



Privilege under Pressure

In an effort to safeguard attorney-client privilege, two lawyers' groups lend their support to better protection for auditor-client communications.

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Attorney-client privilege, the focus of an American Bar Association task force, has become yet another area experiencing fallout from Sarbanes-Oxley.

Stan Keller, a member of the ABA task force on attorney-client privilege and a partner at law firm Edwards Angels Palmer & Dodge, says the privilege has found itself under pressure from auditors, who request information such as legal memos on corporate transactions or accounting treatment. "In the post-Sarbanes-Oxley world...auditors are being held accountable as gatekeepers," acknowledges Keller, so "they want to get as much information as they can."

Now the ABA task force and the Association of Corporate Counsel plan to ask the Public Company Accounting Oversight Board to issue more-explicit guidance on *auditor-client* privilege, according to ACC general counsel Susan Hackett.

Why? Unlike attorney-client privilege, which has its underpinnings in English common law, today auditor-client privilege is recognized (to various degrees) in just 34 states, according to *Corporate Counsel* magazine. But the two are often intertwined, so if sensitive communications between a company and its outside auditor can be obtained by a third party, and those communications include legal opinions or other attorney-client-privileged material, that latter privilege could also be breached.

Auditor-client privilege was the subject of recent litigation between AES Wolf Hollow and The Shaw Group. In 2002, AES commissioned Shaw to build an electric power plant in AES's home state, Texas, for \$99 million. After the project went awry and Shaw sued for lost profits and damages, AES subpoenaed Ernst & Young, Shaw's independent auditor, demanding to examine the company's financials.

Although Shaw and the local office of Ernst & Young are both based in Louisiana, where state law protects the auditor-client privilege, in 2005 a Texas trial judge ordered Ernst & Young to comply with the discovery request. (*Corporate Counsel* noted that Texas also recognizes auditor-client privilege, though its guidelines vary in some respects.) Earlier this year the Texas Supreme Court upheld the trial judge's ruling.

Steve Poss, a partner with law firm Goodwin Procter, also notes that for the past couple of years, concerns have been raised that the Securities and Exchange Commission and the Department of Justice have been interfering with companies' ability to consult with their attorneys. The SEC and the DoJ "have been taking the position that the only way a company can 'cooperate' with them is to waive their attorney-client privilege," says Poss, who notes that "a few judges have said they can't do that."

(In related news this week, a judge also rebuked the DoJ for allegedly pressuring KPMG to "cooperate" with an investigation by withdrawing legal support from employees accused of setting up illegal tax shelters.)

Surprising court decisions such as the case of AES, Shaw, and Ernst & Young are causing uncertainty for corporate executives. "It makes it difficult to consider fully the risks you face when you are exchanging information with your auditor," says Don Peck, chief financial officer of loan-service provider First Marblehead. Even so, he adds, companies must provide their auditors with the information they need to provide attestation under Sarbanes-Oxley.

Goodwin Procter's Poss puts it more strongly: "I think it's not ethical for government to require a waiver of attorney-client privilege to give a company credit for cooperation. Public companies need to be encouraged to put all their cards on their table with outside auditors [and attorneys] without showing their hand to every plaintiff lawyer that may want to sue them and every competitor that may want to take advantage of that."

Indeed, in its amicus brief to the Texas Supreme Court, the Association of Corporate Counsel supported both auditor-client and attorney-client privilege, for the protection of clients' legitimate expectations and for the public interest. "There should be respect for auditor confidentiality and attorney privilege because both encourage companies to act responsibly," maintains the ACC's Hackett.

Keller says that the ABA task force will conduct discussions with regulators and with representatives of the accounting profession to balance the attorney-client privilege with "an effective auditing process to ensure the integrity of financial reporting." The task force will present its report to the ABA House of Delegates during its annual meeting in August, says Keller, then forward the final version to the PCAOB.