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## Contractual Waiver of Corporate Attorney-Client Privilege

**ABSTRACT.** A corporate director, sued in her individual capacity in connection with corporate malfeasance, often seeks to raise the defense that she relied on the advice of the corporation's counsel that the proposed course of conduct was legal. A litigation impasse may arise, however, if the corporation, as sole holder of the attorney-client privilege, refuses to waive its privilege. The impasse leaves the plaintiff unable to evaluate the director's claims and leaves the defendant unable to mount her defense. As a solution to this impasse, this Note proposes that directors and their corporations should contract *ex ante* that the corporation will waive its privilege under these limited circumstances.

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## INTRODUCTION

The succession of shocking corporate scandals since 2002, coupled with increased scrutiny from Congress, the Department of Justice (DOJ), and the Securities and Exchange Commission (SEC), has increased public interest in holding corporate directors and executives personally liable for corporate malfeasance.<sup>1</sup> The DOJ may initiate a suit as a prosecutor for criminal fraud or as a civil plaintiff under the False Claims Act,<sup>2</sup> and since 2002, the number of federal civil fraud charges has increased by as much as 30%.<sup>3</sup> The Office of the Attorney General created the Corporate Fraud Task Force (CFTF) in July 2002 to prosecute criminal corporate malfeasance and to “restore confidence to the marketplace.”<sup>4</sup> By late 2005, the CFTF reported that since its inception it had secured over 700 corporate fraud convictions, including convictions of more than 100 corporate CEOs and presidents, 80 vice presidents, and 30 CFOs.<sup>5</sup>

When a corporate director finds herself under investigation for fraud for corporate actions that she approved or implemented,<sup>6</sup> one defense she may

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1. See, e.g., Verne Kopytoff, *Year in Review: Annus Horribilis; Corporate Scandals, Lingering Recession Made 2002 Truly Horrible Year*, S.F. CHRON., Dec. 29, 2002, at G1; OFFICE OF INSPECTOR GEN., U.S. DEP'T OF HEALTH & HUMAN SERVS. & AM. HEALTH LAWYERS ASS'N, CORPORATE RESPONSIBILITY AND CORPORATE COMPLIANCE: A RESOURCE FOR HEALTH CARE BOARDS OF DIRECTORS 1 (2003), <http://oig.hhs.gov/fraud/docs/complianceguidance/040203CorpRespRscceGuide.pdf> [hereinafter CORPORATE RESPONSIBILITY] (“Personal liability for directors, including removal, civil damages, and tax liability, as well as damage to reputation, appears not so far from reality as once widely believed.”).
  2. 31 U.S.C. §§ 3729-3733 (2000). The Act creates civil liability, including penalties and treble damages, for any person who knowingly presents, or causes to be presented, a false or fraudulent invoice or bill for payment or approval. *Id.* § 3729(a). While this Act enables the government to file civil charges, the government may also bring criminal charges against parties suspected of fraud. This Note therefore refers to the government as either plaintiff or prosecutor and considers the solutions analyzed herein in both the criminal and civil contexts.
  3. Ross Kerber, *Whistle-Blowers' Spotlight Falls on Drug Companies*, BOSTON GLOBE, Apr. 22, 2005, at C1.
  4. Press Release, Dep't of Justice, Fact Sheet: Corporate Fraud Task Force (Aug. 29, 2005), [http://www.usdoj.gov/opa/pr/2005/August/05\\_opa\\_434.htm](http://www.usdoj.gov/opa/pr/2005/August/05_opa_434.htm).
  5. *Id.* The press release highlighted that cases had proceeded against both corporations and individual directors such as Bernard Ebbers of WorldCom and John Rigas of Adelphia. *Id.*
  6. This Note focuses on civil and criminal fraud actions because they present a particularly vivid illustration of the many interests at stake in these cases and of the core legal doctrines implicated. Fraud can give rise to parallel civil and criminal trials and can involve the federal government as plaintiff or prosecutor, thus implicating the American public as stakeholders in the outcome. However, the solutions outlined in this Note may also apply to other

wish to raise is her good faith reliance on the advice of the corporation's counsel that the actions were legal.<sup>7</sup> Generally, when a defendant raises this "advice of counsel defense," the court requires her to waive the attorney-client privilege with respect to the legal opinions upon which she relied. However, the corporate director who hopes to raise this defense faces a unique challenge: she is not actually the holder of the attorney-client privilege, because the corporation was the client who retained the counsel's services. Although society expects and even requires directors to rely on the legal advice of their corporation's counsel,<sup>8</sup> courts have consistently held that the corporation is the sole holder of the attorney-client privilege<sup>9</sup> because to hold otherwise would eviscerate the privilege.<sup>10</sup> Therefore, if a director, sued in her individual capacity, wishes to raise an advice of counsel defense and the corporation refuses to waive its privilege, the legal system reaches an impasse in which two fundamental doctrines are at loggerheads: the defendant director's right to defend herself and the corporation's right to maintain its attorney-client privilege.

This Note examines possible solutions to this impasse and argues that the best solution is to encourage directors and corporations to contract *ex ante*: the corporation will waive its attorney-client privilege if the director, sued in her individual capacity, needs to raise an advice of counsel defense. The default privilege rule should hold all attorney-corporation communications to be presumptively privileged by the corporation; in other words, the default should preserve the current law on establishing attorney-client privilege.<sup>11</sup>

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situations in which directors are sued in their individual capacities, such as suits for violation of other federal regulations or shareholder derivative suits.

7. See *infra* Subsection I.A.1 for a hypothetical scenario demonstrating how the advice of counsel may operate in practice.
8. See CORPORATE RESPONSIBILITY, *supra* note 1, at 2 ("Directors are *not* required to know everything about a topic they are asked to consider. They may, where justified, rely on the advice of management and of outside advisors."); *infra* Section I.B.
9. *E.g.*, *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343 (1985); *United States v. Chen*, 99 F.3d 1495, 1502 (9th Cir. 1996) (holding that a former employee's disclosures of the corporation's attorney-client communications "could not and did not waive the privilege"); *Bushnell v. VIS Corp.*, No. C-95-04256, 1996 U.S. Dist. LEXIS 22572, at \*25 (N.D. Cal. Aug. 29, 1996) (holding that the former president and CEO of a corporation has no power to waive the attorney-client privileges that his corporation has the ability to assert).
10. See *Dexia Credit Local v. Rogan*, 231 F.R.D. 268, 278, 279 & n.6 (N.D. Ill. 2004); *cf.* *Ross v. City of Memphis*, 423 F.3d 596, 603-04 (6th Cir. 2005) (holding that a former city employee may not waive the city's attorney-client privilege to raise an advice of counsel defense).
11. Courts have formulated a number of criteria to determine which communications are in fact privileged. For these purposes, this Note will describe communications to be "presumptively

When the parties have contracted for waiver of the privilege, however, courts should enforce such contracts. Furthermore, courts should encourage the director and corporation to contract for waiver by enforcing a mandatory exclusionary rule. A plaintiff, faced with a director who threatens to raise an advice of counsel defense without having access to the relevant legal opinions, should be granted a motion in limine to prevent the defendant from even mentioning at trial that she relied on the advice of counsel.<sup>12</sup> Consistent application of this exclusionary rule and the motion in limine, while remaining within the existing legal framework, would be an improvement over the current, uncertain regime, and would allow the parties to anticipate how litigation would proceed.

Although a plaintiff may sue both current and former directors in their individual capacities in connection with a corporate fraud, the case of current directors is complicated by two factors. First, fiduciary duty constrains a current director's ability to assert defenses in litigation that are not in the corporation's interests.<sup>13</sup> Second, extralegal pressures (such as the desire for a successful ongoing business relationship) may bear on the current director's and corporation's litigation decisions.<sup>14</sup> Therefore, although much of this Note applies to current directors, its analysis focuses on former directors and indicates particular issues relevant to current directors as they arise. It is important to note that my proposed solution—contractual waiver of attorney-

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privileged" to the extent that they meet the otherwise applicable requirements for the establishment of privilege. For discussions of these criteria, see EDNA SELAN EPSTEIN, *THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE* 45-263 (4th ed. 2001); and JOHN WILLIAM GERGACZ, *ATTORNEY-CORPORATE CLIENT PRIVILEGE* ¶¶ 3.01-.03, at 3-4 to -84 (1987).

12. A motion in limine can be sought before trial in criminal or civil cases, and its purpose is to shield the jury from exposure to prejudicial inadmissible evidence. See *United States v. Komisaruk*, 885 F.2d 490, 493-94, 498 (9th Cir. 1989) ("[E]vidence may be excluded following an *in limine* hearing if the evidence described in the defendant's offer of proof is insufficient as a matter of law to establish a defense."); 1 MCCORMICK ON EVIDENCE § 52, at 222-25 (John W. Strong ed., 5th ed. 1999). See generally WAYNE R. LAFAVE ET AL., 5 *CRIMINAL PROCEDURE* § 24.4 (2d ed. 1999) (describing the purpose and strategies behind the use of a motion in limine in a criminal trial).
13. See, e.g., *Weintraub*, 471 U.S. at 348-49 ("[T]he power to waive the corporate attorney-client privilege rests with the corporation's management and is normally exercised by its officers and directors. The managers, of course, must exercise the privilege in a manner consistent with their fiduciary duty to act in the best interests of the corporation and not of themselves as individuals." (footnote omitted)).
14. See, e.g., *Howard v. SEC*, 376 F.3d 1136, 1147-49 (D.C. Cir. 2004) (indicating that a current director was permitted by the corporation to raise and present evidence for an advice of counsel defense in defending charges that the director personally aided and abetted securities violations committed by his corporation).

client privilege—can assist both former and current directors who, at the time of litigation, have previously negotiated for such a waiver. Thus, while the contours of the legal uncertainty that contributes to the impasse are affected by the current/former distinction, the implementation of the solution ultimately is not.

This Note proceeds in three Parts. Part I describes the legal framework of the advice of counsel defense in the context of corporate directors. Courts have considered the attorney-client privilege to be among the most fundamental testimonial privileges in the legal system. However, a party who raises the advice of counsel defense must waive the attorney-client privilege with respect to the opinions relied upon.<sup>15</sup> If the corporation holds the privilege and refuses to waive, this impasse has implications for both the plaintiff and the defendant. It creates uncertainty as to whether the defendant will be permitted to raise the defense at all during the trial and, if so, whether the plaintiff will be unfairly prejudiced by the inability to cross-examine the defendant on this issue.<sup>16</sup> Part II analyzes this impasse as a form of agency cost and then considers two groups of possible solutions to the problem. Ex post solutions attempt to break the impasse at the time of litigation, while ex ante solutions anticipate the impasse early in the relationship between the director and the corporation. Part II then proposes that the best solution is to encourage directors and corporations to contract ex ante to waive the corporation's privilege under limited circumstances. Part III develops the mechanics of how such a contractual regime would operate. Before concluding, the Note explores how parties could contractually tailor the scope of waiver and the conditions under which waiver would be executed.

## I. THE LEGAL FRAMEWORK

This Part considers how the advice of counsel defense operates in practice and describes its doctrinal framework. The “defense” is actually a category of evidence designed to controvert the scienter element of the plaintiff's prima facie case. Directors are permitted, by courts and in some states by statute, to rely on advice of counsel as a defense to scienter. However, defendants who raise this defense are required to waive their attorney-client privilege so that the opposing party is able to investigate and rebut the defendant's claim. The impasse arises in part because this doctrine of required waiver assumes that the

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15. See *infra* note 39 and accompanying text.

16. See *infra* Section I.B for a complete explanation of the tactical advantages and disadvantages to each party.

defendant is the holder of the privilege; it does not contemplate that a third party may be the privilege holder. Arrival at this impasse during pretrial litigation creates a high level of uncertainty for both the plaintiff and the defendant because it can create tactical advantages and disadvantages for each party depending on the facts of the case.

A. *The Advice of Counsel Defense*

1. *Use of the Defense in Practice*

To understand how the advice of counsel may operate in practice, consider the following hypothetical scenario.<sup>17</sup> During an ongoing investigation, the government is deciding whether to press civil and criminal charges against a hospital and its former CEO. It alleges the hospital paid fees to doctors as inducements for patient referrals, in violation of the Medicare Anti-Kickback Act.<sup>18</sup> The government is intent on charging the former CEO individually. The CEO's lawyers tell the government that no jury would ever convict the CEO because he relied on the advice of the hospital's counsel that the transactions, which amounted to paying the doctors for providing medical services, would be structured so as to avoid violating the Act.

