes and was thus for ordinary business purposes and not in anticipation of litigation).
[32] EPSTEIN at 2-3.
[33] GERGACZ §1.08, at 1-9 to 1-10.
[34] Upjohn, 449 U.S. at 389.
[35] See U.S. v Gonzalez, 1997 WL 155403 (D.N.M. 1997).
[36] EPSTEIN at 3.
[37] Id. at 4.
[38] United Shoe Mach. Corp., 89 F. Supp. at 358.

corporate counsel. The policy of candor in the corporate context is not tied to an individual's decision to communicate, but to the manner in which corporations utilize their attorneys. [39]

The Privilege Fosters Voluntary Legal Compliance. The freedom to consult an attorney helps encourage clients to use attorneys to promote compliance with the law. Such voluntary compliance facilitates the effective administration of the justice system. The privilege aids in the voluntary compliance with law because it enhances the ability of attorneys to counsel clients about their obligations and duties under the law and to urge compliance. An attorney can only provide informed advice about compliance when all communications between attorney and client are protected from compelled disclosure.[40]

For the privilege to be effective in promoting legal compliance, it does not and cannot attach only to communications from the client to the attorney but must attach also to communications from attorney to client. The privilege is for the purpose of encouraging "full and frank communications between attorneys and clients."[41] A lawyer's legal advice to a client often incorporates the content of the confidential information received by the lawyer from the client and which prompted the client to seek legal counsel in the first place.[42]

Promoting legal compliance is one of the most significant incentives offered by the attorney-client privilege to corporate organizations. Corporations are faced by a myriad of complex legal requirements. Sometimes the actions that corporate management considers pursuing may unbeknownst to it violate the law. Extending the privilege to corporations fosters an open dialogue between a corporation's management and corporate counsel, which can help ensure that the corporation complies with laws that might otherwise have been broken. [43]

The privilege provides this incentive more efficiently, effectively and predictably than the threat of punishment or sanctions. Given the complexity and breadth of legal requirements facing corporations, legal compliance should be encouraged as much as possible. If corporate management can consult attorneys about legal issues facing the corporation without fear of such communications being made known, the likelihood the corporation will "self-regulate" and voluntarily comply with the law is increased.[44]

Why should society be so concerned about the performance and quality of the work that attorneys perform? As society becomes more and more complex and as the laws that monitor societal behaviors and relationships become more detailed, competent legal advice grows in importance. If persons fail to seek such advice, compliance will less likely be achieved. "The social good derived from the proper performance of the functions of lawyers acting for their clients is believed to outweigh the harm that may come from the suppression of the evidence in specific cases."[45]

The privilege "is founded upon the necessity, in the interest and administration of justice, of the aid of persons having knowledge of the law and skilled in its practice, which assistance can only be safely and readily availed of when free from the consequences or the apprehension of disclosure."[46] Full and frank communication is not an end in itself, but a means to achieve the main purpose of the privilege, "promoting broader public interest in the observance of law and administration of justice."[47]

Further, the ABA Model Rules of Professional Conduct (the "Model Rules") state, "In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to a client's situation."[48] Accordingly, the privilege plays an important role by allowing the lawyer to obtain information that enables the attorney to function in the role of "counselor," a role that is of ultimate benefit to society. For example, it is to society's benefit for lawyers to raise with corporate decision makers social implications of corporate policy.

Although the privilege can result in the suppression of relevant evidence, i.e. admissions of a client, the long-term social benefits of the privilege outweigh the immediate cost of "lost" evidence. This rationale justifies the protection of communications between attorneys and clients regardless of the status of the client—individual or entity, or the position of the attorney vis-à-vis the client—retained, appointed, or regular employee.[49]

The Privilege Promotes Efficiency in the Legal System. Legal advice is most effective when it is fully informed. Such sound legal advice rests on the attorney's ability to consider all relevant information. If a client withholds information, such a thorough consideration is unlikely to occur. As a result, unjust settlements may be reached, cases may proceed with little if any chance of prevailing, and clients may incur unnecessary legal expenses.[50]

Efficiency is also obtained in addressing and resolving issues before they reach litigation. Preventive measures such as reviewing business practices, transactions, and records provide clients with an efficient and effective way to ensure legal compliance. Such pre-litigation

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[39] GERGACZ §1.20, at 1-20.
[40] EPSTEIN at 6.
[41] Upjohn, 449 U.S. at 389 (emphasis added).
[42] Epstein at 8.
[43] GERGACZ §1.21, at 1-20 to 1-21.
[44] Id.
[45] United Shoe Mach. Corp., 89 F. Supp. at 358.
[46] Hunt, 128 U.S. at 470.
[47] Westinghouse v. Republic of the Phillipines, 951 F.2d 1414, 1423 (3d. Cir. 1991) (quoting Upjohn, 449 U.S. at 389).
[48] MODEL RULES OF PROF'L CONDUCT R. 2.1 (2003). Additionally, the commentary to Rule 2.1 provides, "Advice couched in narrow legal terms may be of little value to a client, especially where practical considerations, such as cost or effects on other people, are predominant. Purely technical legal advice, therefore, can sometimes be inadequate. It is proper for a lawyer to refer to relevant moral and ethical considerations in giving advice. Although a lawyer is not a moral advisor as such, moral and ethical considerations impinge upon most legal questions and may decisively influence how the law will be applied."
[49] RICE § 2:3, at 18.
[50] GERGACZ §1.11, at 1-11.

determinations, as compared with potential litigation costs, are economically beneficial for both clients and the legal system.[51]

While it may be true that in limited instances attorneys abuse the privilege as a tactic to delay and hinder the discovery of otherwise discoverable material, such instances do not justify encroaching upon the protections afforded by the privilege. Rules are already in place to address concerns regarding abuse of the privilege. For example, Rule 3.4(a) of the Model Rules provides, "A lawyer shall not unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act."[52] Additionally, federal and state rules of evidence provide for the application of sanctions to those attorneys who commit discovery abuses.[53]

The Privilege Enhances the Constitutional Right to Effective Assistance of Counsel. The Sixth Amendment to the United States Constitution states, "In all criminal prosecutions, the accused shall enjoy the right to … have the Assistance of Counsel for his defence."[54] This has been interpreted to mean "effective" assistance of counsel by the Court.[55] Although the privilege is recognized as playing a vital role in ensuring the effective assistance of counsel, the Sixth Amendment guarantee of effective assistance of counsel has not been recognized as a constitutional source for the privilege.[56] Nonetheless, when the privilege has been denied in the case of a criminal defendant, the courts have recognized that such a denial may operate to prevent the effective assistance of counsel.[57]

IV. Waiver

Traditionally, a client may forfeit or "waive" the protection of the privilege by voluntarily disclosing information protected by the privilege to a third party or by putting such communications in issue in litigation. Voluntary disclosures to one third party waive the privilege with respect to others on the theory that, if the client is so indifferent to maintaining confidentiality that the client voluntarily discloses privileged information, there is no longer a strong justification for the law to protect the privilege in derogation of the countervailing interest in allowing other parties access to relevant information.[58]

Importantly, however, the law has come to recognize that not all disclosures outside the attorney-client relationship waive the privilege, and that there are circumstances where there is a compelling public interest in allowing clients to make or authorize their lawyers to make such disclosures while still preserving the privilege. Most obviously, it has been recognized that disclosures to agents of the lawyer and to expert consultants retained to assist the lawyer are necessary to enable the lawyer to provide competent advice, advocacy, and other assistance. Similarly, in situations where separately represented clients are aligned in interest, and especially where they are co-parties in litigation, the public interest in ensuring effective representation and in promoting fair outcomes has led courts to recognize a "common interest" or "joint representation" exception to the ordinary concept of waiver.[59]

In some contexts, the tension between the idea that voluntary disclosure waives the privilege and the countervailing idea that certain disclosures are justified on public policy grounds leads to difficult questions about the extent, if any, to which a disclosure of privileged information to a particular party should result in a waiver vis-à-vis otherwise privileged information that was not disclosed. Nonetheless, the privilege can be lost if not scrupulously guarded. Waiver of the privilege may be effected, either expressly or impliedly, by the words or conduct of the client or the client's attorney acting as the agent of the client. When the client is a corporation, the privilege may generally only be waived by members of the management group of such corporation or the corporation's attorney.[60]

In the corporate context, the law governing waiver of the attorney-client privilege and work-product doctrine is unresolved or differs from court to court in several respects. Of particular relevance to the Task Force's current proposals, there are different answers to the question of whether and to what extent these protections will be preserved when a corporation discloses privileged or work-product protected material to a regulator or prosecutor. That is, it is not at all clear that the disclosed material and other related material may be kept from opposing parties in litigation or from others who seek to discover the information in the course of litigation. The Supreme Court has yet to weigh in on these questions, and even if it did, it could conclusively resolve the question only for proceedings governed by federal law, not for state-court proceedings.

There is general agreement that if a company discloses attorney-client privileged material to a regulator or prosecutor, the company thereby waives the attorney-client privilege as far as the particular information is concerned. The cases disagree whether the effect is also to impliedly waive that privilege with respect to all other attorney-client communications on the same subject matter. The Eighth Circuit found that such disclosure did not effectuate a broader waiver in an early decision, Diversified Industries, Inc. v. Meredith.[61] But more recently, the Sixth Circuit rejected the idea of "selective waiver." In In re Columbia/HCA Healthcare

[51] Id.
[52] MODEL RULES OF PROF'L CONDUCT R. 3.4(a) (2003).
[53] See, e.g., FED. R. CIV. P. 37 and O.C.G.A. § 9-11-37 (2005).
[54] U.S. CONST. amend. VI.
[55] McMann v. Richardson, 397 U.S. 759, 771 n. 14 (1970).
[56] RICE § 10:1, at 6.
[57] RICE § 10:6, at 28-29. Of course, a denial of the privilege does not necessarily render the attorney incapable of providing effective assistance. In Weatherford v. Bursey, an undercover agent posed as a codefendant and attended defense strategy sessions with the defendant. Later, the agent testified at the defendant's trial. Weatherford v. Bursey, 429 U.S. 545, 547-50 (1977). The Court held such intrusion into the privilege did not result in a violation of the criminal defendant's Sixth Amendment right to effective assistance of counsel because the intrusion did not impede defense counsel's ability to provide effective representation. Id. at 556-57. Notably, the court relied heavily upon the District Court's finding at trial that no privileged communications were ever revealed to the prosecution. Id. at 556. Despite the Court's holding in Weatherford, an intrusion into the privilege can result in a violation of a criminal defendant's Sixth Amendment right to effective assistance of counsel. See generally, Bishop v. Rose, 701 F.2d 1150 (6th Cir. 1983).
[58] GERGACZ, §§ 5.01-5.08, at 5-2 to 5-10.
[59] EPSTEIN at 185-219.
[60] RICE § 9:3, at 10-11.
[61] Diversified Indus., Inc., 572 F.2d at 604, n.1.

Corporation Billing Practices Litigation, the court concluded that even when the corporation provides privileged information to a regulator pursuant to a confidentiality agreement, the corporation waives the attorney-client privilege as to all communications on the subject matter. Further, it questioned as a matter of policy "whether the Government should assist in obfuscating the 'truth-finding process' by entering into such confidentiality agreements at all. The investigatory agencies of the Government should act to bring to light illegal activities, not to assist wrongdoers in concealing the information from the public domain."[62] On the other hand, one might argue that this ruling will discourage corporations from cooperating with regulators in the future and that it will thwart the policy underlying the privilege by discouraging future corporate clients from making candid disclosures to counsel in the future.

There is equal uncertainty about the legal implications of sharing with a regulator or prosecutor material protected by the work-product doctrine. Several courts have said that when a company discloses its attorneys' work product to a government agency pursuant to a confidentiality agreement, the protections of the work-product doctrine are preserved.[63] The SEC has supported this approach.[64] But the Sixth Circuit in In re Columbia/HCA Healthcare Corporation Billing Practices Litigation took the opposite view, as did a California district court.[65]

V. Recent Government Policies, Practices and Procedures Regarding the Corporate Attorney-Client Privilege and Work-Product Doctrine

In recent years, particularly on the federal level, criminal law enforcement authorities and regulatory authorities have adopted policies and employed practices and procedures that suggest that if corporations disclose documents and information that are protected by the corporate attorney-client privilege and work-product doctrine, they will receive credit for cooperation. Surveys and testimony received by the Task Force assert that government agencies' requests for such information leave corporations with no practical choice but to comply, since the agencies can employ their discretionary exercise of prosecutorial or enforcement authority under criminal law or civil regulation to impose a substantial cost on corporations that assert rather than waive the privilege.[66] In federal criminal cases, prosecutors' authority has been reinforced by a recent amendment to the Commentary for Section 8C2.5 of the Federal Sentencing Guidelines against which the ABA is already on record. Building on the ABA's prior work, the Task Force solicited additional information about these government practices. We heard that these practices are becoming increasingly widespread and are engendering substantial concern within the professional and corporate community that the protections of the attorney-client privilege and work-product doctrine are being eroded. Discussions are being initiated with the relevant enforcement agencies regarding these perceptions and concerns.

