The McNulty Memorandum
Principles of Federal Prosecution of Business Organizations

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Principles of Federal Prosecution of Business Organizations

- Introductory Description of the Topic Presentation
- Review of United States Sentencing Guidelines for Organizations and the Essential Elements of An Effective Compliance Program and its Relationship to the McNulty Memorandum
- The Thompson Memorandum and Remarks by Deputy Attorney General James Comey Concerning Waiver of Privilege and Payment of Employer’s Attorney’s Fees and Cooperation in the Investigation of an Organization’s Misconduct
- Reaction to Application of the Thompson Memo in Government Enforcement Actions
  - Coalition of Interest Groups Criticize Thompson Policy and Practice
  - United States Sentencing Commission Withdraws Statement on Cooperation Relating to Waiver of Attorney-Client Privilege
  - Proposed Spector Legislation Prohibiting Waiver of Privilege and Providing for Selective Waiver
- The McNulty Memorandum and Remarks by Deputy Attorney General Paul J. McNulty
- Implications of McNulty Memorandum for Organizational Compliance and Cooperation in a Government Investigation
  - Does Waiver of Privilege Still Make Sense and When
  - Alternatives to Waiver During Cooperation
  - McNulty Policies and Overall Impact on Effectiveness of Organizational Compliance and Compliance Operations
UNITED STATES SENTENCING GUIDELINES FOR ORGANIZATIONS AND THE ESSENTIAL ELEMENTS OF AN EFFECTIVE COMPLIANCE PROGRAM

- Credit for Organizations Addressing Its Own Misconduct and Cooperation with Government Enforcement Authorities
- Relationship to Compliance

THE “THOMPSON MEMO”

- Nine factors in determining whether to charge a corporation with a crime:
  - the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime
  - the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management;
  - the corporation’s history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it;
  - the corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection;
  - the existence and adequacy of the corporation’s compliance program;
  - the corporation’s remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies.
  - collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution; and
  - the adequacy of the prosecution of individuals responsible for the corporation’s malfeasance;
  - the adequacy of remedies such as civil or regulatory enforcement actions.
WHAT CHANGED?

- Emphasis on completeness of cooperation
- Did the organization impede the government’s investigation through:
  - Overly broad assertions of legal representation of the organization and individuals
  - Give directions not to meet with or cooperate with investigators
  - Incomplete or delayed document production
  - Failure to promptly disclose known illegal conduct
  - Continued financial support of culpable employees
  - Joint defense agreements

THOMPSON MEMO PRINCIPLE IV
“Waiver of Privilege”

General Principle: In determining whether to charge a corporation, that corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government’s investigation may be relevant factors. In gauging the extent of the corporation’s cooperation, the prosecutor may consider the corporation’s willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to waive the attorney-client and work product privileges.
THOMPSON MEMO PRINCIPLE IV  
(Cont’d.)

One factor the prosecutor may weigh in assessing the adequacy of a corporation’s cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors, and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation’s voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances. The Department does not, however, consider waiver of a corporation’s privileges an absolute requirement, and prosecutors should consider the willingness of a corporation to waive the privileges when necessary to provide timely and complete information as only one factor in evaluating the corporation’s cooperation.

SELECTIVE WAIVER

- The majority of United States Court of Appeals (with the exception of the Eighth Circuit) have not recognized the concept of “selective waiver” of the privilege. The Courts which have considered the issue have typically adopted the rationale of the decision in U.S. v. M.I.T., 129 F.3d 681 (1st Cir. 1997).
- The First Circuit Court stated the following: “MIT chose to place itself in this position by becoming a government contractor. In short, MIT’s disclosure to the audit agency resulted from its own voluntary choice, even if that choice was made at the time it became a defense contractor and subjected itself to the alleged obligation of disclosure . . . the general principle that disclosure normally negates the privilege is worth maintaining.” See U.S. v. M.I.T., 129 F.3d 681 (1st Cir. 1997).
- Therefore, disclosure to government agents means waiver of privilege to all other third parties, including civil litigants with their own unique agendas and opportunities.
PROPOSED FEDERAL RULE OF EVIDENCE 502(c)

(c) Selective waiver. In a federal or state proceeding, a disclosure of a communication or information covered by the attorney-client privilege or work product protection — when made to a federal public office or agency in the exercise of its regulatory, investigative, or enforcement authority — does not operate as a waiver of the privilege or protection in favor of non-governmental persons or entities. The effect of disclosure to a state or local government agency, with respect to non-governmental persons or entities, is governed by applicable state law.

