Attorney-Client Privilege and Communications with Auditors from a Corporate Counsel Perspective

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Ethics

- Attorney-client privilege for corporate counsel
- In-house attorneys, audit response letters and discussions with auditors
- Parent-subsidiary privilege issues
- Offering representation to former employees
Erosion of A-C Privilege

- Thompson/Holder Memorandums (scaled back by McNulty and Filip Memoranda).
- United States Sentencing Commission:
  - 1994: approved new guidelines that in some instances deem waiver of the A-C privilege to be “cooperation” for avoiding regulatory action or civil penalties.
- Corporate scandals have brought confidentiality to the forefront.
  - Demand for disclosure over confidentiality.
- Electronic discovery/Electronic document transmission
  - Surfaced new ways in which the A-C privilege may be inadvertently waived. See i.e., In re Google Inc., No. 106, 2012 WL 371913 (C.A.Fed. Feb. 6, 2012)
  - Presenting new client confidentiality issues.
### A-C Privilege Defined

The A-C privilege “test” was set forth in 1950 by US Supreme Court in *United States v. United Shoe Machinery Corp.*:

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<tr>
<td>(1)</td>
<td>the asserted holder of the privilege is or sought to become a client;</td>
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<td>(2)</td>
<td>the person to whom the communication was made</td>
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<td>(a)</td>
<td>is the member of the bar of court, or his subordinate and</td>
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<td>(b)</td>
<td>in connection with this communication is acting as a lawyer;</td>
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<td>(3)</td>
<td>the communication relates to a fact of which the attorney was informed</td>
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<td>(a)</td>
<td>by his client,</td>
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<td>(b)</td>
<td>without the presence of strangers, and</td>
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<td>(c)</td>
<td>for the purpose of securing primarily either</td>
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<tr>
<td>(i)</td>
<td>an opinion of law,</td>
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<td>(ii)</td>
<td>legal services, or</td>
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<td>(iii)</td>
<td>assistance in some legal proceeding, and not</td>
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<td>(d)</td>
<td>for the purpose of committing a crime or tort; and</td>
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A-C Privilege Defined (continued)

(4) the privilege has been
   (a) claimed; and
   (b) not waived by the client.

- While this test implies only communications from client to attorney are protected, communications from attorney to client are also privileged.
A-C Privilege: Requirements/Reasons For

- Protects communications that are:
  - between the corporation/client and the attorney,
  - when the attorney is acting as an attorney (and not, for example, as a business person),
  - for the purpose of seeking legal advice, and
  - in confidence.

- A-C privilege does not protect communications when the privilege is waived.

- A-C privilege developed from two assumptions:
  - good legal advice requires full disclosure of client’s legal problems, and
  - a client will only reveal details required for proper representation if confidences are protected.
A-C Privilege Basics

- Privilege is the client's to assert.
- Privilege may be invoked at any time during the A-C relationship or after it terminates.
- The party asserting the privilege bears the burden of proof.
- Form of communication is irrelevant.
  - E-mails may be privileged, even if they are not encrypted.
  - Non-verbal communications can be privileged.
- Written or electronic communications do not have to be labeled “privileged” or “confidential” in order to be protected by the A-C privilege.
- Conversely, stamping a “privileged” or “confidential” label on a document does not alone establish privilege.
Corporations, partnerships and other legal entities are entitled to assert the A-C privilege.

Organizations can assert the privilege to cover communications with in-house counsel.
Upjohn v. United States - 1981

- U.S. Supreme Court held that A-C privilege applied in a corporate context to protect communications between in-house counsel and non-management employees.
- U.S. Supreme Court rejected the argument that the privilege only applied to the corporation’s “control group” (e.g. the corporation’s “upper-echelon management”)
- Since Upjohn, this privilege has slowly been eroded, especially in the light of corporate scandals over the past decade.
Corporate A-C Privilege Tests

- Two primary tests: Control Group and Subject Matter
- "Control Group" – communication must be made by an employee who is in a position to control or play a substantial role in deciding corporate actions in response to legal advice.
  - Basically limits the privilege to communication with senior management.
  - Minority of jurisdictions use this test. (e.g. Illinois)
“Subject Matter” – applies to any level of employee, so long as:

- Communication is made for the purpose of securing legal advice for the corporation;
- Communication is made at a superior’s request; and
- The employee’s responsibilities include the subject matter of the communication.

