A recent change in federal law enforcement policy governing federal criminal investigations of corporate crime has corporations and their lawyers wondering whether it will effect a real difference in practice. The *Principles of Federal Prosecution of Business Organizations*[1] (*Principles*) describes the policies governing federal prosecutors' exercise of discretion in the investigation and prosecution of federal crimes involving corporations and other businesses. A groundswell of opposition to the government's recent application of the *Principles* has resulted in a Justice Department pronouncement, which is apparently more sensitive to the attorney-client privilege and the need to indemnify corporate employees. The question that remains to be answered is whether the practice of demanding waivers of privilege and pressuring companies not to advance attorneys' fees to employees has become so entrenched in white-collar practice that, in order to curry favor with prosecutors, corporations will "willingly" offer them without a request? Time will tell.

# The McNulty Memorandum: A Reversal in Practice or in Name Only?

BY JOHN K. VILLA

## Historical Development of "Waivers" and Related Demands

The *Principles* prescribes the factors that federal prosecutors can consider in the conduct of corporate criminal investigations and charging decisions. In addition to "common sense" factors[2] such as the nature and seriousness of the offense, the pervasiveness of wrongdoing within the corporation, and the corporation's history of similar conduct, the *Principles* have recently permitted prosecutors to consider the corporation's timely and voluntary disclosure of wrongdoing, and its willingness to cooperate in the investigation of its agents. As originally issued in 1999 by then-Deputy Attorney General Eric Holder (Holder Memorandum),[3] and as reaffirmed in 2003 when reissued by then-Deputy Attorney General Larry Thompson (Thompson Memorandum),[4] the guidelines expressly permitted federal prosecutors to assess the adequacy of a corporation's cooperation on two factors: whether it was willing to waive the attorney-client and work-product protections, and whether it supported "culpable employees" by advancing them attorneys' fees even though not required to do so by law.[5]

Although both the Holder Memorandum and the Thompson Memorandum authorized federal prosecutors to request privilege and work-product waivers and to consider, in a negative light, the corporation's advancement of attorneys' fees, they differed in one significant respect: The former set forth guidelines that were only advisory in nature,[6] while the latter set forth guidelines that were binding on all federal prosecutors.[7] Issued after Enron and a succession of corporate fraud scandals and following the formation of the President's Corporate Fraud Task Force,[8] the Thompson Memorandum was primarily intended to increase "[the] emphasis on and scrutiny of the authenticity of a corporation's cooperation."[9] Thus, even though obtaining a waiver was not an "absolute requirement,"[10] the Thompson Memorandum made clear that prosecutors were required to consider the willingness of a corporation to execute a waiver "as one factor in evaluating the corporation's cooperation."[11] It similarly made clear that the advancement of attorneys' fees to corporate officers and employees under investigation or indictment was a factor to consider "in weighing the extent and value of a corporation's cooperation."[12]

The Thompson Memorandum accelerated the movement among federal prosecutors to demand waivers from corporate targets, often using the execution of a waiver as a de facto condition for more lenient government action.[13] These efforts were aided by the 2004 amendments to the now-advisory federal sentencing guidelines, which credited a corporation with a reduction in its culpability score where the corporation executed a waiver and "such waiver [was] necessary in order to provide timely and thorough disclosure of all

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pertinent information known to the organization."[14] Most experienced white-collar defense counsel viewed the Thompson Memorandum and, to a lesser extent, the 2004 sentencing guidelines, to have created a "culture of waiver" in which government agencies expected corporations to broadly waive the attorney-client and work product protections.[15] Both business and legal groups, including ACC, and its coalition partners, and the American Bar Association (ABA) through its Task Force on the Attorney-Client Privilege, as well as former Justice Department officials, complained that the government's policy eroded the attorney-client and work product protections, and impeded internal corporate efforts to address misconduct.[16]