THOMPSON PRINCIPLE VI
PAYING FOR EVERYONE’S LAWYERS

- Thompson Memo Principle VI: “Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.”

- What is provided in the company’s by-laws or employment contracts or under state law regarding payment of attorney’s fees in a criminal or civil regulatory investigation and prosecution?

- What does the D&O policy provide, and what limitations are there?
**U.S. v. Stein,**

“The bottom line is plain enough. If the government means to take the payment of legal fees into account in making charging decisions only where the payments are part of an obstruction scheme – and thereby narrowly tailor its means to its ends – it would be easy enough to say so. But that is not what the Thompson Memorandum says . . . this aspect of the Thompson Memorandum is not narrowly tailored to achieve a compelling objective. It discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves. It does so in the face of state indemnification statutes that expressly permit businesses entities to provide those means because the states have determined that legitimate public interests may be served. It does so even where companies obstruct nothing and, to the contrary, do everything within their power to make a clean break of the facts to the government and to take responsibility for any offenses they may have committed. It therefore burdens excessively the constitutional rights of the individuals whose ability to defend themselves it impairs and, accordingly, fails strict scrutiny. The legal fee advancement provision violates the Due Process Clause.” 435 F. Supp.2d at 364-365.

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**IS THERE A CULTURE OF WAIVER?**

*American Bar Association, Task Force on Attorney-Client Privilege Report* recommends that none of the following be considered by Federal prosecutors in deciding whether to charge a corporation:

1. that the organization provided counsel to an employee or agreed to **pay an employee’s legal fees and expenses**;

2. that the organization entered into or continues to operate under a **joint defense, information sharing and common interest agreement** with an employee or other represented party with whom the organization believes it has a common interest in defending against the investigation;

3. that the **organization shared its records** or other historical information relating to the matter under investigation with an employee or other represented party; or

4. that the organization chose to retain or otherwise **declined to sanction an employee who exercised his or her Fifth Amendment right against self-incrimination** in response to a government request for an interview, testimony, or other information.
GOVERNMENT POLICY IN PRACTICE

- Overbroad and sometimes reflexive demands for the results of internal investigations.
- Insistence on admissions of wrongdoing by the corporation even while individual criminal and civil actions remained pending.
- Demands that corporations waive privilege and cease indemnifying employees e.g., KPMG.
- Inconsistent demands to investigate/refrain from investigating.
- Insensitivity to ongoing civil litigation.

DEPARTMENT OF JUSTICE’S INITIAL RESPONSE

“Waiver then is one sub-factor or element that might come into play in evaluating one of the nine factors in the Thompson analysis. Thus, recent criticisms of our position on waiver tend to distort its importance in the overall charging decision by inaccurately describing waiver as essential or the only thing prosecutors consider. Let me be very clear: a corporation that chooses not to waive the privilege will not necessarily be charged. Cooperation is but one factor in the analysis and waiver is considered in weighing the adequacy of the cooperation, but it is not a litmus test for cooperation.”

*Assistant Attorney General Paul McNulty*

Sept. 12, 2006

Before the Senate Judiciary Committee
EVOLUTION OF GOVERNMENT POLICY REGARDING WAIVERS

■ Thompson Memo:
  ➢ http://www.usdoj.gov/dag/cftf/corporateguidelines.htm
■ The Seaboard Report:
  ➢ http://sec.gov/litigation/investreport/34-44969.htm
■ The McNulty Memo:

THE McNULTY RETREAT

■ Waiver is not a prerequisite to a finding of cooperation
■ Imposes procedural burdens on requesting waiver within Department of Justice
■ Relegates requests for factual information from organization’s own internal investigations to the rare category
■ Indemnification of employees for legal fees and costs cannot be considered in making charging decisions.
MCNULTY MEMO ADDRESSES TWO CATEGORIES OF INFORMATION

- Category I: Purely factual information relating to the underlying conduct (organization charts, compilations of data, chronologies, purely factual interviews and other factual information developed during organization’s internal investigation)
- Category II: Attorney-Client communications and non-factual attorney work product (includes communications before, during and after the underlying conduct and includes legal advice and mental impressions of counsel).

