TESTIMONY OF DAVID M. BRODSKY

ON BEHALF OF THE CORPORATE COUNSEL CONSORTIUM

BEFORE THE AMERICAN BAR ASSOCIATION TASK FORCE ON THE ATTORNEY-CLIENT PRIVILEGE

ABA MID-YEAR MEETING

SALT LAKE CITY, UTAH

FEBRUARY 11, 2005

LADIES AND GENTLEMEN.

THANK YOU FOR THE OPPORTUNITY OF APPEARING BEFORE YOU TODAY ON A SUBJECT OF VITAL CONCERN TO THIS ASSOCIATION AND TO THE CITIZENS OF THIS COUNTRY: WHETHER THE MODERN CORPORATION WILL CONTINUE TO HAVE THE BENEFITS AND PROTECTIONS OF THE ATTORNEY-CLIENT PRIVILEGE AND ITS NEAR-RELATION, THE WORK-PRODUCT DOCTRINE PROTECTING MATERIALS PREPARED BY COUNSEL IN ANTICIPATION OF LITIGATION.

I AM DAVID M. BRODSKY, A MEMBER OF THE FIRM OF LATHAM & WATKINS LLP, RESIDENT IN NEW YORK, AND I REPRESENT THE CORPORATE COUNSEL CONSORTIUM, COMPOSED OF INTERESTED GENERAL COUNSELS OF PUBLIC COMPANIES IN THE UNITED STATES. ORIGINALLY CONSISTING OF GENERAL COUNSELS WHO WERE MEMBERS OF THE GENERAL COUNSEL WORKING GROUP, CONVENED BY THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK, THE CONSORTIUM NOW CONSISTS OF GENERAL COUNSELS OF COMPANIES AROUND THE COUNTRY WHO SHARE SIMILAR CONCERNS ABOUT THE CONTINUED EROSION OF THE PROTECTIONS OF THE ATTORNEY-CLIENT PRIVILEGE AND WORK-PRODUCT DOCTRINE. THE PARTICULAR FOCUS OF THE CONSORTIUM, AND THEREFORE, OF OUR WORK AND MY TESTIMONY THIS MORNING, IS THE INCREASED INSISTENCE OF OUTSIDE AUDITORS OF PUBLIC COMPANIES THAT PRIVILEGED AND WORK-PRODUCT PROTECTED MATERIALS BE MADE AVAILABLE TO THEM FOR PURPOSES OF THEIR COMPLETING THEIR AUDIT WORK, OR OTHER ASPECTS OF THEIR MANDATED RESPONSIBILITIES FOR PUBLIC COMPANIES. WE HAVE SUBMITTED TO THE TASK FORCE THE LATEST VERSION OF OUR WHITE PAPER, ENTITLED "THE AUDITOR'S NEED FOR THE CLIENT'S DETAILED INFORMATION VS. THE CLIENT'S NEED TO PRESERVE THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT PROTECTION: THE DEBATE, THE PROBLEMS, AND PROPOSED SOLUTIONS." I REFER YOU TO THAT PAPER FOR A DETAILED EXPOSITION OF THE ISSUES.

In my brief remarks today, I want to focus on one proposed solution to the apparent imbroglio that exists and urge that our friends and colleagues in government, in the PCAOB, and in the auditing firms join with us to effect a non-legislative solution in the first instance. Before doing so, let me set the stage for the proposed solution by describing the situation as we see it and have found it through conversations around the country with interested and concerned general counsels.

First, how did the problem we face arise?

In recent years, we have witnessed an astonishing parade of corporations collapsing, or being significantly restructured, under the weight of fraudulent accounting techniques. The corporate scandals of 2001 and 2002 sparked a firestorm of legislative action by Congress, rule-making and enforcement initiatives by the Securities and Exchange Commission ("SEC"), standard-setting by the Public Company Accounting Oversight Board ("PCAOB") and initiatives by other oversight bodies, all of which have heightened the scrutiny over auditors' procedures to verify company positions and representations. This has, in turn, impacted generally accepted auditing standards ("GAAS") and how auditors apply GAAS. The resulting changes in law and policy have strengthened the role of independent auditors in detecting corporate wrongdoing and have mandated that companies, for their part, strengthen internal controls, and increased expectations that companies will provide their auditors with detailed information on a myriad of legal compliance issues that may affect financial reporting.

COMPANIES HAVE ALWAYS DEPENDED ON LEGAL COUNSEL TO GIVE ADVICE AND HANDLE INQUIRIES RELEVANT TO LEGAL COMPLIANCE, FROM CONDUCTING COMPREHENSIVE INVESTIGATIONS OF ALLEGED FRAUD TO ADVISING ABOUT EMPLOYMENT PROBLEMS, ANSWERING QUESTIONS ABOUT WHISTLEBLOWER LETTERS, ADVISING DIRECTORS ABOUT THEIR DUTIES IN CONNECTION WITH MAJOR CORPORATE TRANSACTIONS, STRUCTURING ACTUAL TRANSACTIONS. ADVISING ON DISCLOSURE OBLIGATIONS, OR ESTABLISHING THE BASES FOR TAX POSITIONS. IN THE WAKE OF THE CORPORATE SCANDALS AND RESULTING LEGISLATIVE AND ADMINISTRATIVE ACTION, COMPANIES THAT HAVE STEPPED UP THEIR EFFORTS TO ESTABLISH AND STRENGTHEN INTERNAL CONTROLS AND PROCEDURES, HAVE RETAINED COUNSEL TO REDESIGN PROCEDURES, TO ADVISE OF APPROPRIATE ROLES FOR OFFICERS AND DIRECTORS IN CORPORATE MANAGEMENT AND GOVERNANCE AND, ON OCCASION, TO CONDUCT INVESTIGATIONS.

THE PROBLEMS WE FACE TODAY SURFACE WHEN AUDITORS REQUEST ACCESS TO RECORDS REFLECTING COUNSEL'S EFFORTS AND ADVICE ACROSS A BROAD RANGE OF ISSUES, NOT JUST INTERNAL INVESTIGATIONS, AND SEEK TO IMPOSE ON COMPANIES OBLIGATIONS TO PROVIDE AUDITORS WITH ACCESS TO PRIVILEGED INFORMATION. COMPANIES THAT RESIST DOING SO FACE THE PROSPECT OF AUDIT OPINIONS THAT ARE QUALIFIED OR NOT GIVEN AT ALL, WHILE BY COMPLYING, COMPANIES RISK WAIVING THE PRIVILEGES AND BEING FORCED TO TURN THE INFORMATION OVER TO LITIGATION ADVERSARIES.

FOR ALL OF YOU THAT HAVE REPRESENTED COMPANIES OR THEIR AUDIT COMMITTEES DURING A RESTATEMENT, YOU ALREADY KNOW THE DIFFICULTIES RAISED BY EXISTING EXTERNAL AUDITORS DURING THE PROCESSES THAT NECESSARILY ACOMPANY SUCH STRESSFUL EPISODES. CONDUCTING INTERNAL INVESTIGATIONS UNDER THE WATCHFUL AND JUDGMENTAL EYE OF EXTERNAL AUDITORS AND THE NATIONAL OFFICES OF THE MAJOR FIRMS

INEVITABLY LEADS TO PERIODS WHERE THE FUTURE OF THE COMPANY RESTS ON WHETHER THE AUDITOR IS SATISFIED WITH THE SCOPE AND DEPTH OF THE INVESTIGATION AND RELIES ON PRIVILEGED AND WORK-PRODUCT PROTECTED MATERIALS TO MAKE THAT JUDGMENT. AND SO IT HAS COME TO PASS THAT IN 2005 PUBLIC COMPANIES MUST FEAR THE FORCED PRODUCTION OF PRIVILEGED MATERIALS NOT ONLY TO GOVERNMENTS AND REGULATORS BUT ALSO TO THEIR EXTERNAL AUDITORS. SUCH PRODUCTION RAISES SQUARELY THE POSSIBILITY THAT A WAIVER ARGUMENT WILL BE RAISED – PROBABLY SUCCESSFULLY AT PRESENT IN MOST COURTS OF THIS COUNTRY – BY ADVERSARIAL THIRD PARTIES.

