THE REVIEW OF
SECURITIES & COMMODITIES REGULATION
AN ANALYSIS OF CURRENT LAWS AND REGULATIONS AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 39 No. 21 December 6, 2006

COMPELLED WAIVERS OF THE ATTORNEY-CLIENT PRIVILEGE

SEC and Department of Justice Policies Calling on Corporations to Waive the Attorney-Client Privilege Have Been Protested by the Bar and Other Groups as Coercive, Contrary to the Public Interest, and Raising Fifth and Sixth Amendment Constitutional Issues. Two Recent District Court Opinions in the KPMG Case May Provide a Basis for Condemning the Policies.

By David Z. Seide *

The attorney-client privilege has existed for hundreds of years. Yet respect for that long history has not inhibited the Department of Justice or the Securities and Exchange Commission (SEC) from invoking the Thompson Memorandum[1] and the Seaboard Report,[2] respectively, to demand that companies seeking leniency from prosecution waive the privilege, as a tangible demonstration of their cooperation. The push for waiver has met considerable resistance from the organized bar, and the effort to check the use of privilege waivers has begun to gain traction.

Components of the Thompson Memorandum were recently held to be unconstitutional in *United States v. Stein*, the case arising out of allegedly illegal tax shelters promoted by the KPMG accounting firm. In that still-pending prosecution, the district court issued two remarkable opinions holding that the government acts unconstitutionally when it relies on the Memorandum: (i) to pressure companies to stop advancing legal fees to their employees; and (ii) to cause companies to coerce their employees into incriminating themselves.[3] This article examines the state of waiver demands in the wake of both rulings.

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

[2] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Rel. No. 34-44969 (Oct. 23, 2001), *available at* http://www.sec.gov/litigation/investreport/34-44969.htm.

[3] *See United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006); 440 F. Supp. 2d 315 (S.D.N.Y. 2006). For ease of reference, the opinions will be respectively cited as *Stein I* and *Stein II*.

** DAVID Z. SEIDE is a counsel in the securities department of Wilmer Cutler Pickering Hale and Dorr LLP. His e-mail address is David.Seide@wilmerhale.com. Heather Souder and Ryan Huschka, WilmerHale summer associates, contributed to this article. The views expressed herein are those of the author and do not necessarily represent the views of the firm or its clients.*

IN THIS ISSUE

RSCR Publications LLC Published 22 times a year by RSCR Publications LLC. Executive and Editorial Offices, 299 Park Avenue, 16th floor, New York, NY 10171-3898. Subscription rates: $1,197 per year in U.S., Canada, and Mexico; $1,262 elsewhere (air mail delivered). A 15% discount is available for qualified academic libraries and full-time teachers. For subscription information and customer service call (866) 425-1171 or visit our Web site at www.rscrpubs.com. General Editor: Michael O. Finkelstein; tel. 212-319-6706; e-mail mofinkelstein@hotmail.com. Associate Editor: Sarah Strauss Himmelfarb; tel. 301-294-6233; e-mail shimmelfarb@comcast.net. To submit a manuscript for publication contact Ms. Himmelfarb. ISSN: 0884-2426.

CHALLENGES TO THE PRIVILEGE

The corporate corruption scandals of recent years have created new opportunities for federal prosecutors and regulators. Emboldened by Congressional grants of expanded legal and budgetary authority, federal law enforcement authorities have pushed corporations to turn the attorney-client privilege on its head — through the use of privilege waivers to obtain incriminating evidence to prosecute corporate officers, directors, and advisors. The SEC and the Department of Justice have each made waiver of the privilege a key factor in determining whether or not to charge corporations. And corporations have acceded to waiver demands — particularly publicly traded or financial services corporations subject to substantial regulation and sensitive to the fate of such indicted professional and financial services companies as Drexel Burnham Lambert and Arthur Andersen.

