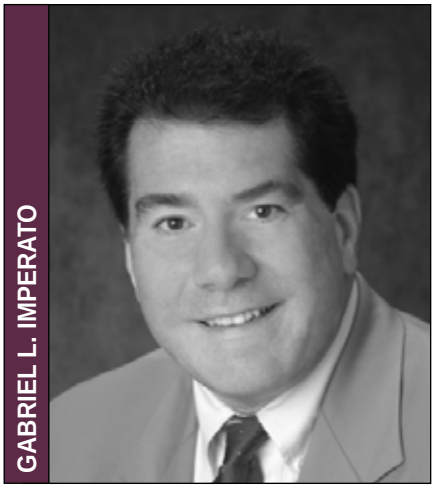
Department of Justice revises prosecution policies, confirms importance of effective compliance plans



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In December 2006, the Department of Justice (DOJ) modified its "Principles for Federal Prosecution of Business Organizations," originally published in January, 2003 (i.e., the Thompson Memo), related to requests for waiver of the attorney/client and work product privileges and payment of attorney fees for organization employees. These recent modifications to the DOJ prosecution policies may have the effect of strengthening compliance effectiveness for business organizations.

In addition, DOJ has confirmed that it will continue to evaluate the existence and adequacy of the corporation's pre-existing compliance program in making its decision as to whether to bring criminal charges against the corporation.

The 2006 revised "Principles for Federal Prosecution of Business Organizations" (now referred to as the McNulty Memo) emphasize that requests for waiver of privilege should be rare, and prosecutors should not negatively consider a refusal by an organization to consent to a request for waiver or the advancement of legal fees to organization employees when making charging decisions in criminal and civil enforcement matters. There were a number of reasons for these revisions, but one important reason cited by Deputy Attorney General McNulty in announcing this change to the Thompson Memo prosecution policy was to strengthen organizational efforts to detect and prevent wrongdoing and misconduct and to encourage self-policing and cooperation with law enforcement by business organizations.

The issue of cooperation and its relation to waiver of the attorney-client privilege and work product protections, and how this issue has evolved over the past several years, resulted in the McNulty Memo. DOJ, as reflected in the McNulty Memo, has placed great importance on effective compliance programs, and some key guidelines are included in the memo itself for evaluating such programs.

The Thompson Memo

The original Thompson Memo pointedly focused on the thoroughness and authenticity of a business organization's cooperation in investigating its own wrongdoing during a government investigation. The Thompson Memo, and the aggressive prosecution policies it reflected, was a natural by product of the abuses identified in earlier corporate scandals, such as Enron, World Com, Arthur Andersen and Health South. The Thompson Memo noted that DOJ must evaluate several specific factors in considering whether to prosecute the corporation, including: the weight of the evidence, the likelihood of success at trial, the deterrent effect, the consequences of filing charges and the adequacy of alternative approaches. The Thompson Memo, however, acknowledges that a federal prosecu-

tor must also examine additional factors before reaching a decision on the treatment of a business organization targeted for investigation. The additional factors cited in the Thompson Memo included: the nature and seriousness of the offense; the risk of harm to the public; the pervasiveness of wrongdoing within the organization; the history of the organization's similar conduct; the disclosure of wrongdoing; the organization's willingness to cooperate; the existence of a compliance program or remedial action; and, the adequacy of charges against any individuals responsible for the misconduct.

The Thompson Memo is perhaps best known for emphasizing its consideration of an organization's "cooperation" during an investigation, and its remedial actions, when contemplating a decision on whether or not to charge the organization. The Thompson Memo also cited factors which would be considered in this evaluation and measured an organization's willingness to cooperate including: the organization's ability to make witnesses available; the disclosure of the complete results of the organization's own internal investigation; and, if necessary, a waiver of the attorney-client privilege and work product protection. The comment section to the Thompson Memo further stated that waiver of a corporation's attorney-client privilege is not an absolute requirement, but sometimes it might be necessary. The Thompson Memo quite clearly advised federal prosecutors that in measuring "cooperation" they may consider whether a business organization turned over the results of its internal investigation and whether it waived applicable attorney-client privileges and work product protections to allow the government adequate access to all materials in the corporation's possession which might be useful to the government's investigation.

