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BEST PRACTICES FOR THE TRANSACTIONAL LAWYER: LEGAL PRIVILEGE AND CONFIDENTIALITY¹

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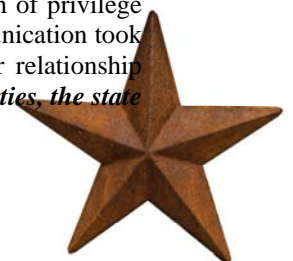
Practice tip. No matter whether you believe the communication to your client is privileged, write it believing that someone besides your client is likely to see it. And that someone may be the Judge.

1. CHOICE OF LAW FOR THE PRIVILEGE DETERMINATION

- **GENERAL RULE.** The law of the state that “supplies the rule of decision” generally applies, except that in federal question cases, the federal common law of privileges will apply.
 - “The parties first contest whether federal or state law governs our analysis of the attorney-client privilege....” As [these] claims arise under federal law—and are before us on federal question jurisdiction under 28 U.S.C. § 1331—the federal common law of attorney-client privilege governs our analysis.” *Willy v. Administrative Review Bd.*, 423 F.3d 483, 495 (5th Cir. 2005) (citing *United States v. Zolin*, 491 U.S. 554, 562, 109 S.Ct. 2619, 105 L.Ed.2d 469 (1989)).
 - **Example:** In a federal securities fraud case, the court will apply the federal common law of privileges. *E.g. Smith v. Smith*, 154 F.R.D. 661 (N.D. Tex. 1994) (refusing to recognize or apply state law mediator privilege), *aff’d without opinion*, 132 F.3d 1454 (5th Cir. 1997).
 - **Example:** In a diversity case, the forum state’s choice of law rules apply. The Texas Supreme Court has adopted the position set forth in the RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 139, which provides for application of the privilege law of the “state which has the most significant relationship with the communication.”² *Ford Motor Co. v. Leggat*, 904 S.W.2d 643, 647 (Tex. 1995) (applying Michigan law, because the communication took place in Michigan).³

² The Restatement provides: “(1) Evidence that is not privileged under the local law of the state which has the most significant relationship with the communication will be admitted, even though it would be privileged under the local law of the forum, unless the admission of such evidence would be contrary to the strong public policy of the forum. (2) Evidence that is privileged under the local law of the state which has the most significant relationship with the communication but which is not privileged under the local law of the forum will be admitted unless there is some special reason why the forum policy favoring admission should not be given effect.” RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 139 (1988).

³ Comment e to the Restatement provides, “The state which has the most significant relationship with a communication ***will usually be the state where the communication took place***, which, as used in the rule of this Section, is the state where an oral interchange between persons occurred, where a written statement was received or where an inspection was made of a person or thing. The communication may take place in a state different from that whose local law governs the rights and liabilities of the parties. So in a case involving an issue in contract that is governed by the local law of state X under the rule of § 187, a question of privilege may arise with respect to a communication that took place in state Y. The state where the communication took place will be the state of most significant relationship in situations where there was no prior relationship between the parties to the communication. ***If there was such a prior relationship between the parties, the state***



2. **TWO BASIC PRINCIPLES:**
ATTORNEY-CLIENT PRIVILEGE AND ATTORNEY WORK PRODUCT

THE UNDERLYING POLICIES

- “The attorney-client and work product protections serve an extremely important function in the U.S. legal system. The attorney-client privilege is one of the oldest and most sacrosanct privileges under U.S. law. As the Supreme Court has stated ‘its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice.’ The work product doctrine also serves similarly important interests.” McNulty Memorandum (2006).

ATTORNEY-CLIENT PRIVILEGE

- **FEDERAL RULE OF EVIDENCE 501. PRIVILEGES—GENERAL RULE.**

“Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience. However, in civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness, person, government, State, or political subdivision thereof shall be determined in accordance with State law.”

- **BASIC STATEMENT OF FEDERAL COMMON LAW PRIVILEGE.**

In *In re Grand Jury Proceedings*, 517 F.2d 666, 670 (5th Cir. 1975), the Fifth Circuit adopted the following attorney-client privilege test: *The privilege applies only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.*

See also *United States v. Robinson*, 121 F.3d 971, 974 (5th Cir. 1997) (“The assertor of the lawyer-client privilege must prove: (1) that he made a confidential communication; (2) to a lawyer or his subordinate; (3) for the primary purpose of securing either a legal opinion or legal services, or assistance in some legal proceeding.”)

- **TEXAS RULE OF EVIDENCE 503. LAWYER-CLIENT PRIVILEGE.**

(a) **Definitions.** –As used in this rule:

of most significant relationship will be that where the relationship was centered unless the state where the communication took place has substantial contacts with the parties and the transaction. So if a husband and wife are domiciled in state X and the wife makes a statement to the husband in state Y while the spouses are spending a weekend in the latter state, X is the state which has the most significant relationship with the communication. Y, on the other hand, might be the state of most significant relationship if the spouses spent a considerable portion of their time there....” RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 139 cmt. e (1988) (emphasis added).



(1) A “client” is a person, public officer, or corporation, association, or other organization or entity, either public or private, who is rendered professional legal services by a lawyer, or who consults a lawyer with a view to obtaining professional legal services from that lawyer.

(2) A “representative of the client” is: (A) a person having authority to obtain professional legal services, or to act on advice thereby rendered, on behalf of the client, or (B) any other person who, for the purpose of effectuating legal representation for the client, makes or receives a confidential communication while acting in the scope of employment for the client.

(3) A “lawyer” is a person authorized, or reasonably believed by the client to be authorized, to engage in the practice of law in any state or nation.

(4) A “representative of the lawyer” is: (A) one employed by the lawyer to assist the lawyer in the rendition of professional legal services; or (B) an accountant who is reasonably necessary for the lawyer’s rendition of professional legal services.

(5) A communication is “confidential” if not intended to be disclosed to third persons other than those to whom disclosure is made in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication.

(b) Rules of Privilege.

(1) *General Rule of Privilege.* –A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client: (A) between the client or a representative of the client and the client’s lawyer or a representative of the lawyer; (B) between the lawyer and the lawyer’s representative; (C) by the client or a representative of the client, or the client’s lawyer or a representative of the lawyer, to a lawyer or a representative of a lawyer representing another party in a pending action and concerning a matter of common interest therein; (D) between representatives of the client or between the client and a representative of the client; or (E) among lawyers and their representatives representing the same client.

(2) *Special Rule of Privilege in Criminal Cases.* –In criminal cases, a client has a privilege to prevent the lawyer or lawyer’s representative from disclosing any other fact which came to the knowledge of the lawyer or the lawyer’s representative by reason of the attorney-client relationship.

(c) Who May Claim the Privilege. –The privilege may be claimed by the client... or similar representative of a corporation, association, or other organization, whether or not in existence. The person who was the lawyer or the lawyer’s representative at the time of the communication is presumed to have authority to claim the privilege but only on behalf of the client.



(d) **Exceptions.** –There is no privilege under this rule:

(1) ***Furtherance of Crime or Fraud.*** –If the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud;

(2) ***Claimants Through Same Deceased Client.*** –As to a communication relevant to an issue between parties who claim through the same deceased client, regardless of whether the claims are by testate or intestate succession or by inter vivos transactions;

(3) ***Breach of Duty by a Lawyer or Client.*** –As to a communication relevant to an issue of breach of duty by a lawyer to the client or by a client to the lawyer;

(4) ***Document Attested by a Lawyer.*** –As to a communication relevant to an issue concerning an attested document to which the lawyer is an attesting witness; or

(5) ***Joint Clients.*** –As to a communication relevant to a matter of common interest between or among two or more clients if the communication was made by any of them to a lawyer retained or consulted in common, when offered in an action between or among any of the clients.

Practice tip. Note that the attorney-client privilege only extends to clients, clients’ representatives, lawyers and lawyers’ representatives. So, if attorney-client privileged material is provided to a company during due diligence,⁴ even if under a non-disclosure agreement,⁵ you have gone outside the confidential lawyer-client relationship and the privilege is most likely waived.

Practice tip. Caution the client not to forward your advice to folks outside the lawyer-client relationship.

