Legal Backgrounder

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# CULTURE OF PRIVILEGE WAIVER COMPROMISES CORPORATE COMPLIANCE

by

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A disturbing trend has emerged in the government investigation and enforcement arena which threatens to erode a bedrock principle of our legal system. Armed with newly-issued directives, aggressive non-lawyer governmental regulators and agency compliance enforcement officials alike have been pressing hard for corporate waivers of the attorney-client privilege. In the wake of corporate scandals and prosecutions of alleged corporate fraud, corporations are under tremendous pressure to acquiesce. However, as they discharge their corporate responsibility to respond to a government investigation or other enforcement action, corporate compliance officers must steadfastly resist further erosion of this important privilege.

The corporate compliance officer of a major U.S. corporation wears many hats. As internal relationship builder, chief enforcer of the code of conduct, cross-functional coalition leader, company advocate and honest broker, the compliance officer holds one of the most dynamic and demanding roles in corporate America. Notwithstanding the multifaceted and changing nature of the role, the corporate compliance officer's primary responsibility continues to be the establishment and/or maintenance of an effective compliance program—that is, one that comports with the principles set forth in the U.S. Sentencing Guidelines.

A critical component of an effective compliance program is open communication achieved through the attorney-client privilege. Developed at common law, the attorney-client privilege encourages full and candid discussion of a client's legal concerns by protecting from disclosure communications between the client and the lawyer. The scope of privileged communications encompasses not only oral communications, but also documents and other records (e.g., memos, notes, letters, or e-mails) those that reflect communications between an attorney and client. The privilege applies to communications between clients and both in-house and outside counsel. However, the prevailing American standard protects communications between in-house counsel and company employees only to the extent that the communications are: (1) made for the purpose of providing legal advice to the company, as opposed to general business advice; (2) confidential when made; and (3) kept confidential by the company.

Historically, the attorney-client privilege has suffered from the real or perceived view that it facilitates the withholding of relevant information from the fact finder. Some courts have tended to narrowly construe the privilege because it is viewed as interfering with the truth-seeking mission of the legal process. For this reason, the party claiming the privilege bears the burden of proving the elements essential to its application.

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The attorney-client privilege occupies an important space in corporate America. As American Bar Association President Karen J. Mathis observed during her recent testimony before the Senate Judiciary Committee: "From a practical standpoint, the privilege plays a key role in helping companies to act legally and properly by permitting corporate clients to seek out and obtain guidance in how to conform conduct to the law."[1] Consequently, the privilege must be jealously protected, especially in this era of ever-changing laws and implementing regulations.

Unfortunately, in recent years, two significant developments have served to weaken the privilege dramatically. The first development was the Justice Department's issuance of two memoranda commonly referred to as the Holder[2] and Thompson[3] Memoranda. Issued in June 1999 and January 2003, respectively, these memoranda were directed to the heads of the various Justice Department components and U.S. Attorneys and both set out several factors to be considered in the decision whether to charge an organization with a crime.

Among the factors both memoranda listed as warranting consideration is "the existence and adequacy of the corporation's compliance program." Another factor addressed corporate cooperation, including a corporation's decision to waive attorney-client and work-product privileges. The Holder/Thompson Memoranda explain that the waiver of these privileges—both with respect to internal investigations and communications between company employees and counsel—facilitates unfettered investigation. As such, the memoranda consider privilege waiver "as one factor in evaluating the corporation's cooperation." While the latter factor has been at the center of recent controversy and public debate, it is its inclusion alongside the compliance program factor that evidences a lack of core appreciation for the interplay between the attorney-client privilege and an effective corporate compliance program.

The second significant development that weakened the attorney-client privilege was a 2004 amendment to the commentary of Section 8C2.5 of the U.S. Sentencing Guidelines that added a provision on waiver in determining a company's culpability score.[4] Application Note 12 to that section states that "[w]aiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score . . . unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization." Thus, a corporation would be ineligible for a reduced sentence if it refused to waive the privilege under those circumstances.

