

March 27, 2007

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# Third Verse, Same as the First

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 MARCH 27, 2007

The U.S. Department of Justice's revised corporate charging policy, which was named after deputy attorney general Paul McNulty, was unveiled in December 2006. In the wake of its predecessor document, the 2003 Thompson Memo, we have seen a steady increase in the resolution of corporate criminal investigations without indictments or trials. Over the last two years (2005–06), the Justice Department has entered into twice as many deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) as in the two previous years (2003–04). See *Chart: Recent Deferred and Non-Prosecution Agreements*.

Even though major corporate and other collective entities continued to face indictments in 2006, such as Schering-Plough Corporation (health care fraud), Citgo Petroleum Corporation (environmental crimes), Milberg Weiss & Bershad (mail fraud), the number of DPAs and NPAs, or corporate pretrial agreements, has risen significantly over the past four years. Indeed, there have been at least 55 DPAs and NPAs from 1992 to 2006. The McNulty Memo is unlikely to change this trend.

## BACKGROUND ON DPAs AND NPAs

Both types of agreements accomplish the same ends, but with different means. In a DPA, a charging document, usually a criminal complaint or criminal information, is filed with the court, and the Justice Department agrees to defer judicial proceedings with a goal of dismissal of the charges after a definite period of time (usually one to three years), provided the company complies with the agreement. The court must approve the tolling agreement, i.e., the exemption of this time period from the statute of limitations and the statutory speedy trial clock. In an NPA, no charging document is filed provided the company adheres to the agreement.

Most of the terms found in these agreements are uniform, including: an admission of wrongdoing; a waiver of the statute of limitations; an uncertain expiration date; a provision agreeing to the admissibility of plea discussions; a provision stating that the entity will operate lawfully; a continuing obligation by the entity to cooperate (e.g., ensuring that employees are available for testimony); a provision stating that the entity's employees will not contradict statements in the agreement; an acknowledgment that obstruction charges are possible if the entity violates the

agreement; upon violation, a period of time in which the entity can appeal to the Justice Department for reconsideration; and provisions for penalties or other restitution.

Not only do the agreements contain these boilerplate provisions, many—but not all—of these have other provisions that are somewhat controversial and have sparked debate in the white-collar defense bar, including the waiver of attorney-client privilege and work-product protection (both ordinarily accompanied by a selective waiver provision that may not be enforced in most circuits); provisions reforming elements of the business, such as the legal department, independent compliance monitors, or consultants (contemplated by the federal sentencing guidelines); and an agreement to implement a new compliance system designed to prevent future misconduct.

Some agreements have community service-type provisions. For instance, in 2006, FirstEnergy Corp. agreed to pay over \$1 million to improve the environment in northern Ohio, and Roger Williams Medical Center agreed to provide \$4 million worth of free (non-tax-deductible) health care over two years.

## CORPORATE PRETRIAL AGREEMENT COST-BENEFIT ANALYSIS

The principal benefit of these corporate pretrial agreements is that the entity avoids the stigma of criminal conviction, which can vary depending on the industry and the structure of the organization. For instance, a conviction for Arthur Andersen meant that effectively it could not work in the public accounting industry. For a professional services firm, such as a law firm, it may mean that the firm will lose clients—particularly class action law firms vying for lead plaintiff status. For a defense contractor, it may mean that the company could be restricted in terms of its contracts with the government, i.e., debarment. Health care

Recent Deferred and Non-Prosecution Agreements

2003	2004	2006	2007
Banco Popular PNC ICLC Canadian Imperial Bank New York Racing Ass'n	Computer Associates Am South Bancorp AIG AOL Edward Jones Symbol Technology Whitehall Jewelers Invision Technology	Hilfiger Monsanto Bristol Myers Squibb KPMG Univ. of Med & Dentistry of NJ AEP Services Micrus Corp. Adelphia MCI Bank of New York Friedman's Inc	Statoil Intermune Schnitzer Steel Firstenergy Nuclear Williams Power Operations Mgmt. Intl. Roger Williams Med. Cntr. HVB Bank Atlantic Western Geco LLC MRA Holdings AIG Healthsouth BAWAG Boeing Prudential Equity Group Mellon Bank Royal Ahold

companies may not be able to participate in federal programs with a federal conviction.

While the benefits of a corporate pretrial agreement are a significant carrot for entities, the costs can be high. There is no judicial oversight for an NPA, and little judicial oversight with a DPA.

Moreover, a plaintiff contemplating a class action now has a perfect template—a factual basis set forth in the agreement along with a provision stating that the entity and its employees cannot contradict the terms of the agreement. Throw in privilege and work product waivers, and the prospects of a civil action or regulatory defense victory dim.

There are also hidden costs, such as the cost to the entity of oversight of its business by the Justice Department—a feature of many agreements—vis-à-vis an independent compliance monitor or reporting arrangement to ensure that an entity is adhering to the agreement.

