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New Developments: (i) The Department of Justice Announces Revisions to the McNulty Memorandum But Leaves Unanswered Questions About Privilege Waiver; and (ii) The Second Circuit Affirms Judge Kaplan's KPMG Ruling

The Revised Principles of Federal Prosecution of Business Organizations

On August 28, 2008, the Department of Justice ("DOJ") issued the revised Principles of Federal Prosecution of Business Organizations, previously called the McNulty Memorandum (named after the then Deputy Attorney General Paul J. McNulty).[1] The revisions, authored under the direction of current Deputy Attorney General Mark Filip, are the product of substantial pressure on the DOJ to modify its policy that a company's willingness to waive the attorney-client privilege or work-product protection is relevant to the charging decision.[2] That pressure included pending Congressional legislation to bar the DOJ from making charging decisions based on waiver of privilege. The Principles, bowing to those pressures, expressly state that credit for cooperation will not depend on waiver of the attorney-client privilege, but rather on disclosure of the "facts known to the corporation about the putative criminal misconduct under review."[3] As explained below, however, the Principles leave unanswered important questions about whether, as a practical matter, companies will still have to waive important privilege protections in order to obtain cooperation credit in any charging decision.

Privilege Waiver. Obviously sensitive to the criticism of the McNulty Memorandum and its predecessors, the new Principles insist that waiver was never considered an absolute prerequisite for corporate cooperation; nonetheless, the Principles acknowledge the widespread concern within the legal community that the prior guidelines "either wittingly or unwittingly" were used to coerce corporations into waiving their privilege.[4] Consequently, the Principles state that "while a corporation remains free to convey non-factual or 'core' attorney-client communications or work product — if and only if the corporation voluntarily chooses to do so — prosecutors should not ask for such waivers and are directed not to do so."[5]

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1 Available at http://lawprofessors.typepad.com/whitecollarcrime_blog/privileges/index.html.

2 See Justice Department Revises Charging Guidelines for Prosecuting Corporate Fraud, August 28, 2008, available at http://www.usdoj.gov/opa/pr/2008/August/08-odag-757.html. By letter dated July 9, 2008, Deputy Attorney General Mark Filip advised Senators Patrick J. Leahy and Arlen Specter, the Chairman and Ranking Member, respectively, of the Senate Committee on the Judiciary, that "in the coming weeks" the DOJ would once again revise its "Principles of Federal Prosecution of Business Organizations." The letter in effect acknowledged that the McNulty Memorandum had not allayed concerns that the "perceived widespread use of privilege waivers has inhibited candid communications between corporate employees and legal counsel whose advice has been sought."

3 Department of Justice, Principles of Federal Prosecution of Business Organizations, Section 9 28.710, available at http://www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf. The Principles have also been incorporated into the U.S. Attorneys Manual.

4 *Id.*

5 *Id.*

The Principles note that corporations may collect information about potential wrongdoing through an internal investigation that may generate materials protected by the attorney-client privilege or the work product doctrine. However, "the government's key measure of cooperation must remain the same as it does for an individual: has the party timely disclosed the relevant facts about the putative misconduct? That is the operative question in assigning cooperation credit for the disclosure of information — not whether the corporation discloses attorney-client or work product materials. Accordingly, a corporation should receive the same credit for disclosing facts contained in materials that are not protected by the attorney-client privilege or attorney work product as it would for disclosing identical facts contained in materials that are so protected."[6]

As a practical matter, this likely means that companies will be expected by federal prosecutors to make oral proffers of the facts known to them and/or otherwise uncovered by an internal investigation. Indeed, the Principles give specific direction, albeit within a footnote, with regard to employee interviews conducted by corporate counsel during an internal investigation. In such situations, the corporation need not produce — and United States Attorneys should not request — "protected notes or memoranda generated by the lawyers' interviews." However, the United States Attorneys may request the relevant factual information that the company attorney acquired from the employees through the interviews.[7] Nor will this likely mean that the company can simply provide a chronology of facts; rather, the DOJ may request the identities of the employees who furnished the factual information and a description of the role of each employee. But on this key point the Principles are silent.

If, in fact, this is how the Principles will be implemented, then the pressures on the DOJ are unlikely to abate. Under the Supreme Court's decision in the *Upjohn* case, communications by individual employees to attorneys for the corporation who are conducting an internal investigation — including communications of facts — are protected by the corporate attorney-client privilege.[8] Even by way of oral proffer, compelling production of the communications on an employee-by-employee basis on pain of loss of cooperation credit would appear to deprive companies of *Upjohn* protection, *i.e.* force them to waive a well-established privilege. Moreover, while the unproduced interview memoranda and the notes will retain their privileged character in any civil proceedings, the same may not be true of the attorney making the oral proffer. Theoretically, the company's attorney could be compelled to testify, in a civil proceeding, to anything he told the DOJ. Many attorneys doubtless would prefer to produce their memoranda and notes to private litigants rather than themselves.

