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Department of Justice McNulty Memo Curtails Controversial Portions of Thompson Memo--Legislation Introduced in the Senate

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Over the past few months, the chorus of critics of the Department of Justice's Thompson Memorandum has continued to grow ever louder. The Memorandum, issued in 2003 by then-Deputy Attorney General Thompson, specifies factors that federal prosecutors are required to use when making charging decisions against corporations suspected of wrongdoing.[i] Among the more notable factors that have proven to be lightning rods for criticism are the demands that corporations, in order to prove their cooperation, waive the attorney-client privilege and produce the results of their internal investigations, and deny payments of attorneys' fees to employees under investigation. The Securities and Exchange Commission (SEC) promulgated a comparable document in 2002 through the Seaboard Report, which also suggests that corporations can demonstrate their cooperation by waiving the privilege.[ii]

These provisions have been criticized by a wide and impressive array of organizations and individuals, including the American Bar Association, the US Chamber of Commerce, the ACLU, former high-ranking Department of Justice (the Department) officials, current SEC Commissioner Atkins and a variety of commentators.[iii] Moreover, in two widely reported published opinions in *United States v. Stein* (the case arising out of the pending criminal prosecution of former employees of the KPMG accounting firm for selling allegedly illegal tax shelters), the district court declared unconstitutional that portion of the Thompson Memorandum that led government prosecutors to pressure KPMG not to pay the legal fees of these employees, contrary to KPMG's standard practice. [iv]

The McNulty Memorandum

A notable development has recently taken place within the halls of the Department of Justice itself. On December 12, 2006, current Deputy Attorney General Paul McNulty issued his own memorandum scaling back the more egregious aspects of the Thompson Memorandum.[v] In particular, and in apparent recognition that waiver demands by line prosecutors throughout the Department have become commonplace, the McNulty Memorandum (the Memorandum) now requires prosecutors to obtain prior senior supervisory approval—starting at the level of the United

States Attorney and rising to the Deputy Attorney General—before making a waiver demand.

The Memorandum does not outlaw waiver demands, but places what appear to be meaningful hurdles in the path of any line prosecutor bent on making such demands. It also requires prosecutors to follow a two-step process before requesting that a corporation provide privileged information. First, in order for an Assistant United States Attorney (AUSA) to request from a corporation "purely factual information, which may or may not be privileged, related to the underlying conduct"—defined in the Memorandum as "Category I" information—the AUSA must obtain prior written authorization from the local United States Attorney, who must in turn consult with the Assistant Attorney General for the Criminal Division at Main Justice in Washington before granting or denying the request. Second, and only if the Category I information "provides an incomplete basis to conduct a thorough investigation," the local United States Attorney can request that a corporation produce "attorney-client communications or non-factual attorney work product"—Category II information—if the Deputy Attorney General provides prior written approval.[vi]

Notably, the Memorandum goes on to direct prosecutors not to take into account for charging decision purposes a corporation's decision not to provide Category II information. However, they can take into account the corporation's response to a Category I information request, and they can continue to make waiver demands in situations where corporations agree to plead guilty and cooperate with the government.

The McNulty Memorandum also sharply curtails that portion of the Thompson Memorandum that seeks to penalize corporations that elect to pay the legal fees for employees under investigation. Under the Memorandum, such payments, which are typically required by state law and incorporated into the bylaws of most corporations, will "generally ... not [be] take[n] into account" as evidence of a lack of cooperation. In a footnote, the Memorandum provides that "[i]n extremely rare cases, the advancement of attorneys' fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation." But the Memorandum then limits the application of that exception by requiring that prosecutors first obtain prior approval from the Deputy Attorney General before they may consider the factor.

As a practical matter, the Memorandum is likely to substantially curtail privilege waiver demands from line prosecutors. Obtaining Deputy Attorney General and other Main Justice approval is often a time-consuming process, requiring the creation of a lengthy memorandum by line prosecutors followed by significant internal review within the Department. This hurdle provides a sensible check on local prosecutorial discretion while assuring nationwide consistency in the application of waiver demands.

Senate Legislation

The McNulty Memorandum was issued on the heels of the legislation proposed in the Senate five days earlier, on December 7, 2006, by outgoing Senate Judiciary Chairman Arlen Specter. His bill, the Attorney-Client Privilege Protection Act of 2006, would flat-out outlaw the most questionable aspects of the Thompson Memorandum.[vii] In particular, the bill would bar federal attorneys or agents engaged in criminal or civil enforcement matters from demanding or requesting that a

corporation waive the attorney-client privilege, and from pressuring companies not to pay legal fees for individual employees.