In addition to demanding waivers, federal prosecutors increasingly pressured corporations into refusing advancement of legal fees for employees suspected of wrongdoing, notwithstanding the existence of statutes or corporate bylaws authorizing such practice.[17] Fear of indictment and its potentially disastrous consequences led many to believe that corporations could not withstand this pressure.[18] Criticized severely by ACC, its coalition partners and the ABA for its interference with "established corporate governance practices" as well as for its infringement on the constitutional rights of corporate employees,[19] federal prosecutors' efforts were recently found unconstitutional as applied to employees of KPMG: The court opined that not only did the government's enforcement of this directive infringe on the employees' right to a fair trial, but it also infringed on their right to the effective assistance of counsel.[20]

In response to the mounting criticism, Acting Deputy Attorney General Robert McCallum issued a memorandum in October of 2005, in which he instructed United States attorneys to establish written waiver review processes "[t]o ensure that federal prosecutors exercise appropriate prosecutorial discretion under the principles of the *Thompson Memorandum*."[21] The memorandum, unfortunately, did not address the advancement of attorneys' fees. McCallum's efforts to soften the directives of the Thompson Memorandum did not quell the criticism. In December of 2006, following several significant events-including an ACC amicus brief in *US v. Stein*—the Sentencing Commission's deletion of privilege waiver as a factor to consider in sentencing corporate defendants[22], Judge Kaplan's decisions on the constitutionality of the Thompson Memorandum as applied to certain KPMG employees,[23] congressional hearings on the matter in both the House[24] and the Senate,[25] and the introduction of a bill designed to override the directives of the Thompson Memorandum[26]—Deputy Attorney General Paul McNulty finally issued a revised set of guidelines.[27]

## The McNulty Memorandum

### A. Attorney-Client and Work-Product Protections

Under the new guidelines set forth in the McNulty Memorandum, cooperation and the timely and voluntary disclosure of wrongdoing remain important factors that federal prosecutors must consider in making charging decisions involving corporations.[28] And, like the prior guidelines, the revised guidelines permit prosecutors to request waivers of the attorney-client and work product protections and, in certain circumstances, to consider a corporation's response to such a request when assessing the extent of the corporation's cooperation.[29] What is supposedly different are the new restrictions imposed on federal prosecutors when seeking waivers from corporate targets. Recognizing the importance of the attorney-client and work product protections,[30] while, at the same time, acknowledging the benefits of full disclosure,[31] the McNulty Memorandum limits the circumstances when prosecutors may request a privilege waiver and, if warranted by the circumstances, sets forth the procedures to follow in making such a request.

In order to be entitled to request a waiver of attorney-client or work product protections, federal prosecutors must now establish that there is a "legitimate need" for the information "to fulfill their law enforcement obligations."[32] According to the guidelines, establishing a legitimate need "requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine" with "the law enforcement needs of the government's investigation."[33] Specifically, whether a legitimate need exists depends upon the following factors:

- the likelihood and degree to which the privileged information will benefit the government's investigation;
- whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require a waiver;
- the completeness of the voluntary disclosure already provided; and
- the collateral consequences to a corporation of waiver.[34]

The guidelines caution that a legitimate need is not established merely by concluding that obtaining the privileged information would be desirable or convenient.[35] Frankly, it is difficult to imagine that an aggressive line prosecutor could not readily convince himself or herself that these factors are nearly always satisfied, thus placing great importance on effective review by superiors—who have historically been unwilling to overrule line prosecutors on discretionary decisions.

Once a legitimate need has been established, the guidelines require writ-

ten authorization before a prosecutor can request a waiver from the corporation. From whom the written approval must be obtained varies, depending upon the type of information sought:

- For purely factual information, characterized as "Category I" information,[36] prosecutors must obtain written authorization from the US attorney, who is required to consult with the assistant attorney general for the Criminal Division before granting the request;[37]
- For privileged information or non-factual attorney work product, characterized as "Category II" information,[38] the US attorney must obtain written authorization from the deputy attorney general after submitting a request for authorization that sets forth law enforcement's legitimate need for the information and identifies the scope of the waiver sought.[39] If granted, the guidelines require the US attorney to communicate this fact in writing to the corporation. Additionally, the guidelines require the deputy attorney general to maintain copies of each request for Category II information.[40] ACC has a comparison chart which can be found at *www.acc.com/public/attnyclientpriv/mcnultychart.pdf.*