Both of the aforementioned developments resulted in tremendous pressure being placed on corporations and their corporate compliance officers to waive the attorney-client privilege so as to appear cooperative with government investigations. Indeed, a 2006 survey conducted by a coalition of organizations including the Association of Corporate Counsel found that 75 percent of inside and outside counsel felt a "'culture of waiver' has evolved in which governmental agencies believe it is reasonable and appropriate for them to expect a company under investigation to broadly waive attorney-client privilege or work product protections."[5] This culture presents a very real dilemma for the corporate compliance officer.

Take for example, Company X which is two years into a 7-year corporate integrity agreement with the federal ABC agency. Company X's audit committee and the company's general counsel instruct the compliance officer to conduct an internal investigation into allegations of routine regulatory infractions at Company X's most profitable business unit. As part of the investigation process, the compliance officer identifies witnesses,

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[1]Testimony of Karen J. Mathis before the Senate Judiciary Committee (Sept. 12, 2006), available at http://www.abanet.org/poladv/letters/attyclient/060912testimony_hrgsjud.pdf.

[2]Memorandum from Eric Holder, Deputy Attorney General, Bringing Criminal Charges Against Corporations (June 16, 1999) available at http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html.

[3]Memorandum from Larry D. Thompson, Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), available at http://www.usdoj.gov/dag/cftf/business_organizations.pdf.

[4]U.S. SENTENCING COMMISSION, AMENDMENTS TO SENTENCING GUIDELINES (May 10, 2004); U.S. SENTENCING COMMISSION, GUIDELINES MANUAL (Nov. 1, 2005).

[5]*See* Survey, The Decline of the Attorney-Client Privilege in the Corporate Context, available at http://www.acca.com/Surveys/attyclient2.pdf.

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reviews applicable policies, rules and procedures, gathers evidence, develops a record, and, ultimately, prepares findings and a report for the audit committee and general counsel.

The compliance officer concludes the investigation and finds the allegations that formed the basis of the investigation to be unsubstantiated. In fact, the investigation revealed that Company X's revamped policies and procedures generally were followed and that recently implemented internal controls worked to ensure overall compliance with company policy and applicable laws and regulations. However, the compliance officer's investigation report included several recommended corrective actions. She knows of the renewed emphasis that Company X's leaders placed on strict compliance with the requirements of the corporate integrity agreement and their commitment to creating a "culture of compliance." She is therefore eager to inform not only the company leaders and the audit committee, but also the agency compliance officials, of the overall positive results of the investigation as they reflect credit upon the effectiveness of the company's improved compliance posture. However, the compliance officer also knows that doing so might draw further agency attention and scrutiny to those elements of the company's operations and compliance procedures that were cited as needing improvement.

Later, during an annual face-to-face meeting with ABC agency's compliance staff, one of Company X's leaders makes an off-the-cuff boast about the positive results of a recent internal investigation. The director of ABC agency's compliance office nods in approval but then demands that Company X disclose to the agency not only the results of the investigation, but also all notes, memoranda, and interview summaries. The disclosure is to be through Company X's compliance officer with whom the director has developed a good working relationship. At this point, Company X's compliance officer faces a real dilemma. She can either (a) turn over the privileged documents to the agency and win favor for cooperating with the agency's regulatory compliance mandate and responsibilities, or (b) refuse to disclose the privileged documents and risk being deemed by the agency compliance officials (and perhaps the debarment official) as uncooperative and not complying with the corporate integrity agreement.

Some compliance officers simply disclose some or all of the documents to the regulatory agency, as demanded. Typically, they are unaware of the substantial risks involved in disclosing the privileged documents and thereby waiving the privilege. They also have a gut feeling that no reasonable alternative exists. One obvious danger in waiving the attorney-client privilege, even inadvertently, is that the company may waive its privileges not only as to the specific communication at issue, but to the entire subject-matter of the communication as well. Such waiver could prove troublesome down the road, especially if the investigation results in a charging decision. Erosion of the privilege can be exacerbated by the mismanagement of other interrelated or connected compliance activities, such as audits, compliance reviews, and internal investigations.

