ANDREWS LITIGATION REPORTER

THOMSON WEST

# Securities Litigation & Regulation

COMMENTARY

REPRINTED FROM VOLUME 12, ISSUE 22 / MARCH 7, 2007

## Will McNulty's Revisions Pacify Critics Of the Thompson Memorandum?

By Claudius O. Sokenu, Esq., and Paula Garrett Lin, Esq.*

After the corporate scandals of the last few years that engulfed corporate America, and the ongoing stock-options investigations, many prosecutors and regulators now routinely demand that corporations waive attorney-client privilege and work product protection to show their cooperation with governmental authorities. This is accomplished through, among other things, the production of privileged documents, notes of employee interviews conducted by lawyers and, where available, reports of internal investigations.[1]

However, in the last year, this culture of waiver, along with the government's insistence that corporations under investigation refuse to pay legal fees or enter into joint defense agreements with current or former employees implicated in corporate wrongdoing, has raised significant concerns about the erosion of constitutionally guaranteed rights and protections, including the near-sacrosanct attorney-client relationship. Criticism of this culture of waiver has come loud and clear from certain members of Congress, at least three former U.S. attorneys general, three former deputy attorneys general, four former solicitors general, several former U.S. attorneys, and scores of former prosecutors, civil libertarians, law professors and practitioners.[2]

This groundswell of opposition has led to four recent developments that are beginning to stem the tide of routine acquiescence to waiver demands from prosecutors and regulators.

First, recognizing the Hobson's choice faced by corporations caught in the crosshairs of government investigations, in April 2006 the Advisory Committee on Evidence Rules approved proposed Rule 502 and recommended its release for public comment. Proposed Rule 502(c) provides that disclosure of protected information to federal agencies "does not operate as a waiver of privilege or protection in favor of non-governmental persons or entities."

Second, effective Oct. 13, 2006, Congress passed the Financial Services Regulatory Relief Act of 2006, which states that an insured depository institution or credit union does not waive its attorney-client privilege by providing privileged materials to a federal, state or foreign banking authority in the course of that authority's supervisory or regulatory process.

**The fear of indictment has doubtless exacerbated corporations' concern about being labeled uncooperative.**

Third, on Dec. 8 then-Senate Judiciary Chairman Arlen Specter introduced legislation targeted at three of the most controversial provisions of the Thompson Memorandum, the Department of Justice's principles on the prosecution of business organizations then in force. Specter's proposed legislation, reintroduced to the new Congress Jan. 4, would bar prosecutors from demanding that corporations waive attorney-client privilege and work product protection.

The proposed law would further bar prosecutors and enforcement agencies from taking into account a corporation's valid assertion of privilege, advancement of legal fees, or a valid joint defense agreement when deciding whether to charge a corporation or whether a corporation has fully cooperated with the government's investigation.

Fourth, Deputy Attorney General Paul J. McNulty, reacting to severe criticisms from Congress and the bar at large, released the Department of Justice's revised principles for the prosecution of business organizations Dec. 12. The McNulty Memorandum purports to revise the Thompson Memorandum by limiting the circumstances under which prosecutors may seek corporate waivers. These recent developments, which corporations should take into consideration when faced with a request for privileged information from prosecutors and regulators, are explained in more detail below.

## Financial Services Regulatory Relief Act

Amending Section 18 of the Federal Deposit Insurance Act, 12 U.S.C. § 1828, and Section 205 of the Federal Credit Union Act, 12 U.S.C. § 1785, the Financial Services Regulatory Relief Act of 2006 provides that an insured depository institution or credit union does not waive its privileges in connection with a disclosure made to a federal, state or foreign banking authority in the course of a supervisory or regulatory process of that authority. The provision states, in pertinent part:

> The submission by any person of any information to any [f]ederal banking agency, [s]tate bank supervisor, or foreign banking authority for any purpose in the course of any supervisory or regulatory process of such agency, supervisor, or authority shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to such information under [f]ederal or [s]tate law as to any person or entity other than such agency, supervisor, or authority.[3]

The Financial Services Regulatory Relief Act is an effort by Congress to address the obvious problems faced by corporations that are coerced to waive attorney-client privilege and work product protection during government investigations. Since most circuit courts have refused to recognize the concept of selective or limited waiver, a company that waives its attorney-client privilege or work product protection in order to cooperate with a government investigation thus waives the privilege as to all.[4]

At least as it relates to depository institutions and credit unions beginning Oct. 13, 2006, these new provisions should provide some protection in shielding privileged information from private third-party litigants who typically seek to use privileged information to shore up their private lawsuits. It remains to be seen how courts will respond to this new tool in the arsenal of depository institutions and credit unions.

