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Waiving the Attorney-Client Privilege Goodbye: The Erosion of the Privilege by Federal Financial Regulatory Agencies

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I. INTRODUCTION

As in-house counsel for a regional bank, a member of management comes to you with the suspicion that the bank is engaged in an unsound practice. The manager is concerned that corrective action is necessary, though the practice has gone unnoticed up to this point. You recommend that the bank conduct an internal investigation and, following the investigation, conclude that the manager’s suspicion was correct. However, before corrective action can be taken, a federal financial regulator comes knocking on your door. The regulator also suspects that the bank is engaged in an unsound practice and seeks full cooperation from you during its investigation. The regulator asks whether any employees have discussed the situation with you and mentions that the regulator will “look favorably” on full and complete cooperation with the investigation.

If this were a discovery request in traditional civil or criminal litigation, your answer would be simple – the attorney-client privilege protects communications between attorney and client and you do not have to disclose to the regulator any discussions that you had with the employee. However, in the context of a federal regulatory investigation, invoking the privilege is more complicated. While attempting to protect the confidences and privacy of the attorney-client communication, invoking the privilege with respect to a financial regulatory investigation could potentially lead to more intense

1. Hickman v. Taylor, 329 U.S. 495, 511 (1947); see infra notes 14-18 and accompanying text.

2. American Bar Association, Task Force on Attorney-Client Privilege Recommendation and Report, at 12-13 (May 18, 2005), available at www.abanet.org/buslaw/attorneyclient/ [hereinafter ABA Task Force Report]. The Report states that “[t]here is general agreement that if a company discloses attorney-client privileged material to a regulator or prosecutor, the company thereby waives the attorney-client privilege as far as the particular information is concerned. The cases disagree whether the effect is also to impliedly waive that privilege with respect to all other attorney-client communications on the same subject matter.” Id. The American Bar Association will hereinafter be referred to as the “ABA.”
investigation into your client's affairs and harsher penalties if violations are discovered. On the other hand, choosing to waive the privilege for the purposes of the regulatory investigation may mean that the privilege is waived for any subsequent litigation by shareholders or other third parties stemming from the investigation.

The dilemma presented in the above hypothetical has occurred with increasing frequency in the post-Enron era of aggressive regulatory investigation. In order to minimize the public attention on investigations and to receive favorable treatment from regulatory agencies, corporations often waive their attorney-client privilege in an attempt to cooperate fully with the regulators. This note will discuss how waiver of the privilege by financial institutions in connection with federal financial regulatory investigations by the bank regulators has led to the erosion of the attorney-client privilege, and the implications of such erosion on the banking industry and on counsel for banking institutions.

Part II of this Note will discuss the application of the attorney-client privilege in the corporate context. Part III will examine the erosion of the privilege by waiver in government investigations, specifically focusing on recent examples in the context of Securities and Exchange Commission and Department of Justice investigations.

3. See Memorandum from Larry D. Thompson, Deputy Attorney General, to United States Attorneys (Jan. 20, 2003) (on file with author) [hereinafter Thompson Memo]. The Thompson Memo revised the principles that Department of Justice prosecutors should use in deciding whether to seek charges against a business. Among the factors identified, the Thompson Memo states that prosecutors may consider "the adequacy of a corporation's cooperation [including] a waiver of the attorney-client and work product protections . . . ."


5. ABA Task Force Report, supra note 2, at 13-14.

6. George J. Terwilliger III, Responding to Investigations, 27 NAT'L J., Aug. 15, 2005, at 13. "[E]nforcement authorities examine in every case both affirmative steps taken immediately to cooperate and, conversely, any efforts to obstruct their investigations. Failure to cooperate can harden prosecutors' attitudes significantly and render a bad situation even worse." Id.

7. The regulators of banking institutions, the Office of Thrift Supervision [hereinafter OTS], the Office of the Comptroller of Currency [hereinafter OCC], the Federal Deposit Insurance Corporation [hereinafter FDIC], and the Federal Reserve Board [hereinafter FRB], will hereinafter be referred to as the "bank regulators."

8. See infra notes 14-24 and accompanying text.

9. Hereinafter SEC.

10. Hereinafter DOJ.

11. See infra notes 25-97 and accompanying text.
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Part IV will discuss the privilege in the context of bank regulators, including the enforcement powers of bank regulators and whether cooperation with bank regulators constitutes waiver for third party actions. Part V will discuss the implications of the erosion of the privilege and proposed legislative solutions to the waiver issue.

II. THE APPLICATION OF THE ATTORNEY-CLIENT PRIVILEGE TO A CORPORATE CLIENT

The attorney-client privilege is a rule of evidence that protects communications between attorney and client from discovery. The privilege is based on the notion that it is in the best interest of the administration of justice for clients to make full disclosure to the attorneys who represent them. The attorney-client privilege only applies to communications between attorney and client. The purpose of the privilege is to "encourage full and frank communication between attorneys and their clients" and should apply "only where necessary to achieve [this] purpose."

Applying the privilege in the context of the corporate client is complicated because of the difficulty in determining who within the corporation falls within the definition of "client." The seminal case regarding the attorney-client privilege in the corporate context is Upjohn v. United States. There, the Supreme Court expressly rejected the notion that the privilege only applies to persons in the corporation's control group. Although the control group test was rejected in

12. See infra notes 98-124 and accompanying text.
13. See infra notes 125-164 and accompanying text.
14. ABA Task Force Report, supra note 2, at 3. The attorney-client privilege is a rule of evidence, but "[w]hen the law of a state provides the rule of decision for an element of a claim or defense in accordance with the Erie doctrine, federal courts must apply the applicable state's law of privileges to evidence offered to prove or disprove that element of the claim or defense." JACK B. WEINSTEIN & MARGARET A. BERGER, WEINSTEIN'S EVIDENCE MANUAL § 18.02 (2005).
19. ABA Task Force Report, supra note 2, at 5.
21. Id. at 397 (concluding that "the narrow 'control group test' . . . cannot, consistent with the principles of the common law as interpreted in the light of reason and experience,
Upjohn, courts have not consistently decided who in a corporation falls within the meaning of "client." To further complicate matters, despite the Supreme Court's holding in Upjohn, some state courts still apply the control group test to determine who the attorney-client privilege applies to within the corporation.