Federal prosecutors and SEC enforcement attorneys, in an effort to streamline complex corporate fraud cases, have increasingly turned to the private law firms hired by corporations to conduct internal investigations. Soon after the report of wrongdoing, the corporation's lawyers often conduct internal investigations to assess the nature and scope of the problem for the corporation, its board of directors, the board's audit committee, and/or a special board committee. The lawyers typically interview corporate employees who feel pressure to cooperate, or else risk losing their jobs. Corporations then attempt to demonstrate their cooperation by waiving the attorney-client privilege and turning over the employee statements and other work product to the government.[4]

WAIVERS IN WHITE-COLLAR CRIMINAL CASES

The Department of Justice first articulated its preference for waivers from corporate defendants in 1999, when then-Deputy Attorney General Eric Holder issued a memorandum advising federal prosecutors that they could — but were not required to — take into account whether the corporation waived the privilege.[5] In 2003, waiver demands became mandatory with the issuance of the Thompson Memorandum by then-Deputy Attorney General Larry D. Thompson.[6] The Memorandum specifies factors that federal prosecutors are required to use when making charging decisions against corporations suspected of wrongdoing. Waiver of the attorney-client privilege is explicitly identified as a factor that must be taken into account in judging the degree of a corporation's cooperation.

Recent high-visibility federal criminal cases illustrate the impact of such waivers. In the Enron and Worldcom cases, the reports of the respective investigations entered the public domain.[7] Private attorneys who participated in internal investigations have been called as government witnesses.[8] And corporations have avoided indictment by entering into deferred prosecution

---

[4] *See*, *e.g.*, Andrew Longstreth, *Double Agent*, AM. LAW., Feb. 1, 2005, *available at* http://www.law.com/jsp/tal/PubArticleTAL jsp?id=1106573737942 (stating that today a private lawyer "conducts hundreds of interviews, scans company computers for damaging e-mails, rummages through the CFO's wastebasket, and then hands potential evidence over to the government").

[5] *See* Independence of the Legal Profession: Federal Government Policies on Privilege Waiver, *available at* http://www.abanet.org/poladv/priorities/privilegewaiver.html (last visited July 19, 2006).

[6] *See* Memorandum from Larry D. Thompson, *supra* note 1.

[7] *See, e.g.*, FindLaw Special Coverage, http://news.findlaw.com/hdocs/docs/ enron/sicreport/index.html (last visited June 21, 2006) (Enron Special Investigative Committee report); http://fl1.findlaw.com/news.findlaw.com/wsj/docs/ worldcom/bdspcomm60903rpt.pdf (last visited July 19, 2006) (Worldcom Special Investigative Committee report).

[8] *See, e.g.*, Posting of John Roper to Enron: TrialWatch, http://blogs.chron.com/enrontrialwatch/archives/2006/05/stock_ sales_que.html (May 8, 2006, 11:16 EST) (discussing the testimony of one of the attorneys who conducted the Enron Special Investigative report); *see also* Longstreth, *supra* note 4 (stating that in some cases the government calls internal investigators to testify).

agreements — which include recitals waiving the privilege.[9]

WAIVERS IN SEC CASES

The SEC followed a similar path in 2001 when it issued the Seaboard Report.[10] The report identified for the first time factors the SEC would use to determine whether and how much credit to give companies that cooperate in an investigation. Cooperation could potentially mitigate an otherwise harsh SEC enforcement proceeding and included such factors as self-policing, self-reporting, remediation, and cooperation with law enforcement authorities.

In addition, the report listed as a factor whether companies promptly make available to the SEC staff the results of an internal review. The report then noted that "[i]n 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."[11]

While the report notes the SEC's willingness to enter into selective waiver and/or confidentiality agreements in an effort to minimize the impact of such a waiver, such provisions have not fared well in the courts. The majority of jurisdictions do not recognize their validity, concluding that a selective waiver of the privilege amounts to a complete waiver of the privilege.[12] A minority have upheld the provision's validity.[13] Given this state of affairs, the net effect of waiving the privilege has meant that the internal investigation reports and memoranda of interviews have essentially been made available to the whole world. They can then be used by competitors to learn business secrets, or by litigants suing the company in private litigation.

REACTION TO PRIVILEGE WAIVERS

By the Bar

The defense bar has greeted the arrival of the waiver provisions with alarm. Government spokespersons have repeatedly asserted that waivers have been sought only in exceptional circumstances.[14] But recent surveys of

---

[9] *See, e.g.*, Deferred Prosecution Agreement, *United States v. Bristol-Myers Squibb Co.*, Cr. No. 2:05-mj-06076 (D.N.J. 2005), *available at* http://www.usdoj.gov/usao/nj/publicaffairs/nj/press/files/pdffiles/deferredpros.pdf; Deferred Prosecution Agreement, *United States v. America Online,Inc.*, Cr. No. 1:04 M 1133 (E.D. Va. 2004), *available at* http://www.usdoj.gov/dag/cftf/chargingdocs/aolagreement.pdf; Deferred Prosecution Agreement, *United States v. Computer Assocs. Int'l*, Cr. No. 04-837 (E.D.N.Y. 2004) *available at* http://www.usdoj.gov/dag/cftf/chargingdocs/compassocagreement.pdf.