IT HAS LONG BEEN ESTABLISHED THAT THE ABILITY OF COMPANIES TO OBTAIN THE ADVICE AND INVOLVEMENT OF LEGAL COUNSEL IN CONFIDENCE IS ESSENTIAL TO THE PUBLIC INTEREST IN PROMOTING CORPORATE LEGAL COMPLIANCE AND ENABLING COMPANIES TO PROTECT LEGITIMATE CORPORATE INTERESTS. WHENEVER THE PRIVILEGES ARE DEBATED, IT IS WELL-RECOGNIZED THAT THE KINDS OF ADVERTENT, INADVERTENT AND SOMETIMES VIRTUALLY COMPELLED PRIVILEGE WAIVERS THAT COMPANIES NOW ARE FACING DENY COMPANIES THE EFFECTIVE ASSISTANCE OF COUNSEL. I BELIEVE THAT THE RECENT AND CONTINUING SHIFT IN POLICY AND REGULATIONS SURROUNDING CORPORATE AMERICA HAS THROWN IMPORTANT PUBLIC POLICIES OUT OF BALANCE. WHILE THE PUBLIC POLICY TO DETECT AND DETER CORPORATE FRAUD IS BEING STRENGTHENED, THE PUBLIC POLICY TO PROTECT THE CONFIDENTIALITY OF ATTORNEY-CLIENT COMMUNICATIONS AND WORK PRODUCT IS BEING WEAKENED. THIS IMBALANCE IS AT THE HEART OF THE EMERGING WAIVER PROBLEM.

IN OUR WORK, WE HAVE CONSISTENTLY PROCEEDED FROM THE PROPOSITIONS THAT AUDITORS MUST BE PROVIDED WITH AS MUCH INFORMATION AS IS NECESSARY TO PERFORM THEIR IMPORTANT PUBLIC FUNCTIONS IN ASSURING THE ACCURACY OF FINANCIAL REPORTING. WE HAVE

MET ON NUMEROUS OCCASIONS, BOTH FORMALLY AND INFORMALLY, WITH THE GENERAL COUNSELS OF THE MAJOR AUDITING FIRMS, AND HAVE DISCUSSED AND REITERATED THIS POINT. IT IS IN THE INTEREST OF ALL THE PUBLIC COMPANIES IN THIS COUNTRY TO COOPERATE TO THE FULLEST EXTENT POSSIBLE WITH THEIR EXTERNAL AUDITORS TO MAXIMIZE THE LIKELIHOOD THAT THE FULLEST MANDATED DISCLOSURE OF ALL MATERIAL INFORMATION TO THE PUBLIC OCCURS. AT THE SAME TIME, WE BELIEVE AND HAVE CONSISTENTLY ASSERTED THAT THAT IT IS IN THE PUBLIC INTEREST TO PROTECT THE ABILITY OF COMPANIES TO MAINTAIN THE CONFIDENTIALITY OF ATTORNEY-CLIENT COMMUNICATIONS AND WORK PRODUCT.

THE CONCEPTS SUPPORTING THE PROTECTION OF ATTORNEY WORK PRODUCT AND PRIVILEGED COMMUNICATIONS ARE NOT INCOMPATIBLE WITH THE FUNCTION OF AUDITORS AND THEIR ABILITY TO OBTAIN THE INFORMATION THAT THEY NEED TO CONDUCT PROPER AUDITS. IN 1975, THE AUDIT AND LEGAL PROFESSIONS DEBATED THE ISSUE AND REACHED AN ACCORD – OR "TREATY," AS IT IS SOMETIMES CALLED – REGARDING THE WAIVER PROBLEM ARISING WHEN AUDITORS ASK THEIR CLIENTS FOR PRIVILEGED INFORMATION AND THE OPINIONS OF COMPANY COUNSEL REGARDING LOSS CONTINGENCIES FOR LITIGATION, CLAIMS AND ASSESSMENTS. THIS "STATEMENT OF POLICY REGARDING LAWYERS' RESPONSES TO AUDITORS' REQUESTS FOR INFORMATION," AS ADOPTED BY THE ABA AND CONSENTED TO BY THE AICPA, STRUCK A BALANCE BETWEEN TWO VERY IMPORTANT PUBLIC INTERESTS: FIRST, TO PROMOTE CONFIDENCE IN THE CAPITAL MARKETS BY ASSURING RELIABLE FINANCIAL REPORTING OF LOSS CONTINGENCY ACCRUALS AND DISCLOSURES UNDER FAS 5, AND SECOND, TO ENCOURAGE COMPANIES TO CONSULT FREELY WITH COUNSEL BY PROTECTING THE CONFIDENTIALITY OF LAWYER-CLIENT COMMUNICATIONS. THE ABA STATEMENT OF POLICY STRUCK THE BALANCE BY LIMITING THE RANGE OF ACCEPTABLE DISCLOSURES THAT LAWYERS MAY MAKE TO AUDITORS WITH THE CLIENT'S

INFORMED CONSENT, AND THUS DEFINED THE SCOPE OF WHAT THE AUDITORS MAY REQUEST FROM LAWYERS REGARDING CONFIDENTIAL ATTORNEY INFORMATION.

IN 1977, THE AICPA AFFIRMED THIS PROTECTION AND LIMITATION REGARDING AUDITOR ACCESS TO PRIVILEGED INFORMATION AND WORK PRODUCT MAINTAINED BY THE CLIENT. THE INTERPRETIVE RELEASE POSES THE QUESTION: "[SAS 12 STATES:] "EXAMINE DOCUMENTS IN THE CLIENT'S POSSESSION CONCERNING LITIGATION, CLAIMS, AND ASSESSMENTS, INCLUDING CORRESPONDENCE AND INVOICES FROM LAWYERS." *WOULD THIS INCLUDE A REVIEW OF DOCUMENTS AT THE CLIENT'S LOCATION CONSIDERED BY THE LAWYER AND THE CLIENT TO BE SUBJECT TO THE LAWYER-CLIENT PRIVILEGE?"* AND ANSWERS AS FOLLOWS: "*NO.* ALTHOUGH ORDINARILY AN AUDITOR WOULD CONSIDER THE INABILITY TO REVIEW INFORMATION THAT COULD HAVE A SIGNIFICANT BEARING ON HIS AUDIT AS A SCOPE RESTRICTION, *IN RECOGNITION OF THE PUBLIC INTEREST IN PROTECTING THE CONFIDENTIALITY OF LAWYER-CLIENT COMMUNICATIONS, [SAS 12] IS NOT INTENDED TO REQUIRE AN AUDITOR TO EXAMINE DOCUMENTS THAT THE CLIENT IDENTIFIES AS SUBJECT TO THE LAWYER-CLIENT PRIVILEGE*." (EMPHASIS ADDED)

AS RECOGNIZED BY BOTH THE AUDITING AND LEGAL PROFESSIONS THROUGH THE CONTINUED VIABILITY OF THE TREATY TODAY, PROMOTING EFFECTIVE CORPORATE GOVERNANCE AND RESPONSIVENESS TO ALLEGATIONS OF WRONGDOING DEPENDS, IN PART, ON PROTECTING THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE. THUS, WHILE AUDITORS REQUIRE ACCESS TO ATTORNEY-CLIENT INFORMATION – AS PART OF THEIR JOB OF PERFORMING AUDITS – THEY RECOGNIZE THE IMPORTANCE OF THE PRIVILEGES BY COOPERATING IN A "TREATY" DESIGNED TO UPHOLD THE PUBLIC INTEREST IN PROTECTING THESE PRIVILEGES IN CERTAIN CONTEXTS.

