



RISKS AND REWARDS OF WAIVING THE ATTORNEY-CLIENT PRIVILEGE

By

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Picture the following scenario: A large public corporation learns that its last quarterly financials were not prepared according to Generally Accepted Accounting Practices and are drastically overstated. The company immediately retains an outside law firm to conduct an internal investigation. The lawyers come in, review thousands of documents, interview numerous employees, including the company's key executives, prepare dozens of memoranda describing the results of their interviews and review of documents, and ultimately issue a final report — all under the auspices of the attorney-client privilege and work-product doctrine. The report indicates that certain of the company's executives had knowledge of the erroneous accounting prior to release of the financial statements. Promptly after public disclosure of the accounting errors, the corporation receives a subpoena from the SEC seeking the production of all relevant documents and communications, including the attorneys' memoranda and final report arising out of the internal investigation. The company seeks legal advice as to how to respond.

While ten years ago most attorneys representing corporate clients would likely have advised them to resist such government subpoenas on the basis of privilege, the opposite is fast becoming the norm in post-Enron America. Today, regulatory scrutiny of corporations has reached an all-time high. With increased regularity, attorneys find themselves in the precarious position of balancing their allegiance to the sacrosanct attorney-client privilege with their duty to achieve the best results for their corporate clients. With the threat of indictment or major enforcement action hanging over a corporation that refuses to waive privilege, lawyers may now find themselves advising clients that waiver is the appropriate course. That being the case, clients must be well advised as to all the available options and the attendant risks and rewards of pursuing each alternative.

Initial Precautions. When representing a corporation during an internal investigation or otherwise, counsel must be cognizant of whom they are representing and whom they are not. In most circumstances, counsel is retained by the board of directors or a special committee of independent directors formed to oversee the matter. In other situations, counsel may be retained by management. Notwithstanding, counsel must be continually aware that his or her allegiance is owed to the corporation, not to any individual or group of individuals, and this must be made clear to everyone involved in the matter.

Attorneys retained by corporations to conduct internal investigations must be concerned with the broader picture. By anticipating a subsequent government investigation and the possibility that the corporation's best interests might be served by cooperating with the government, counsel must take the necessary steps to ensure that the corporation retains the ability to do so. From the outset, it is critical for the attorney to make it crystal clear to everyone that the client is the company — not the individual. This disclosure is extremely important because

courts have found that an implied attorney-client relationship may arise when an individual can demonstrate “that

he submitted confidential information to a lawyer with a reasonable belief that the lawyer was acting as his attorney.” *The Diversified Group, Inc. v. Daugerdas*, 139 F. Supp. 2d 445, 454 (S.D.N.Y. 2001). Thus, failure to inform individuals of the true nature of an attorney’s representation may enable them to demonstrate the existence of an implied attorney-client relationship. This, in turn, may cause a corporation to forfeit the opportunity to cooperate with prosecutors, since it could lose its ability to waive privilege with respect to information derived from such individuals due to the existence of a joint privilege held by the employee and the corporation. Such a joint privilege would require the corporation to obtain the employee’s consent before waiving it — consent which will likely be denied by an employee with potential criminal exposure.

The Benefits of Waiver. Corporate America experienced a rude awakening in the aftermath of the scandals surrounding companies such as Enron and Worldcom. Management is now fully aware of the devastation that a criminal indictment can cause to the operations of a company. The bad press alone cannot only cause a severe loss of market share, but may also lead to executives and clients fleeing the corporation like a sinking ship. It can result in a bankruptcy filing or indeed, as witnessed in the case of Arthur Anderson, the organization may even be forced to close its doors forever. Accordingly, companies under governmental assault must determine whether cooperation can ward off an impending indictment and the inevitable resulting turmoil. In many cases, the corporation agrees to become, in effect, an arm of the government — handling at its own expense the entire investigation itself, with its outside law firm and other expert assistants, and then turning over the results to the government, which can then prosecute the miscreants.