A. Federal Prosecutorial Policies

At common law, corporations were not subject to criminal liability because they were deemed incapable of forming criminal intent, but over time, with the development of broad principles of vicarious corporate criminal liability, corporations have come to face the risk of criminal prosecution based on wrongdoing committed by corporate officers and employees, even when the corporation is essentially the victim. Prosecutors have traditionally recognized that criminal charges ought to be pursued rarely against corporations, but prosecutors nevertheless employ the threat of criminal prosecution to secure corporations' assistance in their criminal investigations and prosecutions of individuals. At one time, this assistance primarily included providing relevant documents and information other than privileged communications and attorneys' litigation work product. Demands for this level of corporate assistance do not, in particular, present concerns from the perspective of the public interest in an effective corporate client-lawyer relationship.

What has become a source of considerable concern from this perspective, however, is the perceived prosecutorial expectation that in order to persuade the prosecution that the corporation has not engaged in conduct deserving of prosecution, or as an aspect of cooperation with the criminal investigation, corporations will provide material that *is* subject to the protection of the attorney-client privilege or work-product doctrine. The Task Force heard from a variety of sources that, whether made overtly or implicitly, these requests, backed by an express or implied threat of harsh treatment for refusing, have become increasingly common.[67]

These practices have been energized by the call from the President of the United States after the collapse of Enron for more vigorous prosecutions of corporations. As part of the response, on January 20, 2003, then Deputy Attorney General Larry Thompson issued a memorandum (the "Thompson Memorandum") to the DOJ addressing the "Principles of Federal Prosecution of Business Organizations."[68] The Thompson Memorandum identified nine factors

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[62] In re Columbia/HCA Healthcare Corporation Billing Practices Litig., 293 F.3d 289, 303 (6th Cir. 2002).

[63] See, e.g., In re Steinhardt Partners, 9 F.3d 230, 236 (2d Cir. 1993); In re Leslie Fay Companies, Inc. Securities Litig., 161 F.R.D. 274, 284 (S.D.N.Y. 1995).

[64] See United States v. Bergonzi, 9th Cir. Cas No. 03-10024, Brief of the Securities and Exchange Commission, 2003 WL 22716310 (April 29, 2003), at *3-4; McKesson HBOC, Inc. v. The Superior Court of San Francisco, Brief of the Securities and Exchange Commission, www.sec.gov/litigation/briefs/mckesson07103.htm (February 8, 2005).

[65] United States v. Bergonzi, 216 F.R.D. 487 (N.D. Ca. 2003).

[66] See, e.g., Statement of James W. Conrad, Jr., Assistant General Counsel, American Chemistry Council ("Finally, in the experience of our members and their outside counsel, companies faced with waiver requests virtually always accede to them. In seeking to resolve the threat to the short-term best interest of the business and its shareholders, particularly the risk of a criminal prosecution of the company, senior corporate management do not dare lose an opportunity for favorable treatment (or, conversely, trigger the wrath of prosecutors). Indeed, it is difficult in today's climate for management of publicly-held companies to do otherwise, since both DOJ and the SEC do not see any legal impediment to obtaining waiver.").

[67] See, e.g., The Executive Summary of the Survey of the Association of Corporate Counsel regarding the Attorney-Client Privilege, (available at http://www.acca.com/Surveys/attyclient.pdf); January 31, 2005 submission of the American College of Trial Lawyers ("These demands, which erode the attorney-client privilege and the work-product doctrine, commonly include not only waiver of these protections, but also disclosure of corporate internal investigations by counsel . . .") (quoting 2002 publication); Submission of Prof. Stephen A. Salzburg and Jan L. Handzlik, on behalf of the ABA Criminal Justice Section, "The Attorney-Client Relationship in an Age of Terrorism and Greed" ("As reflected in legislation, U.S. Department of Justice policy memoranda and litigation releases from the Securities and Exchange Commission, in order to gain an advantage in the charging process or to mitigate punishment, cooperation by targets of investigations with prosecutors and regulators is essential. The emphasis on 'complete' cooperation puts pressure on clients to waive attorney-client privilege and on their lawyers to give up the protections of the work-product doctrine.").

[68] Memorandum from Deputy Attorney General Larry Thompson to Heads of Department Components and U.S. Attorneys, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003) (available at

(footnote continued on next page)

that federal prosecutors should utilize in making their charging decisions regarding corporations or other business entities, including the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection.[69] The ABA Section of Criminal Justice takes the position that the 2003 policy "contemplate[s] that companies identify and hand over damaging documents, disclose results of internal investigations, furnish memoranda of interviews with company officers and employees, and agree to waive attorney-client and work product protections in the course of their cooperation."[70] The stated rationale for the policy is to "permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition [such requests] are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation."[71] However, the DOJ has not issued internal guidelines interpreting the purpose of this policy, when it is to be applied and what safeguards should be in place to prevent abuse at the local level. The Task Force has initiated discussions to explore these questions and to seek an outcome that properly balances all policy considerations including those underlying the privilege and work-product doctrine.

As a practical matter, corporations rarely can resist prosecutorial requests for disclosure, because of the harsh consequences of having to defend against criminal charges, and because, in cases where criminal charges are brought and sustained, corporations depend on the leniency in sentencing that results from providing assistance satisfactory to the prosecution. The difficulty of resisting prosecutorial requests for production of confidential material was reinforced by recent changes to the Federal Sentencing Guidelines.[72] Under the November 1, 2004, amendments to the Commentary for Chapter 8, Section 8C2.5 of the Guidelines, to qualify for a reduction in its sentence for providing assistance to the government investigation, a corporation would be required to waive confidentiality protections if "such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization."[73] In response to this amendment, and even before it went into effect, the ABA voiced its opposition through the adoption of a resolution that the Commentary should be revised "to state affirmatively that waiver of the attorney-client privilege and work product protection should not be a factor in determining whether a sentencing reduction is warranted for cooperation with the government."[74] Following the adoption of this resolution, the ABA and an informal coalition of numerous business, legal and public policy organizations have sought to persuade the Sentencing Commission and Congress to reverse the 2004 amendment.[75]

Although the Thompson Memorandum notes that privilege waivers would not be considered as an absolute requirement,[76] as noted above the DOJ has not developed detailed safeguards to regulate when and how prosecutors may legitimately seek attorney-client privileged information and attorneys' litigation work product, comparable to those internal guidelines developed to regulate other sensitive investigative demands, such as demands for testimony from attorneys concerning their clients, from journalists, and from family members of targets.[77] The Task Force will be discussing other concepts such as requiring that approval be obtained from a high-ranking Department official in situations when corporations offer to relinquish the legal protections afforded to lawyer-client confidentiality. It appears that the DOJ has not collected information about the frequency with which prosecutors obtain privileged material from corporations as an element of corporate cooperation, the circumstances in which the material is obtained, or the precise nature of the material produced. The interest of the DOJ in pursuing these questions with the Task Force is a healthy dynamic that can assist in determining the facts and exploring solutions with respect to this issue.

B. Practices of Federal Regulators

Federal regulators, and particularly the SEC, have begun to adopt policies and practices mirroring those of the Department of Justice, which while discussing "cooperation credit,"

(footnote continued from previous page)

http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm). The Thompson Memorandum expanded and revised previous policies of the DOJ that were established in a memorandum drafted by former Deputy Attorney General Eric Holder. Memorandum from Deputy Attorney General Eric Holder to Head of Department Components and U.S. Attorneys, Bringing Criminal Charges Against Corporations (June 16, 1999), reprinted in Justice Department Guidance on Prosecutions of Corporations, in 66 CRIM. L. REP. (BNA) 189 (1999) (available at http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html).

[69] Thompson Memorandum at 2-3 (emphasis added).

[70] Submission of Prof. Stephen A. Salzburg and Jan L. Handzlik, on behalf of the ABA Criminal Justice Section, "The Attorney-Client Relationship in an Age of Terrorism and Greed" at 8-9.

[71] Thompson Memorandum at 5.

[72] Although the United States Supreme Court's decision in U.S. v. Booker, No. 04-104 and U.S. v. Fanfan, No. 04-105, held that the Federal Sentencing Guidelines will henceforth be only advisory and not mandatory for sentencing judges, courts will still be required to consider the Guidelines, including the Commentary to Section 8C2.5 involving privilege waiver.

[73] U.S. SENTENCING GUIDELINES MANUAL § 8C2.5 (2004) (emphasis added) (available at http://www.ussc.gov/2004guid/8c2_5.htm).

[74] Resolution Adopted by the House of Delegates of the American Bar Association, August 2004.

[75] Other members of the informal coalition include the American Chemistry Council, the American Civil Liberties Union, the Association of Corporate Counsel, Business Civil Liberties, Inc., the Business Roundtable, Frontiers of Freedom, the National Association of Manufacturers, the U.S. Chamber of Commerce, and the Washington Legal Foundation. The ABA and other members of the informal coalitions have met with numerous members and staff of the House and Senate Judiciary Committees and with representatives of the Sentencing Commission in a coordinated effort to reverse the change to the Commentary of Section 8C2.5. On February 9, 2005, the ABA and the informal coalition submitted separate letters to the House Judiciary Subcommittee on Crime, Terrorism and Homeland Security urging Congress to reverse the Commentary amendment. In addition, the informal coalition and the ABA submitted separate letters to the Sentencing Commission on March 3, 2005, and May 17, 2005, respectively, urging the Commission to reconsider and reverse the amendment. Certain members of this informal coalition have also provided testimony to the Task Force regarding their views on this issue and the various lobbying efforts of the informal coalition.

[76] Specifically, the Thompson Memorandum states in its commentary that, "[DOJ] does not…consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation." Thompson Memorandum at 5.

[77] The only guidance provided to AUSA's by the Thompson Memorandum is that "Prosecutors may…request a waiver in appropriate circumstances" and "[W]aiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation." Id. at 5 and 10-11, n.3.

mention disclosures of protected confidential information.[78] On October 23, 2001, pursuant to Section 21(a) of the Securities Exchange Act of 1934, the SEC issued a report outlining some of the criteria that it considers when assessing the extent to which a company's self-policing and cooperation efforts will influence its decision to bring an enforcement action against a company for federal securities law violations (the "Seaboard Report").[79] The Seaboard Report described actions taken by Seaboard Corporation upon its discovery that it might have violated federal securities laws, and listed a series of questions that the SEC considered useful in determining whether it should proceed with an enforcement action. Among the questions were whether the company had "cooperate[d] completely with appropriate regulatory and law enforcement bodies;" whether the company had conducted "a thorough review of the nature, extent, origins and consequences of the conduct and related behavior;" whether the company "promptly [made] available to [SEC] staff the result of its review and provide[d] sufficient documentation reflecting its response to the situation;" whether "the company identif[ied] possible violative conduct with sufficient precision to facilitate prompt enforcement actions against those who violated the law;" whether "the company produce[d] a thorough and probing written report detailing the findings of its review;" and whether "the company voluntarily disclose[d] information [SEC] staff did not directly request and otherwise might not have uncovered." Within the professional community, there is concern that the SEC regards the production of attorney-client privileged information and attorneys' litigation work product developed in the course of the company's internal investigation as an element of the disclosure identified in the Seaboard Report as necessary to allow the SEC to more readily gain access to statements of possible witnesses, subjects, and targets and better evaluate a corporation's level of cooperation. This concern that the SEC now regards waiver of the attorney-client privilege and work-product protection as a necessary element of cooperation is bolstered by public remarks made by SEC officials.[80]

The Task Force also received anecdotal information from attorneys, corporations and their representative organizations that the SEC and other federal regulatory agencies have been regarding disclosures of protected information as an aspect of corporate cooperation necessary to avoid harsh exercise of enforcement authority.[81] Like the DOJ, the SEC and other regulatory agencies have so far not adopted internal guidelines or procedural safeguards regarding privilege and work product waivers. There also is no government data about the frequency with which this practice is employed.

