Prosecutorial Discretion in the Context of Corporate Attorney-Client Relations: A Sketch

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Summary

The Justice Department enjoys prosecutorial discretion to bring criminal charges against a corporation, its culpable officers or employees, or both. For a corporation, indictment alone can be catastrophic, if not fatal, in some instances. The Thompson Memorandum, since replaced with guidelines in the U. S. Attorneys Manual, described the policy factors to be considered in the exercise of prosecutorial discretion. Two of the factors explicitly mentioned were whether a corporation had waived its privileges and whether it had cut off the payment of attorneys' fees for its officers and employees.

Justice Department policies and practices under the Thompson Memorandum led to constitutional challenges based on the Fifth Amendment's self-incrimination clause, the Amendment's due process clause, and the Sixth Amendment's right to counsel clause. Due process and right to counsel concerns were enough for a federal district court in New York to throw out the indictments of thirteen former partners and employees of an accounting firm, charged with creating and marketing fraudulent tax shelters, *United States v. Stein.* The Second Circuit affirmed on right to counsel grounds and consequently found it necessary to address the merits of the due process argument.

The House addressed the conflict in attorney-client protective legislation which it passed in the 110th Congress. Soon thereafter, the Department of Justice announced a revised policy concerning the circumstances under which a corporation's failure to waive its attorney-client privilege might influence the decision to prosecute it. The 110th Congress, which had previously amended the Federal Rules of Evidence relating to the inadvertent waiver of the attorney-client privilege, adjourned without taking further action on the House-passed legislation. Similar proposals, however, have been introduced in 111th Congress, H.R. 4326 (Representative Scott); S. 445 (Senator Specter). This report provides a brief discussion of the legislation, the legal background, and a chronology of related issues and events; it is an abbreviated version of CRS Report RL33842, *The McNulty Memorandum: Attorneys' Fees and Waiver of Corporate Attorney-Client and Work Product Protection*, by (name redacted), without the footnotes or citations to authority found in the longer report.

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Attorney-Client Privilege and Work Product Protection

The attorney-client privilege and work product protection are federal evidentiary privileges. The attorney-client privilege is one of the oldest common law privileges. The purpose of the privilege is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and the administration of justice. It protects confidential communications with an attorney made in order to obtain legal advice or assistance. It is available to corporations as well as to individuals. Although disclosure ordinarily waives the privilege, the circuits are divided over whether the privilege may survive disclosure for limited selective purposes (selective waiver) to government investigators or regulators.

At least since the Supreme Court announced its decision in *Hickman v. Taylor*, the federal courts have recognized that an attorney's work product gathered or created in anticipation of litigation enjoys qualified disclosure protection. The protection can be waived, but here too the circuits are divided on the question of whether it can survive a selective waiver in the form of disclosure to a government investigator or regulator.

Deputy Attorney General Memoranda and Related Matters

Five Deputy Attorneys General have issued memoranda to guide the exercise of prosecutorial discretion on the question of whether criminal charges should be brought against a corporation. Each includes provisions concerning the waiver of attorney-client and attorney work product protection, and all but one address employee legal costs and joint defense agreements as well.

Signed on June 19, 1999, the Holder Memorandum was designed to provide prosecutors with factors to be considered when determining whether to charge a corporation with criminal activity. It emphasized that "[t]hese factors are, however, not outcome-determinative and are only guidelines." The factors consisted of: "1. The nature and seriousness of the offense ... 2. The pervasiveness of wrongdoing within the corporation ... 3. The corporation's history of similar conduct ... 4. The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents ... 5. The existence and adequacy of the corporation's compliance program ... 6. The corporation's remedial actions ... 7. Collateral consequences ... and 8. The adequacy of non-criminal remedies ... ." In the section devoted to cooperation and voluntary disclosure, the Memorandum stated that "In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness ... to waive the attorney-client and work product privileges." The Memorandum also addressed the adverse weight that might be given a corporation's participation in a joint defense agreement with its officers or employees and its agreement to pay their legal fees. Although several academics and defense counsel expressed concern over the possible impact of the waiver feature of the Holder Memorandum, a survey of United States Attorneys conducted in late 2002 indicated that waivers were rarely requested.

On January 30, 2003, the Holder Memorandum was superseded by the Thompson Memorandum. The Thompson Memorandum was essentially a reissuance of its predecessor. Little of the text was new. That portion of both Memoranda devoted to the waiver of attorney-client and work product protections, and cooperation and voluntary disclosure in general—Part VI—was the same except for a new paragraph added in the Thompson Memorandum. The addition said nothing about waivers per se, but made clear the risks that a corporation ran if it failed to be forthcoming early on or continued to support those officers or employees that prosecutors thought culpable. Yet this is one of the few amendments to the Holder Memorandum. To some, the whole scale adoption of language from the earlier Memorandum suggested a Justice Department perception that the problem with the Holder Memorandum was not its content, but rather its application.