Although permitting requests for waivers of privileged communications or opinion work product, the McNulty Memorandum instructs that requests for this type of information should be sought only in rare circumstances and "[o]nly if the purely factual information provides an incomplete basis to conduct a thorough investigation."[41] The guidelines, therefore, contemplate a "step-by-step approach" for seeking corporate waivers:[42] Prosecutors should first request waivers for Category I information,[43] and then, if that information is found insufficient, should request waivers for Category II information.[44]

Finally, with respect to the significance or weight, if any, to be accorded the corporation's response to a waiver request, the revised guidelines provide that executing a waiver is supposedly not a prerequisite to a finding of cooperation.[45] Prosecutors, however, may consider the corporation's response to a request for waiver of Category I information in assessing whether the corporation cooperated with the investigation.[46] In addition, while they are instructed not to consider a corporation's refusal to provide a waiver for Category II information in making a charging decision, prosecutors "may always favorably consider" a corporation's acquiescence to a waiver request when considering the question of the corporation's cooperation.[47]

### B. Advancement of Attorneys' Fees

In a departure from the Thompson Memorandum, the revised guidelines expressly caution prosecutors that they "should generally not take into account" whether a corporation is advancing attorneys' fees to its employees when making a charging decision.[48] But how is this to be enforced when the decision is a subjective one by a line prosecutor? The guidelines explain that indemnification statutes in many states permit corporations to advance legal fees and that, pursuant to these statutes, corporations include advancement of fees provisions in their charters, bylaws, and employment agreements. Consequently, "[a] corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate."[49]

Although not generally permissible, consideration of a corporation's advancement of attorneys' fees is authorized "in extremely rare cases . . . when the totality of the circumstances show that it was intended to impede a criminal investigation."[50] If these circumstances exist, the new guidelines require approval from the deputy attorney general before prosecutors may take this factor into account.[51]

### Impact of the Revised Guidelines

Will the McNulty Memorandum effect a real change in practice that will prevent further erosion of the corporate attorney-client privilege and work product protection, as well as further encroachment upon the right of corporate employees to the advancement of defense funds? That can't yet be known.

The $64,000 question is whether corporations represented by experienced defense counsel will come in offering to waive the privilege to curry favor or noting that they are

not advancing legal fees to employees under suspicion? In other words, will the request be unnecessary because corporations know that submissive behavior and waivers promotes leniency? The same is true of advancing defense fees to corporate employees under investigation—will corporations refuse it even if not requested to do so? All this remains to be seen.

Focusing on the practical aspects of the memorandum's implementation where there is no "offer to waive" and the prosecutor must seek approval, it is an improvement but serious questions abound. The McNulty Memorandum's new authorization procedure no doubt has the potential to slow prosecutors' efforts to obtain corporate waivers so prosecutors may pause before requesting approval for a waiver. And, because of the "legitimate need" standard, US attorneys may hesitate before granting approval or, with respect to Category II information, before seeking approval from the deputy attorney general.

As some groups have noted,[52] however, the revisions may not be sufficient to provide meaningful protection to the attorney-client and work product protections. While imposing a new burden on prosecutors seeking privilege waivers, the revisions do not provide clear guidance as to what constitutes a "legitimate need." For example, although the guidelines provide that the degree to which the information might help the investigation constitutes one factor to consider in establishing a legitimate need, one commentator has noted that, because "there is no threshold degree that must be alleged . . . . [i]n theory, a prosecutor meets this burden by stating any degree, even 'barely at all.'"[53] As noted by one senator, such a burden is one "that should guide the most basic of prosecutorial requests, not sensitive requests for privileged information."[54] Similarly, even though the revised guidelines require supervisory approval before a prosecutor can request a waiver from a corporate target, there is nothing in the revisions to assure that a review of a waiver request will be significant in any appreciable way.[55]

Perhaps most importantly, the new guidelines still permit prosecutors to request waivers of privileged advice and opinion work product (Category II information)[56] and to consider a corporation's response to a waiver request in assessing the entity's cooperation. While the guidelines expressly prohibit consideration of a corporation's refusal to waive these protections with respect to Category II information, this prohibition is essentially nullified by the fact that prosecutors may favorably consider a corporation's acquiescence in a waiver of this type of information.[57] Thus, the pressure to waive may not have been abated by the new guidelines, merely driven below the surface.

