CLE PROGRAM: ATTORNEY CLIENT PRIVILEGE AND ATTORNEY WORK PRODUCT / PRESERVING THE ETHICAL STANDARDS

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THE ABA’S EFFORTS TO PROTECT THE ATTORNEY-CLIENT PRIVILEGE, THE WORK PRODUCT DOCTRINE, AND EMPLOYEE LEGAL RIGHTS DURING CORPORATE INVESTIGATIONS

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Introduction

The American Bar Association and many others in the legal and business communities have become concerned in recent years about various federal governmental policies that erode the attorney-client privilege, the work product doctrine, and employee legal protections in the corporate context. Although all of these policies raise concerns, the ABA has become especially concerned about language in the Department of Justice’s 2006 McNulty Memorandum and 2003 Thompson Memorandum—and other similar federal governmental policies and practices—that pressure companies and other organizations to waive their privileges as a condition for receiving cooperation credit during investigations.1 The ABA also opposes the separate provisions in these federal policies that erode employees’ constitutional and other legal rights by pressuring companies to forgo paying their employees’ legal fees during investigations or to take other punitive actions against them long before any guilt has been established. Despite some recent success, the ABA and its allies are continuing to press the relevant federal agencies and Congress to reverse these policies in order to protect companies’ fundamental attorney-client privilege, work product, and employee legal rights.

The Importance of the Attorney-Client Privilege and the Work Product Doctrine

The attorney-client privilege—which belongs not to the lawyer but to the client—historically has enabled both individual and corporate clients to communicate with their lawyer in confidence. As such, it is the bedrock of the client’s rights to effective counsel and confidentiality in seeking legal advice. From a practical standpoint, the privilege also 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. In addition, the privilege facilitates self-investigation into past conduct to identify shortcomings and remedy problems as soon as possible, 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.

Federal Government Policies That Erode These Protections

A number of federal governmental agencies—including the Department of Justice, the U.S. Sentencing Commission, and others—have adopted policies in recent years that weaken the attorney-client privilege and work product doctrine in the corporate context by encouraging federal prosecutors and other law enforcement officials to pressure companies and other organizations to waive these legal protections as a condition for receiving credit for cooperation during investigations.

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1 On August 9, 2005, the ABA adopted a resolution, sponsored by the ABA Task Force on Attorney-Client Privilege, supporting the preservation of the attorney-client privilege and work product doctrine, opposing governmental actions that erode these protections, and opposing the routine practice by government officials of seeking the waiver of these protections through the granting or denial of any benefit or advantage. Previously, in August 2004, the ABA adopted a resolution 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.” Both ABA resolutions and detailed background reports discussing the history and importance of the attorney-client privilege and work product doctrine and recent governmental assaults on these protections, are available at [http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html](http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html).
The Department of Justice’s privilege waiver policy was set forth in a January 2003 memorandum written by then-Deputy Attorney General Larry Thompson entitled “Principles of Federal Prosecution of Business Organizations.” ² The so-called “Thompson Memorandum” instructed federal prosecutors to consider certain factors in determining whether corporations and other organizations should receive cooperation credit—and hence leniency—during government investigations. One of the key factors cited in the Thompson Memorandum is the organization’s willingness to waive attorney-client and work product protections and provide this confidential information to government investigators. The Thompson Memorandum stated in pertinent part that:

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. 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.

See Thompson Memorandum at pg. 7. The Thompson Memorandum expanded upon a similar directive that a previous Deputy Attorney General, Eric Holder, sent to federal prosecutors in 1999.³

Although the Thompson Memorandum, like the earlier Holder Memorandum, stated that waiver is not an absolute requirement, it nevertheless made it clear that waiver was a key factor for prosecutors to consider in evaluating an entity’s cooperation. It relied on the prosecutor’s discretion to determine whether waiver was necessary in the particular case. While the Department’s privilege waiver policy originally was established by the 1999 Holder Memorandum and expanded by the 2003 Thompson Memorandum, the issue of coerced waiver was further exacerbated in November 2004 when the U.S. Sentencing Commission added language to the Commentary to Section 8C2.5 of the Federal


³ See Memorandum from Eric Holder, Deputy Attorney General, Department of Justice, to Component Heads and United States Attorneys, Bringing Criminal Charges Against Corporations (June 16, 1999), available at http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html. The so-called “Holder Memorandum” stated in pertinent part as follows:

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 privileges.
Sentencing Guidelines that, like the Department’s policy, authorized and encouraged prosecutors to seek privilege waiver as a condition for cooperation.4