VI. How Requiring Disclosure of Confidential Information Undermines the Public Interest

A corporation that feels compelled to comply with a government agency's requests for privileged material and attorneys' litigation work product may receive the benefit of lenient treatment by the particular agency, but it may also pay a considerable price. The chilling effect on clients' comfort level in fully disclosing to attorneys is a significant concern. Moreover, as noted, these disclosures can have the legal effect of waiving the attorney-client privilege or work-product doctrine. Therefore, the disclosed material, and quite possibly additional protected material on the same subject matter, then becomes accessible to private parties, as well as to other public agencies, for their use in litigation against the corporation.[82] The corporation will, in effect, be punished for having previously retained counsel for the salutary end of assisting with a legal problem, and for having directed officers and employees to confide in counsel so that the corporation could benefit from effective advice and assistance.

The chilling effect or waiver to third parties is not a consequence necessarily sought or desired by criminal or regulatory authorities, which are seeking to serve legitimate criminal and civil enforcement objectives. As a general rule, government agencies do not and may not use their power for the purpose of assisting private litigants; further, government agencies have acknowledged that the attorney-client privilege and work-product doctrine serve important societal interests.[83] Nonetheless, under evidentiary law governing the waiver of privileges,[84] complying with government agencies' demands or requests means that corporate clients relinquish legal protection otherwise accorded to attorney-client communications and attorneys' litigation work product. The applicable case law protects the holder of the applicable protection only against legal compulsion – *e.g.*, the threat of a criminal or civil contempt sanction for refusing to produce privileged material. While in today's enforcement environment, a waiver may not be voluntary in a

[78] See January 31, 2005 submission of the American College of Trial Lawyers (identifying "similar cooperation and disclosure programs" adopted by other federal agencies as including "the Department of Justice Antitrust Division Corporate Leniency Policy, the EPA Voluntary Disclosure Program and the HHS Provider Self-Disclosure Protocol").

[79] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exch. Act Rel. No. 44969 (Oct. 23, 2001).

[80] Stephen M. Cutler, Director of the Division of Enforcement at the SEC, Remarks at UCLA School of Law, "The Themes of Sarbanes-Oxley as reflected in the Commission's Enforcement Program," (September 20, 2004) (transcript available at http://www.sec.gov/news/speech/spch092004smc.htm).

[81] January 31, 2005 submission of the American College of Trial Lawyers ("In the three years since Seaboard, anecdotal reports have indicated – unsurprisingly – that an increasing number of defendants have waived the privilege in an attempt to earn credit or cooperation."); February 11, 2005 Letter of Steven R. Schell, Esq. (Identifying practice of EPA and Department of Justice of offering to settle environmental claims against corporations in exchange for disclosure of investigative reports containing corporate executives' earlier communications with counsel in response to EPA notice).

[82] See, e.g., Corporations Committee, Business Law Section, The State Bar of California, "'At Every Peril' New Pressures on the Attorney-Client Relationship," Nov. 13, 2003 ("When allegations of possible misconduct arise, corporations can be subject to multiple types of lawsuits and related actions. At the federal level, alleged misconduct with securities law implications can be subject to administrative or civil enforcement action by the SEC as well as criminal prosecution by the office of the U.S. Attorney. The same alleged misconduct might also be subject to administrative or civil enforcement action a well as criminal prosecution by one or more states. In some cases, the alleged misconduct can result in disciplinary action by a self-regulatory organization. Finally, the alleged misconduct may engender one or more civil lawsuits brought by shareholders. Given the very real potential of multi-track enforcement, corporations face a serious dilemma when asked at a very early stage by just one regulator to waive client confidentiality protections.")

[83] See, e.g., SEC statement and amicus brief, cited in January 31, 2005 submission of the American College of Trial Lawyers at 11. Certainly, government agencies recognize the importance of – and have zealously litigated to preserve – these protections when these agencies themselves retain counsel. See generally, Marion J. Radson & Elizabeth A. Waratuke, "The Attorney-Client and Work Product Privileges of Government Entities," 30 Stetson L. Rev. 799 (2001), submitted by the City, County, and Local Government Law Section of the Florida Bar.

[84] Supra, note 58.

real-world sense, the courts have not caught up to that fact and rule that the resulting disclosures are sufficiently voluntary for purposes of evidentiary law to effect a waiver. The case law was developed well before government agencies adopted the current practice of using cooperation credits to obtain "voluntary" disclosures, and the law does not take into account that the legal authority wielded by government agencies makes their requests coercive as a practical matter.

As corporations become increasingly cognizant of government agencies' policies and practices, the risk is that corporations will respond with greater reluctance to employ counsel or to confide fully in counsel, thereby undermining the public objectives served by the privilege. As the Supreme Court recognized in Upjohn, the attorney-client privilege enables corporate attorneys to obtain the information necessary to "formulate sound advice when their client is faced with a specific legal problem"[85] and thereby "ensure their client's compliance with the law,"[86] but that for counsel to serve this role, it is essential that the "attorney and client . . . be able to predict with some degree of certainty whether particular discussions will be protected."[87] While the policies may not have that intent, the facts suggest that contemporary government practices deprive corporations of the certainty toward which the case law is aimed.

The Task Force heard consistently the concern that from the perspective of a corporation faced with a legal problem, the willingness to retain counsel and confide candidly and truthfully in counsel will be reduced because of the risk that government agencies, subject to scant internal standards, safeguards and guidelines, may later demand and obtain access to confidential communications with counsel, thereby in turn making those communications accessible to private litigants. Some submit that the perception that corporate lawyers have been, in effect, "deputized" by government agencies to develop evidence for those agencies' use will not only discourage disclosures but will undermine the trust and confidence in counsel that have historically been recognized as fundamental to an effective attorney-client relationship.[88] A California state bar association committee summarized what many have suggested to the Task Force as follows: "Over time, clients will . . . become reluctant to consult proactively and fully with legal counsel about issues. Knowing that the enforcement authorities will be privy to all information developed in any self-investigatory process will also serve a disincentive for clients to self-investigate and remediate…. Pressure on corporations to waive client confidentiality protections thus creates additional risks of harm to investors and innocent targets of investigation and, even to the public itself."[89]

[85] Upjohn, 449 U.S. at 392.
[86] Id.
[87] Id. at 393.
[88] See Statement of Atlantic Legal Foundation ("The demand for corporate privilege waivers . . . 'effectively deputizes the company's in-house and outside counsel as agents for prosecutors and regulators, and this makes many employees understandably reluctant to talk to an internal investigator...employees quite naturally have started viewing the company's investigators with the same level of suspicion and apprehension that they hold toward government agents investigating a crime.'") (quoting former United States Solicitor General Theodore Olson).
[89] Corporations Committee, Business Law Section, The State Bar of California, "'At Every Peril' New Pressures on the Attorney-Client Relationship," Nov. 13, 2003 at p. 4.

The Task Force has been told that corporations and their lawyers may already have begun to alter their practices in response to government agencies' erosion of the expectations of confidentiality that the law otherwise affords. As Former United States Solicitor General Theodore Olson concluded in an address on this subject in March 2005, government agencies' practice of compelling corporations to waive the privilege has a "deleterious effect on corporate compliance programs, the ability of companies to self-regulate, and most ironically, their ability effectively to cooperate with the government."[90]

Many individuals and groups submitted testimony that by securing privileged information from a corporation, a government agency may serve the interests of a particular criminal or regulatory investigation, but it sacrifices the long-term, public interests that the Supreme Court and others have long associated with the privilege. The Section of Criminal Justice observed: "Waivers may be in the public interest in many instances, but that is not necessarily true in all cases. Balancing the public interest against the historic purpose of permitting clients to obtain the best possible legal advice by confiding and trusting fully and completely in their lawyers requires both a careful assessment of the strength of the public interest in specific circumstances and the dangers of eroding client confidence in the attorney-client relationship."[91] Among those who have commented to the Task Force concerning the current policies and practices of government agencies, there is broad concern that the appropriate balance is not being struck, and that the public interest, as protected by the attorney-client privilege and work-product doctrine, are under erosion as a consequence.[92]

In summary, there is widespread concern among corporations and the lawyers that serve them that government voluntary waiver programs do not have adequate safeguards in their present form and that the privilege along with the work-product doctrine are being jeopardized. While this may well be due to unintended consequences, the situation must be remedied. The Task Force intends to continue dialogue with the relevant agencies and believes clear articulations by the ABA of policy in this area would be constructive.

[90] Address of Theodore Olson at March 9-10 conference on "The Attorney-Client Privilege: Erosion, Ethics, Problems and Solutions," quoted in Statement of Atlantic Legal Foundation.
[91] Submission of Prof. Stephen A. Salzburg and Jan L. Handzlik, on behalf of the ABA Criminal Justice Section, "The Attorney-Client Relationship in an Age of Terrorism and Greed" at 12.
[92] See, e.g., January 31, 2005 statement of the American College of Trial Lawyers ("each of these practices interferes with the attorney-client relationship and encroaches upon historical protections that have aided – not impeded – the fair administration of justice."); Testimony of Paul Rosenzweig, Senior Legal Reserach Fellow, Center for Legal and Judicial Studies, The Heritage Foundation ("[I]n the near term, [the new policies] will advance prosecutorial interests by giving governmental authorities easier access to corporate information developed through internal investigations. But the natural consequence of routine use of this investigative tool will necessarily be that corporations will decrease their use of internal investigations, or, if they do conduct such investigations, the cautions that the investigating attorneys are obliged to give will create a disincentive for full disclosure. . . . And of course, from the broader societal perspective, that is the wrong answer. We want corporations to be self-regulating to the extent possible. We want to encourage and foster introspection and self-correction. . . [T]he new policies are deeply troubling . . . [in part] because they reflect a short-term utilitarian calculus in disregard for historical antecedents that go back as much as 500 years.").

VII. Future Interaction with Government Agencies

The resolutions recommended by the Task Force build on the ABA's August 2004 resolution opposing the Federal Sentencing Guidelines expectation that corporations waive privileges as an element of assisting government investigations. To a substantial extent, these resolutions are implicit in the earlier one, as well as in the ABA's consistent commitment, in its rules of professional conduct and other positions, to the principle of attorney-client confidentiality.[93] Although the work of the Task Force will continue with the objective of developing more specific policy, the Task Force believes it is important for the ABA to respond to the recent developments described above by expressing its strong support for the preservation of the attorney-client privilege and work-product doctrine, its opposition to policies, practices and procedures of governmental agencies that have the effect of eroding the attorney-client privilege and work-product doctrine, and its endorsement of policies, practices and procedures that recognize the value of those protections.

Consistent with the recommended resolutions the Task Force is continuing dialogue with government agencies to assure that policies, practices and procedures are in effect to protect against any eroding of the attorney-client privilege and work-product doctrine, thereby avoid undermining the public interests served by those protections. The Task Force has been asked by government agencies to gather data to document the perceived problems that are discussed above. We are in the process of doing that and are encouraging the government agencies to do the same. As discussed, we are also studying potential guidelines, safeguards and procedures that would assure proper protections for the holders of the privilege and work product when waivers of the attorney-client privilege and work-product doctrine are involved.

In evaluating potential guidelines, safeguards and procedures as described above, the Task Force is mindful that there are factual complexities that must be considered, such as situations when the privilege is improperly asserted by a corporation and the real question is not one of waiver, but applicability of the privilege. Further, there may be situations when corporations with no pressure on them desire to voluntarily waive the privilege or work product protection. The Task Force has been advised that the ABA Section of Litigation is presently undertaking to develop proposed guidelines to assure adequate protections when various factual scenarios are presented and the Task Force awaits the result of this effort.

It is important to note that the resolutions accompanying this Report do not address the legal consequences of a corporation's disclosure of documents or information covered by the attorney-client privilege or work-product doctrine to a government agency. The question of whether, and to what extent, such disclosures result in a waiver, thereby making previously protected material available to other parties in litigation, has been litigated in cases before state and lower federal courts. At the request of the SEC, the 108th Congress considered, but ultimately failed to pass legislation (H.R. 2179) limiting any waiver of privilege for information submitted to the SEC pursuant to a written agreement.[94] The Task Force has received varying viewpoints regarding the desirability of such legislation, and will continue to study the question. Meanwhile, the Task Force's work has advanced sufficiently to propose the three resolutions accompanying this Report.

VIII. Future Issue-PCAOB and Auditors

While the Task Force has heard from many individuals and entities regarding pressures that auditors are currently exerting on the privilege,[95] the Task Force has not yet gathered enough information to be able to formulate recommendations regarding action to the House of Delegates. Accordingly, this report does not focus on privilege issues related to auditors and their regulating body, the Public Company Accounting Oversight Board (the "PCAOB"). Nonetheless, this section of the report does offer a brief overview of privilege issues related to auditors and case law interpreting disclosures to auditors of material protected by the privilege and work-product doctrine.