The problem, explain the CEO's lawyers, is that the hospital refuses to waive its attorney-client privilege, so the CEO cannot turn over copies of the relevant legal opinions. At this point, the government faces a dilemma: is the government's case against the CEO strong enough to take to trial, or should it decline to file suit? The government has no idea whether the CEO really sought and received the claimed advice, nor does it know if this advice was reasonable. The CEO faces a dilemma of his own: if the hospital never waives privilege, how will he be able to keep himself out of jail?

In such scenarios, the legal community agrees that directors under investigation regularly consider raising an advice of counsel defense.<sup>19</sup> However, it is difficult to discover how frequently directors actually raise the

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17. This hypothetical is based loosely on the circumstances of *United States v. Anderson*, 85 F. Supp. 2d 1047 (D. Kan. 1999). Because it was unsealed after trial, the case provided a rare glimpse into a major healthcare fraud investigation. The "*Anderson case*," as it is commonly known, has been widely discussed because of the government's strategy to indict the defendants' counsel. See, e.g., Stuart M. Gerson & Jennifer E. Gladieux, *Advice of Counsel: Eroding Confidentiality in Federal Health Care Law*, 51 ALA. L. REV. 163, 164, 189 (1999).

18. 42 U.S.C. § 1320a-7b(b) (2000 & Supp. III 2003).

19. E.g., Joseph R. Biden, Jr., *Certifying Statements Under Section 906 of the Sarbanes-Oxley Act: Holding Corporate Executives Accountable for the Accuracy of Corporate Financial Statements*, 15 FED. SENT'G REP. 257, 260 (2003); Gerson & Gladieux, *supra* note 17, at 204.

advice of counsel defense in litigation. One reason is that these cases generally settle. The fact that so few cases go to trial in turn creates even more pressure to settle: fewer cases tried leads to fewer definitive rulings, generating more uncertainty about what is permissible in an increasingly complex regulatory system.<sup>20</sup> Settlements are often kept under seal to avoid reputational damage,<sup>21</sup> making them difficult to study. Also, settlement agreements often contain a statement that the defendants do not admit liability or guilt, and even those in which guilt is admitted do not discuss the defenses raised by the directors.<sup>22</sup>

It is also difficult to assess how frequently the defense is advanced because defendants in any litigation often strategically attempt to exhaust all other defenses before raising the advice of counsel defense, as it implies a waiver of the attorney-client privilege.<sup>23</sup> Therefore, of cases that do go to trial, many will not indicate that an advice of counsel defense was raised, though the defense may have considered raising it or even threatened to do so in an earlier settlement negotiation.<sup>24</sup>

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20. Cf. Gerson & Gladieux, *supra* note 17, at 173.
21. See Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 532 (1991).
22. See, e.g., Settlement Agreement Between the Office of Inspector General of the Department of Health and Human Services and Robert A. Berkman, M.D., *United States v. Berkman*, No. 1:03-cr-00045-JJF-ALL (D. Del. July 17, 2003), available at <http://www.oig.hhs.gov/fraud/cia/agreements/Robert%20A%20Berkman%20MD%2007%2017%202003.pdf> (admitting guilt but omitting any discussion of defense theories); Press Release, SEC, SEC Settles Civil Fraud Charges Filed Against Kevin P. Hannon, Former Chief Operating Officer of Enron Broadband Services (Aug. 31, 2004), <http://www.sec.gov/litigation/litreleases/lr18862.htm> (describing a settlement in which the defendant settled “without admitting or denying” the allegations against him, and omitting any discussion of the defendant’s defense theories).
23. See generally Alan J. Martin et al., *Putting Attorneys on the Witness Stand and Their Advice at Issue: The Perils of Selective Waiver of Privilege*, in ATTORNEY-CLIENT PRIVILEGE IN CIVIL LITIGATION: PROTECTING AND DEFENDING CONFIDENTIALITY 329 (Vincent S. Walkowiak ed., 3d ed. 2004) (advising lawyers to avoid claims, such as the advice of counsel defense, that require a waiver of the attorney-client privilege).
24. In a study of published healthcare fraud opinions from 1995 to 1998, Gerson and Gladieux found that the advice of counsel defense was raised only about 1% of the time. Gerson & Gladieux, *supra* note 17, at 199 tbl.3. As the authors noted, the study excluded “all unpublished opinions, cases not recommended for full-text publication, . . . decisions without published opinions,” and “the far larger number of cases that are never decided because they are settled.” *Id.* at 197.



## 2. *The Doctrinal Nature of the Defense*

The argument that a defendant should not be held liable because she relied in good faith on the advice of her lawyer is a means of establishing good faith and negating scienter.<sup>25</sup> Courts generally state that reliance on advice of counsel is not a separate and affirmative defense, but rather a circumstance indicating good faith, which the trier of fact may consider on the question of fraudulent intent.<sup>26</sup> The advice of counsel defense therefore has the practical effect of a “complete defense” to actions for which scienter is required, such as knowingly submitting an inflated healthcare bill for Medicare reimbursement.<sup>27</sup> In such actions, a defendant’s proof that she relied in good faith on her lawyer’s advice relieves her of liability because it rebuts one of the elements of the plaintiff’s case. However, in actions that do not include an element of scienter, such as an action for illegal payment<sup>28</sup> or unjust enrichment, the defendant cannot avail herself of the defense.<sup>29</sup>

Courts distinguish the advice of counsel defense from true affirmative defenses. An affirmative defense would absolve a defendant of liability even in the face of clear evidence that all elements of the charge, including the requisite

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25. Alternatively, the action of seeking legal advice in and of itself can demonstrate that the defendant met the standard of due care in undertaking the conduct at issue. *See Note, Reliance on Advice of Counsel*, 70 YALE L.J. 978, 979, 986-87 (1961).
  26. *See United States v. Ibarra-Alvarez*, 830 F.2d 968, 973 (9th Cir. 1987) (discussing the advice of counsel defense in a currency smuggling case); *United States v. Conforte*, 624 F.2d 869, 876 (9th Cir. 1980) (tax evasion); *Bisno v. United States*, 299 F.2d 711, 719-20 (9th Cir. 1961) (bankruptcy fraud).
  27. *United States v. Faust*, 850 F.2d 575, 582 (9th Cir. 1988) (holding in a mail fraud case that “[g]ood faith, in general, constitutes a complete defense to any crime which requires fraudulent intent”); *see Bisno*, 299 F.2d at 720; *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 29(1) (2000) (“When a client’s intent or mental state is in issue, a tribunal may consider otherwise admissible evidence of a lawyer’s advice to the client.”).
  28. The doctrine of illegal payment holds that payment of public monies by public officers under mistake of fact or law can be recovered by the public entity. *See, e.g., J.W. Bateson Co. v. United States*, 308 F.2d 510 (5th Cir. 1962).
  29. *See, e.g., United States v. Boyle*, 469 U.S. 241, 249-52 (1985) (holding that advice of counsel may be a viable defense when a taxpayer relies on counsel’s advice as to a matter of law, but that advice of counsel is no defense when a taxpayer violates a statute that imposes strict liability—for example, if he fails to file in a timely manner); *Szumigala v. Nationwide Mut. Ins. Co.*, 853 F.2d 274, 279-82 (5th Cir. 1988) (holding that an advice of counsel defense will lie in a tort action for bad faith insurance defense denial, but not in an action for breach of contract); James M. Fischer, *Should Advice of Counsel Constitute a Defense for Insurer Bad Faith?*, 72 TEX. L. REV. 1447, 1464-67 (1994); G. Van Ingen, Annotation, *Reliance on Attorney, Accountant, or Other Expert in Preparing Income Tax Returns as Defense Against Fraud Penalties*, 22 A.L.R.2d 972 (1952).

mental state, were present. For example, if a defendant in an action for which scienter is a required element raises a statute of limitations defense and the statute has run, she will prevail even if there is clear evidence that she committed the act with actual knowledge. Procedurally, then, the advice of counsel defense is not an affirmative defense, but rather a “negative defense” presented to controvert the plaintiff’s case.<sup>30</sup> The burden of production falls on the defendant, as she has raised the defense,<sup>31</sup> but the burden of persuasion remains with the plaintiff; the defense may use evidence of reliance on advice of counsel merely as a means to weaken the plaintiff’s case.

Courts have assumed that a corporate director may rely on an advice of counsel defense even when the advice was sought on behalf of her corporation,<sup>32</sup> and some states, including Delaware, have endorsed such reliance by statute.<sup>33</sup> At first glance, this assumption seems logical, as a corporation may only advise itself through the listening ears of its directors.<sup>34</sup> However, this assumption overlooks the fact that the client seeking advice is not the director in her individual capacity but the corporation. It is difficult to know what a particular director actually hears when listening to corporate counsel’s advice. She may believe that corporate counsel’s advice is equally

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30. See *United States v. Komisaruk*, 885 F.2d 490, 495 (9th Cir. 1989) (distinguishing, in a criminal case, between evidence provided to prove an affirmative defense, such as justification or necessity, and evidence provided as a “negative defense” to negate the mens rea elements of the crime); *Marino v. Otis Eng’g Corp.*, 839 F.2d 1404, 1408 (10th Cir. 1988) (holding that there is a difference between evidence in support of an affirmative defense and evidence that negates the plaintiff’s allegations in the complaint, and that a court may permit the defendant to introduce the same evidence for one purpose but not the other).
31. Cf. *Gomez v. Toledo*, 446 U.S. 635, 640-41 (1980) (holding that the burden of pleading a negative defense falls on the defendant, as the defendant is more likely to be able to produce the information relevant to that defense).
32. E.g., *United States v. McClatchey*, 217 F.3d 823, 830-32 (10th Cir. 2000) (holding that if the jury had believed that the defendant had relied in good faith on the advice of corporate counsel, he would have been entitled to an acquittal); *Spirit v. Bechtel*, 232 F.2d 241, 247 (2d Cir. 1956) (upholding the validity of the advice of counsel defense asserted by former corporate directors, but not discussing the fact that the counsel represented the company and not the directors individually); Douglas W. Hawes & Thomas J. Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 VA. L. REV. 1, 28 (1976).
33. E.g., DEL. CODE ANN. tit. 8, § 141(e) (2001) (“A member of the board of directors . . . shall, in the performance of such member’s duties, be fully protected in relying in good faith upon . . . opinions, reports or statements presented to the corporation by . . . any other person as to matters the member reasonably believes are within such other person’s professional or expert competence . . .”); see MODEL BUS. CORP. ACT § 8.30(e) (2002).
34. *Commodity Futures Trading Comm’n v. Weintraub*, 471 U.S. 343, 348 (1985) (“As an inanimate entity, a corporation must act through agents. A corporation cannot speak directly to its lawyers.”).

applicable to herself and to the corporation when in fact there could be different legal implications for the corporation than for herself if she is sued individually.

Despite this potential divergence of interests, courts and legislators are correct in allowing directors to rely on counsel's advice as a defense when liability depends on scienter. The success of the defense depends on proving that the defendant had a good faith belief that her actions were legal. Whether counsel's opinion gave the defendant such a good faith belief does not depend on the precise relationship between the defendant and counsel. Any evidence that tends to negate scienter could help the defendant rebut the plaintiff's case.<sup>35</sup>

### B. *The Impasse*

The Supreme Court has steadfastly guarded the attorney-client privilege, considering it fundamental to the successful functioning of the justice system. The landmark case on attorney-client privilege in the corporate setting is *Upjohn Co. v. United States*, in which the Court stated that "[t]he attorney-client privilege is the oldest of the recognized privileges for confidential communications."<sup>36</sup> The privilege is intended "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and the administration of justice."<sup>37</sup> Today, the Court continues to maintain that any narrowing of the scope of the attorney-client privilege could significantly frustrate its purpose. In one recent case, *Swidler & Berlin v. United States*, the Court held that attorney-client communications remained privileged even after the client's death.<sup>38</sup>

Notwithstanding this strong presumption against narrowing the scope of attorney-client privilege, courts generally require a defendant who raises an advice of counsel defense to waive the attorney-client privilege with respect to those documents or conversations relied upon.<sup>39</sup> Notably, this doctrine of

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35. Cf. Gregory E. Maggs, *Consumer Bankruptcy Fraud and the "Reliance on Advice of Counsel" Argument*, 69 AM. BANKR. L.J. 1, 10-11 (1995) (arguing that in the context of bankruptcy fraud, any advice that negates the defendant's scienter should be considered, even if the lawyer was not the defendant's own).

36. 449 U.S. 383, 389 (1981).

37. *Id.*

38. 524 U.S. 399, 403, 411 (1998) (citing *Upjohn*, 449 U.S. at 389).