III. EROSION OF THE PRIVILEGE BY WAIVER IN GOVERNMENT INVESTIGATIONS

The effects of the erosion of the attorney-client privilege have been widely discussed in terms of SEC investigations and the DOJ Federal Sentencing Guidelines. In these areas, pressure by government agencies for full cooperation in investigations has led to an increased disclosure of potentially privileged information, which, in turn, has led to courts deeming the privilege waived with regard to third
govern the development of the law in this area") (internal quotations and citations omitted). The "control group test" is based on the premise that, in order for the privilege to apply, the corporation, not an individual employee must be seeking advice from the attorney. Thus, an employee who is in a position to "control or . . . take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney, . . . then, in effect, he is (or personifies) the corporation when he makes his disclosure to the lawyer and the privilege would apply." Id. at 390, quoting General Electric Co. v. Kirkpatrick, 312 F.2d 742 (CA3 1962).

22. Id. at 391.

23. After Upjohn, the Court of Appeals for the District of Columbia stated that "[i]f the communication is made by a person not within the 'control group' of the corporation, then it is only privileged if: (1) the communication was made for the purpose of securing legal advice; (2) the employee making the communication did so at the direction of his corporate superior; (3) the superior made the request so that the corporation could secure legal advice; (4) the subject matter of the communication is within the scope of the employee's corporate duties; (5) the communication is not disseminated beyond those persons who, because of the corporate structure, need to know its contents." Indep. Petrochemical Corp. v. Aetna Casualty and Surety Co., 672 F. Supp. 1, 4 (D.D.C. 1986) (citing Diversified Industries v. Meredith, 572 F.2d 596, 609 (8th Cir. 1977)). However, two years later, the Ninth Circuit held that the attorney-client privilege applies "to communications by any corporate employee regardless of position when the communications concern matters within the scope of the employee's corporate duties and the employee is aware that the information is being furnished to enable the attorney to provide legal advice to the corporation." Admiral Ins. Co. v. United States Dist. Ct., 881 F.2d 1486, 1492 (9th Cir. 1988) (emphasis added). For a complete discussion of the Circuit Court split on the application of the privilege, see Sherman L. Cohn, The Organizational Client: Attorney-Client Privilege and the No-Contact Rule, 10 GEO. J. LEGAL ETHICS 739, 755-760 (1997).

24. ABA Task Force Report, supra note 2, at 7. For example, the Illinois Supreme Court expressly rejected Upjohn and applied the control-group test. Consolidation Coal v. Bucyrus-Erie Co., 432 N.E.2d 250 (Ill. 1982).

25. See infra notes 27-44 and accompanying text.
It is important to look at the effects of privilege waiver with respect to the SEC and DOJ in order to determine the possible effects the erosion of the privilege will have on financial institutions.

A. SEC's Seaboard Report

The attorney-client privilege has been largely eroded in the context of SEC investigations. In 2001, the SEC declined to take action against the Seaboard Corporation, because of the company's efforts to cooperate with an SEC investigation. An employee of a subsidiary of Seaboard, Chestnut Hill Farms, had "caused the company's books and records to be inaccurate and its financial reports to be misstated." Within weeks of learning about the employee's misconduct, Seaboard fired the employee and disclosed the misstated financial statements to the SEC. The SEC launched an investigation, in which:

[Seaboard] pledged and gave complete cooperation to [the SEC]. It provided the [SEC] with all information relevant to the underlying violations. Among other things, the company produced the details of its internal investigation, including notes and transcripts of interviews of [employees]; and it did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation.

One of the criteria the SEC considered in deciding not to take action against Seaboard was that the "the company voluntarily disclosed information [the SEC] did not directly request and otherwise might not

26. Id.
27. Hereinafter Seaboard.
29. Id.
30. Id.
31. Id. (emphasis added).
have uncovered" and that "the company ask[ed] its employees to cooperate with [the SEC] and ma[de] all reasonable efforts to secure such cooperation." Coupled with public remarks made by SEC officials, the Seaboard Report has been viewed in the legal community as a statement from the SEC that it now "regards the production of attorney-client privileged information . . . as a necessary element of cooperation."

B. The DOJ Thompson Memo and Federal Sentencing Guidelines

In the wake of the high-profile corporate scandals of the early 2000s, government regulatory agencies have become increasingly vigilant in conducting investigations into potential corporate misconduct. The result has been an increase in the level of cooperation with investigations in order to keep the regulators at bay. In 2003, the Deputy Attorney General Larry Thompson published a memo that outlined nine factors for federal prosecutors to consider in making decisions with respect to prosecuting businesses (the "Thompson Memo"). One consideration is "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work-product protection." While the Thompson Memo states that the DOJ does not require waiver of the

32. Id. at 3.
33. Seaboard Report, supra note 28, at 3. In a footnote to the Seaboard Report, however, the SEC states 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. 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." Id. at 5.
35. ABA Task Force Report, supra note 2, at 17.
36. Id. at 14.
37. See Terwilliger, supra note 6.
38. Thompson Memo, supra note 3.
39. Id.
40. Id.
privilege, it also stresses that waivers may be necessary to enable the agency "to evaluate the completeness of the corporation's voluntary disclosure and cooperation."41

New Federal Sentencing Guidelines for corporations that became effective in 2004 give sentencing "points" if an organization fully cooperates in an investigation.42 For example, the Sentencing Guidelines Manual States that "[i]f the organization fully cooperated in the investigation . . . subtract 2 points [from the organization's culpability score]."43 The Thompson Memo's reference to waiver of the privilege, combined with the Federal Sentencing Guideline's rewards for privilege waiver, are important because of the pressure this seems to place on corporate counsel to comply with all requests.44