Additionally, most DPAs and NPAs include a substantial criminal penalty not linked to a particular section of the federal criminal code. The penalty may be many times larger than what could be statutorily imposed by a court following conviction. See *Chart: Top 10 DPA and NPA Criminal Fines*.

## THE IMPACT OF THE McNULTY MEMO OF DPAs AND NPAs

In December 2006 the Justice Department released a memorandum authored by deputy attorney general McNulty, revising certain aspects of the department's corporate charging policy. The McNulty Memo memorialized Judge Lewis Kaplan's admonition in *U.S. v. Stein* that prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to targets.

More importantly, the McNulty Memo set forth a road map that federal prosecutors must use to determine whether a privilege waiver request is appropriate. The prosecutor must consider: whether the privileged information will benefit the government; any alternative means to obtain information; the completeness of preexisting voluntary disclosure; and the collateral consequences of waiver.

If these factors suggest that a privilege waiver is appropriate, the prosecutor must seek approval from the assistant attorney general and first seek only what is termed factual Category I information, such as interview memoranda regarding the underlying misconduct, organizational charts, factual chronologies, or other reports containing investigative facts documented by an entity's legal counsel. If this information proves insufficient, prosecutors may—with the deputy attorney general's permission—then request communications reflecting legal advice, or Category II information, such as attorney notes, memoranda containing counsel's legal conclusions, or other legal advice given to the corporation. Prosecutors need not seek the assistant attorney general's permission, however, if the entity voluntarily waives privilege, but must still document and report such waivers.

Will the McNulty Memo impact DPAs or NPAs?  
Maybe.

The McNulty Memo does not change the nine corporate prosecution factors set forth in the Thompson Memo—which made only minor changes to its predecessor document, the Holder Memo. The factors remain: the nature and seriousness of the offense; pervasiveness of wrongdoing; the company's history of similar conduct; the company's timely and voluntary disclosure; the existence and effectiveness of a pre-existing compliance program; the company's remedial actions; the collateral consequences (including harm to shareholders) of a conviction; the adequacy of prosecution of individuals; and the adequacy of civil or regulatory remedies.

**Top 10 DPA and NPA Criminal Fines (2004-2006)**

Entity	Settlement Total	Criminal Penalty Portion of Settlement Payment—not restitution	Violation
Prudential (8/06)	\$600 million	<b>\$325 million</b>	Securities Fraud
KPMG (8/05)	\$425 million	<b>\$128 million</b>	Tax Fraud
AOL (12/04)	\$210 million	<b>\$60 million</b>	Securities Fraud
Bristol Myers Squibb (6/05)	\$839 million	<b>\$50 million</b>	Securities Fraud
Williams Power (2/06)	\$50 million	<b>\$50 million</b>	Commodities Fraud
Boeing (6/06)	\$615 million	<b>\$50 million</b>	Procurement Fraud
AEP (1/05)	\$60 million	<b>\$30 million</b>	Commodities Fraud
AIG (2/06)	\$800 million	<b>\$25 million</b>	Securities Fraud
Firstenergy (1/06)	\$28 million	<b>\$23 million</b>	Environmental Crime
Westerngeco (6/06)	\$19.6 million	<b>\$18 million</b>	Visa Fraud

Additionally, the McNulty Memo does not change the language that addresses DPAs and NPAs: "In some circumstances, granting a corporation immunity or amnesty or pretrial diversion may be considered in the course of the government's investigation."

Because of the new hurdles for seeking an attorney-client privilege or waiver, there may be fewer waivers. A collateral consequence may be that more entities may structure internal investigations to raise fewer privilege issues. This could result in more extensive cooperation and more pretrial agreements. While it is impossible to gauge the impact—if any—that the McNulty Memo will have on DPAs and NPAs, we believe the impact will be marginal, given that the McNulty Memo is basically a restatement of the 2003 Thompson Memo (which largely mirrored the 1999 Holder Memo). Regardless of McNulty's impact, we have a few factors to keep in mind when considering whether to enter into such an agreement: First, cooperation still is the key to avoiding prosecution, whether by DPAs or NPAs. If the entity has cooperated and the criminal conduct is limited to one or more rogue employees, both the prosecutor and the entity should consider whether the company should be charged at all.

Second, when a company pays significant penalties, this hurts the shareholders, and sometimes can only have a marginal impact on the culprits in terms of their compensation vis-à-vis the entity's stock they hold.

Third, any reforms instituted by the entity to prevent future misconduct must not be paper reforms—the reforms must be real changes designed to prevent future misconduct. Similarly, given the recent guidance provided by the McNulty Memo, the entity should attempt to structure investigations into criminal conduct to minimize privilege issues.

Finally, the entity should consider whether collateral consequences (or lack thereof) following a guilty plea to a criminal information might be preferable to a contract with the government.

Whichever route the company chooses to take should be traveled only after an exhaustive analysis of risk and benefit to the organization, its employees, and its stakeholders and shareholders.

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