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**Federal Criminal Investigations of Business
Entities Under the McNulty Memorandum:
How Much Has *Really* Changed?**

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Federal Criminal Investigations of Business Entities Under the McNulty Memorandum: How Much Has *Really* Changed?

Recently, the United States Department of Justice (DOJ) announced revisions to its policy and procedures for conducting criminal investigations of business entities. These changes are set forth in the *Principles of Federal Prosecution of Business Organizations*, issued by Deputy Attorney General Paul J. McNulty on December 12, 2006 (the McNulty Memorandum). The McNulty Memorandum supersedes and revises guidance contained in the January 2003 *Principles of Federal Prosecution of Business Organizations*, which was issued by then-Deputy Attorney General Larry D. Thompson (the Thompson Memorandum).¹

The purpose of both the McNulty Memorandum and the Thompson Memorandum is to provide guidance to prosecutors making the decision whether to bring criminal charges against a business entity. The McNulty Memorandum reaffirms the DOJ's policy that business organizations should be treated no more or less leniently because of their artificial nature. The McNulty Memorandum also reaffirms the nine factors to be considered by prosecutors when making charging determinations. These factors include:

1. The nature and seriousness of the offense;
2. The pervasiveness of wrongdoing within the organization and the seniority of the employees involved;
3. Prior corporate misconduct;
4. The organization's voluntary and timely disclosure of the misconduct;
5. The existence and adequacy of a preexisting compliance program;
6. The response of management once the conduct was discovered;
7. Collateral consequences;
8. The adequacy of prosecution of individuals responsible; and
9. The adequacy of noncriminal enforcement alternatives.

Both the McNulty and the Thompson Memoranda make clear that if the government perceives the business organization as having not fully cooperated with the government's investigation, then that business is more likely to face criminal indictment, prosecution, and potentially devastating criminal sanctions. Even the lesser sanction of a deferred prosecution has proven to be onerous and costly for businesses that escaped a criminal indictment.

According to the DOJ, the McNulty Memorandum represents a shift in policy designed to lessen the impact of the most controversial aspects of the Thompson Memorandum—the requirement that, in measuring the extent of a business organization's cooperation, prosecutors consider (1) whether or not the business entity is advancing legal fees or otherwise indemnifying its employees whom the government considers to be "culpable" and (2) whether the business entity agreed when asked by the government to waive the protections offered by the attorney-client privilege and the attorney work product doctrine as to materials related to any internal investigation, including delivering to the government reports of findings and notes of otherwise privileged interviews of company personnel. Under the Thompson Memorandum, if a business organization continued to indemnify its employees' legal expenses or refused to waive the work product or attorney-client privilege, then the business ran the risk that the government would consider that business to be "uncooperative." Such a view could in turn greatly enhance the risk of criminal indictment and prosecution—and potential destruction—of the business.

Under the prior DOJ policy, interference by the government with the company's advancement of legal fees and the compelled waiver of privileged attorney-client communication and attorney work product were routine federal law enforcement tactics. Prosecutors regularly conditioned leniency for a business

¹ And in the October 21, 2005 memorandum from then-Acting Deputy Attorney General Robert D. McCallum to Heads of Department Components and United States Attorneys, titled, *Waiver of Corporate Attorney-Client and Work Product Protection*.

entity on the entity's performance of a thorough internal investigation and its disclosure to law enforcement of all investigatory materials—including those protected by the attorney–client privilege and attorney work product. Frequently, such waiver requests were made orally by line prosecutors—without higher authority—at the initiation of the criminal investigation.

These tactics came under much scrutiny and criticism by the courts, Congress, the corporate defense bar, and the business community. As a result, DOJ made the following changes that it details in the McNulty Memorandum: (1) It established formal procedures for federal prosecutors who wish to request that a company waive its attorney–client or work product privilege; and (2) Prosecutors are now precluded from considering the payment of employees' attorneys' fees when evaluating a business organization's level of cooperation with federal authorities during an investigation. Notwithstanding these new restrictions, the McNulty Memorandum recognizes that companies that waive attorney–client and/or work product privileges will receive a benefit of leniency, whether or not the DOJ directly requests such a waiver. Further, the McNulty Memorandum reaffirms that its provisions are for internal DOJ guidance only and do not create any rights, substantive or procedural, enforceable at law by any party in any matter, civil or criminal. Thus, prosecutors are not necessarily required to follow them.