BEFORE A REQUEST FOR WAIVER IS MADE . . .

- There must be a legitimate need established by the DOJ
- Collateral consequences to the corporation may be considered
- United States Attorney must authorize
- USA must get approval of the AAG for the Criminal Division for Category I and from the DAG for Category II Requests
- USA must personally communicate the request to organization.
REQUESTS FOR PRIVILEGED INFORMATION

- Must be for the least intrusive waiver necessary
- Must proceed in phases
  - Phase I: purely factual information
  - Phase II: attorney-client communications only if purely factual information provides an incomplete basis for a thorough investigation.

CATEGORY II INFORMATION

- Generally: This category includes advice and mental impressions of counsel for the organization
- Requires the United States Attorney to obtain written authorization from the Deputy Attorney General
- Refusal to comply with the Government’s request cannot be considered in making a charging decision.
EXCEPTIONS TO THE CATEGORY II PROCEDURES

- Category II information where the prosecutor seeks contemporaneous legal advice and the corporation or an employee is asserting reliance on advice of counsel as a defense
- Category II information where there is a basis for asserting the crime fraud exception
- Category I procedures are applicable even in these cases.

IMPACT OF THE McNULTY RETREAT

- Government initiated requests will be rare
- Limited Scope Waivers create potential for selective waiver and concomitant injustice
- May chill effective negotiations with some prosecutors
- Confusing, perhaps meaningless, distinction between being given credit for waiving, but not being punished for not waiving???
- Memo will do nothing to affect credibility with prosecuting entity.
IMPACT OF THE MCNULTY RETREAT
(Cont’d.)

- What will be the nature and quality of future interactions with prosecutors?
- How should you treat your employees in an investigation?
- Will demands for privilege waivers disappear?
- Will cooperation become “voluntary”?

MEMO WON’T AFFECT BEST PRACTICES OF PROSECUTORS OR COOPERATORS

- Voluntary waiver is still allowed
- Best practice has always been to provide purely factual information
- Indemnification decisions made based on the applicable law
- Where there is a colorable reliance on counsel defense, it can be brought to prosecutors’ attention early.
VOLUNTARY DISCLOSURE (MANDATORY OR VOLUNTARY)

- Individuals – Protected from mandatory disclosure – Fifth Amendment right against self-incrimination
- Business Organizations – Not protected by Fifth Amendment prohibition against compelled disclosure of information
  - Business organizations may do whatever is in its best interests
  - Government expects business organizations to partner in detecting and preventing misconduct and investigating its own wrongdoing

Compliance Guidance from the McNulty Memo

- A pre-existing corporate compliance program is one factor to be considered in determining whether to prosecute a corporation. [Compare with Chapter 8 of the U.S. Sentencing Commission’s Guidelines Manual (November 2006).]
- Mere existence of a compliance program will not shield the corporation from prosecution.
- In fact, commission of crimes despite a compliance program may indicate that the program is ineffective.
- A compliance plan which specifically prohibits the very conduct in question will not absolve a corporation from criminal liability.
- Critical factors in evaluating any compliance program are (1) whether the compliance program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees; and (2) whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to achieve business goals.
- Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation’s line of business.
Compliance Guidance from the McNulty Memo (cont.)

Prosecutors should consider:
- 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 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 of the corporation’s commitment to it.
- Employee discipline.

VOLUNTARY COOPERATION OR ABSOLUTE SURRENDER

“A disclosure to the Department of Justice of either criminal or civil misconduct is oftentimes a much better and more local option for business organizations who decide it is prudent to disclose misconduct, but it depends greatly on the facts and circumstances in each case and the potential outcome to be achieved by disclosure.”

Gabriel L. Imperato,
An Organization’s Duty to Self Report Misconduct: Mandatory or Voluntary
“Compliance Today” March 2006
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