THE SEC IS ALSO ON RECORD PROMOTING WORK PRODUCT PROTECTION FOR THE INTERNAL INVESTIGATION FILES OF PUBLIC COMPANY COUNSEL. THE SEC ARGUED IN *UNITED STATES V. BERGONZI* THAT ITS RESPONSIBILITIES WOULD BE FRUSTRATED IF COMPANIES WERE DETERRED FROM SHARING THEIR WORK PRODUCT FROM INTERNAL INVESTIGATIONS WITH THE SEC, AND BECAUSE OF THIS CONCERN, SUCH PRODUCTION "SHOULD NOT RESULT IN WAIVER OF WORK-PRODUCT PROTECTION BECAUSE PRESERVING WORK-PRODUCT PROTECTION IS IN THE PUBLIC INTEREST." THE SEC POINTED OUT THAT THERE ARE "SIGNIFICANT BENEFITS TO THE PUBLIC" WHEN A COMPANY CAN SHARE ITS WORK PRODUCT WITH THE SEC, THEREBY ALLOWING THE SEC TO FULFILL ITS OVERSIGHT FUNCTION, WITHOUT FEAR BY THE COMPANY THAT ITS WORK PRODUCT WILL END UP IN THE HANDS OF CIVIL LITIGATION ADVERSARIES: "THE CHOICE IS THUS BETWEEN DISCLOSURE ONLY TO GOVERNMENT AGENCIES, WHICH WILL INCREASE THE EFFECTIVENESS AND EFFICIENCY OF GOVERNMENTAL INVESTIGATIONS, AND NO DISCLOSURE AT ALL – NOT A CHOICE BETWEEN DISCLOSURE ONLY TO GOVERNMENT AGENCIES AND DISCLOSURE TO ALL PARTIES."

THE SAME POLICIES UNDERLIE PUBLIC COMPANY DISCLOSURE OF PRIVILEGED COMMUNICATIONS AND WORK PRODUCT TO INDEPENDENT AUDITORS. DISCLOSURE OF SUCH MATERIAL MAY BE PART OF AN EFFECTIVE AND COMPREHENSIVE AUDIT, BUT IT WOULD BE *UNFAIR* FOR COMPANIES TO BE FORCED TO WAIVE THEIR PRIVILEGES AS TO THEIR ADVERSARIES – WHO STAND READY TO USE THIS SENSITIVE INFORMATION TO FILE CIVIL LAWSUITS AND OBTAIN AN IMMEDIATE ADVANTAGE IN LITIGATION – SIMPLY BECAUSE THE COMPANIES MAINTAIN EFFECTIVE INTERNAL CONTROLS FOR RESPONDING TO ALLEGATIONS OF WRONGDOING AND COOPERATE WITH THEIR AUDITORS.

AS WE MAKE CLEAR IN OUR PAPER, THE WAIVER PROBLEM IS VERY REAL. JUDICIAL DEVELOPMENT OF THE LAW GOVERNING WAIVER OF PRIVILEGES IS, AT BEST, MIXED, AFFORDING

NO ASSURANCE TO COMPANIES THAT PRIVILEGED INFORMATION DISCLOSED TO AUDITORS WILL REMAIN PROTECTED FROM ADVERSARIES. THE SOLUTION IS NOT THAT AUDITORS SHOULD BACK OFF FROM OBTAINING CLARIFICATION OR SUBSTANTIATION OF FACTS FROM THEIR CORPORATE CLIENTS. RATHER, ONE SOLUTION – WHICH HAS ALREADY BEEN RECOGNIZED IN SIMILAR CONTEXTS BY THE SEC – IS LEGISLATIVE PROTECTION OF THE PRIVILEGES. LEGISLATION IS NEEDED TO STRIKE THE RIGHT BALANCE IN PUBLIC POLICY BY RECOGNIZING THAT IT IS JUST AS IMPORTANT FOR COMPANIES TO FURNISH ALL INFORMATION TO THEIR AUDITORS NECESSARY FOR THEM TO FULFILL THEIR ROLE AS "GATEKEEPERS" AS IT IS FOR COMPANIES TO PROTECT THEIR PRIVILEGED COMMUNICATIONS WITH COUNSEL AND LITIGATION WORK PRODUCT FROM DISCLOSURE TO THEIR ADVERSARIES.

HOWEVER, IN THE PAST, LEGISLATIVE SOLUTIONS HAVE BEEN LONG IN DEVELOPMENT AND NO SOLUTIONS HAVE BEEN FORTHCOMING SINCE THIS CRISIS BEGAN TO DEVELOP A FEW YEARS AGO. EVEN WITH THE RECOMMENDATION AND BACKING OF THE SEC, AN ATTEMPT TO CRAFT A LIMITED LEGISLATIVE SOLUTION EMBODIED IN H.R. 2179, CURRENTLY PENDING BEFORE CONGRESS, BY PROVIDING THAT DISCLOSURE OF PRIVILEGED INFORMATION TO THE GOVERNMENT DOES NOT WAIVE PRIVILEGES AS TO ANYONE ELSE, HAS NOT MOVED BEYOND HOUSE COMMITTEES. AND IT DOESN'T COME CLOSE, OF COURSE, TO DEALING WITH THE PROBLEM POSED HERE.

SECTION 105(B) OF THE SARBANES –OXLEY ACT ESTABLISHES A BLANKET EVIDENTIARY PRIVILEGE AND DISCOVERY IMMUNITY FOR ALL INFORMATION PROVIDED TO THE PCAOB OR PREPARED IN CONNECTION WITH PCAOB INSPECTIONS AND INVESTIGATIONS OF REGISTERED AUDIT FIRMS. IT ALSO PROVIDES THAT, "WITHOUT THE LOSS OF ITS STATUS AS CONFIDENTIAL AND PRIVILEGED IN THE HANDS OF THE [PCAOB]," THE FOREGOING INFORMATION

may be provided to the SEC and, at the discretion of the PCAOB, to other federal and state regulators. State regulators are tasked with maintaining "such information as confidential and privileged." This provision has been implemented in the PCAOB's Ethics Code and Rules.

Thus, H.R. 2179 and Section 105(b)(5) both address the same waiver problem. Section 105(b) reflects Congress' recognition that disclosure of confidential information by audit firms to an oversight body exposes the audit firm to waivers of privilege. This provision is designed to facilitate effective oversight by the PCAOB and cooperation by audit firms by assuring that confidential information will not be discoverable by others.

As with H.R. 2179, however, this provision does nothing to address the waiver problem facing companies whose *auditors* obtain privileged information. If a company's privileged information winds up in the hands of the PCAOB during an inspection or investigation of the audit firm, Section 105(b)(5) assures that no one can take discovery from the PCAOB. But the company remains exposed to the risk of waiver by having provided privileged information to its auditors in the first place. Both the company and its auditors may be subject to discovery attempts by the company's adversaries, simply because of the company's good corporate governance and compliance with its obligations to cooperate fully with its auditors.