## Proposed Amendment to the Federal Rules of Evidence: Rule 502

In an effort to address the culture of waiver under created by the Thompson Memorandum and the Securities and Exchange Commission's Seaboard report (which also calls for corporations to waive privilege and cooperate with SEC investigations), the Advisory Committee on Evidence Rules released for public comment proposed Federal Rule of Evidence 502. If passed by Congress, proposed Rule 502(c), like the Financial Services Regulatory Relief Act, will permit corporations to produce protected information to government agencies without rendering otherwise privileged documents, information, and advice discoverable by future private civil litigants.[5] The proposed rule, as currently drafted, states:

> Selective waiver — In a federal or state proceeding, a disclosure of a communication or information covered by the attorney-client privilege or work product protection — when made to a federal public office or agency in the exercise of its regulatory, investigative, or enforcement authority — does not operate as a waiver of the privilege or protection in favor of non-governmental persons or entities. The effect of disclosure to a state or local government agency, with respect to non-governmental persons or entities, is governed by applicable state law. Nothing in this rule limits or expands the authority of a government agency to disclose communications or information to other government agencies or as otherwise authorized or required by law.[6]

Public hearings on proposed Rule 502 were held in Phoenix and New York in January, and the public comment deadline was Feb. 15.[7]

## Attorney-Client Privilege Protection Act

The Senate Judiciary Committee held a hearing Sept. 15 on the Thompson Memorandum's effect on the right to counsel in corporate investigations. This public hearing provided critics a platform to further outline their opposition to the Thompson Memorandum.[8] Although participants at the hearing expressed many criticisms of the Thompson Memorandum, two are particularly noteworthy.

First, participants observed that the Thompson Memorandum's policies contribute to a coercive "culture of waiver," in which "governmental agencies believe it is reasonable and appropriate for them to expect a company under investigation to broadly waive [its] attorney client privilege."[9]

The fear of indictment has doubtless exacerbated corporations' concern about being labeled uncooperative. As one observer noted, "In the current climate few, if any, public corporation can afford the risk of possible indictment and the myriad of collateral consequences, not the least of which is the diminution of shareholder value."[10]

Second, the emphasis placed on waiver of the attorney-client privilege threatens to create a counterproductive climate of distrust between corporations and their employees, and would work to undermine corporations' internal compliance programs and procedures. As noted by Karen J. Mathis, president of the American Bar Association, "Because the effectiveness of these internal mechanisms depends in large part on the ability of the individuals with knowledge to speak candidly and confidentially with lawyers, any attempt to require routine waiver of attorney-client [privilege] and work product protections will seriously undermine systems that are crucial to compliance and have worked well."[11]

Further exacerbating the Thompson Memorandum's culture of waiver is the refusal of various courts to recognize the notion of selective or limited waiver, thereby resulting in potential access by private civil litigants to information provided to the government in the course of government investigations. With the exception of the U.S. Court of Appeals for the 8th Circuit in *Diversified Industries Inc. v. Meredith,* 572 F.2d 596, 611 (8th Cir. 1977) *(en banc)*, every circuit court that has considered the question of selective or limited waiver of the attorney-client privilege has declined to adopt such a rule.[12] With respect to the work product protection, only the 4th Circuit has adopted the notion of selective or limited waiver.[13] The 1st, 3rd, 6th, 8th and 10th Circuits have all rejected a selective or limited waiver rule with respect to work product protected information.[14] Some circuits have left open the possibility of recognizing the selective or limited waiver rule in limited circumstances.[15] While in some jurisdictions a confidentiality agreement might go some way to protect privileged information,[16] at least three circuits have held that the disclosure of privileged information operates as a waiver notwithstanding the existence of a confidentiality agreement.[17]

It is against this backdrop that in December Sen. Specter introduced the Attorney-Client Privilege Protection Act of 2006, which is designed to bar three DOJ policies encouraged by the Thompson Memorandum.[18]

First, federal enforcement agents and attorneys would be barred from demanding, requesting or conditioning their approach on "the disclosure by an organization, or person affiliated with that organization, of any communication protected by the attorney-client privilege or any attorney work product."[19]

Second, federal enforcement agents and attorneys would not be permitted to condition valid assertions of attorney-client privilege or work product protection, an organization's advancement of legal fees, or the valid entry into a joint defense agreement on an organizational charging decision.[20]

Third, the proposed legislation would prohibit federal enforcement agents and attorneys from using claims of attorney-client privilege or work product protection, the advancement of attorney fees, or entry into joint defense agreements as factors in determining whether the organization is cooperating with the government.[21]

Specter's proposed legislation was not fully considered before the 109th Congress recessed. Notwithstanding that the McNulty Memorandum (discussed below) was announced Dec. 12 to address the very issues raised by his proposed legislation, Specter, clearly not impressed by the Justice Department's efforts to address his concerns, reintroduced his legislation Jan. 4 without any changes.[22]

Currently, Specter's legislation is before the Senate Committee on the Judiciary.[23] Under the proposed law, a corporation is not prohibited from making, or a federal enforcement agent or attorney is not precluded from accepting, a voluntary and unsolicited offer to share the internal investigation materials of such an organization. Although promising, it is too early to tell whether Specter's proposed legislation will ever become law.[24] What it clearly does, however, is send a strong message to federal regulators that the tactics outlined in the Thompson Memorandum have outlived their usefulness and that the time has come to review their continuing use.

