Federal Prosecutions of Business Organizations: Comparing McNulty to Thompson

By Charles P. Rettig and Heather K. Lee

Charles Rettig and Heather Lee look at the Justice Department's new internal guidelines regarding criminally charging business organizations, which were announced in December in a memo issued by Deputy Attorney General Paul McNulty and compare these new guidelines to the guidelines contained in an earlier memo issued by then-Deputy Attorney General Larry Thompson.

McNulty's Attempt to Neutralize Congress

The U.S. Department of Justice (DOJ) recently announced substantial revisions to its internal guidelines on criminally charging business organizations in a Memorandum issued by Deputy Attorney General Paul McNulty (the "McNulty Memorandum").[1] The new guidelines revise and supersede the guidelines contained in the Thompson Memorandum issued in January 2003 by then Deputy Attorney General Larry D. Thompson. The McNulty Memorandum attempts to limit prosecutors' ability to require business entities to waive their attorney-client and work-product privileges as evidence of cooperation to avoid a criminal indictment, and to consider the corporation's advancement of legal fees to employees/agents in deciding whether to indict the corporation. A change in policy was made in part to "further promote public confidence in the Department"[2] in the wake of mounting criticism from judges, Congress and business groups that certain guidelines under the Thompson Memorandum have infringed upon the attorney-client and work-product privileges and a defendant's constitutional right to fair trial and effective assistance of counsel. Many are surmising that the revised guidelines fall short of the protections they were intended to provide.

Under the McNulty Memorandum, federal prosecutors may only seek waivers of the attorney-client and work product privileges in limited circumstances and must forward such requests through the upper levels at DOJ. Moreover, prosecutors may not consider a corporation's refusal to waive privileged information in a charging decision, but may favorably consider a corporation's acquiescence to the government's waiver request as a cooperation factor. Further, federal prosecutors are not required to obtain authorization to accept productions of privileged materials if a corporation voluntarily offers privileged documents without a request by the government. Finally, prosecutors generally can no longer consider a corporation's payment of the attorneys' fees of its employees/agents when assessing the company's level of cooperation with the investigation, although some questions remain.

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Prosecutors are charged with ensuring that the general purposes of the criminal law -- punishment as warranted, deterrence of future criminal conduct, protection of the public, rehabilitation of the offenders, and any appropriate restitution—are adequately satisfied while taking into account the somewhat unique nature of the corporate "person" (*i.e.,* the business entity can not realistically be "incarcerated"—it can pay a monetary fine/restitution, receive independent oversight of future operations, *etc.*). In determining whether to charge a corporation, prosecutors generally apply the same factors as they do with respect to charging individuals. They must review the sufficiency of the evidence; the likelihood of a conviction; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of any available noncriminal sanctions. In making a decision to charge a corporation with a crime, the government has a limited degree of discretion in determining when, whom, how and sometimes even whether to prosecute for violations of federal criminal law. However, individual prosecutors obviously cannot turn a blind eye to potentially criminal conduct, whether occurring within the context of a business organization or otherwise.

The McNulty Memorandum reinforces the various specific factors federal prosecutors are to consider in reaching a decision as to the proper treatment of a corporate target. As with the factors relevant to charging individuals, these factors are not exclusive but are intended to provide prosecutorial guidance. In conducting an investigation, determining whether to bring charges, and negotiating corporate plea agreements, under the McNulty Memorandum prosecutors are to consider:

- the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crimes[3];
- the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management[4];
- the corporation's history of similar conduct, including prior criminal, civil and regulatory enforcement actions against it[5];
- the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the corporation's willingness to identify the culprits within the corporation (the "Cooperation Factor"[6]);
- the existence and adequacy of the corporation's pre-existing compliance program[7];
- the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies[8];
- collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution[9];
- the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
- the adequacy of remedies such as civil or regulatory enforcement actions.[10]

Under the earlier Thompson Memorandum, "it [was] entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, e.g., voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment."[11] As to the Cooperation Factor, the Thompson Memorandum provided, in part:

> One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances. This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product

related to advice concerning the government's criminal investigation). The Department does not, however, consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.

Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.[12]

The McNulty Memorandum now provides that "[w]aiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government's investigation. However... the disclosure of privilege information may be critical in enabling the government to evaluate the accuracy and completeness of the company's voluntary disclosure." Federal prosecutors may request a waiver of attorney-client or work-product privileges only if there is a "legitimate need" and if so, prosecutors must do so in the "least intrusive" manner and by following the step-by-step approach to requesting information. Whether or not there is a "legitimate need" for requesting a waiver is determined after carefully considering the following factors: (1) the likelihood and degree to which the privileged information will benefit the government's investigation; (2) whether the information sought may be obtained in a timely and complete fashion by using alternative means; (3) the completeness of the voluntary disclosure already provided by the corporation; and (4) the collateral consequences of a waiver to the corporation.

