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THE MCNULTY MEMORANDUM: PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS

On December 12, 2006, Deputy Attorney General Paul McNulty released a memorandum (the "McNulty Memorandum"), outlining the factors to be considered by the Department of Justice ("DOJ") when determining whether to bring criminal charges against a company. The McNulty Memorandum revises and supersedes the January 20, 2003 memorandum authored by former Deputy Attorney General Larry Thompson, commonly referred to as the "Thompson Memorandum."

While the nine factors considered by the DOJ described in the McNulty Memorandum are identical to those discussed in the Thompson Memorandum, the McNulty Memorandum specifically addresses the circumstances under which prosecutors are authorized to request a waiver of the attorney-client privilege or work-product protection. In addition, the McNulty Memorandum addresses whether the DOJ may consider a company's advancement of attorneys' fees to individual employees in its evaluation of the company's cooperation. The nine factors weighed by the DOJ in assessing whether to bring corporate criminal charges are:

Cooperation and Disclosure. The DOJ evaluates the company's timely and voluntary disclosure of wrongdoing, including its willingness to cooperate in the investigation of its employees and agents. Although the Company's willingness to waive the attorney client privilege or work product protection is an element considered by the DOJ when evaluating the completeness of the company's cooperation, the McNulty Memorandum makes clear that the government may request such materials only when there is a "legitimate need for the privileged information to fulfill their law enforcement obligation." (*McNulty Memorandum* at 8). Whether a "legitimate need" exists depends upon:

- the likelihood and degree to which the privileged information will benefit the government's investigation;
- whether the information may be obtained in a timely manner through means other than a waiver;
- the completeness of prior voluntary disclosures; and
- the collateral consequences to the company of a waiver.

(*Id.* at 9). When a legitimate need for privileged material exists, prosecutors must seek the "least intrusive waiver necessary to conduct a thorough investigation," and must first request purely factual information or "Category I" information. (*Id.*) Category I information includes, among other things, factual chronologies, factual summaries, witness statements and interview memoranda. Written authorization from the U.S. Attorney is required *before* a prosecutor may request Category I information from a company. Moreover, the U.S. Attorney must consult with the Assistant Attorney General for the Criminal Division prior to granting or denying a Category I request. The company's response to the government's request for waiver of privilege of Category I information may be considered when evaluating the extent of the company's cooperation.

If the Category I information obtained "provides an incomplete basis to conduct a thorough investigation[,]" the U.S. Attorney may request attorney-client communications and non-factual work product ("Category II") upon written authorization from the Deputy Attorney General. (*McNulty Memorandum* at 10). A company's decision not to provide Category II information, however, may not

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be considered by the DOJ when deciding whether to charge the company criminally. (*Id*.). A company's decision to produce Category II information may be considered by the DOJ when determining whether to initiate a criminal action. (*Id*.).

The McNulty Memorandum also addresses the issue of whether the advancement of attorneys' fees by the company to individuals within the scope of the investigation may be considered by the government when evaluating the company's cooperation. Prior to the McNulty Memorandum, the government had taken the controversial position that paying the attorneys' fees of individuals who are unwilling to cooperate with the government's investigation undermines "authentic cooperation." The McNulty Memorandum establishes the general rule that the DOJ "should not take into account" whether the company is advancing attorneys' fees. (*McNulty Memorandum* at 10). However, "in those extremely rare cases, fee advancement can be considered where the totality of the circumstances show that [fee advancement] was intended to impede a government investigation." (*Prepared Remarks of Deputy Attorney General Paul J. McNulty at the Lawyers for Civil Justice Membership Conference Regarding the Department's Charging Guidelines in Corporate Fraud Prosecutions,* New York, New York, December 12, 2006).

The McNulty Memorandum states that additional factors that may properly be considered in evaluating the nature and extent of a company's cooperation include whether (i) a company has refrained from conducting internal inquiries that might interfere with the government's investigation and (ii) the company has entered into joint defense agreements with its employees or officers.

Nature and Seriousness of the Offense. The DOJ may also evaluate the risk of harm to the public as a result of the underlying conduct, as well as the public interest sought to be protected through the prosecution of the company. Indeed, according to both the McNulty and the Thompson Memoranda, the nature and seriousness of the crime are "primary factors in determining whether to charge a corporation." (*McNulty Memorandum* at 5). Comments to both memoranda state that "[t]he nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors."