The policies articulated in the Holder and Thompson Memoranda were at least roughly similar to enforcement policies announced by a substantial number of federal regulatory agencies that call for voluntary corporate disclosure of statutory or regulatory violations. Some specifically mention the waiver of the attorney-client or work product protection, while others seem to speak with sufficient generality to justify consideration on enforcement and sanction questions.

In May of 2004, the United States Sentencing Commission amended the Commentary in the Sentencing Guidelines that some read as an endorsement of this new more aggressive approach. The change explicitly described the circumstances under which a corporation's failure to waive could have sentencing consequences. Although apparently crafted at least in part to ease corporate anxiety, it seemed to have the opposite effect. The following August, the American Bar Association voted to recommend that the Commentary be changed to state that waiver should not be considered a sentencing factor. The Commission instead removed from the Commentary the language that it had added in 2004.

Then on October 21, 2005 came the McCallum Memorandum. It made no revision in the Thompson Memorandum, but briefly addressed the manner in which the Thompson Memorandum's policy on waiver was to be implemented. The various United States Attorneys were instructed to prepare written guidelines for supervisory approval of requests for corporate waivers. The effort did little to assuage critics.

On May 15, 2006, the Federal Advisory Committee on Evidence reported a proposed evidentiary rule amendment crafted to resolve the splits in the circuits over the selective waiver of corporate attorney-client and work product protection. The selective waiver feature of the rule, however, proved to be highly controversial and was dropped from the proposed rule that the Judicial Conference recommended to the Congress. Congress ultimately accepted the recommendation and enacted a rule with only inadvertent waiver and protective order components.

Constitutional Concerns

In the summer of 2006, a court in the Southern District of New York held in *United States v. Stein* that implementation of the Thompson Memorandum's policy with regard to a corporation's reimbursement of the attorneys' fees of its employees and pressure on them to make incriminating statements violated the Fifth Amendment substantive due process rights of the employees, their Fifth Amendment privilege against self-incrimination, as well as their Sixth Amendment right to the assistance of counsel. The case began with the criminal tax investigation of an accounting firm and its employees. After prosecutors issued subject letters to more than twenty of the firm's officers and employees, they met with the firm's attorneys. At the meeting, the firm indicated that

it intended to "clean house;" that it had already taken some personnel actions; that it meant to cooperate fully with the government's investigation; and that its objective was to avoid indictment of the firm and the fate of Arthur Andersen by acting so as to protect the firm and not the employees and officers targeted. The firm indicated that it had been its practice to cover the litigation costs of its employees, but that it would not pay the fees of employees who refused to cooperate with the government's investigation or who invoked their Fifth Amendment privilege. Prosecutors referred to the Thompson Memorandum and the Sentencing Guidelines and indicated they would take into account any instances where the firm was legally obligated to pay attorneys' fees. They also indicated, however, that misconduct should not be rewarded, and that prosecutors would examine "under a microscope" the payment of any fees that were not legally required.

In consultation with prosecutors, the firm sent the subjects of the investigation form letters informing them that attorneys' fees would be capped at $400,000 and that fees would be cut off for any employee charged with criminal wrongdoing. Thereafter, prosecutors advised the firm's attorney when one of the firm's employees proved uncooperative; the firm then advised the employees that they would be fired and their attorneys' fees cut off if they did not cooperate; and did so in cases of those employees who remained recalcitrant. The firm then entered into a deferred prosecution agreement with prosecutors for the eventual dismissal of charges under which it agreed to waive indictment; pay a $456 million fine; accept restrictions on its practice; waive all privileges including, but not limited to, attorney-client and attorney work product; and provide the government with extensive cooperation in its investigation and prosecution of the firm's former officers and employees.

The by-then indicted former officers and employees moved to have their indictments dismissed on constitutional grounds. The court agreed that constitutional violations had occurred but declined at least temporarily to dismiss the indictments under the understanding that the government had agreed that it would accept, without prejudice to the firm in its deferred prosecution agreement or otherwise, any fee arrangement that the firm should come to with its former officers and employees. It subsequently dismissed the indictment against 13 of the defendants, but declined to do so with respect to three others who had left the firm sometime previously and therefore had not been the victims of the misconduct the court perceived.

On appeal, the government contended that its conduct could not constitute a violation of the Sixth Amendment because (1) it had occurred before indictment and thus before the right to counsel had attached and (2) the employees had no Sixth Amendment right to pay for their counsel of choice with someone else's money. Attachment was no obstacle, replied the court, when the motive or at least the clearly foreseeable result was to impede the employee's criminal defense after he was indicted. As for the Supreme Court's someone else's money (forfeitable assets) comment, it referred to defendants using the government's money, money to which they had neither right nor expectation. Here, the court said the defendants had every reason to expect that the firm would have assumed their legal expenses, but for the government's intervention.