Changes to the Requirement That Prosecutors Consider a Business Organization's Waiver of Its Attorney–Client Privilege and/or Attorney Work Product Protection

Despite the change in policy, under the McNulty Memorandum, the DOJ's practice of requesting and evaluating corporate waivers of attorney–client privilege and attorney work product likely will continue. Although the McNulty Memorandum purports to provide greater protection for the attorney–client and work product privileges, the reality is that a corporation still may be required to waive its attorney–client and work product privileges to receive full credit for having cooperated with a government investigation. The only real difference between the McNulty Memorandum and the Thompson Memorandum is that the McNulty Memorandum creates and describes a process by which prosecutors can seek to obtain the same material they could under the Thompson Memorandum. The ultimate decision is still solely at the discretion of the DOJ. Whether these procedures will, in fact, reduce the amount and the scope of privilege waiver requests or, alternatively, whether written requests will simply become another routine administrative step remains to be seen.

According to the McNulty Memorandum, “[p]rosecutors may only request waiver of the attorney–client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations.” To show a legitimate need, prosecutors must establish:

1. The likelihood that 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 a waiver;
3. The completeness of the voluntary disclosure already provided; and
4. The collateral consequences of a waiver.

If a legitimate need exists, “prosecutors should seek the least intrusive waiver necessary to conduct a complete and thorough investigation, and should follow a step-by-step approach.” According to the McNulty Memorandum, prosecutors should first only request “purely factual information, which may or may not be privileged, relating to the underlying misconduct.” These are considered “Category I” documents, and include copies of key documents, witness statements, purely factual interview memoranda, organization charts created by company counsel, factual chronologies, and factual summaries or reports containing investigative facts documented by counsel. These documents in many cases are materials protected by the attorney work product doctrine.

Before requesting Category I documents, prosecutors must obtain written authorization from the local

United States Attorney, who must provide a copy of the written request to, and consult with, the Assistant Attorney General for the Criminal Division in Washington, D.C. before granting or denying the request. The McNulty Memorandum requires that a copy of this request be maintained in the files of the United States Attorney.

The McNulty Memorandum makes clear that “[a] corporation’s response to the government’s request for waiver of privilege for Category I information may be considered in determining whether a corporation has cooperated in the government’s investigation.” Thus, it is likely that considerable pressure will remain on corporations to waive privilege.

If the prosecutors determine that the Category I information provides an incomplete basis to conduct a thorough investigation, they may further request documents classified as “Category II” documents. To do so, the United States Attorney must obtain written authorization from the Deputy Attorney General. Like the authorization for Category I documents, this approval request must set out law enforcement’s legitimate need for the information and identify the scope of the waiver sought.

The McNulty Memorandum identifies Category II documents as attorney–client communications and nonfactual attorney work product, including legal advice given to corporations before, during, and after the underlying misconduct occurred; attorneys’ notes, memoranda, or reports (or portions thereof) containing counsel’s mental impressions and conclusions; legal determinations reached as a result of an internal investigation; and legal advice given to corporations.

Unlike Category I information, a prosecutor may not consider a corporation’s refusal to provide Category II information in making a charging decision. Nevertheless, the McNulty Memorandum provides that “[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.” Thus, in reality, pressure will continue to remain on companies to disclose Category II information upon request by prosecutors.

Also, even Category II information can be requested by the United States Attorney without approval from the Deputy Attorney General when the request is for either legal advice contemporaneous to the underlying misconduct when the business or one of its employees is relying on the advice-of-counsel defense, or legal advice or communications in furtherance of a crime or fraud, coming within the crime-fraud exception to the attorney–client privilege. The McNulty Memorandum does not specify whether the general prohibition against considering the company’s refusal to turn over Category II documents in making charging decisions applies if a business refuses to turn over documents in this situation.

