Document ID#: 547200610071

AMERICAN BAR ASSOCIATION -- SECTION OF TAXATION

2006 Joint Fall CLE Meeting

TITLE: Attorney-Client and Constitutional Privileges

AUTHOR: Williams, Bradley L.

PANEL: Reports of Subcommittees: Attorney-Client and Constitutional Privileges

DATE: 10/21/06 8:35a

COMMITTEE: Civil and Criminal Tax Penalties

ATTORNEY-CLIENT AND CONSTITUTIONAL PRIVILEGES

ABA Section of Taxation
Committee on Civil and Criminal Tax Penalties
2006 Fall Meeting
Denver, Colorado
October 21, 2006

Bradley L. Williams
ICE MILLER LLP
One American Square, 31st Floor
Indianapolis, IN 46282-0200
(317) 236-2454
bradley.williams@icemiller.com

October 21, 2006

Attorney-Client and Constitutional Privileges

Coerced Waiver

S.D.N.Y. STRIKES DOWN "THOMPSON MEMORANDUM" SANCTIONS AGAINST CORPORATE PAYMENT OF EMPLOYEE LEGAL EXPENSES

United States v. Stein, 440 F.Supp.2d 315 (S.D.N.Y. July 25, 2006)

Judge Kaplan issued this long-awaited opinion on July 25.

Recall that on January 20, 2003, Deputy Attorney General Larry D. Thompson issued a memorandum entitled *Principles of Federal Prosecution of Business Organizations* (available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm). The memorandum sets out factors that DOJ attorneys are to take into account in determining whether, and how vigorously, to pursue criminal charges against organizational defendants.

The Thompson Memorandum has generated controversy on a number of fronts, such as the debate over whether a different portion of the memorandum effectively requires waiver of the organization's attorney-client privilege in order for the organization to demonstrate cooperation with authorities.

The portion at issue in *Stein* was this "general principle" set out in Section VI:

> In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation may be relevant factors.

Employers often indemnify attorney fees for employees involved in a criminal investigation, a practice permitted by many bylaws and regulated by state law. Section VI, paragraph B, of the Thompson Memorandum states (emphasis supplied):

> [A] corporation's promise of support to culpable employees and agents, *either through the advancing of attorneys fees*, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.

Those familiar with the case know that KPMG was for some time under federal criminal investigation arising out of the accuracy of certain financial statements. Knowing that an indictment of the organization would be a fatal blow, KPMG attorneys met with DOJ attorneys on February 25, 2004.

According to the opinion, the DOJ attorneys at the meeting "forcefully" pointed out Section VI(b). Not long after the meeting, KPMG implemented a policy which, among other things, conditioned payment for employee legal fees on that employee's "cooperating fully with the company and with the government." KPMG subsequently sent letters to individual targets stating that indemnification for attorney fees would be

on condition that the individual "cooperate with the government and . . . be prompt, complete and truthful." Certain of the individuals later entered into proffer agreements with the government, and made statements. KPMG cut off attorney fee payments after other individuals failed to complete proffers.

Certain individuals who made proffers were indicted. These defendants moved to suppress their proffer statements. They argued that the government, by pressuring KPMG to condition attorney fees on individual cooperation, effectively coerced their proffer statements in violation of the Fifth Amendment privilege against self-incrimination.

Judge Kaplan held that (1) the government "quite deliberately precipitated KPMG's use of economic threats to coerce the proffer statements in question", and (2) although KPMG was a private actor, its actions were coerced by the government, and thus its actions were attributable to the government. Judge Kaplan ordered the suppression of two individuals' proffer statements.

Several individual defendants sought, through a separate civil complaint, to compel KPMG to continue to advance legal fees. On September 6, Judge Kaplan issued a ruling denying KPMG's motion to dismiss the ancillary action, and setting the civil case for expedited trial on October 17. The opinion may be found at 2006 WL 2556076.

Waiver

ANOTHER CIRCUIT COURT OF APPEALS REJECTS "SELECTIVE WAIVER"

In re Qwest Communications International, Inc., 450 F.3d 1179 (10th Cir. June 19, 2006)

Qwest, under SEC and DOJ civil and criminal investigation, produced over 220,000 pages of documents protected by the attorney-client privilege and/or work product doctrine. Qwest and the agencies entered into confidentiality agreements which stated that Qwest did not waive the attorney-client privilege or work product protection.

