complinet

Prosecutions under the McNulty memorandum: changing style over substance?

KAYE SCHOLER

Jan 09 2007 Daniel R. Alonso and Gregory J. Wallance

Deputy Attorney General Paul McNulty last month formally announced that the US Department of Justice was revising its policy regarding federal prosecution of business organizations, superseding the now-infamous Thompson Memorandum. In the resulting McNulty Memorandum, the Justice Department primarily revised its policy in two areas of recent controversy: requests for waiver of attorney-client privilege and work-product protections from companies seeking leniency from the government and the advancement of fees to company employees in criminal investigations and prosecutions. To understand these topics fully, it is useful to examine the McNulty Memorandum's two predecessors.

Previous policy

In 1999, at the insistence of corporations and defense lawyers who complained there was no uniformity, the Justice Department announced its first corporate charging policy. Issued by then-Deputy Attorney General Eric Holder Jr., and titled "Federal Prosecution of Corporations," the policy became known as the Holder Memorandum. The Holder Memorandum stated, "Corporations should not be treated leniently because of their artificial nature, nor should they be subject to harsher treatment." It set out a variety of factors for prosecutors to consider when making corporate charging decisions, and it introduced the connection between cooperation and the potential waiver of attorney-client privilege and work-product protection that has since proven unpopular and controversial.

The superseding Thompson Memorandum was issued in January 2003 by then-Deputy Attorney General Larry D. Thompson in the wake of the corporate fraud scandals that began in 2001. It changed the Holder principles in two key ways. First, whereas the Holder Memorandum arguably was merely advisory, the Thompson Memorandum more plainly *required* that prosecutors apply the memo's principles in every case where a company might be criminally liable. Second, the Thompson Memorandum stressed that prosecutors must scrutinize more carefully the nature of corporate compliance programs and the efforts at cooperation. While declaring that business entities would be charged only in a minority of cases, the Thompson Memorandum emphasized that "[t]oo often, business organizations, while purporting to cooperate with a [Justice] Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation." Compliance programs, moreover, needed to be "truly effective" and not "mere paper programs."

The goal of the Thompson Memorandum was to persuade companies to cooperate with a Justice Department investigation as fully as they were able, in an effort to root out wrongdoing, to promote self-policing and to encourage high standards of corporate ethics. The carrot at the end of the stick was the possibility that the government would agree not to prosecute the company or to defer prosecution during a specified time period, after which charges would be dismissed.

Indeed, in the five years since the corporate fraud scandals broke, only a small number of companies have been charged criminally by the Justice Department. Certain principles set forth in the Thompson Memorandum have received sharp criticism. In *United States v. Stein*, Federal Judge Lewis Kaplan found the Thompson Memorandum's directive discouraging the payment of employees' legal fees unconstitutional as an infringement of the rights to counsel and against self-incrimination. Likewise, the US Senate was poised at the time the McNulty Memorandum was issued to consider legislation severely curtailing the government's practices with respect to attorney-client privilege, work-product protection, joint defense agreements and the advancement of legal fees. (Senate bill S.186, Sen. Arlen Specter, R-Pa.)

Changes under McNulty

While reciting the same general set of factors relevant to a corporate charging decision that were cited by the Thompson Memorandum, the McNulty Memorandum limits the authority of prosecutors in the areas of privilege waiver and attorney fees. Under McNulty, "[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." Indeed, even requests for waiver are now only authorized if "there is a legitimate need for the privileged information" in order for the government to fulfill its law enforcement obligations. Such need may be demonstrated by the following factors:

1. the likelihood and degree to which the privileged information will benefit the government's investigation;

2. whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver;

3. the completeness of the voluntary disclosure already provided; and

4. the collateral consequences to a corporation of a waiver.

Notably, even if application of these somewhat vague factors establishes a legitimate need for waiver, prosecutors must comply with strict approval and consultation requirements that did not exist previously. First, before requesting a waiver of even "purely factual information" – called "Category I" information and "which may or may not be" covered by a privilege – line prosecutors must obtain the approval in writing of the US attorney, who in turn must furnish a copy to, and first consult with, the assistant attorney general in charge of the criminal division. Significantly, however, a company's response to the government's request for a waiver of privilege for Category I information "may be considered in determining whether a corporation has cooperated in the government's investigation." Typical items that would fall into Category I would be memoranda of factual interviews with witnesses in an internal investigation.

A request for "Category II" information, such as communications involving legal advice or non-factual attorney work product, must be approved in writing by the deputy attorney general and may only be sought in "rare circumstances." A company's rejection of a request for Category II information may not be considered by prosecutors in making a charging decision. Such requests, according to the McNulty Memorandum, are to be sought only in "rare circumstances." Although prosecutors may "favorably consider" a company's compliance with a Category II request in determining whether the company has cooperated with the government's investigation, they are prohibited from considering a refusal to comply with a Category II request.

With respect to fees, the McNulty Memorandum states 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 a footnote, however, the McNulty Memorandum states that in "extremely rare cases" 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." The deputy attorney general must approve any request to consider such a circumstance in a charging decision.