⁴ In *In re John Doe Corp.*, the party asserting the privilege argued that its disclosure of confidential communications “to Underwriter Counsel was not voluntary because it was coerced by the legal duty of due diligence and the millions of dollars riding on the public offering of registered securities.” The court rejected this argument, holding that disclosure to Underwriter Counsel waived the attorney-client privilege. The court explained:

We view this argument with no sympathy whatsoever. A claim that a need for confidentiality must be respected in order to facilitate the seeking and rendering of informed legal advice is not consistent with selective disclosure when the claimant decides that the confidential materials can be put to other beneficial purposes. Federal securities laws put a price of disclosure upon access to interstate capital markets. Once materials are utilized in that disclosure, they become representations to third parties by the corporation. The fact that they were originally compiled by attorneys is irrelevant because they are serving a purpose other than the seeking and rendering of legal advice.

675 F.2d 482, 489 (2d Cir. 1982); see also *Feinberg v. Hibernia Corp.*, 1993 U.S. Dist. LEXIS 3767, at *1 (E.D. La. Mar. 23, 1993) (“In the due diligence investigations by Chase Manhattan and the other banks, Hibernia was ‘willing to sacrifice confidentiality,’ while in this litigation with its own stockholders, Hibernia now asserts ‘that the secrecy of the attorney-client relationship precludes disclosure of the same documents.’”)

⁵ See, e.g., *In Re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 296 (6th Cir. 2002) (“[E]ven if the disclosing party requires, as a condition of disclosure, that the recipient maintain the materials in confidence, this agreement does not prevent the disclosure from constituting a waiver of the privilege; it merely obligates the recipient to comply with the terms of any confidentiality agreement.”).



- **KEY QUESTION—”DOMINANT PURPOSE.”** A key question in a transactional setting is whether a court will later deem the lawyer to have functioned solely or primarily as a business negotiator, rather than a legal advisor. Courts often look at what they consider the “dominant purpose” of the communication. If the dominant purpose is to provide non-legal advice, such as business recommendations or strategies, then the privilege may not apply. In other words, where the attorney’s advice rests “predominantly” on an assessment of legal issues, the privilege should be recognized.⁶
 - *Harlandale Indep. Sch. Dist. v. Cornyn*, 25 S.W.3d 328, 332 (Tex. App.—Austin 2000, no pet.) (“Attorney-client privilege therefore does not apply to communications between a client and an attorney where the attorney is employed in a non-legal capacity, for instance as an accountant, escrow agency, negotiator, or notary public.”)

- **FACTORS TO EVALUATE WHETHER A LAWYER IS ACTING AS A LAWYER FOR THE PURPOSE OF ESTABLISHING PRIVILEGE.**⁷
 - Could the task have been as readily handled by a non-lawyer?⁸
 - What was the purpose for which the lawyer was contacted?⁹
 - Were there any indications by the client about the role of the lawyer?
 - Were there any indications by the lawyer concerning his or her role in communicating with the client?

Practice tip. Having the client, as well as the attorney herself, document that the attorney’s role is to give legal advice is useful. Putting legends on the privileged communications can be useful, but also harmful if overused. Expressly communicating in terms of requesting or providing legal advice is useful.

- **LEGAL SERVICES VERSUS RECITATION OF FACTS.** The attorney-client privilege protects a client’s communications with a lawyer made for the purpose of obtaining legal services; it does not protect underlying facts or evidence. *E.g., Navigant Consulting, Inc. v. Wilkinson*, 220 F.R.D. 467, 475 (N.D. Tex. 2004) (holding that portions of meeting minutes discussing hiring and compensation matters did not

⁶ Raymond L. Swiegart, *Attorney-Client Privilege: Pitfalls and Pointers for Transactional Attorneys*, BUS. LAW TODAY 43 (March/April 2008).

⁷ JOHN WILLIAM GERGACZ, ATTORNEY-CORPORATE CLIENT PRIVILEGE 3-29 through 3-36 and App. A-13 (Thomson West 3d ed. 2007).

⁸ *Dreiling v. Jain*, 93 P.3d 861 (Wash. 2004) (report prepared by a corporate board acting within their corporate roles was not privileged merely because one of the members was an attorney).

⁹ *United States v. Frederick*, 182 F.3d 496 (7th Cir. 1999) (attorney acting in the role of an accountant will not create the privilege even if legal thinking finds its way into the accounting documents); *Georgia-Pacific Corp. v. GAF Roofing Mfg. Corp.*, 1996 WL 29392 (S.D.N.Y. 1996) (communications with in-house counsel acting as a contract negotiator are not privileged); *CCS Assocs., Inc. v. Altman A.M.A., Inc.*, 1994 WL 176898 (E.D. Pa. 1994) (communications with an attorney acting as an escrow agent are not privileged).



constitute legal advice and should not have been redacted, while noting that minutes of an audit committee meeting that did contain legal advice were privileged and could be redacted).

Practice tip. Keep in mind that some of your documents might contain both privileged and non-privileged material. Just because some of the document is privileged doesn't mean that the entire document can be withheld from production.

- **WHOSE PRIVILEGE IS IT?** The attorney-client privilege belongs to the client, and only the client can choose to waive the privilege.

Practice tip. Keep in mind that some courts hold that the attorney-client relationship (and thus the right to waive the privilege) transfers to new owners in an asset transaction.¹⁰

- **VOLUNTARY DISCLOSURE TO LOWER LEVEL EMPLOYEES.** Since *Upjohn*, recognize that it is a necessary fact of representing a corporation that certain employees “need to know” of certain communications. The *Upjohn* test is broader than the “control group,” although the control group is generally presumed to be in the “need to know” category. The focus is on the nature of the communication, who in the corporation is concerned with the matters it covers, and who will need access to it to implement the legal advice rendered.¹¹
 - ***Upjohn Co. v. United States.*** “[A] communication is privileged at least when...an employee or former employee speaks at the direction of the management with an attorney regarding conduct or proposed conduct within the scope of employment. The attorney must be one authorized by the management to inquire into the subject and must be seeking information to assist counsel in... (a) evaluating whether the employee’s conduct has bound or would bind the corporation; (b) assessing the legal consequences, if any, of that conduct; or (c) formulating appropriate legal responses to actions that have been or may be taken....” 449 U.S. 383, 403 (1981).
 - ***Example:*** The defendants argued “that plaintiff waived its attorney-client privilege by permitting employees outside its ‘control group’ to be present at board meetings where legal discussions relevant to this lawsuit occurred.” *Eglin Federal Credit Union v. Cantor, Fitzgerald Sec. Corp.*, 91 F.R.D. 414, 417 (N.D. Ga. 1981). The court explained that “[t]he communications in issue in this case were provided by plaintiff’s assistant general manager, its internal accountant, and its present investment manager, none of whom were in plaintiff’s control group. At the time these employees were asked to attend board meetings, plaintiff was either contemplating filing or had filed this lawsuit based on defendants’ alleged

¹⁰ M&A Jurisprudence Subcommittee, Negotiated Acquisitions Committee, ABA Section of Business Law, *Survey—Mergers and Acquisitions: Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions*, 61 Bus. Law. 987 (Feb. 2006) (citing *Coffin v. Bowater Inc.*, Civ. No. 03-227-P-C, 2005 U.S. Dist. LEXIS 9395 (D. Maine May 13, 2005)).

¹¹ JOHN WILLIAM GERGACZ, ATTORNEY-CORPORATE CLIENT PRIVILEGE § 5.47 (Thomson West 3d ed. 2007);



violations of the securities laws. Plaintiff has contended, and the court finds it reasonable to conclude, that counsel needed the facts and background information known best by these employees by virtue of their employment duties in order to advise plaintiff wisely on this matter.” *Id.* at 418. The court added, “[i]n this case the employees attended board meetings and were permitted to hear legal discussions between board and counsel on the information just related by them. The procedures used to gather the needed information here were admittedly less formal than those utilized in *Upjohn*. On the other hand, there was less need for extensive written communication since plaintiff is much smaller and more geographically compact than the Upjohn Co. In the opinion of the court, the presence of these particular employees at board meetings did not result in a waiver of the attorney-client privilege with respect to these board minutes.” *Id.*

Practice tip. If employees are sitting in a privileged portion of the board meeting like bumps on a log, consider asking them to step out.