[10] *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act, *supra* note 2.

[11] *Id*.

[12] *See In re Qwest Commc'ns Int'l Inc.*, 450 F.3d 1179, 1192 (10th Cir. 2006) (declining to adopt the selective waiver doctrine as an exception to general waiver rules); *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 302 (6th Cir. 2002) ("[W]e reject the concept of selective waiver, in any of its various forms."); *United States v. MIT*, 129 F.3d 681, 686 (1st Cir. 1997) (joining the "reluctance" to allow selective waiver); *Westinghouse Elec.*

footnote continued from previous column…

Corp. v. Republic of the Phil., 951 F.2d 1414, 1425 (3d Cir. 1991) (holding that selective waiver is not permitted, reasoning that it "does nothing to promote the attorney-client relationship"); *In re Martin Marietta Corp.*, 856 F.2d 619, 623 (4th Cir. 1988) ("The Fourth Circuit has not embraced the concept of limited waiver of the attorney-client privilege."); *Permian Corp. v. United States*, 665 F.2d 1214, 1222 (D.C. Cir. 1981) (noting that disclosure of documents to SEC was "incompatible with the continued survival of the privilege"); *Bowne of New York City, Inc. v. AmBase Corp.*, 150 F.R.D. 465, 480 (S.D.N.Y. 1993) (rejecting selective waiver in any form).

[13] Some jurisdictions allow selective disclosure in any situation. *See Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 611 (8th Cir. 1978) (en banc) (holding that only a limited waiver of the privilege occurred when the party disclosed documents in an SEC investigation); *In re LTV Sec. Litig.*, 89 F.R.D. 595, 605 (N.D. Tex. 1981) ("[D]isclosure of the additional materials to the SEC does not justify the class's discovery of the identity of those documents"); *In re Grand Jury Subpoena Dated July 13, 1979*, 478 F. Supp. 368, 373 (D. Wis. 1979) (holding that release of the report to the SEC and IRS is not a waiver of the attorney-client privilege). Other jurisdictions have adopted a middle-of-the-road view, allowing selective disclosure only if the disclosing party has specifically maintained the privilege and obtained a protective order, stipulation, or some other express reservation of the privilege claim. *See Steinhardt Partners, L.P. v. Steinhardt Partners, L.P.*, 9 F.3d 230, 236 (2d Cir. 1993) ("[W]e decline to adopt a *per se* rule that all voluntary disclosures to the government waive work-product protection."); *M & L Bus. Mach. Co. v. Bank of Boulder*, 161 B.R. 689, 696 (D. Colo. 1993) (holding that disclosure did not amount to complete waiver where steps were taken to ensure confidentiality, and there was no evidence of a benefit to the disclosing party).

[14] *See infra* note 17 and accompanying text.

in-house and outside counsel say otherwise. For example, in a 2005 survey, 30% of in-house counsel and 47% percent of outside counsel said that their clients had personally experienced an erosion of the protections offered by the privilege/work-product doctrine, while an astonishing 87% of outside counsel reported that the attorney-client privilege or work-product doctrine had recently been challenged — 25% by federal prosecutors, 15% by federal regulators, and 16% by an opposing party in civil litigation.[15] A 2006 survey of 1,200 in-house and outside counsel similarly reported that almost 75% believe that "a 'culture of waiver' has evolved in which governmental agencies believe that it is reasonable and appropriate for them to expect a company under investigation to broadly waive attorney-client or work-product protections."[16]

These figures contradict public statements by government officials who have contended that requests to waive the privilege are only made in exceptional circumstances.[17] The concerns have prompted the defense bar to greet demands for privilege waivers with much protest.[18]

But the opposition to waivers has gone well beyond a narrow range of defense attorneys to encompass the entire organized bar. In August of 2006, the American Bar Association (ABA) House of Delegates approved recommendations supporting the preservation of the attorney-client privilege and work-product doctrine, and opposing government policies and procedures that "have the effect of eroding constitutional and other legal rights" of employees, past or present, if that employee decides to exercise his or her Fifth Amendment right against self-incrimination.[19] In a similar vein, in May of 2006, the ABA's Task Force on the Attorney-Client Privilege wrote to Attorney General Alberto R. Gonzales to demand the removal of the waiver provision from the Thompson Memorandum,[20] a position seconded in September 2006 by 10 former high-ranking Department of Justice officials from both sides of the political aisle.[21]