The bill goes on to provide that nothing prevents a corporation from making, and the government from accepting, a voluntary production of internal investigation material.[viii] But the version of the bill publicly introduced by Senator Specter omits a provision, circulated in earlier discussion drafts and embodied within proposed Federal Rule of Evidence 502(c), that would have treated voluntary disclosures to the government as not constituting a general waiver of the privilege. Under the current state of the law in most jurisdictions, such disclosures are viewed as general waivers.[ix]

The McNulty Memorandum represents a development that goes well beyond the step taken in October of 2005, when the Department of Justice issued what was referred to as the McCallum Memorandum, requiring each United States Attorney's Office to promulgate a set of protocols before a privilege waiver request could be made to a corporation.[x] But the now-superseded McCallum Memorandum was all process and no substance. It did not address the more controversial aspects of the Thompson Memorandum, nor did it quiet the ever-growing opposition to the Thompson Memorandum. The McNulty Memorandum represents an effort to appease critics and may wind up going a long way toward restoring needed balance to the investigation process.[xi]

The McNulty Memorandum is also a positive development for corporations and individuals confronted with government investigations. Corporations can continue to properly invoke the attorney-client privilege, the oldest privilege in the law. As a result of the privilege's continuing vitality, the quality and accuracy of internal corporate investigations are likely to improve because individual employees are prone to be more candid when they have better reason to believe that their statements will not be turned over to the government. In addition, curtailing most attacks on indemnification will no doubt be viewed as good news by individual company employees who fall under government scrutiny and fear the prospect of bankruptcy in order to pay legal defense fees. Corporations can continue to abide by their charters and pay such fees with substantially less risk of government retribution.

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[i] Memorandum from Larry D. Thompson, Deputy Attorney General, to

Heads of Department Components and United States Attorneys (Jan. 20, 2003), available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

[ii] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Rel. No. 34-44969 (Oct. 23, 2001), available at http://www.sec.gov/litigation/investreport/34-44969.htm.

[iii] See Letter from Robert D. Evans, Director of the American Bar Association's Governmental Affairs Office to the United States Sentencing Commission (March 28, 2006), available at http://www.abanet.org/poladv/abaussc32806.pdf; Speech by SEC Commissioner: Remarks Before the Federalist Society (Sept. 21, 2006): "I strongly believe that the Commission should not view a company's waiver of privilege as a factor that will afford cooperation credit. ... Maybe it is time for the Commission to revisit this issue in a formal way and to clarify that waiver or fundamental rights and protections will not result in lesser allegations and/or remedies." (*available athttp://sec.gov/news/speech/2006/spch092106psa.htm)*; McLucas, Shapiro & Song, *The Decline of the Attorney-Client Privilege in the Corporate Setting*, 96 J. Crim. L. & Criminology 621 (2006).

[iv]*United States v. Stein*, 435 F. Supp 2d 330 (S.D.N.Y. 2006); 440 F. Supp. 2d 315 (S.D.N.Y. 2006).

[v] Memorandum from Paul J. McNulty, Deputy Attorney General, to Heads of Department Components and United States Attorneys (Dec. 12, 2006), available at http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.

[vi] The prior approval requirement resembles the existing obligation imposed on federal prosecutors to obtain prior approval from the Assistant Attorney General for the Criminal Division before a grand jury subpoena may be issued to an attorney relating to the attorney's representation of a client. United States Attorneys Manual § 9-13.410.

[vii] Senator Specter did not formally introduce the legislation. Instead, he brought the legislation to the Senate floor, made remarks about it and put the text of the legislation in the *Congressional Record*.

[viii] According to the press release issued by the Senate Judiciary Committee,

"The bill seeks to protect the attorney-client relationship by:

- Prohibiting federal lawyers and investigators from:
  - requesting that an organization waive its attorney-client privilege or work product doctrine; and
  - conditioning any charging decision or cooperation credit on waiver or non-waiver of privilege, the payment of an employee's legal fees, the continued employment of a person under investigation, or the signing of a joint defense agreement.
- Preserving the organizations ability to offer internal investigation materials to federal prosecutors, but only if such an offer is voluntary and unsolicited by the prosecutors.
- Allowing prosecutors to seek materials that they reasonably believe are not privileged."

[ix] A minority of jurisdictions has held that selective disclosure of privileged materials to the government does not constitute a global waiver. *See Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 611 (8th Cir. 1978) (en banc) (holding that only a limited waiver of the privilege occurred when party disclosed documents in SEC investigation); *In re LTV Sec. Litig.*, 89 F.R.D. 595, 605 (N.D. Tex. 1981) ("[D]isclosure of the additional materials to the SEC does not justify the class' discovery of the identity of those documents"); *In re Grand Jury Subpoena Dated July 13, 1979*, 478 F. Supp. 368, 373 (D. Wis. 1979) (holding that release of report to SEC and IRS is not waiver of the attorney-client privilege).

[x] *See* Memorandum from Robert D. McCallum, Jr., Acting Deputy Attorney General to Heads of Department Components and United States Attorneys (Oct. 21, 2005), available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/ crm00163.htm.

[xi] According to the cover memo accompanying the McNulty Memorandum: "Many of those associated with the corporate legal community have expressed concern that our practices may be discouraging full and candid communications between corporate employees and legal counsel. To the extent this is happening, it was never the intention of the Department for our corporate charging principles to cause such a result."