NO. 05-0552

In The Supreme Court of Texas

IN RE STONE & WEBSTER, INC., THE SHAW GROUP INC., AND ERNST & YOUNG LLP,

Relators.

ON PETITION FOR WRIT OF MANDAMUS
CAUSE No. C2002459 355TH JUDICIAL DISTRICT COURT, HOOD COUNTY, TEXAS

AMICUS BRIEF OF THE ASSOCIATION OF CORPORATE COUNSEL ("ACC") IN SUPPORT OF RELATORS' PETITION FOR WRIT OF MANDAMUS AND BRIEF ON THE MERITS

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QUESTION PRESENTED

Whether accountants' client communications and work product should be protected given the public interest in candid communications between corporate employees and accountants, a client's legitimate expectation of confidentiality, and existing statutory protections.

INTEREST OF *AMICUS CURIAE* ASSOCIATION OF CORPORATE COUNSEL

The source of all fees paid for preparing this brief is the Association of Corporate Counsel (the "ACC"). The ACC is a professional association of more than 19,000 lawyers worldwide who practice in the legal departments of corporations and other organizations in the private sector. As an *amicus curiae*, the ACC presents the perspective of counsel who advise on issues of protected communications and corporate responsibility almost daily, in more than 8,000 corporate settings, including public and private companies both large and small, 49 of the Fortune 50 and 98 of the Fortune 100 companies, Global 50 and Global 100 companies, and various not-for-profit organizations. ACC has approximately 1,380 members in Texas, represented through four chapters: in Houston, Dallas, Austin, and South Central Texas (San Antonio area).

The ACC has an interest in this case because, unless overturned, the decision of the courts below first will chill communications between companies and their accountants, and punish those who cooperate fully with their auditors. Second, the lower court's decision will interfere with corporate counsel's ability to provide clear guidance to their clients in sensitive matters that involve financial compliance or that relate to financial reporting. Corporate counsel are concerned that communications with clients on these sensitive matters, which are then requested by accountants, will place clients in a "Hobson's choice" situation in which they must choose between their right to confidential legal counsel and their

responsibility and interest in cooperating fully with auditors in order to ensure accurate accounting practices and stakeholder confidence. Because we believe this case is essential to the protection of our clients' legitimate expectation of confidentiality of communications – with both accountants and attorneys – and to the public interest in promoting candid communications between corporate employees and accountants, we urge the Court to resolve any uncertainties regarding protection of accountants' client communications and work product, and to underline the continued public policy goals of supporting the confidentiality of client communications with attorneys and accountants.

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The protection of communications between clients and their accountants is crucial because it encourages the full and frank exchanges necessary to avoid, uncover, and address corporate wrongdoing and errors in financial disclosures. As such, the protection of this type of communication promotes "the observance of law and administration of justice." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). Especially given the recent atmosphere of scandal that has plagued the American economy in general – and the Texas economy in particular – it is important to avoid chilling candid client communications with accountants and attorneys by eroding these protections.

Such erosion will be the result, however, if the protection of accountants' client communications and work product is uncertain. Indeed, an uncertain protection is no protection at all to corporate employees facing any significant prospect of legal liability. Uncertainty regarding the protection of their communications with the accountant makes it a rational choice for employees to refrain from identifying wrongdoing or errors altogether rather than expose themselves to potential civil, or even criminal, liability. Moreover, uncertain protection of accountant-client communications begets additional uncertainty regarding the protection of *attorney*-client communications, especially given the current legal environment in which information requested by and provided to auditors contains what otherwise would be privileged attorney-client communications and attorney work product.

Unfortunately, unless reversed, the proceedings in this case alone will create such uncertainty. Exacerbating the uncertainty here is the lower courts' choice to disregard – with neither warning nor analysis – the clearly identified "Accountant-Client Privilege" set forth in the states' statutes. If affirmed, the trial court's ruling sends a message that, in Texas, the protection of accountant-client communications is subject to the unbridled discretion of whichever of the 424 trial court judges a party happens to draw. Moreover, without any standard to cabin this discretion, there cannot be any meaningful appellate review. The bottom line will be that – notwithstanding the seemingly applicable statutory protections – companies doing business in Texas cannot count on their sensitive communications being protected. While Texas is an attractive jurisdiction for business for many obvious reasons, the effective elimination of protections for clients' confidences is a price that the ACC believes many corporations – even those most comfortable with governance principles promoting corporate transparency – will be unwilling to pay.[1]

ARGUMENT

I. PROTECTION OF COMMUNICATIONS BETWEEN CLIENTS AND THEIR ACCOUNTANTS PROMOTES THE OBSERVANCE OF LAW AND ADMINISTRATION OF JUSTICE

Confidentiality is a cornerstone of professional relationships. As courts have long recognized, "confidential communications promote . . . the broader