## The McNulty Memorandum

In response to the growing criticism of policies outlined in the Thompson Memorandum and the supplemental memorandum by Acting Deputy Attorney General Robert McCallum,[25] Deputy Attorney General McNulty released the McNulty Memorandum Dec. 12.[26]

The McNulty Memorandum diverges from its predecessor in two key respects. First, it purports to limit — but does not eliminate — the circumstances under which prosecutors may seek waivers of privilege, and pro-

vides a procedure for seeking such waivers. Second, the McNulty Memorandum takes the position that generally, prosecutors should not take into account whether a corporation is advancing attorney fees to its employees or agents under investigation and indictment. Notably, the McNulty Memorandum did not change the Thompson Memorandum's policy regarding the use of joint defense agreements and the willingness of a corporation to sanction employees for misconduct in assessing the extent and value of a corporation's cooperation in a prosecutor's charging decision.

The McNulty Memorandum dictates that prosecutors may only request waiver if there is a "legitimate need" for the waiver, and sets forth a balancing test for determining whether such a legitimate need exists. If a prosecutor determines that there is a "legitimate need," the McNulty Memorandum sets forth a tiered approach to seeking waivers and requires different levels of authorization based upon the type of information to be sought.

In determining whether there is a "legitimate need" for privileged information, a prosecutor is to consider:

(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.[27]

A "legitimate need for the information is not established by concluding it is merely desirable or convenient to obtain privileged information." Other than listing this rather amorphous four-part test and cautioning that a prosecutor may not engage in perfunctory testing, the McNulty Memorandum leaves a tremendous amount of discretion to the individual prosecutor in deciding whether a "legitimate need" exists for demanding protected information. It is the rare accounting fraud or other complex securities law investigation that will be at risk of failing the four-part "legitimate need" test when a prosecutor is intent on obtaining a waiver.

If a "legitimate need" exists after a "careful balancing" of the four-part test, the McNulty Memorandum counsels prosecutors to then "seek the least intrusive waiver necessary to conduct a complete and thorough investigation" and provides a tiered approach to requesting waiver.

First, prosecutors are instructed that they should request Category I information. Category I information is "purely factual information, which may or may not be privileged, relating to the underlying misconduct." Category I information, according to the McNulty Memorandum, includes material such as "copies of key documents, witness statements, or purely factual interview memoranda regarding the underlying misconduct, organization charts created by company counsel, factual chronologies, factual summaries, or reports … containing investigative facts documented by counsel." Failure to produce Category I information, when requested, can — and most likely will — be considered "in determining whether a corporation has cooperated in the government's investigation."

Before requesting waiver of Category I information, a prosecutor 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." The prosecutor's request for authorization to the U.S. attorney must set forth the "legitimate need" and the scope of the waiver sought, and the U.S. attorney is required to maintain both the request for authorization and the authorization itself. The U.S. attorney must communicate any authorized request for waiver in writing to the corporation.

Prosecutors are permitted to seek Category II information — defined as "attorney-client communications or non-factual attorney work product," including legal advice given to the corporation before, during and after the underlying misconduct occurred — only if Category I information provides "an incomplete basis to conduct a thorough investigation." The McNulty Memorandum tells prosecutors to seek Category II information, which may include attorney notes, memoranda containing counsel's mental impressions and conclusion, or legal determinations reached as a result of an internal investigation, only in "rare circumstances." Unlike with Category I information, a prosecutor must not consider a corporation's refusal to provide a waiver for Category II information in making charging decisions. Nevertheless, the memo says "[p]rosecutors 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."

Before requesting Category II information, the U.S. attorney must request authorization, in writing, from the deputy attorney general, setting forth the "legitimate need" and the scope of the waiver sought. If approval is appropriate, the deputy attorney general must do so in writing. The deputy attorney general must maintain copies of each waiver request and authorization for Category II information. If authorized to request Category II information, the

U.S. attorney must communicate the request in writing to the corporation.

The McNulty Memorandum carves out an exception to this procedure for two types of Category II information: legal advice given at the time of the underlying misconduct, when the corporation or one of its employees is relying upon an advice-of-counsel defense; and legal advice or communications coming within the crime-fraud exception to the attorney-client privilege. Requests for these types of Category II information do not need the approval of the deputy attorney general and should be obtained under the authorization process for Category I information.

Finally, the McNulty Memorandum notes that federal prosecutors are not required to obtain authorization "if the corporation voluntarily offers privileged documents without a request by the government." Voluntary waivers must be reported to the U.S. attorney or the assistant attorney general in the division where the case originated, and that office must maintain a record of these reports.

**Since the McNulty Memorandum does not apply to the SEC, there remains a gaping hole.**

It is difficult to see how the new waiver framework, which seemingly favors form over substance, addresses the fundamental concerns that prompted demands for revisions to the Thompson Memorandum in the first place. Nor does the McNulty Memorandum do anything to address the issue of selective or limited waiver. Moreover, the McNulty Memorandum draws a hollow distinction between treating companies that waive their privilege "favorably" and not holding refusal "against" companies that elect not to waive their privilege. This dubious distinction does nothing to advance the debate.