However, the “subject matter” test also requires that the communication is not disseminated beyond persons who “need to know”.

Majority of jurisdictions use this test (including Texas).
**Corporate Privilege Tests**

- “Modified *Harper & Row* test” / “*Diversified Industries* test”
  - A third test that is essentially indistinguishable from the “Subject Matter” test.
  - Focuses more on the reason the attorney was consulted and attempts to prevent the routine routing of information through counsel to shield from later disclosure.
  - Missouri uses this test. *See* *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977).
A-C Privilege in Partnerships/LLCs

- **Partnerships**
  - All partners are considered to be the client in all A-C communications.
  - Employees of the partnership:
    - Any of the corporation tests can be applied to a partnership employee’s communication to determine whether privilege applies.

- **LLCs**
  - Are LLCs treated like corporations or like partnerships for A-C privilege purposes?
    - Law is unsettled.
      - The court noted that this is a case of first impression and held that LLCs (especially under the facts of this case) are more analogous to corporations, and thus, applied the law of corporate A-C privilege.
## What Does Privilege Not Protect?

- **Identity of client.**
  - *e.g.* Tax avoidance strategy cases

- **Attorney’s observations of client’s demeanor or mental capacity.**
- E-mail replies to communications that are not privileged are likely not privileged.
- Communications given/received by the attorney acting in another role. (business advice v. legal advice – discussed below)
Key target of attack of the A-C privilege is the role of in-house counsel in the corporate context.

“The mere fact that a communication is made directly to an attorney, or an attorney is copied on a memorandum, does not mean that the communication is necessarily privileged.” United States Postal Serv. v. Phelps Dodge Refining Corp., 852 F. Supp. 156, 160 (E.D.N.Y. 1994).
Mixing Legal & Business Advice

- In general, communications by/to in-house counsel regarding business matters or business advice are not privileged.
- When legal and business communications are intertwined, the legal advice must predominate.
  - But the mere fact that business issues are intertwined does not abrogate the privilege.
Are Emails Between Client and Counsel Privileged?

- **Yes if:**
  - Only lawyers/client on email, and
  - Made for the purpose of providing legal advice.

- **No if:**
  - Anyone besides lawyer/client on email:
    - e.g.: investment bankers, accountants, etc.
  - The email is not made for the purpose of receiving legal advice:
    - e.g.: clients merely copy the lawyer on internal discussions of business terms.
Are Drafts of Agreements/Documents Privileged?

- **Yes if:**
  - Draft is created by/for attorneys, and
  - Only shared between attorney and client.

- **No if:**
  - Draft is made by business people; and
  - relates to business terms, or
  - Draft is shared with someone outside the confidential relationship.
Mixing Legal & Business Advice

- Courts have considered an attorney’s location on the org chart – i.e.: attorney working in the legal department v. attorney working in the financial department or some other business side of the house.
- In-house Counsel with dual roles – must prove communication was while “acting as an attorney.”
  - Multiple titles may raise issues:
    - General Counsel and Director of Governmental Affairs
    - General Counsel and Director of Employee Relations
    - General Counsel and Director of Risk Management
- What was the attorney’s role?
  - Business transaction
  - Negotiation
  - Anticipated litigation
Communications with Others: Accountants and Auditors

- Generally, disclosure of privileged information to a client’s outside auditor waives the A-C privilege. See, e.g., *Chevron Corp. v. Pennzoil Co.*, 974 F. 2d 1156, 1162 (9th Cir. 1992).

- Thus, audit response letters have been subject of the “treaty” between the ABA and AICPA (as discussed below).
Communications with Others: Public Relations Consultants

- Privilege law is unclear in this area.
  - But other courts have held that such communications are privileged. *See H.W. Carter & Sons, Inc. v. William Carter Co.*, No. 95 Civ. 1274 (DC), 1995 WL 301351 (S.D.N.Y. May 16, 1995).