WORK PRODUCT DOCTRINE

▪ **FEDERAL RULE OF CIVIL PROCEDURE 26(B)(3).**

(A) *Documents and Tangible Things.* Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent). But, subject to Rule 26(b)(4), those materials may be discovered if: (i) they are otherwise discoverable under Rule 26(b)(1); and (ii) the party shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.

(B) *Protection Against Disclosure.* If the court orders discovery of those materials, it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation. [...]

▪ **TEXAS RULE OF CIVIL PROCEDURE 192.5.**

(a) *Work Product Defined.* –Work product comprises:

(1) material prepared or mental impressions developed in anticipation of litigation or for trial by or for a party or a party's representatives, including the party's attorneys, consultants, sureties, indemnitors, insurers, employees, or agents; or

(2) a communication made in anticipation of litigation or for trial between a party and the party's representatives or among a party's representatives, including the party's attorneys, consultants, sureties, indemnitors, insurers, employees, or agents.

(b) *Protection of Work Product.*

(1) *Protection of Core Work Product—Attorney Mental Processes.* –Core work product—the work product of an attorney or an attorney's representative that contains the attorney's or the attorney's representative's mental impressions, opinions, conclusions, or legal theories—is not discoverable.

(2) *Protection of Other Work Product.* –Any other work product is discoverable only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the material by other means.

(3) *Incidental Disclosure of Attorney Mental Processes.* –It is not a violation of subparagraph (1) if disclosure ordered pursuant to subparagraph (2) incidentally discloses by inference attorney mental processes otherwise protected under subparagraph (1).

(4) *Limiting Disclosure of Mental Processes.* –If a court orders discovery of work product pursuant to subparagraph (2), the court must—insofar as possible—protect against disclosure of the mental impressions, opinions, conclusions, or legal theories not otherwise discoverable. [...]



- **DISTINGUISH FROM ATTORNEY-CLIENT PRIVILEGE.** The work product doctrine is both broader and narrower than the attorney-client privilege.
 - **Work product doctrine limited to “anticipation of litigation.”** The work product doctrine is triggered when the client anticipates litigation.

Practice tip. If the client’s position is that a document constitutes work product because litigation was anticipated, the client needs to have made tangible efforts to have preserved documents at the same time. In a perfect world, a document preservation memorandum would go out the same day that the litigators later claim litigation was anticipated.

- **Work product does not depend on a confidential “communication.”** It protects the notes, mental impressions, and legal analyses and conclusions prepared by a lawyer whether or not communicated.
- **Work product doctrine is more difficult to waive.** “[U]nlike the attorney-client privilege, work-product protection is not necessarily waived by disclosure to a third party who does not have a common legal interest. Disclosure of work-product can result in waiver of the work-product protection, but only if it is disclosed to adversaries or treated in a manner that substantially increases the likelihood that an adversary will come into possession of the material. Unlike the attorney-client privilege, the burden of proving waiver of work-product protection falls on the party asserting waiver.” *Robinson v. Tex. Auto. Dealers Ass’n*, 214 F.R.D. 432, 443 (E.D. Tex. 2003) (citations omitted).
- **WHOSE PROTECTION IS IT?** Courts are split on whether the protection belongs to the lawyer, the client, or both. The majority position, as set forth in the RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, is that “[w]ork product immunity may be invoked by or for a person on whose behalf the work product was prepared.”¹²
- **APPLIES TO DOCUMENTS RELATED TO LEGAL WORK.** Similar to the “dominant purpose” requirement stated above, the attorney’s work must be legal in nature. *Watt Indus., Inc. v. Superior Court*, 171 Cal. Rptr. 503, 504 (Cal. Ct. App. 1981) (court held that lawyer’s notes from phone conversation during negotiations for his client to buy a condominium were not privileged because lawyer acting “merely as a business agent” by conveying client’s bargaining position to a contracting party.)

¹² RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 90 (2000); *c.f. Panter v. Marshall Field & Co.*, 80 F.R.D. 718, 725 n.7 (N.D. Ill. 1978), *citing Hercules, Inc. v. Exxon Corp.*, 434 F. Supp. 136, 156 (D. Del. 1977) (dicta) (“subject matter” waiver more narrowly applied for work product because “work product immunity may be invoked only by an attorney”); *see also* Ernest E. Badway and Marc C. Singer, 7 SECURITIES LAW TECHNIQUES § 109.04 (2007).



3. **PRIVILEGE ISSUES WITH COMMON THIRD PARTIES:
ACCOUNTANTS, AUDITORS AND INVESTMENT BANKERS**

ACCOUNTANTS

- **ACCOUNTANT-CLIENT PRIVILEGE VERSUS ATTORNEY-CLIENT PRIVILEGE.** The “accountant-client privilege,” which is available in some jurisdictions on a limited basis, protects confidential communications between a client and its accountant. The attorney-client privilege may also cover communications between clients and accountants when the accountant is acting as the agent of the attorney.¹³
- **ACCOUNTANT-CLIENT PRIVILEGE.**
 - *U.S. v. Arthur Young & Co.*. There is no *federal* accountant-client privilege. 465 U.S. 805, 817 (1984).
 - **Accountant-client privilege in Texas?** The general rule in Texas is that a communication made by a client to an accountant in connection with services provided to the client is confidential. TEX. OCC. CODE § 901.457(a). **However**, despite the section title, “Accountant-Client Privilege,” the Occupational Code provides that such communications *are* discoverable “[w]hen required by the professional standards for reporting on the examination of a financial statement” or “[t]o respond to a summons under the provisions of the Internal Revenue Code, the 1933 Securities Act, the 1934 Securities Exchange Act, or a court order.” Thus, Section 901.457 is really a rule of “confidentiality,” not evidentiary privilege.
 - **Examples:** *In re Patel*, 218 S.W.3d 911, 920 (Tex. App.—Corpus Christi 2007, orig. proceeding) (“Material that is required to be kept ‘confidential’ may not be protected from disclosure in judicial proceedings. Other than citing section 901.457 of the occupations code, neither party has provided authority for the proposition that an accountant-client evidentiary privilege exists in Texas, and we find none.”) (citations omitted); *Canyon Partners, L.P. v. Developers Diversified Realty Corp.*, No. 3-04-CV-1335-L, 2005 U.S. Dist. LEXIS 26782, at *3 (N.D. Tex. Nov. 4, 2005) (“[T]here is no accountant-client privilege under federal or Texas law.”); *Sims v. Kaneb Services, Inc.*, No. B14-87-00608-CV, 1988 Tex. App. LEXIS 2243, at *14 (Tex. App.—Houston [14th Dist.] June 16, 1988, no writ) (“There is no accountant-client privilege in the State of Texas.”)

¹³ “Accountants, Attorney-Client Privilege, and the *Kovel* Rule: Waiver Through Inadvertent Disclosure via Electronic Communication,” Carl Pacini, Pamela Seay, and Raymond Placid, 28 DEL. J. CORP. L. 893, 908 (2003).