On December 12, 2006, Deputy Attorney General Paul McNulty issued revisions to the Thompson Memorandum that modified, but did not reverse, the Department’s privilege waiver policy. Instead of eliminating the improper practice of requiring or encouraging companies and other organizations to waive their attorney-client privilege and work product protections in return for cooperation credit, the new “McNulty Memorandum” merely requires high level Department approval before formal waiver requests can be made. The memorandum also continues to allow prosecutors to grant cooperation credit for “voluntary,” unsolicited waivers. The McNulty Memorandum provides in pertinent part as follows:

In conducting an investigation, determining whether to bring charges, and negotiating plea agreements, prosecutors must consider the following factors in reaching a decision as to the proper treatment of a corporate target: …4. the corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents (see section VII, infra);…Waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government’s investigation. However, a company’s disclosure of privileged information may permit the government to expedite its investigation. In addition, the disclosure of privileged information may be critical in enabling the government to evaluate the accuracy and completeness of the company’s voluntary disclosure. Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations…Federal prosecutors are not required to obtain authorization if the corporation voluntarily offers privileged documents without a request by the government.5

In addition to the Justice Department and the Sentencing Commission, a number of other federal agencies have adopted similar privilege waiver policies as well, including the Securities and

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4 The 2004 amendment to the Sentencing Guidelines added the following language to the Commentary:

Waiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score [for cooperation with the government]…unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.

While this language begins by stating a general rule that a waiver is “not a prerequisite” for a reduction in the culpability score—and leniency—under the Guidelines, that statement is followed by a very broad and subjective exception for situations where prosecutors contend that waiver “is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.” As a result, the exception essentially swallows the rule. Prior to the change, the Commentary was silent on the issue and contained no suggestion that such a waiver would ever be required. For a detailed discussion of this issue, please see the ABA’s March 28, 2006 written comments to the U.S. Sentencing Commission, available at http://www.abanet.org/poladv/letters/attyclient/060328letter_abausse.pdf.

5 See Memorandum from Paul J. McNulty, Deputy Attorney General, to Heads of Department Components and United States Attorneys, Principles of Federal Prosecution of Business Organizations (December 12, 2006), at pgs. 4, 8, and 11, available at http://www.abanet.org/poladv/priorities/privilegewaiver/2006dec12_privwaiv_dojmcnulty.pdf. The McNulty Memorandum also outlines four factors for determining whether prosecutors have a “legitimate need” to request privileged materials and requires prosecutors to obtain various types of high level Departmental approval before demanding either factual attorney-work product (“Category I”) material or attorney-client communications or non-factual attorney work product (“Category II”) material. Id. at pgs. 8-11.
Exchange Commission (SEC)\textsuperscript{6}, the Commodity Futures Trading Commission (CFTC)\textsuperscript{7}, and the Department of Housing and Urban Development (HUD)\textsuperscript{8}.

**Unintended Consequences of Prosecutor Demands for Privilege Waiver**

The American Bar Association is concerned that the Department of Justice’s new privilege waiver policy outlined in the McNulty Memorandum—like the previous Thompson Memorandum and similar policies adopted by other federal agencies—will continue to cause a number of profoundly negative, if unintended, consequences.

First, the ABA believes that the new McNulty Memorandum and the other similar federal policies will continue to lead to the routine compelled waiver of attorney-client privilege and work product protections. During the four years it was in effect, the Thompson Memorandum and other similar federal policies led many prosecutors and other law enforcement officials to pressure companies and other entities to waive their privileges on a regular basis as a condition for receiving cooperation credit during investigations. From a practical standpoint, companies have no choice but to waive when requested to do so, as the government’s threat to label them as “uncooperative” will have a profound effect not just on charging and sentencing decisions, but on each company’s public image, stock price, and credit worthiness. This growing “culture of waiver”—and the prominent role that the Department’s policy has played in contributing to this trend—was confirmed by a recent survey of over 1,200 corporate counsel conducted by the Association of Corporate Counsel, National Association of Criminal Defense Lawyers, and the ABA.\textsuperscript{9}

\textsuperscript{6} The SEC’s privilege waiver policy is set forth in its 2001 “Seaboard Report,” which is formally known as the “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,” issued on October 23, 2001 as Releases 44969 and 1470. A copy of the Seaboard Report is available at http://www.sec.gov/litigation/investreport/34-44969.htm. In that report, the SEC set forth the criteria that it will consider in determining whether, and to what extent, companies and other organizations should be granted credit for seeking out, self-reporting, and rectifying illegal conduct and otherwise cooperating with the agency’s staff as the SEC decides whether and how to take enforcement action. Like the corresponding policies adopted by the Justice Department, the Seaboard Report encourages companies to waive their attorney-client privilege, work product, and other legal protections as a sign of full cooperation. \textit{See} Seaboard Report at paragraph 8, criteria no. 11, and footnote 3.