Audits play an important role in the orderly functioning of our nation's social and economic systems because they ensure that the financial statements of companies "fairly present" such companies' financial conditions. Because auditors must have access to enough information to conduct audits properly and because corporations have a need to protect certain information from disclosure so that the interests protected by the privilege and the work-product doctrine are not undermined, a natural tension is created between the privilege and work-product doctrine, on the one hand, and audits, on the other hand.

An example of a reconciliation of this tension is found in the AICPA's adoption of its Statement on Auditing Standards No. 12 in January of 1976 and the corresponding adoption by the ABA of its Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information on December 8, 1975. SAS No. 12 is part of the PCAOB's interim audit standards.

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[93] The recommendations of the Task Force, although limited to the attorney-client privilege and work-product doctrine, are consistent with the client confidentiality provisions of the ABA Model Rules of Professional Conduct, including the amendments to Rules 1.6 and 1.13 adopted by the ABA House of Delegates in August 2003. The attorney-client privilege and the lawyer's professional duty of confidentiality under the Rules are related concepts and share some of the same underlying purposes, but they function differently. The privilege is an evidentiary rule covering attorney-client communications whose disclosure by either client or lawyer may not be compelled by law, whereas the Rules of Professional Conduct protections cover the far broader array of information related to the representation that, absent a legal disclosure duty or client consent, lawyers must except in limited circumstances keep confidential. The client confidentiality provisions of the Rules of Professional Conduct reflect a judgment that, absent a compelling public interest, confidentiality is of paramount importance to ensure an effective lawyer-client relationship. The Task Force's recommendations are consistent with this judgment.

[94] H.R. 2179, 108th Cong., 2d Sess., § 4.

[95] See, e.g., Testimony of David Brodsky on behalf of the Corporate Counsel Consortium ("The problems we face today surface when auditors request access to records reflecting counsel's efforts and advice across a broad range of issues, not just internal investigations, and seek to impose on companies obligations to provide auditors with access to privileged information."); Testimony of Kenneth W. Gideon, Chair, ABA Section of Taxation ("By requesting copies of the opinions and assessments themselves rather than seeking assurance that advice on appropriate disclosures has been given, the new practice by auditors raises the risks that the attorney-client and other privileges may be waived to the substantial detriment of public companies and their shareholders.").

These two documents are often collectively referred to as the "Treaty." The purpose of the Treaty is to provide guidance to both attorneys and auditors as to the information auditors need to obtain from a company's counsel as part of the audit and that attorneys can appropriately provide. The Treaty balances the competing interests of the privilege and the work-product doctrine against the auditors' need for information, in part by recognizing the auditors' ability to rely on the attorneys' fulfilling their professional responsibility. This critical underpinning of the Treaty is even more justified today with the SEC's adoption of its Part 205 rules of professional conduct, as provided in Section 307 of the Sarbanes-Oxley Act, and the enhancement of state professional ethics rules.

The AICPA interpretations of SAS No. 12 (AU Section 337.09) also recognize the importance of the attorney-client privilege by limiting the need to examine documents in the company's possession that are subject to the privilege.[96] Recently, however, with increasing frequency, auditors have requested from companies privileged communications or attorneys' litigation work product. The Task Force has been made aware of several types of material that auditors are requesting that companies provide for audits. Examples of the requested material include (1) tax opinions prepared for companies by outside counsel that underlie tax positions and tax accruals;[97] (2) assessments prepared by both in-house and outside counsel that relate to litigation accruals and set forth counsel's reasoning underlying such accruals; (3) reports and papers produced as a result of internal investigations regardless of whether such investigations are ongoing or are likely to have an impact upon an audit; and (4) materials related to compliance with legal and regulatory requirements, e.g., requests to see board and committee members' annual self-assessments.

Requests for such materials may be at variance with the AICPA interpretations by putting in jeopardy the privilege and work-product doctrine. Sparked by the corporate scandals of 2001-2002, legislation, regulations of the SEC and standards and rules of the PCAOB have impacted how generally accepted auditing standards ("GAAS") are applied and have increased scrutiny on auditors' procedures to verify company positions and representations. The PCAOB's and the SEC's roles overseeing auditors' compliance with GAAS in the detection of fraud and public companies' compliance with securities laws have been strengthened. The auditors' role in performing procedures regarding the fair presentation of a company's financial statements has been spotlighted. It is the companies, however, that are charged with developing proper internal controls and cooperating with their auditors in the first instance. And yet, their reward may be vast exposure to civil litigation.

What is the result of disclosures of protected material to public auditors? The decisions raise uncertainties. Disclosing attorney-client privileged documents to outside auditors has been held to waive the privilege, at least as far as those documents are concerned. For example, in a decision dealing with Pfizer's disclosure of privileged information relevant to litigation reserves, the court stated: "Pfizer cannot assert attorney-client privilege for any documents that were provided to its independent auditor. Disclosure of documents to an outside auditor destroys the confidentiality seal required of communications protected by the attorney-client privilege, notwithstanding that the federal securities laws require an independent audit."[98] Whether the waiver is "selective" or has the effect of waiving the privilege as to all communications with counsel on the same subject matter is less clear.

Whether a corporation may share attorneys' litigation work product with public auditors without relinquishing the protection of the work-product doctrine is also uncertain. On one hand, in Medinol, Ltd. v. Boston Scientific Corp., the court found that the protection had been waived when a company shared the results of an internal investigation with outside auditors who were reviewing the company's litigation exposures. The court reasoned that work-product protection is not waived when protected material is disclosed "to a party sharing common litigation interests," but found that the independent auditors did not share common litigation interests with the company.[99] The court concluded, "[T]he auditor's interests are not necessarily aligned with the interests of the company. And, as has become crystal clear in the face of the many accounting scandals that have arisen as of late, in order for auditors to properly do their job, they *must* not share common interests with the company they audit."[100]

More recently, another judge in the United States District Court for the Southern District of New York reached the opposite conclusion in Merrill Lynch & Co. v. Allegheny Energy, Inc.[101] In that case, Merrill Lynch's auditors received attorneys' litigation work product arising out of an internal investigation of a trader's theft, in order to enable the auditors to determine whether the theft impacted on Merrill Lynch's financial statements and whether any conditions reflected adversely on the company's ability to report financial information. Later, the plaintiff in a civil lawsuit relating to the theft sought discovery of the material provided to the auditors. But the court held that the company had not waived work product protection. Characterizing the waiver standard differently from the court in the Pfizer case, the court here said that work product protection is not waived by disclosure to third parties with a common interest, but only by disclosure to adversaries or to conduits to potential adversaries. It acknowledged that "an independent auditor could be conceived of as an adversary because of its important public function to independently ensure the accuracy of a company's financial reports."[102] But it concluded that "any tension between an auditor and a corporation that arises from an auditor's need to scrutinize and investigate a corporation's records and book-keeping practices simply is not the equivalent of an adversarial relationship contemplated by the work-product doctrine. . . . A business and its auditor can and should be aligned insofar as they both seek to prevent, detect and root out corporate fraud."[103] Further, the court justified this result on policy grounds, including that, otherwise, corporations would be discouraged "from conducting a critical self-

[96] See AU Section 337.29 (confirming that language in the company's request letter or the lawyer's response disclaiming waiver of the privilege or work-product doctrine is permissible).
[97] See AU Section 9326.22 (amended April 9, 2003) (regarding support for tax matters).

[98] In re Pfizer Inc. Securities Litig., 1993 U.S. Dist. LEXIS 18215 *22 (S.D.N.Y. 1993).
[99] Medinol, Ltd. v. Boston Scientific Corp., 214 F.R.D. 113, 115 (S.D.N.Y. 2002).
[100] Id. at 116.
[101] Merrill Lynch & Co. v. Allegheny Energy, Inc., 2004 U.S. Dist. LEXIS 21543 (S.D.N.Y. Oct. 22, 2004); see also Laguna Beach County Water Dist. V. Superior Court (Woodhouse), 04 C.D.O.S. 11096 (Cal. Ct. App. December 15, 2004) (finding that in certain circumstances work-product given to an auditor will remain protected from disclosure to third parties).
[102] Merrill Lynch & Co. 2004 U.S. Dist. LEXIS at *19.
[103] Id. at *21-22.

analysis and sharing the fruits of such an inquiry with the appropriate actors,"[104] and, in particular, that it is "important to encourage complete disclosure between a company and its auditor."[105]

The Task Force is currently considering different approaches to address the issue of the disclosure to auditors of materials protected by the privilege and work-product doctrine. One suggestion the Task Force has heard is to encourage the adoption of legislation that would permit corporations to provide privilege and work product protected materials to auditors when necessary in connection with an audit without waiving the protections of the attorney-client privilege and work-product doctrine as to third parties.[106] The Task Force will continue to gather information and hear the opinions of individuals and organizations with a goal of developing policy that strikes the correct balance between the auditors' need for information and corporations' need to protect attorney-client communications and attorneys' litigation work product.

Additionally, there are other significant privilege and work product areas of concern that have been brought to the Task Force's attention. The Task Force is in the process of gathering more facts and insights to determine if its scope of focus should be expanded to cover these areas.

IX. Conclusion

For the foregoing reasons, the Task Force respectfully urges that the House of Delegates adopt the proposed resolutions accompanying this Report.

Respectfully submitted,

The Task Force on the Attorney-Client Privilege

R. William Ide III, Chair

May 18, 2005

[104] Id. at *25.
[105] Id. at *26.
[106] See, e.g., Testimony of David Brodsky on behalf of the Corporate Counsel Consortium ("The Consortium proposes that the SEC and PCAOB, joined by the corporate counsel community and the principal auditors of the vast majority of U.S. public companies, propose and support federal legislation…that would permit companies to provide privileged attorney-client communications and work product to their auditors in connection with audits, reviews, attestations and compliance with Section 10A of the 1934 Securities and Exchange Act without waiving any privileges as to others.").

Michael S. Greco
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May 2, 2006

The Honorable Alberto Gonzales
Attorney General
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

Re: Proposal for Revising Department of Justice Attorney-Client Privilege and Work Product Doctrine Waiver Policy

Dear Mr. Attorney General:

On behalf of the American Bar Association and its more than 400,000 members, I write to enlist your help and support in preserving the attorney-client privilege and work product doctrine and protecting them from Departmental policy and practices that seriously threaten to erode these fundamental rights. Towards that end, we urge you to consider modifying the Justice Department's internal waiver policy to stop the increasingly common practice of federal prosecutors requiring organizations to waive their attorney-client and work product protections as a condition for receiving cooperation credit during investigations. Enclosed is specific proposed language that we believe would accomplish this goal without impairing the Department's ability to gather the information it needs to enforce federal laws.

As you know, the attorney-client privilege enables both individual and organizational clients to communicate with their lawyers in confidence, and it encourages clients to seek out and obtain guidance in how to conform their conduct to the law. The privilege facilitates self-investigation into past conduct to identify shortcomings and remedy problems, to the benefit of corporate institutions, the investing community and society-at-large. The work product doctrine underpins our adversarial justice system and allows attorneys to prepare for litigation without fear that their work product and mental impressions will be revealed to adversaries.

The ABA strongly supports the preservation of the attorney-client privilege and work product doctrine and opposes governmental policies, practices and procedures that have the effect of eroding the privilege or doctrine. Unfortunately, the Department of Justice has adopted—and is now following—a policy that has led many of its prosecutors to routinely pressure organizations to waive the protections of the attorney-client privilege and/or work product doctrine as a condition for receiving cooperation credit during investigations. While this policy was formally established by the Department's 1999 "Holder Memorandum" and 2003 "Thompson Memorandum," the incidence of coerced waiver was exacerbated in 2004 when the U.S. Sentencing Commission added language to Section 8C2.5 of the Federal Sentencing Guidelines that authorizes and encourages the government to seek waiver as a condition for cooperation.

May 2, 2006

In an attempt to address the growing concern being expressed about government-coerced waiver, then-Acting Deputy Attorney General Robert McCallum sent a memorandum to all U.S. Attorneys and Department Component Heads last October instructing each of them to adopt "a written waiver review process for your district or component," and it is our understanding that U.S. Attorneys are now in the process of implementing this directive. Though well-intentioned, the McCallum Memorandum likely will result in numerous different waiver policies throughout the country, many of which may impose only token restraints on the ability of federal prosecutors to demand waiver. More importantly, it fails to acknowledge and address the many problems arising from the specter of forced waiver.

According to a recent survey of over 1,200 in-house and outside corporate counsel, which is available at http://www.acca.com/Surveys/attyclient2.pdf, almost 75% of the respondents believe that a "culture of waiver" has evolved in which governmental agencies believe that it is reasonable and appropriate for them to expect a company under investigation to broadly waive attorney-client or work product protections. Corporate counsel also indicated that when prosecutors give a reason for requesting privilege waiver, the Holder/Thompson/McCallum Memoranda and the amendment to the Sentencing Guidelines were among the reasons most frequently cited.