When facing criminal indictment (and certain annihilation), no corporation in America today is going to take the risk of foregoing "favorable" treatment points that can mean the difference between survival and certain death in the hopes that its refusal to waive will not be held against it. One need only look to the Justice Department's prosecution of accounting firm Arthur Andersen for a sobering analysis of what bad things can happen when a company is indicted.[28]

According to the New York Times, the government had proposed a deferred prosecution agreement, but had, in the view of Andersen's lawyers, given Andersen too little time to determine whether the deal would be acceptable. After prosecutors ended negotiation, Andersen provided a new proposal, which purportedly contained "as much as 90 percent" of the government's proposed agreement.[29] The government rejected this new proposal.[30]

Early reaction to the McNulty Memorandum questions whether these new procedures meaningfully address the criticisms levied at the Thompson Memorandum. In the view of the ABA, the McNulty Memorandum "merely requires high-level department approval before waiver requests can be made. As such, [it] threatens to further erode the ability of corporate leaders to seek and obtain the legal guidance they need to effectively comply with the law."[31]

The bottom line is that prosecutors can still lean on corporations to produce Category I and II privileged information, while dangling cooperation credit as an incentive. It also remains to be seen how stringently the U.S. attorneys across the country will apply the "legitimate need" and "incomplete basis to conduct a thorough investigation" tests.

Moreover, since the McNulty Memorandum does not apply to the SEC, there remains a gaping hole to which corporations should be attuned. As noted above, the SEC's Seaboard report also requires that corporations waive their attorney-client privilege and work product protections to get credit for cooperation.[32] As is standard practice, the SEC and the DOJ routinely share information about their respective investigations. Nothing in the McNulty Memorandum prevents the DOJ from sitting on the sidelines while the SEC demands that a corporation waive its attorney-client privilege and work product protections without having to comply with strictures similar to those outlined in the McNulty Memorandum.[33] Once the SEC receives the protected information, it is free to share it with any other governmental agency, including the DOJ.

While this all might seem a bit cynical, the last few years have shown that it is not at all a far-fetched issue to consider.[34] When faced with such a situation, will the SEC agree to a corporation's request not to share the privileged information with the DOJ? The SEC will almost always decline to agree to such a request.

Separately, in a tacit effort to address a pair of decisions handed down last summer by U.S. District Judge Lewis Kaplan in the KPMG tax shelter cases, the McNulty Memorandum now counsels prosecutors not to "take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and

indictment."[35] In *United States v. Stein,* 435 F. Supp. 2d 330 (S.D.N.Y. 2006) (*Stein I*), Judge Kaplan ruled that the Thompson Memorandum's guideline on the advancement of legal fees by corporate employers, both alone and coupled with the action of the U.S. Attorney's Office, violated the Fifth and Sixth Amendment rights of the individual KPMG defendants.

In *United States v. Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006) (*Stein II*), Judge Kaplan suppressed statements by two defendants because the statements had been "deliberately" coerced by the government. Judge Kaplan found that KPMG, under pressure from the government to cooperate, itself pressured its employees to grant government requests for pre-indictment interviews and threatened to stop payment of legal fees should the employees refuse to cooperate. The revision to the Thompson Memorandum in this regard should give corporations more comfort to advance legal fees to current and or former employees without wondering whether the government will view advancement of legal fees as a failure to cooperate.[36]

Corporations should, however, be mindful that in "extremely rare cases, the advancement of legal fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation."[37] The McNulty Memorandum counsels that when such circumstances exist, "fee advancement is considered with many other telling facts to make a determination that the corporation is acting improperly to shield itself and its culpable employees from government scrutiny."[38] This view supposedly echoes the government's position on an appeal of Judge Kaplan's suppression order in *Stein I,* currently pending before the 2nd Circuit, in which the government argues that its consideration of the advancement of attorney fees is limited to these narrow circumstances.[39] Where the "extremely rare case" exists, a prosecutor must obtain approval from the deputy attorney general (in accordance with the procedure for requesting waivers with respect to Category II information) before considering this factor in the charging decision.[40]

The McNulty Memorandum did not change the Thompson Memorandum as it relates to the use of joint defense agreements and employee sanctions. In other words, the McNulty Memorandum still views the use of a joint defense agreement and the failure to sanction employees engaged in wrongful conduct as probative of whether a corporation is shielding its culpable employees and agents from a government investigation.[41] The ABA has criticized the decision to retain these two policy considerations, arguing that the McNulty Memorandum "does not fully protect employees' legal rights in that it continues to allow prosecutors to force companies to take punitive actions against their employees in some cases in return for cooperation credit, long before any guilty is established."[42]

In addition to not changing the use of joint defense agreements and employee sanctions, the McNulty Memorandum retained the other following Thompson Memorandum factors that prosecutors must consider.

**Nature and seriousness of offense.**[43] This principle is cited as a primary concern. Independent of the other factors, the seriousness of a crime alone may warrant prosecution. However, it is also noted that even if the crime is very severe, it may not warrant prosecution if committed by one rogue employee.[44] Prosecutors are told to look to other divisions within the Justice Department, such as the environmental, tax, antitrust and criminal divisions, to see if they have policies that point toward or away from prosecution for certain industries or practices.

**Pervasiveness of wrongdoing within the corporation.**[45] Prosecutors are advised to look toward the pervasiveness of a violation to decide whether to prosecute. Thus, even if a violation is relatively minor, if it is perpetuated by several employees, officers and/or directors of a corporation, the principles would support prosecution. The memorandum particularly emphasizes acts of wrongdoing that are condoned by a company's upper management. The guidelines tie the first two principles closely together and make them interdependent to a greater extent than the other principles. The relationship between the two can be imagined as a graph with each principle sitting on a different axis. Thus, if a crime is only moderately serious but very pervasive, the first two principles would support a prosecution. The involvement of management in wrongdoing is the most important issue in determining pervasiveness. Managers are often the leaders that establish a corporation's culture. As such, a violation perpetrated by several management level employees, as opposed to low-level workers, could weigh strongly in favor of prosecution.