The SEC agreed to maintain the confidentiality of the documents and not disclose them to a third party, unless disclosure was required by law or would further the SEC's "discharge of its duties and responsibilities." Qwest agreed that DOJ could share the documents with other state, federal or local agencies, and that it could make direct or derivative use of the documents. Qwest further agreed that DOJ could make use of the documents "in any lawful manner in furtherance of its investigation," including grand jury proceedings, court proceedings, consultation with other agencies, and consultation with experts.

Various private civil suits were filed against Qwest and consolidated in the United States District Court for the District of Colorado. Qwest refused to produce the 220,000 pages of documents previously turned over. The district court granted the plaintiffs' motion to compel, and Qwest sought mandamus in the Tenth Circuit.

The circuit panel held that mandamus was an appropriate remedy to test the validity of the discovery order. On the merits, the panel joined the majority of circuits, holding that disclosure of the documents to the agencies operated as a waiver of the attorney-client privilege and work product protection as to demands from subsequent private civil plaintiffs. Qwest could not selectively waive the privilege as to one adversary.

The panel specifically rejected Qwest's claim that selective waiver was necessary to encourage cooperation with government investigation. The panel also held that the confidentiality agreements, which allowed the agencies wide latitude to use the documents, were ineffectual in preserving Qwest's privilege claim.

Finally, the panel declined to recognize a new privilege for materials surrendered in a government investigation. "Whether a rule-making or legislative venue is appropriate to address the[se] issues . . . is a question for the Standing [Rules] Committee [of the Judicial Conference of the United States] and for Congress."

Which brings us to . . .

Federal Rules of Evidence

PROPOSED FEDERAL EVIDENCE RULE WOULD RECOGNIZE "SELECTIVE WAIVER" DOCTRINE

The Advisory Committee on Evidence Rules of the Judicial Conference has drafted an amendment to Fed. R. Evid. 502 that would, if adopted, change the result in *Qwest* and many other decisions which refuse to recognize selective waiver. Proposed Rule 502(c) would provide:

> In a federal or state proceeding, a disclosure of a communication or information covered by the attorney-client privilege or work product protection – when made to a federal public office or agency in the exercise of its regulatory, investigative, or enforcement authority – does not operate as a waiver of the privilege or protection in favor of non-governmental persons or entities. The effect of disclosure to a state or local government agency, with respect to non-governmental persons or entities, is governed by the applicable state law. Nothing in this rule limits or expands the authority of a government agency to disclose communications or information to other government agencies or as otherwise authorized or required by law.

This provision, along with several others, was published for comment in August. The comment period expires February 15, 2007. For more information see http://www.uscourts.gov/rules/newrules1.html.

Grand Jury Subpoenas

TARGET OF INVESTIGATION MAY CONDUCT PRIVILEGE REVIEW OF DOCUMENTS SUBPOENAED FROM THIRD PARTY

In Re Grand Jury Subpoenas 04-124-03 and 04-124-05, 454 F.3d 511 (6th Cir. July 12, 2006)

After a corporate bankruptcy filing, new post-filing management filed suit against the former owner for fraudulent conveyances. A federal grand jury subpoenaed documents from the company, and the former owner sought to intervene and assert personal privilege claims.

The district court allowed intervention but denied the former owner's request to review the subpoenaed documents for privileged material. The government proposed to assemble a "taint team" of government personnel not part of the investigation to conduct the privilege review, and the district court agreed with the procedure.

The appellate panel reversed. Grand juries may not use their investigative authority to violate a valid privilege. The panel held that a government-staffed "taint team" was not sufficiently removed from the attorneys conducting the investigation to preserve a valid privilege. The principle of grand jury secrecy did not require a preference for a government-only privilege review, since the documents in question were prepared in the ordinary course of business and would not themselves disclose matters occurring before the grand jury.