Like the waiver provisions, the new provision governing the advancement of attorneys' fees has the potential to preclude prosecutors from coercing cooperation by threatening to consider the corporation's advancement of fees. However, while they are cautioned against considering this factor, they are not expressly prohibited from doing so.

Is the McNulty Memorandum a pyrrhic victory? Time will tell, unless Congress intervenes in the interim to prevent further implementation of the revised guidelines and force a reversal in governmental policy. Explaining that "[t]here is no need to wait to see how the McNulty memorandum will operate in practice[,]" since "[its] flaws . . . are already apparent[,]"[58] Senator Arlen Specter has reintroduced a bill created and endorsed by ACC and its coalition partners designed to preserve the corporate attorney-client privilege and work product protection, as well as the constitutional rights of corporate employees.[59] Entitled the "Attorney-Client Privilege Protection Act of 2007," the bill would prohibit federal prosecutors or agents, in any investigation, from demanding, requesting, or conditioning treatment on an organization's disclosure of privileged or protected information, or from using any valid assertion of the attorney-client or work product protections or advancement of legal expenses as a factor in determining whether the organization has cooperated with the government for purposes of making a charging decision.[60] In addition, the bill would prohibit government attorneys from demanding or even requesting corporations to refrain from advancing legal defense fees or expenses to their employees.[61] As stated by Senator Spector in introducing the bill, "[t]he federal prosecutor has enough power without the coercive tools of the privilege waiver, whether that waiver policy is embodied in the Holder, Thompson, McCallum, or McNulty memorandums. I see no need to have the Justice Department 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."[62]

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For a complete list of supplemental material, a bibliography can be found at *www.acc.com/public/article/attyclient/acc-ac-biblio.pdf*

