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Is the McNulty Memorandum Fool's Gold?

Federal prosecution of business organizations under DOJ's new corporate charging guidelines

After years of vicious attacks by waves of criminal defense lawyers and one courageous jurist, the United States Department of Justice released a memorandum authored by then Deputy Attorney General Paul J. McNulty purportedly revising its position on corporate charging guidelines in December 2006. "Principles of Federal Prosecution of Business Organizations" (Dec. 12, 2006), http://justice.gov/dag/speech/2006/McNulty-memo.pdf. Now, over a year after its publication, a review and assessment on its impact on corporate charging decisions is appropriate.

The McNulty Memorandum is a "roadmap"— not a law — but a DOJ policy. That is, the McNulty Memorandum instructs federal prosecutors when those prosecutors consider charging business organizations with crimes, evaluating cooperation, recommending remedial measures and seeking the waiver of the attorney-client and work-product privileges from these entities. Although most of the ink spilled on the McNulty Memorandum by commentators discusses the waiver of the attorney-client and work-product privileges, critical portions of the McNulty Memorandum are seemingly ignored. This article addresses the principles relating to the federal prosecution of business organizations under the McNulty Memorandum.

The McNulty Memorandum discusses both the duties of the federal prosecutor as well as corporate leaders in the context of charging a business entity with a federal crime. The DOJ insists that prosecuting corporate crime is one of its high priorities.

Initially, the McNulty Memorandum lays out general principles for charging a business entity, in that these entities should not be treated any differently because of their artificial nature than any other wrongdoer. Further, if an indictment is necessary, federal prosecutors are reminded that there are "positive" benefits to a corporation from this process, including improved corporate governance, change of culture or behavior and a better ability to detect and deter future wrongdoing. The McNulty Memorandum stresses that federal prosecutors must consider all factors when faced with possible corporate wrongdoing. For example, federal prosecutors must consider whether the public would benefit from indicting a business entity, including, but not limited to, deterrence considerations and specific risks to the general public, as well as if there are remedial measures undertaken by the business entity. Federal prosecutors are also expected to consider charging individual directors, officers, employees or shareholders at the same time they are reviewing whether to charge the business entity. Similarly, federal prosecutors should not deter individual action if the entity accepts full responsibility for a particular criminal activity.

Federal prosecutors, in investigating and prosecuting criminal wrongdoing, are required to act professionally when discharging their duties, and consider (and encourage) corporate compliance and regulation. The DOJ assumes that business leaders are responsible for such actions and those leaders must protect the true owners of the business entity — the shareholders. Federal prosecutors expect these leaders to work with them for the benefit of their shareholders (apparently, even if it is against the leader's personal interest).

Nevertheless, when making these charging decisions, federal prosecutors consider factors regardless of whether there was a direct or indirect benefit to the business entity, and view corporate leadership as the first line of defense — an unenviable position if something goes awry.

The McNulty Memorandum discusses nine specific principles that federal prosecutors apply in determining whether to charge a business entity.

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Obviously, the first factor relates to the nature and seriousness of the offense, as well as the risk and harm to the public from the corporate conduct. Federal prosecutors evaluate the nature and seriousness of harm to the public by considering specific DOJ policies that seek to deter such harm, which were in place at the time the business entity may have violated them. Violating such DOJ policies may in itself indicate public harm, and result in charges against the entity by the DOJ.

The "pervasiveness of wrongdoing within the corporation" and if corporate management are involved in this wrongdoing comprise the second factor in this test while the third factor considers a corporation's history of similar or like misconduct (criminal, civil or regulatory enforcement actions). For example, if the crime was localized to a single or rogue employee, federal prosecutors would be less likely to charge the corporation, but evidence of involvement from corporate leadership will cause the DOJ to view the conduct as pervasive within the organization's entirety. The DOJ, when considering the corporation's past history, will, however, recognize good corporate citizenship before charging the entity.