The ABA is concerned that government waiver policies weaken the attorney-client privilege and work product doctrine and undermine companies' internal compliance programs. Unfortunately, the government's waiver policies discourage entities both from consulting with their lawyers—thereby impeding the lawyers' ability to effectively counsel compliance with the law—and conducting internal investigations designed to quickly detect and remedy misconduct. The ABA believes that prosecutors can obtain the information they most frequently seek and need from a cooperating organization without resorting to requests for waiver of the privilege or doctrine.

The ABA and a broad and diverse coalition of business and legal groups—ranging from the U.S. Chamber of Commerce to the American Civil Liberties Union—previously expressed these and other similar concerns to Congress and the Sentencing Commission. In addition, a prominent group of nine former senior Justice Department officials—including three former Attorneys General from both parties—submitted similar comments to the Sentencing Commission last August. These statements and other useful resources on the topic of privilege waiver are available at http://www.abanet.org/poladv/acprivilege.htm and on the website of the ABA Task Force on Attorney-Client Privilege at http://www.abanet.org/buslaw/attorneyclient/.

After considering the concerns raised by the ABA, the coalition, former Justice Department officials, and others, as well as the results of the new survey of corporate counsel that documented the severe negative consequences of the 2004 privilege waiver amendment to the Sentencing Guidelines, the Commission voted unanimously on April 5, 2006 to remove the privilege waiver language from the Guidelines. Unless Congress affirmatively takes action to modify or disapprove of the Commission's proposal, it will become effective on November 1, 2006. While we are extremely gratified by the Commission's action, the Justice Department's waiver policy continues to be problematic and needs to be addressed.

The ABA Task Force on Attorney-Client Privilege and the coalition have prepared suggested revisions to the Holder/Thompson/McCallum Memoranda that would remedy the problem of government-coerced waiver while preserving the ability of prosecutors to obtain the important factual information

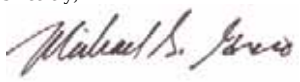
May 2, 2006

that they need to effectively enforce the law. The revised memorandum enclosed herewith would accomplish these objectives by (1) preventing prosecutors from seeking privilege waiver during investigations, (2) specifying the types of factual, non-privileged information that prosecutors may request from companies as a sign of cooperation, and (3) clarifying that any voluntary waiver of privilege shall not be considered when assessing whether the entity provided effective cooperation. We believe that this proposal, if adopted by the Department, would strike the proper balance between effective law enforcement and the preservation of essential attorney-client and work product protections, and we urge you to consider it.

If you or your staff have any questions or need additional information about this vital issue, please ask your staff to contact Bill Ide, the Chair of the ABA Task Force on Attorney-Client Privilege, at (404) 527-4650 or Larson Frisby of the ABA Governmental Affairs Office at (202) 662-1098.

Thank you for considering the views of the American Bar Association on this subject, which is of such vital importance to our system of justice.

Sincerely,



Michael S. Greco

enclosure

SUGGESTED REVISIONS TO DEPARTMENT OF JUSTICE POLICY CONCERNING WAIVER OF CORPORATE ATTORNEY-CLIENT AND WORK PRODUCT PROTECTIONS

PREPARED BY THE AMERICAN BAR ASSOCIATION TASK FORCE ON ATTORNEY-CLIENT PRIVILEGE

FEBRUARY 10, 2006

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM:

DATE:

RE: Guidelines for Determining "Timely and Voluntary Disclosure of Wrongdoing and Willingness to Cooperate"

This Memorandum amends and supplements the October 21, 2005 memorandum issued by Acting Deputy Attorney General Robert D. McCallum, Jr. ("*McCallum Memorandum*") concerning Waiver of the Corporate Attorney-Client and Work Product Protections. In general, the *McCallum Memorandum* requires establishment of a review process for federal prosecutors to follow before seeking waivers of these protections. The *McCallum Memorandum* also notes the Department of Justice that "places significant emphasis on prosecution of corporate crimes."

This Memorandum also amends and supplements the Department's policy on charging business organizations set forth in the memorandum issued by Deputy Attorney General Larry D. Thompson to Heads of Department Components and United States Attorneys, *Re: Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003) (hereinafter *"Thompson Memorandum"),* reprinted in *United States Attorneys' Manual*, tit. 9, Crim. Resource Manual, §§ 161-62. As noted in the *McCallum Memorandum*, one of the nine (9) factors that was identified for federal prosecutors to consider under the *Thompson Memorandum* (§ II.A.4.) is "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection."

In particular, this Memorandum amends the *Thompson Memorandum* by striking the following portion of § II.A.4.: "…including, if necessary, the waiver of corporate attorney-client and work product protection." As amended, § II.A.4. directs that federal prosecutors consider "…the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents."

This Memorandum also amends § VI.A. of the *Thompson Memorandum* by striking the last clause: "…and to waive attorney-client and work product protection;" and by striking the word "complete" from the third clause preceding "results of its internal investigation." As amended, that sentence of § VI.A. states: "In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; and to disclose the results of its internal investigation."

This Memorandum also amends § VI.B. by striking the fourth paragraph and adding language in its place that recognizes the importance of the attorney-client and work product protections and the adverse consequences that may occur when attorneys within the Department of Justice seek the waiver of these protections. As amended, the fourth paragraph of § VI.B. states:

> "The Department of Justice recognizes that the attorney-client privilege and the work-product doctrine are fundamental to the American legal system and the administration of justice. These rights are no less important for an organizational entity than for an individual. The Department further recognizes that an attorney may be an effective advocate for a client, and best promote the client's compliance with the law, only when the client is confident that its communications with counsel are protected from unwanted disclosure and when the attorney can prepare for litigation knowing that materials prepared in anticipation of litigation will be protected from disclosure to the client's adversaries. *See Upjohn Co. v. United States*, 449 U.S. 383, 392-393 (1981). The Department further recognizes that seeking waiver of the attorney-client privilege or work-product doctrine in the context of an ongoing Department investigation may have adverse consequences for the organizational entity. A waiver might impede communications between the entity's counsel and its employees and unfairly prejudice the entity in private civil litigation or parallel administrative or regulatory proceedings and thereby bring unwarranted harm to its innocent public shareholders and employees. *See also* § IX (Collateral Consequences). Attorneys within the Department shall not take any action or assert any position that directly or indirectly demands, requests or encourages an organizational entity or its attorneys to waive its attorney-client privilege or the protections of the work product doctrine. Also, in assessing an entity's cooperation, attorneys within the Department shall not draw any inference from the entity's preservation of its attorney-client privilege and the protections of the work product doctrine. At the same time, the voluntary decision by an organizational entity to waive the attorney-client privilege and the work product doctrine shall not be considered when assessing whether the entity provided effective cooperation."[1]

[1] Notwithstanding the general rule set forth herein, attorneys within the Department may, after obtaining in advance the approval of the Assistant Attorney General of the Criminal Division or his designee, seek materials otherwise

(footnote continued on next page)

Section VI. of the *Thompson Memorandum* is further amended and supplemented by adding new subpart C. that states:

> "C. In assessing whether an organizational entity has been cooperative under § II.A.4. and § VI.B., attorneys within the Department should take into account the following factors:
>
> "1. Whether the entity has identified for and provided to attorneys within the Department all relevant data and documents created during and bearing upon the events under investigation other than those entitled to protection under the attorney-client privilege or work product doctrine.
>
> "2. Whether the entity has in good faith assisted attorneys within the Department in gaining an understanding of the data, documents and facts relating to, arising from and bearing upon the matter under investigation, in a manner that does not require disclosure of materials protected by the attorney-client privilege or work product doctrine.
>
> "3. Whether the entity has identified for attorneys within the Department the individuals with knowledge bearing on the events under investigation.
>
> "4. Whether the entity has used its best efforts to make such individuals available to attorneys within the Department for interview or other appropriate investigative steps.[2]
>
> "5. Whether the entity has conducted a thorough internal investigation of the matter, as appropriate to the circumstances, reported on the investigation to the Board of Directors or appropriate committee of the Board, or to the appropriate governing body within the entity, and has made the results of the investigation available to attorneys within the Department in a manner that does not result in a waiver of the attorney-client privilege or work product doctrine.
>
> "6. Whether the entity has taken appropriate steps to terminate any improper conduct of which it has knowledge; to discipline or terminate culpable employees; to remediate the effects of any improper conduct; and to ensure that the organization has safeguards in place to prevent and detect a recurrence of the events giving rise to the investigation."

(footnote continued from previous page)

protected from disclosure by the attorney-client privilege or the work product doctrine if the organization asserts, or indicates that it will assert an advice of counsel defense with respect to the matters under investigation. Moreover, attorneys within the Department also may seek materials respecting which there is a final judicial determination that the privilege or doctrine does not apply for any reason, such as the crime/fraud exception or a waiver. In circumstances described in this paragraph, the attorneys within the Department shall limit their requests for disclosure only to those otherwise protected materials reasonably necessary and which are within the scope of the particular exception.

[2] Actions by an entity recognizing the rights of such individuals are not inconsistent with this factor.

U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General *Washington, D.C. 20530*

January 20, 2003

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM: Larry D. Thompson
Deputy Attorney General

SUBJECT: Principles of Federal Prosecution of Business Organizations

As the Corporate Fraud Task Force has advanced in its mission, we have confronted certain issues in the principles for the federal prosecution of business organizations that require revision in order to enhance our efforts against corporate fraud. While it will be a minority of cases in which a corporation or partnership is itself subjected to criminal charges, prosecutors and investigators in every matter involving business crimes must assess the merits of seeking the conviction of the business entity itself.

Attached to this memorandum are a revised set of principles to guide Department prosecutors as they make the decision whether to seek charges against a business organization. These revisions draw heavily on the combined efforts of the Corporate Fraud Task Force and the Attorney General's Advisory Committee to put the results of more than three years of experience with the principles into practice.

The main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation's cooperation. Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution. The revisions also address the efficacy of the corporate governance mechanisms in place within a corporation, to ensure that these measures are truly effective rather than mere paper programs.

Further experience with these principles may lead to additional adjustments. I look forward to hearing comments about their operation in practice. Please forward any comments to Christopher Wray, the Principal Associate Deputy Attorney General, or to Andrew Hruska, my Senior Counsel.

Federal Prosecution of Business Organizations[1]

I. Charging a Corporation: General

A. General Principle: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture, alter corporate behavior, and prevent, discover, and punish white collar crime.

B. Comment: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed herein. First and foremost, prosecutors should be aware of the important public benefits that may flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal conduct that is pervasive throughout a particular industry, and thus an indictment often provides a unique opportunity for deterrence on a massive scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm, e.g., environmental crimes or financial frauds, are by their nature most likely to be committed by businesses, and there may, therefore, be a substantial federal interest in indicting the corporation.

Charging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Only rarely should provable individual culpability not be pursued, even in the face of offers of corporate guilty pleas.

Corporations are "legal persons," capable of suing and being sued, and capable of committing crimes. Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should consider the corporation, as well as the responsible individuals, as potential criminal targets.

[1] While these guidelines refer to corporations, they apply to the consideration of the prosecution of all types of business organizations, including partnerships, sole proprietorships, government entities, and unincorporated associations.

Agents, however, may act for mixed reasons -- both for self-aggrandizement (both direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. In *United States v. Automated Medical Laboratories*, 770 F.2d 399 (4th Cir. 1985), the court affirmed the corporation's conviction for the actions of a subsidiary's employee despite its claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." The court stated, "*Partucci* was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well-being and its lack of difficulties with the FDA." Similarly, in *United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982), the court held, "criminal liability may be imposed on the corporation only where the agent is acting within the scope of his employment. That, in turn, requires that the agent be performing acts of the kind which he is authorized to perform, and those acts must be motivated -- at least in part -- by an intent to benefit the corporation." Applying this test, the court upheld the corporation's conviction, notwithstanding the substantial personal benefit reaped by its miscreant agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name. As the court concluded, "Mystic--not the individual defendants--was making money by selling oil that it had not paid for."

Moreover, the corporation need not even necessarily profit from its agent's actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

> [B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which be inimical to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.

770 F.2d at 407 (emphasis added; quoting *Old Monastery Co. v. United States*, 147 F.2d 905, 908 (4th Cir.), cert. denied, 326 U.S. 734 (1945)).