- While the law is unclear, a few conclusions can be drawn regarding when privilege may attach:
  - More likely to attach when the attorney hires the PR consultant.
  - There must be a clear nexus between the PR consultant’s work and the attorney’s representation of the client.
  - More likely to attach when the client does not have in-house PR capabilities or when the client is a foreign company.
Communications with Others: Public Relations Consultants (continued)

- **Tips**
  - Assume the communications will **not** be privileged.
  - Communicate verbally rather than in writing or electronically, when possible.
  - Only share documents that would be expected to be discovered in litigation.
  - May be better for the law firm to hire the PR firm.
A-C Privilege Apply for In-House Counsel in Foreign Jurisdictions

- **European Union:**

- **UK & Canada:**
  - Similar to the US, A-C privilege applies as long as the attorney is not wearing a “business advisory hat”.

- **China:**
  - It’s unclear as to whether it applies to in-house counsel.
## Avoiding the Traps to Lost Privilege

- Understand the key components necessary to assert privilege.
- Understand who your client is.
- Educate your client about privilege.
- Make sure you are wearing your “attorney hat” and be aware when mixing business and legal advice.

### Non-attorneys working for in-house counsel

- For example, employees who work in company compliance, internal audit, risk management, and reporting functions.
- Agency Relationship: non-attorneys working for in-house counsel are seen as agents of attorneys for purposes of protecting the privilege.
- However, these non-attorneys may also perform corporate or business tasks unrelated to the protected agency relationship.
- Understand when their work is protected and when it is not protected.
Avoiding the Traps to Lost Privilege (continued)

- Don’t over-assert the privilege.
- Cautious communication
  - Electronic communication: Should it be spoken rather than emailed?
  - Should the distribution be limited?
  - Limit disclosure of legal advice only to those that have a need to know.
- Avoid Rule 30(b)(6) designations.
  - Rule 30(b)(6) of the Federal Rules of Civil Procedure requires the designation of a corporate representative to testify on the record as to any topic or topics germane to the litigation set forth in the 30(b)(6) notice.
  - Most courts generally hold that merely designating an attorney pursuant to 30(b)(6) does not waive any privilege. However, since an in-house attorney is an agent of the corporation, serving as a 30(b)(6) witness may cause in-house counsel to unintentionally waive the client’s privilege.
Avoiding the Traps to Lost Privilege
(continued)

- Be cautious of inadvertent waiver, especially in the context of governmental agency investigations.

  Internal Investigations – numerous issues.
  - Use the “Upjohn” or “corporate Miranda”: I represent the corporation, not you. This interview is covered by the A-C privilege. That privilege belongs to the corporation – not you. The corporation may decide, in its sole discretion, whether or not to disclose this information to third parties, including the government.

- Be aware that different jurisdictions apply different protections.
  - As noted above, a minority of states still follow the “control group” test which limits the privilege to top management.
  - Foreign jurisdictions – privilege may or may not apply.
IN-HOUSE ATTORNEYS AND AUDIT RESPONSE LETTERS
Auditor v. Attorney: Differing Duties

- Auditor’s Duty: public in nature.
  - To the reader of the client’s financial statements.
- Attorney’s Duty: private in nature.
  - To the client.
- There is an obvious tension between these duties. Each has a different professional standard of care.
### The “Treaty”

- ABA and AICPA reached a compromise in December 1975 and January 1976.
  - Memorialized in the ABA “Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests for Information” and AICPA “Statement on Auditions Standards Number 12” (“SAS 12”).
- Attorney cannot respond to the auditor’s request unless consented to by the company/client.
- In an audit response letter, the attorney should “normally refrain from expressing judgments as to the outcome [of litigation] except in those relatively few cases where it appears to the lawyer that an unfavorable outcome is either ‘probable’ or ‘remote.’”
- Historically, audit letters prepared in conformance with the treaty requirements did not waive the A-C privilege or work-product immunity.
  - However, protection of the A-C privilege is less clear after the enactment of Rule 13(b)(2)-(2) (discussed below).
Rule 13(b)(2)-(2)

- Rule 13(b)(2)-(2)(b)(1):
  - No officer or director of an issuer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence any independent public or certified public accountant engaged in the performance of an audit or review of the financial statements of that issuer that are required to be filed with the Commission pursuant to this subpart or otherwise if that person knew or should have known that such action, if successful, could result in rendering the issuer’s financial statements materially misleading.