\textsuperscript{7} The CFTC’s privilege waiver policy was contained in an August 11, 2004 Enforcement Advisory titled “Cooperation Factors in Enforcement Division Sanction Recommendations” issued by the agency’s Division of Enforcement, but the Commission issued a revised Enforcement Advisory eliminating the waiver language on March 1, 2007. The Commission’s original 2004 policy, the ABA’s July 7, 2006 letter recommending changes in the policy, and the Commission’s new March 1, 2007 policy are available at http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html.

\textsuperscript{8} HUD’s privilege waiver policy is contained in a February 3, 2006 formal Notice to public housing authorities urging them to include an addendum in all contracts with legal counsel that would restrict their attorneys’ ability to assert the attorney-client privilege on behalf of these clients in regard to HUD investigations and enforcement proceedings. HUD’s 2006 Notice is available at http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html.

\textsuperscript{9} According to the survey, 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 government officials give a reason for requesting privilege waiver, the policies adopted by the Justice Department, the Sentencing Commission, the SEC, and other agencies were among the reasons most frequently cited. The detailed survey results are available at http://www.acca.com/Surveys/attyclient2.pdf.
Instead of eliminating the improper practice of prosecutors demanding waiver, the McNulty Memorandum continues to allow such demands so long as prosecutors receive high level Departmental approval. These demands are unjustified, as prosecutors only need the relevant facts to enforce the law, not the opinions and mental observations of corporate counsel.

In addition, while the McNulty Memorandum imposes modest procedural limits on formal government requests for waiver, it continues to encourage companies to “voluntarily” waive their privileges without formally being asked in order to receive cooperation credit and less harsh treatment. Because companies will continue to feel extreme pressure to waive in virtually every case, the “culture of waiver” created by the Thompson Memorandum will continue under the McNulty Memorandum. As a result, the applicability of the privilege will remain highly uncertain in the corporate context. This is unacceptable, because as the U.S. Supreme Court noted in the case of Upjohn Co. v. United States, 449 U.S. 383, 393 (1981), “an uncertain privilege…is little better than no privilege at all.”

Second, the ABA believes that the McNulty Memorandum, like the previous Thompson Memorandum and the other similar federal policies, will continue to seriously weaken the confidential attorney-client relationship between companies and their lawyers, resulting in great harm both to companies and the investing public. Lawyers for companies and other organizations play a key role in helping these entities and their officials comply with the law and act in the entity’s best interests. To fulfill this role, lawyers must enjoy the trust and confidence of the company’s officers, directors, and employees, and must be provided with all relevant information necessary to properly represent the entity. By allowing prosecutors to continue to force companies to waive these fundamental protections in many cases—and more importantly, by continuing to provide cooperation credit to companies that “voluntarily” waive without formally being requested to do so—the new policy, like the Thompson Memorandum, will discourage company personnel from consulting with the company lawyers. This, in turn, will impede the lawyers’ ability to effectively counsel compliance with the law, resulting in harm not only to companies, but to employees and investors as well.

Third, while the McNulty Memorandum and the other similar federal policies were intended to aid government prosecution of corporate criminals, they will continue to make detection of corporate misconduct more difficult by undermining companies’ internal compliance programs and procedures. These mechanisms, which often include internal investigations conducted by the company’s in-house or outside lawyers, are one of the most effective tools for detecting and flushing out malfeasance. Indeed, Congress recognized the value of these compliance tools when it enacted the Sarbanes-Oxley Act in 2002. Because the effectiveness of these internal mechanisms depends in large part on the ability of the individuals with knowledge to speak candidly and confidentially with lawyers, policies such as the McNulty Memorandum that pressure companies to waive their attorney-client and work product protections seriously undermine systems that are crucial to compliance and have worked well.

For all these reasons, the ABA believes that the Department of Justice’s privilege waiver policy and other similar federal agency policies are counterproductive. They undermine rather than enhance compliance with the law, as well as the many other societal benefits that are advanced by the confidential attorney-client relationship.
The ABA’s Response to the Privilege Waiver Problem

The ABA is working to protect the attorney-client privilege and the work product doctrine in a number of ways. In 2004, the ABA Task Force on Attorney-Client Privilege was created to study and address the policies and practices of various federal agencies that have eroded attorney-client privilege and work product protections. The Chair of the Task Force, Bill Ide, is a prominent corporate attorney, a former president of the ABA, and the former senior vice president, general counsel, and secretary of the Monsanto Corporation. The ABA Task Force has held a series of public hearings on the privilege waiver issue and received testimony from numerous legal, business, and public policy groups. The Task Force also crafted new ABA policy—unanimously adopted by the ABA House of Delegates—supporting the attorney-client privilege and work product doctrine and opposing government policies that erode these protections. The ABA’s policy and other useful resources on this topic are available on our Task Force website at http://www.abanet.org/buslaw/attorneyclient/.