> Under the McNulty Memorandum, federal prosecutors may seek waivers of the attorney-client and work product privileges only in limited circumstances and must channel such requests through top-level staff at DOJ.

Category I Information

If a "legitimate need" exists, prosecutors must follow the specified procedural steps in requesting privileged material. Prosecutors first should request purely factual information "which may or may not be privileged" ("Category I information"). Before asking for a corporate wavier of Category I information, prosecutors must obtain written authorization from the U.S. Attorney who must provide a copy of the request to, and consult with, the Assistant Attorney General for the Criminal Division before granting or denying the request. Prosecutors' request for authorization to seek a waiver must describe law enforcement's "legitimate need" for the information and identify the scope of the waiver sought. A copy of each waiver request and authorization for Category I information must be maintained in the files of the U.S. Attorney. If the request is authorized, the U.S. Attorney must communicate the request in writing to the corporation.

Prosecutors may consider "a corporation's response to the government's request for waiver of privilege for Category I information ... in determining whether a corporation has cooperated in the government's investigation."

Category I information includes copies of key documents, witness statements, factual interview

memoranda and factual summaries prepared by counsel related to the underlying misconduct. It also includes legal advice contemporaneous to the underlying misconduct when the corporation or one of its employees is relying upon an advice-of-counsel defense and legal advice or communications that fall within the crime-fraud exception to the attorney-client privilege.

Category II Information

If a prosecutor concludes that Category I information is insufficient to conduct a thorough investigation, the prosecutor may request—only in rare circumstances—that the corporation provide attorney-client communications or nonfactual attorney work product ("Category II information"). Category II information includes legal advice given to the corporation before, during and after the underlying misconduct occurred, attorney notes, memoranda or report containing attorney's mental impression and conclusions, and legal determination reached as a result of internal investigation.

Before requesting a waiver of Category II information, the prosecutor must obtain written authorization from the Deputy Attorney General. As with Category I information, requests for authorization to seek a waiver must set forth law enforcement's legitimate need for the information and identify the scope of the waiver sought. A copy of each waiver request and authorization for Category II information must be maintained in the files of the Deputy Attorney General. If the request is authorized, the U.S. Attorney must communicate the request in writing to the corporation.

Unlike the refusal to provide Category I information, the new guidelines mandate that prosecutors cannot consider a corporation's refusal to waive privilege of Category II information against the corporation in making a charging decision. However, prosecutors may always favorably consider a corporation's acquiescence to the government's waiver request in determining whether a corporation has cooperated in the government's investigation. Under this standard, is there truly a difference from the Thompson Memorandum?

"Voluntary" Submissions

Federal prosecutors are not required to obtain authorization to accept productions of privileged materials if a corporation voluntarily offers privileged documents without a request by the government. Being on the receiving end of an indictment is tantamount to a corporate death sentence. Therefore, the "voluntary" nature of any such submissions is highly questionable. The revised guidelines unfortunately fall short in requiring an appropriate review and authorization process prior to the government's "voluntary" receipt of privileged materials.

Advancement of Fees

Another Cooperation Factor is whether a corporation is protecting "culpable" employees/agents by advancing legal fees or by other means. The McNulty Memorandum provides that "[p]rosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment" in weighing the extent and value of the corporation's cooperation. However, this new policy may be limited to situations in which advancement of attorneys' fees is required by state law. The McNulty Memorandum explains that "[m]any state indemnification statutes grant corporations the power to advance the legal fees of officers under investigation prior to a formal determination of guilt. As a consequence, many corporations enter into contractual obligations to advance attorneys' fees through provisions contained in their corporate charters, bylaws or employee agreement. Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate." The McNulty Memorandum does not specifically state what happens when a corporation voluntarily advances legal expenses as a matter of corporate practice, in the absence of any state law, although "[p]rosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment." Once again, the potential impact of such actions remains an open, but deadly question.

The McNulty Memorandum carves out an exception for "extremely rare cases" where "the advancement of attorneys' fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation."[13] However, prosecutors must obtain an approval from the Deputy Attorney General before this factor may be considered in their charging decision.