- Enacted pursuant to Congress’ directive in SOX Section 303 to address attorneys’ conduct with regard to certified audits.
Implications of 13(b)(2)-(2)

- May put a higher standard on the need for attorneys to disclose information.
  - Thus, may further erode A-C privilege.
- An audit response letter could conform with the Treaty but violate 13(b)(2)-(2) if omitted information is subsequently viewed as material.
- Counsel must now weigh seriously the question of whether they can decline to evaluate a claim simply because it does not fall within the “probable” or “remote” bucket.
- If a lawsuit in question results in a catastrophic judgment, will the SEC charge that counsel “misled” the auditor with an incomplete response that counsel “should have known XX could result in rendering the financial statements materially misleading?”
The Auditor Engagement Letter

- Consider negotiating operating guidelines, disclosure limitations and confidentiality issues with the auditors from the beginning.
- Although it may seem awkward to “negotiate with the auditor,” companies will be able to discuss and agree upon disclosure issues at the very beginning instead of when faced with an intrusive inquiry letter in the middle of an audit.
The Auditor Engagement Letter

- In the engagement letter, companies should request that the auditors abide by the Treaty and that auditor demand letters need to find ways to satisfy audit information requirements without invading the limits of any privilege.

- Additionally, require auditors to acknowledge the confidentiality of information received during the audit and limit its use solely for the purpose of the engagement.
  - Consider a confidentially agreement (or include confidentiality provisions in the engagement letter).
Responding to the Auditor

- **Follow the Treaty.**
  - It’s not a mandatory format, but it provides protection for the attorney.
  - In light of the potential for increased liability under SOX Section 303 and Rule 13(b)(2)-(2), compliance with the Treaty is not only helpful in protecting confidentiality, it is also the best defense against claims that communications with auditors were misleading.

- **Obtain the Appropriate Client Request.**
  - Under the Treaty, the privileged status of the attorney’s response is conditioned on it being made in response to the appropriate request of the client.
## Responding to the Auditor

- **Conduct an internal investigation.**
  - The attorney’s response under the Treaty implies that he/she has made reasonable efforts to determine all loss contingencies related to matters which all attorneys at his/her firm have devoted substantive attention in the form of legal consultation or representation of the client.
  - Prepare and distribute a general memo to all attorneys;
  - Distribute a more specific memo to attorneys known to be currently or historically working on matters for the client; and
  - Communicate with the client prior to the attorney’s response to ensure the completeness of the list of matters to be disclosed.
Responding to the Auditor

- **Objective Materiality Limitation.**
  - Establish a materiality threshold with the auditor.
  - Set forth materiality threshold in the client’s request letter and reference in the attorney's response letter.
- Generally, do not disclose client confidences.
  - Additionally, include express language stating that there is no intent to waive the A-C privilege.
- **Structure Opinion with Care.**
  - Under the Treaty, the attorney is not required to provide an opinion or estimate unless the attorney is satisfied that an unfavorable result is “probable” or “remote”. This determination usually cannot be made until late stages in the litigation.
Responding to the Auditor

- **Structure Opinion with Care (cont.)**
  - If an unfavorable outcome is neither probable or remote, the attorney should express *no opinion*. Thus, responses such as “we have not formed an opinion,” “we cannot form an opinion” or “because the case is in early stages of discovery, we have not formed an opinion” are problematic and potentially misleading.
  - Consider a response such as “Because we have not concluded that an unfavorable outcome is either ‘probable’ or ‘remote’ (as defined in the ABA statement of Policy), we express no opinion as to the likely outcome of such matter.”
Responding to the Auditor

- Structure Opinion with Care (cont.)
  - But, attorneys and corporations must be cognizant of Rule 13(b)(2)-(2) and the possibility that the SEC might view such responses as misleading or interfering with audits.
  - Also, take care to not verbally disclose an opinion/estimate when discussing the response with the auditor.
Responding to the Auditor

- Communicate with the client.
  - Review draft response with the client to confirm completeness of list and absence of disclosure of any confidences.
  - Professional responsibility to consult with the client regarding unasserted claims/assessments which may require financial statement disclosure.
Responding to the Auditor

- Consider SEC Loss-Contingency Disclosure Requirements.
  - Additional accounting / disclosure rules for publicly held clients.