The ABA and its Task Force also are working in close cooperation with a broad and diverse coalition of influential legal and business groups—ranging from the U.S. Chamber of Commerce and the Association of Corporate Counsel to the American Civil Liberties Union and the National Association of Criminal Defense Lawyers—in an effort to modify the Department of Justice’s waiver policy and the similar policies adopted by other federal agencies to clarify that waiver of attorney-client privilege and work product protections should not be a factor in determining cooperation. Towards that end, the ABA sent letters to the Justice Department, the Sentencing Commission, and other federal agencies urging them to modify their policies.

In its May 2, 2006 letter to Attorney General Alberto Gonzales, which is attached as Appendix A, the ABA expressed its concerns over the Department’s privilege waiver policy and urged it to adopt specific revisions to the Thompson Memorandum that were prepared by the ABA Task Force and the coalition. These suggested revisions to the Department of Justice’s policy would help remedy the problem of government-coerced waiver while preserving the ability of prosecutors to obtain the important factual information they need to effectively enforce the law. To accomplish this, the ABA’s proposal would amend the Department’s policy by prohibiting prosecutors from seeking privilege waiver during investigations, specifying the types of factual, non-privileged information that prosecutors may request from companies as a sign of cooperation, and clarifying that any voluntary waiver of privilege shall not be considered when assessing whether the entity provided effective cooperation. This new language is designed to strike the proper balance between effective law enforcement and the preservation of essential attorney-client privilege and work product protections.

10 See ABA resolution regarding privilege waiver approved in August 2005, discussed in note 1, supra.


12 The ABA’s various letters and comments to the Justice Department, the Sentencing Commission, the CFTC, HUD, and the SEC, as well as the coalition’s letters and comments to the Sentencing Commission, are available at http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html.
ABA Outreach To State And Local Bars

In recognition of the nationwide implications of the privilege waiver problem, the ABA also has reached out to state and local bar associations and other organizations throughout the country on this issue. On January 31 and again on May 2, 2006, the president of the ABA sent a letter to hundreds of state and local bar leaders across the country urging them to take the following steps:

Establish Their Own Committees. Several state and local bars – including the New York, California, Florida, Arkansas, Connecticut, Illinois, and Boston bars – already have established committees to educate themselves on the issue and to assure that the privilege is protected. The ABA continues to urge all bars to establish committees or task forces and then coordinate their efforts with those of the ABA Task Force.

Contact Local U.S. Attorneys and the Justice Department. Just as the ABA wrote to Attorney General Gonzales, it is also urging state and local bars to write to their U.S. Attorneys urging them to adopt waiver review procedures that do not allow any requests, direct or indirect, for waiver of the privilege and work product. Bar groups also are being encouraged to send a separate letter to the Justice Department that makes the central points outlined in the ABA’s May 2 letter to Attorney General Gonzales.

Send An Op-ed Piece to Local Media Outlets. Bar groups are also being urged to contact their local media with an op-ed supporting the change in Justice Department policies, and provided a model for local adaptation.

These letters, and other related items of interest to state and local bar leaders, are available online at www.abanet.org/buslaw/attorneyclient/materials/stateandlocalbar/home.shtml.

Currently, the ABA and its Task Force on Attorney-Client Privilege are further expanding their outreach to state and local bars around the country—with a special emphasis on bars from states represented on the House and Senate Judiciary Committees—and are asking them to persuade their Representatives and Senators to support comprehensive legislation to reverse Justice Department and other federal agency policies that erode the privilege.

Former Senior Justice Department Officials Speak Out Against Privilege Waiver Policies

In addition to the ABA and the coalition, a prominent group of former senior Justice Department officials—including three former Attorneys General from both parties—submitted letters to the Sentencing Commission and the Justice Department on August 15, 2005 and September 5, 2006, respectively. In their letter to Attorney General Gonzales, a copy of which is attached statement as Appendix B, the former officials voiced many of the same concerns previously raised by the ABA and the coalition and urged the Department to amend the Thompson Memorandum “…to state affirmatively that waiver of attorney-client privilege and work product protections should not be a factor in determining whether an organization has cooperated with the government in an investigation.”

This remarkable letter, coming from the very people who ran the Department of Justice a few short years ago, demonstrates just how widespread the concerns over the Department’s privilege waiver policy have become. The fact that these individuals previously served as the nation’s top law enforcement officials—and were able to convict wrongdoers without demanding the wholesale production of privileged materials—makes their comments even more credible.

