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Litigation Alert

DOJ Revises Policy on Demanding Waiver of Attorney-Client Privilege

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On December 12, 2006, the Justice Department announced new guidelines for federal prosecutors to follow in charging business organizations. The new guidelines make significant changes to the circumstances under which the government may demand a waiver of the attorney-client privilege and work product protections from a company that is the subject of a criminal investigation.

BACKGROUND

The Department's new policy comes in the wake of the recent decision in the KPMG tax shelter case, which held that the Department's then-existing guidelines for the prosecution of business organizations, set forth in the so-called "Thompson Memorandum" (http://www.usdoj/dag/crft/corporate_guidelines.htm), were unconstitutional. *See United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006). In *Stein*, the court found that the Thompson Memorandum contained an inherent, unconstitutional threat — if a company agreed to indemnify its employees for their legal expenses and advance attorneys' fees in the absence of a statutory or contractual duty to do so, this may be construed as an act of non-cooperation and a factor weighing in favor of indictment. The court observed that, faced with the "corporate equivalent of capital punishment" if indicted, KPMG abandoned its long-standing practice of paying its partners' pre- and post-indictment legal expenses without regard to cost. Under KPMG's new policy, KPMG would not pay legal fees to any employee who refused to talk to the government or invoked the Fifth Amendment; fees were capped at $400,000; and payment of all legal expenses would be stopped if the employee were charged. The *Stein* court found that KPMG would not have adopted this new policy absent the implicit threats in the Thompson Memorandum.

SENATOR SPECTER'S RESPONSE

In response to *Stein*, Senator Arlen Specter (R-PA) recently introduced the "Attorney Client Privilege Act of 2006." Supported by several business and legal groups, including the ABA, the U.S Chamber of Commerce, as well as by former Attorney General Richard Thornburgh, the proposed Act would make it illegal for any government attorney or agent to "demand, request, or condition treatment on the disclosure by an organization, or person affiliated with that organization, of any communication protected by the attorney-client privilege or any attorney work product . . . ." The Act would also make it illegal to condition any civil or criminal charging decision as to whether an organization is cooperating with the government on:

- a valid assertion of the attorney-client or work product privilege;
- the provision of counsel or the payment of an employee's legal expenses;
- entering into a joint defense agreement with company employees;
- sharing of information regarding the government's investigation with company employees; or
- the failure of an organization to terminate employment or otherwise sanction an employee for invoking any constitutional rights in response to a request from the government.

Unlike the DOJ guidelines, which only govern the conduct of Department of Justice attorneys, Senator Specter's bill would apply to all federal agencies, including the SEC and the IRS.

THE DOJ'S RESPONSE: LARGELY STAYING THE COURSE

Senator Specter's proposed bill sets out a sweeping and categorical bright-line rule prohibiting government attorneys from demanding or requesting that an organization waive the attorney-client or work product privileges, or conditioning leniency on whether an organization acquiesces to such a request. In sharp contrast, the DOJ's response, authored by Deputy Attorney General McNulty, largely reiterates the policy statements of the Thompson Memorandum, but adds several layers of bureaucratic hoops that prosecutors must now jump through. The McNulty Memorandum is available at http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.

"Legitimate Needs" Test

First, the McNulty Memorandum sets out a "legitimate needs" test that federal prosecutors must now satisfy before requesting a waiver of attorney-client privilege. Whether there is a legitimate need depends upon:

- the likelihood and degree to which the privileged information will benefit the government's investigation;
- whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver;
- the completeness of the voluntary disclosure already provided; and
- the collateral consequences to a corporation of a waiver.

In practice, it is unlikely that this standard will be hard to meet. Prosecutors will argue that early access to the results of a company's internal investigation, witness statements and relevant documents will expedite, and thereby "benefit" the government's investigation, as well as enable the government to evaluate the accuracy and completeness of the company's voluntary disclosure.

Category I and Category II Information

Provided "legitimate needs" exist, the McNulty Memorandum directs prosecutors to seek the "least intrusive" waiver necessary to conduct a complete and thorough investigation. On this subject, the McNulty Memorandum distinguishes between "Category I" and "Category II" information.

Category I is meant to encompass "factual" information. It includes key documents, witness statements, factual interview memoranda, chronologies, fact summaries, and the like. Before requesting that a corporation waive applicable privileges for Category I information, the line prosecutor must obtain written authorization from the local U.S. Attorney, who in turn must provide a copy of the request to and consult with the Assistant Attorney General of the Criminal Division before granting the request. Notably, the McNulty Memorandum makes explicit 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, considerable pressure will remain on corporations to waive privilege. In short, the McNulty Memorandum provides no protection – other than several layers of bureaucratic approvals – for traditional fact-based materials. It remains to be seen whether requests for such information will become less routine in the face of those administrative hurdles.