▪ **ATTORNEY-CLIENT PRIVILEGE AND ACCOUNTANTS.**

- **The *Kovel* Rule.** A lawyer may cloak an accountant with the protection of the attorney-client privilege. In *United States v. Kovel*, the Second Circuit held that the presence of an accountant as an attorney’s agent does not negate the attorney-client privilege. 296 F.2d 918, 922 (2d Cir. 1961). The privilege, however, applies only to communications **for the purpose of obtaining legal advice**, not accounting services. *Id.*¹⁴
 - *Ferko v. NASCAR*, 218 F.R.D. 125, 135 (E.D. Tex. 2003) (applying federal law) (The privilege “only applies when communications are made ‘for the purpose of obtaining legal advice from the lawyer.’” “If the client seeks only accounting advice, or seeks the accountant’s advice instead of the lawyer’s, no privilege exists. Moreover, a lawyer may not render communications between the attorney’s client and the accountant privileged just by placing an accountant on his or her payroll. A mere agency relationship between an attorney and an accountant will not automatically establish protection under the attorney-client privilege. Nor will a general claim that an accountant does some work for an attorney suffice. Instead, an attorney must prove that he or she hired an accountant for a specific purpose. That purpose, in turn, must relate significantly to the disputed communications or documents.”)
 - *First F.S.B. of Hegewisch v. United States*, 55 Fed. Cl. 263 (Fed. Cl. 2003) (holding that, while disclosure of board minutes to an accounting firm for purposes of assisting the company’s counsel in determining the extent of an officer’s defalcation did not constitute a waiver of the attorney-client privilege, the disclosure of those same board minutes for the business purpose of performing annual audits constituted a waiver of the privilege with regard to all disclosed minutes).
- **Texas Rule of Evidence 503(a)(4).** A “representative of the lawyer” is one employed by the lawyer to assist the lawyer in the rendition of professional legal services; or an accountant who is reasonably necessary for the lawyer’s rendition of professional legal services.
 - *Parker v. Carnahan*, 772 S.W.2d 151, 157 (Tex. App.—Texarkana 1989, writ denied) (“[A]n attorney may employ an accountant for the client’s benefit in order for communications from the client to qualify for the attorney-client privilege. This does not make the accountant an agent of the attorney. Basic principles of agency law would be applicable, and this

¹⁴ For a discussion of case law further defining the *Kovel* Rule, see Carl Pacini, Pamela Seay, and Raymond Placid, *Accountants, Attorney-Client Privilege, and the Kovel Rule: Waiver Through Inadvertent Disclosure Via Electronic Communication*, 28 DEL. J. CORP. L. 893 (2003).

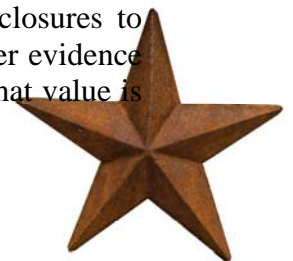


agency would have to be determined on the basis of the attorney’s control of the work done by the accountant.”)

Practice tip. Don’t assume that your communications with the client’s accountants are privileged. A position that the communication is privileged is stronger where the law firm has engaged the accountant.

AUDITORS

- **ATTORNEY-CLIENT PRIVILEGE DEPENDS ON SCOPE OF STATE ACCOUNTANT PRIVILEGE.** Unless there is a state statute recognizing an accountant privilege that is broad enough to cover auditors, the general rule is that disclosure of attorney-client communications to auditors waives the attorney-client privilege.
 - **Federal privilege for communications to auditors unlikely.** Whether or not a federal court recognizes a privilege for auditors will depend on that circuit’s application of *Kovel*. Given the fact that an auditor is to be independent, however, it is unlikely that a federal court will recognize the privilege. *US v. Adlman*, 68 F.3d 1495, 1500 (2d Cir. 1995) (no privilege); *US v. El Paso. Co.*, 682 F.2d 530,540 (5th Cir. 1982) (same).
 - **Example:** Boston Scientific disclosed minutes of its Special Litigation Committee to Ernst & Young, its outside auditor. *Medinol v. Boston Sci. Corp.*, 214 F.R.D. 113, 117 (S.D.N.Y. 2002). The court required Boston Scientific to produce the meeting minutes on the ground of waiver of work product protection. The court explained, “[w]hile Boston Scientific held meetings of its Special Litigation Committee with an eye to litigation, the disclosures to the independent auditor had no such purpose. Boston Scientific and its outside auditor Ernst & Young did not share ‘common interests’ in litigation, and disclosures to Ernst & Young as independent auditors did not therefore serve the privacy interests that the work product doctrine was intended to protect.” *Id.* at 116-17.
 - **Privilege unlikely in Texas.** Texas does not recognize an accountant-client privilege that would protect auditors, because Texas’s privilege only protects “an accountant who is reasonably necessary for the lawyer’s rendition of professional legal services,” which does not likely include an auditor due to independence constraints. Texas Rule of Evidence 503(a)(4)(A); *SEC v. Brady*, 238 F.R.D. 429, 439 (N.D. Tex. 2006) (“Even disclosure of privileged information directly to a client’s independent auditor, accountant, or tax analyst destroys confidentiality.”)
- **WORK PRODUCT DOCTRINE.** There is a split among courts concerning whether or not a party can compel discovery of attorneys’ disclosures regarding loss contingencies to auditors. Some courts have refused to compel discovery of attorneys’ disclosures to auditors on the grounds that attorney analyses of loss contingencies are neither evidence nor relevant—or, to the extent that these analyses have any probative value, that value is



outweighed by unfair prejudice and public interest concerns. *See, e.g., Tronitech, Inc. v. NCR Corp.*, 108 F.R.D. 655 (S.D. Ind. 1985). Other courts have held that any evaluation of litigation risk and loss exposure prepared in response to an audit inquiry does not constitute work product at all because the work was prepared primarily for a business purpose (i.e., auditing financial statements), rather than “in anticipation of litigation.” *See, e.g., United States v. Gulf Oil Corp.*, 760 F.2d 292, 296-97 (Temp. Emerg. CA 1985) (attorney letters in response to audit inquiries, although containing the mental impressions of defendant’s attorney regarding litigation exposure, did not qualify for work product protection because they were not created in anticipation of litigation, but rather “created, at [the auditor’s] request, in order to allow [the auditor] to prepare financial reports which would satisfy the requirements of the federal securities laws”). A more recent approach by courts suggests that work product includes any material prepared “because of” actual or potential litigation, thus encompassing analysis of litigation exposure prepared in response to an audit inquiry. These authorities reject the earlier, parochial construction of “work product” and find the “because of” construction to be more faithful to the language of Rule 26(b)(3) and to the purpose of the work product doctrine. *See US v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998).

INVESTMENT BANKERS

- **COURTS HAVE REFUSED TO EXTEND THE KOVEL RULE.** In *United States v. Ackert*, the Second Circuit refused to extend the *Kovel* rule to protect a communication between a third-party investment banker, who was not a client or an agent of a client, and an attorney solely because a communication proved important to the attorney’s ability to represent the client. 169 F.3d 136, 138 (2d Cir. 1999).¹⁵
- **OTHER COURTS HAVE HELD THAT DISCLOSURE OF CONFIDENTIAL COMMUNICATIONS TO INVESTMENT BANKERS DOES NOT NECESSARILY WAIVE THE PRIVILEGE.** *Blau v. Harrison (In re JP Morgan Chase & Co. Secs. Litig.)*, MDL No. 1783, 2007 U.S. Dist. LEXIS 60095, at **21-22 (N.D. Ill. Aug. 13, 2007) (applying a “balanced approach” that limits the privilege to those instances where the party asserting the privilege demonstrates that the investment banker confidentially communicated with counsel “for the purpose of obtaining legal

¹⁵ In 1989, Goldman, Sachs approached Paramount with an investment proposal. Along with other Goldman, Sachs representatives, David Ackert pitched the investment proposal to Paramount representatives at a meeting on September 15. Although Ackert discussed the possible tax consequences of investments with potential clients, he did not provide legal or tax advice. After September 15, Meyers, Paramount’s tax counsel, contacted Ackert several times to discuss various aspects of the Goldman, Sachs proposal. Paramount paid Goldman, Sachs a fee of \$1.5 million for services rendered. In connection with an audit of Paramount, the IRS issued a summons to Ackert seeking his testimony about the 1989 proposal. Paramount asserted attorney-client privilege. *Id.* at 138. The attorney in this case was not relying on a third-party expert (Ackert) to interpret information given to the attorney by his client. The lawyer sought out the expert for information that was not possessed by either the attorney or the client. The Second Circuit thus appears to have held in Ackert that *Kovel* applies to communications with non-legal professionals only if the non-attorney acted “as a translator or interpreter of client communications.” “Accountants, Attorney-Client Privilege, and the *Kovel* Rule: Waiver Through Inadvertent Disclosure via Electronic Communication,” Carl Pacini, Pamela Seay, and Raymond Placid, 28 DEL. J. CORP. L 893 (2003).



advice”); *Calvin Klein Trademark Trust v. Wachner*, 124 F. Supp. 2d 207, 209 (D. N.Y. 2000) (“[I]t is clear to the Court that [the investment bankers’] roles in participating in those discussions and helping draft these documents, to the extent such roles were more than ministerial, involved rendering expert advice as to what a reasonable business person would consider “material” in this context. “Materiality” in this regard is a mixed question of fact and law, which a responsible law firm in Wachtell’s place would not be able to adequately resolve without the benefit of an investment banker’s expert assessment of which facts were “material” from a business person’s perspective. [The investment banker] was therefore serving, so far as these documents are concerned, an interpretive function much more akin to the accountant in [*Kovel*].”