C. Does Cooperation with Regulators Constitute a Waiver for Third Party Actions?

In light of the SEC's Seaboard Report and the Thompson Memo, it appears that cooperation with investigation, including privilege waiver, is necessary to a favorable outcome.45 Thus corporate counsel must weigh favorable treatment with the risks associated with waiver.46 Because waiver in a regulatory investigation may result in waiver for third party actions, careful consideration must be given as to the best course of action.47 However, questions remain as to whether cooperation with investigation is actually a "voluntary" action that would constitute a privilege waiver48 and whether the regulatory agency

42. Notice of Submission to Congress of Amendments to the Sentencing Guidelines, 69 Fed. Reg. 28994 (May 19, 2004). These new federal sentencing guidelines state that "in some circumstances waiver of the attorney-client privilege . . . may be required in order to satisfy the requirements of cooperation." Id.
43. U.S. Sentencing Guidelines Manual § 8C2.5(g)(2) (2004). The "culpability score" is a measure used by the DOJ to determine the range of the fine imposed on the organization. Id.
45. See supra notes 25-44 and accompanying text.
46. See supra notes 14-44 and accompanying text
47. See supra notes 14-44 and accompanying text.
48. See infra notes 51-62 and accompanying text.
conducting the investigation is really an "adversary" to the financial institution for purposes of waiving the privilege. As discussed below, some jurisdictions have used the concept of "selective waiver" to simplify the process of turning over potentially privileged information to regulatory agencies.

1. Is the Cooperation Sufficiently "Voluntary" to Constitute a Waiver?

"Voluntary" disclosure of privileged information will amount to a waiver of the attorney-client privilege. In general, the attorney-client privilege is deemed waived when information is voluntarily disclosed to a third party or a party makes the privileged communications an issue in litigation. Because regulatory agencies are third parties, disclosure of privileged information to regulatory agencies is often deemed a waiver of the privilege. Most courts have taken the view that disclosures to regulators with enforcement authority are voluntary, to the extent that the company voluntarily chose the type of business that subjects it to such regulatory review.

Corporations generally have to make a judgment call in deciding whether to comply with the government's request for waiver: cooperate and risk disclosure of privileged information or withhold and face potential backlash. Corporations

49. See infra notes 63-82 and accompanying text.
50. See infra notes 83-97 and accompanying text.
51. In re Steinhardt Partners, 9 F.3d at 235 (holding that "[t]he waiver doctrine provides that voluntary disclosure . . . waives the privilege as to other parties").
52. See David Francescani & Michael Auturo, Caught Between a Rock and a Hard Place: Companies Continue to Wrestle with Dilemma that Disclosing Privileged Information to Regulators and Auditors May Result in Waiver, N.Y. L.J., June 20, 2005, at 10.
53. See, e.g., In re Columbia/HCA Healthcare Corp. Billing Practices Litig., 293 F.3d 289 (6th Cir. 2002) (holding that when a corporation gives privileged information to a regulator, the corporation waives the attorney-client privilege, even when made pursuant to a confidentiality agreement). But see Diversified Industries v. Meredith, 572 F.2d at 561 (holding that Diversified made only a limited waiver of information when making a disclosure pursuant to an SEC investigation).
54. See Reed Smith, Disclosure of Privileged Communications and Work Product to Regulators, MONDAQ BUS. BRIEFING, July 2, 2004. For example, in United States v. MIT, the Court of Appeals for the First Circuit stated that MIT's disclosure of materials to the Department of Defense amounted to a waiver of the attorney-client privilege because the disclosure "resulted from its own voluntary choice, even if that choice was made at the time it became a defense contractor and subjected itself to the alleged obligation of disclosure." United States v. MIT, 129 F.3d 681, 687 (1st Cir. 1997).
that choose voluntary disclosure do so because they believe that there is some benefit to be gained from disclosure.\textsuperscript{56} This "benefit" may be in the form of offers of leniency, confidentiality agreements to protect against disclosure to third parties, or complete dismissal of the investigation if the questionable practice has been subsequently corrected.\textsuperscript{57} Likewise, entities that choose not to voluntarily disclose privileged information have implicitly decided that the risks of disclosure outweigh the possible benefit of disclosing potentially harmful communications between attorney and client.\textsuperscript{58}

In April 2005, the Association of Corporate Counsel issued the results of an online survey titled "Is the Attorney-Client Privilege Under Attack?"\textsuperscript{59} More than thirty percent of in-house counsel respondents indicated that their clients had "personally experienced an erosion in the protections offered by the privilege" in the previous four years.\textsuperscript{60} The respondents stated that "[d]ecisions to claim or waive privilege were a standard factor used by the government in deciding whether to charge, whom to charge, and the seriousness of the charges."\textsuperscript{61} Because of the high pressure placed on counsel to comply with investigations, the practice seems more like coercion than a feasible, voluntary option.\textsuperscript{62}

2. Is the Government an "Adversary" For Purposes of Waiving the Privilege?

Once a party allows an adversary to share the otherwise privileged thought processes of counsel, the need for the privilege seemingly disappears.\textsuperscript{63} As a general rule, when a court finds that a disclosure of information was \textit{voluntarily} made to an \textit{adversary}, it will be more likely to find that the privilege was waived than if they were

\begin{itemize}
  \item \textsuperscript{56} In re Steinhardt Partners at 235-36 (quoting James B. Cox, \textit{Insider Trading Regulation and the Production of Evidence}, 64 \textit{WASH. U.L.Q.} 421 (1986)).
  \item \textsuperscript{58} In re Steinhardt Partners, 9 F.3d at 236.
  \item \textsuperscript{59} Association of Corporate Counsel, \textit{Executive Summary: Association of Corporate Counsel Survey: Is the Attorney-Client Privilege Under Attack?}, Apr. 6, 2005 [hereinafter ACC Survey].
  \item \textsuperscript{60} Id.
  \item \textsuperscript{61} Id.
  \item \textsuperscript{62} See Francescani & Auturo, supra note 52.
  \item \textsuperscript{63} In re Steinhardt Partners, 9 F.3d at 235.
\end{itemize}
otherwise compelled to turn over the information. This naturally leads to the question of whether the government agency requesting the investigation is considered an adversary for purposes of waiving the privilege. Courts have refused to state categorically that a government agency investigation automatically puts the agency and the corporation in an adversarial position, apparently because there may be situations in which the corporation under investigation and the regulatory agency have a common interest in analyzing the information.

