On the same day that a panel of the U.S. Court of Appeals for the Second Circuit upheld the dismissal of all charges against thirteen former partners and employees of KPMG based upon a holding that the government had violated the defendants’ Sixth Amendment rights by pressuring KPMG to cut off payment of their legal fees, United States v. Stein, No. 07-3042 (2d Cir. Aug. 28, 2008), Deputy Attorney General Mark Filip announced a major revision in the Department of Justice’s guidelines governing the evaluation of corporate conduct in the course of criminal investigations. Reacting to sharp judicial criticism and the threat of federal legislation to restrain federal prosecutors, these new changes to the Principles of Federal Prosecution of Business Organizations (PFPBO) mark the most significant shift in federal policy governing the prosecution of business organizations since the guidelines were first promulgated nearly a decade ago.

The PFPBO is the primary policy statement governing the exercise of prosecutorial discretion in federal criminal cases involving organizational subjects. However, from the time the guidelines were first issued in 1999, by then-Deputy Attorney General Eric Holder, through the revisions contained in the Thompson Memorandum of 2003 and the McNulty Memorandum of 2006, they have stirred strong criticism because of the criteria used to evaluate a company’s cooperation, and thus its qualification for prosecutorial leniency. The guidelines permitted prosecutors to consider a corporation’s willingness to waive the attorney-client privilege and work product protections in gauging the extent of the company’s cooperation. The guidelines also authorized prosecutors to evaluate whether a corporation appeared to be protecting its “culpable” employees by considering a variety of factors, including the corporation’s advancement of attorneys fees to employees who are targets of the investigation, the retention of such employees on the payroll, and the sharing of information with such employees through participation in a joint defense agreement.

The modifications to the PFPBO introduced by the McNulty Memorandum in 2006 required prosecutors for the first time to obtain prior written authorization before requesting production of attorney-client privileged material. The McNulty Memorandum directed prosecutors to focus initially on purely factual material, what was described as “Category I” information, but
authorized prosecutors to request “Category II” information, i.e., attorney-client communications and non-factual attorney work product, if the available factual information proved to be incomplete. These changes did little to quell the protests.

The primary complaint about the PFPBO has been that the guidelines were significantly eroding the protections of the attorney-client privilege and were being applied in a manner that threatened important constitutional rights, including the Sixth Amendment rights of persons who were subjects or targets of a federal criminal investigation. In Stein, supra, the Second Circuit affirmed the central findings that U.S. District Court Judge Lewis Kaplan reached two years ago: (1) absent the PFPBO and the actions of the U.S. Attorney’s Office, KPMG would have paid the legal fees of its partners and employees; (2) KPMG’s decision not to advance the legal fees “followed as a direct consequence of the government’s overwhelming influence” through its application of the cooperation criteria in the PFPBO; and (3) the government thus unjustifiably interfered with the individual defendants’ relationship with counsel, in violation of the Sixth Amendment.

Lawmakers on Capitol Hill also have threatened to take legislative action in the wake of escalating complaints from business groups, bar associations, and civil liberties groups. Legislation introduced in the Senate earlier this year would bar federal prosecutors and agency attorneys from requiring corporations to waive attorney-client privilege and work product protection in return for leniency in charging decisions. A similar bill was passed by the U.S. House of Representatives last year.

Against this backdrop and in an effort to forestall threatened congressional action, Deputy Attorney General Filip announced the following major revisions to the PFPBO:

- Prosecutors are forbidden from requesting the disclosure of non-factual privileged information. Credit for cooperation will not depend on whether a corporation has waived attorney-client privilege or work product protection, but rather upon whether the corporation has timely disclosed the relevant factual information about the alleged misconduct.
- In evaluating cooperation, prosecutors are not to take into account whether a corporation is advancing attorneys’ fees or providing counsel to employees, officers, or directors under investigation or indictment.
- Prosecutors are instructed that mere participation in a joint defense agreement does not render a corporation ineligible to receive cooperation credit, and prosecutors may not ask a corporation to refrain from entering into such agreements.
- In evaluating whether a corporation has taken adequate remedial measures, prosecutors may consider whether the corporation has adequately disciplined wrongdoers, but only after the corporation has identified those employees as culpable for the misconduct.

Although these revisions address many of the sharpest criticisms that have been leveled against the PFPBO, it is far from certain that these changes will be sufficient to eliminate the pressure for federal legislation in this area. Even though this iteration of the PFPBO has for the first time been incorporated into the U.S. Attorneys’ Manual, Title 9, Chapter 9-28.000, the guidelines remain a policy statement that can be amended again by future administrations. Moreover, the PFPBO are intended to govern the exercise of prosecutorial discretion by federal prosecutors, but they do not address the privilege waiver policies of other government agencies that refer matters to the Department of Justice. The Department of Justice has announced that it will urge the Securities and Exchange Commission to amend its privilege waiver policies to conform to the new revisions in the PFPBO, thereby highlighting the advisory nature of the PFPBO.

In view of the abbreviated legislative calendar during this election year, it appears unlikely that the Senate will take action during this Congress on the pending Attorney-Client Privilege Protection Act of 2008. In the meantime, counsel for corporations should take note of another new provision contained in the
revised PFPBO, at U.S. Attorneys’ Manual 9-28.760. That provision invites counsel who believe that prosecutors are violating the new guidance to raise their concerns with the appropriate U.S. Attorney or the Assistant Attorney General and provides that such allegations of attorney misconduct will be investigated through established mechanisms.

To learn more about these issues, how Blank Rome can help a company develop and implement best practices in the formulation of senior executive compensation packages, or how we may help a client respond both to governmental investigations into executive pay trends and to shareholder lawsuits arising from similar issues, please contact Joe Poluka at 215.569.5624 or Poluka@BlankRome.com.