Finally, prosecutors are not required to obtain authorization if the business voluntarily offers privileged documents without a request by the government. However, voluntary waiver must be reported to the United States Attorney or the Assistant Attorney General where the case originated, and a record of these reports must be maintained in that office. Given the fact that the DOJ explicitly states that prosecutors will grant leniency in their sentencing determinations to companies they perceive as cooperating fully with the government, the pressure on businesses to voluntarily waive privilege likely will remain as strong as ever.

In particular, considerable pressure will remain on corporations to produce to prosecutors factual work product materials, such as investigative reports and interview memoranda, as prosecutors can still consider a corporation’s refusal to provide those items in making charging decisions. Although the prosecutor may not overtly rely on a business’s refusal to waive its privileges, its refusal may still nevertheless influence the prosecutor’s decision of whether to charge the business. However, recent developments in Congress suggest that the McNulty Memorandum may not be the last word on the ability of federal prosecutors to invade the attorney–client and work product privileges. After reviewing the McNulty Memorandum and finding it inadequate to protect the attorney–client and work product privileges, Senator Arlen Specter introduced the Attorney-Client Protection Act of 2007. If enacted, the Act would prohibit federal prosecutors from even attempting to access attorney–client communications

and attorney work product.² In a statement on the Senate floor, Senator Specter said that the McNulty Memorandum effectively continues to “discourage corporate employees from having frank conversations with lawyers” and “inadvertently discourages the types of internal investigations and dialogues [necessary] to detect and prevent corporate fraud.” We will continue to closely monitor this development.

Changes to the Requirement That a Prosecutor Consider Whether a Business Ceased Indemnifying Its Employees’ Attorneys’ Fees

Prior to the McNulty Memorandum, prosecutors could consider in making a charging decision a company’s decision to indemnify legal expenses of employees whom the government deemed “culpable” in misconduct—regardless of whether those employees ever were charged with a crime or even designated as “targets” of a government investigation. In a series of scathing decisions denouncing aggressive law enforcement tactics authorized by the Thompson Memorandum, Judge Lewis Kaplan of the Southern District of New York held that both government interference with corporate decisions to advance legal fees to employees and government efforts to condition such fee advancements on employees’ participation in interviews with investigators were impermissible and unconstitutional. See *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).

Now, under the McNulty Memorandum, prosecutors generally are restricted from taking into consideration whether a corporation is advancing attorneys’ fees to employees or agents under investigation and indictment. This acknowledges the fact that in many states indemnification of employees’ legal expenses is required by law or, in many situations, corporations have agreed in employment contracts or corporate bylaws to indemnify employees. Nevertheless, the McNulty Memorandum explicitly provides that a prosecutor may inquire about an attorney’s representation, including how and by whom attorneys’ fees are paid. Such inquiries necessarily require businesses to speculate as to how their otherwise legitimate decisions to indemnify employees will be viewed by prosecutors.

Furthermore, the McNulty Memorandum does not eliminate consideration of employee indemnification when the indemnification is intended to impede the investigation. In the absence of a statutory or contractual obligation to indemnify employees, the determination of whether indemnification will be viewed as legitimate or an attempt to impede the investigation lies with the prosecutor. Also of concern is the McNulty Memorandum’s specific authorization for prosecutors to consider as factors in weighing the value of a company’s cooperation whether the business has (1) entered into joint defense agreements with its employees, (2) agreed to share documents between the company and employees under investigation, or (3) retained employees without sanctioning them regardless of whether there has been any formal determination of wrongdoing by the employees.

Although prosecutors are now required to obtain approval from the Deputy Attorney General before considering a business’s decision to indemnify employees in making a charging decision, a company’s payment of at least certain employees’ legal fees will continue to influence prosecutors. Indeed, the McNulty Memorandum continues to label employees under investigation as “culpable” regardless of any determination or finding of wrongdoing. We will continue to monitor the results of the McNulty Memorandum in this regard as well.

² The Attorney-Client Protection Act of 2007 is identical to the Attorney-Client Protection Act of 2006, which was also introduced by Senator Specter prior to the DOJ’s issuance of the McNulty Memorandum.

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