Maintaining privilege in the face of regulatory investigations

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Introduction

Despite Japan's position as a prominent global business hub, many businesspeople are unaware that Japanese law does not recognise attorney-client privilege as the concept is commonly understood in the West. Attorney-client privilege is a well-established principle in many jurisdictions (eg, the United States, the United Kingdom and Europe) that protects the privacy of communications between legal counsel and clients. The effective absence of this form of protection in Japan is notable for a number of reasons, but one of the most important is that it means that Japanese regulators are permitted to compel the production of or seize sensitive communications, materials and advice received from legal counsel. This is of particular concern in the context of regulatory investigations, where there is often a threat of multi-jurisdictional civil litigation and the management of sensitive documents is crucial. A Japanese affiliate's failure to communicate effectively with regulators in Japan or implement appropriate information management procedures could have a number of negative consequences, from regulatory penalties to the waiver of attorney-client privilege.

Broadly speaking, attorney-client privilege protects all communications between lawyer and client from disclosure in order to promote full and frank discussions. In contrast, the Japanese legal system's equivalent of attorney-client privilege protects only (subject to certain exceptions) those materials held by legal counsel from disclosure, in order to protect lawyers' confidentiality obligations to their clients. Japanese law requires lawyers – including registered foreign-law lawyers (*gaikokuho jimu bengoshi*) – to hold as confidential all materials and information received from clients in the course of their professional duties.

Attorney-client privilege and Japanese practice

Japanese regulators such as the Japan Financial Services Agency and the Japan Free Trade Commission (JFTC) are generally given broad regulatory powers under the applicable legislation. These powers include the right to obtain materials that would otherwise be protected by attorney-client privilege, whether by way of seizure (eg, in the context of an onsite inspection/dawn raid) or compelled production pursuant to a formal reporting order. Despite these broad powers, Japanese regulators tend to prefer a collaborative approach and often seek input, information and materials – including those that would otherwise be protected by attorney-client privilege – on a voluntary basis by way of informal information requests. While the tone of such informal requests may be voluntary, in practice the regulators expect such requests to be complied with by the subject entity and market practice reflects this. Generally, all requests received from regulators, including the aforementioned informal requests, are regarded in practice as quasi-compulsory. Market participants understand that the regulators are empowered to compel the production of or seize all materials held by subject entities and, as such, attempts to challenge or refuse such informal requests – which could damage

the relationship with the regulator and provoke the issuance of a formal order or commencement of a formal investigation – are rare.

Involuntary disclosure

The general rule under common law is that disclosure of privileged material can be considered a waiver of such privileged protection. Consequently, there is a risk that if materials protected by attorney-client privilege are voluntarily submitted to or (much less commonly) seized by a Japanese regulator, such materials could lose their privileged protection under common law and become discoverable in the context of any litigation. Under common law, there are limited exceptions to the general rule that disclosure of privileged materials constitutes a waiver of such protections – notably, where it can be demonstrated that such disclosure was involuntary. Generally, in common law jurisdictions (eg, the United States), where the court is satisfied that any production of privileged materials was in fact genuinely involuntary, the privilege protections will generally not be held to have been waived and, in the context of any litigation, the subject materials will remain outside the scope of discovery. In assessing whether a disclosure was involuntary, US courts will generally consider a number of factors, including whether:

- the disclosure was made in response to a court order or subpoena or the demand of a governmental authority;
- the disclosing party would be subject to penalties if it failed to produce the documents; and
- the disclosing party objected to the disclosure and asserted any available privilege protections over such documents.

As such, under US law, where privileged materials are disclosed by a Japanese entity to a Japanese regulator – whether by way of seizure or formal production order – a reasonable argument can be presented that such disclosure should be classified as involuntary. Unfortunately, however, the criteria considered by the US courts fail to fully capture the accepted regulatory practice in Japan. As noted above, Japanese regulators prefer to engage with subject entities informally and, in that respect, tend to request documents and materials without exercising any of their formal regulatory powers, preferring not to undergo the formalities that would be required should they seek such documents or materials by way of seizure or formal reporting order.

Involuntary disclosure and Japanese regulatory environment

The US court in *In Re Vitamin Antitrust Litigation* (2002 US Dist LEXIS 26490 (DDC January 23 2002) was called on to consider the issue of whether materials submitted to the JFTC in response to an informal request qualified as an involuntary disclosure under US law. In response to an informal request, one of the defendants had submitted to the JFTC certain documents that would ordinarily be protected by attorney-client privilege under US law. The defendant asserted that although the JFTC had not formally compelled production of the materials, such submissions should be considered as involuntary disclosures under US law due to, in part, the expectations of the JFTC and, more generally, Japanese market practice. Therefore, such production should not constitute a waiver of privilege over those materials. The plaintiffs, in arguing that such submissions should be viewed as voluntary and therefore subject to a waiver of any attorney-client privilege, noted that although the JFTC had legal authority to compel production of the documents, this legal authority had not been invoked; and had the defendant not complied with such informal request from the JFTC, it would not have been punished under Japanese law. Consequently, such production was not an 'involuntary production' as defined under US law. The court, considering the three factors described above, agreed with the plaintiff in holding that submission of the materials was voluntary for the purposes of US law. As such, the defendant was held to have waived any attorney-client privilege over the materials that had been produced.

Recommendations

In any cross-border litigation or regulatory investigation, special attention must be paid to the applicable confidentiality and privilege rules in each relevant jurisdiction so that appropriate procedures can be implemented to ensure that there is no inadvertent waiver of protections that would otherwise be available. This is of particular importance where Japanese entities are involved. The absence of the common law concept of attorney-client privilege – combined with the unique,

collaborative approach taken by regulators in overseeing the activities of market participants in Japan – is unlike the situation in other jurisdictions, such as the United States. As such, many Japanese corporations are often unfamiliar with the concept of attorney-client privilege and the serious consequences that may arise from any mistreatment of such information. Further, as evidenced by the decision of the US court in *Re Vitamins*, this can lead to entities being forced to weigh the importance of protecting their claim of attorney-client privilege over certain materials in the context of litigation against the benefit of maintaining a positive relationship with the regulators in Japan and producing those very same materials.

Careful planning is required to ensure that no rights or protections that would ordinarily be available are inadvertently waived. The following are some of the ways to manage materials in the context of a cross-border regulatory investigation that involves Japan:

- Engage legal counsel in Japan and other key jurisdictions in the discussion process from an early stage. Legal counsel can assist in assessing the relative sensitivity of subject materials and communications and how such materials should be distributed among the relevant team members.
- Limit the circulation of copies of sensitive materials to the extent reasonably possible based on the advice of legal counsel. As noted above, materials held by Japanese counsel are generally protected from disclosure, subject to certain limited exceptions; therefore, consider conveying particularly sensitive information or materials via legal counsel and allow legal counsel to determine the method by which such information may be circulated to the relevant parties. In addition, all materials should be clearly labelled as 'privileged and confidential'.
- Where a Japanese entity is asked by a Japanese regulator to produce materials that would or may be protected by attorney-client privilege, take particular care and involve legal counsel in the process. Legal counsel can assist in engaging with the Japanese regulator and working towards framing any such production as an 'involuntary disclosure' as understood under US law, to mitigate the risk of the court finding such privilege to have been waived by the production.

Comment

As global regulatory investigations become more common, the conflict among jurisdictions as to how communications and materials exchanged between legal counsel and clients should be treated will become increasingly important. The loss of privilege over sensitive materials can have a dramatic effect on any litigation. However, careful planning with legal counsel can mitigate this risk of an unintended waiver of legal privilege.

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