

**ATTORNEY-CLIENT PRIVILEGE CONSIDERATIONS  
IN THE CONTEXT OF DEBTOR WRONGDOING**

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**I. Purpose and Scope of the Attorney-Client Privilege**

**A. Purpose**

The purpose of the attorney-client privilege is to protect not only providing professional advice to those who can act upon it, but also providing information to the lawyer to ensure sound and informed advice. Upjohn Co. v. United States, 449 U.S. 383, 391 (1981). The privilege encourages clients to be completely truthful with their attorneys, to enable their cases to be honestly and effectively defended, and "to promote broader public interest in the observance of law and [the] administration of justice." Upjohn, 449 U.S. at 393 (1981).

**B. Scope**

The attorney-client privilege protects only the contents of the communication itself. If the information can be obtained from a source other than the privileged communication, then disclosure is not protected from discovery. United States v. O'Malley, 786 F.2d 786, 794 (7th Cir. 1986) ("the privilege attaches not to the information but to the communication of the information").

**II. Ownership and Control of the Privilege**

**A. Who Controls the Privilege?**

Outside of bankruptcy, the client is the sole holder of the attorney-client privilege. See In re Bame, 251 B.R. 367, 372 (Bankr. D.Minn. 2000). However, "under the Bankruptcy Code the privilege as a rule of evidence may be invoked or waived by the person owning the related causes of action," thus the DIP or Trustee may invoke or waive the privilege. See Whyte v. Williams, 152 B.R. 123, 125 (Bankr. N.D. Tex. 1992).

**B. Control of the Privilege in a Chapter 7 Case**

When a corporation files for chapter 7, the chapter 7 trustee obtains control over the debtor corporation's attorney-client privilege with respect to pre-bankruptcy communications. Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343 (1985). Because a corporation's management controls the attorney-client privilege outside of bankruptcy, in

bankruptcy, the actor whose duties most closely resemble those of management - the trustee - should control the privilege. Id. at 351-52.

### **C. Control of the Privilege by a Chapter 11 DIP**

The same result in Weintraub would be reached in a chapter 11 case, because if the corporation files a petition for relief under chapter 11 of the Code, control of the corporation passes from the corporation as a "debtor" to the corporation as a "debtor in possession" in the absence of appointment of a trustee. See Whyte, 152 B.R. at 127. The debtor in possession is a fiduciary of the bankruptcy estate. See id. at 127-28. Prior to a bankruptcy filing, management's fiduciary duty is to the corporation's shareholders, but with a debtor-in-possession that fiduciary duty may run to the creditors as well as shareholders. See id. Although management of the corporation in a chapter 11 case remains in control of the debtor-in-possession, it must exercise control of the corporation's evidentiary privileges consistent with its fiduciary obligation to the entire bankruptcy estate. See id. Consequently, the debtor-in-possession as a fiduciary of the bankruptcy estate obtains control of the debtor's pre-petition evidentiary privileges. See id. By the same token, if a chapter 11 trustee is appointed, the debtor of course ceases to be a debtor-in-possession and control of the debtor's pre-petition attorney/client privilege passes to the chapter 11 trustee. See id. Otherwise, a chapter 11 corporate debtor-in-possession controls the attorney-client privilege with respect to both its pre- and post-petition communications with its counsel, and can thus effectuate the turnover of documents from counsel. See American Metrocomm Corp. v. Duane Morris & Heckscher, LLP, 274 B.R. 641 (Bankr. D. Del. 2002).

## **III. Debtor Wrongdoing and the Attorney-Client Privilege – When Counsel Gets Blamed**

### **A. Similarities Among "Mega-Case" Bankruptcies**

One theme that has emerged in the Enron Corp. chapter 11 case is the claim by Enron's management that they relied on the advice of their professional advisors. In his testimony before Congress, Jeffrey Skilling stated that he relied on Andersen's advice.<sup>1</sup> Herbert Winokur, an Enron board member, has similarly stated, "The outside experts at Arthur Andersen and at Vinson & Elkins failed us."<sup>2</sup>

Given the similarities of these recent "mega-cases", in terms of the widespread use of questionable business and accounting practices, it is understandable why management (or former management) of mega-case debtors such as Enron, WorldCom, and Adelphia will attempt to assign blame for their companies' downfalls on the "advice of counsel" they received, especially as these executives and former executives increasingly become targets of shareholder and other lawsuits.