II. Charging a Corporation: Factors to Be Considered

A. General Principle: Generally, prosecutors should apply the same factors in determining whether to charge a corporation as they do with respect to individuals. *See* USAM § 9-27.220, *et seq.* Thus, the prosecutor should weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial,; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. *See* id. However, due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring charges, and negotiating plea agreements, prosecutors should consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (*see* section III, *infra*);

2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management (*see* section IV, *infra*);

3. the corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it (*see* section V, *infra*);

4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection (*see* section VI, *infra*);

5. the existence and adequacy of the corporation's compliance program (*see* section VII, *infra*);

6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies (*see* section VIII, *infra*);

7. collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution (*see* section IX, *infra*); and

8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance;

9. the adequacy of remedies such as civil or regulatory enforcement actions (*see*

section X, infra).

B. Comment: As with the factors relevant to charging natural persons, the foregoing factors are intended to provide guidance rather than to mandate a particular result. The factors listed in this section are intended to be illustrative of those that should be considered and not a complete or exhaustive list. Some or all of these factors may or may not apply to specific cases, and in some cases one factor may override all others. The nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors. Further, national law enforcement policies in various enforcement areas may require that more or less weight be given to certain of these factors than to others.

In making a decision to charge a corporation, the prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute for violations of Federal criminal law. In exercising that discretion, prosecutors should consider the following general statements of principles that summarize appropriate considerations to be weighed and desirable practices to be followed in discharging their prosecutorial responsibilities. In doing so, prosecutors should ensure that the general purposes of the criminal law -- assurance of warranted punishment, deterrence of further criminal conduct, protection of the public from dangerous and fraudulent conduct, rehabilitation of offenders, and restitution for victims and affected communities -- are adequately met, taking into account the special nature of the corporate "person."

III. Charging a Corporation: Special Policy Concerns

A. General Principle: The nature and seriousness of the crime, including the risk of harm to the public from the criminal conduct, are obviously primary factors in determining whether to charge a corporation. In addition, corporate conduct, particularly that of national and multi-national corporations, necessarily intersects with federal economic, taxation, and criminal law enforcement policies. In applying these principles, prosecutors must consider the practices and policies of the appropriate Division of the Department, and must comply with those policies to the extent required.

B. Comment: In determining whether to charge a corporation, prosecutors should take into account federal law enforcement priorities as discussed above. *See* USAM § 9-27-230. In addition, however, prosecutors must be aware of the specific policy goals and incentive programs established by the respective Divisions and regulatory agencies. Thus, whereas natural persons may be given incremental degrees of credit (ranging from immunity to lesser charges to sentencing considerations) for turning themselves in, making statements against their penal interest, and cooperating in the government's investigation of their own and others' wrongdoing, the same approach may not be appropriate in all circumstances with respect to corporations. As an example, it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*,voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business and for which the Antitrust Division has therefore established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government. As another example, the Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses. Thus, in determining whether or not to charge a corporation, prosecutors should consult with the Criminal, Antitrust, Tax, and Environmental and Natural Resources Divisions, if appropriate or required.

IV. Charging a Corporation: Pervasiveness of Wrongdoing Within the Corporation

A. General Principle: A corporation can only act through natural persons, and it is therefore held responsible for the acts of such persons fairly attributable to it. Charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees or by all the employees in a particular role within the corporation, *e.g.*, salesmen or procurement officers, or was condoned by upper management. On the other hand, in certain limited circumstances, it may not be appropriate to impose liability upon a corporation, particularly one with a compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee. There is, of course, a wide spectrum between these two extremes, and a prosecutor should exercise sound discretion in evaluating the pervasiveness of wrongdoing within a corporation.

B. Comment: Of these factors, the most important is the role of management. Although acts of even low-level employees may result in criminal liability, a corporation is directed by its management and management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged. As stated in commentary to the Sentencing Guidelines:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority ... who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization.

USSG §8C2.5, comment. (n. 4).

V. Charging a Corporation: The Corporation's Past History

A. General Principle: Prosecutors may consider a corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it, in determining whether to bring criminal charges.

B. Comment: A corporation, like a natural person, is expected to learn from its mistakes. A history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs. Criminal prosecution of a corporation may be particularly appropriate where the corporation previously had been subject to non-criminal guidance, warnings, or sanctions, or previous criminal charges, and yet it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the conduct in spite of the warnings or enforcement actions taken against it. In making this determination, the corporate structure itself, *e.g.*, subsidiaries or operating divisions, should be ignored, and enforcement actions taken against the corporation or any of its divisions, subsidiaries, and affiliates should be considered. *See* USSG § 8C2.5(c) & comment. (n. 6).

VI. Charging a Corporation: Cooperation and Voluntary Disclosure

A. General Principle: In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation may be relevant factors. In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection.

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor is likely to encounter several obstacles resulting from the nature of the corporation itself. It will often be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying the culprits and locating relevant evidence.

In some circumstances, therefore, granting a corporation immunity or amnesty or pretrial diversion may be considered in the course of the government's investigation. In such circumstances, prosecutors should refer to the principles governing non-prosecution agreements generally. *See* USAM § 9-27.600-650. These principles permit a non prosecution agreement in exchange for cooperation when a corporation's "timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective." Prosecutors should note that in the case of national or multi-national corporations, multi-district or global agreements may be necessary. Such agreements may only be entered into with the approval of each affected district or the appropriate Department official. *See* USAM §9-27.641.

In addition, the Department, in conjunction with regulatory agencies and other executive branch departments, encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose their findings to the appropriate authorities. Some agencies, such as the SEC and the EPA, as well as the Department's Environmental and Natural Resources Division, have formal voluntary disclosure programs in which self-reporting, coupled with remediation and additional criteria, may qualify the corporation for amnesty or reduced sanctions.[2] Even in the absence of a formal program, prosecutors may consider a corporation's timely and voluntary disclosure in evaluating the adequacy of the corporation's compliance program and its management's commitment to the compliance program. However, prosecution and economic policies specific to the industry or statute may require prosecution notwithstanding a corporation's willingness to cooperate. For example, the Antitrust Division offers amnesty only to the first corporation to agree to cooperate. This creates a strong incentive for corporations participating in anti-competitive conduct to be the first to cooperate. In addition, amnesty, immunity, or reduced sanctions may not be appropriate where the corporation's business is permeated with fraud or other crimes.

One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances.[3] The Department does not, however, consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.

Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either

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[2] In addition, the Sentencing Guidelines reward voluntary disclosure and cooperation with a reduction in the corporation's offense level. *See* USSG §8C2.5)g).

[3] This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation.

through the advancing of attorneys fees,[4] through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation. By the same token, the prosecutor should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.

Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.

VII. Charging a Corporation: Corporate Compliance Programs

A. General Principle: Compliance programs are established by corporate management to prevent and to detect misconduct and to ensure that corporate activities are conducted in accordance with all applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents. Indeed, the commission of such crimes in the face of a compliance program may suggest that the corporate management is not adequately enforcing its program. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

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[4] Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate.

B. Comment: A corporate compliance program, even one specifically prohibiting the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior. See United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir. 1983) ("a corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if... such acts were against corporate policy or express instructions."). In *United States v. Hilton Hotels Corp.*, 467 F.2d 1000 (9th Cir. 1972), *cert. denied,* 409 U.S. 1125 (1973), the Ninth Circuit affirmed antitrust liability based upon a purchasing agent for a single hotel threatening a single supplier with a boycott unless it paid dues to a local marketing association, even though the agent's actions were contrary to corporate policy and directly against express instructions from his superiors. The court reasoned that Congress, in enacting the Sherman Antitrust Act, "intended to impose liability upon business entities for the acts of those to whom they choose to delegate the conduct of their affairs, thus stimulating a maximum effort by owners and managers to assure adherence by such agents to the requirements of the Act."[5] It concluded that "general policy statements" and even direct instructions from the agent's superiors were not sufficient; "Appellant could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks." *See also United States v. Beusch,* 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for the acts of its employees done contrary to express instructions and policies, but ... the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation."); *United States v. American Radiator & Standard Sanitary Corp.*, 433 F.2d 174 (3rd Cir. 1970) (affirming conviction of corporation based upon its officer's participation in price-fixing scheme, despite corporation's defense that officer's conduct violated its "rigid anti-fraternization policy" against any socialization (and exchange of price information) with its competitors; "When the act of the agent is within the scope of his employment or his apparent authority, the corporation is held legally responsible for it, although what he did may be contrary to his actual instructions and may be unlawful.").

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program

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[5] Although this case and *Basic Construction* are both antitrust cases, their reasoning applies to other criminal violations. In the Hilton case, for instance, the Ninth Circuit noted that Sherman Act violations are commercial offenses "usually motivated by a desire to enhance profits," thus, bringing the case within the normal rule that a "purpose to benefit the corporation is necessary to bring the agent's acts within the scope of his employment." 467 F.2d at 1006 & n4. In addition, in *United States v. Automated Medical Laboratories*, 770 F.2d 399, 406 n.5 (4th Cir. 1985), the Fourth Circuit stated "that Basic Construction states a generally applicable rule on corporate criminal liability despite the fact that it addresses violations of the antitrust laws."

or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: "Is the corporation's compliance program well designed?" and "Does the corporation's compliance program work?" In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs.[6] Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are the directors provided with information sufficient to enable the exercise of independent judgment, are internal audit functions conducted at a level sufficient to ensure their independence and accuracy and have the directors established an information and reporting system in the organization reasonable designed to provide management and the board of directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. *In re: Caremark,* 698 A.2d 959 (Del. Ct. Chan. 1996).

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. In addition, prosecutors should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department

[6] For a detailed review of these and other factors concerning corporate compliance programs, see United States Sentencing Commission, GUIDELINES MANUAL, §8A1.2, comment. (n.3(k)) (Nov. 1997). *See* also USSG §8C2.5(f)

of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with compliance programs and can be very helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist U.S. Attorneys' Offices in finding the appropriate agency office and in providing copies of compliance programs that were developed in previous cases.

VIII. Charging a Corporation: Restitution and Remediation

A. General Principle: Although neither a corporation nor an individual target may avoid prosecution merely by paying a sum of money, a prosecutor may consider the corporation's willingness to make restitution and steps already taken to do so. A prosecutor may also consider other remedial actions, such as implementing an effective corporate compliance program, improving an existing compliance program, and disciplining wrongdoers, in determining whether to charge the corporation.

B. Comment: In determining whether or not a corporation should be prosecuted, a prosecutor may consider whether meaningful remedial measures have been taken, including employee discipline and full restitution.[7] A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government.

Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. While corporations need to be fair to their employees, they must also be unequivocally committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

[7] For example, the Antitrust Division's amnesty policy requires that "[w]here possible, the corporation [make] restitution to injured parties...."

In addition to employee discipline, two other factors used in evaluating a corporation's remedial efforts are restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its "acceptance of responsibility" and, consistent with the practices and policies of the appropriate Division of the Department entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider.

IX. Charging a Corporation: Collateral Consequences

A. General Principle: Prosecutors may consider the collateral consequences of a corporate criminal conviction in determining whether to charge the corporation with a criminal offense.

B. Comment: One of the factors in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, prosecutors may take into account the possibly substantial consequences to a corporation's officers, directors, employees, and shareholders, many of whom may, depending on the size and nature (e.g., publicly vs. closely held) of the corporation and their role in its operations, have played no role in the criminal conduct, have been completely unaware of it, or have been wholly unable to prevent it. Prosecutors should also be aware of non-penal sanctions that may accompany a criminal charge, such as potential suspension or debarment from eligibility for government contracts or federal funded programs such as health care. Whether or not such non-penal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency, a decision that will be made based on the applicable statutes, regulations, and policies.

Virtually every conviction of a corporation, like virtually every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the severity of collateral consequences, various factors already discussed, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs, should be considered in determining the weight to be given to this factor. For instance, the balance may tip in favor of prosecuting corporations in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity. Similarly, where the top layers of the corporation's management or the shareholders of a closely-held corporation were engaged in or aware of the wrongdoing and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral, but a direct and entirely appropriate consequence of the corporation's wrongdoing.

The appropriateness of considering such collateral consequences and the weight to be given them may depend on the special policy concerns discussed in section III, *supra*.

X. Charging a Corporation: Non-Criminal Alternatives

A. General Principle: Although non-criminal alternatives to prosecution often exist, prosecutors may consider whether such sanctions would adequately deter, punish, and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution, *e.g.*, civil or regulatory enforcement actions, the prosecutor may consider all relevant factors, including:

1. the sanctions available under the alternative means of disposition;
2. the likelihood that an effective sanction will be imposed; and
3. the effect of non-criminal disposition on Federal law enforcement interests.