Indeed, the coalition opposing the Thompson Memorandum has grown to include such diverse groups as the American Chemistry Council, the American Civil Liberties Union, the Association of Corporate Counsel, Business Civil Liberties, Inc., the Business Roundtable, the Financial Services Roundtable, Frontiers of Freedom, National Association of Criminal Defense Lawyers, National Association of Manufacturers, National Defense Industrial Association, Retail Industry Leaders Association, the U.S. Chamber of Commerce, and the Washington Legal Foundation.[22]

OFFICIAL REACTION

The pushback from the organized bar and other well-known constituencies may help to explain why there

---

[15] *See* National Association of Criminal Defense Lawyers, *National Association of Criminal Defense Lawyers Survey: The Attorney-Client Privilege is Under Attack* (Apr. 2005), *available at* http://www.nacdl.org/public.nsf/Legislation/Overcriminalization002/ $FILE/AC_Survey.pdf.

[16] Written Testimony of ABA President Karen J. Mathis before the Senate Judiciary Committee Concerning *The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations* (Sept. 12, 2006), *available at* http://judiciary.senate.gov/testimony.cfm?id=2054&wit_id=5742, citing survey completed in March, 2006 by the ABA, Association of Corporate Counsel, and the National Association of Criminal Defense Lawyers, *available at* http://www.acca.com/Surveys/attyclient2.pdf.

[17] *See, e.g.*, *Industry Fears DOJ Bid to Waive 'Privilege' in Environment Crimes Suits*, INSIDE EPA, May 26, 2006 (citing statements by U.S. Attorney for the Northern District of Alabama at the March 2006 American Bar Association white collar crime conference that waiver requests in the Northern District of Alabama "must be approved first, a practice that only happens in rare circumstances").

[18] *See, e.g.*, Kathryn Keneally, *New Life for Selective Waiver*, 30-Feb CHAMPION 42 (2006); Ronald C Minkoff, *A Lead in the Dike: Expanding the Doctrine of Waiver of the Attorney-Client Privilege*, 154 PLI/NY 165, 178 (2005).

[19] *See* ABA Press Release, *ABA Adopts New Policy on Presidential Signing Statements, Attorney-Client Privilege and Inspector General for the Federal Judiciary*, at http://www.abanet.org/media/releases/news080806_1.html (last visited Aug. 11, 2006); links to the recommendations and accompanying reports can be found at http://www.abanet.org/buslaw/attorneyclient/home.shtml (last visited Aug. 11, 2006).

[20] Letter from Michael S. Greco, President, American Bar Association to the Honorable Alberto Gonzales, Attorney General, Department of Justice (May 2, 2006), *available at* http://www.abanet.org/poladv/acprivgonz5206.pdf.

[21] *See* Appendix C to Testimony of ABA President Karen J. Mathis, *supra* note 16; *see also* Written Statement of Former Attorney General Edwin Meese III before the Senate Judiciary Committee Concerning *The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations* (Sept. 12, 2006), *available at* http://judiciary.senate.gov/testimony.cfm?id=2054&wit_id=5741.

[22] *See* Letter from Robert D. Evans, Director of the American Bar Association's Governmental Affairs Office to the United States Sentencing Commission (March 28, 2006), *available at* http://www.abanet.org/poladv/abaussc32806.pdf (last visited Aug. 11, 2006).

have been some signs of government pullback to seeking waivers. For example, the Department of Justice issued in October 2005 what has been referred to as the McCallum Memorandum, requiring each United States Attorney's Office to promulgate a set of protocols before a privilege-waiver request can be made to a corporation.[23]

Moreover, the United States Sentencing Commission Convention reversed itself on the waiver issue in May of 2006. After conducting two days of hearings on the subject, the Commission voted to delete waiver as a consideration for determining the culpability score for convicted organizations under the federal Sentencing Guidelines.[24] In addition, the House Subcommittee on Crime, Terrorism, and Homeland Security held hearings on the waiver issue in March of 2006, the Senate Judiciary Committee held hearings on the issue on September 12, 2006, and the Chairman of the Senate Judiciary Committee recently announced his intention to introduce legislation outlawing the Thompson Memorandum's waiver provision.[25]

Also on the horizon is a proposed revision to the Federal Rules of Evidence. Under the proposal, and as envisioned in the Seaboard Report, corporations could make a selective waiver of the privilege to the federal government without waiving the privilege as to other third parties.[26] But this proposal likely has limited application, because it applies only to proceedings in federal courts, where the Federal Rules of Evidence operate.