An address by the then Deputy Attorney General of the United States, James Comey, to attendees of the American Bar Association Health Fraud Institute 2004 in New Orleans, further elaborated on the federal government's view of "cooperation." The Deputy Attorney General noted that DOJ understands the term "cooperation", as reflected in the Thompson Memo, Sentencing Guideline Amendments of 2004, and in court decisions, to mean assistance that discloses all pertinent information sufficient for the government to identify the individuals responsible for criminal conduct and to understand the full scope of that conduct. According to the Deputy Attorney General, at that time, DOJ expected that cooperating organizations should enable government investigators to gather facts before they become stale and assist in recovering losses incurred by the victims of wrongdoing. However, the Deputy Attorney General did note that what constitutes cooperation can vary from case-to-case and that, at a minimum, it must be recognized that if a corporation has learned precisely what happened and who is responsible, then it must turn the information over to the appropriate authority to receive credit for cooperation or a reduced culpability score under the United States Sentencing Guidelines for Organizations. The Deputy Attorney General emphasized during his remarks that if a business organization expected to receive credit for cooperation, then "it must help the government catch the crooks."

The critics of the Thompson Memo and its application regarding cooperation and waiver of the attorney-client privilege and work product protections believe that DOJ was effectively mandating waiver as a factor in assessing cooperation. These critics argued, as a practical matter, that DOJ was routinely demanding waivers, making it the norm, rather than the exception, which was a proposition that Deputy Attorney General Comey expressly rejected during his remarks at the ABA Health Fraud Institute in 2004.

The DOJ position of "give us the necessary information one way or another or face prosecution" is exactly the situation that the critics of the Thompson Memo feared would develop regarding the issue of cooperation and waiver of the attorney-client privilege and work product protections. These critics argued that a waiver of privileged information would cause: (1) less thorough organizational internal investigations in their efforts to detect and prevent wrongdoing (because of the fear that the organization would ultimately have to turn over this factual information as a consequence of "cooperating" with federal law enforcement authorities); (2) a chilling effect on the ability of counsel to give advice to

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clients in compliance matters (also for fear of it being disclosed to federal law enforcement authorities); (3) an erosion of the fundamental relationship between business organizations and their employees (because of the likelihood that organization "cooperation" with federal law enforcement authorities would result in the disclosure of information forming the basis for individual employee culpability); (4) a relaxation of government investigation methods by piggybacking the efforts of the organization's review; and (5) an increased exposure to civil litigation by third parties (because of waiver of the attorney-client privileges and work product protections).

There is very little doubt that the combined effect of the Thompson Memo, the Sentencing Guideline Amendments of 2004, and aggressive incentives for a business organization to cooperate created dynamics which left business organizations little choice but to cooperate fully and promptly with federal law enforcement investigators. These circumstances literally coerced business organizations into cooperation and according to critics created a "culture of waiver" of the attorney-client privilege and work product protections for business organizations. The chief executives and counselors of business organizations have speculated whether "cooperation" under these circumstances really meant anything more than "unconditional surrender."

Criticism Mounts and the McNulty Memorandum is published

The application of the principles and guidelines enunciated in the original 2003 Thompson Memo by various DOJ attorneys across the country precipitated a mounting crescendo of criticism and actions by the Courts, the United States Sentencing Commission, and ultimately the United States Congress. The Coalition to Preserve the Attorney-Client Privilege ("The Coalition") lobbied the United States Sentencing Commission and the United States Congress about its concerns with the application of the Thompson Memo and erosion of the attorney-client privilege. The Coalition consisted of a broad base of business organizations, including the Association of Corporate Counsel, the Business Roundtable, the United States Chamber of Commerce, the Retail Industry Leaders Association, the National Association of Criminal Defense Lawyers, the National Association of Manufacturers and, ultimately, several former Attorneys General of the United States. The United States Sentencing Commission also weighed in on this issue and modified its commentary language, which was associated with the amendments to Chapter 8 of the Sentencing Guidelines for Organizations in 2004. The original commentary language stated the following with respect to cooperation and waiver of the attorney-client privilege:

> Waiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score [for cooperation with the government]…unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.