For example, Computer Associates (“CA”) was the focus of a major investigation conducted by several federal agencies, including the SEC and the FBI, following a lengthy internal investigation during which CA’s audit committee learned that \$2.2 billion of revenue was incorrectly reported. Press Release, “*Department of Justice: Former Computer Associates Executives Indicted on Securities Fraud, Obstruction Charges*,” (Sept. 22, 2004) available at http://www.usdoj.gov/opa/pr/2004/September/04_crm_642.htm.

To avoid prosecution, CA cooperated with the government by terminating the officers and employees responsible for the improper accounting, appointing new management, adding a minimum of two new independent directors, reorganizing its finance department and establishing several new committees to ensure compliance and disclosure. Further, CA waived all privileges and fully disclosed the results of the investigation to the government. It also agreed to pay \$225 million to compensate shareholders. *Id.* The United States Attorney’s Office cited CA’s “acceptance of responsibility, continued cooperation, remedial measures, and agreement to compensate victims of its fraud . . .” as factors forming the basis of its decision not to prosecute. *Id.*

Interestingly, CA’s internal investigation included interviews of numerous executives by an outside law firm. Several lied to the attorneys about their improper accounting methodology, and they were charged with obstruction of justice — for lying not to the federal investigators, but to the company’s attorneys with knowledge that such misinformation would be passed on to the government.

The Department of Justice has stated that the decision to prosecute a corporation will often be affected by the level of the corporation’s cooperation with the government. In January 2003, the United States Deputy Attorney General propounded a memorandum setting forth certain factors that federal prosecutors should weigh in determining whether to bring criminal charges against a corporation, including:

1. the nature and seriousness of the offense;
2. the pervasiveness of wrongdoing within the corporation;
3. the corporation’s history of similar conduct;
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;*
5. the existence and adequacy of the corporation’s compliance program; and
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*.

Larry D. Thompson, “*Principles of Federal Prosecution of Business Organizations*,” United States Department of Justice – Office of the Attorney General at 3 (Jan. 20, 2003) (emphasis added).

In the same vein, the SEC has also set forth the criteria it will employ to determine whether it should give credit for cooperation. *See* 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, SEC Release No. 34-44969, 2001 WL 1301408 at 2 (Oct. 23, 2001). The SEC will ask such questions as:

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

Id. at 3. In a footnote, the SEC acknowledges that the attorney-client and work product privileges “serve important social interests,” and states that it “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.” *Id.* at 4 n.3. Reading between the lines, however, it is apparent that when the SEC deems it necessary, it will likely put great weight on a company’s decision to either assert or waive privilege. One may be hard pressed to imagine a situation where the SEC would not find it necessary to review privileged material generated during the course of an internal investigation.

Indeed, these days the trend is for prosecutors to place great weight on disclosure of protected information and to request a privilege waiver almost out of hand. We have even heard of overzealous regulators pressuring corporations to sign privilege waivers before the internal investigation even started and any evidence of wrongdoing was discovered.

This tendency to give credit for waiver of attorney-client and work product protections also extends to the judiciary. The commentary to the 2005 Federal Sentencing Guidelines provides that an organization’s “[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.” U.S. SENTENCING GUIDELINES MANUAL § 8C2.5, cmt. n.12 (2005). However, this year, in response to adverse comments submitted by various bar associations and other organizations, the U.S. Sentencing Commission agreed to revise the commentary and eliminate any reference to waiver of privilege.

In sum, today it is clear that waiver of attorney-client and work product protections will be weighed by prosecutors and regulators in determining whether to bring charges against corporations and by judges in considering how to punish them.¹ Armed with such knowledge, corporate counsel must determine in each instance whether the benefit of waiver outweighs the harm.