In the eyes of the district court, the government's conduct so struck at the heart of the adversarial nature of the criminal justice system that it commanded redress without reference to proof of actual prejudice to its victims, and warranted the rarely granted dismissal of the indictments.

The court of appeals agreed. It held (1) that the firm's "adoption and enforcement of a policy under which it conditioned, capped and ultimately ceased advancing legal fees to defendants followed as direct consequence of the government's overwhelming influence;" (2) that the firm's "conduct therefore amounted to state action;" (3) that "the government thus unjustifiably

interfered with defendants' relationship with counsel and their ability to mount a defense in violation of the Sixth Amendment;" and (4) that "the government did not cure the violation."

Legislative Activity in the 109th Congress

Both the House and Senate Judiciary Committees held hearings on the policy reflected in the Thompson Memorandum during the 109th Congress, and in its final days, Senator Specter introduced S. 30 which, among other things, would have prohibited federal authorities from requesting a waiver of organizational attorney-client or work product protection or predicating the adverse exercise of prosecutorial discretion of the absence of such a waiver or the payment of attorneys' fees for their employees or officers.

McNulty Memorandum

The McNulty Memorandum, announced December 12, 2006, superseded the Thompson and McCallum Memoranda. While it incorporated a great deal of the substance of its predecessors, the McNulty Memorandum rewrote the principles and commentary that address corporate attorney-client and work product protection waivers as well as those covering the payment of employee litigation costs.

It dropped the specific reference to the waivers from the general statement of factors to be weighed when considering whether to charge a corporation. Where earlier Memoranda stated that waiver was not an "absolute" requirement for the favorable exercise of prosecutorial discretion, suggesting to some that it was a requirement under most circumstances, the McNulty Memorandum suggested that prosecutors' waiver requests were to be considered the exception rather than the rule.

Moreover, the McNulty Memorandum divided attorney-client and work product material into two categories. Category I consisted of factual information. Category II material was described in much the same manner as opinion work product material. The Memorandum cautioned prosecutors that only in rare circumstances should they seek the waiver of Category II material. A request for Category I had to be approved by the United States Attorney in consultation with the head of the Department's Criminal Division; a request for Category II information required prior approval of the Deputy Attorney General. A corporation's refusal to waive cannot be considered in the exercise of prosecutorial discretion. The Memorandum also added an explicit provision concerning attorneys' fees, declaring that, "Prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment," except in "extremely rare cases" where it can be taken into account with the approval of the Deputy Attorney General.

Legislative Activity in the 110th Congress

Senator Specter introduced the Attorney-Client Privilege Protection Act of 2007 (S. 186) early in the 110th Congress. The bill as introduced is identical to S. 30 (109th Cong.) that the Senator introduced at the end of the last Congress. It is also identical to H.R. 3013 introduced in the House by Representative Scott and virtually identical to the version of that bill passed by the

House. Senator Specter later introduced S. 3217 which would have carried forward, with some modification, the features of the House bill.

Following House passage of H.R. 3013, then Deputy Attorney General Mark Filip issued a superseding memorandum accompanied by a revised chapter of the U.S. Attorneys Manual. The 110th Congress adjourned without further action of the proposals.

Filip Memorandum

The Filip Memorandum dates from August 28, 2008. Following the pattern of earlier Memoranda, much of what appears in the U.S. Attorneys Manual is a verbatim recitation of the McNulty Memorandum. Some things, however, are new. The Filip Memorandum revisions "concern what measures a business entity must take to qualify for the long-recognized 'cooperation' mitigating factor, as well as how payment of attorneys' fees by a business organization for its officers or employees, or participation in a joint defense or similar agreement, will be considered in the prosecutive analysis."

Thus, the Memorandum declares that "a corporation remains free to convey non-factual or 'core' attorney-client communications or work product—if and only if the corporation voluntarily chooses to do so—prosecutor should not ask for waivers and are directed not to do so." Nevertheless, "cooperation is a potential mitigating factor, by which a corporation . . . can gain credit in a case that otherwise is appropriate for indictment and prosecution." The entity's receipt of credit for its cooperation turns on its timely disclosure of information relating to the government's investigation, regardless of whether the entity acquired or maintains information under circumstances that entitle it to claim attorney-client or attorney work product protection. Nor does a corporation's payment of its employees' attorneys' fees or its entry into a joint defense agreement preclude credit for cooperation.

On the other hand, "[i]f the payment of attorney fees were used in a manner that would otherwise constitute criminal obstruction of justice—for example, if fees were advanced on the condition that an employee adhere to a version of the facts that the corporation and the employee knew to be false—these Principles would not (and could not) render inapplicable such criminal prohibitions."