The McNulty Memorandum makes it clear that prosecutors can continue to ask questions about an

attorney's representation of a corporation or its employees, including how and by whom attorneys' fees are paid because these questions may be necessary to assess other issues, such as conflict-of-interest.[14] Additionally, a prosecutor may consider, in weighing the extent and value of its cooperation, the corporation's "promise of support culpable employees and agents", including providing information to the employees about the government's investigation pursuant to a joint defense agreement or retaining the employees without sanction for their misconduct.

Thompson Memorandum Violated the Fifth and Sixth Amendments to the Constitution

The Thompson Memorandum had exerted tremendous pressure on companies under investigation. The McNulty Memorandum came in the wake of mounting criticism from judges, Congress and business groups that the DOJ is too heavy-handed in pressuring corporations about how to respond to criminal investigations. In a matter involving various former partners of KPMG, LLP and others, Judge Lewis A. Kaplan of the Federal District Court in Manhattan (S.D.N.Y.) raised questions over whether portions of the Thompson Memorandum may have violated the Defendants constitutional rights to legal representation and a fair trial. On June 26, 2006, Judge Kaplan rendered a strongly worded Opinion (consisting of 83 pages) essentially condemning portions of the Thompson Memorandum and determined, in significant part, that:

> The issue now before the Court arises at an intersection of three principles of American law.
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> The first principle is that everyone accused of a crime is entitled to a fundamentally fair trial. This is a central meaning of the Due Process Clause of the Constitution.
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> The second principle, a corollary of the first, is that everyone charged with a crime is entitled to the assistance of a lawyer. A defendant with the financial means has the right to hire the best lawyers money can buy. A poor defendant is guaranteed competent counsel at government expense. This is at the heart of the Sixth Amendment.
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> The third principle is not so easily stated, not of constitutional dimension, and not so universal. But it too plays an important role in this case. It is simply this: an employer often must reimburse an employee for legal expenses when the employee is sued, or even charged with a crime, as a result of doing his or her job. Indeed, the employer often must advance legal expenses to an employee up front, although the employee sometimes must pay the employer back if the employee has been guilty of wrongdoing....
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> Most of the defendants in this case worked for KPMG, one of the world's largest accounting firms. KPMG long has paid for the legal defense of its personnel, regardless of the cost and regardless of whether its personnel were charged with crimes. The defendants who formerly worked for KPMG say that it is obligated to do so here. KPMG, however, has refused.
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> If that were all there were to the dispute, it would be a private matter between KPMG and its former personnel. But it is not all there is. These defendants (the "KPMG Defendants") claim that KPMG has refused to advance defense costs to which the defendants are entitled because the government pressured KPMG to cut them off. The government, they say, thus violated their rights and threatens their right to a fair trial.
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> Having heard testimony from KPMG's general counsel, some of its outside lawyers, and government prosecutors, the Court concludes that the KPMG Defendants are right. KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses.
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> Those who commit crimes—regardless of whether they wear white or blue collars—must be brought to justice. The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend....
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> The Court declares that so much of the Thompson Memorandum and the activities of the USAO as threatened to take into account, in

deciding whether to indict KPMG, whether KPMG would advance attorneys' fees to present or former employees in the event they were indicted for activities undertaken in the course of their employment interfered with the rights of such employees to a fair trial and to the effective assistance of counsel and therefore violated the Fifth and Sixth Amendments to the Constitution.

The Opinion reflects the strong feelings of Judge Kaplan after having heard extensive testimony from KPMG's General Counsel, some of the outside lawyers for KPMG, and some of the individual prosecutors. Until the government began discussing the payment of the Defendants' legal fees with KPMG under the glare of the Thompson Memorandum, "KPMG had an unbroken track record of paying legal expenses of it's partners and employees incurred as a result of their jobs, without regard to cost."[15]

> Under the McNulty Memorandum, federal prosecutors may only seek waivers of the attorney-client and work product privileges in limited circumstances and must forward such request through the upper level at DOJ.

In the Enron related prosecution of Kenneth Lay (deceased) and Jeffrey Skilling, defense counsel attacked the credibility of many former Enron executives who pled guilty asserting that the former executives were "robbed of their free will" by the Enron task force, and pled guilty to crimes they did not commit out of fear of lengthy prison terms and expensive legal trials. Defense counsel (unsuccessfully) asserted that the cooperating former Enron executives could not be relied on for the "unvarnished truth."

