DAVIS POLK & WARDWELL

Date: **September 5, 2008**

To: **Interested Persons**

Re: **White Collar Update**

For two separate but related reasons, August 28, 2008, was an especially significant day for the Department of Justice ("DOJ"), the white collar defense bar, and the corporate community.

First, and most importantly, DOJ issued its third major revision to its corporate charging principles in the last five years. This most recent iteration of DOJ's corporate charging principles reflects the second effort by DOJ to respond to many of the concerns and issues raised by the legal community in recent years, and was clearly issued, at least in part, in an attempt to fend off proposed legislation intended to address perceived excesses in DOJ's policies and practices. These newest revised principles effect material changes to DOJ's corporate charging policy and further undo certain of its prior proclamations. They were issued by Deputy Attorney General Mark Filip and supersede Deputy Attorney General Paul J. McNulty's December 2006 Memorandum (the "McNulty Memo"), which had superseded Deputy Attorney General Larry D. Thompson's January 2003 Memorandum (the "Thompson Memo"), which had superseded Deputy Attorney General Eric H. Holder's June 1999 Memorandum (the "Holder Memo"). Essentially, and most notably, it is now generally DOJ's position that, as long as a company discloses the relevant facts, DOJ will not withhold cooperation credit from that company, even if the company:

(a) does not waive the attorney-client privilege or work product protection,
(b) advances the attorneys' fees of its employees, and
(c) enters into joint defense agreements.

As set forth in greater detail below, while on paper the changes that appear in this newest DOJ policy (the "Filip Policy") appear to be quite substantial in certain important respects, it remains to be seen (1) how the perceived changes will actually play out in practice, (2) whether they will be adopted by other law enforcement and regulatory agencies, and (3) whether they will succeed in derailing proposed legislation regarding the attorney-client privilege.

Second, a three-judge panel of the U.S. Court of Appeals for the Second Circuit unanimously affirmed Southern District Judge Lewis Kaplan's dismissal of criminal charges against 13 former KPMG employees in *United States v. Stein*. This was particularly noteworthy because Judge Kaplan's dismissal of these charges was based on his finding that prosecutors in the Southern District of New York, acting pursuant to DOJ's corporate charging policy in effect at the time, violated the defendants' Sixth Amendment rights.

I. Revised DOJ Charging Principles

DOJ's newly-issued corporate charging guidance, which was effected as a revision to the U.S. Attorneys' Manual, modifies the framework in which DOJ will evaluate a company's cooperation with its investigations, particularly vis-à-vis waivers of the attorney-client privilege and work production protection. Previously, pursuant to the McNulty Memo, federal prosecutors could, upon demonstrating a "legitimate need," request privilege waivers of a company and, to the extent the information sought was factual in nature (so-called Category I information) – as opposed to non-factual attorney work product (so-called Category II information) – could consider a company's refusal to comply with such a request in evaluating the company's cooperation. (Notably, this particular McNulty policy, which had only been instituted in December 2006, was itself a fairly momentous change from the prior Thompson and Holder Memos with respect to privileged communications and work product, and was also clearly in response to mounting pressure from the legal community and proposed legislative solutions to the perceived problems with DOJ's policies.)

The Filip Policy dispenses with the McNulty Memo's two-tiered analysis of privileged information and articulates a simplified cooperation standard:

> the government's key measure of cooperation must remain the same as it does for an individual: has the party timely disclosed the relevant facts about the putative misconduct? That is the operative question in assigning cooperation credit for the disclosure of information – *not* whether the corporation discloses attorney-client or work product materials.

U.S. Attorneys' Manual, § 9-28.720(a) (emphasis in original). As a result, federal prosecutors also may not request the disclosure of communications reflecting legal advice and non-factual attorney work product, except in rare instances in which an advice-of-counsel defense has been asserted, or where the communications are in furtherance of a crime or fraud. *Id.* at § 9-28.720(b).