The United States Sentencing Commission reconsidered this commentary and in May 2006 deleted the phrase "unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization," thereby staking out "neutral" ground on the issue. The federal courts also addressed the application of the principles in the Thompson Memo related to waiver of the attorney-client privilege in the case of *U.S. v. Stein*, in the Southern District of New York (otherwise known as the KPMG case). This case involved the prosecution of individual partners and employees of the accounting and consulting firm, KPMG. The organization had not only waived attorney-client privilege and disclosed information to the federal government in this case, but had withdrawn financial support for the defense of its employees during its cooperation with the federal government and prior to reaching a settlement of potential charges against the organization. The United States District Court in reviewing the prosecutorial tactics against KPMG and the business organization's response to those tactics found that the overwhelming coercion against the organization to waive attorney-client privilege and to withdraw support to its employees, violated the individuals Fifth Amendment right to due process and the Sixth Amendment right to counsel. These findings by the Court had a profound effect on the momentum and criticism of prosecutorial tactics involving waiver and support of the defense of employees by organizations. Finally, the United States Senate introduced Legislation in November of 2006 entitled the "Attorney-Client Privilege Protection Act of 2006." This proposed legislation prohibits waiver of the attorney-client privilege by an organization and allows for limited and selective waiver of privilege upon disclosure of informa-

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tion to the government. These actions clearly set the stage for a revision of the Principles of Federal Prosecution of Business Organizations reflected in the Thompson Memo, ultimately resulting in publication of the McNulty Memo.

The McNulty Memo is an attempt by DOJ to amend the content of the Thompson Memo regarding requests for waiver of privileges by organizations and indemnification of the costs for employee legal defense. The McNulty Memo affirmed the nine basic factors in making prosecution decisions, as reflected in the Thompson Memo, but adds some unprecedented restrictions on prosecutors who are seeking privileged "factual" and "legal" information from organizations. It creates new procedural approval requirements, within DOJ, before requests for a waiver of attorney-client privilege and work product protections can be made by line prosecutors in law enforcement investigations. The McNulty Memo cautions that requests for waiver should be sought only in rare circumstances and mandates that federal prosecutors must establish a legitimate need for privileged information and must seek approval before requesting such information from the Deputy Attorney General of the United States. The new procedures require that when a federal prosecutor seeks privileged "factual" information (i.e., facts developed as a result of an organization's internal investigation) from an organization, then approval must be obtained from the local United States Attorney, who must consult with the Deputy Attorney General. On the other hand, a request for waiver of attorney/client privilege and work product protections which includes "legal advice given to a corporation before, during, and after the underlying misconduct occurred, as well as 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. . . ." must be authorized in writing by the Deputy Attorney General and then communicated in writing to the business organization by the local United States Attorney.

The tone of the McNulty Memo was also reflected in the Deputy Attorney General's remarks to "Lawyers for Civil Justice" in New York on December 12, 2006, coinciding with the announcement and dissemination of the revised Principles of Federal Prosecution of Business Organizations. Deputy Attorney General McNulty emphasized that the "memorandum amplifies the limited circumstances under which prosecutors may ask for waivers of privilege". The Deputy Attorney General further emphasized that prosecutors must show a "legitimate need" for such privileged information and advised that in order to meet this test, prosecutors must show;

1. The likelihood and degree to which the information will benefit the government's investigation,
2. Whether information can be obtained in a timely and complete manner by using alternative means that do not require a waiver,
3. The completeness of the voluntary disclosure already provided, and
4. The collateral consequences to requesting a waiver.