In other areas touching on privilege issues, the Principles largely restate existing policies. For example, the Principles make clear that material not covered by privilege, including emails between non-attorney employees and business records, may still be requested. Likewise, the Principles reserve the right to request communications underlying an "advice of counsel" defense. According to the Principles, "[t]he Department cannot fairly be asked to discharge its responsibility to the public to investigate alleged corporate crime, or to temper what would otherwise be the appropriate course of prosecutive action, by simply accepting on faith an otherwise unproven assertion that an attorney — perhaps even an unnamed attorney — approved potentially unlawful practices. Accordingly, where an advice-of-counsel defense has been asserted, prosecutors may ask for the disclosure of the communications allegedly supporting it."[9] The Principles also reserve the right to seek communications in furtherance of a crime or fraud, which by law fall outside the scope of the privilege.

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6 Principles of Federal Prosecution of Business Organizations, Section 9-28.720.

7 *Id.* at n.3.

8 See *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

9 Principles of Federal Prosecution of Business Organizations, Section 9-28.720.

Employee Discipline as a Charging Factor. Separately, the fate of employee discipline as a relevant factor remains uncertain. In a letter to the Senate Judiciary Committee in July, Deputy Attorney General Filip represented that under the forthcoming Principles prosecutors "will not consider whether the corporation has retained or sanctioned employees in evaluating cooperation."[10] Although this factor no longer appears in the Principles' subsection on cooperation credit, the subsection on Restitution and Remediation states that "[a]mong the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined wrongdoers, once those employees are identified by the corporation as culpable for the misconduct."[11] The Principles explain the relevance of this factor by noting that prosecutors "should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers."[12] Part of the discrepancy between Filip's original letter and the revised Principles is explained by his letter's caveat that, although employee discipline should not be relevant for cooperation, it may still be relevant for evaluating the quality of remedial measures and compliance programs. However, given that remediation and corporate compliance programs are still relevant factors in determining whether to charge a corporation and "how to resolve corporate criminal cases," it seems likely that this finely nuanced distinction will have no practical effect.

Attorneys' Fees Advancement to Employees and Joint Defense Agreements. Finally, the Principles unequivocally clarify certain DOJ policies that had been the subject of controversy. In making charging decisions, prosecutors may not:

- consider whether the corporation has advanced attorneys' fees to its employees in evaluating cooperation.[13]

- take into account, in evaluating cooperation, joint defense agreements entered into by a corporation.[14]

The Second Circuit Affirms Judge Kaplan's KPMG Ruling

Overall, the Principles represent a considerable, but hardly complete, retreat from the aggressive policies of its predecessors, the Holder, Thompson, and McNulty Memoranda. Thus, there was a special irony in the fact that on the day that the DOJ released the Principles, the United States Court of Appeals for the Second Circuit affirmed District Judge Kaplan's ruling in the KPMG case. There, Judge Kaplan had dismissed tax-shelter fraud charges against 13 former KPMG partners and employees on the ground that the DOJ had interfered with their Sixth Amendment right to counsel.[15] Judge Kaplan found that, during the investigation, the DOJ had told KPMG that it would consider whether the corporation had advanced legal fees to its employees in evaluating cooperation, which caused the corporation to stop advancing the legal fees. Judge Kaplan's ruling became a rallying point for the various groups, including bar associations, corporate counsel associations, business groups, and criminal defense organizations, who lobbied Congress to enact legislation barring consideration of both advance legal payments to employees and privilege waiver as factors in charging decisions.

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[10] Mark Filip, Letter to Senators Leahy and Specter, at 3 (July 9, 2008).

[11] Principles of Federal Prosecution of Business Organizations, Section 9-28.900.

[12] *Id.*

[13] *Id.* at Section 9-28.730.

[14] *Id.*

[15] U*nited States v. Stein*, 495 F. Supp. 2d 390, 427 (S.D.N.Y. 2007).

Upholding the dismissal, the Second Circuit stood firmly behind Judge Kaplan's ruling.[16] The court concluded that KPMG's enforcement of the DOJ policy constituted state action "as a direct consequence of the government's overwhelming influence," resulting in a Sixth Amendment violation, and that no remedy other than dismissal would return defendants to the *status quo ante*.[17] The Second Circuit rejected the prosecution's argument that KPMG's past practice regarding payment of attorneys' fees had been voluntary and could not have generated a reasonable expectation of payment by the employees. The court stated that, absent state action, KPMG would have paid the fees "without regard to cost."[18] The court did not decide whether the DOJ policy also violated the defendants' Fifth Amendment rights.[19]

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[16] See *United States v. Stein*, Docket No. 07-3042-cr, 2008 U.S. App. LEXIS 18524 (2d Cir. August 28, 2008).

[17] *Id.* at *5-6.

[18] *Id.* at *63-64.

[19] *Id.* at *6.