### **B. "Advice of Counsel" Defense**

#### **1. General rule**

The general rule is that a party cannot affirmatively assert reliance upon "advice of counsel" as the basis of a defense of a claim in a proceeding with a third party

<sup>1</sup> Available at [http://money.cnn.com/2002/02/26/news/enron\\_hearing](http://money.cnn.com/2002/02/26/news/enron_hearing).

<sup>2</sup> Available at <http://www.usatoday.com/money/energy/enron/2002-02-08-hearings.htm>.

without waiving all privileged communications on that issue. See, e.g., In re Gaming Lottery Sec. Litig., 2000 U.S. Dist. LEXIS 3931 (S.D.N.Y. 2000); United States v. Workman, 138 F.3d 1261, 1264 (8th Cir. 1997).

A client may not testify as to some portion of a communication with his attorney or disclose an attorney's opinion on a given issue, and then refuse to permit full disclosure as to the entire communication on that particular issue. A waiver will be deemed to have occurred. See id. Furthermore, when an advice of counsel claim is raised, the reasonableness of the reliance on that advice may become a means of challenging the defense of "advice of counsel." See id. Not only does the entirety of the attorney's advice on the same subject matter become discoverable, but any corollary advice given by others on the same issue also becomes discoverable. See id.

**2.**

## Application to Enron and Other Cases

In reviewing Enron and other similar cases, testimony given by Jeffrey Skilling might constitute a waiver of the attorney-client privilege as to all advice given to Enron regarding certain transactions by its counsel. Thus, regardless of whether the attorney-client privilege has been affirmatively waived by the debtor corporation, either as a debtor-in-possession or by the trustee, as in Weintraub, the communications by counsel (and other non-attorney advisors) may not be protected.<sup>3</sup> However, the privilege is not necessarily waived when a deponent answers questions put to him by responding that he acted on advice of counsel, if that advice itself is not an element of the claim or defense on a subject matter at issue. See Libbey Glass, Inc. v. Oneida, Ltd., 1999 U.S. Dist. LEXIS 4558 (N.D. Ohio 1999) (A reference to the fact that the client relied on advice of counsel in a deposition is not sufficient to waive the privilege where none of the substance of that advice is revealed and where it will not be used as a defense.)

As previously stated, this may provide an incentive for creditors to always push for appointment of a chapter 11 trustee to increase chances that the attorney-client privilege will be waived, potentially opening up new causes of action.

### C.

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<sup>3</sup> **In re Gaming Lottery Sec. Litig., 2000 U.S. Dist. LEXIS 3931 (S.D.N.Y. 2000).**

In a class-action securities fraud suit, the defendant managers of Gaming Lottery Corp. attempted to raise the "advice of counsel" defense with respect to advice they claimed to have received from their attorney regarding the legitimacy of a corporate asset-purchase and operating agreement transaction. In attempting to show that their reliance on counsel's advice negated their alleged intent to defraud, the court held that

Since the defendants claim they were relying on [the] advice [of] their attorney, the legal advice they received from any other lawyers on that subject relates to the reasonableness of defendants' reliance and is not subject to the attorney/client privilege....Any relevant advice the defendants received from their own lawyers or other persons, including any advice with respect to the advisability of going ahead with the proposed [transaction]...bears on the issue of their reasonable reliance. Under the conditions here, the defendants, by testifying to reliance on [counsel], have waived the privilege with respect to anyone else that bear on their state of mind in proceeding [with the transaction].

In re Gaming Lottery Sec. Litig., 2000 U.S. Dist. LEXIS 3931, at \*7-8.