**Congressional Concerns Over the Department’s Waiver Policy**

Many congressional leaders also have raised concerns over the privilege waiver provisions in the Justice Department’s Thompson Memorandum. On March 7, 2006, the House Judiciary Subcommittee on Crime, Terrorism, and Homeland Security held a hearing on the general issue of government coerced waiver of the attorney-client privilege. During the hearing, virtually all of the Subcommittee members from both political parties expressed strong support for preserving the attorney-client privilege and serious concerns regarding the Department’s waiver policy. Subsequently, during a Senate Judiciary Committee hearing on September 12, 2006, both Chairman Arlen Specter (R-PA) and Ranking Member Patrick Leahy (D-VT) expressed serious reservations about the Department’s waiver policy and urged Deputy Attorney General McNulty and the Department to adopt major changes to the policy. In addition, the House Judiciary Subcommittee on Crime, Terrorism, and Homeland Security held a similar hearing on the McNulty Memorandum on March 8, 2007. As with the two previous congressional hearings, virtually all of the Subcommittee’s members agreed with the concerns that had been raised by the ABA and the coalition over the Justice Department’s policy and expressed a willingness to consider pursuing a legislative remedy.

**Recent Federal Agency Actions and Proposed Legislation**

After considering the concerns raised by the ABA, the coalition, former Justice Department officials, congressional leaders, and others, the Sentencing Commission voted unanimously on April 5, 2006, to remove the privilege waiver language from the Sentencing Guidelines, and that change became effective on November 1, 2006. Similarly, the CFTC eliminated the privilege waiver language from its cooperation standards on March 1, 2007 and issued a new Enforcement Advisory that specifically recognizes the importance of preserving the privilege. When it became apparent that the Justice Department would not agree to adopt similar meaningful changes to its own policy, however, legislation was introduced in the Senate last December that would bar the Department and all other federal agencies from engaging in this conduct. The ABA and the coalition promptly endorsed the legislation. When the Department finally issued the McNulty Memorandum on December 12, 2006

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15 The written statements of the ABA and the other witnesses appearing at the three hearings are available at [http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html](http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html).

16 The CFTC’s new cooperation standards of March 1, 2007 are available at [http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html](http://www.abanet.org/poladv/priorities/privilegewaiver/acprivilege.html).

17 The “Attorney-Client Privilege Protection Act of 2006” was introduced by Sen. Arlen Specter (R-PA) on December 7, 2006 as S. 30.
and it became clear that the new policy fell far short of what is needed to prevent further erosion of these fundamental legal rights, the Senate legislation was reintroduced on January 4, 2007 as S. 186.

**Federal Government Policies That Erode Employees’ Constitutional and Other Legal Rights**

While preserving the attorney-client privilege and the work product doctrine is critical to promoting effective corporate governance and compliance with the law, the ABA believes it is equally important to protect employees’ constitutional and other legal rights—including the right to effective counsel and the right against self-incrimination—when a company or other organization is under investigation. Unfortunately, in addition to its privilege waiver provisions, the Justice Department’s McNulty and Thompson Memoranda also contain language directing prosecutors, in determining cooperation, to consider a company’s willingness to take certain punitive actions against its own employees and agents during investigations. Several other federal agencies, including the SEC\(^{18}\) and HUD\(^{19}\), have adopted similar policies or practices as well.

The Thompson Memorandum encouraged prosecutors to deny cooperation credit to companies and other organizations that assist or support their so-called “culpable employees and agents” who are the subject of investigations by (1) providing or paying for their legal counsel, (2) participating in joint defense and information sharing agreements with them, (3) sharing corporate records and historical information about the conduct under investigation with them, or (4) declining to fire or otherwise sanction them for exercising their Fifth Amendment rights in response to government requests for information.\(^{20}\) Although the new McNulty Memorandum bars prosecutors from requiring companies to not pay their employees’ attorney fees in most cases, it continues to allow this practice in some

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\(^{18}\) The SEC’s Seaboard Report contains language in the last sentence of its cooperation criteria no. 11 that encourages companies to “make all reasonable efforts to secure” their employees’ cooperation with Commission staff during investigations. See footnote 6, supra. Although this language is not as explicit as the corresponding language in the Justice Department’s policies, the ABA is concerned that it could result in the erosion of employees’ constitutional and other legal rights to the extent that companies are asked to not advance the employees’ legal fees or to terminate employees unless they agree to waive their Fifth Amendment rights against self-incrimination.

\(^{19}\) Officials in HUD’s Enforcement Center have been accused of threatening to take enforcement action against the directors of state and local government entities that administer federal awards because they covered the costs of legal assistance for their employees from program funds. While HUD does not appear to have a formal, written policy forbidding payment of these employee legal fees, the agency’s threats to take enforcement action have eroded employees’ constitutional and other legal rights in much the same way as the more formal Justice Department and SEC policies. The ABA’s December 8, 2006 letter to HUD expressing concerns over this practice is available online at: [http://www.abanet.org/poladv/letters/attyclient/2006dec08_hudattyfees_1.pdf](http://www.abanet.org/poladv/letters/attyclient/2006dec08_hudattyfees_1.pdf).