To determine whether a regulator is considered an adversary, courts will look at the degree of commonality of interests between the institution being investigated and the regulatory body. Even in the early stages of a regulatory investigation, "courts have held that disclosures of information to regulatory agencies that do not have common litigation objectives with the corporation constitute a waiver of the privilege." In Steinhardt Partners, the Second Circuit concluded that the SEC was in an adversarial position to Steinhardt when requesting a waiver of privileges during its investigation. Steinhardt voluntarily submitted a memorandum containing legal theories to the SEC while being investigated for possible violations regarding treasury markets. Salomon Brothers subsequently sued Steinhardt, alleging fraud and manipulation in Treasury markets, and requested production of the documents previously turned over to the SEC in the government investigation. The district court ordered Steinhardt to produce the documents to Salomon Brothers and Steinhardt petitioned for a writ of mandamus to set aside the district court's order, arguing that the documents were protected by the work product doctrine. The court

64. Id. (emphasis added).
65. Upjohn v. United States, 449 U.S. at 396. In Upjohn, the Supreme Court expressly stated that "[c]rafting rules relating to privilege in matters of government investigations must be done on a case by case basis." Id.
66. In re Steinhardt Partners, 9 F.3d at 236. For example, in In re Sealed Case, the Second Circuit stated that the work product protection is only waived if the privileged material is disclosed to a party who doesn't share common interests. 676 F.2d 793, 817 (D.D.C. 1982).
67. Francescani and Auturo, supra note 52, at 10.
68. See, e.g., United States v. MIT, 129 F.3d at 687.
69. 9 F.3d 230 (1993).
70. Id. at 236.
71. Id. at 235.
72. Id. at 232.
73. Id. at 232-33.
held that the SEC was an adversary to Steinhardt in the investigation, and that the privilege was therefore waived as to the subsequent litigation, but "decline[d] to adopt a per se rule that all voluntary disclosures to the government waive work product protection."\(^74\)

This portion of the Steinhardt decision suggests that information provided while complying with routine regulatory functions may not place the institution in the requisite "adversarial" position with the regulator to constitute a waiver of the privilege. The court stated that "the determinative fact in analyzing the adversarial nature of the relationship is the fact that Steinhardt knew that it was the subject of an SEC investigation, and that the memorandum was sought as part of this investigation."\(^75\)

In In re Bank One Securities Litigation,\(^76\) the U.S. District Court for the Northern District of Illinois considered whether the work product doctrine\(^77\) was waived by Bank One when Bank One produced documents in response to an OCC examination.\(^78\) Although Bank One was not yet a party to litigation, the court held that the relationship between Bank One and the OCC was adversarial in nature because "[t]he OCC targeted Bank One for an investigation due to questionable practices adopted by Bank One."\(^79\) Considering Bank One\(^80\) and Steinhardt Partners\(^81\) together, it appears that, regardless of whether disclosure occurs during formal enforcement proceedings or an agency's routine examinations, privileged materials will constitute a waiver of the privilege and preclude the bank from claiming the materials are privileged in subsequent litigation.\(^82\)

\(^{74}\) In re Steinhardt Partners, 9 F.3d at 236.

\(^{75}\) Id. at 234.

\(^{76}\) 209 F.R.D. 418 (2002).

\(^{77}\) Id. Though this case involved the work-product doctrine, the case is applicable here because much of the rationale behind waiver of the attorney-client privilege overlaps with the rational applied to the waiver of the work product doctrine. See, e.g., In re Steinhardt Partners, 9 F.3d at 235.

\(^{78}\) In re Bank One, 209 F.R.D. at 420-23.

\(^{79}\) Id. at 424.

\(^{80}\) See supra notes 76-79 and accompanying text.

\(^{81}\) See supra notes 69-75 and accompanying text.

\(^{82}\) See Reed Smith, supra note 54.
3. Selective Waiver

In an attempt to simplify the decision of whether to comply with a regulatory agency's requests for waiver of the attorney-client privilege, some jurisdictions\(^83\) have adopted the concept of selective waiver.\(^84\) Selective waivers allow a corporation to comply with the regulatory investigation and waive the privilege as to that agency, while preserving the privilege for subsequent litigation as against third parties.\(^85\) The doctrine of selective waiver was first recognized in the Eighth Circuit decision in *Diversified Industries v. Meredith*.\(^86\) Federal appellate courts are currently split on the issue of selective waiver.\(^87\) The District of Columbia, Second, Third, Fourth, and Sixth Circuits do not recognize selective waiver.\(^88\) The First, Seventh, and Eighth Circuits have suggested that selective waiver might be available if it is supported by a confidentiality agreement.\(^89\) The Court of Appeals for the Ninth Circuit has left the issue open, but several district courts have declined to follow *Diversified*.\(^90\)

Even though Federal Appellate Courts are split on the existence of selective waiver,\(^91\) the doctrine presents a compelling solution to the waiver issue.\(^92\) The SEC has long been an advocate of creating a

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\(^83\) See infra notes 86-90 and accompanying text.


\(^87\) Burns, *supra* note 85.