Legislative Fix

Senator Arlen Specter, the former Chairman of the Senate Judiciary Committee, introduced a bill (S. 186) initially on December 7, 2006 and reintroduced on January 4, 2007, entitled the "Attorney-Client Privilege Protection Act of 2007". This bill would categorically prohibit the government from demanding, requesting or conditioning treatment on the disclosure by an organization of privileged information, and would forbid consideration of a company's valid assertion of the attorney-client or work-product privileges, provision of counsel or payment of attorneys' fees to an employee, as well as the entry into a joint defense, information sharing or common interest agreement with an employee, as a factor in determining whether the company is cooperating with the government or as a charging decision condition.

Does McNulty Go Far Enough?

Measuring the degree of "voluntary" cooperation in determining whether to prosecute a business entity is and will remain a difficult task. Whether the new procedures under the McNulty Memorandum will serve as effective safeguards of a corporation's attorney-client privilege and a defendant's constitutional right to effective counsel and fair trial remain to be seen. To corporations facing federal criminal investigations, cooperation with the government is of foremost concern. While corporations might worry a bit less that advancement of legal fees to their employees will automatically be viewed as a failure to cooperate with prosecutors, they still have to consider a voluntary waiver of attorney-client privilege in some cases as part of their cooperation efforts during an investigation.

American Bar Association (ABA) President Karen Mathis issued a press release denouncing the revised guidelines as falling "far short of what is needed to prevent further erosion of fundamental attorney-client privilege, work product, and employee protections during government investigation," and urging Congress to promptly consider and pass the Specter bill.[16] The U.S. Chamber of Commerce issued a statement supporting the elimination of payment of the attorneys' fees of employees as a factor in consideration but criticizing the DOJ's continued policy with respect to joint defense agreements and its right to reward corporations for waiving attorney-client protections as "not good enough."[17]

The McNulty Memorandum represents DOJ's acknowledgement of the chilling effects of the Thompson Memorandum on the attorney-client and work product privileges and a defendant's con-

stitutional right to counsel and a fair trial. DOJ has attempted to fix the problem before Congress does so by enacting the Specter bill or some other similar legislation. Senator Patrick Leahy (D-VT), the new Chairman of the Senate Judiciary Committee, issued a statement that he is "pleased that the [DOJ] has heeded bipartisan criticism of its policy...and moved away from its most excessive practices in corporate fraud investigation." However, he "remain[ed] concerned that, depending on how the new policies are implemented, prosecutors may still be able to inappropriately consider a corporation's waiver of [an] important privilege."[18]

Whether the revised DOJ procedures will effectively safeguard various privileges and constitutional rights will depend on how the new policy is implemented and "by the real and perceived ways" in which the federal prosecutors achieve results.[19] In the meantime, many will likely be forced to proactively "voluntarily" waive the very rights and privileges that have long defined the most civilized society in the world...the United States of America.

ENDNOTES

1. Memorandum from Paul McNulty to Heads of Department Components and United States Attorneys, Re: Principles of Federal Prosecution of Business Organizations (issued on December 12, 2006), available at *www.usdoj.gov/dag/speech/2006/mcnulty.memo.pdf.*
2. See Cover Memorandum to the McNulty Memorandum.
3. (see McNulty Memorandum, Section IV)
4. (see McNulty Memorandum, Section V)
5. (see McNulty Memorandum, Section VI)
6. (see McNulty Memorandum, Section VII)
7. (see McNulty Memorandum, Section VIII)
8. (see McNulty Memorandum, Section IX)
9. (see McNulty Memorandum, Section X)
10. (see McNulty Memorandum, Section XI)
11. (see Thompson Memorandum, Section III)
12. (see Thompson Memorandum, Section VI)
13. (see McNulty Memorandum, footnote 3).
14. (see McNulty memorandum, footnote 4).
15. *J. Stein,* DC N.Y., 435 FSupp2d 330 (2006).
16. Statement by ABA President Karen J. Mathis regarding revisions to the Justice Department's Thompson Memorandum (December 12, 2006), available at *www.abanet.org/abanet/media/statement/statement.cfm?releaseid=59.*
17. New DOJ Policy Does Not Adequately Protect Attorney-Client Privilege, available at *www.uschamber.com/press/release/2006/december/06-190.htm.*
18. Reaction of Senator Patrick Leahy (D-Vt.), Ranking Member and Incoming Chairman, Senate Judiciary Committee, to Revisions to the Thompson Memorandum (Dec. 12, 2006), available at *http://leahy.senate.gov/press/200612/121206.html.*
19. See Cover Memorandum to the McNulty Memorandum wherein Deputy Attorney General Paul McNulty reminded prosecutors that public confidence in DOJ is affected by "the results we achieve and by the real and perceived ways in which we achieve them."