
The fraudulent accounting debacles and accompanying collapses of major corporations such as Enron, Tyco International, and other companies shortly after the turn of the millennium rightly put the government on notice that stepped up oversight and prosecution of corporate accounting practices were required to restore investor confidence and faith.

However, what began as simple prosecutorial strategy – for example, informally encouraging corporations to waive the attorney-client privilege to gain access to its internal investigations in exchange for leniency – has morphed into an aggressive policy (as expressed in the Thompson Memorandum) over the last several years that undercuts the privilege and right of individuals to be represented by counsel paid for by their employer.

The Holder Memorandum

The roots of the Thompson Memorandum lie within another Department of Justice Memorandum entitled Federal Prosecution of Corporations (more commonly known as the “Holder Memorandum”), authored by then-United States Deputy Attorney General Eric Holder. The Holder Memorandum (the text of which can be found at http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html) sets forth factors prosecutors are to consider in determining whether to charge a corporation with a criminal offense. These factors include: “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 the corporate attorney-client and work product protection” as well as “whether the corporation appears to be protecting its culpable employees and agents” by “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.” The Holder Memorandum concludes that all of these factors “may be considered by a prosecutor in weighing the extent and value of a corporation’s cooperation.”

Thus, as far back as 1999, the groundwork had been laid to pressure corporations merely under investigation to waive the attorney-client privilege and lean on employees to cooperate by threatening to withhold attorneys fees or terminate their
employment. Although the Holder Memorandum is tempered to a certain extent by providing that the listed factors are not “outcome-determinative,” the stage had been set for an even more aggressive approach following the accounting disasters that occurred after 2000.

The Thompson Memorandum
The more aggressive approach came in the form of the Thompson Memorandum, written in 2003 by Larry D. Thompson, the United States Department of Justice Deputy Attorney General. The Thompson Memorandum (officially titled Principles of Federal Prosecution of Business Organizations and available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm) was the result of a Corporate Fraud Task Force established by Executive Order. The Thompson Memorandum did not significantly alter the relevant factors identified by the Holder Memorandum. Rather, the major change instituted by the Thompson Memorandum is that, unlike the Holder Memorandum, it was binding on federal prosecutors.

Consequently, under the Thompson Memorandum, in analyzing whether an indictment against a corporate entity is appropriate, a U.S. Attorney was required to weigh in favor of indictment if she or he suspected that a corporation was paying a culpable employee's attorneys fees, or if the corporation did not terminate that employee. Essentially, strict adherence to the Thompson Memorandum left a corporation with no choice in these matters. The import of these decisions is not in question. The stakes of a formal indictment (much less a conviction) are simply too high for most corporations to risk. With the virtual destruction of Arthur Anderson LLP upon indictment (few remember the company was eventually acquitted), the practical effect of the Thompson Memorandum was to effectively curtail the funding of attorneys fees for potentially culpable employees – to say nothing of making waiver of a corporation's attorney-client privilege a nearly foregone conclusion.

The Pendulum Begins to Swing Back?: United States v. Stein
A recent decision handed down by the federal District Court in the Southern District of New York may provide a glimpse at how courts will, in the future, view and potentially disallow aggressive prosecutorial tactics. The Stein opinion announces its intentions by immediately setting forth a summary of the constitutional principles involved in the decision: first, the right to a fundamentally fair trial; second, the right to the assistance of a lawyer; and third (although not a constitutional right, one recognized by the Stein court as an important consideration), the common practice of an employer paying for the legal expenses of an employee sued or accused of a crime emanating from his or her work. It is from the intersection of these principles that the main holding of Stein is drawn.

Factually, the Stein case addresses issues related to an IRS investigation of KPMG relating to allegedly abusive tax shelters developed, marketed, and implemented by KPMG. In keeping with a long-standing policy, KPMG agreed to pay for legal representation for certain officials who were facing potential criminal allegations. In one of its first meetings with the prosecutors, it was made clear to KPMG that any payment of legal fees to employees would not be looked on favorably by the government in determining whether KPMG would be indicted. As a direct result of this meeting and follow-up communications with prosecutors, KPMG announced that it would pay legal fees to employees; however, employees had to agree to fully cooperate with the government, which included foregoing any exercise of the employees' Fifth Amendment right to remain silent. Further, prosecutors insisted that KPMG stress to its employees that legal representation was not required to talk to federal investigators. Finally, KPMG made it clear that payment of legal fees would cease if the employee were criminally charged by the government.

This arrangement between KPMG and the prosecutors resulted in numerous employees being denied legal fees for alleged failure to cooperate with the government. KPMG also terminated the employment of some employees who failed to
adequately cooperate with the government. The issue ripened for decision in the *Stein* case when certain individually charged employees objected to the actions of the government.