\(^89\) Burns, *supra* note 85. In a confidentiality agreement, a corporation will agree to produce privileged information to a regulatory agency, in exchange for a written agreement that the disclosure of the protected materials will be kept from adverse parties "to the extent possible under the law." *In re McKesson*, HBCOC Inc., 2005 WL 934331, *9 (N.D. CA). For an example of a confidentiality agreement see, http://www.abanet.org/buslaw/attorneyclient/materials/022/022.pdf (last visited Oct. 14, 2005).


\(^91\) See *supra* notes 86-90 and accompanying text.

\(^92\) Okrzesik, *supra* note 84 at 119-20. Okrzesik cites J. Boggs' dissent in Columbia/HCA, advocating the use of selective waiver because it will lead to increased
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selective waiver, stating that it would "significantly enhance the Commission's ability to conduct expeditious investigations and obtain prompt relief." Selective waiver, as applied to bank regulators, would have the same effect of clarifying what rights are being waived when cooperating with regulators, without adversely affecting the privilege's goal of encouraging full and frank communications between attorneys and their clients. However, the circuit court split and the fact that the Supreme Court has not yet addressed the issue of selective waiver indicate that other recourses to protecting the privilege from erosion would be better suited for the short term.

IV. FEDERAL FINANCIAL REGULATORY AGENCIES AND THE PRIVILEGE

A. Supervision, Examination, and Enforcement Powers of Bank Regulators

As the Supreme Court noted in 1947, the banking industry has been "one of the longest regulated and most closely supervised of public callings." As a result of the "close and continuous relationship between the regulators and the regulated," a bank regulator typically has free access to all information in a financial institution's possession. The level of access to information that the bank regulator's have is shockingly intrusive compared to traditional requests for information in civil litigation. For example, in response to a request during the course of an OTS investigation that the regulators

information provided to government agencies in investigations and thus "aid the truth-seeking process." Id. (quoting In re Columbia/HCA Healthcare Corp. Billing Practices Litig., 293 F.3d 289, 291, 307 (6th Cir. 2002) (Boggs, J., dissenting)).

93. Id.


95. See supra note 85 and accompanying text.

96. See supra note 17 and accompanying text.

97. See supra notes 86-90 and accompanying text.


100. Susan Beck & Michael Orey, They Got What They Deserved, AM. LAWYER, May 1992 at 68 ("[U]nder bank board rules [the OTS regulators] had the right to go in and look at any and all of [the financial institution's] books and records at any time.").

101. Id.
direct their requests for information to the financial institution’s lawyers rather than the financial institution itself, the director of examinations wrote:

An examination is not civil litigation discovery. . . . Unfettered access, including the ability to appear at [a thrift] without advance notice, is essential to the fulfillment of [the regulators’] function.102

Because of the expectation of free access and full disclosure by the financial institutions, the level of cooperation that the regulators enjoy during the course of an investigation undoubtedly plays a role in the enforcement decisions ultimately made by the regulators.

In terms of enforcement, the bank regulators have congressional authority to use a variety of enforcement powers against banks and thrift institutions, as well as “institution-affiliated” parties.103 There are two types of enforcement actions in general: informal supervisory actions and formal enforcement mechanisms.104 Informal supervisory actions will generally include a regulator’s report that identifies problems within the institution, and serves the purpose of putting the bank’s directors on notice that there is a problem so that they can take corrective measures.105 Formal enforcement orders, on the other hand, include a wide array of actions, ranging from consent orders to civil money penalties of up to $1.25 million dollars per day for being in violation of an order.106

The bank regulator conducting the investigation has the authority to determine if it is necessary to take formal actions against a bank and affiliated parties.107 It is through this exercise of discretion that bank regulators can “reward” the banks and affiliated parties for

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102. Id.
104. BROOME & MARKHAM, supra note 103, at 609.
105. Id.
107. Broome & Markham, supra note 103, at 609.
waiving the privilege and fully disclosing all requested information at the outset of the investigation. The bank regulator has the authority to decide what type of formal enforcement order will be sought and the degree of severity of any such order. For example, a bank could be required to enter into a formal written agreement with the agency to stop an unsound practice. While a breach of the formal written agreement could result in a civil money penalty, the only initial penalty is the agreement itself. On the other hand, the same practice could result in an automatic assessment of a civil money penalty for each day the institution is in violation of a law or regulation.

B. Cooperation with Bank Regulators and Waiver for Third Party Actions

1. Supervision and Examination

When a bank regulator initiates an investigation into a banking institution or corporation, the bank regulator will request information from the institution. Inevitably, some of the requested information would be non-discoverable in litigation because it falls within the realm of the attorney-client privilege. In response to the bank regulators' request, the institution will likely produce the otherwise privileged documents for one of several reasons: (1) the agency promises cooperation credit for disclosure of the protected information; (2) the

108. See supra notes 25-44 and accompanying text.
111. Id.
112. However, if the regulator chose to seek this penalty, the penalty must be approved by an Administrative Law Judge (ALJ). 12 U.S.C. § 1818(i)(2) (2001).
113. ABA Task Force Report, supra note 2, at 13.
114. Id. This is especially problematic if the institution has already completed an internal investigation of the issue itself, either through an internal audit or by hiring an outside entity. See Buchanan, supra note 41, at 604-05. As a result of the internal investigation, it is likely that more privileged information exists and it is likely that the information closely relates to the topic of the investigation. Id. The findings in an internal investigation will likely be the type of information the bank will want to protect the most under the privilege. Id.
115. See Dunst & Sims, supra note 57, at 4. The SEC has recently renewed its focus on investigations in the wake of high profile securities scandals, such as Enron. To facilitate cooperation with investigations, the SEC has been willing to give companies benefits for cooperation, even to the extent of "giving a company a complete pass (despite the corporate
institution wants the investigation to proceed quickly and go away quietly; or (3) the institution fears monetary and prosecutorial repercussions for not disclosing everything up front.\textsuperscript{116}

Typically, voluntary disclosure of otherwise privileged information constitutes a waiver of the privilege for subsequent litigation.\textsuperscript{117} However, courts have varied in their decisions whether the disclosure of otherwise privileged information to regulatory agencies should also serve to waive the privilege.\textsuperscript{118} Whether or not courts determine that the financial institutions have waived the attorney-client privilege regarding voluntarily disclosed information in subsequent third party actions will inevitably impact whether financial institutions continue the practice of full cooperation with bank regulators, both in their supervisory role and during the course of examinations and investigations.

