

Client Alert

U.S. Department of Justice Moderates Guidelines for Prosecution of Corporate Fraud

The pendulum appears to be swinging back. On December 12, 2006, United States Deputy Attorney General (DAG) Paul McNulty announced revisions to the guidelines used by the Department of Justice (DOJ) for deciding when to seek indictment of a corporation. Those decisions had previously been guided by a DOJ policy known as the Thompson Memorandum, which directed prosecutors to consider, among other things, the company's waiver of attorney-client and work product privileges, and its advancement of legal fees to employees subject to the government investigation. Under the revisions announced last week, prosecutors may not consider the corporation's advancement of legal fees to employees except in rare cases, and may only request corporations to waive attorney-client and work product protections under certain defined circumstances and procedures.

The Thompson Memorandum (formally titled Principles of Federal Prosecution of Business Organizations) was issued in January 2003 by then DAG Larry D. Thompson. Issued in the wake of the corporate scandals that marked the beginning of the decade—Enron, Global Crossing, Tyco, and Adelphia Communications, among others—the Thompson Memorandum set forth nine factors for prosecutors to consider in deciding whether to seek criminal charges against a corporation. Most significantly, the Memorandum directed prosecutors to consider whether the corporation (a) had agreed to waive attorney-client and work product protections, and (b) appeared to be providing support to culpable employees and agents, including through the payment of their attorneys' fees.

These two factors led to criticism from a number of sources. Most notably, during the summer of 2006 United States District Judge Lewis A. Kaplan of the Southern District of New York issued two groundbreaking opinions in the KPMG tax shelter litigation, described as the largest tax fraud case in U.S. history. In the first decision (*Stein I*), Judge Kaplan found that “so much of the Thompson Memorandum and the activities of the [U.S. Attorney's Office] as threatened to take into account [in connection with the decision to indict] . . . whether KPMG would advance attorneys' fees to present or former employees . . . violated the Fifth and Sixth Amendments to the Constitution.” *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006). In the second decision (*Stein II*), Judge Kaplan suppressed statements made to prosecutors by two KPMG defendants on the grounds that the statements had been coerced by KPMG's threat, under pressure of the Thompson Memorandum and the U.S. Attorney's Office, to fire them and cut off payment of attorneys' fees. *United States v. Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006).

In addition to Judge Kaplan's decisions, criticism came from other fronts as well. Hearings before the Senate Judiciary Committee conducted in September 2006 featured critical testimony from former high-ranking DOJ officials, among others, as well as pointed questioning of DAG McNulty from Senators on both sides of the aisle. Earlier this month, Senator Arlen Specter introduced a bill, titled the “Attorney-Client Privilege Protection Act of 2006,” that would bar federal prosecutors or agents from requesting a corporation to waive the attorney-client privilege and from pressuring companies not to pay legal fees for individual employees.

Faced with this groundswell of opposition, last week DAG McNulty issued a Memorandum (the [McNulty Memorandum](#)) that scales back those provisions of the Thompson Memorandum that have drawn the most fire. With respect to the advancement of legal fees, the McNulty Memorandum provides that “[p]rosecutors generally should not take into account whether a corporation is advancing attorneys’ fees to employees or agents” in making their charging decisions. (Memorandum at 11.) The Memorandum carves out one exception—“when the totality of the circumstances show that [the advancement of fees] was intended to impede a criminal investigation”—but notes that this exception should occur only in “extremely rare cases,” and directs that prosecutors must obtain approval from the DAG before invoking it. (Memorandum at 11, n.3.)

With respect to the waiver of attorney-client privilege, the McNulty Memorandum stresses that the “attorney-client privilege is one of the oldest and most sacrosanct privileges under U.S. law,” and that “waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government’s investigation.” (Memorandum at 8.) “Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information,” which will depend on a number of defined factors, including whether the information sought can be obtained through alternative means. Further, prosecutors must seek the “least intrusive waiver necessary” pursuant to a step-by-step approach spelled out in the Memorandum. (Memorandum at 8-9.)

In the first instance, prosecutors should request only “purely factual information relating to the underlying misconduct” (referred to as Category I information), such as “copies of key documents, witness statements or purely factual interview memoranda.” Before requesting such information, however, prosecutors must obtain written authorization from their United States Attorney, who in turn must consult with the Assistant Attorney General for the Criminal Division in Washington, D.C. (Memorandum at 9.)

Only if this Category I information “provides an incomplete basis to conduct a thorough investigation,” should prosecutors request the corporation to provide attorney-client communications or non-factual attorney work product (Category II information), for example “legal advice given to the corporation before, during and after the underlying misconduct occurred.” Prosecutors should only seek such Category II information in “rare circumstances,” however, and may do so only after obtaining written authorization from the DAG. (Memorandum at 10.)

In the face of a government request for privileged information, a corporation may of course choose either to comply or not comply. Under the McNulty Memorandum, a refusal to provide Category I information may still be considered by prosecutors in determining whether to charge a corporation. With respect to Category II information, the Memorandum contains somewhat conflicting directives; while “prosecutors must not consider” a corporation’s declination to provide such information in making charging decisions, they “may always favorably consider a corporation’s acquiescence . . . in determining whether a corporation has cooperated in the government’s investigation.” (Memorandum at 10.)

The changes effected by the McNulty Memorandum have stirred differing views among the defense bar as to their meaningfulness. While some applaud the hurdles that prosecutors must now clear in order to seek attorney-client privileged information, others complain that the McNulty Memorandum does not go far enough. The latter point out that, clearly with respect to Category I information and to some extent with respect to Category II information, prosecutors may still consider a corporation’s willingness to waive the attorney-client privilege in making their charging decisions. But whether the glass is half empty or half full, there is no denying that the pendulum appears to be swinging back from the apogee it reached under the Thompson Memorandum.

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