The Deputy Attorney General went on to say that "the privilege is protected to such an extent, that even if prosecutors have established a legitimate need and I approve a request for a waiver, the DOJ will not hold it against the corporation if it declines to give the information. That is, prosecutors will not view it negatively in making a charging decision" according to the Deputy Attorney General.

The content of the McNulty Memo and the Deputy Attorney General's remarks before the civil lawyers reflect that the revisions to the Federal Principles of Prosecution of Business Organizations are designed to encourage organizations to prevent wrongdoing through self-policing and cooperation with law enforcement. The Deputy Attorney General, in fact, stated that "the best corporate prosecution is the one that never occurs. Through successful corporate compliance efforts, investor harm can be avoided. Corporate officials must be encouraged to seek legal advice if they are in doubt about requirements of the law". The Deputy Attorney General further emphasized that "if that relationship (i.e. attorney-client) is interfered with, if those communications are unfairly breached, it makes it harder for companies to detect and remedy wrongdoing."

Finally, it should be highlighted that the McNulty Memo does make a distinction between the disclosure of attorney-client privilege "factual" information and attorney-client privileged "legal" information for purposes of a determination of the business organization's cooperation. The factual information is the kind of information gathered by an organization through its own internal investigation and essentially involves the who, what, where, why and when of misconduct. This is the kind of information which can be requested with the permission of the

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local United States Attorney who must merely consult with the Deputy Attorney General. If a corporation declines to provide this information to the government, then the government prosecutors may negatively take that into consideration in measuring the degree of the organization's cooperation. The request for waiver of the attorney-client privilege to obtain the advice of counsel or the mental impressions of counsel must be requested directly from the Deputy Attorney General, and if approved, requested in writing from the business organization. A refusal by the business organization to turn this type of privileged information over to the government is not supposed to be negatively held against the organization during consideration of the government's charging decision.

Payment of Counsel Fees

As many compliance officers have experienced in all sorts of investigational inquiries, among the first questions asked by the individuals who may be implicated is whether the company will find them an attorney and pay for the associated cost. The associated expense is likely to be significant, particularly if multiple individuals require separate counsel. There may be many reasons why the company would want to bear that cost: it may make the employee or other represented party more cooperative; it may assure that the employee is competently represented if the corporation has some control over the choice of counsel; and it usually assures a more cooperative and coordinated defense amongst the corporation and related parties. The corporation may also be obligated to advance fees by law or contract.

The Thompson Memo discussed the advancement of attorney fees as potentially adverse evidence to be considered in weighing the extent and value of a corporation's cooperation.[1] As discussed above, the *U.S. v Stein* case found that DOJ prosecutorial tactics which had resulted in KPMG's waiver of attorney client and work product privileges and withdrawal of the advancement of attorney fees for KPMG employees to demonstrate the corporation's "cooperation," violated constitutional protections for the individual employees of the corporation. Against the backdrop of *Stein*, and in contrast to the Thompson Memo, the McNulty Memo states that, "[p]rosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment." The McNulty Memo emphasizes that many state indemnification statutes grant corporations the power to advance such fees for officers under investigation prior to a formal determination of guilt. (The Thompson Memo also noted this fact and observed in a footnote that, "[o]bviously, a corporation's compliance with governing law should not be considered a failure to cooperate,"[2] but otherwise found payment of fees potentially objectionable conduct in protecting culpable employees and agents.) In addition, as the McNulty Memo notes, contractual provisions may also require advancement of legal fees. Therefore, a corporation's compliance with the law and its contractual obligations cannot be considered a failure to cooperate. Prosecutors may, however, inquire about the source of payment of fees, and in "extremely rare" conditions, the advancement of fees might be taken into consideration when the totality of the circumstances show that payment was intended to impede a criminal investigation. If such circumstances exist, approval must be obtained from the Deputy Attorney General before prosecutors may consider this factor in their charging decisions.