2. Enforcement Actions

Because of the close relationship between the bank regulators and financial institutions and because of the importance of stability for banks and other financial institutions to the economy, regulators have traditionally refrained from using formal enforcement actions,\textsuperscript{119} except in extreme circumstances.\textsuperscript{120} The result of this practice is a striking difference in the formal methods of enforcement used by regulators such as the SEC. Banking regulators typically “use methods of informal supervision, almost always without formal adjudication, even

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\item admission of hundreds of millions of dollars of financial statement irregularities) on the basis of its ‘extensive cooperation with the Commission’s investigation.’” \textit{Id.} (quoting SEC Charges Royal Ahold and Three Former Top Executives With Fraud, SEC Press Release, Oct. 13, 2004).
\item \textsuperscript{116} \textit{Id.} “[T]he SEC has recently assessed massive civil penalties – Worldcom was fined over $2 billion – in part for failure to provide complete or correct information in a timely manner.” \textit{Id.}
\item \textsuperscript{117} \textit{See supra} note 51 and accompanying text.
\item \textsuperscript{118} \textit{See, e.g.,} Diversified Industries v. Meredith, 572 F.2d at 561 (holding that Diversified made only a limited waiver of information when making a disclosure pursuant to an SEC investigation). \textit{But see In re Columbia/HCA Healthcare Corporation Billing Practices Litigation,} 293 F.3d 289 (6th Cir. 2002) (holding that when a corporation gives privileged information to a regulator, the corporation waives the attorney-client privilege, even when made pursuant to a confidentiality agreement).
\item \textsuperscript{119} \textit{See supra} notes 104-106 and accompanying text.
\item \textsuperscript{120} Baxter, \textit{supra} note 99.
\end{itemize}
for the determination of controversies."\textsuperscript{121}

Because of the traditional openness of the relationship between financial institutions and their regulators, whether the regulator chooses a formal or informal enforcement action against a bank may be important in determining whether the agency is then an "adversary" for purposes of litigation.\textsuperscript{122} When an informal enforcement action is taken, the argument that the regulator is not in an adversarial position is stronger because the relationship between the regulator and the financial institution is still cooperative in nature. Formal enforcement actions, however, are arguably more comparable to enforcement actions taken by the SEC, who rarely resort to informal measures of enforcement.\textsuperscript{123} It is interesting to note that, in regards to SEC actions, courts are likely to hold that the regulator and corporation are in an adversarial position, and that the attorney-client privilege has thus been waived with respect to third party actions.\textsuperscript{124} This could indicate a possible division in privilege waivers between formal and informal enforcement actions taken by banking regulators, the former being more likely to be characterized as "adversarial," and thus more likely to result in privilege waivers as to third party actions.

V. THE IMPLICATIONS OF THE EROSION AND LEGISLATIVE SOLUTIONS

A. Implications

As regulatory agencies appear to be eroding the attorney-client privilege through their requests for cooperation in investigations, the real question involves what effect the erosion of the doctrine will have on the banking industry. If the attorney-client privilege is eroded to the extent that institutions disclose all information to regulators automatically, regulators will have to spend much less time and money on investigations.\textsuperscript{125} If regulators are more assured that they are receiving full and complete cooperation with their investigations, this

\begin{itemize}
\item \textsuperscript{121} Id.
\item \textsuperscript{122} See supra notes 63-82 and accompanying text.
\item \textsuperscript{123} Baxter, supra note 99.
\item \textsuperscript{124} See supra notes 68-74 and accompanying text.
\item \textsuperscript{125} See Buchanan, supra note 41, at 605.
\end{itemize}
could lead to more predictability in issuing enforcement actions for wrongdoing.\textsuperscript{126}

Despite these possible beneficial effects of the erosion of the privilege, the negative effects will likely outweigh the positive. First, the erosion of the privilege will likely discourage candor in communications between financial institutions and their attorneys.\textsuperscript{127} In the 2005 survey conducted by the Association of Corporate Counsel, ninety-five percent of respondents stated that if the privilege did not offer protections, they think that “there will be a ‘chill’ in the flow or candor of information from their clients.\textsuperscript{128} Absent this necessary candor between attorney and client, counsel will be ill-equipped to give useful advice and financial institutions’ ability to benefit from their investment in legal services will be impaired.\textsuperscript{129}

Another likely effect of the erosion of the attorney-client privilege is that self-reporting and self-investigating by financial institutions will be deterred.\textsuperscript{130} Because regulatory agencies give credit for complete cooperation with investigations,\textsuperscript{131} there is less incentive for a financial institution to uncover information that they may be required to disclose during a government investigation.\textsuperscript{132} If a questionable practice goes unnoticed by the institution, there is no potentially privileged information to disclose. As the erosion of the privilege becomes more well known, each internal investigation will be done bearing in mind the possibility that the information could become subject to a regulatory investigation in the future.\textsuperscript{133} With this in mind, counsel may try to limit the amount of internal policing and internal reporting by employees.\textsuperscript{134} In addition to the direct effects that the erosion of the privilege could have on financial institutions, there is also the fear that the erosion of the attorney-client privilege with respect to

\textsuperscript{126} See supra notes 107-112 and accompanying text.
\textsuperscript{127} ABA Task Force Report, supra note 2, at 18.
\textsuperscript{128} ACC Survey, supra note 59, at 2.
\textsuperscript{129} ABA Task Force Report, supra note 2, at 18-19.
\textsuperscript{130} McPhee & Welsh, supra note 44, at 25.
\textsuperscript{131} See supra notes 27-44 and accompanying text.
\textsuperscript{132} McPhee & Welsh, supra note 44, at 24.
\textsuperscript{133} Id.
\textsuperscript{134} Id.
organizational clients could lead to the erosion of the privilege in other areas.\footnote{ACC Survey, \textit{supra} note 59, at 8. For example, if the corporate privilege is eroded, "it's a short step to eroding individuals' privileges next." \textit{Id.}}

\section*{B. Legislative Solutions}

Because of the potentially detrimental implications of the erosion of the attorney-client privilege on financial institutions and other corporations and the inconsistency of courts, the solution to the issue may best be left to legislatures. Possible legislative solutions have been suggested by the ABA and the SEC, and are discussed below.