Category II is intended to cover legal advice given to the corporation before, during and after the underlying conduct occurred. This includes attorneys' notes, memoranda and reports containing counsel's mental impressions, and conclusions or legal advice given to the corporation. Before requesting Category II information, the local U.S Attorney must obtain written authorization from the Deputy Attorney General and, if authorized, the request must be communicated in writing to the corporation. Unlike Category I information, a prosecutor may not consider a corporation's refusal to provide Category II information in making a charging decision. In the next breath, however, 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." How prosecutors can "favorably consider" a company's acquiescence in the disclosure of Category II information, while not negatively considering a company's failure to do so, is left unexplained. Hence, in terms of real world conduct, pressure will remain on companies to disclose Category II information upon request to avoid indictment.

Indemnification and Advancement of Fees

The subject of indemnification and advancement is discussed under the heading "Shielding Culpable Employees and Agents." This speaks volumes on how DOJ is likely to view this issue going forward. Distancing itself from Senator Specter's proposed bill, the McNulty Memorandum makes explicit that a company's "promise of support to culpable employees" by retaining them without sanction for their misconduct or providing them with information about the government's investigation pursuant to a joint defense agreement "may be considered by the prosecutor in weighing the value of a company's cooperation." Given that these are all pre-indictment considerations, where an employee has not even been charged (much less found guilty of any misconduct), this guidance is troubling.

Turning to the issue of legal costs, the McNulty Memorandum states that "[p]rosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment," noting that many states have indemnification statutes. Accordingly, "a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate." Again, the McNulty Memorandum breaks no new ground from the Thompson Memorandum on

this issue, and largely ignores the situation presented in *Stein*, where KPMG had a long-standing policy – but no statutory or contractual obligation – to provide for indemnification and advancement of fees. The McNulty Memorandum addresses the KMPG situation in a footnote, observing that "[i]n extremely rare cases, the advancement of attorney's fees may be taken into account when the totality of the circumstances show that it was intended to impede a government investigation."

In the absence of a statutory or contractual indemnification obligation, the circumstances under which indemnification will be viewed as legitimate as opposed to an act of obstruction lies in the murky waters of prosecutorial discretion. In an attempt to limit that discretion, the McNulty Memorandum states that approval must be obtained from the Deputy Attorney General before prosecutors may consider this factor in their charging decisions. But this "approval" process is naive at best, as a prosecutor's subjective assessment of the level of a company's cooperation is seldom expressed, in writing, on a factor-by-factor basis. Moreover, the McNulty Memorandum explicitly provides that a prosecutor may ask questions about an attorney's representation, including how and by whom attorneys' fees are paid. Such inquiries necessarily require companies to guess how their otherwise legitimate decisions to indemnify employees will be viewed by skeptical prosecutors. Thus, the constitutional infirmities of the Thompson Memorandum, identified in *Stein*, largely remain in the new DOJ policy statement.

PRACTICE POINTERS

- Indemnification and advancement of fees will not be seen as a lack of cooperation where the payments are made pursuant to either a statutory or contractual obligation.
- Companies should review their articles, bylaws and indemnity agreements to determine whether advancement of fees is permissive or mandatory. Mandatory advancement of fees will prevent the government from taking the position that such payments amount to obstruction. While many companies have mandatory advancement, others have instead opted for some discretion, so that they can refuse to advance fees to bad actors. Directors and officers should carefully weigh these considerations and make an informed decision on advancement.
- Where there is no such statutory or contractual obligation, a company's decision to indemnify and advance fees should be supported by established, long-standing policies, or by legitimate business needs, *e.g.*, to promote corporate goodwill, and thereby attract and retain high-quality employees, officers and directors.
- Companies should carefully consider when, if ever, it is appropriate to condition indemnification and advancement of fees on an employee's cooperation with government investigators and willingness to waive Fifth Amendment protections.
- Companies should carefully consider when, if ever, it is appropriate to enter into a joint defense agreement with allegedly culpable employees.
- Company counsel (in-house and external) should take great care when creating privileged and work product documents and materials, particularly those relating to items under government investigation. In the absence of legislative relief, many companies will choose to produce these materials to the government even though they are privileged.

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