B. Comment: The primary goals of criminal law are deterrence, punishment, and rehabilitation. Non-criminal sanctions may not be an appropriate response to an egregious violation, a pattern of wrongdoing, or a history of non-criminal sanctions without proper remediation. In other cases, however, these goals may be satisfied without the necessity of instituting criminal proceedings. In determining whether federal criminal charges are appropriate, the prosecutor should consider the same factors (modified appropriately for the regulatory context) considered when determining whether to leave prosecution of a natural person to another jurisdiction or to seek non-criminal alternatives to prosecution. These factors include: the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action; the probable sanction if the regulatory authority's enforcement action is upheld; and the effect of a non-criminal disposition on Federal law enforcement interests. *See* USAM §§ 9-27.240, 9-27.250.

XI. Charging a Corporation: Selecting Charges

A. General Principle: Once a prosecutor has decided to charge a corporation, the prosecutor should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's conduct and that is likely to result in a sustainable conviction.

B. Comment: Once the decision to charge is made, the same rules as govern charging natural persons apply. These rules require "a faithful and honest application of the Sentencing Guidelines" and an "individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the Federal criminal code, and maximize the impact of Federal resources on crime." *See* USAM § 9-27.300. In making this determination, "it is appropriate that the attorney for the government consider, *inter alia*, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993.

XII. Plea Agreements with Corporations

A. General Principle: In negotiating plea agreements with corporations, prosecutors should seek a plea to the most serious, readily provable offense charged. In addition, the terms of the plea agreement should contain appropriate provisions to ensure punishment, deterrence, rehabilitation, and compliance with the plea agreement in the corporate context. Although special circumstances may mandate a different conclusion, prosecutors generally should not agree to accept a corporate guilty plea in exchange for non-prosecution or dismissal of charges against individual officers and employees.

B. Comment: Prosecutors may enter into plea agreements with corporations for the same reasons and under the same constraints as apply to plea agreements with natural persons. *See* USAM §§ 9-27.400-500. This means, *inter alia*, that the corporation should be required to plead guilty to the most serious, readily provable offense charged. As is the case with individuals, the attorney making this determination should do so "on the basis of an individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the federal criminal code, and maximize the impact of federal resources on crime. In making this determination, the attorney for the government considers, inter alia, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993. In addition, any negotiated departures from the Sentencing Guidelines must be justifiable under the Guidelines and must be disclosed to the sentencing court. A corporation should be made to realize that pleading guilty to criminal charges constitutes an admission of guilt and not merely a resolution of an inconvenient distraction from its business. As with natural persons, pleas should be structured so that the corporation may not later "proclaim lack of culpability or even complete innocence." *See* USAM §§ 9-27.420(b)(4), 9-27.440, 9-27.500. Thus, for instance, there should be placed upon the record a sufficient factual basis for the plea to prevent later corporate assertions of innocence.

A corporate plea agreement should also contain provisions that recognize the nature of the corporate "person" and ensure that the principles of punishment, deterrence, and rehabilitation are met. In the corporate context, punishment and deterrence are generally accomplished by substantial fines, mandatory restitution, and institution of appropriate compliance measures, including, if necessary, continued judicial oversight or the use of special masters. *See* USSG §§ 8B1.1, 8C2.1, *et seq*. In addition, where the corporation is a government contractor, permanent or temporary debarment may be appropriate. Where the corporation was engaged in government contracting fraud, a prosecutor may not negotiate away an agency's right to debar or to list the corporate defendant.

In negotiating a plea agreement, prosecutors should also consider the deterrent value of prosecutions of individuals within the corporation. Therefore, one factor that a prosecutor may consider in determining whether to enter into a plea agreement is whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals. Prosecutors should rarely negotiate away individual criminal liability in a corporate plea.

Rehabilitation, of course, requires that the corporation undertake to be law-abiding in the future. It is, therefore, appropriate to require the corporation, as a condition of probation, to implement a compliance program or to reform an existing one. As discussed above, prosecutors may consult with the appropriate state and federal agencies and components of the Justice Department to ensure that a proposed compliance program is adequate and meets industry standards and best practices. *See* section VII, *supra*.

In plea agreements in which the corporation agrees to cooperate, the prosecutor should ensure that the cooperation is complete and truthful. To do so, the prosecutor may request that the corporation waive attorney-client and work product protection, make employees and agents available for debriefing, disclose the results of its internal investigation, file appropriate certified financial statements, agree to governmental or third-party audits, and take whatever other steps are necessary to ensure that the full scope of the corporate wrongdoing is disclosed and that the responsible culprits are identified and, if appropriate, prosecuted. *See* generally section VIII, *supra*.

U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

October 21, 2005

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM: Robert D. McCallum, Jr. RDM
Acting Deputy Attorney General

SUBJECT: Waiver of Corporate Attorney-Client and Work Product Protection

The Department of Justice places significant emphasis on the prosecution of corporate crimes. The Department's policy on charging business organizations is contained in the Memorandum from Deputy Attorney General Larry D. Thompson to Heads of Department Components and United States Attorneys, *Re: Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003) (hereinafter "*Thompson Memorandum*"), *reprinted in United States Attorneys' Manual*, tit. 9, Crim. Resource Manual, §§ 161-62. The *Thompson Memorandum* sets forth nine factors that federal prosecutors must consider in determining whether to charge a corporation or other business organization. One of the nine factors is "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection." *Thompson Memorandum* § II.A.4.

To ensure that federal prosecutors exercise appropriate prosecutorial discretion under the principles of the *Thompson Memorandum*, some United States Attorneys have established review processes for waiver requests that require federal prosecutors to obtain approval from the United States Attorney or other supervisor before seeking a waiver of the attorney-client privilege or work product protection. Consistent with this best practice, you are directed to establish a written waiver review process for your district or component. The *United States Attorneys' Manual* will be amended to reflect this policy. Such waiver review processes may vary from district to district (or component to component), so that each United States Attorney or component head retains the prosecutorial discretion necessary, consistent with their circumstances, to seek timely, complete, and accurate information from business organizations.

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 44969 / October 23, 2001

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 1470 / October 23, 2001

Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions

Today, we commence and settle a cease-and-desist proceeding against Gisela de Leon-Meredith, former controller of a public company's subsidiary.[1] Our order finds that Meredith caused the parent company's books and records to be inaccurate and its periodic reports misstated, and then covered up those facts.

We are not taking action against the parent company, given the nature of the conduct and the company's responses. Within a week of learning about the apparent misconduct, the company's internal auditors had conducted a preliminary review and had advised company management who, in turn, advised the Board's audit committee, that Meredith had caused the company's books and records to be inaccurate and its financial reports to be misstated. The full Board was advised and authorized the company to hire an outside law firm to conduct a thorough inquiry. Four days later, Meredith was dismissed, as were two other employees who, in the company's view, had inadequately supervised Meredith; a day later, the company disclosed publicly and to us that its financial statements would be restated. The price of the company's shares did not decline after the announcement or after the restatement was published. The company pledged and gave complete cooperation to our staff. It provided the staff with all information relevant to the underlying violations. Among other things, the company produced the details of its internal investigation, including notes and transcripts of interviews of Meredith and others; and it

did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation.

The company also strengthened its financial reporting processes to address Meredith's conduct -- developing a detailed closing process for the subsidiary's accounting personnel, consolidating subsidiary accounting functions under a parent company CPA, hiring three new CPAs for the accounting department responsible for preparing the subsidiary's financial statements, redesigning the subsidiary's minimum annual audit requirements, and requiring the parent company's controller to interview and approve all senior accounting personnel in its subsidiaries' reporting processes.

Our willingness to credit such behavior in deciding whether and how to take enforcement action benefits investors as well as our enforcement program. When businesses seek out, self-report and rectify illegal conduct, and otherwise cooperate with Commission staff, large expenditures of government and shareholder resources can be avoided and investors can benefit more promptly.[2] In setting forth the criteria listed below, we think a few caveats are in order:

First, the paramount issue in every enforcement judgment is, and must be, what best protects investors. There is no single, or constant, answer to that question. Self-policing, self-reporting, remediation and cooperation with law enforcement authorities, among other things, are unquestionably important in promoting investors' best interests. But, so too are vigorous enforcement and the imposition of appropriate sanctions where the law has been violated. Indeed, there may be circumstances where conduct is so egregious, and harm so great, that no amount of cooperation or other mitigating conduct can justify a decision not to bring any enforcement action at all. In the end, no set of criteria can, or should, be strictly applied in every situation to which they may be applicable.

Second, we are not adopting any rule or making any commitment or promise about any specific case; nor are we in any way limiting our broad discretion to evaluate every case individually, on its own particular facts and circumstances. Conversely, we are not conferring any "rights" on any person or entity. We seek only to convey an understanding of the factors that may influence our decisions.

Third, we do not limit ourselves to the criteria we discuss below. By definition, enforcement judgments are just that -- judgments. Our failure to mention a specific criterion in one context does not preclude us from relying on that criterion in another. Further, the fact that a company has satisfied all the criteria we list below will not foreclose us from bringing enforcement proceedings that we believe are necessary or appropriate, for the benefit of investors.

In brief form, we set forth below some of the criteria we will consider in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation -- from the extraordinary step of taking no enforcement action to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents we use to announce and resolve enforcement actions.

1. What is the nature of the misconduct involved? Did it result from inadvertence, honest mistake, simple negligence, reckless or deliberate indifference to indicia of wrongful conduct, willful misconduct or unadorned venality? Were the company's auditors misled?

2. How did the misconduct arise? Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?

3. Where in the organization did the misconduct occur? How high up in the chain of command was knowledge of, or participation in, the misconduct? Did senior personnel participate in, or turn a blind eye toward, obvious indicia of misconduct? How systemic was the behavior? Is it symptomatic of the way the entity does business, or was it isolated?

4. How long did the misconduct last? Was it a one-quarter, or one-time, event, or did it last several years? In the case of a public company, did the misconduct occur before the company went public? Did it facilitate the company's ability to go public?

5. How much harm has the misconduct inflicted upon investors and other corporate constituencies? Did the share price of the company's stock drop significantly upon its discovery and disclosure?

6. How was the misconduct detected and who uncovered it?

7. How long after discovery of the misconduct did it take to implement an effective response?

8. What steps did the company take upon learning of the misconduct? Did the company immediately stop the misconduct? Are persons responsible for any misconduct still with the company? If so, are they still in the same positions? Did the company promptly, completely and effectively disclose the existence of the misconduct to the public, to regulators and to self-regulators? Did the company cooperate completely with appropriate regulatory and law enforcement bodies? Did the company identify what additional related misconduct is likely to have occurred? Did the company take steps to identify the extent of damage to investors and other corporate constituencies? Did the company appropriately recompense those adversely affected by the conduct?

9. What processes did the company follow to resolve many of these issues and ferret out necessary information? Were the Audit Committee and the Board of Directors fully informed? If so, when?

10. Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins and consequences of the conduct and related behavior? Did management, the Board or committees consisting solely of outside directors oversee the review? Did company employees or outside persons perform the review? If outside persons, had they done other work for the company? Where the review was

conducted by outside counsel, had management previously engaged such counsel? Were scope limitations placed on the review? If so, what were they?

11. Did the company promptly make available to our staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review? Did the company voluntarily disclose information our staff did not directly request and otherwise might not have uncovered? Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?[3]

12. What assurances are there that the conduct is unlikely to recur? Did the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct? Did the company provide our staff with sufficient information for it to evaluate the company's measures to correct the situation and ensure that the conduct does not recur?

13. Is the company the same company in which the misconduct occurred, or has it changed through a merger or bankruptcy reorganization?

We hope that this Report of Investigation and Commission Statement will further encourage self-policing efforts and will promote more self-reporting, remediation and cooperation with the Commission staff. We welcome the constructive input of all interested persons. We urge those who have contributions to make to direct them to our Division of Enforcement. The public can be confident that all such communications will be fairly evaluated not only by our staff, but also by us. We continue to reassess our enforcement approaches with the aim of maximizing the benefits of our program to investors and the marketplace.

By the Commission (Chairman Pitt, Commissioner Hunt, Commissioner Unger).

Footnotes

[1] *In the Matter of Gisela de Leon-Meredith*, Exchange Act Release No. 44970 (October 23, 2001).

