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## THE ATTORNEY-CLIENT PRIVILEGE: A CASUALTY OF POST-ENRON ENFORCEMENT

by

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Consider these recent occurrences. A highly regarded federal judge in New York orders the production of a million e-mails in forty-eight hours, precluding any attorney review for privilege. Company counsel replies: “But, Your Honor, what about the attorney-client privilege?” The judge answers “All privileges preserved.” The preservation of the privilege is all well and good, but the client’s legal strategy certainly was no longer secret.

Then, as Ken Lay, former CEO of Enron, was indicted, Andrew Weissman, head of the Justice Department’s Enron Task Force, made a statement he himself stated was aimed at all of Corporate America: “Your constituents are owed complete candor.”

Finally, Frank Quattrone, formerly a senior banker at CSFB, is convicted of hindering a government investigation — obstruction was the offense, not the underlying subject of the original investigation.

The common question raised for lawyers in the face of each of these examples: how viable is the traditional attorney-client privilege in the current climate? While the government has an important interest in acquiring information that could significantly help the prosecution and/or trial of parties responsible for securities fraud, the extent to which the government has been asserting this interest appears to diminish defendants’ rights to confidential legal advice.

This erosion becomes more apparent if one considers the dynamic created by the overpowering influence of the government’s ability to indict. The company must, under all circumstances, avoid an indictment. The specter of an indictment, and the desire to satisfy prosecutors, motivates a business entity to hand over everything from their lawyer’s notes to the CEO’s shirt size. The lessons of Drexel Burnham Lambert Inc. and Arthur Andersen LLP are clear. Drexel collapsed after indictment — no trial. Andersen suffered catastrophic consequences following its indictment by the government. Its clients and key partners fled to more secure audit firms. Once the government indicts, customers seek out competitors, and employees leave rather than face an uncertain future.

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The sea change began in earnest after the collapse of Enron. Congress enacted the Sarbanes-Oxley Act (SOX) which could require lawyers to affirmatively act when uncovering fraud. Much of SOX is consistent with previous policies relating to lawyers' responsibilities. The traditional standards of professional conduct required an attorney to report acts of fraud "up the corporate ladder." However, in the prior regime, the attorney-client privilege was protected internally. Today, SOX allows a lawyer to reveal confidential information to the SEC upon uncovering a fraudulent act. 17 C.F.R. § 205.3(d)(2). While the Act states that an attorney "may" report, it is to be expected that this will, over time, inexorably lead to broader erosion of the attorney-client privilege.

On January 20, 2003, Deputy Attorney General Larry Thompson addressed the principles of federal prosecution of business organizations in the so-called Thompson Memo. This supplanted a previous memorandum from the Department of Justice — the Holder Memo — and focused, not only on the facts of, but on the quality of, a firm's cooperation with a government investigation. The Thompson Memo set forth nine factors a prosecutor should consider in deciding whether to charge a company:

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;
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;
6. the corporation's remedial actions, including any efforts to ... cooperate with the relevant government agencies;
7. collateral consequences, including disproportionate harm to [parties] not proven personally culpable and impact on the public arising from the prosecution;
8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
9. the adequacy of remedies such as civil or regulatory enforcement actions.

Memorandum from Larry D. Thompson, Deputy Attorney General, to Heads of Department Components, United States Attorneys (Jan. 20, 2003), at [http://www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm).

Factor #4 is of great interest. The Thompson Memo states that a prosecutor, in assessing the extent of cooperation, should consider a 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 privilege and work product protection. The comment section to the Thompson Memo states that waiver of a corporation's attorney-client privilege is not an absolute requirement but sometimes might be necessary. In the context of a directive that promises leniency to corporations which quickly and voluntarily comply, the company's ability to rely on the attorney-client privilege seems problematic.