4. “AT ISSUE” WAIVER OF THE ATTORNEY-CLIENT PRIVILEGE

- **WHERE OTHERWISE PRIVILEGED INFORMATION IS PUT “AT ISSUE” IN THE CASE, THE ATTORNEY-CLIENT PRIVILEGE IS GENERALLY WAIVED.** *Sedco International, S.A. v. Cory*, 683 F.2d 1201, 1206 (8th Cir.), *cert. denied*, 459 U.S. 1017 (1982) (the attorney-client privilege is waived by implication “when a client asserts reliance on an attorney’s advice as an element of a claim or defense”); *Trans World Airlines v. Hughes*, 332 F.2d 602, 615 (2d Cir.), *cert. granted*, 379 U.S. 912 (1964), *cert. dismissed*, 380 U.S. 248 (1965) (attorney-client privilege “waived as the result of the defendants’ pleading advice of counsel as a defense”); *Fox v. California Sierra Financial Services*, 120 F.R.D. 520, 530 (N.D. Cal. 1988) (when a party asserts affirmative defenses and, therefore, places the information supporting those affirmative defenses at issue, the privilege is waived); *In re Consolidated Litigation Concerning International Harvestors Disposition of Wisconsin Steel*, 666 F. Supp. 1148, 1151 (N.D. Ill. 1987) (when party raises good faith business judgment as an affirmative defense and attorney-client communications comprise a significant portion of the information relating to that defense “there is little doubt that the attorney-client privilege would be waived as to those communications and others pertaining to the same subject matter.”)
- **TEXAS COURTS APPLY SEVERAL FACTORS IN DETERMINING WHETHER TO FIND THAT THE ATTORNEY-CLIENT PRIVILEGE IS WAIVED WHERE IT IS PUT AT ISSUE.** *Republic Ins. Co. v. Davis*, 856 S.W.2d 158, 163 (Tex. 1993) (“First, before a waiver may be found the party asserting the privilege must seek affirmative relief. Second, the privileged information sought must be such that, if believed by the fact finder, in all probability it would be outcome determinative of the cause of action asserted. Mere relevance is insufficient. A contradiction in position without more is insufficient. The confidential communication must go to the very heart of the affirmative relief sought. Third, disclosure of the confidential communication must be the only means by which the aggrieved party may obtain the evidence. If any one of these requirements is lacking, the trial court must uphold the privilege.”)
 - **Example:** Physician’s medical center privileges were terminated on the basis that he failed to report a suit against him. Physician claimed he did not report based on the advice of his attorney. The court held that the attorney-client privilege would not shield the advice that the attorney gave the physician. *In re Basco*, 221 S.W.3d 637, 639 (Tex. 2007).
- **“AT ISSUE” WAIVERS ARE LIKELY SUBJECT MATTER WAIVERS.** Courts distinguish between a situation where a party inadvertently waives privilege—for example, by accidentally producing a privileged communication or by showing a document to a third party—from a situation where the party intentionally waives the privilege in order to rely on advice of counsel as a defense. In the former situation, courts generally hold that the privilege is only waived with respect to that communication; in the “at issue” situation, a court will likely hold that the party has waived the attorney-client privilege or work product protection with respect to *that subject matter*.



- *In re EchoStar Comm. Corp.*, 448 F.3d 1294, 1301 (Fed. Cir. 2006) (“[S]elective waiver of the privilege may lead to the inequitable result that the waiving party could waive its privilege for favorable advice while asserting its privilege on unfavorable advice. In such a case, the party uses the attorney-client privilege as both a sword and a shield. To prevent such abuses, we recognize that when a party defends its actions by disclosing an attorney-client communication, it waives the attorney-client privilege as to all such communications regarding the same subject matter.”) (citations omitted).
- *U.S. v. CITGO Petroleum Corp.*, No. C-06-563, 2007 U.S. Dist. LEXIS 27986, at *17-18 (S.D. Tex. Apr. 16, 2007) (“[A] broad subject matter waiver is often justified on the grounds that such waiver is warranted if the holder of the privilege relies on the advice of counsel as part of its defense or claim, or selectively discloses portions of privileged communications in their own self-interest, or by some other means intentionally waives privilege....The primary distinction between this case and the cases permitting broad subject matter waiver is the inadvertent nature of [the defendant’s] disclosure. Overall the treatment of the inadvertent and scope of waiver issues should be analyzed in terms of fairness and the ‘principal concern is selective use of privileged material to garble the truth, which mandates giving the opponent access to related privileged material to set the record straight.’”)

Practice tip. Recognize early on situations where the client might need to assert your advice to support its claim or defense.



5. **WAIVER OF THE ATTORNEY CLIENT PRIVILEGE:**
DEPARTMENT OF JUSTICE AND SECURITIES EXCHANGE COMMISSION

THE DEPARTMENT OF JUSTICE

- **MCNULTY MEMORANDUM.** “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.”

- **THRESHOLD DETERMINATION—FEDERAL PROSECUTORS MUST HAVE A LEGITIMATE LAW ENFORCEMENT NEED.** “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. A legitimate need for the information is not established by concluding it is merely desirable or convenient to obtain privileged information. The test requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine and the law enforcement needs of the government’s investigation. Whether there is a legitimate need depends upon: (1) the likelihood and degree to which the privileged information will benefit the government’s investigation; (2) whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver; (3) the completeness of the voluntary disclosure already provided; and (4) the collateral consequences to a corporation of a waiver.¹⁶

¹⁶ See Paul E. McGreal, *Corporate Compliance Survey*, 63 BUS. LAW. 195 (Nov. 2007).



- **ONCE THRESHOLD LEGITIMATE NEED IS ESTABLISHED, FEDERAL PROSECUTORS MUST DECIDE WHICH TYPE OF PRIVILEGED INFORMATION TO SEEK:** Category I or Category II information.

Category I ¹⁷	Category II ¹⁸
Copies of key documents, witness statements, or purely factual interview memoranda regarding the underlying misconduct, organization charts created by company counsel, factual chronologies, factual summaries, or reports (or portions thereof) containing investigative facts documented by counsel.	Attorney-client communications or non-factual attorney work product, including legal advice given to the corporation before, during, and after the underlying misconduct occurred.
To request Category I information, a federal prosecutor must first seek approval from the U.S. Attorney	Federal prosecutors may only request Category II information if “the purely factual information provides an incomplete basis to conduct a thorough investigation” and “the United States Attorney...obtain[s] written authorization from the Deputy Attorney General.”

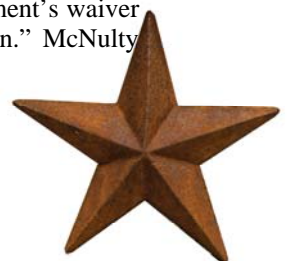
Practice tip. In practice, not much has changed since McNulty. The expectation is that the government should not have to go through the process of requesting a waiver at all—the company should volunteer to do so.

THE SECURITIES EXCHANGE COMMISSION

- **SEABOARD REPORT.** Like the McNulty Memorandum, the Seaboard Report discusses the factors that the SEC will consider in deciding whether to bring an enforcement action against an organization. Included are: How did the misconduct arise? Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct? How was the misconduct detected and who uncovered it? How long after discovery of the misconduct did it take to implement an effective response? What steps did the company take upon learning of the misconduct? What assurances are there that the conduct is unlikely to recur?