Considerations for the future

Whether the McNulty Memorandum in fact reduces the pressure on companies to waive privilege in order to benefit from cooperation remains to be seen. Despite acknowledging the importance of attorney-client and work-product protections, the Justice Department has nonetheless reserved the right to *penalize* companies that decline to produce the broadly-defined Category I information, while *rewarding* those companies that voluntarily produce information under Category I or II. Similarly, just what constitutes "rare circumstances" that allow prosecutors to take into account advancement of attorneys' fees to employees presently is unknown.

Although it is clearly too early to gauge the impact of the McNulty Memorandum, several observations can be made.

First, the reality is that in corporate investigations in recent years, the government has almost always limited its waiver requests to Category I materials such as the results of internal investigations, ordinarily steering clear of requests for "pure" attorney-client communications. The major exceptions to this practice have been (1) in cases involving a potential defense of reliance on counsel, the contents of contemporaneous legal advice, and (2) in cases involving possible obstruction of the government's investigation, the contents of any communications exempted from attorney-client protection by the crime-fraud exception. But these two particular circumstances in any event are specifically exempted from the more onerous approval requirements of Category II, and instead need only be approved by the US attorney. Thus, the only technical change in *practice* may be the more onerous approval requirements.

Second, although the new policy may not affect a sea change in practice, its restrictions on the unfettered ability of line prosecutors to make ill-considered, reflexive requests for privilege waiver may embolden corporate defense attorneys to be more aggressive than in the recent past in defending corporations in criminal investigations. To be sure, the mere prospect of an indictment remains devastating to most corporations, and the standards for corporate criminal liability continue to be minimal. However, there is likely to be a psychological effect and cultural change in the way that white-collar prosecutors and defense lawyers interact, which may well serve to shift the relative bargaining power of the two sides. At a minimum, defense attorneys should now resist the temptation automatically to offer a waiver of privilege at the outset of an investigation, and should instead consider whether such waiver should be delayed until more facts come to light or should be withheld altogether.

Third, it remains to be seen whether the change in policy will have any effect on the proliferation in recent years of deferred-prosecution and non-prosecution agreements. The Thompson Memorandum, which for the first time

explicitly authorized the possibility of the deferred prosecution of corporations (under its official name "pretrial diversion"), sharply increased the number of such agreements, a trend that has imposed extraordinarily burdensome requirements on many companies.(*See generally* D. Alonso, "Use Caution in Negotiating Deferred Prosecution Agreements, 235 New York Law Journal 4, March 1 2006). In the nearly four years since the Thompson Memorandum was promulgated in 2003, Justice Department prosecutors have entered into at least 33 deferred- and non-prosecution agreements, as compared to merely a dozen in the previous nine years. (Brandon L. Garrett, "Structural Reform Prosecution," *Virginia Law Review*, due for publication in June 2007) The McNulty Memorandum pointedly does not alter any reference to deferred prosecution agreements, and even created a heading titled "Qualifying for Immunity, Amnesty or Pretrial Diversion" in the section discussing the value of cooperation. This ensures that the government's appetite for these agreements is unlikely to wane.

Finally, objecting that the McNulty Memorandum does not go far enough, the Association of Corporate Counsel and others have already gone on record (PDF) protesting the new policy and urging the Senate to act on more stringent legislation. Whether the Senate will take up the issue now that the Justice Department has acted is unknown, but it is likely that the Justice Department believes that revising its policy the way it did will be sufficient to stave off legislative action. The government may well be right for another reason – legislation controlling the exercise of prosecutorial discretion is extremely rare outside of the sentencing context, and Congress may well wish to tread lightly in an area that implicates the separation of powers.

Daniel R. Alonso, a partner in the white collar litigation and internal investigations group at Kaye Scholer LLP, is the former Chief of the Criminal Division in the United States Attorney's Office for the Eastern District of New York. Mr. Alonso has represented numerous corporations in internal investigations of suspected wrongdoing, and also represents executives in connection with government investigations.

Gregory J. Wallance, also a partner at Kaye Scholer LLP and a former Assistant U.S. Attorney for the Eastern District of New York, concentrates in white-collar and financial services litigation. Mr. Wallance has represented numerous individuals and organizations, including Fortune 500 companies, in state and federal criminal and regulatory cases and investigations. He has conducted internal investigations of suspected criminal activities for major corporations, trade associations and financial firms and advised a variety of companies on how to establish corporate compliance programs.

Related content

Related Articles

- Justice Department revises policy on business prosecutions
- Judge slams 'Thompson memorandum' ban on paying employees' legal fees
- Justice Department addresses waivers of privilege
- The Andersen legacy
- Has corporate fraud prosecution become obsolete?
- Have federal prosecutors lost an arrow in their quiver?
- KPMG to pay $456m fine for tax shelters

News by Subject

- Corporate Governance and Ethics
- Compliance Monitoring and Oversight
- Sanctions, Regulatory Enforcement and Criminal Proceedings

News by Country

- United States

External sites

- Association of Corporate Counsel, What Does the DOJ's Issuance of the "McNulty Memorandum" Mean for You and Your Client (Dec. 13, 2006)

Related Rulebooks
US Department of Justice

- Principles of Federal Prosecution of Business Organizations (The "Thompson Memorandum")
- Principles of Federal Prosecution of Business Organizations (Revisions to the "Thompson Memorandum")