**Nguyen v. Excel Corp., 197 F.3d 200 (5th Cir. 1999).**

In Nguyen, Corporate executives claimed during depositions that they relied on advice of counsel to substantiate their good faith defense to a violation of federal law. The court held that the privilege was deemed waived and the defendant corporation's attorneys could be deposed on what advice they had given the client.

## **Crime-Fraud Exception**

Attorney-client communications may be excepted from the privilege under the crime-fraud exception. A client cannot seek legal advice on how to accomplish or perpetuate an ongoing or future fraud or continue to cover up a past one.

### **1. Test**

The Eleventh Circuit has established a widely-followed two-pronged test to determine whether legal advice was sought in furtherance of the commission of an ongoing fraud or crime. In re Grand Jury Investigation (Schroeder), 842 F.2d 1223, 1226 (11th Cir. 1988).

a. The first prong is that there must be a prima facie showing that the client was engaged in criminal or fraudulent conduct when he sought the advice of counsel, that he was planning such conduct when he sought the advice of counsel, or that he committed a crime or fraud subsequent to receiving the benefit of counsel's advice.

b. The second prong requires a showing that the attorney's assistance was obtained in furtherance of the criminal or fraudulent activity or was closely related to it.

### **2. Attorney Knowledge or Intent**

An attorney is not required to have intent, or even knowledge, of the client's crime or fraud.

a. "[F]or the crime-fraud exception to apply, the attorney need not himself be aware of the illegality involved; it is enough that the communication furthered, or was intended by the client to further, that illegality." In re Grand Jury Proceedings, 87 F.3d 377, 381-82 (9th Cir. 1996), cert. denied sub nom., Corporation v. U.S., 519 U.S. 945 (1996).

b. "[I]nasmuch as today's attorney-client privilege exists for the benefit of the client, not the attorney, it is the client's knowledge and intentions that are of paramount concern to the application of the crime-fraud exception; the attorney need know nothing about the client's ongoing or planned illicit activity for the exception to apply. It is therefore, irrelevant, that [an attorney] may have been in the dark about the details of that activity." Id.

### **3. Practical Application**

Attorneys need to be aware that the communications between them and their clients may be excepted from the attorney-client privilege if the advice given by them was used, even without their knowledge, to accomplish the types of accounting frauds now surfacing in case such as Enron, Adelphia and WorldCom.

## **D.**

## **The Common-Interest, Or Joint Defense, Privilege**

### **1. Overview and Rationale of the Common-Interest Privilege**

Parties involved in multi-party litigation and represented by separate counsel often need to communicate with one another and exchange information, for purposes such as coordinating joint strategies of defense or prosecution, enhancing the settlement posture of a case, and pooling litigation resources. The common-interest privilege serves as an exception to the general rule that the attorney-client privilege is waived when confidential information is disclosed to a third party. The rationale for the privilege is to encourage cooperation among the parties with common legal interests who might be reluctant to exchange information beneficial to their common cause for fear that they might waive their privileges.<sup>4</sup> See *Lasalle Bank Nat'l Ass'n v. Lehman Bros. Holdings, Inc.*, 209 F.R.D. 112, 116 (D. Md. 2002).

### **2. What the Privilege Protects**

The common-interest privilege protects exchanges of information among parties who share such common legal interests in pending or threatened litigation, and in some cases, non-litigation circumstances, even though the parties are represented by separate counsel. See *id.*

### **3. Basis of the Common-Interest Privilege**

#### **a. Federal Basis**

Under Federal Rule of Evidence 501, the ability of a party to claim the common-interest privilege will depend upon the law of the particular state which supplies the decisional law. Federal Rule of Evidence 501 provides in relevant part:

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

#### **b. Texas Basis**

Texas has adopted a rule that expressly recognizes the common-interest privilege as part of the attorney-client privilege, which provides that:

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<sup>4</sup> Michael L. Knapek & Scott A. Wheatley, *Clients in Crisis in the Multiparty Context: The Common Interest Privilege*, Texas State Bar Continuing Legal Education Conference, San Antonio, Texas (August 1-2, 2002) (on file with author).