The Risks of Waiver. While it is clear that there are certain benefits which may inure to a corporation

¹These practices have the effect of destroying the hallowed attorney-client privilege, for centuries an important aspect of Anglo-American law, and have caused increased commotion amongst the organized Bar. While various efforts are underway to limit the government’s pursuit of this strategy, *see Congress is Pressed to Halt Erosion of Corporate Attorney-Client Privilege*, 90 Antitrust & Trade Reg. Rep. 2244 at 249-50 (Mar. 10, 2006); Lorraine Woellert, *Just Saying ‘No’ to Uncle Sam – The Backlash Against Prosecutors Coaxing Companies to Waive Attorney-Client Privilege*, BUSINESS WEEK, Jan. 23, 2006 at 37-38, a lawyer representing a company faced with a serious governmental investigation must deal with the current reality, leaving aside his or her personal view of the sanctity of the privilege.

that

cooperates with prosecutors by waiving its attorney-client and work product protections, one must balance such benefits against the potential risks. As an initial matter, there is no guarantee that a corporation's cooperation with the government will shield it from prosecution or enforcement actions. After all, the government could ultimately decide to prosecute anyway, and the privileged information that the corporation produced might end up serving as the basis of the government's case. Another effect of cooperation is the inevitable rift it will cause between the corporation and management. It is unlikely that the corporation will be able to continue providing defense counsel and otherwise paying the expenses of defending against the investigation for any officers or employees being prosecuted by the government.

Even if the government decides not to prosecute, the corporation will have to contend with the inevitable flurry of civil cases, including class actions, seeking enormous damages. This alone can result in a great deal of bad press, loss in stock price and some of the other side effects of a government indictment. Without a doubt, zealous plaintiffs' attorneys will request production of all privileged material turned over to the government based on principles of waiver. Such release of a corporations' confidential and proprietary information can cause a great deal of harm to a corporation's ongoing and prospective business dealings. Moreover, at least in some cases, those materials by themselves may be sufficient to establish plaintiffs' claims.

Most courts find that disclosing privileged information to the government or anyone else results in a waiver of the privilege as to any other third party. *See In re Steinhardt Partners, L.P.*, 9 F.3d 230 (2d Cir. 1993); *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414 (3d Cir. 1991). These courts require the production of all such material to the plaintiffs. Although a minority of courts have decided that the production of privileged material to the government only results in a "selective waiver" and deny disclosure as to private third parties, *see Diversified Indus., Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1978), the majority of courts recognize no such exception. Thus, attorneys advising corporate clients to waive the privilege must also warn their clients of the substantial risk that private plaintiffs are bound to obtain copies of the material that was produced to the government. Moreover, once the privilege is waived as to certain communications and information on a given subject matter, the privilege may also be waived as to all related communications and information — even that which was not previously produced. *United States v. Jones*, 606 F.2d 1069, 1072 (4th Cir. 1982).

Can anything be done to avoid this result? Probably not. However, many attorneys ask the relevant government agency to sign confidentiality or non-waiver letter agreements. The SEC will often agree in writing that disclosure of confidential material is selective and will not be deemed a general waiver. (On the other hand, the CFTC has refused to do so on more than one occasion.) Depending upon the jurisdiction, some courts give weight to a selective waiver agreement, and hold that privilege was not waived and that the documents (or at least some of them) need not be produced to third parties. The majority of courts, however, find that a confidentiality agreement between the government and a private party is just a contract and cannot preserve privilege as to third parties. *See Chubb Integrated Sys. v. Nat'l Bank of Washington*, 103 F.R.D. 52, 67-68 (Dist. D.C. 1984). While there is a "common interest rule," which provides that parties with common interests in a litigation may share privileged information without waiving their right to assert privilege as to third parties, it is tough to establish that the relationship between prosecutors and a target corporation is anything but adversarial. *See Republic of the Philippines v. Westinghouse Elec. Co.*, 132 F.R.D. 284 (Dist. N.J. 1990). Nonetheless, a well-drafted confidentiality or non-waiver agreement may be useful as a negotiation tool in a subsequent civil case since it will at least establish that both the government and the corporation intended the production to be kept confidential.

Conclusion. When facing a government demand for protected information, attorneys representing corporate clients must assist management in engaging in a cost-benefit analysis of the potential risks and rewards of cooperation and the production of privileged material. On the one hand, cooperation, could lead to a reduction in penalties or avoidance of an indictment altogether. On the other hand, it is extremely likely that once produced, privileged material is up for grabs to any private litigants suing the corporation. Such discovery can lead to protracted litigation and an expensive settlement.