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The Defense of Corporate America: The Year in Review

It has been a tumultuous year for American business organizations and practitioners who represent them. In response to a chorus of objections claiming the government over-reacted to corporate scandals real and perceived, the Legislative and Executive branches have made changes intended to ease the burden placed on businesses attempting to satisfy government demands, whether in the context of a criminal investigation or regulatory compliance.

Various government agencies, including the U.S. Sentencing Commission and the Securities and Exchange Commission (SEC), have followed suit.

DOJ's Thompson Memorandum

Much of the legal community's criticism has focused on the Department of Justice's guidelines on the prosecution of corporations, known as the Thompson Memorandum. This year, the DOJ's policies regarding the cooperation value of subject organizations repeatedly were challenged.

First, the government's practice of seeking corporate waiver of attorney-client and work product protection came under fire as having a chilling effect on attorney-client and employer-employee communications. Then, a series of decisions in the KPMG-related prosecution in the U.S. District Court for the Southern District of New York, *United States v. Stein*, shifted the focus to other aspects of the government's policy. Specifically, objections were made to those parts of the Thompson Memorandum that looked unfavorably upon a corporation's: 1) indemnification of individual employees' attorney's fees; 2) entry into joint defense or common interest agreements; and 3) failure to terminate employees who did not cooperate with the government's investigation.[1]

Assaults on the Thompson Memorandum have come from a number of fronts. In 2004, the American Bar Association established a task force to investigate concerns about federal prosecutors' execution of the DOJ guidelines, ultimately adopting a number of resolutions strongly opposing what had become routine prosecutorial practices, arguing that their implementation threatened to undermine fundamental legal and constitutional values. For instance, the ABA adopted a policy position opposing government practices that sought "to obtain a waiver of the attorney-client privilege or work product doctrine through the grant or denial of any benefit or advantage…."

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In furtherance of this position, the ABA petitioned the U.S. Sentencing Commission to amend its organizational Sentencing Guidelines to appropriately reflect the sanctity of privilege and work product doctrines. In April 2006, the Sentencing Commission responded by voting unanimously to eliminate guideline commentary stating that an organization's willingness to waive the privilege and/or doctrine could be relevant to a determination that the entity was cooperating with the government and therefore eligible for a reduced penalty. The guideline changes became effective Nov. 1, 2006.

Judge Lewis Kaplan's decisions in *Stein*, issued this past summer, raised Thompson Memorandum-related issues from a courtroom perspective. In *Stein I*, the court found that the Thompson Memorandum's provision dealing with the advancement of legal fees by corporate employers, both alone and coupled with the actions of the Southern District's U.S. Attorney's Office, violated the defendants' Fifth and Sixth amendment rights.[2] *Stein II* resulted in the suppression of certain defendants' statements, finding that the statements had been "deliberately" coerced by the government when it insisted that KPMG pressure employees to grant government requests for pre-indictment interviews or lose their right to have KPMG pay their legal fees.[3]

In September 2006, the Senate Judiciary Committee held hearings on the Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations. During the hearings, notable speakers including Edwin Meese III, former U.S. attorney general, Karen Mathis, president of the ABA, and private practitioners, charged the government with "overzealousness" in investigating and prosecuting corporations, resulting in the erosion of constitutional rights.[4] Around the same time, a bipartisan group of 11 former senior Justice Department officials wrote Attorney General Alberto Gonzalez to protest the government's application of the Thompson Memorandum, seen as "seriously eroding" the attorney-client privilege.[5]

The Attorney-Client Protection Act of 2006

Finally, on Dec. 7, 2006, Senator Arlen Specter, R-Pa., introduced to Congress the Attorney-Client Protection Act of 2006 (the act). Senator Specter stated:

> [A]lthough the Thompson memorandum was issued with laudable goals in mind, two key components of the Thompson memorandum directly threaten long-standing principals of attorney-client privilege and the right to counsel…. I see no need for the Justice Department to publicly express a policy that encourages waiver of attorney-client privilege, especially where the policy is backed by the heavy hammer of possible criminal charges. Cases should be prosecuted based on their merits, not based on how well an organization works with the prosecutor.[6]

The legislation, written in conjunction with the ABA, the National Association of Criminal Defense Lawyers (NACDL), the ACLU, Association of Corporate Counsel, and the U.S. Chamber of Commerce, is intended to "place on each agency clear and practical limits designed to preserve the attorney-client privilege and work product protections available to an organization and preserve the constitutional rights and other legal protections available to employees of such an organization."[7]