THE KPMG DECISIONS

All of the foregoing provides informative background to the recent rulings in *United States v. Stein*.[27] While the case was limited to declaring unconstitutional that portion of the Thompson Memorandum purporting to penalize corporations for advancing legal fees to employees under investigation and to coerce corporations into obtaining incriminating statements from employees, its reasoning may apply with equal force to the privilege-waiver provisions in the Thompson Memorandum and the Seabord Report.

Pertinent Facts

The *Stein* case centers on an Internal Revenue Service investigation into allegedly illegal tax shelters sponsored by KPMG, LLP, one of the world's largest accounting firms.[28] In early 2004, the IRS made a criminal referral to the Department of Justice, which in turn passed it on to the Manhattan United States Attorney's Office ("USAO").[29]

KPMG had good reason to fear that the reputational damage associated with an indictment would be enough to destroy the firm. After all, Arthur Andersen collapsed within months of being indicted in the Enron case, even though the Supreme Court ultimately reversed its conviction.[30] And KPMG's lawyers made clear to the government that KPMG believed that an indictment would be fatal to the organization.[31]

---

[23] *See* Memorandum from Robert D. McCallum, Jr., Acting Deputy Attorney General to Heads of Department Components and United States Attorneys (Oct. 21, 2005), *available at* http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/ crm00163.htm.

[24] *See* United States Sentencing Commission, *Amendments to the Sentencing Guidelines* at 45 (May 18, 2006), *available at* http://www.ussc.gov/2006guid/ FinalUserFrdly.pdf.

[25] *White Collar Enforcement (Part I): Attorney-Client Privilege and Corporate Waivers: Oversight Hearing Before the H. Comm. on the Judiciary, Subcomm. on Crime, Terrorism and Homeland Security*, 109th Cong. D193 (2006); *The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations*, *available at* http://judiciary.senate.gov/hearing.cfm?id=2054; *Specter Tells of Upcoming Legislation to Stop Thompson Memo Practices*, *available at* http://lawprofessors.typepad.com/whitecollarcrime_blog/ (last visited Sept. 19, 2006).

[26] FED. R. EVID. 502 advisory committee's note (Proposed Amendment 2006).

[27] *See supra* note 3.

[28] *See generally Stein I*, 435 F. Supp. 2d at 338-39.

[29] *See id.* at 339.

[30] *See Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005). As the district court observed in *Stein II*:

> Many companies faced with allegations of wrongdoing are under intense pressure to avoid indictment, as an indictment – especially of a financial services firm – threatens to destroy the business regardless of whether the firm ultimately is convicted or acquitted. That is precisely what happened to Arthur Andersen & Co., one of the world's largest accounting firms, which collapsed almost immediately after it was indicted – and the Supreme Court's eventual reversal of its conviction did not undo the damage. So any entity facing such catastrophic consequences must do whatever it can to avoid indictment.

Stein II, 440 F. Supp. 2d at 337.

[31] *See Stein II*, 440 F. Supp. 2d at 320.

In the words of the district court, the government pressed its advantage.[32] During meetings at the USAO, federal prosecutors told KPMG's lawyers that the company's cooperation would be measured against the dictates of the Thompson Memorandum. KPMG then went about demonstrating to the USAO that it was satisfying the Memorandum's requirements on a number of fronts. First, KPMG capped the legal fees to its partners and employees under investigation, threatened to cut off fees to employees whom the government deemed "uncooperative," and then cut off fees following indictment. KPMG had a long-standing policy of advancing legal fees to employees involved in any civil, criminal, or regulatory proceeding arising within the scope of the person's duties and responsibilities to KPMG. Following meetings with lawyers from the USAO, however, it was clear that the government wanted KPMG to change its practice. Subsequently, KPMG informed its employees that the firm would now only advance legal fees up to a cap of $400,000, that the employee had to "cooperate with the government and be prompt, complete, and truthful," and that payment of fees would immediately cease if the employee was indicted.[33]

Second, the district court found "that the government, both through the Thompson Memorandum and the actions of the USAO, quite deliberately coerced, and in any case significantly encouraged, KPMG to pressure its employees to surrender their Fifth Amendment rights."[34] KPMG told employees they had a choice: cooperate and participate in government interviews or give up their jobs and KPMG-provided legal fees.