39. See, e.g., *Bittaker v. Woodford*, 331 F.3d 715, 718-21 (9th Cir. 2003) (containing an extensive discussion of implied waiver of attorney-client privilege when placing advice of counsel at

required waiver assumes that the defendant is the holder of the privilege; current doctrine does not provide an answer for what is to happen when a third party is the privilege holder. This assumption leads to an impasse when the defendant director indicates she would like to raise an advice of corporate counsel defense.

The impasse can create a tactical advantage or disadvantage for either party. For the plaintiff, the scenario can create a disadvantage because he will be unable to gather evidence to refute the defendant's claims. Alternatively, the scenario can create an advantage for the plaintiff, allowing him to threaten the defendant that she will be unable to present any convincing evidence to a jury and may be entirely prohibited from making the assertion by a motion in limine.<sup>40</sup> For the defendant director, the scenario can create a disadvantage because she may be unable to present exculpatory evidence. If the director faces criminal charges, this could be considered an abrogation of her constitutional right to defend herself. The scenario may, however, advantage the defendant if she can purposefully exploit the plaintiff's inability to cross-examine her and convince a jury that she lacked the requisite scienter. Moreover, the corporation and the director could collude to exploit their informational advantage by purposefully relying on the corporation's right to withhold the privilege while the director tells the plaintiff that she desperately wants to share the legal materials but is "unable" to do so because of the corporation's recalcitrance.<sup>41</sup>

### C. Current Federal and State Jurisprudence

In considering how this impasse can be broken, two issues arise. The first is whether the director has any kind of individual authority to waive the corporation's attorney-client privilege. The second is whether, if the director has no such authority and the corporation refuses to waive, the director may

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issue in a criminal context); *Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*, 32 F.3d 851, 863 (3d Cir. 1994); *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162-63 (9th Cir. 1992); *United States v. Bilzerian*, 926 F.2d 1285, 1292-93 (2d Cir. 1991); *Lorenz v. Valley Forge Ins. Co.*, 815 F.2d 1095, 1098 (7th Cir. 1987). State law has also recognized this doctrine. *See, e.g., Metro. Life Ins. Co. v. Aetna Cas. & Sur. Co.*, 730 A.2d 51, 60-63 (Conn. 1999) (providing an extensive overview of the "at issue" doctrine with citations to many other state cases).

40. The fact that the current legal regime does not indicate which of these outcomes is more likely would further increase the risk-averse defendant's apprehension and improve the plaintiff's position going into settlement.
41. These tactics are examples of the proverbial "sword and shield" tactic that courts strongly disfavor: "[T]he attorney-client privilege cannot at once be used as a shield and a sword. A defendant may not use the privilege to prejudice his opponent's case or to disclose some selected communications for self-serving purposes." *Bilzerian*, 926 F.2d at 1292 (citations omitted).

proceed with the advice of counsel defense. There are two federal cases that have considered these issues, and they have taken opposite positions.<sup>42</sup> The two state cases on point consider only the first issue.<sup>43</sup>

In a recent district court opinion, *United States v. W.R. Grace (Grace II)*,<sup>44</sup> several directors of the corporation, charged in their individual capacities with conspiracy to violate the Clean Air Act and to defraud the United States,<sup>45</sup> argued that they wanted to raise an advice of counsel defense but that Grace was refusing to waive its privilege.<sup>46</sup> Acknowledging the lack of authority on point, the court conducted its own Sixth Amendment analysis.<sup>47</sup> It determined that a balancing test should be used to determine when the defendants' right to defend themselves should prevail over Grace's right to maintain its attorney-client privilege.<sup>48</sup> The court also set forth the procedure by which such a test would be accomplished. The judge would determine whether he would force a waiver of privilege "on a document-by-document basis at trial, where the probative value of each bit of evidence can be evaluated in the context of the government's case and in light of what the evidence shows."<sup>49</sup> The defendants were required to file notice at least two days in advance of their intent to introduce any such communications.<sup>50</sup>

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42. When the United States proceeds under the False Claims Act or any other federal statute, federal courts will apply their own rules of privilege when state interests are not infringed. *E.g.*, *Odmark v. Westside Bancorporation, Inc.*, 636 F. Supp. 552, 554 (W.D. Wash. 1986). Federal common law governs issues of privilege. *E.g.*, FED. R. EVID. 501; *United States v. Hodge & Zweig*, 548 F.2d 1347, 1353 (9th Cir. 1977).
  43. State cases can be illustrative even in a discussion focused on federal law. In the absence of clear federal common law, federal courts may look to other sources, including state law. *United States v. Ellis*, 714 F.2d 953, 955 (9th Cir. 1983).
  44. 439 F. Supp. 2d 1125 (D. Mont. 2006).
  45. The facts of the case are stated in an earlier opinion. *United States v. W.R. Grace (Grace I)*, 233 F.R.D. 586, 587-88 (D. Mont. 2005).
  46. *Grace II*, 439 F. Supp. 2d at 1129. The directors were seeking severed trials on the grounds that, *inter alia*, it would be easier to effect a waiver of the corporation's privilege against its will if the trials were separated. *Id.* As the court noted, the defendants' theory that severability of the trial would have any effect on the privilege question was questionable. *See id.* at 1129, 1136, 1144 n.18. However, the court felt the need to address the privilege issue on the merits to resolve the case. *Id.* at 1136.
  47. For an in-depth discussion of the Sixth Amendment jurisprudence, see *infra* Subsection II.B.3.
  48. *Grace II*, 439 F. Supp. 2d at 1142.
  49. *Id.* at 1142-43.
  50. *Id.* at 1143 n.16.

A recent Sixth Circuit opinion, *Ross v. City of Memphis*,<sup>51</sup> reversed a district court decision that had taken a similar approach to *Grace II*. *Ross* considered this question in the context of a former police chief sued for Title VII discrimination, who wished to present his good faith reliance on the city's counsel as grounds for his qualified immunity defense. The Sixth Circuit held on interlocutory appeal that the former police chief could not waive the privilege and that no balancing test should be used.<sup>52</sup> Relying heavily on the policy arguments for attorney-client privilege in *Upjohn* and *Swidler & Berlin*, the court held that making the city's ability to maintain its attorney-client privilege contingent on the litigation choices of a former employee<sup>53</sup> "renders the privilege intolerably uncertain."<sup>54</sup> The court did not address whether, subsequent to this ruling, the defendant police chief would be permitted to continue to assert the advice of counsel defense.<sup>55</sup>

*Ross* hews closely to the general rule in corporate law that a former employee may not waive the corporation's attorney-client privilege.<sup>56</sup> In

51. 423 F.3d 596 (6th Cir. 2005).

52. *Id.* at 603-04.

53. It is possible that the *Ross* decision depended on a unique aspect of Title VII cases against government employees that is not present in the corporate context. Under the doctrine of qualified immunity, government officials performing their duties are shielded from civil damages liability as long as their actions could reasonably have been thought consistent with the rights they are alleged to have violated. *Anderson v. Creighton*, 483 U.S. 635, 638-39 (1987). The *Ross* court stated that, in a Title VII case against a police officer, "reliance on the advice of counsel is not usually a component of the qualified immunity defense," and so "the defendant claiming reliance on the advice of counsel[] is not being treated unfairly. He retains the use of a qualified immunity defense, which generally turns on the objective reasonableness of an official's actions." 423 F.3d at 603-04. This language implies that the court's decision turned in part on the fact that evidence about the defendant's subjective state of mind was irrelevant to his defense.

54. *Ross*, 423 F.3d at 604.

55. The *Ross* case is still unfolding. Most recently, after an unsuccessful attempt to win summary judgment on the qualified immunity defense without raising an advice of counsel defense, *Ross v. City of Memphis*, 394 F. Supp. 2d 1024, 1041-42 (W.D. Tenn. 2005), the defendant appears to have resumed attempts to gain access to the city counsel's advice, this time by arguing (unsuccessfully) that he had a joint client privilege, *Ross v. City of Memphis*, No. 02-2454 M1/An, 2006 U.S. Dist. LEXIS 17390, at \*1-3 (W.D. Tenn. Mar. 21, 2006).

56. *E.g.*, *United States v. Chen*, 99 F.3d 1495, 1502 (9th Cir. 1996) (holding that a former employee's disclosures of the corporation's attorney-client communications "could not and did not waive the privilege"); *Bushnell v. VIS Corp.*, No. C-95-04256 MHP, 1996 U.S. Dist. LEXIS 22572, at \*25 (N.D. Cal. Aug. 29, 1996) (holding that a former president and CEO of a corporation has no power to waive the corporation's attorney-client privilege). The *Bushnell* court also held that a former director may not "pierce" or otherwise invade the corporation's attorney-client privilege to inspect documents created during his tenure. 1996

*Commodity Futures Trading Commission v. Weintraub*,<sup>57</sup> the Supreme Court considered whether former directors of a bankrupt corporation could assert the corporation's attorney-client privilege against the corporation's court-appointed trustee, who wished to waive the privilege in order to investigate possible wrongdoing. The Court's language has become the leading statement of this doctrine:

[W]hen control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well. New managers installed as a result of a takeover, merger, loss of confidence by shareholders, or simply normal succession, may waive the attorney-client privilege with respect to communications made by former officers and directors. Displaced managers may not assert the privilege over the wishes of current managers, even as to statements that the former might have made to counsel concerning matters within the scope of their corporate duties.<sup>58</sup>

State jurisprudence on the impasse is also undeveloped. The California Court of Appeal held in 2004 that displaced managers who raised an advice of counsel defense could not waive the corporation's attorney-client privilege.<sup>59</sup> Citing both *Weintraub* and California precedent, the court held that the defendants in their individual capacities were not the clients of the corporation's lawyers and therefore could not waive the corporation's attorney-client privilege by asserting the advice of counsel defense.<sup>60</sup> The court addressed the plaintiffs' concern that they would be unable to evaluate or counter the advice of counsel defense absent discovery by stating:

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U.S. Dist. LEXIS 22572, at \*23; accord *Dexia Credit Local v. Rogan*, 231 F.R.D. 268, 278 (N.D. Ill. 2004).

57. 471 U.S. 343 (1985).

58. *Id.* at 349; see also *United States v. Plache*, 913 F.2d 1375, 1381 (9th Cir. 1990) (holding that a former director of a bankrupt corporation indicted for mail fraud could not assert the corporation's attorney-client privilege over the wishes of the court-appointed receiver); *In re Boileau*, 736 F.2d 503, 506 (9th Cir. 1984) (holding that a former director of a bankrupt corporation retained no authority to assert the privilege when the court-appointed examiner waived it).

59. *Venture Law Group v. Superior Court*, 12 Cal. Rptr. 3d 656, 661-63 (Ct. App. 2004).

60. *Id.* at 662; see also *State ex rel. Lause v. Adolf*, 710 S.W.2d 362, 364 (Mo. Ct. App. 1986) (holding that six current and former directors sued in their personal capacities could not waive their corporation's attorney-client privilege by attempting to raise an advice of counsel defense).

We understand [plaintiffs'] argument that they must be allowed to depose [the corporation's attorney] in order to test the validity of the advice of counsel defense and the individual defendants' credibility. However, as this court has explained, the privilege is not vitiated by the fact that its exercise may occasionally suppress relevant evidence. It has been recognized that the search [for] truth must sometimes give way to the purposes of the privilege. Thus, the privilege is not to be set aside when one party seeks verification of the authenticity of its adversary's position.<sup>61</sup>

Although the court did not directly consider whether the defendants would nonetheless be permitted to mention at trial that they followed the advice of counsel, the court's language suggests they would be.<sup>62</sup>

In light of these conflicting authorities, the current law is unclear as to whether a director may waive the corporation's privilege absent its consent and, if not, whether the defendant can present her advice of counsel defense. In the few cases on point, courts are split over whether they would be willing to force any kind of unilateral waiver of the corporation's privilege. *Grace II* gives some insight into the cumbersome procedure that would be used in a balancing test regime to determine when waiver is required. Moreover, no authority that eschews the balancing test approach has clearly indicated how the trial would proceed if the defendant sought to mount a defense for which she could not obtain evidence. No authority has addressed whether the defendant could be prohibited by a motion in limine from even mentioning at trial that she relied on advice of counsel.<sup>63</sup> The very uncertainty created by this lack of authority may in turn create more pressure for parties to settle, further contributing to the lack of published judicial guidance.<sup>64</sup>

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61. *Venture Law Group*, 12 Cal. Rptr. 3d at 662-63 (internal quotation marks and citations omitted).

62. *Id.* at 663.