This represents a substantial modification of the previous standard in the McNulty Memorandum which explicitly permitted prosecutors to weigh negatively any number of specifically identified impediments—some well short of a criminal obstruction of justice.

Legislative Activity in the 111th Congress

Early in the 111th Congress, Senator Specter introduced the Attorney-Client Privilege Protection Act of 2009 (S. 445), for himself and Senators Landrieu, Carper, Kerry, McCaskill, and Cochran. It is essentially the same as the later Specter proposal in the 110th Congress (S. 3217). Towards the end of the first session, Representative Scott (Va.) introduced a similarly styled Attorney-Client Privilege Protection Act of 2009 (H.R. 4326), for himself and Representatives Conyers, Smith (Tex.), Nadler, Delahunt, Coble, and Lungren. It is a replica of the bill which the House passed in the 110th Congress (H.R. 3013).

The two 111th Congress proposals are much the same, although with occasional differences. They espouse a common purpose: "to place on each agency clear and practical limits designed to serve 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."

They would define "attorney-client privilege" as currently understood under the federal law, that is as "the attorney-client privilege as governed by the principles of the common law, as they may be interpreted by the courts of the United States in the light of reason and experience, and the principles of article V of the Federal Rules of Evidence." They would adopt an equally contemporaneous definition of "attorney work product," i.e., "materials prepared by, or at the direction of an attorney in anticipation of litigation, particularly any such materials that contain a mental impression, conclusion, opinion, or legal theory of that attorney."

The Specter bill (S. 445) alone would insert a definition of "organization." The definition would foretell the scope of the bill, since the bill's commands speak to how federal prosecutors and investigators may deal with organizations. The bill's definition has two distinct components—what is an organization and what is not for purposes of the bill. It describes organizations as persons other than human beings and expressly includes state, local, and municipal governmental entities. The absence of similar definition in the Scott bill (H.R. 4326) leaves open the question whether federal, state, local, and municipal entities fall within the scope of its provisions. The omission of federal and tribal governmental entities from the Specter bill's definition suggests that they would not be considered organizations for purposes of the bill.

The Specter bill (S. 445) would exclude from the definition of organization, drug cartels (continuing criminal enterprises (21 U.S.C. 848(c))); designated foreign terrorist organizations (18 U.S.C. 2339B(g)(6)); and entities charged under the RICO provisions. The RICO exemption may raise questions. Common business organizations do not ordinarily include drug cartels or designated foreign terrorists organizations, but they are infrequently associated with RICO prosecutions. Federal racketeer influenced and corrupt organization (RICO) provisions proscribe, among other things, the patterned commission of two or more other federal or state offenses in order to conduct the affairs of an enterprise whose activities affect interstate or foreign commerce, 18 U.S.C. 1962(c). Depending upon the circumstances, an organization might either be an offender or the victimized intestate enterprise, 18 U.S.C. 1961(3), (4). Since the bill uses the phrase "entity charged," it might be thought to apply only to offending organizations and only after they are indicted. Such a reading, however, may be more narrow than its sponsors intend.

In somewhat different terms, the two bills would bar the Justice Department and other federal investigative, regulatory or prosecutorial agencies from demanding that an organization: (1) waive its attorney-client privilege or attorney work product protection; (2) decline to pay the legal expenses of an employee; (3) avoid joint defense, information sharing or common interest agreements with its employees; (4) refrain from disclosing information concerning an investigation or enforcement action to employees; or (5) terminate or discipline an employee for the employee's exercise of a legal right or prerogative with respect to a governmental inquiry.

They would also preclude using such organizational activity as the basis in whole or in part for a civil or criminal charge against the organization. Only the Specter bill (S. 445) would also prohibit the government from rewarding an organization for waiving its attorney-client privilege or work product protection.

Both bills would allow the government to request information it believes is beyond the scope of the attorney-client privilege or the attorney work product protection. Also, they would not prevent an organization, on its own initiative, from sharing the results of an internal investigation with authorities, although the Specter bill (S. 445) would preclude the government from considering such a waiver positively.

Each of the bills declares that its proposals are not intended to apply to situations when the government is statutorily authorized to demand a waiver. It is not entirely clear what subsection 3014(e) is intended to preserve when it refers to "any other federal statute that *may* authorize[s], in the course of an examination or inspection, an agent or attorney of the United States to require or compel the production of attorney-client privilege material." Many federal statutes authorize the examination or inspection of corporate records and other materials. Few, if any, federal statutes state in so many words that federal inspectors may examine otherwise privileged attorney-client or work product material. In fact, if privilege is mentioned at all, the statute is likely to preserve the privileged material against inspection.

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