KPMG's cooperation ultimately satisfied the government. In August of 2005, KPMG and the government entered into a deferred prosecution agreement agreeing to extensive continuing cooperation generally and in connection with the indictment of former KPMG partners and employees allegedly responsible for promoting the illegal tax shelters ("the KPMG defendants").[35] Soon after, the KPMG defendants were indicted and KPMG cut off payments of their legal fees.[36]

The KPMG defendants reacted by filing motions to dismiss the indictment, to suppress their statements to the government, and, alternatively, to order KPMG to advance their legal fees. The government opposed the motion. The district court ordered limited discovery and then conducted several days of hearings to resolve contested factual issues concerning the voluntariness of KPMG's actions.[37]

In its two decisions, the district court ruled in favor of the KPMG defendants. In the first opinion, the court found that the government, through the Thompson Memorandum and the USAO's action, violated the Fifth and Sixth Amendment rights of the KPMG defendants by causing KPMG to cut off payment of legal fees and other defense costs upon indictment.[38] In the second opinion, the court ruled that the government similarly violated the Fifth Amendment rights of two of the KPMG defendants by causing KPMG to coerce them into making incriminating statements to the government.[39] Although the court was not asked to assess the constitutionality of the Thompson Memorandum's privilege-waiver provision, its core constitutional reasoning is worth a closer look.[40]

Pertinent Principles

The court's Fifth Amendment analysis is bottomed on its finding that the Thompson Memorandum's requirements were fundamentally unfair to the KPMG defendants. The Fifth Amendment's requirement of fundamental fairness, embodied in its due process clause, protects the autonomy of criminal defendants to control the manner and substance of their defense

[32] *See Stein I*, 435 F. Supp. 2d at 347.

[33] *Id.* at 345-46.

[34] *Stein II*, 440 F. Supp. 2d at 337.

[35] *See Stein I,* 435 F. Supp. 2d at 349-50.

[36] *See id.* at 350.

[37] *See id.* at 352.

[38] *See id.* at 356. The court declined to dismiss the indictment, but ruled that the KPMG Defendants were entitled to the advancement of legal fees from KPMG.

[39] *See Stein II*, 440 F. Supp. 2d at 337. The court ordered the suppression of the statements, as well as all evidence derived from them.

[40] The SEC's conduct should also be subject to similar scrutiny. For example, in May of 2004, Lucent Technologies, Inc. settled an SEC enforcement action that included a $25 million penalty based on the company's "lack of cooperation." Among the facts cited by the SEC in its press release in support of this finding was Lucent's expansion of the scope of employees who could be indemnified against the consequences of an SEC enforcement action. An SEC official quoted in the release observed that "[s]tiff sanctions and exposure of their conduct will serve as a reminder to companies that only genuine cooperation serves the best interests of investors." SEC Press Release, *Lucent Settles SEC Enforcement Action Charging the Company with $1.1 Billion Accounting Fraud*, http://sec.gov/news/press/2004-67.htm (last visited Aug. 11, 2006).

without prosecutorial interference.[41] Given what it found to be the historical importance of indemnification and the advancement of legal fees to the success of businesses in the United States,[42] and KPMG's long-standing practice of advancing legal fees to its employees,[43] the court concluded that the pressure put on KPMG by the USAO unfairly impinged upon the KPMG defendants' ability to defend themselves and therefore did not survive strict-scrutiny constitutional analysis.[44] Similarly, the court found that the government acted unconstitutionally by compelling KPMG to apply economic coercion to its employees for the purpose of rendering statements to the government.[45]

Notably, the *Stein* court did not suppress statements from all of the defendants who merely cited some kind of economic duress. The courts rejected arguments made by five other defendants that their statements were coerced because they were made to the government after KPMG conditioned payment of their legal fees on cooperation. Rather, the court only suppressed statements rendered by defendants who were threatened with losing their jobs if they did not cooperate.[46]

The court further ruled that the Thompson Memorandum, in conjunction with the USAO's conduct, also violated Sixth Amendment principles. As the court described it, the Sixth Amendment protects defendants' rights to choose their own lawyers and to use their own funds to mount an effective defense.[47] Although the right to counsel typically attaches at the initiation of adversarial proceedings, the court found that the Thompson Memorandum, on its face, acted to limit the KPMG defendants' access to funds for their defense. Thus, even though the actions of the USAO occurred prior to indictment, "the [Thompson Memorandum] was adopted and the USAO acted in circumstances in which [the detriment to KPMG defendants' right to counsel] was known to be exceptionally likely."[48] That led the court to conclude that the Thompson Memorandum undermines the adversarial process fundamental to the American criminal justice system.