Act of Production Immunity

ACT OF PRODUCTION IMMUNITY PROTECTS AGAINST FUTURE USE OF *CONTENTS* OF SUBPOENAED DOCUMENTS

United States v. Ponds, 454 F.3d 313 (D.C. Cir. July 14, 2006)

Ponds, a criminal defense lawyer, represented a drug dealer named Harris. As a retainer, Harris' mother gave Ponds a 1991 Mercedes Benz which Ponds titled in his sister's name.

Harris eventually pled guilty. At the plea hearing, the court asked about the whereabouts of the Mercedes for forfeiture purposes, but Harris failed to mention that he had the car.

The government commenced an investigation of Ponds for obstruction of justice, contempt of court, and money laundering. After locating the Mercedes in Ponds' apartment complex, the government subpoenaed Ponds to produce the car and for several categories of documents pertaining to it. Ponds expressed his intent to assert his Fifth Amendment privilege against self-incrimination, and an AUSA sought and obtained an act-of-production immunity order under 18 U.S.C. § 6002.

The records demonstrated, among other things, that the Mercedes was registered to Ponds' sister, that Ponds had financial accounts and numerous financial transactions with his sister, and that Ponds used money orders to pay for service on the Mercedes.

Soon thereafter, the AUSA filed an ex parte application to authorize the IRS to disclose Ponds' 1996 and 1997 tax returns. The application was granted, and the IRS reported that Ponds had not filed returns for those years. Eventually the government, using information from the produced documents, obtained and executed a search warrant on Ponds' home and office, which yielded more records. Ponds was indicted and convicted on various charges including tax evasion under Code §7201. The district court denied a *Kastigar*-based motion do dismiss.

The D.C. Circuit panel reversed the convictions. Relying on *United States v. Hubbell*, 530 U.S. 27 (2000), the panel held that the production of the documents pertaining to the Mercedes were sufficiently testimonial to implicate Pond's

Fifth Amendment rights. The immunity order barred the government from making use of the contents of the documents produced, because the information in them came from Ponds' production, not from a source wholly independent from his compelled production.

Section 6002 broadly prohibits direct or indirect use of compelled testimony. *Hubbell* itself drew a distinction between the existence, location and authenticity of documents and the unprotected contents of the documents. But the panel held this distinction was only relevant in determining whether an act of production implicated the Fifth Amendment. The *Kastigar* inquiry, whether the contents of the documents are "derived from a legitimate source wholly independent of the compelled testimony", stood on different footing.

Under section 6002, Ponds' immunity for the act of producing the documents extended to any information "directly or indirectly derived" from the testimonial act of production. The government had no independent knowledge of most of the contents of the documents, but it was the contents which led to the further investigative steps. So section 6002 protected the contents from use in the search warrant application.

The panel reversed and remanded for additional findings. To prevail, the government must establish (emphasis in original) "beyond a reasonable doubt that the tax evasion case *would* have been vigorously pursued, and the search warrant sought and obtained, had the government not relied on the documents revealed by Ponds' act of production."

This decision would appear to bar *any* subsequent use of documents produced under a section 6002 act of production immunity grant. Query whether the scope of section 6002 is still coextensive with the Fifth Amendment.

Work Product Doctrine

CPA-CONSULTANT'S POST-TRANSACTION ADVICE MEMORANDUM HELD PROTECTED WORK PRODUCT

United States v. Roxworthy, 457 F.3d 590 (6th Cir. Aug. 10, 2006)

The IRS summonsed the corporate taxpayer to produce two memoranda prepared by KPMG concerning the likely federal tax consequences of a completed transaction. The district court rejected the corporate taxpayer's work product claim and enforced the summons.

Reversed. (1) A document is prepared "in anticipation of litigation" if it is prepared "because of the prospect of litigation." (2) A party asserting work product must demonstrate that it had a subjective anticipation of litigation which was objectively reasonable. (3) The fact that the company waited until after the transactions were complete to seek advice supported its claim that it anticipated litigation. (4) A document prepared both in the ordinary course of business, and in anticipation of litigation, may still be protected work product. (5) Regardless whether anticipation of an audit was equivalent to anticipation of litigation, the company reasonably anticipated litigation in this case. An annual IRS audit was a certainty due to the company's size, the transaction at issue was large, and the IRS had previously targeted similar transactions.