**The corporation's prior history.**[46] Prosecutors are instructed that a corporation, like a natural person, is expected to learn from its mistakes. A history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs. Criminal prosecution of a corporation may be particularly appropriate where the corporation previously had been subject to non-criminal guidance, warnings or sanctions, or previous criminal charges, and yet it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the conduct. In making this determination, the corporate structure itself, *e.g.,* subsidiaries or operating divisions, should be ignored, and enforcement actions

taken against the corporation or any of its divisions, subsidiaries and affiliates should be considered.

**Corporate compliance programs.**[47] Prosecutors are instructed to scrutinize compliance programs closely to ensure corporations have put effective programs in place. However, having a compliance program that appears adequate is no longer enough. Prosecutors are now directed to determine whether a compliance program is truly effective or whether it is merely a "paper program" — a program that looks good on paper but is actually ineffective in practice.

Factors that point to a satisfactory compliance program include: the promptness of reporting wrongdoing by the company to the government; the company's subsequent cooperation in the investigation; whether directors exercise independent review over proposed corporate actions; whether directors receive enough information to exercise independent judgment; whether internal audit functions allow for independent and accurate audits; and whether there is an adequate information and reporting system that enables directors to receive the information they need.

**Restitution and remediation.**[48] Under the guidelines, prosecutors are compelled to examine three factors in determining whether to credit the claim that appropriate restitution and remediation have taken place: employee discipline, monetary restitution, and reform of corporate practices and compliance programs. A corporation's response to wrongdoing is taken as indicative of its willingness to curtail future wrongdoing. Any action by the corporation that suggests it is attempting to protect employees who have engaged in malfeasance will generally lead federal prosecutors to conclude that a corporation, and more specifically its management, condones such behavior and that wrongdoing has become part of the corporate culture. Any such action bespeaks pervasiveness and will strongly point toward the appropriateness of prosecution.

**Collateral consequences.**[49] Prosecutors are told to examine the consequences of the proposed prosecution on officers, directors, employees and shareholders of the corporation. As with the prosecution of a natural person, any prosecution of a corporation will have unwanted collateral consequences and, according to the Justice Department, such a consideration alone should not stop a prosecution. Prosecutors should balance the consequences of prosecution against the pervasiveness of the conduct at issue, as well as the effectiveness of a company's compliance program.

**Adequacy of the prosecution of individuals responsible for the malfeasance.** While the McNulty Memorandum does not elaborate on this factor, prosecutors are likely to prosecute a company where, for whatever reason, the individuals responsible for a company's criminal conduct have not been (or cannot be) prosecuted to the fullest extent of the law. For example, where the individuals responsible for the alleged criminal conduct are outside the jurisdiction of federal prosecutors, the company may well be prosecuted more aggressively than the criminal conduct would otherwise warrant. In addition, the McNulty Memorandum counsels that in determining whether to enter into a plea agreement with a corporation, prosecutors may consider "whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals."[50]

**Non-criminal alternatives.**[51] Prosecutors are instructed to consider whether non-criminal alternatives would adequately deter, punish and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution, *e.g.,* civil or regulatory enforcement actions, prosecutors may consider all relevant factors, including: the sanctions available under the alternative means of disposition, the likelihood that an effective sanction will be imposed and the effect of non-criminal disposition on federal law enforcement interests. Such an alternative is inappropriate, however, where the violation is egregious, there is a pattern of wrongdoing, or there exists a corporate history of violations. Thus, non-criminal alternatives appear to be adequate for small or first-time violations and play into the analysis under earlier principles such as compliance programs, severity, pervasiveness and past corporate history.

## Conclusion

Depository institutions covered by the Federal Deposit Insurance Act and credit unions covered by the Federal Credit Union Act may now provide privileged information to any federal banking agency, state bank supervisor or foreign banking authority without waiving or otherwise destroying the privileged nature if the information. While proposed Federal Rule of Evidence 502 and Specter's Attorney-Client Privilege Protection Act make their way through Congress, it remains to be seen whether the new directives of the McNulty Memorandum will slowly begin to turn the tide against routine demand for waivers. The McNulty Memorandum does at least offer concrete hope that corporations generally may pay the attorneys fees of their employees without staring down the barrels of a federal indictment.