Notes

1. U.S. Department of Justice, Office of the Deputy Attorney General, *Principles of Federal Prosecution of Business Organizations* (December 12, 2006), available at *www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.*
2. *See United States v. Stein*, 435 F. Supp. 2d 330, 336 (S.D.N.Y. 2006).
3. *See* U.S. Department of Justice, Office of the Deputy Attorney General, *Federal Prosecution of Corporations at* ¶ 2 (June 16, 1999), available at *www.usdoj.gov/criminal/fraud/policyChargingcorps.html* ("Holder Memorandum").
4. *See* U.S. Department of Justice, Office of the Deputy Attorney General, *Principles of Federal Prosecution of Business Organizations* (January 20, 2003), available at *www.usdoj.gov/dag/cftf/corporate_guidelines.htm* ("Thompson Memorandum").
5. *See Holder Memorandum* at §§II(A)(4), VI(B); Thompson Memorandum at §§II(4), VI(B).
6. In introducing the guidelines, then-Deputy Attorney General Holder explained that the factors to be considered by federal prosecutors in making their charging decisions are "not outcome-determinative [but] are only guidelines." Accordingly, "[f]ederal prosecutors are not required to reference these factors in a particular case, nor are they required to document the weight they accorded specific factors in reaching their decision." *Holder Memorandum*, at ¶ 2.
7. *See* U.S. Department of Justice, *Criminal Resource Manual* § 163 (2005) (stating, in reference to the Thompson Memorandum, that federal prosecutors "must consider" the revised guidelines "in determining whether to charge a corporation or other business organization").
8. *See* Exec. Order No. 13271, 3 C.F.R. 1162 (2002).
9. *Thompson Memorandum* at ¶ 3.
10. *Id.* at § VI(B).
11. *Id.*
12. *Id.*
13. *See White Collar Enforcement (Part 1): Attorney-Client Privilege and Corporate Waivers: Oversight Hearing Before Subcomm. on Crime, Terrorism and Homeland Security of the House Comm. on the Judiciary*, H.R. Doc. Ser. No. 109-112, at 97 (March 7, 2006), (Letter from the American Bar Association to the Subcommittee on Crime, Terrorism, and Homeland Security).
14. U.S.S.G. § 8C2.5, App. Note 12 (2004).
15. Association of Corporate Counsel, et al., *The Decline of the Attorney-Client Privilege in the Corporate Context: Survey Results at 3-4, available at www.acca.com/Surveys/attyclient2.pdf.*
16. *See* ABA Task Force on the Attorney-Client Privilege, *Report to the ABA House of Delegates* (May 18, 2005); *Letter from Former Department of Justice Officials to the U.S. Sentencing Commission* (Aug. 15, 2005), available on the website of the ABA Task Force at *www.abanet.org/buslaw/attorneyclient/home.shtml.*
17. *See* Kirby D. Behre and Jeremy Evans, *Pulling the Rug Out*, 5 Corp. Counsel 69, at ¶ 3 (Nov. 2005), ("[A] company's refusal to indemnify a director or officer may directly contradict its corporate bylaws, as well as state laws. But faced with either placating a federal prosecutor or ignoring state corporate law, companies sometimes pick the latter").
18. *See Stein*, 435 F. Supp. 2d at 336 ("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").
19. ABA Task Force on the Attorney-Client Privilege, *Report to the ABA House of Delegates on Employee Rights as Adopted*, at 6 (Aug. 2006), available *www.abanet.org/buslaw/attorneyclient/materials/hol/emprights_report_adopted.pdf.*
20. *Stein*, 435 F. Supp. 2d at 381-382. In a subsequent ruling, the court held that the government's conduct, which forced KPMG to threaten non-payment of its employees legal fees if they did not cooperate with the government investigation by disclosing any personal wrongdoing, violated the constitutional right to remain silent. *United States v. Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006).
21. U.S. Department of Justice, Office of the Deputy Attorney General, *Memorandum re Waiver of Corporate Attorney-Client and Work Product Protection*, at ¶ 2 (October 21, 2005) ("McCallum Memorandum").
22. *See* U.S. Sentencing Commission, *News Release* (April 11, 2006).
23. *See* n. 20, *supra*.
24. *See White Collar Enforcement (Part 1): Attorney-Client Privilege and Corporate Waivers: Oversight Hearing Before Subcomm. on Crime, Terrorism and Homeland Security of the House Comm. on the Judiciary*, H.R. Doc. Ser. No. 109-112 (March 7, 2006).
25. *See The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations: Hearing Before the Senate Comm. on the Judiciary* (Sept. 12, 2006), (testimony available at *http://judiciary.senate.gov/hearing.cfm?id=2054*).
26. *See* S. 30, 109th Cong., 2d Session (2006) (introduced by Sen. Arlen Specter and entitled Attorney-Client Privilege Protection Act of 2006).
27. U.S. Department of Justice, Office of the Deputy Attorney General, *Principles of Federal Prosecution of Business Organizations* (December 12, 2006), available at *www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf* ("McNulty Memorandum").
28. *See McNulty Memorandum*, § III(A)(4) at 4.
29. *See id*, § VII(B)(2) at 8-12.
30. In a speech announcing the revisions, Deputy Attorney General McNulty acknowledged the abundant criticism leveled against the Thompson Memorandum, noting that many perceived the prior policy as having chilled attorney-client communications, thereby discouraging corporate compliance. *See Prepared Remarks of Deputy Attorney General Paul J. McNulty at the Lawyers for Civil Justice Membership Conference Regarding the department's Charging Guidelines in Corporate Fraud Prosecutions* (Dec. 12, 2006), available at *www.usdoj.gov/dag/speech/2006/dag_speech_061212.htm.*
31. *See McNulty Memorandum*, § VII(B)(2) at 8 ("Waiver . . . is not a prerequisite to a finding that a company has cooperated in the government's investigation. However, a company's disclosure of privileged information may permit the government to expedite its investigation . . . . [and] may be critical in enabling the government to evaluate the accuracy and completeness of the company's voluntary disclosure").
32. *Id.* at 8-9.
33. *Id.* at 9.
34. *Id.*