The *Stein* court concluded that the principles set forth in the Thompson Memorandum, coupled with meetings between KPMG and federal prosecutors, allowed the conclusion that the government had “conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys,” resulting in KPMG’s revised policy regarding the payment of legal fees for employees. This led to the holding that the government, through the Thompson Memorandum and actions of the prosecutors, had violated the Fifth and Sixth Amendment rights of individual defendants by causing KPMG to cut off payment of legal fees and defense costs.

The court neatly summarized the rights of criminal defendants: “In everyday language, they are entitled to a fair shake.” More specifically, the *Stein* opinion held that the “Constitutional requirement of fairness in criminal proceedings not only prevents the prosecution from interfering actively with the defense, but also from passively hampering the defendant’s efforts.” Finally, the court concluded: “[T]he only question now before the Court is whether a criminal defendant has a right to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference...this Court concludes that such a right is basic to our concepts of justice and fair play. It is fundamental.”

**Implications of the *Stein* Decision**

The direct result of the *Stein* decision is, at a minimum, to make enforcement of the Thompson Memorandum provision regarding employee legal fees unconstitutional in the Southern District of New York. Unfortunately, the most important questions to corporations under investigation today cannot yet be answered definitively. From a judicial viewpoint, it may take some time for other federal trial and circuit courts to address the issues raised by *Stein*. Boding well for corporations, however, is the fact that *Stein* is a well-reasoned and well-articulated opinion that strikes a fair balance between prosecutorial discretion and the protection of constitutional rights. Moreover, it is likely that with the *Stein* opinion as ammunition, more corporations will fight aggressive prosecutorial methods in an attempt to protect their rights.

To those corporations currently under investigation, news of future changes may come as little solace. If nothing else, however, the *Stein* decision should provide corporations with, at a minimum, a modicum of leverage when dealing with the government. Even more encouraging, as this article went to press, it was expected that the Department of Justice would soon announce amendments to the Thompson Memorandum. Among the changes rumored include a provision whereby a federal prosecutor would need to secure approval from the Attorney General or his Deputy before seeking waiver of attorney-client privilege. Additionally, changes to the requirement that corporations waive attorneys fees for potentially culpable employees is being reconsidered in light of the *Stein* decision.

Finally, a bill has been introduced in Congress titled the “Attorney-Client Privilege Protection Act of 2006.” The text of the bill provides that the purpose of the proposed Act is “to place on each agency clear and practical limits designed to preserve the attorney-client privilege and work product protections available to an organization and preserve the constitutional rights and other legal protections available to employees of such an organization.” The Act would forbid federal agencies from conditioning civil or criminal charges on a valid exercise of the attorney-client privilege by an organization, by the provision of counsel to an organization’s employees, by the failure to terminate an employee or by the entry of a joint defense agreement. In short, the proposed Act would gut the Thompson Memorandum and level the playing field for corporations.

Although corporations certainly cannot claim to be out of the woods when faced with an aggressive federal prosecutor, signs exist that a sense of proportion and reasonability may soon reshape the investigative landscape.
The McNulty Memorandum

Just prior to this newsletter going to press, the Department of Justice released a memorandum intended to supersede the Thompson Memorandum, also entitled Principles of Federal Prosecution of Business Organizations, authored by Paul J. McNulty (the “McNulty Memorandum,” available at http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf). Although the ramifications of the McNulty Memorandum may not be fully known for some time, on its face it seeks to soften some of the stricter provisions of the Thompson Memorandum.

Specifically, the McNulty Memorandum addresses two issues. First, the Memorandum echoes the holding of the Stein decision: “Prosecutors generally should not take into account whether a corporation is advancing attorneys’ fees to employees or agents under investigation and indictment.” The Memorandum goes on to note that many state statutes give corporations permission to grant legal fees to employees in advance of a determination of guilt; therefore, a prosecutor should not consider such action by an entity as a failure to cooperate. The Memorandum does, however, allow a prosecutor to inquire as to whether a corporation or its employees are represented.

Second, the McNulty Memorandum addresses the “sacrosanct” attorney-client privilege. The Memorandum clearly states that waiver of the attorney-client privilege “is not a prerequisite to a finding that a company has cooperated in the government’s investigation.” However, if prosecutors determine there is a “legitimate need” for the information, they may still seek waiver. A four factor test is set forth to determine whether a legitimate need exits. If so, prosecutors may employ the “least intrusive” waiver necessary to conduct their investigation. The Memorandum then lists two categories of information. “Category I” information includes documents, witness statements, interview memoranda, and factual chronologies, summaries, and reports. To request a Category I waiver, a prosecutor must consult with the United States Attorney, who must in turn consult with the Assistant Attorney General for the Criminal Division before granting such a request. “Category II” information, meanwhile, includes attorney notes and reports which may contain the internal impressions of the attorney. Category II requests are to be rare, and require authorization from the Deputy Attorney General. In theory, these requirements will ensure that higher level review of waiver requests will occur prior to waiver. Finally, the Memorandum states that waiver of Category II information will be looked upon favorably in charging decisions.