A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client: . . . (C) by the client or a representative of the client, or the client's lawyer or a representative of the lawyer, to a lawyer or a representative of a lawyer representing another party in a pending action and concerning a matter of common interest therein.

Texas Rule of Evidence 503(b)(1)(c) (March 1, 1998); see Rio Hondo Implement Co. v. Euresti, 903 S.W.2d 128, 131 (Tex.Ct.App.—Corpus Christi 1995, writ denied).

#### **4. Allowable Parties to Communications**

Use of the common interest privilege typically occurs most often when attorneys representing clients exchange information to be used in the joint defense or prosecution of an action. See Lasalle Bank Nat'l Ass'n, 209 F.R.D. at 116; Travelers Cas. & Sur. Co. v. Excess Ins. Co., 197 F.R.D. 601, 607 (S.D. Ohio 2000). The privilege also encompasses statements made by a party directly to counsel for another party with common interests. See Id. However, the common-interest privilege does not apply to communications between the client of one attorney and the client of another attorney. See, e.g., Tex. R. Evid. 503.

#### **5. Waiver of the Common-Interest Privilege**

A party to the communications may waive the privilege by disclosing the confidential information to persons outside the scope of the common-interest relationship. However, one protection afforded to parties to a common-interest arrangement is that waiver of the common-interest privilege requires the consent of all and may not be unilaterally waived. See John Morrell & Co. v. Local Union 304a, 913 F.2d 544, 556 (8th Cir. 1990); In re Grand Jury (00-2H), 211 F. Supp. 2d 555, 559 (M.D. Penn. 2001); In re Megan-Racine Assocs., Inc., 192 B.R. 321, 324 (Bankr. N.D.N.Y. 1995).

### **IV. Sarbanes-Oxley Act of 2002 and Its Effect on the Attorney-Client Privilege**

#### **A. Relevant Provisions**

Section 307 of the Sarbanes-Oxley Act imposes an obligation upon attorneys to report evidence of material violations of securities laws or breaches of fiduciary duty. The SEC is required to issue rules setting forth minimum standards of professional conduct for attorneys appearing and practicing in any way before the SEC in the representation of issuers.

Specifically, the SEC must adopt rules:

1. "(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof)"; and
2. "(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the

evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors."

## **B. Implications**

The statute as drafted seemingly requires attorneys to disclose evidence of federal crimes and also state law violations of fiduciary duty. The language of the Act leaves open a number of complex issues:

1. What is specifically covered by the terms "evidence," "material violation" and "similar violation"?
2. Does this provision require the disclosure of information that could lead to a violation of the securities laws?
3. How the provision affects the attorney-client privilege under the various state codes of legal ethics?
4. Where is the line drawn between merely aggressive accounting and fraudulent behavior such that counsel is put in a compromising situation with respect to the attorney-client privilege?

Furthermore, these reforms arguably subvert the purpose of the attorney-client privilege by:

1. Placing counsel in a whistleblower position – may breed mistrust;
2. Imposing inherently subjective standards for reportable offenses – where to draw the line?;
3. Creating a regulatory environment where over-zealous counsel risk alienating management, while less-stringent interpretation of the rules risks violating the law;
4. Possibly encouraging companies in general to become risk averse, thus slowing business innovation and growth (and the economy).

## **V. Conclusion**

It is readily apparent that the unique characteristics of the seemingly ever-increasing mega-cases have a significant systemic impact upon the legal doctrines and structures currently in place. In sum, the attorney-client privilege is merely one of a number of areas in which these extraordinary cases push and expand (and sometimes contract) conventional notions of the adequacy of existing doctrines to address the specific issues that may arise. Arriving at the conclusion that reform is need is often not a difficult step. Where the difficulty arises of course,

is in formulating and proposing reform measures to compensate for such (perceived) shortcomings.