\(^{20}\) The Thompson Memorandum provided in pertinent part that:

…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 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.

See Thompson Memorandum, note 2 supra, at pgs. 7-8. The Thompson Memorandum does not provide any measure by which an organization is expected to determine whether an employee or agent 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.
situations.\textsuperscript{21} In addition, the new memorandum continues to allow prosecutors to force companies to take the other three types of punitive action against employees outlined in the Thompson Memorandum in return for cooperation credit.\textsuperscript{22}

The ABA strongly opposes the Justice Department’s policy, even as modified by the McNulty Memorandum, and the other similar federal agency policies for a number of reasons.\textsuperscript{23}

First, these policies are inconsistent with the fundamental legal principle that all prospective defendants—including an organization’s current and former employees, officers, directors and agents—are presumed to be innocent. When implementing the directives in the McNulty and Thompson Memoranda, prosecutors take the position that certain employees and other agents suspected of wrongdoing are “culpable” long before their guilt has been proven or the company has had an opportunity to complete its own internal investigation. In those cases, the prosecutors often pressure the company to fire the employees in question or refuse to provide them with legal representation or otherwise assist them with their legal defense as a condition for receiving cooperation credit. The Department’s policy stands the presumption of innocence principle on its head. In addition, the policy overturns well-established corporate governance practices by forcing companies in certain cases to abandon the traditional practice of indemnifying their employees and agents or otherwise assisting them with their legal defense for employment-related conduct until it has been determined that the employee or agent somehow acted improperly.

Second, the ABA believes it should be the prerogative of a company to make an independent decision as to whether an employee should be provided defense or not and the government should not be able to make this determination, even in the “extremely rare cases” referenced in footnote 3 of the McNulty Memorandum. The fiduciary duties of the directors in making such decisions are clear, and they—not government officials—are in the best position to decide what is in the best interest of the shareholders.

Third, the ABA believes that these government policies improperly weaken the entity’s ability to help its employees to defend themselves in criminal actions. It is essential that employees, officers,

\textsuperscript{21} The McNulty Memorandum states that “prosecutors generally should not take into account whether a corporation is advancing attorneys’ fees to employees or agents under investigation and indictment...(but) in extremely rare cases, the advancement of attorneys’ fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation.” See McNulty Memorandum at p. 11 and footnote 3.

\textsuperscript{22} The McNulty Memorandum states that “a corporation’s promise of support to culpable employees and agents, e.g., 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.” See McNulty Memorandum at p. 11.

\textsuperscript{23} On August 8, 2006, the ABA approved a resolution, sponsored by the ABA Task Force on Attorney-Client Privilege and the New York State Bar Association, opposing government policies, practices and procedures that erode employees’ constitutional and other legal rights by requiring, encouraging, or permitting prosecutors to consider certain factors in determining whether a company or other organization has been cooperative during an investigation. These factors include whether the organization (1) provided or funded legal representation for an employee, (2) participated in a joint defense and information sharing agreement with an employee, (3) shared its records or historical information about the conduct under investigation with an employee, or (4) declined to fire or otherwise sanction an employee who exercised his or her Fifth Amendment rights in response to government requests for information. The ABA resolution and a detailed background report are available at http://www.abanet.org/buslaw/attorneyclient/.
directors and other agents of organizations have access to competent representation in criminal cases and in all other legal matters. In addition, competent representation in a criminal case requires that counsel investigate and uncover relevant information.\(^{24}\) The McNulty and Thompson Memoranda seek to undermine the ability of employees and other personnel to defend themselves by seeking to prevent companies from sharing records and other relevant information with them and their lawyers. However, subject to limited exceptions, lawyers should not interfere with an opposing party’s access to such information.\(^{25}\) The language in the Department’s policies undermines these rights by encouraging prosecutors to penalize companies that provide information or, in some cases, legal counsel to their employees and agents during investigations.

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 when government prosecutors—citing the directives in footnote 3 of the McNulty Memorandum or the similar policies of other federal agencies—succeed in pressuring a company not to pay for the employee’s legal defense, the employee typically will be unable to afford effective legal representation. In addition, when prosecutors demand and receive a company’s agreement to not assist employees with other aspects of their legal defense—such as participating in joint defense and information sharing agreements with the employees with whom the company has a common interest in defending against the investigation or by providing them with corporate records or other information that they need to prepare their defense—the employees’ rights are undermined.