However, while the concept of "we don't care if you waive, just provide the relevant facts," might sound simple enough, and therefore easily achievable, the challenges to providing the "relevant facts" without waiving privilege may in fact be greater than one would have initially thought. This is because in many cases, the "relevant facts" are only learned through privileged communications between company counsel and company employees in the course of an internal investigation. In this regard, it is important to note that the Filip Policy expressly underscores both the importance of companies conducting internal investigations, and the importance of companies providing relevant information to DOJ, even if that information was only learned through a privileged internal investigation. Specifically, the Filip Policy states that (1) DOJ "encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose the relevant facts to the appropriate authorities," *id*. at § 9-28.750, and (2) "[t]o earn [cooperation] credit . . . the corporation does need to produce, and prosecutors may request, relevant factual information – *including relevant factual information acquired through [interviews by company counsel]*, unless the identical information has otherwise been provided." *Id.* at § 9-28.720(a), n. 3 (emphasis supplied). Nonetheless, at the same time, the Filip Policy also provides that "[t]o receive cooperation credit for providing factual information, the corporation need not produce, and prosecutors may not request, protected notes or memoranda generated by the lawyers' interviews." *Id.*

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So where exactly does that leave a company that has conducted a privileged internal investigation and that wants to provide the government with the "relevant facts" it has learned through that investigation? While the Filip Policy is conspicuously silent on this critical question, there should be a variety of approaches that can be pursued which would effectively minimize the risk of waiver while simultaneously providing the government with the information it wants. These include, for instance, giving attorney proffers which do not provide specifics in terms of attributions, or inviting the government to interview certain employees about particular matters. Assuming the cooperation of DOJ prosecutors in working through these important issues, we will hopefully see over the coming months a new set of working protocols being developed that will satisfy the understandable and important needs of both the corporate world and DOJ. Such protocols should make it more likely that a company will be able to successfully oppose future waiver arguments (and withhold privileged and protected interview notes and memoranda from production) in any related investigation, litigation or other proceeding.

The Filip Policy also addresses two other key issues. First, as under the McNulty Memo, it generally precludes consideration of a company's advancement of attorneys' fees to individual employees under investigation. *Id.* at § 9-28.730. Second, the Filip Policy imposes new guidelines regarding joint defense agreements. Under the new regime, "the mere participation by a corporation in a joint defense agreement does not render the corporation ineligible to receive cooperation credit, and prosecutors may not request that a corporation refrain from entering into such agreements." *Id.* at § 9-28.730. The Filip Policy does note, however, that in entering into such agreements, a corporation may not wish to preclude itself from "providing some relevant facts [to the government] . . . and thereby limiting its ability to seek . . . cooperation credit." *Id.* Accordingly, the policy suggests that corporations "craft[] or participat[e] in joint defense agreements, to the extent they choose to enter them, that provide such flexibility as they deem appropriate." *Id.* Relatedly, the Filip Policy permits prosecutors to request – and consider a company's response to that request – that the company at times not share certain information with others. As a result, companies seeking to enter into joint defense arrangements while maintaining the ability to earn cooperation credit must ensure that the arrangements permit them to (1) disclose to DOJ any relevant facts they learn from the other parties to the joint defense agreement, and (2) withhold from their counterparties any information specified by DOJ.

While the private sector's response to the Filip Policy has been generally very positive, it is important to recognize that its issuance has not changed the defense landscape as much as some may hope. As noted above, it does not eliminate the risk that, in certain circumstances, providing "relevant facts" to DOJ may be deemed to have constituted a privilege waiver. In addition, other than with respect to the privilege sections, the Filip Policy is basically a substantively light mark-up of DOJ's prior corporate charging policies – *i.e.*, DOJ still considers most of the same factors it considered under its prior policies when evaluating whether to seek charges against a company, including, for example, whether the company has "appropriately disciplined wrongdoers" (which is part of DOJ's evaluation of "whether the corporation has taken meaningful remedial measures"). *Id.* at § 9-28.900(B). Moreover, the Filip Policy obviously only applies to DOJ, and does not bind any other federal or state law enforcement or regulatory agencies, such as the Securities and Exchange Commission. Finally, as is quite clear from the fact that over the last 10 years Deputy Attorneys General Filip, McNulty, Thompson and Holder have each issued corporate charging policies that at the time were considered ground-breaking, this purely internal DOJ policy is obviously subject to unilateral and material revision by DOJ at any point in the future.

