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Compliance Readiness – Law Firms

Thompson Memo Setbacks Don't Diminish Need For Strong Compliance Program

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Recent months have not been kind to the Thompson Memorandum, which embodies U.S. Department of Justice guidelines for prosecuting business organizations. Several prosecutorial tactics authorized by the Memorandum have been harshly criticized by a federal judge, the ABA, and a group of former Justice Department officials. Meanwhile, the Senate Judiciary Committee recently held hearings on such tactics, during which the current Deputy Attorney General staunchly defended the Memorandum but acknowledged the possibility of future revisions.¹ The criminal defense bar reportedly “smells blood” and is poised to wage a broader assault on the Memorandum.²

Before anyone hastily proclaims the demise of the Thompson Memorandum, however, it should be emphasized that all of these recent attacks have questioned only one of its points of emphasis: the government's scrutiny of a company's cooperation with federal investigators *after* potentially unlawful conduct has been identified. By contrast, none of the attacks dispute the other key pillar of the Memorandum: the government's scrutiny of the compliance mechanisms a company had in place *before* it came under investigation. Thus, compa-

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nies are well-advised to continue taking seriously the government's promise of leniency for those who have truly effective compliance programs, as well as its threats of harsh treatment for those who don't.

The Thompson Memo's Woes

The Thompson Memorandum – titled “Principles of Federal Prosecution of Business Organizations” – was issued to senior federal prosecutors in January 2003 by then-Deputy Attorney General Larry Thompson.³ It mostly reiterated principles from an earlier memorandum by Thompson's predecessor, Eric Holder, but it made critical revisions in tone and emphasis. The “main focus” of the revisions was increased scrutiny of “the authenticity of a corporation's cooperation” during investigations. A secondary focus was increased scrutiny of company compliance programs to ensure that they are “truly effective rather than mere paper programs.”

The Thompson Memorandum authorizes federal prosecutors, when gauging a company's cooperation, to consider the corporation's willingness to identify the culprits within the corporation, to make witnesses available, to disclose the results of any internal investigation, and to waive attorney-client and work product protection. It also says that prosecutors may request a company to waive privilege “both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel,” and that “a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be

considered by the prosecutor in weighing the extent and value of a corporation's cooperation.”

These concepts are not unique to the Thompson Memorandum. In October 2001, the Securities and Exchange Commission issued a report, commonly known as the “Seaboard Report,” identifying 13 factors it considers in determining whether to charge companies in enforcement proceedings.⁴ These factors include: “Did the company cooperate completely with appropriate regulatory and law enforcement bodies?”; “Did the company promptly make available to our staff the results of its [internal] review?”; and “Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?” The SEC noted that “[i]n some cases, the desire to provide information to the Commission staff may cause companies to consider choosing not to assert the attorney-client privilege, the work product protection and other privileges, protections and exemptions with respect to the Commission.” The SEC also raised eyebrows in May 2004 when it attributed a \$25 million civil penalty against Lucent Technologies, Inc. in part to that company's indemnification of certain employees, which the agency said was “contrary to the public interest.”⁵

U.S. Sentencing Commission guidelines also provide incentives for companies to “fully cooperate” with government investigations, and in November 2004 the Commission inserted commentary indicating that, although waiver of privilege is not *required* in *all* cases to receive cooperation credit, it may be a “prerequisite” in some.⁶ Under pressure from business, civil rights, and bar organizations, the Commission recently deleted this controversial commentary effective in November 2006.⁷

Notwithstanding the Sentencing Com-

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with questions about this article.*

mission's retreat on privilege waivers, the government's criteria for measuring corporate cooperation remain highly controversial. This controversy has been fueled by two decisions from Judge Lewis Kaplan in the Southern District of New York and by positions taken by the ABA and former Justice Department officials, all of which have taken direct aim at various "cooperation" factors of the Thompson Memorandum.

Judge Kaplan's decisions were issued in a criminal tax shelter case against several former partners of KPMG. On June 26, 2006, he ruled that federal prosecutors, following Thompson Memorandum guidelines, violated Fifth and Sixth Amendment rights to counsel by effectively coercing KPMG into reversing its initial decision to advance legal fees to the defendants facing indictment.⁸ On July 25, 2006, he suppressed certain pre-trial statements because prosecutors, again following the Memorandum, had effectively coerced the statements by pressuring KPMG to use threats of employment termination to induce the defendants to talk to the government.⁹

Although Judge Kaplan did not address privilege waivers, that aspect of the Thompson Memorandum is also under fire. Echoing criticism from several quarters that the government has been coercing such waivers, the ABA House of Delegates in August 2005 adopted a resolution opposing "the routine practice by government officials of seeking to obtain a waiver of the attorney-client privilege or work product doctrine through the granting or denial of any benefit or advantage."¹⁰ A year later, it adopted another resolution opposing the tactics condemned by Judge Kaplan's decisions.¹¹ Most recently, in September 2006, ten former Justice Department officials wrote a letter to the current Attorney General charging that current prosecutorial tactics are "seriously eroding" these protections.¹²

Compliance Expectations Alive And Well

In contrast to mounting attacks on the "cooperation" criteria of the Thompson Memorandum, another important aspect of the Memorandum has survived unscathed. Overshadowed by the Memorandum's stated "main focus" on cooperation has been its secondary emphasis on "the efficacy of the corporate governance mechanisms in place within a corporation." As previously noted, the Memorandum directs prosecutors to scrutinize corporate compliance measures to ensure that they are "truly effective rather than mere paper programs."