Fourth, several of these employee-related provisions of the Justice Department’s policy have been declared to be constitutionally suspect by the federal judge presiding over the pending case of \textit{U.S. v. Stein}, also known as the “KPMG case.” On June 26, 2006, U.S. District Court Judge Lewis A. Kaplan issued an extensive opinion suggesting that the provisions in the Thompson Memorandum making a company’s advancement of attorneys’ fees to employees a factor in assessing cooperation violated the employees’ Fifth Amendment right to substantive due process and their Sixth Amendment right to counsel.\(^{26}\) In addition, Judge Kaplan subsequently determined that certain KPMG employees’ statements were improperly coerced in violation of their Fifth Amendment rights against self-incrimination as a result of the pressure that the government and KPMG placed on the

\(^{24}\) 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.”).

\(^{25}\) 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 co-defendants information which such person has a right to give.”); ABA Model Rules of Professional Conduct, Rule 3.4(g) (providing that a lawyer may 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.”).

employees to cooperate as a condition of continued employment and payment of legal fees.27 Because the McNulty Memorandum and other similar federal policies continue to permit these same practices in some instances, they remain constitutionally suspect as well.

For all of these reasons, the ABA supports legislation like S. 186 that would bar the Justice Department and other federal agencies from demanding, requesting, or encouraging that companies take any of these four types of punitive action against employees or other corporate agents as a condition for receiving cooperation credit. The ABA believes that legislation containing these reforms, and a prohibition on federal agencies pressuring companies to waive their attorney-client privilege or work product protections, would strike the proper balance between effective law enforcement and the preservation of essential attorney-client, work product, and employee legal protections.

**Conclusion**

Although the ABA and the coalition have succeeded in raising awareness of the privilege waiver problem and persuading the Sentencing Commission and the CFTC to reconsider and reverse their respective waiver policies, much still needs to be done. In addition to the Justice Department, numerous other federal agencies—including the SEC, HUD, and others—continue to require waiver of the attorney-client privilege, the work product doctrine, and/or employee legal rights in order to receive favorable treatment during investigations. Therefore, the ABA, the coalition, and other like-minded entities will continue their efforts to persuade the relevant federal agencies to roll back their policies—and Congress to enact comprehensive legislation like S. 186—in order to protect the confidential attorney-client relationship, employees’ constitutional and other legal rights, and all of the societal benefits that they provide.

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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.
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](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](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/](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
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
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
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.

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² Actions by an entity recognizing the rights of such individuals are not inconsistent with this factor.
"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."
September 5, 2006

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

Re: Proposed Revisions to Department of Justice Policy Regarding Waiver of the Attorney-Client Privilege and Work-Product Doctrine

Dear Mr. Attorney General:

We, the undersigned former senior Justice Department officials, write to enlist your support in preserving the attorney-client privilege and work-product doctrine. We believe that current Departmental policies and practices are seriously eroding these protections, and we urge you to take steps to change these policies and stop the practice of federal prosecutors requiring organizations to waive attorney-client privilege and work-product protections as a condition of receiving credit for cooperating during investigations.

As former Department officials, we appreciate and support your ongoing efforts to fight corporate crime. Unfortunately, we believe that the Department’s current policy embodied in the 1999 “Holder Memorandum” and the 2003 “Thompson Memorandum,” which encourages individual federal prosecutors to demand waiver of the attorney-client privilege and the work-product doctrine in return for cooperation credit, is undermining rather than strengthening compliance in a number of ways. In practice, companies who are all aware of the policies outlined in the Thompson Memorandum have no choice but to waive these protections. The threat of being labeled “uncooperative” simply poses too great a risk of indictment to do otherwise.

The Department’s carrot-and-stick approach to waiving attorney-client privilege and work-product protections gravely weakens the attorney-client relationship between companies and their lawyers by discouraging corporate personnel at all levels from consulting with counsel on close issues. Lawyers are indispensable in helping companies and their officials understand and comply with complex laws and act in the entity’s best interests. In order to fulfill this important function, lawyers must enjoy the trust and confidence of the board, management, and line operating personnel, so that they may represent the entity effectively and ensure that compliance is maintained (or that noncompliance is quickly remedied). By making waiver of privilege and work-product protections nearly assured, the Department’s policies discourage personnel within companies and other organizations from consulting with their lawyers, thereby impeding the lawyers’ ability effectively to counsel compliance with the law. This, in turn, harms not only the corporate client, but the investing public as well.
The Department’s policies also make detection of corporate misconduct more difficult by undermining companies’ internal compliance programs and procedures. These mechanisms, which often include internal investigations conducted by the company’s in-house or outside lawyers, have become one of the most effective tools for detecting and flushing out malfeasance. Indeed, Congress recognized the value of these compliance tools when it enacted the Sarbanes-Oxley Act in 2002. Because the effectiveness of internal investigations depends on the ability of employees to speak candidly and confidentially with the lawyer conducting the investigation, any uncertainty as to whether attorney-client privilege and work-product protections will be honored makes it harder for companies to detect and remedy wrongdoing early. As a result, we believe that the Department’s consideration of waiver as an element of cooperation undermines, rather than promotes, good compliance practices.