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Largely because of the above residual concerns, many practitioners have continued their call for passage of the Attorney-Client Privilege Protection Act of 2008 which, if passed in its current form, would preclude "an agent or attorney of the United States . . ." in "any [f]ederal investigation or criminal or civil enforcement matter . . . ," from requesting that a company waive the attorney-client privilege or work production protections. It would further prevent such agents or attorneys from considering a company's valid assertion of privilege, entry into a joint defense agreement, or advancement of attorneys' fees to current or former employees, in evaluating a company's cooperation or reaching a charging decision. It remains unclear, however, whether there exists sufficient support in Congress to ensure passage. Indeed, although Senator Arlen Specter has expressed continued support for the legislation, *see Specter Responds to DOJ's Revisions of Attorney-Client Privilege Guidelines*, August 28, 2008 ("[The Filip Policy is a] step in the right direction but [it] leave[s] many problems unresolved so that legislation will still be necessary."), Senator Patrick Leahy, a previous supporter of the legislation, appears to have reserved judgment on whether legislation will now be necessary. *See Comments Of Senator Patrick Leahy On The Department Of Justice's New Policy Regarding The Corporate Attorney-Client Privilege*, August 28, 2008 ("[The Filip P]olicy ensures that the Department will evaluate corporate cooperation based on the information provided, rather than whether or not a corporation waived the privilege . . . I hope that other federal agencies working with the Justice Department on corporate investigations will wholeheartedly embrace this new approach.")

II. *United States v. Stein*

As noted above, in a separate but related development, the Second Circuit upheld Judge Kaplan's decision in the *Stein* case, and ruled that the U.S. Attorney's Office for the Southern District of New York (the "USAO") violated the Sixth Amendment rights of certain individuals under investigation. As has been widely reported, Judge Kaplan ruled last year that the USAO, in connection with an investigation of KPMG, LLP ("KPMG"), improperly forced KPMG to stop advancing attorneys' fees for any employees who refused to cooperate with the USAO or who were indicted. Judge Kaplan found that KPMG's actions were the direct result of pressure applied by the USAO, and concluded that the USAO had thus violated the employee defendants' rights under the Fifth and Sixth Amendments.

The Second Circuit affirmed Judge Kaplan's ruling, and held that the USAO violated the Sixth Amendment rights of the KPMG employee defendants at issue.[1] *United States v. Stein*, 07-3042-cr, 2008 U.S. App. LEXIS 18524 (2d Cir., Aug. 28, 2008). The Court's ruling contained four essential elements. First, the Court upheld Judge Kaplan's factual finding that, *inter alia*, KPMG's decision to condition fee advancement on cooperation and to halt such advancement upon indictment was the result of the DOJ policy in effect at the time (*i.e.*, the Thompson Memo) and the actions of the individual prosecutors under that policy. Second, and predicated on this factual finding, the Court held that there existed a sufficient nexus between the USAO and KPMG that the latter's conduct constituted state action. Specifically, it ruled that KPMG, which was acting under threat of indictment, "operated as a willful participant in joint activity with the government . . . , because the USAO significantly encouraged KPMG's [actions and because] . . . prosecutors became entwined in the control of KPMG." *Id.*, at *39, 41 (internal quotations omitted). Third, the Court ruled that, although certain of the USAO's conduct occurred pre-indictment, the conduct was

[1] Because the Second Circuit ruled that there existed an uncured Sixth Amendment violation, it did not reach the Fifth Amendment issues.

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intended "to impair the [employees'] relationship with counsel post-indictment" and, as a result, it could "ripen into cognizable Sixth Amendment deprivations upon indictment." *Id.*, at *55. Fourth and finally, the Court held that the USAO – by causing KPMG to condition the advancement of fees on cooperation and to halt such advancement upon indictment – had unjustifiably interfered with the individual defendants' "right to defend [themselves] using whatever assets [they had] or might reasonably and lawfully obtain." *Id.*, at *62. Because the USAO had not cured this violation, the Court upheld Judge Kaplan's dismissal of the indictments.

Although the Thompson Memo is no longer in effect and, as described above, DOJ's current policy now precludes federal prosecutors from considering whether companies are advancing attorneys' fees in most instances when evaluating cooperation, the Second Circuit's affirmance of Judge Kaplan's landmark decision in *Stein* has nonetheless validated several concerns the white collar bar had had with certain of DOJ's practices. In so doing, we suspect that going forward, many in the bar and on the bench will be encouraged to more closely scrutinize and challenge the policies and practices of DOJ and other law enforcement and regulatory agencies to ensure the preservation of established protections and privileges and that the constitutional rights of individuals are appropriately upheld.

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For further information relating to the foregoing, please contact a member of Davis Polk's White Collar Criminal Defense Group.

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