While companies can afford to wait until a problem arises before taking measures to earn credit for "cooperation" under the

Thompson Memorandum, they have no such luxury when seeking credit for effective corporate governance and compliance. Inevitably, such credit will depend entirely on conditions existing *before* the problem surfaced. Worse yet, unless the problem was detected by the company's own compliance processes, prosecutors may presume that those processes were *ipso facto* inadequate. Thus, companies must focus on effective compliance *now* – to prevent problems from occurring at all or, at the very least, to ensure prompt detection and remediation before the government comes knocking.

Of course, the Thompson Memorandum is only a starting point for determining what an exemplary governance and compliance regime should look like. Many experts have offered specific guidance in this area, including some in this issue of MCC. We note just a few general principles derived from the Thompson Memorandum itself and from our collective experiences in the government and in representing companies before the Justice Department and SEC:

- Compliance and ethics should be ingrained by top management into the corporate culture, and not be just a "paper program"
- Corporate governance should ensure that the board of directors gets enough information to exercise genuinely independent review over management
- Companies should commit sufficient staff and resources to ensure effective audits, careful documentation, and close analysis of compliance efforts
- Companies should do more than "go through the motions" with rote compliance training – e.g., by effectively and frequently educating their personnel on compliance obligations and periodically evaluating employee comprehension
- Compliance programs should address the risks associated with the company's specific industry and regulatory environment
- Compliance programs should ensure that misconduct is promptly detected; promptly disclosed to the board and, if appropriate, to the company's auditors, the government, and the public; and promptly remedied through disciplinary action
- Compliance programs should ensure that relevant corporate documents and electronic data can be effectively preserved at the first sign of potential wrongdoing

Companies may ask: how much leniency can a compliance program earn? The Thompson Memorandum itself states that "the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for conduct undertaken by its officers, directors, employees, or agents." Corporate sentencing statistics are not encouraging; according to tables

published annually by the U.S. Sentencing Commission, no corporate defendant has been explicitly credited at sentencing with having had an effective compliance program since at least the year 2000.¹³ We are likewise unaware of any case in which the SEC has explicitly rewarded a company for having an exemplary compliance program.

On the other hand, a company's *lack* of an effective compliance regime is almost certain to result in a more harsh result. Under both the Thompson Memorandum the SEC's Seaboard Report, a company's failure in this area will weigh in favor of charging the company as a defendant. Moreover, whereas no companies appear to have recently received *lighter* criminal sentences due to the *presence* of an effective compliance program, several hundred have had their *lack* of a compliance program cited as a culpability factor warranting an *enhanced* sentence. Finally, although a recent SEC policy statement on penalties against companies is curiously silent on whether an effective compliance program is a relevant factor,¹⁴ in practice the SEC frequently cites the absence of such a program as a factor supporting a civil penalty.

Given this reality, companies should focus immediate attention on establishing strong corporate governance and compliance regimes notwithstanding recent prosecutorial setbacks involving other criteria of the Thompson Memorandum.

¹ Testimony of Paul J. McNulty Before the Senate Judiciary Committee, Sept. 12, 2006 (available at www.usdoj.gov/dag/testimony/2006/091206dagmcnulty_testimony_thompson_memo.htm).

² See, e.g., Pamela A. MacLean, Defense Bar Smells Blood, *National Law Journal*, Aug. 21, 2006, p. S6; Alexia Garamfalvi, Court Ruling Emboldens Foes of DOJ Policy, *Legal Times*, July 3, 2006, p. 1.

³ The Thompson Memorandum is available online at www.usdoj.gov/dag/cftf/corporate_guidelines.htm. For an authoritative primer on the Memorandum, see Christopher A. Wray and Robert K. Hur, Corporate Criminal Prosecution in a Post-Enron World: The Thompson Memo in Theory and Practice, 43 *Am. Crim. L. Rev.* 1095, 1118 (2006).

⁴ SEC Release No. 34-44969 (Oct. 23, 2001) (available at www.sec.gov/litigation/investreport/34-44969.htm).

⁵ SEC Press Rel. No. 2004-67 (May 17, 2004) (available at www.sec.gov/news/press/2004-67.htm).

⁶ U.S. Sentencing Guidelines Manual § 8C2.5, Comment n.12 (2004).

⁷ Minutes of U.S. Sentencing Commission, April 5, 2006, at 7-8 (available at www.uscc.gov/CMEETING.HTM).

⁸ United States v. Stein, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).

⁹ United States v. Stein, 2006 U.S. Dist. LEXIS 50723 (S.D.N.Y. July 25, 2006).

¹⁰ This resolution is available online at www.abanet.org/poladv/report111.pdf.

¹¹ This resolution is available online at www.abanet.org/media/docs/302Brevised.pdf.

¹² This letter is available online at www.acca.com/public/attyclientpriv/agsept52006.pdf.

¹³ These statistics are available online at www.uscc.gov/annrpts.htm.

¹⁴ SEC Press Rel. No. 2006-4 (Jan. 4, 2006) (available at www.sec.gov/news/press/2006-4.htm).