These sections are designed to enable the government to obtain work product and attorney-client communications from regulated entities without exposing those entities to claims of waiver and wholesale discovery by other

ADVERSARIES. BOTH SECTIONS RECOGNIZE THAT PRESERVATION OF PRIVILEGES FOLLOWING DISCLOSURE TO THE GOVERNMENT CANNOT BE LEFT TO THE COURTS, WHICH ARE BOUND TO APPLY COMMON LAW PRINCIPLES OF WAIVER.

ALTHOUGH NOT LIKELY TO BE FORTHCOMING SOON, THE CONSORTIUM PROPOSES THAT THE SEC AND PCAOB, JOINED BY THE CORPORATE COUNSEL COMMUNITY AND THE PRINCIPAL AUDITORS OF THE VAST MAJORITY OF U.S. PUBLIC COMPANIES, PROPOSE AND SUPPORT FEDERAL LEGISLATION, MODELED ON H.R. 2179, THAT WOULD PERMIT COMPANIES TO PROVIDE PRIVILEGED ATTORNEY-CLIENT COMMUNICATIONS AND WORK PRODUCT TO THEIR AUDITORS IN CONNECTION WITH AUDITS, REVIEWS, ATTESTATIONS AND COMPLIANCE WITH SECTION 10A OF THE 1934 SECURITIES AND EXCHANGE ACT WITHOUT WAIVING ANY PRIVILEGES AS TO OTHERS.

SINCE LEGISLATION IS NOT LIKELY TO BE FORTHCOMING, WHAT SHOULD WE TURN TO IN THE SHORTER TERM AS PROPOSED SOLUTIONS?

THE CONSORTIUM URGES THAT THE PCAOB ISSUE INTERPRETIVE GUIDANCE, WITH APPROVAL BY THE SEC, ADVISING THAT AN AUDITOR IS GENERALLY EXPECTED TO OBTAIN ADEQUATE EVIDENCE TO SUPPORT ITS CONCLUSIONS WITHOUT DEMANDING INFORMATION PROTECTED BY THE ATTORNEY-CLIENT PRIVILEGE OR WORK PRODUCT DOCTRINE. AN AUDITOR SHOULD ONLY REQUIRE SUCH INFORMATION IF IT DETERMINES THAT THERE ARE NO OTHER SOURCES FROM WHICH IT CAN FULFILL ITS PROFESSIONAL OBLIGATIONS. WE NOTE THAT THIS APPROACH IS CONSISTENT WITH THE AICPA'S 1977 GUIDANCE REGARDING SAS 12, AS I DISCUSSED A MOMENT AGO

WE ALSO URGE THAT THE PCAOB ADOPT AN ETHICAL RULE, MODELED ON RULE 301 OF THE AICPA CODE OF PROFESSIONAL CONDUCT REQUIRING AUDITORS TO MAINTAIN THE

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CONFIDENTIALITY OF ALL CLIENT INFORMATION, AND CARVING OUT THE EXCEPTIONS SET FORTH IN RULE 301 – *I.E.*, COMPLIANCE WITH COMPULSORY LEGAL PROCESS AND THE AUDITOR'S OBLIGATION TO COOPERATE WITH ITS OWN OVERSIGHT BODIES. THE RULE SHOULD ALSO PROVIDE THAT AUDITORS MUST GIVE CLIENTS NOTICE BEFORE PRODUCING CLIENT INFORMATION PURSUANT TO COMPULSORY LEGAL PROCESS IN ORDER TO PROVIDE CLIENTS WITH ADEQUATE TIME TO SEEK JUDICIAL PROTECTION AGAINST DISCLOSURE.

IN TAKING THIS ACTION, THE PCAOB WOULD ASSIST COMPANIES THAT ARE FORCED TO SEEK JUDICIAL PROTECTION OF PRIVILEGED INFORMATION THAT HAS BEEN DISCLOSED TO AUDITORS. WHEN AUDITORS DO REQUIRE ACCESS TO PRIVILEGED INFORMATION IN ORDER TO PERFORM PROFESSIONAL SERVICES, THE RISK OF WAIVER IS SQUARELY PRESENTED. THOSE COURTS THAT HAVE BEEN WILLING TO PROTECT WORK PRODUCT FROM WAIVER (IF NOT ATTORNEY-CLIENT COMMUNICATIONS) AFTER DISCLOSURE TO AUDITORS HAVE RELIED HEAVILY ON THE AUDITOR'S OBLIGATION TO MAINTAIN THE INFORMATION IN CONFIDENCE.

IN ADDITION, THE PCAOB SHOULD PROMULGATE GUIDANCE THAT AN AUDITOR DOES NOT VIOLATE INDEPENDENCE STANDARDS BY ENTERING INTO A WRITTEN AGREEMENT WITH A CLIENT PROVIDING FOR THE CONFIDENTIAL TREATMENT OF CLIENT INFORMATION PROVIDED TO THE AUDITOR, SUBJECT TO THE AUDITOR'S PROFESSIONAL OBLIGATION TO COOPERATE WITH THE PCAOB AND OTHER OVERSIGHT BODIES.

IN TAKING THIS STEP, THE PCAOB WOULD FURTHER ASSIST COMPANIES THAT MUST MAKE THEIR CASE IN COURT FOR NON-WAIVER BY ALLOWING AUDITORS TO ENTER INTO CONFIDENTIALITY AGREEMENTS WITH CLIENTS. CONFIDENTIALITY AGREEMENTS HAVE BEEN

CRUCIAL IN THE HANDFUL OF DECISIONS FINDING NON-WAIVER DESPITE DISCLOSURE OF WORK PRODUCT TO GOVERNMENT INVESTIGATORS.

FINALLY, THE PRINCIPAL PROPOSAL THAT WE URGE ON THE TASK FORCE IS ONE WHICH CAN BE ADOPTED IN DAILY PRACTICE AND WITHOUT LEGISLATION: THE AGREEMENT BY INTERESTED PARTIES THAT THERE IS A COMMON GOAL, OR INTEREST, IF YOU WILL, BETWEEN AND AMONG CORPORATIONS AND THEIR EXTERNAL AUDITORS, AND UNDER THE WATCHFUL EYE OF THE PUBLIC AND SEMI-PUBLIC REGULATORS OF AUDITORS AND PUBLIC CORPORATIONS OF ENSURING FULL AND ACCURATE FINANCIAL DISCLOSURES TO THE PUBLIC IN ACCORDANCE WITH GAAP. AS ONE COURT STATED, "[T]HE DETERMINATION OF WHETHER THE COMMON INTEREST DOCTRINE APPLIES CANNOT BE MADE CATEGORICALLY. . . . WHAT IS IMPORTANT IS NOT WHETHER THE PARTIES THEORETICALLY SHARE SIMILAR INTERESTS BUT RATHER WHETHER THEY DEMONSTRATE ACTUAL COOPERATION TOWARD A COMMON LEGAL GOAL." COURTS HAVE FOUND THAT THE COMMON INTEREST DOCTRINE MAY ATTACH EVEN IF TWO PARTIES SHARE INTERESTS WHICH ARE NOT COMPLETELY CONGRUENT, AND WHICH ARE PART LEGAL AND PART COMMERCIAL.