63. The case law is particularly lacking on this point because, as discussed *supra* Subsection I.A.1, these cases usually settle, and the settlements do not discuss the defense theories. The few cases that have generated published opinions thus far have been pretrial motions. Of those cases with published subsequent history, they may not have gone to trial, or the defendant may have otherwise changed her litigation strategy to avoid the impasse. For example, after the Sixth Circuit's decision in *Ross*, the defendant police officer went forward with a qualified immunity defense and apparently dropped the advice of counsel theory. *Ross v. City of Memphis*, 394 F. Supp. 2d 1024 (W.D. Tenn. 2005). The defendants in *Grace II* have not appealed the privilege ruling as of the time of this writing.

64. See *supra* Subsection I.A.1.



## II. POSSIBLE SOLUTIONS

An agency cost analysis provides the best framework in which to evaluate potential solutions to the impasse that arises when a director attempts to raise an advice of counsel defense but the corporation refuses to waive its privilege. This Part surveys *ex post* solutions, which tend to increase the costs to all parties, and *ex ante* solutions, which are more effective at reducing the costs associated with the impasse. The most effective solution would be for the corporation and the director to contract for the corporation to waive its attorney-client privilege if the director must raise an advice of counsel defense.

### A. *The Impasse as Agency Cost*

The best framework for evaluating potential solutions comes from understanding the impasse as an expression of agency costs between the director and the shareholders.<sup>65</sup> The agency relationship generally takes the form of “a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent.”<sup>66</sup> Importantly, decision-making is an inherent part of what the agent has been authorized to do. An agent does not simply execute; an agent makes decisions. Agency costs, which reduce the value of the agency relationship, occur when the incentives for the agent differ from the incentives for the principal; these divergent interests may lead the agent to contribute suboptimally to the venture as she pursues her own interests at the expense of the principal’s.

In the corporate context, the director is the agent of the shareholders and, as such, must make decisions for the corporation. Agency costs arise in the decision-making context when the incentives of the director differ from the incentives of the shareholders. Today, these incentives diverge because the director faces a greater risk of liability than the corporation for deciding to take a course of action that, in hindsight, proves to be illegal.<sup>67</sup> Therefore, she will

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65. This Note uses a simplified model of the firm and assumes that shareholders are the owners of the firm, directors are their agents, and all executives are also directors. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308-30 (1976) (developing the theory of the firm using simplified organizational models and agency theory).

66. *Id.* at 308.

67. Risks related to the legality of a given business decision are considered to be similar, perhaps inseparable for purposes of this discussion, to what might be termed purely “financial” risks. Any business decision, such as the decision to approve a merger for a given price,

be more risk averse than the shareholders would like. Because lower-risk ventures traditionally lead to lower returns, the agency costs will lower the value of the firm.<sup>68</sup>

Thus, the principal and agent may incur monitoring and bonding costs to reduce agency costs—often by realigning the parties’ interests—and to bring the value of the relationship closer to its optimal level.<sup>69</sup> In an agency cost framework, the solution to the impasse will likely take the form of a bonding cost. Such a bonding cost can help align the interests of the director and shareholder so that directors take on the optimal level of risk for the corporation and thus allow the corporation to earn the optimal level of returns.

To align the divergent interests of the parties, it is necessary to consider the costs to each party involved. First, consider the experience of the corporation. Agency theory predicts that directors may overinvest in positions that are suboptimal and less aggressive to reduce the risk of personal liability when the corporation has a valid defensive theory that the directors cannot raise. With respect to the attorney-client privilege, the unpredictability of the current legal regime also creates high risks for corporations in the form of litigation uncertainty and judicial error. The possibility that a court may waive the corporation’s privilege at some unknown point in the future significantly increases the corporation’s uncertainty. Such waiver is especially costly because once a privileged document has been released, even erroneously, it may be difficult or impossible to reclaim privilege for that document.<sup>70</sup>

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implicates the law and creates a liability risk as well. See Roberta Romano, *What Went Wrong with Directors’ and Officers’ Liability Insurance?*, 14 DEL. J. CORP. L. 1, 13-15, 21-24 (1989) (arguing that changes in the economic environment, changes in legal standards, and uncertainty in legal standards all contribute equally to changes in directors’ potential liability and risk preference).

68. Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 551 (2003) (“[M]anagers sabotage shareholders either by diverting corporate wealth to themselves or by failing to take appropriate risks on behalf of the firm.”); cf. Romano, *supra* note 67, at 4 (arguing that shareholders want “to ensure that directors take the desired level of risk, as they might otherwise be too cautious for fear of the potential liability for a decision that proves harmful with hindsight”).
69. Parties do not incur bonding costs because they are “free,” but because the parties believe the costs will be an investment that results in a net reduction of agency costs and thus a net increase in the value of the firm. Jensen & Meckling, *supra* note 65, at 326.
70. Errors by judges about whether to force waiver of a corporation’s privilege are highly likely given that there is little authority on this question. Moreover, once privilege has been waived for particular documents, the privilege no longer exists, so an erroneous order by a judge to release documents is in some sense unreviewable. The reviewability of a court’s privilege ruling is the subject of some disagreement. Martin et al., *supra* note 23, at 344, 350 n.102; see also *Ross v. City of Memphis*, 423 F.3d 596, 599 (6th Cir. 2005) (comparing Sixth

Turning to the costs borne by the defendant director, the most obvious cost is bearing the entire risk of personal liability for each decision. Today's directors risk jail or civil penalties not merely for choosing to do things that are illegal, but also for conduct that would not result in liability (such as a questionable course of action based on good faith reliance on a legal opinion) if only the director had access to the exculpatory opinion on which she based her decision.<sup>71</sup> The director also experiences costs in the form of litigation uncertainty due to the unpredictability of the legal regime. These costs will be most acute during settlement negotiations, as the director who is unsure of her access to key privileged materials may be unable to assess her chances at trial and thus her position going into settlement.

Many costs are also externalized onto society, primarily due to the unpredictability of the legal regime. In contrast to the individual corporation, which is merely concerned *ex post* with maintaining privilege of a select set of documents, the universe of other corporate entities suffers from *ex ante* litigation uncertainty and judicial error costs—as these firms go about their day-to-day business, they cannot be completely confident of the strength of their attorney-client privilege. They will be unsure of how to proceed in making complex decisions that require professional legal advice. The noncorporate public also faces costs in government-initiated actions, which implicate the public interest. The uncertainties and disadvantages that this regime creates for a plaintiff trying to win a case are great, as discussed in Section I.B. Finally, the public as taxpayer suffers high costs in the form of unrecovered tax money that may have been fraudulently obtained.

The agency cost analysis and the identification of the costs involved suggest that the optimal solution is the one that reduces the many costs to all parties and also most effectively internalizes those costs that are currently externalized. The above analysis shows that the two costs that are common to all three parties are litigation uncertainty and risk of judicial error; the ideal solution will be one that brings clarity and certainty to the process.

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Circuit law to D.C. Circuit and Third Circuit law on the permissibility of interlocutory appeal of discovery orders involving privilege).

71. For example, the individual defendants in *Grace II* appear to have chosen a course of conduct that was only illegal depending on the interpretation of federal environmental regulations. They would not face liability for knowingly violating the statute if they could prove that they believed, based on counsel's advice, that they were not violating it. Access to the privileged legal opinions could thus be critical to the individual defendants' cases. See *Grace II*, 439 F. Supp. 2d 1125 (D. Mont. 2006).

### B. *Ex Post Solutions*

Ex post solutions attempt to break the impasse at the time of litigation. The ex post solutions include allowing one party to unilaterally invade the corporation's privilege, applying evidence law to simply exclude any mention of the defendant's claim, or interpreting a defendant's right to mount a defense as trumping the corporation's privilege. These solutions are less effective than ex ante solutions because within their current doctrinal parameters they tend to increase uncertainty costs. Also, they only internalize externalities in limited cases. Attempts to utilize these solutions more effectively would require significant changes to current legal regimes. In contrast, as I will discuss below, a contractual solution would require little change to current law.

#### 1. *Piercing the Privilege*

One solution to the impasse is to allow one party to unilaterally invade or "pierce"<sup>72</sup> the corporation's privilege. For example, the prosecution may be able to pierce the corporation's privilege under the crime-fraud exception. This doctrine allows a court to order waiver of a corporation's privilege when the prosecution can make a preliminary showing that the attorney's services were intentionally used in the service of furthering the alleged fraud.<sup>73</sup> The doctrine is extremely limited, however, and may be applied only when the prosecution has evidence that the defendant intended the attorney's services to be an actual element of the commission of the crime—for example, if the defendant's lawyers assisted the defendant in the actual preparation of tax returns that all parties knew were fraudulent.<sup>74</sup> The doctrine will not apply when the defendant merely sought the attorney's legal advice in contemplation of future conduct that turned out to be illegal in hindsight—for example, if the

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72. Many cases use the term "pierce" to describe allowing one party to access privileged materials notwithstanding the other party's valid attorney-client privilege. *See, e.g.,* *Bushnell v. VIS Corp.*, No. C-95-04256 MHP, 1996 U.S. Dist. LEXIS 22572, at \*23 (N.D. Cal. Aug. 29, 1996) ("Bushnell cannot pierce the attorney-client or work product privileges asserted by defendants . . .").

73. *See United States v. Zolin*, 491 U.S. 554, 563 (1989).

74. *See United States v. Chen*, 99 F.3d 1495, 1503-04 (9th Cir. 1996) (holding that evidence that the defendants' attorneys had purposefully participated in the preparation of fraudulent tax returns was sufficient to permit the prosecution to invoke the crime-fraud exception); *see also United States v. Davis*, 1 F.3d 606, 610 (7th Cir. 1993) (holding that the crime-fraud exception applied when the defendant tricked his attorney into misrepresenting the defendant's level of compliance with discovery orders).

defendant sought legal advice on securities disclosure requirements to determine the legality of conduct before taking action.<sup>75</sup>

Some courts have wrestled with allowing a defendant director to pierce the corporation's privilege to access particular documents she viewed when she was employed by the corporation, without allowing the defendant to technically "waive" the corporation's privilege.<sup>76</sup> The majority view, however, is that a defendant director may *not* pierce the corporation's privilege, even to access documents that she may have viewed or solicited.<sup>77</sup>

Solutions that depend on allowing either the plaintiff or the defendant to pierce the corporation's attorney-client privilege are unsatisfactory because they would apply in very limited circumstances under current law and would not reduce agency costs. Piercing the privilege would actually increase agency costs due to increased litigation uncertainty and risk of judicial error. The risk that a party's privilege could be waived unilaterally at some future point would eviscerate the privilege. In addition to having a chilling effect on attorney-client candor, this would increase litigation uncertainty and judicial error costs, as parties would be unable to assess the strength of their privilege and to manage the risk of disclosure accordingly.<sup>78</sup>

## 2. *Motion in Limine*

Another *ex post* solution is to take a do-nothing approach: to apply evidence law without special consideration for the interests at stake and to accept the consequences of such application. One device that would likely be employed is a motion in limine, a pretrial device that enables a party to prohibit an opponent from presenting offending evidence at trial by seeking an advance ruling on its admissibility.<sup>79</sup> The motion allows the moving party to prevent prejudicial matter that would ultimately be inadmissible from entering

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75. *In re Bankamerica Corp. Sec. Litig.*, 270 F.3d 639, 643 (8th Cir. 2001) ("[T]he crime-fraud exception does not apply when a publicly held company seeks legal advice concerning its disclosure obligations and then commits an *unintentional* disclosure violation.").

76. *See, e.g.*, *Dexia Credit Local v. Rogan*, 231 F.R.D. 268, 277 (N.D. Ill. 2004); *Finovia Capital Corp. v. Lawrence*, No. 3-99-CV-2552-M, 2001 U.S. Dist. LEXIS 2087, at \*6-7 (N.D. Tex. Feb. 22, 2001); *Bushnell*, 1996 U.S. Dist. LEXIS 22572, at \*23.

77. *E.g.*, *Bushnell*, 1996 U.S. Dist. LEXIS 22572, at \*23; *see also Dexia Credit Local*, 231 F.R.D. at 278. *But see* *Gottlieb v. Wiles*, 143 F.R.D. 241, 247 (D. Colo. 1992) (holding that a former director may pierce the corporation's attorney-client privilege to view documents he could have viewed upon request at the time they were generated).

78. *See supra* Section I.B for more discussion of the costs of uncertainty in privilege law.

79. 75 AM. JUR. 2D *Trial* § 94 (1991).

the record at all.<sup>80</sup> The policy permitting motions in limine recognizes that merely asking an improper question in front of the jury may unfairly prejudice the moving party even though the offending evidence is excluded at trial.<sup>81</sup> Using this procedure, courts could simply grant a plaintiff's motion in limine to prevent the defendant director who cannot secure a waiver of the corporation's privilege from raising the advice of counsel defense at all. Or courts could deny the motion and allow the defendant to take the stand and make a bald, unsubstantiated claim that she relied on the advice of counsel even though she will not be able to present any evidence to this effect.