¹⁷ “Before requesting that a corporation waive the attorney-client or work product protections for Category I information, prosecutors must obtain written authorization from the United States Attorney who must provide a copy of the request to, and consult with, the Assistant Attorney General for the Criminal Division before granting or denying the request. A prosecutor’s request to the United States Attorney for authorization to seek a waiver must set forth law enforcement’s legitimate need for the information and identify the scope of the waiver sought. A copy of each waiver request and authorization for Category I information must be maintained in the files of the United States Attorney. If the request is authorized, the United States Attorney must communicate the request in writing to the corporation.” McNulty Memorandum, p 9.

¹⁸ “If a corporation declines to provide a waiver for Category II information after a written request from the United States Attorney, prosecutors must not consider this declination against the corporation in making a charging decision. Prosecutors may always favorably consider a corporation’s acquiescence to the government’s waiver request in determining whether a corporation has cooperated in the government’s investigation.” McNulty Memorandum, p 10.



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

DISCLOSURE TO THE GOVERNMENT AND WAIVER OF THE PRIVILEGE

- **MAJORITY APPROACH—STRICT WAIVER.** Despite the statements of the Seaboard Report and the McNulty Memorandum, a majority of courts have rejected the concept of a “selective waiver.” When a company hands over its internal investigative report to the Department of Justice or Securities Exchange Commission, that report may then be discoverable in third party lawsuits. Recently, in *In re Initial Public Offering Securities Litigation*, the court held that “[v]oluntary disclosure of attorney work product, regardless of the existence of a confidentiality agreement, will waive work product privilege absent special circumstances.” Thus, “[p]arties wishing to take advantage of the privilege that protects attorney work product must zealously maintain the confidentiality of that work product from their adversaries.”¹⁹
- **MINORITY APPROACH—LIMITED OR SELECTIVE WAIVER.** Given that the strong majority trend is in favor of a strict waiver approach, one should not rely on the availability of a limited waiver argument. Nevertheless, should a client waive the privilege with respect to the government, any reservation of the privilege should be accompanied by a clear, unequivocal confidentiality agreement. The best approach is to clearly indicate that the corporation has no intent to waive, but instead intends to cooperate with government investigation.²⁰

¹⁹ Justin P. Klein and John C. Grugan, “Selective Waiver Doctrine Rejected” (Ballard Spahr Andrew & Ingersoll, LLP March 4, 2008); *see also In re Columbia/HCA Healthcare Corp.*, 293 F.3d 289 (6th Cir. 2002) (disclosure to the government, even under a confidentiality agreement, waived the privilege).

²⁰ JOHN WILLIAM GERGACZ, ATTORNEY-CORPORATE CLIENT PRIVILEGE §§ 5.53-5.62 (Thomson West 3d ed. 2007); *Saito v. McKesson HBOC, Inc.*, 2002 WL 31657622, at *11 (Del. Ch. 2002) (although a work product case, language throughout seems to suggest that disclosure to the government under a confidentiality agreement would not waive the attorney-client privilege either); *In re Keeper of the Records*, 348 F.3d 16 (1st Cir. 2003).



- **FIFTH CIRCUIT.** The Fifth Circuit has not addressed the issue directly, but its precedent on attorney-client privilege and work product protection is fairly clear that the Fifth Circuit would adopt the majority view that any release of privileged materials waives the privilege. The Northern District of Texas has also held that the privilege was waived as to the subject matter of the disclosed communications, not just the documents themselves.²¹

- **OTHER ISSUES**
 - **Confidentiality agreements.** Federal courts are split concerning whether a confidentiality agreement will prevent waiver of the attorney-client privilege and/or work product protection with respect to otherwise protected information.²² In practice, parties seeking to preserve the privilege should severely restrict the use of the materials by the government so as to prevent disclosure to third parties.

 - **Efforts to address issues created by the Thompson/McNulty Memoranda.**
 - **(a) U.S. Sentencing Guidelines.** The Guidelines deleted language suggesting that failure to waive the privilege(s) should be given negative consideration in sentencing.

 - **(b) Attorney-Client Privilege Protection Act of 2007.** This Act seeks to legislatively overturn certain provisions of the Thompson and McNulty Memoranda. It would prohibit federal government attorneys from demanding or requesting that a corporation waive its privilege and from pressuring companies not to pay legal fees for individual employees. The bill does, however, allow a company to make a voluntary production of internal investigation materials. The House version of the bill passed in November, and the Senate is expected to take it up this year.²³

DISCLOSURE TO OTHER REGULATORY AGENCIES

- **FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2006.** An insured depository institution or credit union does not waive its attorney-client privilege by

²¹ *Securities & Exchange Comm'n v. Brady*, 238 F.R.D. 429, 440-41 (N.D. Tex. 2006) (“[T]he Fifth Circuit has yet to adopt the selective waiver doctrine. Moreover, this court is persuaded by the reasoning of the great weight of authority which has declined to adopt the selective waiver doctrine.”)

²² Compare *In re Columbia/HCA Healthcare Corp. Billing Practices Litigation*, 293 F.3d 289 (6th Cir. 2002) (finding confidentiality agreement served only to obfuscate the truth finding process), with *Lawrence E. Jaffe Pension Plan v. Household Int’l, Inc.*, 244 F.R.D. 412 (N.D. Ill. 2006) (holding that the party preserved its work product protection by a confidentiality agreement that limited future disclosure by the SEC).

²³ Available at <http://www.acc.com/public/s186.pdf>.



providing privileged materials to a federal, state, or foreign banking authority in the course of that authority's supervisory or regulatory process.²⁴

TO DISCLOSE OR NOT TO DISCLOSE?

- **WEIGH THE PROS AND CONS.** Voluntary disclosure coupled with appropriate corrective actions enables a company to argue that, as a responsible corporate citizen, it should not be prosecuted or subjected to civil or administrative sanctions. Thus, the client should be aware of its options, including the benefits and risks involved. The following tips are instructive.²⁵
 - Be aware of potential privilege waivers as discussed above.
 - The McNulty Memorandum suggests that invocation of privileges may be considered something less than full cooperation.
 - Often, disclosure has a chilling effect on employee cooperation in an ongoing investigation.
 - Be aware of the requirements of the Federal Sentencing Guidelines. Cooperation must be “timely and thorough.” Disclosure must be *prior* to an imminent threat of disclosure.
- **MANDATORY DISCLOSURE.** Disclosure may be mandated in certain circumstances.²⁶ For example,
 - If evidence of illegality or material misconduct is uncovered in the course of an internal investigation, disclosure may be required under the securities laws.²⁷
 - Additionally, the crime-fraud exception provides that communications made for the purpose of committing a crime or perpetrating a fraud are outside the scope of the attorney-client privilege. The exception does not apply to communications concerning crimes or frauds that have already

²⁴ Mayer Brown Rowe & Maw, *Waiving Attorney Client Privilege: The Changing Landscape in Corporate Internal Investigations* (Feb. 21, 2007).

²⁵ Robert S. Bennett, Alan Kriegel, Carl S. Rauh, and Charles F. Walker, *Internal Investigations and the Defense of Corporations in the Sarbanes-Oxley Era*, 62 BUS. LAW. 55 (Nov. 2006).

²⁶ Robert S. Bennett, Alan Kriegel, Carl S. Rauh, and Charles F. Walker, *Internal Investigations and the Defense of Corporations in the Sarbanes-Oxley Era*, 62 BUS. LAW. 55 (Nov. 2006).

²⁷ See, e.g., Section 10A of the Exchange Act (codified at 15 U.S.C. § 78j-1 (2000 & Supp. IV 2004)) (requiring certain illegal conduct to be reported to the Commission by issuers and auditors); *In re W.R. Grace & Co.*, Exchange Act Release No. 39157. 1997 SEC Lexis 2038 (Sept. 30, 1997) (emphasizing directors' obligations to provide accurate and complete disclosure of information required by reporting provisions of federal securities laws).



occurred. *SEC v. Chesnoff*, No. 4:05-MC-043-Y, 2006 U.S. Dist. LEXIS 49090, at *13-14 (N.D. Tex. July 18, 2006) (“[W]hen a client seeks legal advice in furtherance of a crime or fraud, the attorney-client communications are not privileged, and may be discovered. The exception applies even if the criminal activity is solely on the part of the attorney or even when the attorney is unaware that the client is planning a crime or fraud. The controlling question is whether there is a reasonable basis to suspect that communications at issue were undertaken to facilitate or conceal the commission of a crime or fraud. The party seeking discovery has the burden of establishing that the crime-fraud exception applies, and must present a prima-facie case that the communications were made in furtherance of a crime or fraud. This burden is not satisfied by a showing that the material in question might provide evidence of a crime or fraud.”)