WHILE IT IS TRUE THAT OUTSIDE AUDITORS MUST BE INDEPENDENT, THE "INDEPENDENCE IN MENTAL ATTITUDE" STANDARDS UNDER GAAS DO NOT PRECLUDE AUDITORS FROM SHARING A COMMON LEGAL AND COMMERCIAL GOAL WITH THEIR CLIENT. AS DESCRIBED BY THE AICPA IN AU §220.02, "INDEPENDENCE DOES NOT IMPLY THE ATTITUDE OF A PROSECUTOR BUT RATHER A JUDICIAL IMPARTIALITY THAT RECOGNIZES AN OBLIGATION FOR FAIRNESS" TO ALL THOSE AFFECTED BY A BUSINESS, INCLUDING MANAGEMENT, OWNERS AND CREDITORS. AUDITORS ARE NOT EXPECTED TO HAVE AN *ADVERSARIAL* RELATIONSHIP WITH THE COMPANIES THEY AUDIT; INDEED, THE AICPA CODE OF CONDUCT RECOGNIZES THAT EVEN THE THREAT OF ADVERSITY BETWEEN AN AUDITOR AND CLIENT CAN ITSELF IMPAIR INDEPENDENCE.

I NOTE, AS MOST IF NOT ALL ATTENDEES HERE WILL KNOW, THAT A WRITTEN AGREEMENT OUTLINING TWO PARTIES' COMMON INTERESTS AND NEED FOR CONFIDENTIALITY IS PERSUASIVE (AND SOMETIMES MANDATORY) EVIDENCE THAT SHARING OF ATTORNEY-CLIENT PRIVILEGED COMMUNICATIONS AND WORK PRODUCT WILL NOT CONSTITUTE A WAIVER.

TODAY, THE SEC ENFORCEMENT DIVISION REGULARLY ENTERS INTO CONFIDENTIALITY AGREEMENTS WITH AUDIT COMMITTEES AND COMPANIES UNDER INVESTIGATION. THEIR STANDARD FORM AGREEMENT PROVIDES THAT

> "IN LIGHT OF THE INTEREST OF THE STAFF OF THE U.S. SECURITIES AND EXCHANGE COMMISSION (THE "STAFF") IN DETERMINING WHETHER THERE HAVE BEEN ANY VIOLATIONS OF THE FEDERAL SECURITIES LAWS, AND THE XYZ COMMITTEE'S INTERESTS IN INVESTIGATING AND ANALYZING THE CIRCUMSTANCES AND PEOPLE INVOLVED IN THE EVENTS AT ISSUE, THE XYZ COMMITTEE WILL PROVIDE TO THE STAFF COPIES OF THE REPORT, INTERVIEW MEMORANDA AND INVESTIGATIVE WORKING PAPERS, IN ADDITION TO ORAL BRIEFINGS ("CONFIDENTIAL MATERIALS"). … BY PRODUCING THE CONFIDENTIAL MATERIALS PURSUANT TO THIS AGREEMENT, THE XYZ COMMITTEE DOES NOT INTEND TO WAIVE THE PROTECTION OF THE ATTORNEY WORK PRODUCT DOCTRINE, ATTORNEY-CLIENT PRIVILEGE, OR ANY OTHER PRIVILEGE APPLICABLE AS TO THIRD PARTIES. … THE STAFF WILL NOT ASSERT THAT THE XYZ COMMITTEE'S PRODUCTION OF THE CONFIDENTIAL MATERIALS TO THE COMMISSION CONSTITUTES A WAIVER OF THE PROTECTION OF THE ATTORNEY WORK PRODUCT DOCTRINE, THE ATTORNEY-CLIENT PRIVILEGE, OR ANY OTHER PRIVILEGE APPLICABLE AS TO ANY THIRD PARTY."

THERE SHOULD BE NO REASON THAT AUDITORS CANNOT ENTER INTO SUCH CONFIDENTIALITY AGREEMENTS WITH CLIENTS WITH THEIR "INDEPENDENCE" INTACT. ARMED

WITH SUCH WRITTEN INDICATION OF THE SCOPE OF THE AGREEMENT BETWEEN COMPANY AND AUDITOR, THE CHANCES ARE SIGNIFICANTLY GREATER THAT COURTS WILL ADOPT A MORE FAVORABLE VIEW OF THE SELECTIVE WAIVER DOCTRINE AS NOW EXISTS, AND WILL HOPEFULLY TIDE US OVER UNTIL THE FULLER LEGISLATIVE AND ADMINISTRATIVE SOLUTIONS PROPOSED HERE ARE ADOPTED.

THANK YOU FOR PERMITTING ME TO TESTIFY ON THIS IMPORTANT ISSUE. I AM OF COURSE AVAILABLE FOR ANY QUESTIONS YOU MAY HAVE.

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First, how did the problem we face arise?

In recent years, we have witnessed an astonishing parade of corporations collapsing, or being significantly restructured, under the weight of fraudulent accounting techniques. The corporate scandals of 2001 and 2002 sparked a firestorm of legislative action by Congress, rule-making and enforcement initiatives by the Securities and Exchange Commission ("SEC"), standard-setting by the Public Company Accounting Oversight Board ("PCAOB") and initiatives by other oversight bodies, all of which have heightened the scrutiny over auditors' procedures to verify company positions and representations. This has, in turn, impacted generally accepted auditing standards ("GAAS") and how auditors apply GAAS. The resulting changes in law and policy have strengthened the role of independent auditors in detecting corporate wrongdoing and have mandated that companies, for their part, strengthen internal controls, and increased expectations that companies will provide their auditors with detailed information on a myriad of legal compliance issues that may affect financial reporting.

COMPANIES HAVE ALWAYS DEPENDED ON LEGAL COUNSEL TO GIVE ADVICE AND HANDLE INQUIRIES RELEVANT TO LEGAL COMPLIANCE, FROM CONDUCTING COMPREHENSIVE INVESTIGATIONS OF ALLEGED FRAUD TO ADVISING ABOUT EMPLOYMENT PROBLEMS, ANSWERING QUESTIONS ABOUT WHISTLEBLOWER LETTERS, ADVISING DIRECTORS ABOUT THEIR DUTIES IN CONNECTION WITH MAJOR CORPORATE TRANSACTIONS, STRUCTURING ACTUAL TRANSACTIONS, ADVISING ON DISCLOSURE OBLIGATIONS, OR ESTABLISHING THE BASES FOR TAX POSITIONS. IN THE WAKE OF THE CORPORATE SCANDALS AND RESULTING LEGISLATIVE AND ADMINISTRATIVE ACTION, COMPANIES THAT HAVE STEPPED UP THEIR EFFORTS TO ESTABLISH AND STRENGTHEN INTERNAL CONTROLS AND PROCEDURES, HAVE RETAINED COUNSEL TO REDESIGN PROCEDURES, TO ADVISE OF APPROPRIATE ROLES FOR OFFICERS AND DIRECTORS IN CORPORATE MANAGEMENT AND GOVERNANCE AND, ON OCCASION, TO CONDUCT INVESTIGATIONS.

THE PROBLEMS WE FACE TODAY SURFACE WHEN AUDITORS REQUEST ACCESS TO RECORDS REFLECTING COUNSEL'S EFFORTS AND ADVICE ACROSS A BROAD RANGE OF ISSUES, NOT JUST INTERNAL INVESTIGATIONS, AND SEEK TO IMPOSE ON COMPANIES OBLIGATIONS TO PROVIDE AUDITORS WITH ACCESS TO PRIVILEGED INFORMATION. COMPANIES THAT RESIST DOING SO FACE THE PROSPECT OF AUDIT OPINIONS THAT ARE QUALIFIED OR NOT GIVEN AT ALL, WHILE BY COMPLYING, COMPANIES RISK WAIVING THE PRIVILEGES AND BEING FORCED TO TURN THE INFORMATION OVER TO LITIGATION ADVERSARIES.