These options leave all of the risks and costs completely in place. If the court does grant the motion in limine, the defendant director will have to mount a defense without what might be her critical exculpatory argument. The defendant director will now bear all of the agency costs because she bears far more risk of liability than the corporation. If the court permits the defendant to take the stand and make a bald assertion, the court gives the defense an opportunity to exploit the sympathies of the jury while giving the plaintiff no benefit at all. In this situation, the parties face uncertainty because they must try to predict how a jury will respond to the defendant's presentation of a legal theory that the defense cannot support and that the plaintiff cannot discredit through cross-examination. The agency costs are largely externalized onto the plaintiff or prosecution, which, in civil or criminal fraud cases, is often a representative of the public.

Current law also does not give any guidance as to which of these options is more likely to be ordered by a court.<sup>82</sup> This lack of guidance adds additional litigation uncertainty costs, as it is harder to predict whether a court will grant a motion in limine. A defendant or plaintiff, unable to predict the outcome of the motion in limine, will have a more difficult time assessing the strength of its position going into settlement negotiations, as well as a more difficult time developing a litigation strategy.

A consistent approach to ruling on motions in limine would reduce the additional agency costs associated with uncertainty as to the outcome of the motion. The parties would at least know whether the unsubstantiated claim

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80. *Id.*

81. *Id.*; see also *supra* note 12.

82. For example, subsequent to the Sixth Circuit's decision in *Ross*, the district court heard a summary judgment motion on whether the police chief was still protected from personal liability by the doctrine of qualified immunity, and there was no discussion of the advice of counsel defense. *Ross v. City of Memphis*, 394 F. Supp. 2d 1024 (W.D. Tenn. 2005). It is impossible to tell from this opinion whether the plaintiff moved for a motion in limine to exclude all discussion of this defense or whether the defendant simply stopped pursuing it.

would be permitted. However, as discussed above, decisions to grant or deny both lead to an outcome that itself creates substantial uncertainty: in particular, denying the motion in limine leaves the parties to speculate how a jury will take unsupported and unexamined claims into account in weighing the element of scienter. Therefore, applying evidence law with no additional legal innovation simply begs critical questions and offers little solution to the problems of agency costs and externalities.

### 3. *Doctrinal Solutions: The Constitutional Right to a Defense*

The most compelling ex post solution is to have a court apply a balancing test to determine when the defendant's right to mount a defense should trump the corporation's right to maintain its attorney-client privilege. Since 1967, the Supreme Court has acknowledged and expanded the scope of a criminal defendant's constitutional right to mount a defense, grounded alternatively in the Compulsory Process Clause,<sup>83</sup> the Confrontation Clause,<sup>84</sup> and the Due Process Clause.<sup>85</sup> By 1987, the Court had developed a balancing test to determine whether a particular evidentiary privilege must yield to this right: whether the interests served by the exclusionary rule justify the limitation imposed on the defendant's constitutional right to present exculpatory evidence.<sup>86</sup> However, the Court has consistently held that testimonial privileges, which include the attorney-client privilege, need not be balanced against the defendant's right to defend herself.<sup>87</sup>

In *Swidler & Berlin*, the Court proved extremely resistant to granting any exceptions to the attorney-client privilege.<sup>88</sup> The Court feared that a balancing test approach, even limited to criminal cases involving a deceased defendant, would introduce such substantial uncertainty into the privilege's application

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83. See *Washington v. Texas*, 388 U.S. 14, 19 (1967).

84. See *Davis v. Alaska*, 415 U.S. 308, 320 (1974).

85. See *Chambers v. Mississippi*, 410 U.S. 284, 294 (1973) ("The right of an accused in a criminal trial to due process is, in essence, the right to a fair opportunity to defend against the State's accusations.").

86. *Rock v. Arkansas*, 483 U.S. 44, 51-53 (1987).

87. E.g., *Washington*, 388 U.S. at 23 n.21 ("Nothing in this opinion should be construed as disapproving testimonial privileges . . ."); accord *Chambers*, 410 U.S. at 295. But see *Grace II*, 439 F. Supp. 2d 1125, 1140 (D. Mont. 2006) (holding that the Supreme Court's exclusion of testimonial privileges in *Washington* did not indicate the Court's opposition to the use of balancing tests when the attorney-client privilege was at stake, but merely acknowledged that the issue was not before the Court).

88. 524 U.S. 399, 409 (1998).

that it would eviscerate the privilege: “A ‘no harm in one more exception’ rationale could contribute to the general erosion of the privilege, without reference to common law principles or ‘reason and experience.’”<sup>89</sup> Indeed, under a balancing test regime, a court may decide during some future litigation that a privilege must be pierced, meaning that the corporation ultimately has no reliable privilege. A corporation cannot have frank and open communications with counsel if it understands that a future defendant’s need to reveal privileged information may persuade a court to pierce its attorney-client privilege.<sup>90</sup> This concern was central to the reasoning in the recent *Ross* case.<sup>91</sup> Criticizing the district court, which had used a balancing test to decide that the city of Memphis must waive its attorney-client privilege, the Sixth Circuit stated:

The district court’s reasoning renders any municipality’s privilege dependent on *ex post* litigation choices made by its employees. . . . As the Supreme Court has warned, “[a]n uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all.” Making the City’s ability to invoke attorney-client privilege contingent on litigation choices made by one of its former employees renders the privilege intolerably uncertain.<sup>92</sup>

Even if current doctrine did hold that a defendant’s constitutional right to mount a defense could prevail over a third party’s attorney-client privilege, this doctrine would only provide a solution for criminal cases. The Court’s rulings in this area have been grounded in the constitutional provisions governing defendants’ rights in criminal trials. A constitutional right to present the evidence necessary to mount a defense in civil cases has never been recognized.<sup>93</sup> If the Court did recognize such a right in both criminal and civil

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89. *Id.* at 410; *see id.* at 409 (“Balancing *ex post* the importance of the information against client interests, even limited to criminal cases, introduces substantial uncertainty into the privilege’s application. For just that reason, we have rejected use of a balancing test in defining the contours of the privilege.”).

90. Of course, this argument assumes that undermining the privilege in this way would be bad for society, which is the stance taken by the Supreme Court. It leaves open the question of whether there might ultimately be a net benefit in undermining the privilege to vindicate a defendant’s right to mount a full defense.

91. *Ross v. City of Memphis*, 423 F.3d 596 (6th Cir. 2005).

92. *Id.* at 603-04 (alteration in original) (citation omitted).

93. Professor Imwinkelried argues provocatively that there *should* be a due process right to present the evidence necessary for a defense in civil cases as well. Edward J. Imwinkelried,



trials, this would not be the end of the inquiry. We would still need to know *how* a balancing test would be applied. Courts would have to balance the third-party corporation's interest (which may also be a proxy for society's interest in maintaining the attorney-client privilege) with the defendant's interest in presenting her defense. Scholars have generally floundered in attempts to suggest an appropriate test.<sup>94</sup>

Any balancing test solution will also leave in place most of the agency costs associated with unpredictability in litigation and judicial error. If the court balances the interests in favor of the defendant, the corporation will bear the risk of uncertain attorney-client privilege and the associated litigation uncertainty. If the court balances the interests in favor of the corporation, the defendant director bears the increased risk associated with higher liability. The fact that such tests are highly fact-specific and prone to inconsistent results and judicial error means that neither party can predict which way the court would balance the interests, further increasing litigation uncertainty.<sup>95</sup>

Moreover, these solutions will do little to internalize the uncertainty and error costs borne by society. Any time a court holds that the corporation's privilege should outweigh the defendant's interest, society will continue to bear substantial costs in the form of litigation uncertainty for the plaintiff or prosecution. In civil fraud cases, the public may also bear the risk of being unable to recover taxpayer money if it was fraudulently obtained by a director who had the requisite scienter.

In conclusion, applying an *ex post* balancing test, like piercing the privilege or using a motion in limine, increases agency costs by increasing uncertainty. All three approaches also threaten to eviscerate the attorney-client privilege and therefore are not effective solutions to the impasse.

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*Questioning the Behavioral Assumption Underlying Wigmorean Absolutism in the Law of Evidentiary Privileges*, 65 U. PITT. L. REV. 145, 168-69 (2004).

94. The balancing tests advanced by other scholars invariably result in a case-by-case determination of which interest will prevail, creating a high risk of litigation uncertainty and judicial error. More critically, the proponents of these tests often concede that they do not create a satisfying solution when the particular privilege implicated is the attorney-client privilege. See, e.g., Robert N. Clinton, *The Right To Present a Defense: An Emergent Constitutional Guarantee in Criminal Trials*, 9 IND. L. REV. 711, 815-80 (1976); Welsh S. White, *Criminal Law: Evidentiary Privileges and the Defendant's Constitutional Right To Introduce Evidence*, 80 J. CRIM. L. & CRIMINOLOGY 377, 414-16 (1989).
95. Were a court to implement a procedure like the one required in *Grace II*, in which the defense must request a waiver on a document-by-document basis as the trial progresses, the uncertainty factor would increase enormously: not only would each party be uncertain going into trial as to the strength of its case, but it would have to wonder from day to day during the trial whether it would be permitted to present (or investigate) individual materials.

### C. *Ex Ante Solutions*

Ex ante solutions tend to generate more efficient results because they allow the parties to anticipate future litigation and allocate risks and costs among themselves. These solutions include altering the relationships between the parties and their lawyers or contracting to waive the privilege under certain circumstances. Particularly when contracting occurs, the parties will tend to collaborate to lower costs and thereby increase the contractual surplus. Contemplation of future litigation costs also encourages a reduction in externalities, as parties become more aware ex ante of the costs associated with possible future decisions.<sup>96</sup>

#### 1. *Multiple Clients or Multiple Lawyers*

One ex ante solution is to consider the director and the corporation as joint clients of the same counsel. If both parties are clients, each has an equal right to waive the privilege notwithstanding the objections of the other. This approach, called “joint client privilege,” has been applied consistently by federal courts in other settings. Under current doctrine, however, the standards to establish a joint client privilege are extremely high.<sup>97</sup> For example, *Odmark v. Westside Bancorporation, Inc.* adopted the following test for establishing joint client privilege: “If [the director] makes it clear when he is consulting the company lawyer that he personally is consulting the lawyer and the lawyer sees fit to accept and give communication knowing the possible conflicts that could arise, he may have a privilege” that both he and the company would have independent authority to waive.<sup>98</sup> Thus, a joint client privilege would be difficult to establish in practice without significant change to the doctrine.

Even if the bar to establish joint client privilege were lowered, the solution is problematic. It is likely to lead to conflicts of interest and increased transaction costs, as corporate counsel would constantly be advising two clients

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96. See Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. (PAPERS & PROC.) 347, 348 (1967) (defining externalities as the effects of contracting parties’ actions on others or themselves that have not been brought to bear on the decisions of at least one of the contracting parties).

97. See, e.g., *Odmark v. Westside Bancorporation, Inc.*, 636 F. Supp. 552, 555-56 (W.D. Wash. 1986); see also *Citibank, N.A. v. Andros*, 666 F.2d 1192, 1196 (8th Cir. 1981) (holding that when the trustee and directors of a corporation hold a joint privilege, the trustee’s waiver does not bar the directors from asserting their individual privileges in other proceedings).

98. 636 F. Supp. at 555-56 (citing *In re Grand Jury Proceedings*, 434 F. Supp. 648, 650 (E.D. Mich. 1977), *aff’d*, 570 F.2d 562 (6th Cir. 1978)).

whose interests were not fully aligned. The attorney might have to give two sets of advice when the law applies differently to corporations and directors. For example, to violate the False Claims Act, a defendant must have knowledge that the claim submitted to the government is false.<sup>99</sup> A corporate agent's knowledge may be imputed to the corporation,<sup>100</sup> but the corporation's knowledge may not necessarily be imputed to any individual agent.<sup>101</sup> It is easier, then, to prove that a corporation had knowledge than that an individual director had knowledge.