The Securities and Exchange Commission's "Seaboard § 21(a) Report" exemplifies the practical effect of these governmental guidelines. A wrongdoer's actions allegedly led to misstatements of a subsidiary's financial statements. The parent company's management acted within one week to rectify the mistakes. Additionally, it was noted that the company "did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation." U.S. Securities and Exchange Commission, Release No. 44969 (Oct. 23, 2001), at <http://www.sec.gov/litigation/investreport/34-44969.htm>. The SEC took no action against Seaboard. Of note in footnote three of the report, the SEC stated that the attorney-client privilege serves a very important purpose but, in certain circumstances, companies might feel compelled to waive it. Waiver is not the end goal but only "a means (where necessary) to provide relevant and ... critical information." *Id.*

Government's aggressive approach to obtaining "cooperation" creates an untenable situation for prosecutorial targets. The Department of Justice's policy of granting leniency to targeted businesses, in most situations, coerces them to cooperate. Cooperation is thus far from "voluntary." A company's waiver of the attorney-client privilege is also permanent. Therefore, not only does the government gain information prosecutors can use to criminally charge the responsible individuals, but plaintiffs' lawyers can use it in support of securities class action lawsuits.

The SEC has joined the Department of Justice in demanding strict compliance with its disclosure requests. If a company hinders an investigation in any way, the SEC has not hesitated to fine severely. For example, on June 3, 2004, Symbol Technologies agreed to settle an SEC enforcement action which charged the company with accounting fraud. Press Release, *U.S. Securities and Exchange Commission, Symbol Technologies Agrees to Settle SEC Enforcement Action Charging the Company With Accounting Fraud* (June 3, 2004), at <http://www.sec.gov/news/press/2004-74.htm>. In addition to the \$101 million penalty to settle with the investors and the U.S. Postal Inspection Service Consumer Fraud Fund, Symbol faced

an additional \$37 million penalty based on its conduct during the investigation. It was charged that Symbol initially tried to cover up the misconduct and impede two internal investigations and the SEC's investigation. The SEC did consider Symbol's eventual cooperation in lessening the penalty. *Id.*

While the government believed that Symbol Technologies affirmatively acted to obstruct the SEC's investigation, on April 11, 2002, the SEC fined Xerox, in part for its "lack of full cooperation." Press Release, *U.S. Securities and Exchange Commission, Xerox Settles SEC Enforcement Action Charging Company with Fraud* (Apr. 11, 2002), at <http://www.sec.gov/news/press/2002-52.txt>. Xerox also settled the underlying case with the SEC which alleged that the company used faulty accounting practices.

On March 10, 2004, Stephen Cutler, Director of the Commission's Division of Enforcement, said that a settlement with Banc of America Securities (BAS) "makes clear that we will not tolerate unreasonable delay in responding to our inquiries and will act aggressively to protect the integrity of the Commission's investigative processes." Press Release, *U.S. Securities and Exchange Commission, SEC Brings Enforcement Action Against Banc of America Securities for Repeated Document Production Failures During a Pending Investigation* (Mar. 10, 2004), at <http://www.sec.gov/news/press/2004-29.htm>. BAS allegedly failed to promptly produce certain relevant e-mails, compliance reviews, and documented personal trading activities of a former senior employee of the firm. The SEC determined that BAS willfully failed to cooperate and fined the company \$10 million. *Id.*

While the government's advisory memoranda advise that the waiver of the attorney-client privilege is just an option, the reality may be otherwise. In 2003, Shirah Neiman of the U.S. Attorney's Office for the Southern District of New York, stated that an organization needs to hand over information relevant to securities fraud to the government. If a company cannot give that information without waiving the attorney-client privilege, the company "need[s] to waive the privilege." Susan Kavanagh, *What Prosecutors Look For in a Compliance Program*, FEDERAL ETHICS REPORT, July 2003, at [http://www.eoa.org/EOA\\_Resources/FER\\_July03.pdf](http://www.eoa.org/EOA_Resources/FER_July03.pdf). A number of corporate defense lawyers say that the government "routinely request[s] a waiver] when companies enter negotiations with the government [if they wish] to avoid criminal prosecution." Vanessa Blum, *U.S. Mounts New Attack on Privilege*, LEGAL TIMES, Mar. 17, 2003. Additionally, prosecutors might even demand waivers as the first option in the beginning of an investigation. *Id.*

No one will argue that the government should lack the ability to thoroughly investigate potential acts of securities fraud, but the government is creating numerous new problems. The confidentiality of the attorney-client privilege remains an absolute necessity. Tyco International Ltd. General Counsel William Lytton aptly stated one aspect of the predicament that weighs on companies under investigation: "I am perfectly happy to ... waive the attorney-client privilege to the Department of Justice ... except that it is later going to be used to line the pockets of a rabid plaintiffs bar." *Id.*