FOR ALL OF YOU THAT HAVE REPRESENTED COMPANIES OR THEIR AUDIT COMMITTEES DURING A RESTATEMENT, YOU ALREADY KNOW THE DIFFICULTIES RAISED BY EXISTING EXTERNAL AUDITORS DURING THE PROCESSES THAT NECESSARILY ACOMPANY SUCH STRESSFUL EPISODES. CONDUCTING INTERNAL INVESTIGATIONS UNDER THE WATCHFUL AND JUDGMENTAL EYE OF EXTERNAL AUDITORS AND THE NATIONAL OFFICES OF THE MAJOR FIRMS

INEVITABLY LEADS TO PERIODS WHERE THE FUTURE OF THE COMPANY RESTS ON WHETHER THE AUDITOR IS SATISFIED WITH THE SCOPE AND DEPTH OF THE INVESTIGATION AND RELIES ON PRIVILEGED AND WORK-PRODUCT PROTECTED MATERIALS TO MAKE THAT JUDGMENT. AND SO IT HAS COME TO PASS THAT IN 2005 PUBLIC COMPANIES MUST FEAR THE FORCED PRODUCTION OF PRIVILEGED MATERIALS NOT ONLY TO GOVERNMENTS AND REGULATORS BUT ALSO TO THEIR EXTERNAL AUDITORS. SUCH PRODUCTION RAISES SQUARELY THE POSSIBILITY THAT A WAIVER ARGUMENT WILL BE RAISED – PROBABLY SUCCESSFULLY AT PRESENT IN MOST COURTS OF THIS COUNTRY – BY ADVERSARIAL THIRD PARTIES.

IT HAS LONG BEEN ESTABLISHED THAT THE ABILITY OF COMPANIES TO OBTAIN THE ADVICE AND INVOLVEMENT OF LEGAL COUNSEL IN CONFIDENCE IS ESSENTIAL TO THE PUBLIC INTEREST IN PROMOTING CORPORATE LEGAL COMPLIANCE AND ENABLING COMPANIES TO PROTECT LEGITIMATE CORPORATE INTERESTS. WHENEVER THE PRIVILEGES ARE DEBATED, IT IS WELL-RECOGNIZED THAT THE KINDS OF ADVERTENT, INADVERTENT AND SOMETIMES VIRTUALLY COMPELLED PRIVILEGE WAIVERS THAT COMPANIES NOW ARE FACING DENY COMPANIES THE EFFECTIVE ASSISTANCE OF COUNSEL. I BELIEVE THAT THE RECENT AND CONTINUING SHIFT IN POLICY AND REGULATIONS SURROUNDING CORPORATE AMERICA HAS THROWN IMPORTANT PUBLIC POLICIES OUT OF BALANCE. WHILE THE PUBLIC POLICY TO DETECT AND DETER CORPORATE FRAUD IS BEING STRENGTHENED, THE PUBLIC POLICY TO PROTECT THE CONFIDENTIALITY OF ATTORNEY-CLIENT COMMUNICATIONS AND WORK PRODUCT IS BEING WEAKENED. THIS IMBALANCE IS AT THE HEART OF THE EMERGING WAIVER PROBLEM.

IN OUR WORK, WE HAVE CONSISTENTLY PROCEEDED FROM THE PROPOSITIONS THAT AUDITORS MUST BE PROVIDED WITH AS MUCH INFORMATION AS IS NECESSARY TO PERFORM THEIR IMPORTANT PUBLIC FUNCTIONS IN ASSURING THE ACCURACY OF FINANCIAL REPORTING. WE HAVE

met on numerous occasions, both formally and informally, with the General Counsels of the major auditing firms, and have discussed and reiterated this point. It is in the interest of all the public companies in this country to cooperate to the fullest extent possible with their external auditors to maximize the likelihood that the fullest mandated disclosure of all material information to the public occurs. At the same time, we believe and have consistently asserted that that it is in the public interest to protect the ability of companies to maintain the confidentiality of attorney-client communications and work product.

The concepts supporting the protection of attorney work product and privileged communications are not incompatible with the function of auditors and their ability to obtain the information that they need to conduct proper audits. In 1975, the audit and legal professions debated the issue and reached an accord – or "Treaty," as it is sometimes called – regarding the waiver problem arising when auditors ask their clients for privileged information and the opinions of company counsel regarding loss contingencies for litigation, claims and assessments. This "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," as adopted by the ABA and consented to by the AICPA, struck a balance between two very important public interests: first, to promote confidence in the capital markets by assuring reliable financial reporting of loss contingency accruals and disclosures under FAS 5, and second, to encourage companies to consult freely with counsel by protecting the confidentiality of lawyer-client communications. The ABA Statement of Policy struck the balance by limiting the range of acceptable disclosures that lawyers may make to auditors with the client's

INFORMED CONSENT, AND THUS DEFINED THE SCOPE OF WHAT THE AUDITORS MAY REQUEST FROM LAWYERS REGARDING CONFIDENTIAL ATTORNEY INFORMATION.

IN 1977, THE AICPA AFFIRMED THIS PROTECTION AND LIMITATION REGARDING AUDITOR ACCESS TO PRIVILEGED INFORMATION AND WORK PRODUCT MAINTAINED BY THE CLIENT. THE INTERPRETIVE RELEASE POSES THE QUESTION: "[SAS 12 STATES:] 'EXAMINE DOCUMENTS IN THE CLIENT'S POSSESSION CONCERNING LITIGATION, CLAIMS, AND ASSESSMENTS, INCLUDING CORRESPONDENCE AND INVOICES FROM LAWYERS.' *WOULD THIS INCLUDE A REVIEW OF DOCUMENTS AT THE CLIENT'S LOCATION CONSIDERED BY THE LAWYER AND THE CLIENT TO BE SUBJECT TO THE LAWYER-CLIENT PRIVILEGE?"* AND ANSWERS AS FOLLOWS: "*NO.* ALTHOUGH ORDINARILY AN AUDITOR WOULD CONSIDER THE INABILITY TO REVIEW INFORMATION THAT COULD HAVE A SIGNIFICANT BEARING ON HIS AUDIT AS A SCOPE RESTRICTION, *IN RECOGNITION OF THE PUBLIC INTEREST IN PROTECTING THE CONFIDENTIALITY OF LAWYER-CLIENT COMMUNICATIONS, [SAS 12] IS NOT INTENDED TO REQUIRE AN AUDITOR TO EXAMINE DOCUMENTS THAT THE CLIENT IDENTIFIES AS SUBJECT TO THE LAWYER-CLIENT PRIVILEGE*." (EMPHASIS ADDED.)

AS RECOGNIZED BY BOTH THE AUDITING AND LEGAL PROFESSIONS THROUGH THE CONTINUED VIABILITY OF THE TREATY TODAY, PROMOTING EFFECTIVE CORPORATE GOVERNANCE AND RESPONSIVENESS TO ALLEGATIONS OF WRONGDOING DEPENDS, IN PART, ON PROTECTING THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE. THUS, WHILE AUDITORS REQUIRE ACCESS TO ATTORNEY-CLIENT INFORMATION – AS PART OF THEIR JOB OF PERFORMING AUDITS – THEY RECOGNIZE THE IMPORTANCE OF THE PRIVILEGES BY COOPERATING IN A "TREATY" DESIGNED TO UPHOLD THE PUBLIC INTEREST IN PROTECTING THESE PRIVILEGES IN CERTAIN CONTEXTS.