More critically, frequent use of joint client privilege would eventually eviscerate the corporate attorney-client privilege. If a director is personally a joint client with the corporation, she has waiver rights regarding legal advice given to her under the joint client agreement that cannot be restricted to her term of employment. If every director is a joint client with the corporation, then each director will have the power to waive the corporation's privilege, even after she has left the firm, whether or not she needs to raise an advice of counsel defense. Because director turnover is inevitable in a going concern, regular use of joint client privilege would mean that a corporation's attorney-client privilege would be secure only to the extent that fiduciary duty could prevent current directors from waiving the privilege when it was not in the corporation's best interest.<sup>102</sup>

The second possible solution of this type would be to have each director maintain individual counsel at all times, essentially bringing her own lawyer to work. The increased transaction costs, not to mention logistical nightmares, associated with this solution are immediately apparent. Even in current practice, as soon as a company discovers it is under federal investigation for fraud, it often hires outside counsel for itself and suggests to key directors that they secure their own outside counsel. The various lawyers representing all the parties immediately begin honing individualized strategies for their clients, figuring out who needs to be "hung out to dry" so that their clients can come

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99. See 31 U.S.C. § 3729(b)(1)-(3) (2000).

100. See, e.g., *United States ex rel Quirk v. Madonna Towers, Inc.*, 278 F.3d 765, 768 (8th Cir. 2002) (examining the testimony of the chief administrator and chief financial officer to determine whether the defendant corporation had sufficient knowledge of the falsehood).

101. See, e.g., *L.B. Indus., Inc. v. Smith*, 817 F.2d 69, 71 (9th Cir. 1987) (holding that to be held personally liable for a corporate fraud, a director must have personal knowledge of, or involvement in, the fraud).

102. This Note does not reach the question of what duties a fiduciary or agent owes to her principal when both parties share a joint client privilege. It is sufficient for these purposes to argue that were these duties the sole force for maintaining a corporation's attorney-client privilege, the scope of the privilege would be significantly narrower and more uncertain than under the current regime.

out relatively unscathed. To import these kinds of tensions earlier into the agency relationship could serve only to drive a wedge between the directors and the corporation.

2. *Contracting for Waiver of Privilege*

The solution I propose is that the corporation should agree to waive its attorney-client privilege with respect to specified legal opinions, but only if the director is being sued in her individual capacity and needs to raise an advice of counsel defense. This solution, which I term “contractual waiver of privilege,” greatly reduces litigation uncertainty and judicial error costs for all parties. It forces the agent and principal to internalize costs that are otherwise borne by society in the form of unclear legal rules, prosecutorial ineffectiveness, and lost taxpayer money.

In contrast to the other solutions I have explored, which would rely on doctrinal change, the contractual waiver of privilege relies primarily on the dealings of individual actors and entities. Accordingly, the proposed solution is not one of reshaping the law, but rather of reshaping actors’ choices within the existing legal framework. In addition to being more practical to implement, this solution is preferable to a balancing test or other *ex post* regimes in which a judge may eventually force a corporation to waive its privilege because this solution allows and encourages the parties to agree upon and control the conditions and scope of the waiver.

Professors Robert Scott and George Triantis have argued that contract design, including design of employment contracts, should be an opportunity for parties to anticipate future litigation.<sup>103</sup> Parties can reduce their back-end costs (i.e., litigation costs that include the gathering of exculpatory evidence, litigation uncertainty, and judicial error) by investing more at the front end (at the time of formation) and by contracting for measures that reduce future litigation costs.<sup>104</sup> Scott and Triantis suggest that the time of contracting should be a time for the parties to anticipate “who is more likely to be suing and for what.”<sup>105</sup> Directors can anticipate that they are likely to be sued in connection with decisions that in hindsight have adverse consequences. Thus, a director negotiating her employment package can contract to reduce the cost

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<sup>103</sup>. Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 878 (2006).

<sup>104</sup>. *Id.* at 818-19. Scott and Triantis discuss contractual provisions designed to reduce litigation costs between the parties to the contract. I extend their argument to anticipating litigation arising out of the contract between one of the contracting parties and a third party.

<sup>105</sup>. *Id.* at 878.

to her of getting the exculpatory evidence in future litigation. She can secure the company's promise to waive its attorney-client privilege under limited circumstances.

Although at first glance this solution might appear to require the director to forfeit some monetary compensation in consideration of the agreement to waive privilege, this is not the likely outcome. The contractual waiver of privilege will enable the director to make more aggressive decisions. By taking on more risk for the corporation, the director is likely to increase its overall returns.<sup>106</sup> Thus, by agreeing to waive its privilege under very limited circumstances, the firm can experience a marginal surplus from the director-corporation employment contract that makes the design of the contract rational for both parties.

### III. CONTRACTING SOLUTIONS IN DEPTH

The previous Part demonstrated the potential advantages of contractual waivers of privilege between the corporation and its director. This Part now develops the suggestion in detail, first showing that a contractual waiver is enforceable, and then developing a theory of which legal rules concerning the waivers should be defaults and which should be mandatory. Finally, this Part begins to explore how such provisions might be structured.

#### A. *Are Contractual Waivers of Privilege Enforceable?*

The first question that arises when considering the feasibility of contractual waivers of privilege is whether courts would enforce such provisions. Recent Supreme Court cases indicate that the Court would be likely to do so in both criminal and civil cases.

*United States v. Mezzanatto*<sup>107</sup> concerned whether a criminal defendant may, in a contract prior to trial, waive the evidentiary rule that statements made in

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<sup>106</sup>. This argument suggests that directors will raise the firm's risk-taking from its current level to the shareholders' desired level. The corporation's actual current risk level reflects the shareholders' desired level minus the amount of risk that directors refuse to take on for fear of personal liability. The difference between the desired risk level and the actual risk level is one way to measure the agency cost associated with the impasse. *See supra* Section II.A. The contractual waiver of privilege reduces this cost by making the personal risk a director faces for a given decision more similar to the risk the corporation faces for the same conduct (because the director can raise the advice of counsel defense as easily as the corporation can).

<sup>107</sup>. 513 U.S. 196 (1995).

the course of plea discussions are inadmissible against the defendant.<sup>108</sup> The Court, in a 7-2 decision, gave an emphatic “yes.” The Court stated, “A criminal defendant may knowingly and voluntarily waive many of the most fundamental protections afforded by the Constitution.”<sup>109</sup> Although the Court did not mention attorney-client privilege, the Court cited precedents that expressly allowed waiver of the privilege against compulsory self-incrimination, the right to a jury trial, the right to confront one’s accusers, and the right to counsel.<sup>110</sup> The Court also held that evidentiary rules are presumptively waivable and that courts have “‘liberally enforced’ agreements to waive various exclusionary rules of evidence”<sup>111</sup> because “evidentiary stipulations are a valuable and integral part of everyday trial practice. Prior to trial, parties often agree in writing to the admission of otherwise objectionable evidence, either in exchange for stipulations from opposing counsel or for other strategic purposes.”<sup>112</sup>

The Court specifically addressed the concern that enforcing such a waiver would create a “chilling effect” on the plea bargaining process by making defendants “think twice” before speaking candidly in plea bargaining.<sup>113</sup> The Court stated that this potential cost was offset by the fact that enforcing the waivers would facilitate plea bargaining when, without such a waiver agreement in place, the prosecution would be unwilling to move forward with the negotiation.<sup>114</sup> In other words, contractual waivers of evidentiary privileges should be permitted because they allow parties to transact more efficiently and thereby improve the functioning of the legal system. This holding, and its underlying policy endorsing the waiver of evidentiary rights in a criminal trial (in which defendants’ rights are most salient), appears highly applicable to the question of enforceability of *ex ante* contractual waivers of attorney-client privilege between the corporation and its directors.

The *Mezzanatto* Court placed two limitations on its broad holding. The first was that “[t]here may be some evidentiary provisions that are so fundamental to the reliability of the factfinding process that they may never be waived without irreparably ‘discredit[ing] the federal courts.’”<sup>115</sup> While one could

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108. FED. R. EVID. 410. At the time of the case, this rule was codified at FED. R. CRIM. P. 11(e)(6).

109. *Mezzanatto*, 513 U.S. at 201.

110. *Id.*

111. *Id.* at 202.

112. *Id.* at 203.

113. *Id.* at 206 (internal quotation marks omitted).

114. *Id.* at 207.

115. *Id.* at 204 (second alteration in original).

construe this limiting language to include attorney-client privilege, the Court's decision set the standard for such a fundamentally unenforceable provision far higher: its example of an unenforceable contractual waiver was one in which the parties stipulated to trial by a jury of twelve orangutans.<sup>116</sup> Moreover, the Court distinguished between agreements that deprive the courts of relevant testimony and agreements that allow admission of evidence that would otherwise be excluded; the latter are strongly favored and likely to be enforced.<sup>117</sup> An *ex ante* contractual waiver of privilege between a director and her corporation would be just such an agreement. The Court's second limitation was that the waiver in question would be enforceable only "absent some affirmative indication that the agreement was entered into unknowingly or involuntarily."<sup>118</sup> This limitation is unlikely to pose a problem in the corporate context because sophisticated parties such as a candidate director and a corporation are generally presumed to have bargained knowingly and voluntarily.

The Court has also enforced *ex ante* contractual waivers of constitutional due process rights in civil litigation. In *D.H. Overmyer Co. v. Frick Co.*, the Court held that a debtor could waive its right to jury trial through a *cognovit* action, whereby it agrees at the time the debt is negotiated that if it does not pay the balance on the maturity date, judgment will be entered against it.<sup>119</sup> Under such a *cognovit* action, the debtor also waives the rights to trial, to raise any and all defenses, and to appeal the judgment. The Court held that such agreement was not a *per se* violation of the Fourteenth Amendment Due Process Clause and that the only factor that affected its constitutionality was whether the parties were of equal bargaining power and contracting sophistication.<sup>120</sup> Since *Overmyer*, the Court has continually enforced predispute contractual waivers of due process rights, including arbitration clauses and forum selection clauses, as long as contract law standards of consent are satisfied.<sup>121</sup>

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116. *Id.* (citing *United States v. Josefik*, 753 F.2d 585, 588 (7th Cir. 1985)).

117. *Id.* at 204-05.

118. *Id.* at 210.

119. 405 U.S. 174, 185-86 (1972).

120. *Id.* at 187-88.

121. See Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses, and Other Contractual Waivers of Constitutional Rights*, LAW & CONTEMP. PROBS., Winter/Spring 2004, at 167. Judge Posner has argued that courts tend to enforce contractual waivers of important trial rights and that these contracts *should* be enforceable because they allow parties to reduce litigation uncertainties. Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1595 (2005).

*B. The Corporation's Incentives*

The next consideration is whether corporations would be amenable to such agreements. The contractual waiver does present a cost to the corporation, particularly given that once attorney-client privilege has been waived with respect to a document in a particular lawsuit, that document cannot be shielded from discovery in future suits.<sup>122</sup> However, three factors should incentivize the corporation to invest in a contractual waiver of privilege: efficiency gains from the waiver that will increase net value to the firm, the need to recruit talented directors, and pressure created by directors' and officers' (D&O) insurance companies.

As I discussed in Section II.A, the costs associated with contractual waiver are an investment by the corporation, a form of bonding cost designed to align the director's interests with those of the shareholders. The contractual waiver of privilege reduces the personal risk that the director faces to equal the risk that the corporation faces. Agency theory predicts that corporations will bear the cost of the contractual waiver of privilege if it results in a net increase in value to the firm.<sup>123</sup> By restoring the risk level faced by the director to the relatively lower level faced by the corporation, shareholders will ensure that the risks taken by the director are commensurate with the risk level they desire for their investment, thus improving the likelihood that returns will meet their expectations.<sup>124</sup> Moreover, in an efficient market, information that the firm has now decreased the risk faced by its directors, thus providing incentives for the directors to make optimally aggressive decisions,<sup>125</sup> should result in an increase in stock price to anticipate the rise in future cash flows generated by this

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122. GERGACZ, *supra* note 11, ¶ 5.01, at 5-3 to -6.

123. Jensen & Meckling, *supra* note 65, at 325-26.

124. See Romano, *supra* note 67, at 4 (arguing that shareholders want "to ensure that directors take the desired level of risk, as they might otherwise be too cautious for fear of the potential liability for a decision that proves harmful with hindsight").

125. The optimal level of risk is defined as the level of risk that the shareholders desire the corporation to take. Whatever the optimal level, under the current regime, the director will take *less* risk than is optimal—making lower-risk decisions to offset the higher personal risk she faces. The contractual waiver of privilege restores the level of risk the director is willing to take back up to the optimal level. If shareholders believe one of their directors is taking on too *much* risk, they have two options. They can diversify their portfolio by investing in other companies, or they can exercise their voting rights and have the director replaced. The uncertainty associated with the impasse is far less reliable as a way to rein in overly risky directors than either of these two options and moreover is not tailored to manage only the overly risky directors.



investment (i.e., the waiver agreement).<sup>126</sup> Thus, firms would have a near-term financial incentive to invest in waiver to see net growth in firm value.