Increasingly, non-lawyer governmental regulators, investigators and auditors, who may not appreciate the value of the attorney-client privilege to corporate compliance or its importance to our legal system as a whole, are brazenly requiring unwitting corporate compliance officers to waive the privilege. This practice has spilled over into federal departments beyond the Justice Department. Indeed, the Securities and Exchange Commission has been very publicly accused of coercing waivers of the privilege in its enforcement activities and urged to appoint an advisory committee.[6] This spill over has resulted in an ominous and deepening erosion of the attorney-client privilege. All in-house counsel, particularly corporate compliance officers, must be vigilant against acceding to inappropriate waiver "requests" and inadvertent waiver of the privilege. Failure to do so could lead to even further erosion of the privilege.

Fortunately, the legal community continues to push back against these incursions with varying degrees of success. Heeding the criticisms aired in solicited comments, public hearings, and legal commentary, the Sentencing Commission removed the waiver provision of Application Note 12 from the Sentencing Guidelines.[7] It observed that the language "could be misinterpreted to encourage waivers."[8] The Justice Department also

[6] *See* Press Release, U.S. Chamber of Commerce, Chamber Calls on SEC to Appoint Advisory Committee to Examine Enforcement Practices; Enforcement Is "Increasingly Punitive and Adversarial," Chamber Study Finds (Mar. 9, 2006), available at http://www.uschamber.com/press/releases/2006/march/06-42.htm.

[7] U.S. SENTENCING COMMISSION, GUIDELINES MANUAL (Nov. 1, 2006).

[8] 71 Fed. Reg. 28063, 28073 (May 15, 2006).

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issued new guidance; first, in the form of the McCallum Memorandum.[9] Issued in October 2005, the memorandum directed U.S. Attorneys to "establish a written waiver review process;" however, it failed to outline a uniform policy. Superseding the McCallum Memorandum as well as the Holder/Thompson Memoranda, the McNulty Memorandum[10] cured this deficiency.

Issued in December 2006, the McNulty Memorandum acknowledged that "[m]any of those associated with the corporate legal community have expressed concern that [DOJ] practices may be discouraging full and candid communications between corporate employees and legal counsel." Accordingly, the McNulty Memorandum attempts to establish a protocol for prosecutors requesting waiver and divides the information sought into two categories. Category I includes purely factual information relating to the underlying misconduct. Category II includes attorney-client communication or non-factual attorney work product which "should only be sought in rare circumstances." In making a charging decision, prosecutors cannot consider a corporation's declination of a request for Category II information. Therefore, while a corporation's refusal to disclose attorney-client communications cannot count against it, its failure to disclose information the government deems "purely factual" can. The new language in the McNulty Memorandum is intended to expand upon DOJ's policies and guidance pertaining to the "authenticity of a corporation's cooperation with a government investigation." While imperfect, the McNulty Memorandum is a step in the right direction towards restoring the attorney-client privilege and open communication.

Powerful congressional leaders have also become involved in restoring the integrity of the attorney-client privilege. In September 2006 and in March of this year, the Judiciary Committees of both houses heard testimony from concerned leaders in the legal and corporate communities on the impact the waiver provisions have on the legal system and industry. Also, Senator Arlen Specter (R-PA) has introduced the Attorney-Client Privilege Protection Act of 2007 which would prohibit federal prosecutors from considering a corporation's refusal to waive privilege.[11] Not surprisingly, among the proposed act's findings are that "protecting attorney-client privileged communications from compelled disclosure fosters voluntary compliance with the law" and "waiver demands and other tactics of Government agencies are encroaching on the constitutional rights and other legal protections of employees." Passage of the act promises to patch-up if not fully mend the damage done to this vital principle of our legal system.

While lessening, the sustained culture of waiver caused by allowing charging decisions to be based on whether a corporation disclosed attorney-client information threatens the vitality of the attorney-client relationship. By resisting the pressure to inappropriately waive, corporations and their compliance officers can protect corporate America's ability to obtain the legal guidance it needs to conform to the laws that govern it.

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[9]Memorandum from Robert D. McCallum, Jr., Acting Deputy Attorney General, on Waiver of Corporate Attorney-Client and Work Product Protection (Oct. 21, 2005) (on file with author).

[10]Memorandum from Paul J. McNulty, Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), available at http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.

[11]S. 186, 110th Cong. (2007).

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