The fourth factor considered is the corporation's timely and voluntary disclosure of its wrongdoing and whether it cooperated in the DOJ investigation. The DOJ values corporate cooperation, and, in a later article, we will discuss its position concerning waiving the attorney-client and work-product privileges as part of cooperation. However, there is more to cooperation than these waivers. The DOJ considers whether a business entity will qualify for immunity, amnesty or pretrial diversion based upon numerous factors, such as whether it attempts to shield culpable employees and agents.

In *United States v. Stein*, for example, federal prosecutors were confronted with a business entity's payment of legal fees for certain employees who were under federal investigation. *U.S. v. Stein*, 495 F. Supp. 2d 390 (S.D.N.Y. 2007). The DOJ considered these payments an impediment to its investigation, and, essentially, forced the business entity to stop paying those legal fees. Although the United States District Court rejected the federal prosecutors' heavy-handed practice, the McNulty Memorandum continues to stress that federal prosecutors must consider the payment of attorney's fees to employees under investigation when instigating a criminal prosecution against the business entity. Finally, cooperation does not entitle the business entity to immunity, and providing cooperation does not mean immunity will be granted.

The DOJ's fifth and sixth charging factors involve whether the business entity has undertaken any remedial action, including whether it implemented a corporate compliance program; improved an existing one; replaced or disciplined the wrongdoers or management; and/or paid restitution. Corporate compliance programs are critical in the DOJ's assessment of whether to charge a corporation. The DOJ assumes these compliance programs are a proper way of affecting future corporate behavior. The McNulty Memorandum trumpets this requirement, along with restitution and remediation when deciding the necessity of a criminal prosecution against the entity.

The seventh factor relates to the collateral consequences of DOJ actions. That is, if those collateral consequences will harm shareholders, pension holders or employees, who are not involved in the wrongdoing, federal prosecutors must assess the impact of the corporate criminal conviction before deciding to charge the business entity with a criminal offense. Of course, the existence of these consequences does not stop criminal proceedings where there is merit as demonstrated in the fatal *Arthur Anderson* case.

Federal prosecutors must also consider the eighth factor as to whether there has been previous adequate prosecution of the individual or individuals responsible for the corporation's wrongdoing.

Lastly, federal prosecutors must consider if there are adequate remedies in a civil or regulatory enforcement action before instituting a criminal prosecution. The DOJ will allow an adequate noncriminal alternative to an indictment, including, but not limited to, civil or regulatory enforcement actions, if the DOJ believes civil or regulatory enforcement may address these issues. Thus, the DOJ may consider not criminally charging a corporation, but it is equally possible that the DOJ may still bring criminal charges even if civil or regulatory enforcement actions have occurred or are threatened.

The McNulty Memorandum also addresses (albeit in passing) the federal prosecutor's duty to select the actual and appropriate criminal charge against a corporation.

Such determinations are made when federal prosecutors decide that a criminal prosecution is warranted against the business entity. Federal prosecutors are reminded that recommending a grand jury charge against a particular corporation must only be done when there exists well-documented criminal conduct. Again, the McNulty Memorandum suggests that these decisions are to be done on an individualized basis and in line with the Federal Criminal Code, as well as the *United States Attorney's Manual*.

The McNulty Memorandum also reminds federal prosecutors of their ability to use corporate plea agreements to resolve these matters and, essentially, refers federal prosecutors to various provisions in the *United States Attorney's Manual* requiring certain terms to be included in the plea agreement. These plea agreements should address punishment, deterrence, rehabilitation and compliance in the corporate context. Of course, there is recognition for special circumstances, but federal prosecutors should not agree to accept a corporate guilty plea in exchange for some form of a nonprosecution or dismissal of charges against the business entity's individual officers or employees.

In sum, the McNulty Memorandum requires careful review to understand the DOJ charging process for business entities. The McNulty Memorandum is not a retrenchment by the DOJ of its pursuit of corporate wrongdoers or its ability to seek and obtain harsh and significant sanctions against these entities. Instead, this policy statement is merely one in a long line of DOJ pronouncements, indicating its strong and never-ending war on corporate crime. Recent events have only reinforced this conclusion.

Next month, a second article will explore cooperation with the DOJ and the waiver of the attorney-client and work-product privileges. ■