- Written policy.
  - Consider adopting an office-wide audit response letter policy.
PARENT-SUBSIDIARY PRIVILEGE ISSUES
Parent-Subsidiary Privilege Issues

What privilege issues might arise when:

- The corporate legal department provides legal advice to both parent and wholly-owned subsidiary in a matter involving the relationship between the two entities?
- A single law firm counsel is retained as outside counsel to assist with a parent-subsidiary transaction?
Parent-Subsidiary Privilege Issues

“The roles of in-house counsel are many … The primary advantages of in-house (rather than outside) counsel are the breadth of their knowledge of the corporation and their ability to begin advising senior management on important transactions at the earliest possible stage, often well before anyone would think to hire a law firm.”

_In re Teleglobe Communications Corp., 493 F.3d 345, 369 (3d Cir. 2007)._
Parent-Subsidiary Privilege Issues

“[P]arent companies often centralize the provision of legal services to the entire corporate group in one in-house legal department.”

_Teleglobe_, 493 F.3d at 369.

“The universal rule of law … is that the parent and subsidiary share a community of interest, such that the parent (as well as the subsidiary) is the ‘client’ for purposes of the attorney-client privilege.”

_Id. at 370.

“Numerous courts have recognized that, for purposes of the attorney-client privilege, the subsidiary and the parent are joint clients, each of whom has an interest in the privileged communications.”

_Id. at 370.
Parent-Subsidiary Privilege Issues

- The effect of co-client, or community-of-interest representations of parent and subsidiary: otherwise privileged communications within the co-client or community-of-interest group remain privileged.

  “Delaware courts have recognized that parents and their wholly-owned subsidiaries have the same interests because all of the duties owed to the subsidiaries flow back up to the parent.”

  *TeleGlobe*, 493 F.3d at 366.
What Can Go Wrong?

- **Teleglobe**: Subsidiary files for bankruptcy protection and sues parent.
- **Spinoff** (*In re Iridium, VFB v. Campbell’s Soup*): Post-bankruptcy fraudulent transfer claims.
What Can Go Wrong?

- As to the scope of the co-client representation, the attorney-client privilege is a joint privilege.
  - Neither parent nor (former) subsidiary may withhold jointly-privileged information from the other party to the shared privilege.
  - The privilege remains intact against the outside world.
Limitations on the Joint Privilege

- Scope of the co-client representation may be limited by agreement.
- Co-client representation continues until client discharges lawyer or lawyer withdraws.
- The relationship may terminate by implication.
“[T]he question of when to acquire separate counsel is often difficult. … [T]he best answer is that once the parties’ interests become sufficiently adverse that the parent does not want future controllers of the subsidiary to be able to invade the parent’s privilege, it should end any joint representation on the matter of the relevant transaction.”

TeleGlobe, 493 F.3d at 373.
OFFERING REPRESENTATION TO FORMER EMPLOYEES
### Offering Joint Representation of Former Employees and Officers in Litigation

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<td>Defendant identified witnesses, including former employees, pursuant to court conference order.</td>
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<td>Witness addresses were listed as “c/o [defense counsel].”</td>
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<tr>
<td>Defense counsel thereafter contacted all named witnesses and offered to represent them at defendant’s expense.</td>
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<tr>
<td>All former employees orally agreed to joint representation and thereafter signed retainer letters.</td>
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<td>Plaintiff moved to disqualify defense counsel.</td>
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Offering Joint Representation of Former Employees and Officers in Litigation

- DR 2-103(A)(1): prohibition on lawyer solicitation “by in-person or telephone contact … unless the recipient is a close friend, relative, former client or existing client ….”
- “[T]he court is troubled, to say the least, that [defense counsel] actively solicited the non-party witnesses in clear violation of DR 2-103(A)(1) ….”
Offering Joint Representation of Former Employees and Officers in Litigation


  "Unfortunately, [defense counsel] has a history in this litigation of improperly thwarting plaintiff’s attempts to obtain discovery."

Rivera, 2008 WL 4635476, at 6.
Offering Joint Representation of Former Employees and Officers in Litigation

- Rule 7.03(a), Texas Disciplinary Rules of Professional Conduct:

  “A lawyer shall not, by in-person contact, or by regulated telephone or other electronic contact … seek professional employment concerning a matter arising out of a particular occurrence or event … from a prospective client or nonclient who has not sought the lawyer’s advice regarding employment or with whom the lawyer has no family or past or present attorney-client relationship when a significant motive for the lawyer’s doing so is the lawyer’s pecuniary gain.”
Questions
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