[1] The ACC further incorporates by reference the Statement of Facts and Argument and Authorities of Relators' Brief on the Merits and Relators' Petition for Writ of Mandamus, which provide an outstanding analysis of the merits and precedent supporting confidentiality of accountant-client communications.

societal interest of the effective administration of justice." *Republic Ins. Co. v. Davis*, 856 S.W.2d 158, 160 (Tex. 1993). In short, guarantees of confidentiality encourage employees to engage in the full and frank communications necessary to avoid, uncover, and address corporate wrongdoing and errors. Confidentiality also gives hesitant employees, who are not sure if there is a problem to correct, the comfort of knowing that their report will not lead to third party "discovery" of problems that were later found to be without foundation or merit.

While courts have addressed protections of *attorney*-client communications more frequently than accountant-client communications, many of the policy arguments strongly favoring protection hold true for both. By encouraging clients' candor, protecting the confidentiality of these sensitive communications "promote[s] . . . the observance of law and administration of justice." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981); *see also United States v. Chen*, 99 F.3d 1495, 1500 (9th Cir. 1996) ("counseling clients and bringing them into compliance with the law" is a "valuable social service [that] cannot be performed effectively if clients are scared to tell their lawyers what they are doing"); *Trammel v. United States*, 445 U.S. 40, 50 (1980) (the attorney-client privilege promotes "a public good transcending the normally predominant principle of utilizing all rational means for ascertaining truth"); ABA Presidential Task Force on the Attorney-Client Privilege, *Task Force Report* at 7-11, available at http://www.abanet.org/buslaw/attorneyclient/materials/hod/report.pdf (discussing reasons attorney-client privilege is important to the American justice system);

Comments of the ABA Section of Antitrust Law on the Proposed Amendments to the Sentencing Guidelines for Organizations at 6, available at *http://www.abanet.org/antitrust/comments/2004/sentencingguidelines0704.pdf* ("the Supreme Court has repeatedly stressed that effective communications and legal representation require certainty in the support for the [attorney-client] privilege").

As with the attorney-client privilege, "[t]he purpose of the accountant-client privilege is to insure an atmosphere wherein the client will transmit all relevant information to his accountant without fear of any future disclosure in subsequent litigation." *Gearhart v. Etheridge*, 208 S.E.2d 460, 461 (Ga. 1974); *Sears, Roebuck & Co. v. Gussin*, 714 A.2d 188, 193 (Md. 1998) ("The purpose of the accountant-client privilege is to encourage free and open communication between the accountant and the client"); *Neusteter v. Dist. Ct., City & Cty. of Denver*, 675 P.2d 1, 5 (Colo. 1984) (en banc) ("The accountant-client privilege encourages full and frank communication between certified public accountants and their clients so that professional advice may be given on the basis of complete information, free from the consequences or the apprehension of disclosure"); *Federal Ins. Co. v. Arthur Anderson & Co.*, 816 S.W.2d 328, 330 (Tenn. 1991) (analogizing accountant-client relationship to attorney-client relationship).[2] "Without an atmosphere of confidentiality the client might withhold facts he considers

[2] Consistent with the strong policy arguments favoring privilege, legislatures in various states have codified the accountant-client privilege. *See, e.g.*, Relators' Brief on the Merits at 12.

unfavorable to his situation thus rendering the accountant powerless to adequately perform the services he renders." *Gearhart*, 208 S.E.2d at 461; Jaffee, "Is the Supreme Court Ready to Recognize Another Privilege? An Examination of the Accountant-Client privilege in the Aftermath of Jaffee v. Redmond," 55 *Wash. & Lee L. Rev.* 247, 271-78 (1998) (noting, among other things, that an auditor's primary resource in its audit of financial disclosures is company executives); AICPA, ET § 301 (barring accountants from disclosing confidential client information except under certain circumstances).

II. UNCERTAINTY REGARDING THE PROTECTION OF ACCOUNTANT-CLIENT COMMUNICATIONS EFFECTIVELY ELIMINATES IT ALTOGETHER

As the U.S. Supreme Court has observed, "[a]n uncertain privilege . . . is little better than no privilege at all." *Upjohn Co. v. United States*, 449 U.S. 383, 393 (1981); *accord* ABA Presidential Task Force on the Attorney-Client Privilege, *Task Force Report* at 18-20, available at http://www.abanet.org/buslaw/attorneyclient/materials/hod/report.pdf. Uncertainty regarding the protection of accountant-client communications will lead employees to be less candid regarding wrongdoing and error, and result in fewer internal investigations and less expeditious discovery of accounting problems or irregularities that could have and should have been detected and corrected. If confidentiality is not certain, employees are left to balance the justifications for and against reporting based on their own situation, and not on the best interests of the public and the company.