Finally, we believe that the Department’s position with regard to privilege waiver encourages excessive “follow-on” civil litigation. In virtually all jurisdictions, waiver of attorney-client privilege or work-product protections for one party constitutes waiver to all parties, including subsequent civil litigants. Forcing companies and other entities routinely to waive their privileges during criminal investigations provides plaintiffs’ lawyers with a great deal of sensitive—and sometimes confidential—information that can be used against the entities in class action, derivative, and similar suits, to the detriment of the entity’s employees and shareholders. This risk of future litigation and all its related costs unfairly penalizes organizations that choose to cooperate on the government’s terms. Those who determine that they cannot do so—in order to preserve their defenses for subsequent actions that appear to involve great financial risk—instead face the government’s wrath.

We are not alone in voicing these concerns. According to a survey conducted earlier this year of over 1,200 in-house and outside corporate counsel, which is available at http://www.acc.org/Surveys/attyclient2.pdf, almost 75 percent of the respondents agreed with the statement 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 policy contained in the Holder/Thompson memoranda was most frequently cited.

We recognize that, in an attempt to address the growing concern being expressed about government-induced 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.” 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 being established throughout the country, many of which may impose only token restraints on the ability of prosecutors to demand waiver. More importantly, it fails to acknowledge and address the many problems arising from the specter of forced waiver.
As you probably know, these views were expressed forcefully to Mr. McCallum on March 7 at a hearing of the House Judiciary Committee’s Subcommittee on Crime, Terrorism and Homeland Security. The U.S. Sentencing Commission also validated these concerns when it voted on April 5, over the Department’s objection, to rescind the “waiver as cooperation” amendment it had made only two years earlier to the commentary on its Organizational Sentencing Guidelines.

We agree with the position taken by the American Bar Association, as well as by the members of a broad coalition to preserve the attorney-client privilege representing virtually every business and legal organization in this country: Prosecutors can obtain needed information in ways that do not impinge upon the attorney-client relationship—for example, through corporate counsel identifying relevant data and documents and assisting prosecutors in understanding them, making available witnesses with knowledge of the events under investigation, and conveying the results of internal investigations in ways that do not implicate privileged material.

In sum, we believe that the Thompson Memorandum is seriously flawed and undermines, rather than enhances, compliance with the law and the many other societal benefits that arise from the confidential attorney-client relationship. Therefore, we urge the Department to revise its policy to state affirmatively that waiver of attorney-client privilege and work-product protections should not be a factor in determining whether an organization has cooperated with the government in an investigation.

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

Sincerely,

Griffin B. Bell
Attorney General
(1977-1979)

Carol E. Dinkins
Deputy Attorney General
(1984-1985)

Walter E. Dellinger III
Acting Solicitor General
(1996-1997)

Stuart M. Gerson
Acting Attorney General
(1993)

Jamie Gorelick
Deputy Attorney General
(1994-1997)

Theodore B. Olson
Solicitor General
(2001-2004)

Assistant Attorney General,
Civil Division (1989-1993)

George J. Terwilliger III
Deputy Attorney General
(1991-1992)

Kenneth W. Starr
Solicitor General
(1989-1993)

Dick Thornburgh
Attorney General

Seth P. Waxman
Solicitor General
(1997-2001)
RESOLUTION ADOPTED BY THE

HOUSE OF DELEGATES

OF THE

AMERICAN BAR ASSOCIATION

AUGUST 7-8, 2006*

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.

*Note: The Resolution, but not the attached Report, constitutes ABA policy.
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.\(^2\)

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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
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. 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

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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
- 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.

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.
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.

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. 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

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.
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.

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. 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.

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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.
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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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:

7 Preamble to ABA “Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests”.

• 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.

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

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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.
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.”\textsuperscript{12} The term “evidential matter” refers to “underlying accounting data and all corroborating information available to the auditor.”\textsuperscript{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.\textsuperscript{14}

**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.

\textsuperscript{12} \textit{Id.}
\textsuperscript{13} AU Section 326.15.
\textsuperscript{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.
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. It subsequently adopted Rule 3101, providing definitions of certain terms used in Auditing Standard No. 3 and other auditing and related professional practice standards. 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.” 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 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.” 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

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

The SEC’s Advisory Committee on Smaller Public Companies in its final report dated April 23, 200619 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.

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

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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).

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,

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ABA Task Force on Attorney-Client Privilege

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