- Sarbanes-Oxley requires the corporate officer signing a company’s periodic report to certify, *e.g.*, that any fraud, whether or not material, which involves management (or other employees who have a significant role in the company’s internal controls), be disclosed to the auditors and the audit committee.²⁸
- SEC Staff Accounting Bulletin 99, may require disclosure of information uncovered in the course of an internal investigation even where that material information is quantitatively immaterial, if the information is nevertheless “qualitatively” material, *e.g.*, where the information bears on the integrity of senior management.²⁹

²⁸ See 18 U.S.C. § 1350 (Supp. IV 2004); 17 C.F.R. § 240.13a-14 (2006).

²⁹ Available at <http://www.sec.gov/interps/account/sab99.htm>; See also 41 U.S.C.A. §§ 51-58 (West 1987 & Supp. 2006) (requiring contractors to report in writing to the Inspector General of the contracting agency or other designated officials when they have reason to believe a kickback may have occurred between upper and lower tier contractors in connection with a government contract); 42 U.S.C. § 1320a-7b(a)(3) (2000 & Supp. III 2003)) (obligating health care providers to report known fraud).



6. ISSUES ARISING IN INTERNAL INVESTIGATIONS

- **ASSERTING WORK PRODUCT PROTECTION IN AN INTERNAL INVESTIGATION.** As previously discussed, the triggering event for work product protection is the reasonable anticipation (both subjective and objective) of litigation. Because the purpose of an internal investigation is usually to determine whether any wrongdoing occurred, that triggering event may not arise until late in the investigation, if at all. To best position the investigation for work product protection, the company and its counsel should consider the following steps:
 - As soon as the company learns of potential misconduct, it should retain outside counsel to conduct an investigation and assess the prospect of future litigation.
 - The company should enter into a retention agreement with counsel, stating that counsel is being retained to investigate certain potential misconduct, which the company believes could result in future litigation.
 - As soon as appropriate, outside counsel should notify the company in writing that, based on the preliminary investigation, the company will likely be subject to future litigation.
 - Any outside consultants should be retained by the outside counsel and the retention agreement should state that all documents generated by the consultant should be kept confidential and will be protected by the work product doctrine.
 - In order to cloak documents with work product protection, the attorney cannot just act as a fact gatherer. The attorney, while gathering facts, should include his or her mental impressions and opinion in order to protect the documents from disclosure. Documents prepared during the investigation should be clearly marked as “privileged and confidential/attorney work product” and, to the extent possible, reflect that they contain the attorney’s thought processes and legal theories.³⁰
 - Because counsel cannot predict whether a court will later apply work product protection to the investigation, counsel should be particularly cautious to whom they communicate and what is disclosed given the broad concept of waiver of the attorney-client privilege.

- **INTERVIEWING EMPLOYEES WHILE MAINTAINING PRIVILEGE AND AVOIDING CONFLICTS.** Remember that counsel represents the interests of the corporation, board of directors, or board committee, not the individual employee. The privilege belongs to the client, and it is the client’s decision—not the employee’s—whether to waive the privilege.³¹

³⁰ Jeffrey Thomas and Susan T. Stead, *Attorney-Client Privilege and Confidentiality Issues in Internal and External Investigations*, 35 THE BRIEF 12 (Summer 2006).

³¹ Paul B. Murphy and Lucian E. Dervan, *Attorney-Client Privilege and Employee Interviews in Internal Investigations* (Aug. 2006).



- **Waiver issues in communicating with employees.** Generally, communications with former employees are not privileged, unless the employee has a continuing duty to the corporation.³² On the other hand, most courts find that the privilege continues to protect communications with an employee even after the employee leaves the company.³³

Practice tip. Investigating attorneys should generally give each interviewee what has come to be known as the “Upjohn warning” or “corporate Miranda warning.” The warning should include the following elements: (i) the attorney represents the company, not the individual employee; (ii) the interview is protected by the attorney-client privilege, which is controlled exclusively by the company, and not the employee; (iii) the company may decide, in its sole discretion, to disclose all or part of the interview to third-parties, including any governmental agencies.³⁴

- **ABA Model Rule of Professional Conduct 1.13(f).** “In dealing with an organization’s directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization’s interests are adverse to those of the constituents with whom the lawyer is dealing.”
 - *Comment to the rule.* “There are times when the organization’s interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.”

Practice tip. Determine whether or not it is desirable to encourage (but not advise) the employee to retain separate counsel. Note that if joint representation is undertaken and a conflict later emerges, corporate counsel may be disqualified from representing either the corporation or the employee.³⁵

³² *Verschoth v. Time Warner, Inc.*, No. 00-CV-1339 (AGS)(JCF), 2001 U.S. Dist. LEXIS 3174, at *8 (S.D.N.Y. Mar. 22, 2001).

³³ *Smith v. Kalamazoo Ophthalmology*, 322 F. Supp. 2d 883, 892 (W.D. Mich. 2004); *United States ex rel. Hunt v. Merck-Medco Managed Care, LLC*, 340 F. Supp. 2d 554, 558 (E.D. Pa. 2004).

³⁴ Paul B. Murphy and Lucian E. Dervan, *Watching Your Step: Avoiding the Pitfalls and Perils of Corporate Internal Investigations*, ALAS LOSS PREVENTION JOURNAL (Summer 2005).

³⁵ Robert S. Bennett, Alan Kriegel, Carl S. Rauh, and Charles F. Walker, *Internal Investigations and the Defense of Corporations in the Sarbanes-Oxley Era*, 62 Bus. Law. 55 (Nov. 2006).



7. ISSUES ARISING IN REPRESENTATION OF SPECIAL COMMITTEES

- **BE MINDFUL OF WHO THE “CLIENT” IS.** If counsel is retained by an audit or special committee of the board of directors, the *client is the committee*, not the board. Some courts may find that disclosure of the committee’s (and/or its counsel’s) conclusions to the full board constitutes a waiver of the privilege.³⁶
 - “It is counterintuitive to think that while the Board permitted the Special Committee to retain its own counsel, the Special Committee would not have the benefit of the attorney-client privilege inherent in that relationship or the Board of Directors or management, instead of the Special Committee, would have control of such privilege.” *In re BCE West LP*, No. M-8-85, 2000 WL 1239117, at *2 (S.D.N.Y. 2000).
- **SCOPE OF WAIVER WHEN SPECIAL COMMITTEE RELIES UPON REPORT TO SEEK DISMISSAL OF DERIVATIVE SUIT.** After an investigation, special committees often determine that a shareholder derivative suit is not in the best interest of the company and, therefore, seek dismissal of such claims. The report of the special committee is usually the primary evidence to support its motion to dismiss. Plaintiffs’ counsel will likely seek discovery of all documents remotely relating to the report. The issue then becomes what plaintiffs’ counsel is entitled to receive.
 - **Examples:** Delaware courts hold that plaintiffs are only entitled to receive “copies of the Special Committee’s report, minutes of the meetings of the Special Committee, and minutes of any meeting of the board of directors relating to the creation or functioning of the Special Committee, including any meeting of the board of directors at which the recommendation of the Special Committee was considered or approved.” *Grimes v. DSC Communications Corp.*, 724 A.2d 561, 567 (Del. Ch. 1998). Other courts have found that all documents reviewed by the special committee in preparing its report are discoverable, despite any claim of attorney-client privilege or work product protection. *See, e.g., Joy v. North*, 692 F.2d 880, 893 (2d Cir. 1982), *cert denied*, 460 U.S. 105 (1983); *Zitin v. Turley*, No. Civ. 89-2061-PHX-CAM, 1991 WL 282814 (D. Ariz. June 20, 1991).
- **WARNING—THE RYAN DECISIONS.** In *Ryan v. Gifford*, shareholders filed a derivative action that named several directors as defendants. Civ. Action No. 2213-CC, 2007 Del. Ch. LEXIS 168 (Del. Ch. Nov. 30, 2007) and 2008 Del. Ch. LEXIS 2 (Jan. 2, 2008). The Board formed a Special Committee, comprised of one independent director, to investigate the allegations. The Special Committee hired outside counsel, who then conducted the investigation by reviewing 300,000 documents and interviewing over 30 current and former employees and directors. Following the investigation, the Special Committee and counsel orally presented their report to the full Board. However, present

