newsletter

Staying Ahead
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Government Enforcement Litigation

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Threats to the Attorney-Client Privilege

By James M. Becker and Mark C. Cawley

No one can force you or your company to waive the attorney-client privilege or the work-product protection, right? Wrong. In fact, the U.S. Department of Justice routinely demands that companies waive those protections—and many do so of their own accord—to qualify for leniency in government prosecutions. Similarly, the U.S. Sentencing Guidelines list voluntary waiver as one factor in determining whether a corporation qualifies for a sentencing reduction for cooperating with the government. These policies effectively force companies to waive the attorney-client privilege and work-product protection, and result in the disclosure to third parties—including the plaintiff's bar—of documents and communications that would otherwise remain confidential. In doing so, these policies have severely eroded the attorney-client relationship and have prompted calls for reform from the criminal defense bar and industry groups. Fortunately, policy changes may be in the offing.

The Justice Department's Privilege-Waiver Policy

The Justice Department's so-called "Thompson Memorandum," a 2003 policy statement on charging corporations with criminal offenses, lists as one of nine factors to be considered in deciding whether or not to prosecute "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection." On October 21, 2005, Deputy Attorney General Robert D. McCallum Jr. issued a memorandum requiring all U.S. Attorneys to develop written procedures for reviewing requests by federal prosecutors for waiver of the attorney-client privilege or work-product protection. Deputy Attorney General McCallum wrote: "To ensure that federal prosecutors exercise appropriate prosecutorial discretion under the principles of the Thompson Memorandum, some United States Attorneys have established review processes for waiver requests that require federal prosecutors to obtain approval from the United States Attorney or other supervisor before seeking a waiver of the attorney-client privilege or work product protection. Consistent with this best practice, you are directed to establish a written waiver review process for your district or component."

By requiring high-level approval of waiver requests, this policy is a step in the right direction. It encourages each district to develop an office-wide (rather than attorney-specific) policy on when, and if, waiver requests will be made. Still, it does not provide nationwide

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standards governing the propriety of requesting privilege waivers, and, as a result, encourages the development of policies that may vary from district to district. More meaningful reform may lie in possible amendments to the U.S. Sentencing Guidelines.

Possible Amendments To The U.S. Sentencing Guidelines

The Commentary to Section 8C2.5 of the United States Sentencing Guidelines for corporations discusses the meaning of "timely and thorough" cooperation necessary for a company to qualify for a reduced sentence under the Guidelines. The current commentary, added in 2004, provides:

> Waiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score under subdivisions (1) and (2) of subsection (g) [Self-Reporting, Cooperation, and Acceptance of Responsibility] unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.

The government has viewed this commentary as an invitation to demand waivers routinely as a condition of corporations receiving credit for cooperation in an investigation.

The tide may be changing. At its public meeting on November 15, 2005, the U.S. Sentencing Commission received testimony from former Justice Department officials, the Association of Corporate Counsel, the National Association of Manufacturers, the Chemistry Council, the Chamber of Commerce, the American Bar Association, and the National Association of Criminal Defense Lawyers – all of whom emphasized the adverse effects of the Justice Department's insistence upon waivers. As a result, the Commission, in publishing its proposed amendments to the Guidelines on January 27, 2006, solicited public comment on whether the above language on waiver of the attorney-client privilege and work product (1) "is having unintended consequences; (2) if so, how specifically has it adversely affected the application of the sentencing guidelines and the administration of justice; (3) whether this commentary language should be deleted or amended; and (4) if it should be amended in what manner." Written comments are due by March 28, 2006. Meanwhile, the American Bar Association, working with groups such as the Association of Corporate Counsel, has been surveying in-house and outside corporate counsel to gather data verifying the scope of the coerced-waiver problem for presentation to the Sentencing Commission and others.

Is Deleting Or Changing The Guidelines' Commentary Meaningful?