The strong negotiating position of the directors they are trying to recruit should also incentivize firms to agree to contractual waivers of privilege. Firms generally believe that there is a tight market for high-quality directors and will make substantial economic investments to recruit them. Evidence of this includes the high pay extracted by new directors,<sup>127</sup> as well as a history of corporate investment in other costs that reduce directors' personal liability, including the purchase of D&O insurance and the adoption of charter provisions that limit directors' personal liability.<sup>128</sup> Thus, while the cost of contractual waiver is real, firms are likely to bear it to recruit directors to join the firm.

Finally, D&O insurers will put pressure on corporations to contract for conditional waiver.<sup>129</sup> D&O insurers have two primary incentives to encourage such waivers. The first is that insurers generally attempt to reduce litigation uncertainties in order to correctly price premiums and evaluate settlement offers.<sup>130</sup> A contractual waiver would significantly reduce the litigation uncertainties associated with the impasse. The second incentive is to make sure that charges that a director has engaged in fraud or deceitful practice are adjudicated on the merits. This is because D&O insurance policies generally exclude coverage for fraud claims, but in most states this exclusion only applies

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126. See STEPHEN A. ROSS ET AL., *CORPORATE FINANCE* 362-76 (3d ed. 1993); cf. Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, J. ECON. PERSP., Spring 2001, at 121, 134-35 (citing empirical evidence that institutional investors play an important role in current capital markets, monitor firms closely, and will pay a premium for companies with good corporate governance).

127. See, e.g., Gretchen Morgenson, *Outside Advice on Boss's Pay May Not Be So Independent*, N.Y. TIMES, Apr. 10, 2006, at A1 (noting that defenders of director compensation say it reflects the "increasingly complex and competitive arena" for directors).

128. See DEL. CODE ANN. tit. 8, § 102(b)(7) (2004) (permitting charter amendments); Alfred F. Conard, *A Behavioral Analysis of Directors' Liability for Negligence*, 1972 DUKE L.J. 895, 898-900 (arguing that directors will not serve unless protected from personal liability); Romano, *supra* note 67, at 1-2, 4 (noting that many directors will not serve without D&O insurance).

129. See TORT & INS. PRACTICE SECTION, AM. BAR ASS'N, *DIRECTORS AND OFFICERS LIABILITY INSURANCE DESKBOOK* 11 (David E. Bordon et al. eds., 1998) [hereinafter D&O DESKBOOK] (stating that insurers have freedom at the time a policy is drafted to determine the contours of the policy and to ensure profitability and predictability).

130. D&O insurance policies generally require the insured to obtain the insurer's prior consent to any settlement, and the insured has a duty to cooperate with the insurer by providing it with sufficient information on which to evaluate the proposed settlement. *Id.* at 151.

after the fraud has been successfully adjudicated. A settlement that does not stipulate to fraud does not trigger the fraud exclusion.<sup>131</sup> To the extent that a risk-averse director (or plaintiff), unable to present (or discredit via cross-examination) an advice of counsel defense, may be overly tempted to settle and thus avoid an adjudication of fraud, insurance companies may be forced to cover claims they would otherwise hope to exclude under the fraud exception. Thus, insurance companies have incentives to pressure corporations to contract for conditional waiver, and they can apply this pressure in two ways. They can use their right to “assist in the litigation” to demand the practice outright,<sup>132</sup> or they can simply increase premiums for those corporations that refuse to contract for waiver.<sup>133</sup>

### C. Default and Mandatory Rules

Having addressed the threshold questions of enforceability and corporate amenability, this Note now analyzes which legal rules should be defaults that the parties may contract around and which should be mandatory.<sup>134</sup> As a preliminary step, it is important to note that we are allocating not one, but two sets of risks. On the one hand, we are allocating between a director and a corporation the risks associated with making management decisions. The rule as between these two parties should be a default that parties may contract around. The parties are entering into an agency relationship. In settings like

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131. See *id.* at 121-23; Marc Mayerson, *What a Director (or Officer) Wants: A Guide for Insureds to the Wordings of D&O Policies*, Insurance Scrawl, Feb. 11, 2006, [http://www.insurancescrawl.com/archives/2006/02/whats\\_a\\_directo.html](http://www.insurancescrawl.com/archives/2006/02/whats_a_directo.html).

132. D&O policies traditionally do not impose a duty to defend on the insurer. However, the policies frequently give the insurer a right to “associate in the defense” of the insured. D&O DESKBOOK, *supra* note 129, at 100-01; Christopher W. Martin, *Director and Officer Insurance*, HOUS. LAW., Mar./Apr. 2004, at 38, available at [http://www.thehoustonlawyer.com/aa\\_mar04/aa\\_feature/page38/page38.htm](http://www.thehoustonlawyer.com/aa_mar04/aa_feature/page38/page38.htm). There are some examples of insurers requiring the insured to waive certain procedural protections *ex ante*. See, e.g., Mayerson, *supra* note 131 (discussing a policy that required the insured to waive the protection of an automatic stay in bankruptcy).

133. D&O insurers evaluate a corporation’s “corporate governance” as a factor in determining premiums. See, e.g., Corporate Legal Times & Foley & Lardner LLP, *D&O Insurance: What Directors Want, and Where the Market Is* Heading 37 (June 16, 2005), [http://www.foley.com/files/tbl\\_s88EventMaterials/FileUpload587/352/D&O%20Insurance.PPT#258](http://www.foley.com/files/tbl_s88EventMaterials/FileUpload587/352/D&O%20Insurance.PPT#258); PAUL HOPKIN, *DIRECTORS’ AND OFFICERS’ LIABILITY INSURANCE GUIDANCE AND ADVICE FOR RISK MANAGERS* 8-9 (2004), [http://www.airmic.com/Spd/Downloadfiles/AIRMIC\\_D\\_and\\_O\\_guide.pdf](http://www.airmic.com/Spd/Downloadfiles/AIRMIC_D_and_O_guide.pdf).

134. This task is admittedly the most difficult. Cf. Scott & Triantis, *supra* note 103, at 857 (“We have been hard pressed, however, to find scholarly treatises on procedure or evidence that identify the subset of these rules that are default rather than mandatory provisions.”).

director recruitment, in which the parties are sophisticated and have strong bargaining positions, allowing them to bargain over the terms enables them to allocate the risks associated with decision-making in the way that both parties believe is optimal for the relationship.<sup>135</sup>

On the other hand, by allowing directors to contract for waiver of a corporation's rights in litigation, we are also allocating the risks between a defendant and plaintiff, unknown at the time of contract, that critical evidence (in the form of the legal opinions relied upon) will be undiscoverable at trial. This allocation of risk is involuntary for at least one party because there is no plaintiff with whom the director may contract *ex ante*. Therefore the legal rule governing their relations should be mandatory.

### 1. *Default Rules*

Looking first at the default rule between the director and corporation, if the default were that a corporate director could presumptively waive all materials she has viewed (meaning that she could authorize the waiver of the corporation's attorney-client privilege with respect to those documents), it would place a burden on corporations to contract to make documents nonwaivable every time a legal opinion is sought. This rule places the burden on the party most likely to know the law and to be able to manage its privilege proactively. However, this default would add greatly to the transaction costs accompanying every consultation with counsel and every major business decision, as the corporation would have to contract to make each opinion nonwaivable every time. Further adding to the costs would be the risk that in the event of litigation, ambiguities in a contract to make the counsel's opinion nonwaivable would be construed against the corporation. Corporations would forever have to worry that a poorly drawn contract could lead to an inadvertent waiver concerning documents that the corporation had intended to keep privileged.<sup>136</sup> From a doctrinal perspective, we might say that this default could

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135. This proposition is supported by the observation that director employment is largely unregulated today. The corporation's decisions about the terms of a director's contract are protected by the business judgment rule. *E.g.*, *Brehm v. Eisner*, No. 411, 2006 Del. LEXIS 307, at \*79-80 (June 8, 2006). As long as there is no element of self-dealing, if the existing board follows a standard of reasonable care in negotiating the new director's contract, even if it fails to follow "best practices," the court will not substitute its judgment as to the actual substance of the contract for that of the board. *See, e.g.*, *In re Walt Disney Co. Derivative Litig.*, Consolidated C. A. No. 15452, 2005 Del. Ch. LEXIS 113, at \*7-8 (Aug. 9, 2005), *aff'd*, *Brehm*, 2006 Del. LEXIS 307.

136. Note that *Mezzanatto* specifically stated that a pretrial contract to waive an evidentiary privilege is enforceable only absent an indication that the agreement was entered into

eviscerate the privilege. Under Supreme Court cases such as *Upjohn* and *Weintraub*, which consider the attorney-client privilege fundamental to the successful functioning of the legal system,<sup>137</sup> the default of “presumptively waivable” simply would not stand.<sup>138</sup>

Therefore, the default should be that the corporation holds the attorney-client privilege on all communications with its attorney,<sup>139</sup> even if the director must rely on the opinion to make management decisions. The director could then contract to obtain the corporation’s agreement to waive its privilege with respect to those documents relied upon if the director, sued in her individual capacity, needs to raise an advice of counsel defense. Doctrinally, this default is satisfying in that it closely embodies the current law of attorney-client privilege and allows the corporation to determine the conditions under which it will waive.

This default could present a cost in that it may create a trap for the unwary or uninformed director who does not know the state of privilege law or who may be unable to understand the kinds of communications for which she should negotiate waivability. For example, in the healthcare context, the Medicare laws are highly complex, and the definition of what may constitute a false claim under the False Claims Act is broad and unintuitive.<sup>140</sup> A director would need to take great care to secure waivability for the right opinions. However, if the practice of contractual waiver becomes widespread, a reasonable director should be able to anticipate the need to contract for waiver and could perhaps consult a personal attorney at the time of the employment contract to assist in the analysis. Similarly, D&O insurers are likely to rapidly

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“unknowingly or involuntarily.” *United States v. Mezzanatto*, 513 U.S. 196, 210 (1995). If a corporation’s attempt to make a certain opinion nonwaivable failed due to an imperfection in the contract, the corporation could argue that it had thereby been forced to leave an opinion waivable “unknowingly or involuntarily.” Therefore, in addition to the problems listed above, a “presumptively waivable” regime might also be unconstitutional under *Mezzanatto*.

137. See *supra* Section I.B.

138. Cf. *Swidler & Berlin v. United States*, 524 U.S. 399, 409 (1998) (rejecting even a minor exception carved out of the attorney-client privilege rule that applied only to communications by a deceased witness in a criminal trial, because it would introduce “substantial uncertainty” into the privilege’s application).

139. Subject, of course, to the normal constraints on what documents qualify as privileged. See *supra* note 11.

140. For example, the False Claims Act creates an action for “reverse false claims,” in which the defendant “knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government.” 31 U.S.C. § 3729(a)(7) (2000); see *United States ex rel. Taylor v. Gabelli*, 345 F. Supp. 2d 313, 331 (S.D.N.Y. 2004).

aggregate information on what types of communications should be made waivable and to communicate this to the director or the corporation.<sup>141</sup> These costs are surmountable, and given the practical evisceration of privilege that would result from a presumptively waivable default, the presumptively nonwaivable default is the preferable regime.

## 2. *Mandatory Rules*

Although the default of nonwaivability encourages efficient allocation of management decision-making risks between the director and corporation, this default would in some cases create an unsatisfactory externality for the plaintiff: the risk that the defendant director and corporation have not made any agreement as to waiver of privilege would fall on the plaintiff, leaving her unable to discover the relevant legal opinions.

In a new regime in which contractual waivers of privilege are the norm, there would be a few scenarios in which the plaintiff could face discovery with a director and corporation who have not previously contracted for waiver of privilege. One possibility is that a particularly recalcitrant corporation has refused to make any concession to the director. Another possibility is that a self-professed “bargain-basement” director has purposefully opted not to extract such a conditional waiver agreement in order to market herself more cheaply to the corporation; she is willing to take her chances at trial. A third possibility is that the corporation and director have colluded not to waive privilege to exploit the uncertainties of trial and perhaps play “cooperative party, uncooperative party.” The director may give the impression that she dearly wishes to cooperate with the plaintiff and provide the legal opinions but that her hands are tied because the corporation is refusing to cooperate and waive the privilege.<sup>142</sup> Although the first of these scenarios reveals a more sympathetic defendant than the other two, the fact that the costs are being externalized onto the plaintiff suggests that we need another rule in the system to allocate the risks.

The court has two choices with regard to a defendant who wishes to assert an advice of counsel claim but has not secured a waiver. The first option is to allow the defendant to mention at trial that she relied in good faith on the

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141. See *supra* notes 129-133 and accompanying text for more on the role of D&O insurers.