The SEC is also on record promoting work product protection for the internal investigation files of public company counsel. The SEC argued in *United States v. Bergonzi* that its responsibilities would be frustrated if companies were deterred from sharing their work product from internal investigations with the SEC, and because of this concern, such production "should not result in waiver of work-product protection because preserving work-product protection is in the public interest." The SEC pointed out that there are "significant benefits to the public" when a company can share its work product with the SEC, thereby allowing the SEC to fulfill its oversight function, without fear by the company that its work product will end up in the hands of civil litigation adversaries: "The choice is thus between disclosure only to government agencies, which will increase the effectiveness and efficiency of governmental investigations, and no disclosure at all – not a choice between disclosure only to government agencies and disclosure to all parties."

The same policies underlie public company disclosure of privileged communications and work product to independent auditors. Disclosure of such material may be part of an effective and comprehensive audit, but it would be *unfair* for companies to be forced to waive their privileges as to their adversaries – who stand ready to use this sensitive information to file civil lawsuits and obtain an immediate advantage in litigation – simply because the companies maintain effective internal controls for responding to allegations of wrongdoing and cooperate with their auditors.

As we make clear in our paper, the waiver problem is very real. Judicial development of the law governing waiver of privileges is, at best, mixed, affording

NO ASSURANCE TO COMPANIES THAT PRIVILEGED INFORMATION DISCLOSED TO AUDITORS WILL REMAIN PROTECTED FROM ADVERSARIES. THE SOLUTION IS NOT THAT AUDITORS SHOULD BACK OFF FROM OBTAINING CLARIFICATION OR SUBSTANTIATION OF FACTS FROM THEIR CORPORATE CLIENTS. RATHER, ONE SOLUTION – WHICH HAS ALREADY BEEN RECOGNIZED IN SIMILAR CONTEXTS BY THE SEC – IS LEGISLATIVE PROTECTION OF THE PRIVILEGES. LEGISLATION IS NEEDED TO STRIKE THE RIGHT BALANCE IN PUBLIC POLICY BY RECOGNIZING THAT IT IS JUST AS IMPORTANT FOR COMPANIES TO FURNISH ALL INFORMATION TO THEIR AUDITORS NECESSARY FOR THEM TO FULFILL THEIR ROLE AS "GATEKEEPERS" AS IT IS FOR COMPANIES TO PROTECT THEIR PRIVILEGED COMMUNICATIONS WITH COUNSEL AND LITIGATION WORK PRODUCT FROM DISCLOSURE TO THEIR ADVERSARIES.

HOWEVER, IN THE PAST, LEGISLATIVE SOLUTIONS HAVE BEEN LONG IN DEVELOPMENT AND NO SOLUTIONS HAVE BEEN FORTHCOMING SINCE THIS CRISIS ROSE TO THE SURFACE A FEW YEARS AGO. EVEN WITH THE RECOMMENDATION AND BACKING OF THE SEC, AN ATTEMPT TO CRAFT A LIMITED LEGISLATIVE SOLUTION EMBODIED IN H.R. 2179, CURRENTLY PENDING BEFORE CONGRESS, BY PROVIDING THAT DISCLOSURE OF PRIVILEGED INFORMATION TO THE GOVERNMENT DOES NOT WAIVE PRIVILEGES AS TO ANYONE ELSE, HAS NOT MOVED BEYOND HOUSE COMMITTEES. AND IT DOESN'T COME CLOSE, OF COURSE, TO DEALING WITH THE PROBLEM POSED HERE.

SECTION 105(B) OF THE SARBANES–OXLEY ACT ESTABLISHES A BLANKET EVIDENTIARY PRIVILEGE AND DISCOVERY IMMUNITY FOR ALL INFORMATION PROVIDED TO THE PCAOB OR PREPARED IN CONNECTION WITH PCAOB INSPECTIONS AND INVESTIGATIONS OF REGISTERED AUDIT FIRMS. IT ALSO PROVIDES THAT, "WITHOUT THE LOSS OF ITS STATUS AS CONFIDENTIAL AND PRIVILEGED IN THE HANDS OF THE [PCAOB]," THE FOREGOING INFORMATION

MAY BE PROVIDED TO THE SEC AND, AT THE DISCRETION OF THE PCAOB, TO OTHER FEDERAL AND STATE REGULATORS. STATE REGULATORS ARE TASKED WITH MAINTAINING "SUCH INFORMATION AS CONFIDENTIAL AND PRIVILEGED." THIS PROVISION HAS BEEN IMPLEMENTED IN THE PCAOB'S ETHICS CODE AND RULES.

THUS, H.R. 2179 AND SECTION 105(B)(5) BOTH ADDRESS THE SAME WAIVER PROBLEM AS IT PERTAINS TO DISCLOSURES OF PRIVILEGED INFORMATION TO REGULATORS. SECTION 105(B) REFLECTS CONGRESS' RECOGNITION THAT DISCLOSURE OF CONFIDENTIAL INFORMATION BY AUDIT FIRMS TO AN OVERSIGHT BODY EXPOSES THE AUDIT FIRM TO WAIVERS OF PRIVILEGE. THIS PROVISION IS DESIGNED TO FACILITATE EFFECTIVE OVERSIGHT BY THE PCAOB AND COOPERATION BY AUDIT FIRMS BY ASSURING THAT CONFIDENTIAL INFORMATION WILL NOT BE DISCOVERABLE BY OTHERS.

AS WITH H.R. 2179, HOWEVER, THIS PROVISION DOES NOTHING TO ADDRESS THE WAIVER PROBLEM AS IT PERTAINS TO DISCLOSURES OF PRIVILEGED INFORMATION BY COMPANIES TO THEIR *AUDITORS*. IF A COMPANY'S PRIVILEGED INFORMATION WINDS UP IN THE HANDS OF THE PCAOB DURING AN INSPECTION OR INVESTIGATION OF THE AUDIT FIRM, SECTION 105(B)(5) ASSURES THAT NO ONE CAN TAKE DISCOVERY FROM THE PCAOB. BUT THE COMPANY REMAINS EXPOSED TO THE RISK OF WAIVER BY HAVING PROVIDED PRIVILEGED INFORMATION TO ITS AUDITORS IN THE FIRST PLACE. BOTH THE COMPANY AND ITS AUDITORS MAY BE SUBJECT TO DISCOVERY ATTEMPTS BY THE COMPANY'S ADVERSARIES, SIMPLY BECAUSE OF THE COMPANY'S GOOD CORPORATE GOVERNANCE AND COMPLIANCE WITH ITS OBLIGATIONS TO COOPERATE FULLY WITH ITS AUDITORS.

These sections are designed to enable the government to obtain work product and attorney-client communications from regulated entities without exposing those entities to claims of waiver and wholesale discovery by other adversaries. Both sections recognize that preservation of privileges following disclosure to the government cannot be left to the courts, which are bound to apply common law principles of waiver.

Although not likely to be forthcoming soon, the Consortium proposes that the SEC and PCAOB, joined by the corporate counsel community and the principal auditors of the vast majority of U.S. public companies, propose and support federal legislation, modeled on H.R. 2179, that would permit companies to provide privileged attorney-client communications and work product to their auditors in connection with audits, reviews, attestations and compliance with Section 10A of the 1934 Securities and Exchange Act without waiving any privileges as to others.

Since legislation is not likely to be forthcoming, what should we turn to in the shorter term as proposed solutions?

The Consortium urges that the PCAOB issue interpretive guidance, with approval by the SEC, advising that an auditor is generally expected to obtain adequate evidence to support its conclusions without demanding information protected by the attorney-client privilege or work product doctrine. An auditor should only require such information if it determines that there are no other sources from which it can fulfill its professional obligations. We note that this

APPROACH IS CONSISTENT WITH THE AICPA'S 1977 GUIDANCE REGARDING SAS 12, AS I DISCUSSED A MOMENT AGO.