\subsection*{1. The ABA Report}

On May 18, 2005, the ABA Task Force on the Attorney-Client Privilege (ABA Task Force)\footnote{See ABA Task Force Report, \textit{supra} note 2.} issued a report which identified that "the attorney-client confidentiality has come under serious pressure [due to]... requests by prosecutors and government regulators for the production of material protected by the attorney-client privilege."\footnote{\textit{Id.} at 1-2.} Although the Task Force's report focused on investigative requests by the SEC, the report suggests that investigative practices of other federal agencies may be eroding the privilege in a similar fashion.\footnote{\textit{Id.} at 13 (stating that "[i]n recent years, particularly on the federal level, criminal law enforcement authorities and regulatory authorities have adopted policies and employed practices and procedures that suggest that if corporations disclose documents and information that are protected by the corporate attorney-client privilege and work-product doctrine, they will receive credit for cooperation").} The bank regulators serve similar regulatory functions with similar investigation practices as those employed by the SEC and outlined in the Task Force's report. Because these bank regulators have similar investigative functions to that of the SEC, it is likely that any decision on whether disclosure constitutes waiver of the privilege in the context of the SEC would also apply to bank regulators.\footnote{Case law pertaining to SEC examinations has been applied to cases involving the bank regulators. For example, in \textit{In re Bank One Securities Litigation}, the U.S. District Court for the Northern District of Illinois relied on SEC cases including \textit{Westinghouse} and \textit{Salomon Brothers Treasury Litigation v. Steinhardt Partners}, in concluding that Bank One and the OCC were "adversaries" for purposes of waiving the work-product protection. \textit{In re}}
Financial institutions are required to share an increasing amount of information with bank regulators, due to strict reporting requirements and the increased voracity in investigations. The disclosure scenario in regards to the bank regulators differs from that of the SEC scenario because the bank regulators have different objectives. Whereas the SEC's primary mission is to "protect investors," the bank regulators' objective is to ensure the safety and soundness of the financial institutions themselves. Because the bank regulators seek to assure the safety and soundness of the financial institution, it is unlikely that they would take measures that could ruin a financial institution's business. Further, because the bank regulators seek to ensure the safety and soundness of the financial institution, the regulators have a continued presence on-site at many large banks. For example, the OCC has twenty-four "large bank resident examiner teams," who work full time on-site at each of the nation's largest national banks. Because of the continued presence of the regulators, whether or not disclosure of privileged information waives the privilege is clearly important for financial institutions, as their daily activities could potentially disclose information to on-site regulators, that might be privileged but for the disclosure.


140. Testimony of Mr. Steve Bartlett on Behalf of the Financial Services Roundtable to the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 21, 2005.


142. See About the OCC, http://www.occ.gov/aboutocc.htm (last visited Oct. 13, 2005); see also Mission Statement of the OTS, http://www.ots.treas.gov/mission.cfm?cat Number=39 (last visited Oct. 13, 2005). In recent years, the bank regulators have shifted the focus of their examinations, placing emphasis on an institution's internal control systems and on the way it manages and controls its risks, rather than investigating whether a bank was operating in a safe and sound manner at a specific point in time. UNITED STATES GENERAL ACCOUNTING OFFICE REPORT TO CONGRESSIONAL REQUESTORS, Risk-Focused Bank Examinations: Regulators of Large Banking Organizations Face Challenges, at 2, Jan. 2000.

143. See supra note 142 and accompanying text.

144. See supra note 142 and accompanying text.


146. Id.

147. United States General Accounting Office Report to Congressional Requestors, Risk-Focused Bank Examinations: Regulators of Large Banking Organizations Face Challenges, at 4, Jan. 2000. In addition to these on-site examiners, the OCC designates the nation's largest banks, defined as having over $25 billion in assets, between one and three deputy comptrollers located in their Washington D.C. headquarters. Id. at 16.
The bank regulators recognize that the production of attorney-client privileged documents during the course of an examination may result in a waiver of the privilege. The OCC Rules of Practice and Procedure expressly state that the agency is not entitled to discover privileged materials. The bank regulators have recognized this provision as a limitation on the open exchange of information needed to carry out successful examinations and have attempted to mitigate the effects of the potential waiver. For example, the OCC states that "[we are] of the view that a bank that discloses privileged information to an examiner during an examination does not waive its privileges" and encourages its examiners to take steps to safeguard a bank’s privileged materials during the investigation. Similarly, the FRB’s investigation policy is to protect materials obtained during the course of an investigation or examination from disclosure to third parties “to the greatest extent possible consistent with applicable law and the public interest.” Despite these declarations by the bank regulators, it is not clear, if the bank regulators’ position on whether disclosure to their agents constitutes a waiver is determinative of whether the privilege will actually be deemed waived by a court.

The ABA Task Force Report suggests the adoption of federal legislation that would permit institutions to provide privileged information to regulators in connection with an investigation without waiving the privilege as to third parties. Such legislation would provide regulators with ability to protect certain information from losing its privileged status in subsequent litigation and could prove to be a useful tool in balancing the need to preserve the privilege with the need for timely and complete disclosure in regulatory investigations.