Specifically, the legislation provides that in a federal investigation, including criminal prosecutions or civil enforcement actions, an agent or attorney of the United States shall not request that an organization waive its attorney-client privilege or work product doctrine. Furthermore, the government attorney cannot condition any charging decision or cooperation credit on the corporation's waiver or nonwaiver of the privilege, the payment of employee's legal fees, the continued employment of a person under investigation or the signing of a joint defense agreement. The act does not limit an organization from voluntarily sharing internal investigation information with the government, nor does it limit the government from seeking materials it reasonably believes are not protected by either privilege or work product.

Although Congress has adjourned for the holidays,

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Senator Specter has indicated his intention to reintroduce the bill at Congress' new session in January 2007. Commentators believe the significance of the bill will not diminish between congressional sessions because it is backed by an impressive number of organizations and individuals, drawing support from across political party lines.

That being said, there is some criticism of the legislation. First, there is no established procedure to be followed in the event that a government attorney violates the law, nor is there any stated remedy in the event such a violation is found. Some believe a remedy like that contained in Federal Rule of Criminal Procedure 6(e), which punishes a knowing violation of the secrecy of grand jury proceedings with contempt of court, should be used for prosecutorial misconduct under the act. Other experts disagree. Rather, they believe the judiciary should be allowed to craft an appropriate remedy, dismissing an indictment in appropriate cases, but having the flexibility to impose a less extreme sanction, such as the exclusion of evidence, where justified.[8]

Moreover, some are concerned that the legislation may breach the separation of powers requirement because the Legislative Branch effectively is directing the Executive Branch in the exercise of its executive powers. Karen Mathis, president of the ABA, argues, however, that the proposed legislation is similar to the McDade-Murtha provision, also known as the "Ethical Standards for Prosecutors Act," enacted by Congress in the late-1990s to hold federal prosecutors to the same state laws and rules, and local federal court rules, as other attorneys in the state.

"Although the McDade-Murtha provision was enacted in response to a different set of federal prosecution policies and practices…, we believe the provision…provides a clear example of Congress' authority to adopt legislation modifying specific Justice Department directives to its prosecutors."[9]

The McNulty Memorandum

• ***Justice's Response to the Proposed Legislation.*** Five days after Senator Specter introduced his legislation, U.S. Deputy Attorney General Paul J. McNulty announced that the DOJ was releasing revised corporate charging guidelines for federal prosecutors throughout the country. The new memorandum, informally referred to as the McNulty Memorandum, replaces the Thompson Memorandum in its entirety (and the Holder Memorandum is now a distant memory).

The McNulty Memorandum adopts a "tiered approach" to when prosecutors may request protected materials from a business organization. First, a prosecutor may not seek privileged attorney-client communications, legal advice or non-fact attorney work product, without approval directly from the deputy attorney general himself, and only in "rare circumstances." Such request must demonstrate the government's "legitimate need" for the information and the scope of the waiver sought. In order to demonstrate a "legitimate need," federal prosecutors must address:

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.

When prosecutors seek waiver of the privilege to documents of a purely factual nature, such as attorney-prepared chronologies or notes regarding key events or witness statements, they must seek the approval of their U.S. attorney, who will make a determination in consultation with the assistant attorney general of the criminal division. In addition, where a corporation declines to provide the requested materials, either factual or nonfactual, the McNulty Memorandum directs prosecutors not to consider the corporation's decision as a factor against the corporation when making a decision whether to charge the organization. However, prosecutors may favorably consider a corporation's decision to provide protected materials and are not required to obtain approval from superiors where a corporation voluntarily offers such materials.

Finally, the DOJ's revised guidelines also state that prosecutors generally cannot consider a corporation's advancement of attorney's fees to employees when making a decision whether to charge a corporation. The "rare exception" to this rule is when the totality of the circumstances demonstrates that the advancement of attorney's fees was intended to impede the government's investigation. In a speech announcing the changes set forth in his memorandum, Deputy Attorney General McNulty noted that corporations often are bound by state statutes, corporate bylaws, or contractual provisions to indemnify employees in such a manner, and that the new policy more readily recognized this fact.