Through the eyes of corporate employees, if a corporate accountant may be compelled to divulge her communications, then talking to the corporation's accountant is no different than talking to a prosecutor or to the other side in civil litigation. Corporate accountants will be seen as deputized middlemen who are not valued by clients for their ability to help the company maintain the highest financial standards and vouch for the accuracy of the company's books, but rather who are valued by the government and the plaintiffs' bar for their role in facilitating the prosecution of their corporate clients and employees when failures inevitably occur. Even employees who believe they are personally innocent of wrongdoing would rather stay quiet than speak up and risk unforeseeable consequences, knowing that innocent action might appear in a less favorable light when subject to hindsight in the frenzied aftermath of a corporate scandal, especially when there is pressure to assign responsibility to *someone* involved in the conduct at issue. From this perspective of employees, uncertain protection truly is no protection at all.

Further, the uncertainty created by this case will be particularly acute given the trial court's action in the face of previously enacted statutory protections. Existing law in both Texas and Louisiana at the time of the trial court's action explicitly protected accountant-client communications. If a statute entitled "Accountant-Client Privilege" cannot provide certainty regarding the protection of accountant-client communications, employees will doubt that anything can.

III. DENYING CORPORATIONS' ACCOUNTANT-CLIENT PRIVILEGE ALSO FORCES THEM TO WAIVE THEIR ATTORNEY-CLIENT PRIVILEGE

The role of corporate accountants in promoting the observance of law and administration of justice has grown even more important during the past five years. Scandals at Enron and other corporations[3] earlier this decade sparked a firestorm of legislative action by Congress, rulemaking and enforcement initiatives by the Securities and Exchange Commission, standard-setting by the Public Company Accounting Oversight Board, and activity by other oversight bodies at both the state and federal levels. Collectively, these legal and policy changes have heightened the role and responsibility of accountants in preventing, detecting, and addressing corporate wrongdoing and errors in financial disclosures. Hand in hand with this heightened role are the increased expectations that corporations will provide their accountants with access to a wide range of internal information, including highly sensitive business information as well as privileged attorney-client communications and attorney work product, on issues such as litigation reserves, the results of internal investigations, and compliance audits.

If accountant-client communications are not protected in this post-Enron environment, corporations face a "Hobson's choice" of either (i) withholding privileged information and risk the prospect of audit opinions that are qualified or

[3] In addition to Enron, the corporations at which the media have reported corporate scandals within just the past five years include Adelphia Communications, Cedant, Computer Associates, Credit Suisse First Boston, Global Crossing, HealthSouth, Hollinger International, ImClone Systems, Qwest, Rite Aid, Tyco International, and WorldCom. *See, e.g.*, Stephen Labaton, "Crime and Consequences Still Weigh on Corporate World: Four Years Later, Enron's Shadow Lingers as Change Comes Slowly," *N.Y. Times*, January 5, 2006, at C1, C4.

not issued at all or (ii) waiving legitimate privilege, thereby dissuading candid employee disclosures to the accountants and being forced to turn otherwise privileged information over to litigation adversaries. As a matter of both policy and equity, ACC believes that neither option is what courts or legislatures intended companies to face. The first is completely untenable given the financial markets' immediate and devastating reaction to anything short of unqualified audit opinions in the post-Enron world. This means corporations must choose the second option, effectively forcing them to permit a "backdoor waiver" of information they have every reason to expect they should be able to keep out of the hands of adversaries and competitors.

The unfortunate policy implications are clear. A backdoor waiver of attorney-client and work product privileges "could very well discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry with the appropriate actors." *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 449 (S.D.N.Y. 2004) (noting that "it is less likely that corporations will engage in this sort of self-investigation if the results of such an investigation can be discovered in parallel civil litigation") (citations and internal quotation marks omitted). Moreover, by creating uncertainty in the attorney-client privilege and attorney work product doctrine, this backdoor waiver leads to the erosion of those privileges, as well. The strong public interest in assuring that accountants have access to all information required to conduct proper audits and to detect fraud or other wrongdoing is properly served – and indeed,

advanced – by the accountant-client privilege. *See generally* Jaffee, "Is the Supreme Court Ready to Recognize Another Privilege? An Examination of the Accountant-Client Privilege in the Aftermath of Jaffee v. Redmond," 55 *Wash. & Lee L. Rev.* 247, 271-78 (1998). If the lower courts' holdings in the instant case are not overturned, however, corporations choosing to do business in Texas must forego both their accountant-client and attorney-client privileges.

PRAYER

For all these reasons, ACC prays that this Court grant Relators' Petition for Writ of Mandamus and reverse the actions of the trial court with respect to its May 19, 2005 disclosure order.

Respectfully submitted,

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