Importance of Compliance Programs in the Decision to Prosecute

Also among the nine factors which prosecutors must consider in deciding whether to prosecute a corporation is "the existence and adequacy of the corporation's pre-existing compliance program."[3] Consequently, the existence of an effective compliance program may help a corporation to avoid prosecution altogether, as well as give the corporate entity a favorable advantage under the U.S. Sentencing Guidelines, if it is prosecuted and convicted.

While expressing its support for compliance programs, the McNulty memo expressly notes that the existence of a compliance program is not sufficient, in and of itself, to justify *not* charging a corporation for criminal conduct undertaken by its officers, directors, employees, and agents. In fact, such conduct might suggest that the corporation is not adequately enforcing its program. In short, the compliance program must be, as noted by DOJ, both *adequately designed* for maximum effectiveness in preventing and detecting wrongdoing, and *enforced* by corporate management. Although DOJ recognizes that no compliance program will ever prevent all criminal activity, a "paper program" will provide no advantages to the corporation in terms of a DOJ prosecution decision.

While DOJ has no formal guidelines for corporate compliance programs,

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specific factors for prosecutors to consider in evaluating the effectiveness of a compliance program, as identified in the McNulty memo, include the following:

- The comprehensiveness of the compliance program;
- The extent and pervasiveness of the criminal conduct at issue;
- The number and level of corporate employees involved in the criminal conduct;
- The seriousness, duration, and frequency of the misconduct;
- Any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to the corporate compliance programs;
- The promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation;
- Whether the corporation has established governance mechanisms that can effectively deter and prevent misconduct;
- Whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts; and
- Whether the corporation's employees are adequately informed about the compliance program and the corporation's commitment to it.

The McNulty Memo further notes that a compliance program must be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. To evaluate this factor, prosecutors are directed to consult with other relevant federal and state agencies with the expertise to evaluate the adequacy of the program's design and implementation. The importance of employee disciplinary actions is also noted. Again, the emphasis as reflected in the McNulty memo is to give "credit" in the charging decisionmaking process only for robust, relevant and well-supported compliance programs which evidence convincing efforts at the detection of misconduct and assuring that business activities are conducted in full compliance with the law.

Conclusion

The McNulty Memo clearly seeks to reverse a practice and/or perception involving "routine requests" for waiver of the attorney-client and work product protections by business organizations. The McNulty Memo attempts to emphasize the importance of the attorney-client privilege and work product protections. The procedures for approval of such requests within the DOJ are unprecedented and clearly designed to ensure that such requests are rarely made, and that when they are made, the requests will be uniformly reviewed at the highest levels of the Department of Justice. It will remain to be seen how the McNulty Memo and its principles and procedures are applied in practice and its impact on future organization compliance efforts and effectiveness.

The factors identified by the McNulty Memo for evaluating a compliance program are relevant even in the absence of concern about facing prosecution. Additional "expectations" for compliance program effectiveness were added by the 2004 amendments to the U.S. Sentencing Guidelines in Chapter 8, Part B, Section 8B2.1, including:

1. The business organization must promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.
2. Senior Management/Board of Directors must demonstrate a commitment to compliance efforts.
3. The individual with day-to-day operational responsibility for the compliance program must be given adequate resources, appropriate authority, and direct access to the Board or an appropriate subgroup.
4. The business organization must not vest substantial discretion with individuals known (through the exercise of due diligence) to have engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.
5. Training must not only include all employees, including those with substantial discretion or supervisory authority, but also be addressed to members of the Board of Directors.
6. Enhanced auditing and monitoring is expected.
7. Incentives should be offered for performance in accordance with the compliance and ethics program (as well as discipline for compliance program violations).
8. An organization is expected to periodically assess the risk of occurrence of criminal conduct.

Compliance officers now have clear standards against which to measure the functionality of their compliance programs. An effective compliance program may help the corporation to avoid prosecution and result in a downward departure in application of the Sentencing Guidelines, if prosecution (and conviction) is not avoided. ■

1. Thompson Memo at 5.
2. Thompson Memo, n. 4.
3. McNulty Memo at 4.