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September 2008

Department of Justice Revises Its Policy for Criminally Charging Corporations As Appeals Court Criticizes Prior Practices

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Last week, the Department of Justice ("**DOJ**") retreated significantly from several of its most controversial practices in pursuing criminal cases against corporations and their employees as the Court of Appeals for the Second Circuit issued a rebuke of prior DOJ practices in this area.

The DOJ revised its corporate charging guidelines in several significant areas: waiver of privileges, advancing and indemnifying legal fees for employees, and operating under joint defense agreements. Under the new Guidelines, DOJ prosecutors may no longer condition a company's "credit" for cooperating with DOJ upon the company's waiver of attorney-client privilege and work product protections. Second, prosecutors are prohibited from considering whether a company is advancing or reimbursing an employee for his or her legal fees incurred in connection with the DOJ investigation. Third, federal prosecutors may no longer consider whether a company has entered into a joint defense agreement or whether the company has disciplined employees in deciding whether a company should receive credit for cooperating with DOJ.

Under prior practice, in pursuing investigations, the DOJ sometimes used two particularly aggressive tactics which significantly intruded on the attorney-client relationship. The first involved prosecutors threatening criminal charges to force waivers of corporate attorney-client privilege and work product protections. The second involved prosecutors threatening to count as a strike against corporations the advancement of legal fees to its officers, directors and employees, during the course of an investigation. The DOJ's corporate charging policies reflected a dichotomy – corporations were (and are) expected to conduct thorough internal investigations of suspected wrongdoing and to share those results with the government. Yet DOJ's positions on waiver of privilege, indemnification and joint defense agreements made it incredibly difficult to gather information from the very people most likely to have relevant information – the company's employees.

The government's new policy prohibiting these past practices was done begrudgingly, and only after tremendous pressure from Congress and the Courts, including the Second Circuit's decision last week affirming the dismissal of the indictment of 13 former partners and employees of KPMG.

THE STEIN/KPMG DECISION

On August 28th the Second Circuit U.S. Court of Appeals affirmed the dismissal of an indictment against 13 former partners and employees of KPMG. The case involved a massive tax investigation by the U.S. Attorney's Office for the Southern District of New York focused on KPMG and a number of its partners. The U.S. Attorney's Office made it clear to KPMG that the advancement of attorneys' fees was a significant consideration in whether or not KPMG would be charged. In response to this pressure, KPMG deviated from its longstanding policy of advancement by capping the amount of fees that it would advance, conditioning the payment of any attorney fees on full cooperation by the employee with the prosecutors, and cutting off any fees upon indictment.

Judge Lewis Kaplan found that the government deprived the defendants of their Sixth Amendment right to counsel by causing KPMG to impose conditions on the company's payment of fees. See *United States v. Stein, 435 F.Supp.2d 330, 367-373 (S.D.N.Y. 2006) (Stein I).* The Second Circuit resoundingly affirmed Judge Kaplan's decision that the government deprived the defendants "of their right to counsel under the Sixth Amendment by causing KPMG to place conditions on the advancement of legal fees to [defendants] and to cap the fees and ultimately end them."

THE REVISED DOJ CORPORATE CHARGING POLICY

The same day, in recognition of Judge Kaplan's findings and Congress's rumblings, Deputy Attorney General ("**DAG**") Mark Filip announced further revisions to the Corporate Charging Guidelines. The revisions reflect that cooperation credit would not depend on whether the company waived attorney-client privileges or work product protections; advanced attorneys' fees for the investigation, entered into joint defense agreements, or terminated or disciplined employees. The clear emphasis, according to DAG Filip, is the value of cooperation and the disclosure of relevant facts. In summarizing the changes, DAG Filip stated:

> "First, credit for cooperation will not depend on whether a corporation has waived attorney/client privilege or work product protection, or produced materials protected by attorney/client or work product protections. It will depend on disclosure of the facts. Corporations that timely disclose relevant facts may receive due credit for cooperation, regardless of whether they waive attorney/client privilege or work product protection in the process."
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> "[Additionally], the new policy instructs prosecutors not to consider whether a corporation has advanced attorneys' fees to its employees, officers or directors when evaluating cooperativeness …. A corporation's payment of or advancement of attorneys' fees to its employees will be relevant only in the rare situation where it, combined with other circumstances, would rise to the level of criminal obstruction of justice."
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> "[Next], under the new policy, federal prosecutors may not consider whether the corporation has entered into a joint defense agreement in evaluating whether to give the corporation credit for cooperating. There are legitimate reasons why a business would choose to enter, or not enter, into that kind of agreement. The government may, of course, ask that a corporation refrain from taking information the government provided it and disclosing that information to third parties."
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> "[Finally], prior guidance allowed prosecutors to consider whether a corporation disciplined or terminated

> employees for the purpose of evaluating cooperation. That is now disallowed. Prosecutors may only consider whether a corporation has disciplined employees that the corporation identifies as culpable, and only for the purpose of evaluating the corporation's remedial measures or compliance program."

The impact of these changes remains to be seen. The newly revised Principles of Federal Prosecution of Business Organizations make clear that a corporation may be required to disclose facts uncovered during its internal investigation. The law in most Federal Circuits generally suggests that disclosure of the results of an internal investigation to the government may be deemed a waiver of attorney/client privilege and work product protection in subsequent litigation. Indeed, a federal judge in San Francisco reaffirmed that longstanding majority position only last week.[1]

Further, while the participation in a joint defense agreement can no longer be viewed as per se uncooperative, a corporation may be penalized for some actions that occur as a result of a joint defense agreement. A corporation may obtain information only by participation in a joint defense agreement, yet may be prohibited by the agreement not to disclose such information without permission. Rather unrealistically, the new Principles explain that corporations seeking full credit for cooperation should fashion their joint defense agreements with enough flexibility to account for such requirements. Such "flexibility," as experience shows, will likely prevent the corporation from learning the information in the first place.

Lastly, these are internal policies of the Justice Department and in no way have the force of law. Perhaps more tellingly, other government agencies, most particularly the SEC, have said nothing about changing its policies regarding cooperation, most of which look chillingly like the now repudiated Thompson Memorandum.

Whether this effort by the Department of Justice will head off and deflect the legislation presently pending before Congress remains to be seen. If it does result in Congressional action being deferred, how prosecutors use the discretion still provided within the Principles will be watched with great interest in many quarters.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] U.S. District Court Judge Marilyn Patel of San Francisco ordered Howrey LLP to hand over attorney's notes to the former McAfee General Counsel to be used in his defense of civil charges stemming from the company's stock options backdating scandal. *SEC v. Roberts, Case No. 07-04580, N.D.Ca*.