35. *Id.* at 8-9.
36. Category I information includes witness statements, purely factual interview memoranda regarding the misconduct, organization charts created by company counsel, factual chronologies, factual summaries, or reports containing investigative facts documented by counsel. *Id.* at 9.
37. *Id.*
38. Category II information includes attorney notes, memoranda or reports containing counsel's mental impressions and conclusions, legal determinations reached as a result of an internal investigation, or legal advice. *Id.* at 10.
39. Prosecutors need not follow the approval process for Category II information if the information falls within the crime-fraud exception to the attorney-client privilege or relates to an advice-of-counsel defense, but, instead, are instructed to follow the authorization process for Category I information. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* at 9.
43. *Id.*
44. *Id.* at 10.
45. *Id.* at 8.
46. *Id.* at 9.
47. *Id.* at 10.
48. *Id.*, § VII(B)(3) at 11.
49. *Id.*
50. *Id.* at n. 3.
51. *Id.* (directing prosecutors to follow the procedures for obtaining privilege waivers of Category II information).
52. *See* American Bar Association, *News Release* (Dec. 12, 2006) (Statement of Karen J. Mathis, President, ABA, Re Revisions to the Justice Department's Thompson Memorandum); U.S. Chamber of Commerce, *New Release* (Dec. 12, 2006) (New DOJ Policy Does Not Adequately Protect Attorney-Client Privilege).
53. John J. Carney and Dennis O. Cohen, *McNulty Memo: Changes Game or Keeps Congress Out?*, 1/3/2007 N.Y.L.J. 4 (col. 4), at ¶ 9.
54. 153 Cong. Rec. S182 (daily ed. Jan. 4, 2007) (statement of Sen. Arlen Specter in introducing S. 186).
55. *See id.* (noting that the memorandum fails to define "consult" in connection with the requirement that the U.S. Attorney consult with the Assistant Attorney General for the Criminal Division before approving a request for waiver of Category I information, and, as a consequence, fails to provide meaningful review of the U.S. Attorney's decision).
56. Because the McNulty Memorandum provides an exception to the waiver request approval process for advice in furtherance of a crime or fraud or subject to an advice of counsel defense, some have criticized the memorandum for failing to address the need for obtaining any other privileged advice. As noted by Senator Specter, "[t]he only two types of attorney advice that are likely to be relevant in a criminal investigation are exempted from the memo's coverage. With that exception, I fail to see why Category 2 information is needed at all. Prosecutors do not need to know what attorneys are advising their clients unless the advice is in furtherance of a crime or the client puts the advice in issue by raising it as a defense." 153 Cong. Rec. S182 (daily ed. Jan. 4, 2007) (statement of Sen. Arlen Specter in introducing S. 186).
57. *See* Martha Neil, *Thompson Memo Changes Not Enough, ABA Says*, ABA Journal eReport (Dec. 15, 2006) (relaying the comments of one observer who noted that this provision puts the corporation in a "catch-22" situation).
58. 153 Cong. Rec. S181-S182 (daily ed. Jan. 4, 2007) (statement of Sen. Arlen Specter in introducing S. 186).
59. *See* S. 186, 110th Cong., 1st Session (introduced on January 4, 2007, and entitled the "Attorney-Client Privilege Protection Act of 2007").
60. *See id.* at § 3(b)(1), (2). Other factors that would be prohibited from consideration in making a charging decision are the existence of a joint defense, information sharing, or common interest agreement between the corporation and any of its employees, the fact that the corporation may have shared information regarding the investigation with its employees, or the corporation's refusal to terminate or otherwise sanction an employee because of the employee's decision to exercise constitutional rights or other legal protections in response to a government request. *Id.* at § 3(b)(2).
61. *Id.* at § 3(b)(3) (also prohibiting any demands or requests to refrain from taking any of the actions set forth in n. 59, *supra*).
62. 153 Cong. Rec. at S182.