142. In *Grace II*, the government even argued that Grace and its former directors had colluded and agreed that Grace would vigorously refuse to waive privilege to induce the court to grant a severed trial. 439 F. Supp. 2d 1125, 1144 (D. Mont. 2006). The court did not accept this argument, although it stated that it believed the arguments related to privilege might have been “manufactured” to make a case for severability. *Id.* at 1144 n.18.

advice of corporate counsel, and then to allow the corporation's attorney-client privilege to bar any further examination or cross-examination on that claim (the "mentionable" rule).<sup>143</sup> The second option is to forbid the defendant even to mention the advice of counsel claim during trial by granting the plaintiff a motion in limine to exclude all such evidence (the "unmentionable" rule).<sup>144</sup> To adopt the mentionable rule would allow the director to externalize most of the costs associated with the impasse onto the plaintiff and public. Allowing the defendant to mention that she relied in good faith on the advice of corporate counsel without requiring her to present proof that the opinion was reasonable and that her reliance was in good faith is simply an invitation to the jury to allow sympathy to manipulate the decision-making process. The prospect of a mentionable rule would also provide fewer incentives for the director and corporation to contract for a conditional waiver of privilege, particularly among those who are willing to skimp on front-end contracting costs in the hopes of saving at the back end. (They may believe that the risk of being sued is low or that they may benefit from jury sympathy in a mentionable regime.) Therefore, the most efficient rule is to make the advice of counsel claim unmentionable. This rule must be mandatory, as there is no way *ex ante* for the director to contract with a future plaintiff.

One possible alternative is for the rule to be unmentionable in civil trials and mentionable in criminal trials. This approach might accord with the notion that in criminal trials the defendant deserves the utmost opportunity to defend herself.<sup>145</sup> A firmer grounding for this two-tiered approach might be found in the fact that the plaintiff's burden of proof is different in criminal trials than in civil trials. As discussed in Section I.A, the advice of counsel claim is not an affirmative defense but a category of evidence presented to controvert an element of the plaintiff's *prima facie* case. In a criminal trial, the prosecution must prove the element of knowledge beyond a reasonable doubt. If the defendant can raise a reasonable doubt as to her state of mind by mentioning that she was relying in good faith on the advice of corporate counsel, a jury should be entitled to consider this assertion (and the defendant's credibility) in

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143. Cross-examination would be barred on the grounds that it would require the defendant to reveal information about privileged communications, if not the contents of the communications themselves.

144. For more information on the motion in limine, see *supra* notes 79-81 and accompanying text.

145. Note, however, that while the Constitution does create stronger rights to defend oneself at criminal trial than civil trial, see *supra* Subsection II.B.3, these rights are not strong enough to prevail over a third party's attorney-client privilege. The approach analyzed in this paragraph is grounded in a "sense of fairness" as opposed to explicit constitutional rights.

deciding whether the prosecution has met its burden of proof on the element of knowledge.

While there is some intuitive appeal to this two-tiered approach, it is ultimately problematic. This approach does little more than allow the director and corporation to externalize their agency costs in criminal trials but not civil trials. Allowing a mentionable rule in criminal trials still invites the jury to make uninformed decisions, as the jury will be expressly asked to make determinations about assertions that have not been properly cross-examined. These costs outweigh any benefit to giving directors more room to play to the jury in criminal trials.

In conclusion, the analysis suggests that the appropriate rule should be a mandatory rule that, absent an *ex ante* agreement for conditional waiver of privilege, the advice of counsel claim should be completely unmentionable in both civil and criminal trials. This rule will create a strong incentive for the parties to contract and may therefore be seen as what Professor Ian Ayres calls a “good kind of coercion.”<sup>146</sup> Because the proposed default and mandatory regime falls squarely within longstanding Supreme Court doctrine and other related case law and would not require overturning any cases, passing new statutes, or changing the Federal Rules of Evidence, there are no legal impediments to prevent corporations from implementing this solution immediately.<sup>147</sup>

#### *D. The Terms of the Agreement*

The core of the suggested solution lies in the interaction of two rules: the default nonwaivable rule encouraging directors and corporations to contract for conditional waivers of attorney-client privilege and the mandatory unmentionable rule excluding evidence in the absence of such a contract. To develop the solution more fully, this Section explores how a contractual waiver of privilege might be structured.

The basic form of the provision would, of course, be the agreement that if the director becomes a defendant in litigation, and if (and only if) the defendant needs to raise the advice of counsel defense, the corporation will agree to waive the attorney-client privilege with respect to the relevant communications. The regime would not require that a corporation must agree to waive or share its privilege without limit. Through contract, the corporation

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<sup>146</sup> Ian Ayres, *First Amendment Bargains*, 18 YALE J.L. & HUMAN. (SPECIAL ISSUE) 178, 195 (2006).

<sup>147</sup> *Mezzanatto* in particular indicates that current law allows and encourages predispute waivers, as the rules of evidence are presumptively waivable. See *supra* notes 107-112 and accompanying text.

can determine both the scope of the waiver and the conditions under which it will waive. To manage the substantive scope of waiver, the corporation should contract to waive the privilege as narrowly as possible. The corporation and director could agree on a process in advance to identify waivable opinions or communications. For example, they could create a list of criteria based on the business process of the corporation that, if met, would render a document waivable.

In addition to substantive scope, the parties could also negotiate to limit the occasions on which the privilege would be waived. The parties might set forth other defenses that a director must exhaust prior to raising an advice of counsel defense. The agreement might also create more bars to waiver in a civil suit than in a criminal suit, in which the prospect of criminal fines or imprisonment makes the right to mount a defense more salient. For example, with documents that are particularly sensitive, the corporation might contract that the director will not raise the advice of counsel defense in a future civil suit in exchange for full indemnification if she is found liable, while permitting the director to raise the defense if necessary in a criminal suit.

The parties might stipulate to the procedure of *in camera* review to screen out cases in which the defendant director's advice of counsel defense is so weak that the defense is not really necessary. *In camera* review is not considered a waiver of attorney-client privilege<sup>148</sup> and so could be a safe way to allow a court to review the opinion and determine if the advice of counsel defense is viable without creating an involuntary waiver of privilege.

The court could review *in camera* the legal opinion and evidence of whether the director did rely on the opinion in good faith and could sort the evidence into three categories that would be treated differently. One category would be evidence that is sufficiently clear as a matter of law for the judge to make a determination on the advice of counsel defense without taking the question to a jury. The court could render a partial summary judgment on the issue, avoiding a situation in which the corporation has to waive the privilege at trial. For example, if the judge, upon reviewing the legal opinion, could determine that as a matter of law the opinion itself was unreasonable (and therefore not exculpatory), then the defense would fail as a matter of law. There would be no need to waive the privilege on this opinion and present it to a jury.<sup>149</sup>

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148. See, e.g., *In re Bevill*, Bresler & Schulman Asset Mgmt. Corp., 805 F.2d 120, 125 (3d Cir. 1986).

149. Some elements of a case that involve mixed issues of law and fact may be properly ruled on by a judge without abrogating a defendant's Seventh Amendment jury trial right. See, e.g., *United States ex rel. Berge v. Bd. of Trs. of the Univ. of Ala.*, 104 F.3d 1453, 1460 (4th Cir. 1997).



The second category would be evidence that is either so weak or so irrelevant that the judge can determine as a matter of law that the defendant has not averred a strong enough defense to merit its inclusion at trial. This would be something like a Rule 12(b)(6) motion on an affirmative defense or counter-defense. The corporation and director could agree that in this case, the corporation will not waive the privilege and the director will drop this argument from her defense. This category would protect corporations from being forced to waive privilege when the director is grasping at straws and raising frivolous defenses—for example, if the plaintiff's cause of action does not include an element of scienter.<sup>150</sup>

The final category would be evidence that presents a material issue of fact that warrants a jury trial on whether the defendant's purported good faith reliance on corporate counsel's advice negated the requisite scienter for culpability. In this case, the corporation would execute its waiver and permit the director to make the defense at trial. By using in camera review in this manner, corporations can limit their waiver of privilege to those circumstances in which there is a true material issue of fact regarding the director's good faith reliance and in which the defense cannot otherwise be ruled upon as a matter of law.

Of course, the benefit of a contract solution is that the parties can bargain to customize the terms of the waiver of privilege in ways that anticipate the unique needs of their agency relationship. As corporations and directors first attempt to put the proposed solution into practice, there will be an increase in the costs associated with litigation uncertainty and judicial error as the parties create new contract provisions that have yet to be interpreted by courts. However, as courts confront these provisions more frequently and set out clear interpretations of the clauses, a body of precedent will build up that will enable the next contracting parties to create provisions that are more reliable and less susceptible to opportunistic litigation.<sup>151</sup> Over time, the costs associated with

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1997). For each element in the plaintiff's prima facie case, there is a threshold issue of whether the case is so weak that no jury could credit it, in which case a judge may properly rule on the element without abrogating the right to jury trial. *Id.* (citing *United States v. Gaudin*, 515 U.S. 506, 516 (1995)). Also, parties may agree by contract to allow a judge to conduct an in camera review and rule on some issues as a matter of law, even if this agreement ultimately functions as a contractual waiver of jury trial rights. *See Ware*, *supra* note 121, at 169 (demonstrating that courts permit parties to waive jury trial rights through contract).

150. *See supra* note 28 and accompanying text.

151. *See Charles J. Goetz & Robert E. Scott, The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 286-88 (1985) (describing the process by which contractual provisions are developed and tested and ultimately achieve legal recognition through consistent interpretations by the courts).

the implementation of this solution will drop.<sup>152</sup> From an *ex ante* perspective, then, despite the initial unpredictability that could surround the creation of the new contractual waiver provisions, the transition costs are surmountable, and this undertaking will be rational in the long run.<sup>153</sup>

The brief exploration in this Section has not by any means exhausted the range of possibilities for the contractual waiver of privilege. What it has demonstrated is that the parties can successfully customize these provisions to tailor the scope and circumstances of waiver.

## CONCLUSION

The scenario suggested by this Note implicates core theoretical issues concerning the right to defend oneself and the fundamental value of the attorney-client privilege to our legal system. It also raises a question that is timely and immensely practical. Anecdotal evidence suggests that cases such as these have arisen with some regularity and have the potential to arise in the future for almost any corporation.

As this Note has shown, the impasse created at the time of litigation can be understood as a result of agency costs that have not been properly managed *ex ante* when the director and corporation enter into an agency arrangement. These costs result in lower value to the firm, as the director will make suboptimal decisions that lower her risk of personal liability to compensate for her diminished ability to defend herself. The failure to manage these costs also results in significant externalities in the form of unpredictability, insurmountably high evidentiary costs, and, in civil fraud cases, lost taxpayer money. Most of the possible solutions to this problem do little to lower the agency costs because they do nothing to resolve the litigation uncertainty and risk of judicial error inherent in the system. In particular, while there is some appeal to the idea that a defendant's constitutional right to mount a defense should sometimes prevail over the corporation's right to maintain its privilege, attempts to solidify this doctrine ultimately lead to some form of balancing

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152. Moreover, much of this cost is borne by society through the judicial system, which through precedent can create a "publicly supplied contract law that contains efficient solutions to common contracting problems." Schwartz & Scott, *supra* note 68, at 596. So, not only are the costs minimal over time, but they are also subsidized by the public.

153. Those transition costs borne by early adopters (after the public subsidy is taken into account, *see supra* note 152) could create some disincentives for any one firm to become the first to implement the new contractual waiver regime. However, the pressure of the market for talented directors and the pressure created by D&O insurers may help overcome initial hesitation. *See supra* Section III.B.

test. Any balancing test inherently preserves the high cost of litigation uncertainty and risk of judicial error while doing little to internalize externalities.

A regime in which corporations and directors contract *ex ante* for conditional waivers of the corporation's attorney-client privilege is the most efficient because it lowers costs to all parties, adds net value to the firm, and significantly internalizes externalities. As between the director and the corporation, there should be a default rule that attorney-client communications are privileged and that the parties are encouraged to contract around this default in the form of *ex ante* waivers conditioned on specific circumstances. As between the director and the plaintiff, who is unknown at the time the conduct at issue is occurring, there should be a mandatory rule that, when the director has not secured a waiver, the advice of counsel defense will be completely unmentionable at trial. The parties can also work together to minimize the cost to the corporation in the form of unnecessary waivers of privilege by limiting both the scope of the promised waiver and the conditions upon which the corporation will execute waiver. As corporations consider how they will manage the costs and risks inherent in decision-making, taking precautions *ex ante* to contract for waivers of privilege will pay off in substantial benefits to the corporation, to the directors, and to society.