The McNulty Memo has a tiered approach to when prosecutors may request protected materials. They may not seek privileged attorney-client communications…without approval directly from the deputy attorney general and only in "rare circumstances" showing a "legitimate need."

Summing up the new memorandum, Mr. McNulty stated:

> The Department respects a company's right to ferret out wrongdoing within its ranks—to do its own self-policing. It respects the confidential communications between counsel and employees during an internal investigation and the corporation's right to assert privilege. But, along with this respect, we also have expectations. We expect corporate counsel to insist on compliance with the law…to offer "good counsel," to advise corporate leadership that a particular, possibly illegal, course of action will harm not only the company's own shareholders, but the investing public as well.[10]

Reaction to McNulty Memo

The legal community's response to the DOJ's efforts as articulated in the McNulty Memorandum are best summed up as "too little, too late." ABA President Mathis said that the new guidelines "fall far short of what is needed to prevent further erosion of fundamental attorney-client privilege, work product, and employee protections during government investigations…[and] are but a modest improvement." Similarly, NACDL President Martin S. Pinales observed that although the new rules require approval for formal waiver requests, "requests for waiver can be implied without any approval or oversight, [so that] the fact that the new DOJ policy continues to reward companies that waive privilege suggests that the business of investigating companies will be business as usual."

Moreover, many note that the McNulty Memorandum does not eliminate other troubling provisions of the Thompson Memorandum, such as those addressing valid joint defense or information sharing agreements. Commentators note that the provisions set forth in the McNulty Memorandum are only internal DOJ guidelines. Accordingly, where a federal prosecutor does not follow the guidelines, failing to obtain approval before requesting a waiver, there is nothing a corporation or its employees can do in response.[11]

For this reason, many legal organizations and professionals feel the Specter legislation is a better option. The passage of the act creates a means by which businesses and their employees can seek judicial intervention in the case of prosecutorial misconduct. As noted by one commentator, the DOJ always has been able to secure a waiver of privileged materials in court where the crime-fraud exception applies. The attempt by DOJ to bypass judicial review in other cases is simply an example of an executive agency trying to legislate.[12]

Although the extent of congressional action remains to be seen, it is clear that the government believes it is compelled to respond to the legal community's calls for change to its policies on corporate governance and independence. Just days ago, the SEC "issued a flurry of deregulatory orders and proposals" intended to ease the burden on public companies created by agency "overreaction" to corporate scandals.[13] Although these efforts were not as extensive as some would have liked, recent activity by both the DOJ and the SEC foreshadows a shift in institutional policies towards greater corporate independence and self-governance.

1. Elkan Abramowitz and Barry A. Bohrer, "Assault on the Thompson Memo: KPMG and Beyond," New York Law Journal (Sept. 5, 2006).
2. *United States v. Stein*, 435 FSupp2d 330 (SDNY 2006).
3. *United States v. Stein*, 440 FSupp2d 315 (SDNY 2006).
4. Transcripts from Senate Judiciary Committee hearing available at http://judiciary.senate.gov/hearing.cfm?id=2054); see also, Robert G. Morvillo and Robert J. Anello, "Preserving Your Job While Asserting the Fifth Amendment," New York Law Journal (Dec. 5, 2006) (detailing testimony).
5. Jason McLure, "Former Justice Officials Critical of Thompson Memo Policy," Legal Times (Sept. 9, 2006).
6. Press Release, U.S. Senate Judiciary Committee, "Specter Introduces 'Attorney-Client Privilege Protection Act of 2006,'" (Dec. 7, 2006) (available at
7. Attorney-Client Privilege Protection Act of 2006 §2(b) (purpose of act).
8. See, e.g., Peter J. Henning and Ellen S. Podgor, White Collar Crime Prof Blog (available at http://lawprofessors.typepad.com/whitecollarcrime_blog/).
9. Letter to the Honorable Patrick J. Leahy from Karen J. Mathis, Nov. 21, 2006.
10. Prepared Remarks of Deputy Attorney General Paul J. McNulty at the Lawyers for Civil Justice Membership Conference, Dec. 12, 2006.
11. See, e.g., Peter J. Henning and Ellen S. Podgor, White Collar Crime Prof Blog (available at http://lawprofessors.typepad.com/whitecollarcrime_blog/).
12. Id.
13. Stephen Labaton, "SEC Eases Regulations on Business," The New York Times, Dec. 14, 2006.