## Notes

[1] *See generally* Larry D. Thompson, Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), available at www.usdoj.gov/dag/cftf/corporate_guidelines.htm; *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions,* Rel. No. 34-44969 (Oct. 23, 2001), available at 2001 WL 1301408 (hereinafter Seaboard report); National Association of Securities Dealers, *Principle Considerations in Determining Sanctions* (2006), available at www.nasd.com/RegulatoryEnforcement/NASDEnforcementMarketRegulation/NASDSanctionGuidelines/PrincipalConsiderationsinDeterminingSanctions/index.htm; Memorandum from Susan Merrill, Executive Vice President, New York Stock Exchange Division of Enforcement, to All Members, Member Organizations and Chief Operating Officers, NYSE Information Memo No. 05-65 (Sept. 14, 2005), available at http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E88525707C004C6DE0/$FILE/Microsoft%20Word%20-%20Document%20in%2005-65.pdf; Memorandum from Susan Merrill, Executive Vice President, New York Stock Exchange Division of Enforcement, to All Members, Member Organizations and Chief Operating Officers, NYSE Information Memo 05-77 (Oct. 7, 2005), available at http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E88525709200683l4A/$FILE/Microsoft%20Word%20-%20Document%20in%2005-77.pdf; Commodity Futures Trading Commission, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations, COMM. FUT. L. REP. (CCH) ¶ 29,819 (C.F.T.C. 2004).

[2] *See, e.g., Memo to Gonzales,* WALL ST. J., Sept. 8, 2006, at A14 (reporting on memorandum critical of the Thompson Memorandum sent by former top Justice Department officials from five different administrations, including Griffin Bell, Dick Thornburgh, Jamie Gorelick, Theodore Olson, Kenneth Starr and Seth Waxman, to Attorney General Roberto Gonzales).

[3] *Financial Services Regulatory Relief Act of 2006,* Pub. L. No. 109-351, § 607, 120 Stat. 1966 (2006), codified at 12 U.S.C. § 1828(x) (depository institutions) and 12 U.S.C. § 1785(j) (credit unions).

[4] *See, e.g., In re Qwest Commc'ns Int'l Inc.,* 450 F.3d 1179, 1192, 1201 (10th Cir. 2006), *cert. denied,* 127 S. Ct. 584 (2006) (holding that because Qwest had waived privileges when it disclosed otherwise privileged materials to the SEC and DOJ in an effort to cooperate with government investigations, the District Court did not abuse its discretion in ordering Qwest to produce materials to private third-party civil litigants). *See also* discussion of federal courts' reluctance toward selective waiver, *infra* and notes 12-17.

[5] *See* Report of the Advisory Committee on Evidence Rules, Proposed Amendment to the Federal Rules of Evidence, FED. R. EVID. 502(c), at 12, available at www.uscourts.gov/rules/Excerpt_EV_Report_Pub.pdf (revised June 30, 2006). Proposed Rule 502(c) must be enacted directly by Congress, because it is a rule affecting privileges that seeks to bind state courts. *See id.* at 9; 28 U.S.C. § 2074(b).

[6] Report of the Advisory Committee on Evidence Rules, Proposed Amendment to the Federal Rules of Evidence, FED. R. EVID. 502(c), *supra* note 5, at 5.

[7] *See* Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, Memorandum to the Bench, Bar, and Public on Proposed Amendments to the Federal Rules (Aug. 10, 2006), available at www.uscourts.gov/rules/Memo_Bench_Bar_and_Public_2006.pdf.

[8] *See, e.g.,* The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations: Hearing Before the United States Senate Committee on the Judiciary, 109th Cong. (Sept. 12, 2006) (hereinafter Senate hearings); *Memo to Gonzales,* WALL ST. J., Sept. 8, 2006, at A14; *John Hasnas, Department of Coercion,* WALL ST. J., Mar. 11, 2006; White Collar Enforcement (Part I): Attorney-Client Privilege and Corporate Waivers: Hearing Before the Subcommittee on Crime, Terrorism & Homeland Security of the House Committee on the Judiciary, 109th Cong. (Mar. 7, 2006) (hereinafter House hearings).

[9] Senate hearings, *supra* note 8 (testimony of Edwin Meese III).

[10] Senate hearings, *supra* note 8 testimony of Mark B. Sheppard).

[11] Senate hearings, *supra* note 8 (testimony of Karen J. Mathis).

[12] *Qwest, supra* note 4, 450 F.3d at 1200; *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.,* 293 F.3d 289, 302 (6th Cir. 2002); *United States v. Mass. Inst. of Tech.,* 129 F.3d 681, 686 (1st Cir. 1997); *Westinghouse Elec. Corp. v. Republic of the Philippines,* 951 F.2d 1414, 1425 (3d Cir. 1991); *In re Martin Marietta Corp.,* 856 F.2d 619, 623-24 (4th Cir. 1988); *In re John Doe Corp.,* 675 F.2d 482, 489 (2d Cir. 1982); *Permian Corp. v. United States,* 665 F.2d 1214, 1219-20 (D.C. Cir. 1981).

[13] *See Martin Marietta, supra* note 12, 856 F.2d at 623, 626 (adopting selective waiver for opinion work product but declining to apply selective waiver to protect non-opinion work product).

[14] *See Qwest, supra* note 4, 450 F.3d at 1192 (concluding that selective waiver did not apply to work product disclosed to the government under the circumstances); *In re Chrysler Motors Corp. Overnight Evaluation Program Litig.,* 860 F.2d 844, 846-47 (8th Cir. 1988) (rejecting selective waiver for non-opinion work product); *Mass. Inst. of Tech.,* 129 F.3d at 687 (rejecting selective waiver for non-opinion work product); *Westinghouse,* 951 F.2d at 1429 (rejecting selective waiver of work product where disclosures were inconsistent with the objectives of the work product doctrine); *Columbia/HCA Healthcare, supra* note 12, 293 F.3d at 306-307 (concluding that many of the reasons for disallowing selective waiver of attorney-client privilege also applied to the work product doctrine).