APPLICATION OF ***STEIN*** TO ATTORNEY-CLIENT WAIVERS

The attorney-client privilege in the usual case of alleged corporate malfeasance arises from involvement of corporate attorneys in the investigation of the conduct at issue. As such, the privilege belongs to the corporation, which under Seaboard or the Thompson Memorandum may be pressured to waive them in civil or criminal proceedings.

Compelling waivers of the privileges does not interfere with the corporation's right to counsel in the same way as cutting off of funds did to the individual employees in *Stein*. But the threat of waiver can nevertheless be a highly significant impediment to counsel's effective defense. The possibility of a compelled waiver will give employees a disincentive to report internal wrongdoing to counsel, and thus impair the corporation's understanding of what wrongdoing occurred and its ability to get critical fact-specific advice from counsel. Thus, the privilege is essential to creating the "atmosphere of openness" that lies at the heart of effective legal representation. The attorney-client privilege in particular is an even more deeply rooted part of the American legal system — and thus even more deserving of protection -- than the right of corporate employees to indemnification that was protected in *Stein*.[49]

Besides interfering with the corporation's right to counsel, the threat of requiring privilege waivers fails constitutional strict scrutiny because it is not narrowly tailored to produce the stated goal of full corporate disclosure. Commentators have argued that the

---

[41] *See Stein I*, 435 F. Supp. 2d at 358.

[42] The court noted that today all states have statutes addressing the indemnification of corporate directors, officers, employees, and other agents in recognition of the fact that such policies encourage corporate service by capable individuals.

See id. at 354.

[43] *See id.* at 356.

[44] *See id.* at 364-65.

[45] *See id.* at 365. That conclusion may not be especially different from *Garrity v. New Jersey*, 385 U.S. 493 (1967), where the Court held that when the government threatens a public employee with job loss unless the employee responds to questions, any statements the employee makes are deemed to be compelled and therefore inadmissible in criminal proceedings against him.

[46] *See Stein II*, 440 F. Supp. 2d at 330-33.

[47] *See Stein I,* 435 F. Supp. 2d at 366.

[48] *Id.*

[49] American College of Trial Lawyers, *The Erosion of the Attorney-Client Privilege and Work-Product Doctrine in Federal Criminal Investigations*, 41 Duq. L. Rev. 307, 312 (2003). The privilege dates back to the reign of Elizabeth I and is the oldest of the privileges for confidential communications. *Id.* at 311. The attorney work- product doctrine also derives from common law origins and facilitates the adversarial process by enabling attorneys to prepare without fear that the product of their labor will be used against their clients. *Id.* at 313.

government can typically obtain information "sufficient for law enforcement personnel to identify the nature and extent of the offense and the individuals responsible for criminal conduct" when corporations reveal only non-privileged material. [50]

It is true that in civil SEC enforcement proceedings, the pressure on the corporation is usually not as great as in threatened criminal proceedings. The degree of pressure may make a difference in the constitutional calculus, as it did in *Stein* where the court only found coercion where employees who did not cooperate were threatened with discharge, not merely the refusal to pay legal fees. But the range of SEC penalties in negotiated settlements can be very large —from zero to hundreds of millions of dollars — depending on whether the Commission concludes that the company has fully cooperated in the investigation. The difference can be important even for large public companies and it may be magnified by the signal it gives to follow-on civil actions. Moreover, when the SEC pressures a captive corporation, such as a broker-dealer, to act in uncustomary ways, or works hand in glove with the Justice Department in combined civil and criminal investigations, its conduct should be subject to special scrutiny. In such cases in particular, but not exclusively, it cannot be seriously argued that a corporation acts voluntarily when it satisfies the government's privilege-waiver demands.[51] The issues cogently articulated in *Stein* may thus resonate for SEC investigations, and the fundamental fairness concerns which permeate the *Stein* opinions are likely to affect any analysis of the SEC's conduct.[52]

The foregoing arguments have also begun to gain followers inside the SEC. For instance, Commissioner Paul Atkins recently publicly declared his opposition to the privilege waivers as a condition of cooperation:

> I strongly believe that the Commission should not view a company's waiver of privilege as a factor that will afford cooperation credit. This would ensure that a waiver is not considered a "plus" even when the Staff points it out in a recommendation. Maybe it is time for the Commission to revisit this issue in a formal way and to clarify that waiver of fundamental rights and protections will not result in lesser allegations and/or remedies. [53]

WHERE DO WE GO FROM HERE?