WE ALSO URGE THAT THE PCAOB ADOPT AN ETHICAL RULE, MODELED ON RULE 301 OF THE AICPA CODE OF PROFESSIONAL CONDUCT REQUIRING AUDITORS TO MAINTAIN THE CONFIDENTIALITY OF ALL CLIENT INFORMATION, AND CARVING OUT THE EXCEPTIONS SET FORTH IN RULE 301 – *I.E.*, COMPLIANCE WITH COMPULSORY LEGAL PROCESS AND THE AUDITOR'S OBLIGATION TO COOPERATE WITH ITS OWN OVERSIGHT BODIES. THE RULE SHOULD ALSO PROVIDE THAT AUDITORS MUST GIVE CLIENTS NOTICE BEFORE PRODUCING CLIENT INFORMATION PURSUANT TO COMPULSORY LEGAL PROCESS IN ORDER TO PROVIDE CLIENTS WITH ADEQUATE TIME TO SEEK JUDICIAL PROTECTION AGAINST DISCLOSURE.

IN TAKING THIS ACTION, THE PCAOB WOULD ASSIST COMPANIES THAT ARE FORCED TO SEEK JUDICIAL PROTECTION OF PRIVILEGED INFORMATION THAT HAS BEEN DISCLOSED TO AUDITORS. WHEN AUDITORS DO REQUIRE ACCESS TO PRIVILEGED INFORMATION IN ORDER TO PERFORM PROFESSIONAL SERVICES, THE RISK OF WAIVER IS SQUARELY PRESENTED. THOSE COURTS THAT HAVE BEEN WILLING TO PROTECT WORK PRODUCT FROM WAIVER (IF NOT ATTORNEY-CLIENT COMMUNICATIONS) AFTER DISCLOSURE TO AUDITORS HAVE RELIED HEAVILY ON THE AUDITOR'S OBLIGATION TO MAINTAIN THE INFORMATION IN CONFIDENCE.

IN ADDITION, THE PCAOB SHOULD PROMULGATE GUIDANCE THAT AN AUDITOR DOES NOT VIOLATE INDEPENDENCE STANDARDS BY ENTERING INTO A WRITTEN AGREEMENT WITH A CLIENT PROVIDING FOR THE CONFIDENTIAL TREATMENT OF CLIENT INFORMATION PROVIDED TO THE AUDITOR, SUBJECT TO THE AUDITOR'S PROFESSIONAL OBLIGATION TO COOPERATE WITH THE PCAOB AND OTHER OVERSIGHT BODIES.

In taking this step, the PCAOB would further assist companies that must make their case in court for non-waiver by allowing auditors to enter into confidentiality agreements with clients. Confidentiality agreements have been crucial in the handful of decisions finding non-waiver despite disclosure of work product to government investigators.

Finally, the principal proposal that we urge on the Task Force is one which can be adopted in daily practice and without legislation: the agreement by interested parties that there is a common goal, or interest, if you will, between and among corporations and their external auditors, and under the watchful eye of the public and semi-public regulators of auditors and public corporations of ensuring full and accurate financial disclosures to the public in accordance with GAAP. As one court stated, "[T]he determination of whether the common interest doctrine applies cannot be made categorically. . . . What is important is not whether the parties theoretically share similar interests but rather whether they demonstrate actual cooperation toward a common legal goal." Courts have found that the common interest doctrine may attach even if two parties share interests which are not completely congruent, and which are part legal and part commercial.

While it is true that outside auditors must be independent, the "independence in mental attitude" standards under GAAS do not preclude auditors from sharing a common legal and commercial goal with their client. As described by the AICPA in AU §220.02, "independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness" to all those affected by a business, including management, owners and creditors. Auditors

ARE NOT EXPECTED TO HAVE AN *ADVERSARIAL* RELATIONSHIP WITH THE COMPANIES THEY AUDIT; INDEED, THE AICPA CODE OF CONDUCT RECOGNIZES THAT EVEN THE THREAT OF ADVERSITY BETWEEN AN AUDITOR AND CLIENT CAN ITSELF IMPAIR INDEPENDENCE.

I NOTE, AS MOST IF NOT ALL ATTENDEES HERE WILL KNOW, THAT A WRITTEN AGREEMENT OUTLINING TWO PARTIES' COMMON INTERESTS AND NEED FOR CONFIDENTIALITY IS PERSUASIVE (AND SOMETIMES MANDATORY) EVIDENCE THAT SHARING OF ATTORNEY-CLIENT PRIVILEGED COMMUNICATIONS AND WORK PRODUCT WILL NOT CONSTITUTE A WAIVER.

TODAY, THE SEC ENFORCEMENT DIVISION REGULARLY ENTERS INTO CONFIDENTIALITY AGREEMENTS WITH AUDIT COMMITTEES AND COMPANIES UNDER INVESTIGATION. THEIR STANDARD FORM AGREEMENT PROVIDES THAT

> "IN LIGHT OF THE INTEREST OF THE STAFF OF THE U.S. SECURITIES AND EXCHANGE COMMISSION (THE "STAFF") IN DETERMINING WHETHER THERE HAVE BEEN ANY VIOLATIONS OF THE FEDERAL SECURITIES LAWS, AND THE XYZ COMMITTEE'S INTERESTS IN INVESTIGATING AND ANALYZING THE CIRCUMSTANCES AND PEOPLE INVOLVED IN THE EVENTS AT ISSUE, THE XYZ COMMITTEE WILL PROVIDE TO THE STAFF COPIES OF THE REPORT, INTERVIEW MEMORANDA AND INVESTIGATIVE WORKING PAPERS, IN ADDITION TO ORAL BRIEFINGS ("CONFIDENTIAL MATERIALS"). … BY PRODUCING THE CONFIDENTIAL MATERIALS PURSUANT TO THIS AGREEMENT, THE XYZ COMMITTEE DOES NOT INTEND TO WAIVE THE PROTECTION OF THE ATTORNEY WORK PRODUCT DOCTRINE, ATTORNEY-CLIENT PRIVILEGE, OR ANY OTHER PRIVILEGE APPLICABLE AS TO THIRD PARTIES. … THE STAFF WILL NOT ASSERT THAT THE XYZ COMMITTEE'S PRODUCTION OF THE CONFIDENTIAL MATERIALS TO THE COMMISSION CONSTITUTES A WAIVER OF THE PROTECTION OF THE

ATTORNEY WORK PRODUCT DOCTRINE, THE ATTORNEY-CLIENT PRIVILEGE, OR ANY OTHER PRIVILEGE APPLICABLE AS TO ANY THIRD PARTY."

THERE SHOULD BE NO REASON THAT AUDITORS CANNOT ENTER INTO SUCH CONFIDENTIALITY AGREEMENTS WITH CLIENTS WITH THEIR "INDEPENDENCE" INTACT. ARMED WITH SUCH WRITTEN INDICATION OF THE SCOPE OF THE AGREEMENT BETWEEN COMPANY AND AUDITOR, THE CHANCES ARE SIGNIFICANTLY GREATER THAT COURTS WILL ADOPT A MORE FAVORABLE VIEW OF THE SELECTIVE WAIVER DOCTRINE AS NOW EXISTS, AND WILL HOPEFULLY TIDE US OVER UNTIL THE FULLER LEGISLATIVE AND ADMINISTRATIVE SOLUTIONS PROPOSED HERE ARE ADOPTED.

THANK YOU FOR PERMITTING ME TO TESTIFY ON THIS IMPORTANT ISSUE. I AM OF COURSE AVAILABLE FOR ANY QUESTIONS YOU MAY HAVE.