[15] *See, e.g., In re Subpoenas Duces Tecum,* 738 F.2d 1367, 1372-75 (D.C. Cir. 1984) (disclosure of work product to SEC constituted a waiver rested on three factors: The party claiming privilege sought to use it in a way inconsistent with the purpose of the privilege, "appellants had no reasonable basis for believing that the disclosed materials would be kept confidential by the SEC" and no public policy behind the work product privilege demanded an exception to the waiver rule under the circumstances); *In re Steinhardt Partners,* 9 F.3d 230, 236 (2d Cir. 1993) (declining to adopt a per se rule that all voluntary disclosures to the government waive work product protection on the basis that such a rigid rule "would fail to anticipate situations in which the disclosing party and the government may share a common interest in developing legal theories and analyzing information, or situations in which the SEC and the disclosing party have entered into an explicit agreement that the SEC will maintain the confidentiality of the disclosed materials").

[16] *See, e.g., Steinhardt Partners, supra* note 15, 9 F.3d at 236 (citing existence of confidentiality agreement as one way in which to avoid a complete waiver of materials provided to the government); *Law-*

*rence E. Jaffe Pension Plan v. Household Int'l Inc.,* No. 02 C 5893, 2006 WL 3524016, at *20-*22 (N.D. Ill. Dec. 6, 2006) (noting that 7th Circuit has not yet decided position on selective waiver and that selective waiver has been disfavored by district courts within 7th Circuit, but holding that under the circumstances, defendant had not waived privilege with respect to documents produced to the SEC because it had entered into confidentiality agreement with SEC); *In re Natural Gas Commodity Litig.,* No. 03 Civ. 6186VMAJP, 2005 WL 1457666, at *9 (S.D.N.Y. June 21, 2005) (holding that under *Steinhardt Partners,* defendants had not waived work product privilege because they had explicit confidentiality agreements with the government agencies that had received the protected materials and because the plaintiffs had not shown a substantial need for the work product because they had received the underlying documents on which the analyses were based).

[17] *See Qwest, supra* note 4, 450 F.3d at 1194 (dismissing notion that confidentiality agreements with enforcement agencies warranted selective-waiver rule under the circumstances); *Columbia/HCA Healthcare Corp., supra* note 12, 293 F.3d at 307 (rejecting notion of selective waiver under circumstances, notwithstanding confidentiality agreement); *Chrysler Motors Corp., supra* note 14, 860 F.2d at 847 (holding that agreement with adversary not to disclose work product materials to a third party could not protect the materials from waiver).

[18] Attorney-Client Privilege Protection Act of 2006, S. 30, 109th Cong., 2d Sess. (2006); *see also* Associated Press, *Specter Files Fraud Case Legislation,* N.Y. Times, Dec. 7, 2006; *Carrie Johnson, Shift in Corporate Prosecution Ahead: Government to Stiffen Rules on Indicting Corporations,* Wash. Post, Nov. 30, 2006, at D1.

[19] Attorney-Client Privilege Protection Act of 2006, *supra* note 18, § 3(a).

[20] *Id.*

[21] *Id.*

[22] *See* Attorney-Client Privilege Protection Act of 2007, S. 186, 110th Cong., 1st Sess. (2007). *See also* 153 Cong. Rec. S42-01, at S181-183 (Jan. 4. 2007) (statement of Specter). When reintroducing this legislation to the 110th Congress, Specter observed said: "There is no need to wait to see how the McNulty Memorandum will operate in practice. The flaws in that memorandum are already apparent." *Id.*

[23] *See* Attorney-Client Privilege Protection Act of 2007, *supra* note 22, status available at http://thomas.loc.gov/cgi-bin/bdquery/z?d110:SN00186:@@@L&summ2=m&.

[24] *See Sen. Specter Continues Efforts to Force DOJ to Stop Seeking Corporate Waiver of Privilege,* BNA White Collar Crime Report, Vol. 1, No. 26, at 827 (Jan. 19, 2007) (noting that Sen. Patrick Leahy "plans to give DOJ a chance to implement the new policy before deciding whether to move ahead with the legislation"); Richard Ben-Veniste & Raj De, *The 'McNulty Memo': A Missed Opportunity to Reverse Erosion of Attorney-Client Privilege,* Legal Backgrounder, Washington Legal Foundation, Vol. 22, No. 3 (Jan. 19, 2007) ("Speculation now centers on whether the McNulty Memo will forestall, or at least delay, legislative action on the expected DOJ argument that until the impact of this new policy guidance can be gauged, it would be premature for Congress to act.").

[25] *See* Memorandum From Acting Deputy Attorney General Robert McCallum, Waiver of Corporate Attorney-Client and Work Product Protection (Oct. 21, 2005).

[26] *See* Paul J. McNulty, Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), available at www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf, at 1-2 (discussing role of public criticism of Thompson Memorandum in issuing new guidance) (hereinafter McNulty Memorandum); Carrie Johnson, *Shift in Corporate Prosecution Ahead: Government to Stiffen Rules on Indicting Companies,* Wash. Post, Nov. 30, 2006, at D1.