In the wake of the KPMG opinions and the other developments discussed above, defense attorneys have a variety of courses available to them to fight privilege-waiver demands. First, the opinions provide ammunition to mount constitutional challenges. Counsel can seek to enjoin government investigations founded on evidence coerced out of corporations via privilege waivers. Later, they can move to dismiss indictments or enforcement proceedings based on such evidence or to suppress the introduction at trial of evidence derived from coercive tactics.

Second, even if counsel consider waiver to be a realistic option, they can negotiate narrow waivers. For example, they may find the government receptive to accepting a waiver limited to advice rendered prior to the commencement of any internal investigation. Indeed, the Justice Department recently cited this distinction in its recent settlement of a market-timing investigation without bringing criminal charges against Prudential Equity Group, LLC. There, the Deputy

---

[50] *See* David Zornow and Keith Krakaur, *On the Brink of a Brave New World: The Death of Privilege in Corporate Criminal Investigations*, 37 Am. Crim. L. Rev. 147, 54 (2000) (quoting United States Sentencing Guidelines, 18 U.S.C.A. §8C2.5, cmt. n.12 (1998)).

[51] *See*, *e.g.*, Priscilla Walton, *Waiving the Attorney-Client Privilege Goodbye: The Erosion of the Privilege by Federal Financial Regulatory Agencies*, 10 N.C. Banking Inst. 397, 405 (2006) (stating that "[b]ecause of the high pressure placed on counsel to comply with investigations, the practice seems more like coercion than a feasible, voluntary option").

[52] Indeed, in a recent opinion granting a defendant summary judgment against the SEC in an insider trading case, the district court took the SEC to task for misquoting an opponent and misrepresenting facts and law. The court went on to urge the SEC "to remember that a suit by the SEC is akin to a criminal prosecution in that it is accusing a private individual of wrongdoing. In such cases, the SEC acts as

footnoted continued from previous column…

'the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done.' " *SEC v. Heartland Advisers Inc.,* No. 03-C-1427, 2006 WL 2547090 at *5 n. 4 (E.D. Wis. Aug. 31, 2006) (internal quotations omitted).

[53] Speech by SEC Commissioner Atkins: Remarks Before the Federalist Society (Sept. 21, 2006), *available at* http://sec.gov/news/speech/2006/spch092106psa.htm.

Attorney General noted that while Prudential had agreed to waive the privilege, the waiver was limited in time to advice rendered while market-timing practices were still underway.[54] Moreover, the Deputy Attorney General has further recently observed that "[I]f the [cooperating] company can [identify wrongdoers] without waiving the privilege, the Department is satisfied and we are happy to work with the company to eliminate or minimize any need for privilege waivers."[55]

Third, counsel should hold the government to its procedural obligations. They should query the government to establish that the protocols required by the McCallum Memorandum on waiver issues are observed, and should make a record when those protocols are ignored.

Finally, they can continue to advocate for the elimination of privilege-waiver demands. The recent success in preventing further erosion of the privilege can be attributed to the unflagging advocacy from the diverse constituencies of the organized bar. It will require continuing vigilant efforts to ensure that the fundamental principles of attorney-client confidence retain their vitality in the years to come. ■

[54] *See Transcript of Deputy Attorney General Paul J. McNulty at Press Conference Regarding Prudential Equity Group Securities Fraud Allegations* (Aug. 28, 2006), *available at* http://www.usdoj.gov/dag/speech/2006/dag_speech_060828.htm (last visited Aug. 31, 2006).

[55] Written Testimony of Deputy Attorney General Paul J. McNulty before the Senate Judiciary Committee Concerning *The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations* (Sept. 12, 2006), *available at* http://judiciary.senate.gov/testimony.cfm?id=2054&wit_id=2742.

The Review of Securities & Commodities Regulation