Pervasiveness of the Conduct. The DOJ also considers the company's corporate culture and evaluates whether the wrongdoing is pervasive and whether senior level executives participated in the wrongdoing. When evaluating the pervasiveness of the criminal activity, the role of management is most important because "management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged." Like the Thompson Memorandum, the McNulty Memorandum cites to the U.S. Sentencing Guidelines governing sentencing of organization defendants which state:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority ... who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization.

USSG §8C2.5, comment. (n. 4). The McNulty Memorandum, like its predecessor, provides that it may not be appropriate to criminally prosecute a company where the conduct constitutes a "single isolated act of a rogue employee" and the company has an existing compliance program. (*McNulty Memorandum* at 6).

Company's History of Similar Conduct. The DOJ also evaluates the company's history for similar misconduct when determining whether to initiate criminal proceedings. If a company has a prior conviction or has entered into a previous non-prosecution or deferred prosecution agreement with the DOJ, the government will be less willing to dispose of a subsequent criminal allegation in the absence of a formal prosecution. In short, a "corporation, like a natural person, is expected to learn from its mistakes." (*McNulty Memorandum* at 6). For example, the deferred

prosecution agreement entered into by Arthur Andersen in 1996 has been cited as a basis for the government's decision to initiate criminal charges against that firm in 2002.

Existence and Adequacy of the Company's Compliance Program. The DOJ also considers the existence and effectiveness of the company's compliance program in place at the time of the subject conduct. Like the Thompson Memorandum, the McNulty Memorandum, "recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees[.]" (*McNulty Memorandum* at 14). In this regard, the DOJ reviews whether the company merely had a "paper program" or a carefully designed compliance program. In other words, the DOJ considers whether the company's compliance program is "adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives." When evaluating the design and effectiveness of a compliance program, the DOJ considers (i) the program's breadth; (ii) the scope of the criminal activity involved; (iii) the level of participation among corporate employees; (iv) the nature and frequency of the misconduct; and (v) remedial actions taken by the company to address the misconduct and prevent its recurrence.

The Company's Remedial Actions. In addition, in deciding whether criminal charges are appropriate, the DOJ considers whether the company has taken meaningful remedial actions in response to the identified wrongdoing. For example, the DOJ evaluates whether the company has terminated the employment of culpable individuals, and whether senior management who missed, or failed to respond to warning signs of misconduct, have been replaced or released. Moreover, although companies may not avoid prosecution solely by paying a large sum of money, the DOJ may consider the company's "willingness to make restitution and steps already taken to do so." (*McNulty Memorandum* at 15).

Collateral Consequences of Prosecution. When deciding whether to bring a criminal action against a company, the DOJ also considers the potential harm a resulting conviction will have on the non-culpable shareholders, pension holders and employees. For example, companies who conduct business with the United States government face additional collateral consequence such as suspension or debarment. The DOJ also considers the public interest in making its charging decisions. For example, when entering into a deferred prosecution agreement with Bristol-Myers Squibb in June 2005, U.S. Attorney Christopher Christie (District of New Jersey) stated that his office "balanced the need for punishment with an acknowledgment that this company provides great value and that its work should continue." (Press Release, "*Bristol-Myers Squibb Charged with Conspiring to Commit Securities Fraud; Prosecution Deferred for Two Years*," (June 15, 2005)).

In practice, the DOJ also has considered whether a potential merger is at risk. For example, when entering into a non-prosecution agreement with MCI in 2005, the U.S. Attorney considered that prosecution "could harm the impending merger between MCI and Verizon Communications Inc." (Press Release, "*Office of the U.S. Attorney for the Southern District of New York, U.S. Enters Non-Prosecution Agreement with MCI*," (Sept. 1, 2005)). Likewise, the fact that General Electric was in the process of acquiring InVision may have assisted in the decision to enter into a non-prosecution agreement.

Adequacy of the Prosecution of Individuals. When determining whether to prosecute a company, the DOJ also evaluates whether the government's goals of deterrence, punishment and rehabilitation can be adequately served by the prosecution of the individuals responsible for the malfeasance. The McNulty Memorandum, like its predecessor, acknowledges that the strongest deterrent against future corporate wrongdoing may be the imposition of individual criminal liability because companies act through individuals. (*McNulty Memorandum* at 2).

Adequacy of Civil Remedies. The McNulty Memorandum also encourages consideration of whether the primary goals of criminal prosecution – deterrence, punishment and rehabilitation –

can be achieved through a non-criminal action or settlement. Specifically, when determining whether a non-criminal disposition is appropriate, the DOJ will consider "the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action; the probable sanction if the regulatory authority's enforcement action is upheld; and the effect of a non-criminal disposition on Federal law enforcement interests." (*McNulty Memorandum* at 17).