[27] McNulty Memorandum, *supra* note 26*,* § VII.B.2.

[28] *See* Jonathan D. Glater, *Government Rejects Andersen Proposal,* N.Y. Times, Apr. 26, 2002, at C6; *see also* Kurt Eichenwald and Jonathan D. Glater, *Andersen Sends New Proposal for Settlement to Government,* N.Y. Times, Apr. 25, 2002, at C1.

[29] Eichenwald and Glater, *supra* note 28, at C1.

[30] Glater, *supra* note 28, at C6.

[31] Press Release, American Bar Association, Statement by ABA President Karen J. Mathis Regarding Revisions to the Justice Department's Thompson Memorandum (Dec. 12, 2006), *available at* www.abanet.org/abanet/media/statement/statement.cfm?releaseid=59 (hereinafter ABA press release).

[32] *See* Seaboard report, *supra* note 1. The Seaboard report explains that "[i]n some cases, the desire to provide information to the commission staff may cause companies to consider choosing not to assert the attorney-client privilege, the work product protection and other privileges, protections and exemptions with respect to the commission." *Id.* n.3.

[33] The SEC issued the Seaboard report Oct. 23, 2001, which outlined the framework under which the SEC staff will evaluate a corporation's cooperation in determining whether to institute enforcement action. The report reflects the SEC's approach to corporate cooperation. *See* Seaboard report, *supra* note 1. The Seaboard report came about as a result of the SEC's investigation of a division of Seaboard Corp., in which the agency announced that as a result of Seaboard's response after discovering the alleged misconduct, the SEC would not take action against Seaboard. Among other things, the Seaboard report emphasized the role that a corporation's internal investigation would play in assessing the degree to which a corporation cooperating with the SEC's investigation:

> Did the company promptly make available to our staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review? Did the company voluntarily disclose information our staff did not directly request and otherwise might not have uncovered? Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?

In addition, the SEC issued a press release Jan. 4, 2006, announcing the principles that it will consider when determining whether, and to what extent, monetary penalties should be imposed on issuers in settled enforcement actions. Press Release, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), available at www.sec.gov/news/press/2006-4.htm. In this statement, the SEC indicated that in deciding whether to impose a monetary penalty, it would consider, *inter alia,* the presence or lack of remedial

steps taken by the issuer and the extent to which the issuer cooperated with the SEC and other law enforcement agencies.

[34] *See, e.g., United States v. Stringer,* 408 F. Supp. 2d 1083, 1089 (D. Or. 2006); *United States v. Scrushy,* 366 F. Supp. 2d 1134, 1140 (N.D. Ala. 2005).

[35] McNulty Memorandum, *supra* note 26, § VII.B.3.

[36] For a detailed discussion of the *Stein* decisions' influence on the SEC and DOJ policies of compelled waiver, see David Z. Seide, *Compelled Waivers of the Attorney-Client Privilege,* 39-21 Rev. Sec. & Commod. Reg. 235 (2006).

[37] McNulty Memorandum, *supra* note 26, § VII.B.3 n.3.

[38] McNulty Memorandum, *supra* note 26, at § VII.B.3.

[39] Brief for Appellant at 43, 47-56, *United States v. Smith and Watson,* No. 06-3999-cr (2d Cir. Nov. 6, 2006). In its brief the government urges that Judge Kaplan's interpretation of the Thompson Memorandum was contrary to the testimony and record below. In support of this position, the government contends that the prosecutors' actions and subsequent testimony before Judge Kaplan demonstrated that prosecutors would consider the advancement of attorney fees only in the context of whether a firm "appears to be protecting its culpable employees and agents"; that nothing in the record suggests that KPMG's approach to attorney fees played any role in the charging decision regarding KPMG; and that the language contained in the Thompson Memorandum pertaining to consideration of advancement of legal fees was "conditional and limited language, specifically directed to a limited circumstance under which a target corporation might be seeking to shield its culpable employees under the guise of cooperating." *Id.* at 51, 54-55.

[40] McNulty Memorandum, *supra* note 26, § VII.B.3 n.3.

[41] *Id.* § VII.B.3.

[42] ABA Press Release, *supra* note 31. For an additional discussion of the limited impact of the McNulty Memorandum, *see generally* Ben-Veniste and De, *supra* note 24.

[43] *See generally* McNulty Memorandum, *supra* note 26, § IV.

[44] *See id.* § V.A.

[45] *See generally id.*

[46] *See generally id.* § VI.

[47] *See generally* McNulty Memorandum, *supra* note 26, § VIII.

[48] *See generally id.* § IX.

[49] *See generally id.* § X.

[50] *See* McNulty Memorandum, *supra* note 26, § XIII.

[51] *See generally id.* § XI.

** Claudius O. Sokenu is a litigation partner in the New York office of Mayer, Brown, Rowe & Maw LLP in New York and a former senior counsel with the Securities and Exchange Commission's Enforcement Division in Washington. He is a member of the New York City Bar Association's Task Force on Corporate Governance, which examined the role of lawyers in the corporate scandals of the last several years.*

*Paula Garrett Lin is a litigation associate in the same office.*