³⁶ *In re OM Group Sec. Litig.*, 226 F.R.D. 579, 592 (N.D. Ohio 2005) (court held that committee waived privilege through written presentation to the full board of directors and ordered production of presentation and underlying documents).



at the meeting were Board members and their counsel (i.e. defendants and counsel in the derivative action). Later, over attorney-client privilege and work product objections, plaintiffs in the derivative action successfully compelled discovery of (1) all communications between outside counsel and the Special Committee throughout the investigation; (2) outside counsel's presentation of the final report to the Special Committee and to the Board, (3) outside counsel's investigation materials, including interview notes and the firm's forensic analysis of the company's computer systems.³⁷ In the 2008 *Ryan* decision, the Delaware Chancery Court offered additional guidance:

- **The plaintiffs were able to show “good cause.”** The court emphasized that its initial ruling was based predominantly on the plaintiff's showing of good cause. Specifically, good cause existed because the Special Committee never produced a written report, and all of the knowledgeable witnesses asserted their Fifth Amendment rights against self-incrimination and refused to testify.
- **The waiver was a result of disclosure to directors in their individual capacities, i.e. adverse to company.** With respect to waiver, the key factor was the fact that the Special Committee gave its final report to the full Board; and, specifically, to the directors who had allegedly engaged in illegal conduct and whose individual counsel attended the presentation. The court found that the disclosure was not to those directors in their fiduciary capacity, but rather in their individual capacities, in which their interests were adverse to the company.
- **Important takeaways.** (1) A special committee should consider requesting two reports from counsel—one on the factual findings and the other containing legal advice; (2) a special committee should be structured in a way that ensures it has the power to act without approval from the full board; (3) a special committee should disclose its final report to directors acting in their fiduciary capacity; (4) a special committee should not disclose its report to directors' individual counsel; (5) a special committee should take appropriate measures to prevent directors from using the information from the committee's report to exculpate themselves in litigation.

Practice tip. If the goal is to preserve privilege over a report and investigation by a special committee, the company should refrain from disclosing the substance of the investigation report or its conclusions, except in the most general terms, in public statements or in submissions to government regulators.

³⁷ Thaddeus J. Malik, David M. Greenwald, and Mercedes M. Davis, *Special Committees and Protecting Privilege*, THE CORPORATE COUNSELOR (Mar. 2008).



8. **JOINT REPRESENTATION OF PARENT AND SUBSIDIARY
WITHIN CORPORATE FAMILY**

- **RECENT CASE—*IN RE TELEGLOBE COMMUNICATIONS CORP.*** Here, the Third Circuit addressed the issue of defining what entities constitute “joint clients” in the corporate family context. The court held that a parent and subsidiary will be considered joint client, which means:
 - “Intra-group information sharing” does not amount to a waiver of the attorney-client privilege.
 - The joint client privilege is subject to bilateral, not unilateral, control. Therefore, one joint client cannot unilaterally strip the other of the protection of the privilege in disputes with third parties. Both joint clients must consent to a waiver of the privilege.
 - In the event of adverse litigation between the joint clients, the privilege generally is waived.³⁸
 - The court also provided advice for parent corporations that wish their communications with in-house counsel to be shielded from subsidiaries. To ensure preservation of the privilege in such circumstances, counsel should (1) jointly represent parents and subsidiaries only when necessary; (2) clearly limit the scope of the joint representations; and (3) advise the parent to engage separate counsel for subsidiaries when their interests could diverge from those of the parent. 493 F.3d 345 (3d Cir. 2007).³⁹

³⁸ Kevin P. Allen, *In re Teleglobe: The Attorney Client Privilege and In-House Counsel*, PROFESSIONAL LIABILITY 14 (Apr. 2008).

³⁹ Ian Goldrich and David Wawro, *The Significance of Recent Lawyer-Client Privilege Decisions*, TORYS ON LITIGATION AND DISPUTE RESOLUTION (Feb. 13, 2008).



APPENDIX—
PRIVILEGE RULES FOR NEW YORK, VIRGINIA, AND CALIFORNIA

NEW YORK

Attorney-Client Privilege

N.Y. C.P.L.R. § 4503.

(a) 1. Confidential communication privileged. Unless the client waives the privilege, an attorney or his or her employee, or any person who obtains without the knowledge of the client evidence of a confidential communication made between the attorney or his or her employee and the client in the course of professional employment, shall not disclose, or be allowed to disclose such communication, nor shall the client be compelled to disclose such communication, in any action, disciplinary trial or hearing, or administrative action, proceeding or hearing conducted by or on behalf of any state, municipal or local governmental agency or by the legislature or any committee or body thereof. Evidence of any such communication obtained by any such person, and evidence resulting therefrom, shall not be disclosed by any state, municipal or local governmental agency or by the legislature or any committee or body thereof. The relationship of an attorney and client shall exist between a professional service corporation organized under article fifteen of the business corporation law to practice as an attorney and counselor-at-law and the clients to whom it renders legal services.

Work Product Doctrine

N.Y. C.P.L.R. § 3101. Scope of Disclosure.

(c) **Attorney's work product.** The work product of an attorney shall not be obtainable.

(d) **Trial preparation.** [...] 2. Materials. Subject to the provisions of paragraph one of this subdivision, materials otherwise discoverable under subdivision (a) of this section and prepared in anticipation of litigation or for trial by or for another party, or by or for that other party's representative (including an attorney, consultant, surety, indemnitor, insurer or agent), may be obtained only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the case and is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of the materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions or legal theories of an attorney or other representative of a party concerning the litigation.

VIRGINIA

Attorney-Client Privilege

Virginia Supreme Court Rule 4:1(b)(1). In General.

Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action, whether it relates to the claim or defense of the party seeking discovery or to the claim or defense of any other party, including the existence, description, nature, custody, condition and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of any discoverable matter. It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.



Work Product Doctrine

Virginia Supreme Court Rule 4:1(b)(3). Trial Preparation: Materials.

Subject to the provisions of subdivision (b)(4) of this Rule, a party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this Rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative (including his attorney, consultant, surety, indemnitor, insurer, or agent) only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

CALIFORNIA

Attorney-Client Privilege

Cal. Evid. Code § 954. Lawyer-client privilege

Subject to Section 912 and except as otherwise provided in this article, the client, whether or not a party, has a privilege to refuse to disclose, and to prevent another from disclosing, a confidential communication between client and lawyer if the privilege is claimed by:

(a) The holder of the privilege;

(b) A person who is authorized to claim the privilege by the holder of the privilege; or

(c) The person who was the lawyer at the time of the confidential communication, but such person may not claim the privilege if there is no holder of the privilege in existence or if he is otherwise instructed by a person authorized to permit disclosure.

The relationship of attorney and client shall exist between a law corporation as defined in Article 10 (commencing with Section 6160) of Chapter 4 of Division 3 of the Business and Professions Code and the persons to whom it renders professional services, as well as between such persons and members of the State Bar employed by such corporation to render services to such persons. The word "persons" as used in this subdivision includes partnerships, corporations, limited liability companies, associations and other groups and entities.

Work Product Doctrine

Cal. Civ. Proc. Code § 2018.030. Certain writings not discoverable; When other work product may be subject to discovery

(a) A writing that reflects an attorney's impressions, conclusions, opinions, or legal research or theories is not discoverable under any circumstances.

(b) The work product of an attorney, other than a writing described in subdivision (a), is not discoverable unless the court determines that denial of discovery will unfairly prejudice the party seeking discovery in preparing that party's claim or defense or will result in an injustice.