[2] We note that the federal securities laws and other legal requirements and guidance also promote and even require a certain measure of self-policing, self-reporting and remediation. *See, e.g.,* Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1 (requiring issuers and auditors to report certain illegal conduct to the Commission); *In the Matter of W.R. Grace & Co.,* Exchange Act Release No. 39157 (Sept. 30, 1997) (emphasizing the affirmative responsibilities of corporate officers and directors to ensure that shareholders receive accurate and complete disclosure of information required by the proxy solicitation and periodic reporting provisions of the federal securities laws); *In the Matter of Cooper Companies, Inc.,* Exchange Act Release No. 35082 (Dec. 12, 1994) (emphasizing responsibility of corporate directors in safeguarding the integrity of a company's public statements and the interests of investors when evidence of fraudulent conduct by corporate management comes to their attention); *In the Matter of John Gutfreund,* Exchange Act Release No. 31554 (Dec. 3, 1992) (sanctions imposed against supervisors at broker-dealer for failing promptly to bring misconduct to attention of the government). *See also Federal Sentencing Guidelines* § 8C2.5(f) & (g) (organization's "culpability score" decreases if organization has an effective program to prevent and detect violations of law or if organization reports offense to governmental authorities prior to imminent threat of disclosure or government investigation and within reasonably prompt time after becoming aware of the offense); *New York Stock Exchange Rules* 342.21 & 351(e) (members and member organizations required to review certain trades for compliance with rules against insider trading and manipulation, to conduct prompt internal investigations of any potentially violative trades, and to report the status and/or results of such internal investigations).

[3] In some cases, the desire to provide information to the Commission staff may cause companies to consider choosing not to assert the attorney-client privilege, the work product protection and other privileges, protections and exemptions with respect to the Commission. The Commission recognizes that these privileges, protections and exemptions serve important social interests. In this regard, the Commission does not view a company's waiver of a privilege as an end in itself, but only as a means (where necessary) to provide relevant and sometimes critical information to the Commission staff. Thus, the Commission recently filed an *amicus* brief arguing that the provision of privileged information to the Commission staff pursuant to a confidentiality agreement did not necessarily waive the privilege as to third parties. *Brief of SEC as Amicus Curiae, McKesson HBOC, Inc.,* No. 99-C-7980-3 (Ga. Ct. App. Filed May 13, 2001). Moreover, in certain circumstances, the Commission staff has agreed that a witness' production of privileged information would not constitute a subject matter waiver that would entitle the staff to receive further privileged information.

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Statement of the Securities and Exchange Commission Concerning Financial Penalties

FOR IMMEDIATE RELEASE
2006-4

Washington, D.C., Jan. 4, 2006 – The U.S. Securities and Exchange Commission today issued the following statement concerning financial penalties:

Today the Commission announced the filing of two settled actions against corporate issuers, SEC v. McAfee, Inc. and In the Matter of Applix, Inc. In one, the company will pay a civil money penalty; in the other, a penalty is not part of the settlement.

The question of whether, and if so to what extent, to impose civil penalties against a corporation raises significant questions for our mission of investor protection. The authority to impose such penalties is relatively recent in the Commission's history, and the use of very large corporate penalties is more recent still. Recent cases have not produced a clear public view of when and how the Commission will use corporate penalties, and within the Commission itself a variety of views have heretofore been expressed, but not reconciled.

The Commission believes it important to provide the maximum possible degree of clarity, consistency, and predictability in explaining the way that its corporate penalty authority will be exercised. To this end, we are issuing this statement describing with particularity the framework for our penalty determinations in these two cases. We have issued these decisions, and this statement of principles, unanimously.

In determining whether or not to impose penalties against the corporations in these cases, we carefully considered our statutory authority, and the legislative history surrounding that statutory authority.

In 1990, Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act (the "Remedies Act"), which gave the Commission authority generally to seek civil money penalties in enforcement cases.[1] The penalty provisions added by the Remedies Act expressly authorize the Commission to obtain money penalties from entities, including corporate issuers. These provisions also enhanced the Commission's authority to fine individuals. Today, we limit our discussion to penalties against corporations, although we view penalties against individual offenders as a critical component in punishing and deterring violative conduct.

The Remedies Act legislative history contains express references to penalty assessments against corporate issuers of securities. In its Report on the legislation, the Senate Committee on Banking, Housing, and Urban Affairs expressly noted both that the civil money penalty provisions would be applicable to corporate issuers, and that shareholders ultimately may bear the cost of penalties imposed on corporate issuers. According to the Report, such penalties should be assessed when the securities law violation that is the basis of the penalty has resulted in an improper benefit to the shareholders. It also cautioned that the Commission and courts should, in considering corporate issuer penalties, take into account whether the penalty would be paid by shareholders who had been the principal victims of the violation:

The Committee believes that the civil money penalty provisions should be applicable to corporate issuers, and the legislation permits penalties against issuers. However, because the costs of such penalties may be passed on to shareholders, the Committee intends that a penalty be sought when the violation results in an improper benefit to shareholders. In cases in which shareholders are the principal victims of the violations, the Committee expects that the SEC, when appropriate, will seek penalties from the individual offenders acting for a corporate issuer. Moreover, in deciding whether and to what extent to assess a penalty against the issuer, the court may properly take into account whether civil penalties assessed against corporate issuers will ultimately be paid by shareholders who were themselves victimized by the violations. The court also may consider the extent to which the passage of time has resulted in shareholder turnover.[2]

As this discussion indicates, a key question for the Commission is whether the issuer's violation has provided an improper benefit to the shareholders, or conversely whether the violation has resulted in harm to the shareholders. Where shareholders have been victimized by the violative conduct, or by the resulting negative effect on the entity following its discovery, the Commission is expected to seek penalties from culpable individual offenders acting for a corporation. This same point was made in the SEC's memorandum in support of the Remedies Act, which the then Chairman of the SEC, David Ruder, transmitted to the Senate in a January 18, 1989 letter.[3]

In addition to the benefit or harm to shareholders, the statute and its legislative history suggest several other factors that may be pertinent to the analysis of corporate issuer penalties. For example, the need for effective deterrence is discussed throughout the legislative history of the Remedies Act.[4] The Senate Report also notes the importance of good compliance programs and observes that the availability of penalties may encourage development of such programs.[5] The Senate Report also observes that penalties may serve to decrease the temptation to violate the law in areas where the perceived risk of detection of wrongdoing is small.[6] Other factors discussed in the legislative history include whether there was fraudulent intent, harm to innocent third parties, and the possibility of unjust enrichment to the wrongdoer.[7]

The Sarbanes-Oxley Act of 2002 changed the ultimate disposition of penalties. Section 308 of Sarbanes-Oxley (the Fair Funds provision) allows the Commission to take penalties paid by individuals and entities in enforcement actions and add them to disgorgement funds for the benefit of victims. Penalty moneys no longer always go to the Treasury. Under Fair Funds, penalty moneys instead can be used to compensate the victims for the losses they experienced from the wrongdoing. If the victims are shareholders of the corporation being penalized, they will still bear the cost of issuer penalty payments (which is the case with any penalty against a corporate entity). When penalty moneys are ultimately returned to all or some of the investors who were victims of the violation, the amounts returned are less the administrative costs of the distribution. While the legislative history of the Fair Funds provision is scant, there are two general points that can be discerned. First, the purpose of the provision is to provide an additional source of compensation to victims of securities law violations. Second, the provision applies to all penalties and makes no distinction between penalties against individuals or entities.[8]

We have considered the legislative histories of both the Remedies Act and the Fair Funds provisions of the Sarbanes-Oxley Act in reaching the decisions we announce today.

We proceed from the fundamental principle that corporate penalties are an essential part of an aggressive and comprehensive program to enforce the federal securities laws, and that the availability of a corporate penalty, as one of a range of remedies, contributes to the Commission's ability to achieve an appropriate level of deterrence through its decision in a particular case.

With this principle in mind, our view of the appropriateness of a penalty on the corporation in a particular case, as distinct from the individuals who commit a securities law violation, turns principally on two considerations:

The presence or absence of a direct benefit to the corporation as a result of the violation. The fact that a corporation itself has received a direct and material benefit from the offense, for example through reduced expenses or increased revenues, weighs in support of the imposition of a corporate penalty. If the corporation is in any other way unjustly enriched, this similarly weighs in support of the imposition of a corporate penalty. Within this parameter, the strongest case for the imposition of a corporate penalty is one in which the shareholders of the corporation have received an improper benefit as a result of the violation; the weakest case is one in which the current shareholders of the corporation are the principal victims of the securities law violation.

The degree to which the penalty will recompense or further harm the injured shareholders. Because the protection of innocent investors is a principal objective of the securities laws, the imposition of a penalty on the corporation itself carries with it the risk that shareholders who are innocent of the violation will nonetheless bear the burden of the penalty. In some cases, however, the penalty itself may be used as a source of funds to recompense the injury suffered by victims of the securities law violations. The presence of an opportunity to use the penalty as a meaningful source of compensation to injured shareholders is a factor in support of its imposition. The likelihood a corporate penalty will unfairly injure investors, the corporation, or third parties weighs against its use as a sanction.

In addition to these two principal considerations, there are several additional factors that are properly considered in determining whether to impose a penalty on the corporation. These are:

The need to deter the particular type of offense. The likelihood that a corporate penalty will serve as a strong deterrent to others similarly situated weighs in favor of the imposition of a corporate penalty. Conversely, the prevalence of unique circumstances that render the particular offense unlikely to be repeated in other contexts is a factor weighing against the need for a penalty on the corporation rather than on the responsible individuals.

The extent of the injury to innocent parties. The egregiousness of the harm done, the number of investors injured, and the extent of societal harm if the corporation's infliction of such injury on innocent parties goes unpunished, are significant determinants of the propriety of a corporate penalty.

Whether complicity in the violation is widespread throughout the corporation. The more pervasive the participation in the offense by responsible persons within the corporation, the more appropriate is the use of a corporate penalty. Conversely, within this parameter, isolated conduct by only a few individuals would tend not to support the imposition of a corporate penalty. Whether the corporation has replaced those persons responsible for the violation will also be considered in weighing this factor.

The level of intent on the part of the perpetrators. Within this parameter, the imposition of a corporate penalty is most appropriate in egregious circumstances, where the culpability and fraudulent intent of the perpetrators are manifest. A corporate penalty is less likely to be imposed if the violation is not the result of deliberate, intentionally fraudulent conduct.

The degree of difficulty in detecting the particular type of offense. Because offenses that are particularly difficult to detect call for an especially high level of deterrence, this factor weighs in support of the imposition of a corporate penalty.

Presence or lack of remedial steps by the corporation. Because the aim of the securities laws is to protect investors, the prevention of future harm, as well as the punishment of past offenses, is a high priority. The Commission's decisions in particular cases are intended to encourage the management of corporations accused of securities law violations to do everything within their power to take remedial steps, from the first moment that the violation is brought to their attention. Exemplary conduct by management in this respect weighs against the use of a corporate penalty; failure of management to take remedial steps is a factor supporting the imposition of a corporate penalty.

Extent of cooperation with Commission and other law enforcement. Effective compliance with the securities laws depends upon vigilant supervision, monitoring, and reporting of violations. When securities law

violations are discovered, it is incumbent upon management to report them to the Commission and to other appropriate law enforcement authorities. The degree to which a corporation has self reported an offense, or otherwise cooperated with the investigation and remediation of the offense, is a factor that the Commission will consider in determining the propriety of a corporate penalty.

This framework for the consideration of the propriety of corporate penalties is grounded in the Commission's statutory authority and supported by the legislative history underlying that authority. It is the Commission's intent that the elucidation of these principles will provide a high degree of transparency to our decisions in these and future cases, and will be of assistance to the Commission's professional staff, to corporate issuers and their counsel, and to the public.

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[1] Before the enactment of the Remedies Act, the Commission's penalty authority was essentially limited to the ability to seek penalties in district court for insider trading violations.

[2] S. Rep. No. 337, 101st Cong., 2d Sess. at 17 (1990) ("1990 Senate Report").

[3] *Securities Law Enforcement: Hearings on H.R. 975 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 101st Cong., 1st Sess. 47-48 (1989) (statement of David S. Ruder, Chairman, SEC, attaching Memorandum of the SEC in Support of the Securities Law Enforcement Remedies Act of 1989).

[4] *See, e.g.*, 1990 Senate Report at 6-11; *see also* Section 21B(c)(5) of the Exchange Act.

[5] 1990 Senate Report at 10-11.

[6] 1990 Senate Report at 15.

[7] 1990 Senate Report at 14. *See, e.g.*, Section 21B(c)(1)-(3) of the Exchange Act.

[8] *See* House Committee on Financial Services Release, "Baker Proposes FAIR Account to Return Funds to Defrauded Investors" (July 17, 2002)(including statements of Chairman Oxley and Chairman Baker), available at http://financialservices.house.gov/news.asp.

Additional materials:

Litigation Release 19520
Administrative Proceeding Release No. 33-8651**<>**

http://www.sec.gov/news/press/2006-4.htm

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