Immediate reaction to the McNulty Memorandum has been mixed. Although many have applauded the Justice Department’s apparent decision to adopt the Stein holding in regard to the payment of attorneys fees to employees, several commentators, including the American Bar Association, have expressed concern as to how effective the Memorandum will be with respect to protection of the attorney-client privilege. On a pragmatic level, some fear that the Memorandum will do little to stem pressure tactics used by prosecutors. Specifically, no provision in the Memorandum prevents prosecutors from simply stating in an initial meeting with a targeted corporation that it would be advantageous for the entity to waive the privilege, in the hopes the entity will simply do precisely that. In the event that an entity waives the attorney-client privilege voluntarily, no communication with the Department of Justice is required.

The McNulty Memorandum indisputably rolls back portions of the Thompson Memorandum by mimicking the Stein holding regarding payment of employee attorneys fees. However, some time will be required to determine whether it affects prosecutorial strategy in seeking, and defense strategy in refusing, waiver of the attorney-client privilege.
Bill Michael joined Dorsey’s Minneapolis office in October 2006. He is a partner in the Trial group concentrating on white collar crime and regulatory defense, civil and criminal securities fraud, civil and criminal health care fraud, and complex financial and internal investigations.

Bill is an experienced trial attorney with more than 100 jury trials. He served for 10 years as a federal prosecutor in both the Southern District of Florida and the District of Minnesota. He has also been lead counsel in more than 70 federal trials throughout the country. While at the Department of Justice, he was selected to instruct federal prosecutors in trial skills at the National Advocacy Center, and in 1996 received the Department’s Director’s Award, from Attorney General Janet Reno, for exceptional service.

In addition to instructing on trial skills, Bill speaks nationwide in the areas of health care fraud, financial investigations and internal investigations. He also frequently teaches attorneys, investigators, and executives on appropriate techniques and measures when handling various criminal and regulatory matters.

Bill previously served as a member of the U.S. Army Special Forces (Green Berets). He is a frequent radio and television commentator and guest expert on a variety of issues, including terrorism, military justice and complex federal investigations.

“Joining the Dorsey firm is a tremendous personal privilege, he says. “The firm’s expertise in a varied range of practice areas, as well as its outstanding national reputation and diverse geographic presence will greatly contribute to superior representation of the client matters I am involved in. Additionally, the strength of the white collar group nationally, both in breadth and depth, is incredible and I look forward to working with this team in assisting the firm’s clients throughout the country.”
Keith Strong was named United States Magistrate Judge for Great Falls. He was appointed by Montana’s three federal district court judges. As reported by the Billings Gazette, Chief Judge Donald Molloy said Keith “has a wonderful reputation among lawyers and judges.”

Zach Carter’s appointment to the Board of Directors of Cablevision was recently noted in a Wall Street Journal article. Zach’s appointment occurred in the wake of published reports and voluntary disclosures that the company was facing issues with backdated stock options. Zach has been appointed to the newly-formed Special Litigation Committee. He, along with retired Justice of the Chancery Court of Delaware Grover Brown, will have full authority to make all decisions on behalf of the company concerning derivative lawsuits pending in the Chancery Court in Delaware. Cablevision operates the second largest cable system in the New York metropolitan area, as well as Madison Square Garden, the New York Knicks, the New York Rangers, and Radio City Music Hall.

Page Hall moderated a panel discussion titled “The Judges Speak to the Bar” at the 14th Judicial Conference of the United States Court of International Trade on November 6. The panel included Chief Judge Jane A. Restani, as well as other judges and a representative from the Department of Justice.

Bill Michael was the featured speaker at an engagement hosted by the Twin Cities Lawyers Subcommittee of the ABA White Collar Crime Committee. Bill’s subject was “War Stories from the Anderson/Zomax Insider Trading Trial.” Ed Magarian and Kim Fuhrman will participate in a panel on April 20, 2007 titled “What Every Company Should Know About Dealing with Search Warrants and Grand Jury Subpoenas.” The site of the panel has yet to be determined. If you are interested in attending this seminar, please contact Ed Magarian (magarian.edward@dorsey.com) for further information. CLE credit (including ethics credit) will be sought.

Chris Shaheen was mentioned in a New York Times article related to the Buca Inc. investigation. Chris, representing Buca, discussed what, if any, SEC actions would be taken against Buca. This took place in the wake of three former officers of Buca pleading guilty to federal fraud charges in connection with a scheme creating false profits.

Ed Magarian, Bill Michael, Holly Eng, and Bill Wernz all participated in a presentation at Dorsey’s sixth annual Corporate Counsel Symposium titled “Defusing Time Bombs: Critical Early Decisions in Internal Investigations.” The four Dorsey lawyers were joined by Stephen Kilgriff of SUPERVALU. If you are interested in obtaining the materials used in the presentation, please contact Ed Magarian (magarian.edward@dorsey.com).
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