149. 12 C.F.R. § 19.24(c) (2005). “Privileged documents are not discoverable. Privileges include the attorney-client privilege, work-product privilege, any government’s or government agency’s deliberative process privilege, and any other privileges the Constitution, any applicable act of Congress, or the principles of common law provide.” Id.
150. Reed Smith, supra note 54.
151. See OCC COMPTROLLER’S HANDBOOK, supra note 148, at 8.
153. ABA Task Force Report, supra note 2, at 25.
154. Id.
The SEC has made recommendations similar to the ABA's proposed legislation. In an SEC report made pursuant to the Sarbanes-Oxley Act of 2002, the SEC recommended enactment of legislation "to allow companies to produce internal reports and other documents pertaining to investigations without waiving any privileges." The SEC's recommendation for legislation may indicate recognition that regulators do not have the authority to determine whether disclosure of privileged information will cause privileges to be waived. That courts have held disclosure to the OCC renders the privilege waived in subsequent litigation further indicates that regulators do not have the authority to preserve the privilege.

2. Proposed Changes to Federal Sentencing Guidelines

On November 1, 2004, amendments to the federal sentencing guidelines that relate to corporations and financial institutions went into effect. Of particular importance in these new guidelines was a change in the commentary to section 8C2.5 of the guidelines, which suggested that waiver of the attorney-client privilege is a necessary element of full cooperation in some investigations. Prior to the 2004 amendments, the Sentencing Guidelines commentary was silent on the issue of privilege waiver. Robert Evans, Director of the ABA Governmental Affairs Division, stated that the amended commentary

157. See infra notes 76-79 and accompanying text.
158. Bruce A. Green & David C. Clifton, Feeling A Chill, Changing Government Policies are Pressing Corporations and Attorneys to Disclose Protected Information, ABA JOURNAL 61, 63 (Dec. 2005).
159. Notice of Submission to Congress of Amendments to the Sentencing Guidelines, 69 Fed. Reg. 28994 (May 19, 2004). The commentary states that "waiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score [for cooperation with the government]....unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization." However, the ABA believes that this "exception is likely to swallow the rule" and that organizations will be forced to grant routine requests for waivers. Letter of Robert D. Evans, Director of ABA Governmental Affairs to the U.S. Sentencing Commission, Aug. 15, 2005 at 3.
160. Evans, supra note 159.
authorizes and encourages the government to require entities to waive their attorney-client protections in order to show 'thorough' cooperation with the government and thereby qualify for a reduction in the culpability score – and a more lenient sentence – under the sentencing guidelines.\textsuperscript{161}

The ABA has taken the position that the amended commentary has led to forced privilege waivers. Because of this, the ABA proposed an amendment to section 8C2.5, which would “clarify that the waiver of the attorney-client privilege... should not be a factor in determining whether a sentencing reduction under the guidelines is warranted for cooperation with the government.”\textsuperscript{162} The sentencing commission has included the privilege waiver amendment on its list of issues to be considered in the 2005-2006 amendment cycle,\textsuperscript{163} but the effect, if any, that the ABA recommendations will have is not clear. However, the proposed ABA amendment has garnered the support of numerous other groups, including the U.S. Chamber of Commerce, the American Civil Liberties Union, and the National Association of Criminal Defense Attorneys.\textsuperscript{164}

\textsuperscript{161} \textit{Id.}

\textsuperscript{162} \textit{Id.} The proposed change in the commentary would read as follows: To qualify for a reduction under subsection (g)(1) or (g)(2), cooperation must be both timely and thorough. To be timely, the cooperation must begin essentially at the same time as the organization is officially notified of a criminal investigation. To be thorough, the cooperation should include the disclosure of all pertinent non-privileged information known by the organization. A prime test of whether the organization has disclosed all pertinent non-privileged information is whether the information is sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible for the criminal conduct. ... Waiver of attorney-client privilege and of work product protections is not a factor in determining whether a reduction in culpability score under subdivisions (1) and (2) of subsection (g) is warranted.

\textsuperscript{163} \textit{Id.}

\textsuperscript{164} \textit{Id.}

\textsuperscript{161} Id.
\textsuperscript{162} Id. The proposed change in the commentary would read as follows: To qualify for a reduction under subsection (g)(1) or (g)(2), cooperation must be both timely and thorough. To be timely, the cooperation must begin essentially at the same time as the organization is officially notified of a criminal investigation. To be thorough, the cooperation should include the disclosure of all pertinent non-privileged information known by the organization. A prime test of whether the organization has disclosed all pertinent non-privileged information is whether the information is sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible for the criminal conduct. ... Waiver of attorney-client privilege and of work product protections is not a factor in determining whether a reduction in culpability score under subdivisions (1) and (2) of subsection (g) is warranted.

\textsuperscript{163} Green & Clifton, \textit{supra} note 158.

\textsuperscript{164} Id.
VII. Conclusion

The attorney-client privilege is being eroded in the context of federal financial regulators through their requests for cooperation in investigation. In general, the privilege is only waived when the information is voluntarily disclosed to adversaries. Though the regulatory agency is arguably not an "adversary" and the disclosure of information may not be "voluntary," the trend is for courts to deem the privilege waived as to subsequent litigation and third parties. As privilege waivers have become increasingly prevalent, the attorney-client privilege has become eroded in the regulatory context. The idea of selective waiver of information disclosed during the course of regulatory investigations is a compelling deterrent to the erosion of the privilege, but circuit courts are divided on whether selective waiver is allowed. Therefore, as the ABA and the SEC have suggested, the best solution to the erosion of the privilege may be found in legislative action. Though it is not clear what overall affect this will have on the banking industry, it is clear that the erosion of the privilege could dramatically impact the cooperative relationship financial institutions currently enjoy with the bank regulators.

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165. See supra notes 51-82 and accompanying text.
166. Id.
167. See supra notes 27-82 and accompanying text.
168. See supra notes 83-97 and accompanying text.
169. See supra notes 136-157 and accompanying text.