Because the Justice Department has cited the above Commentary as legal reinforcement of its coerced-waiver policy, the Commission should delete the Commentary and make clear that waiver is not a relevant factor in deciding whether a company has cooperated. As former Justice Department officials as diverse as former President Carter's Attorney General, Griffin Bell, and former Republican Solicitor Generals, Kenneth Starr and Theodore Olsen, wrote in their letter of August 15, 2005 to the Commission: "we believe the privilege waiver amendment, though well-intentioned, is undermining rather than strengthening compliance with the law in a number of ways." First, they noted that the privilege-waiver amendment weakens the attorney-client privilege between companies and their lawyers and actually makes detecting and preventing corporate wrong-doing more difficult. The amendment makes it more likely that corporations will turn over internal legal memoranda, and corporate officials and personnel who know this are less likely to consult with their lawyers in the first place—thereby impeding corporate counsels' ability to effectively assist the corporation in complying with often complex laws.

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Second, the former Justice Department officials argued that the privilege-waiver amendment will make detection of corporate misconduct more difficult by undermining companies' internal compliance programs and procedures. These programs, which often include internal investigations, are one of the most effective tools for detecting corporate malfeasance. Such investigations, however, are effective only if personnel are willing to talk candidly with counsel, and any uncertainty about whether the attorney-client privilege or work-product protection will be honored make candid discussions far less likely. Likewise, knowing that the fruits of their internal investigation might have to be disclosed to the Department of Justice, companies may be far less willing to conduct internal investigations or to adequately document them when they do.

Third, the former Justice Department officials also noted that forced disclosure of privileged corporate memoranda and other

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internal documents often fuels ruinous—and frequently unjustified—follow-on civil litigation. In most jurisdictions, waiver of the attorney-client privilege as to one party (e.g., the government) constitutes waiver as to all parties, including civil litigants. Forcing companies to disclose sensitive internal memoranda to the government effectively provides plaintiffs' lawyers with considerable ammunition that can be used against companies in class action, derivative, and other litigation. The amendment thus penalizes companies who conduct internal investigations by subjecting them to the risk of such litigation and its attendant costs.

Finally, by forcing corporations to disclose memoranda of internal investigations, the privilege-waiver amendment may cause corporations to unwittingly expose corporate officers and employees to criminal liability. In cases of clear-cut wrongdoing (such as individuals receiving kick-backs from suppliers in government-funded programs), corporations have every incentive to root out individuals responsible for malfeasance. It is a different matter, however, when the wrong-doing is not so well established or not intended by the individuals involved. Compliance with many federal laws (especially those involving government contracts or Medicare reimbursement) is complex and companies—and individuals who work for them—can inadvertently violate those laws. Frequently, privileged statements made during internal investigations and disclosed as part of an unrelated government investigation can provide the government ammunition to prosecute offenses not encompassed by its original investigation.

What Should Be Done?

The most promising way to eliminate the ill-effects of the current privilege-waiver policy lies in the proposed amendments to the U.S. Sentencing Guidelines. The Sentencing Commission should amend the Guidelines to make clear that privilege waiver is not an appropriate or relevant factor in determining cooperation for purposes of sentence reduction. This, in turn, will reduce the incentive for corporations to accede to Justice Department requests for privileged documents and may prompt the Justice Department to alter the Thompson Memorandum's criteria for prosecuting corporations.

Debate over these issues is just beginning, and Saul Ewing will continue to report important developments in this newsletter as they occur. ■

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Keeping Pace With Perchlorate Issues

By Joseph F. O'Dea, Jr. and Gregory G. Schwab

Perchlorate, a substance widely used in defense and aerospace activities, is a hot environmental topic that will continue to be of great importance to companies in the defense and aerospace industries in the years to come. Ever since perchlorate contamination was first discovered in 1985 at a Superfund site, heightened scrutiny and improved detection methods have led to its discovery in 35 states and in drinking water sources in more than 25 of those states. Because of the prevalence of perchlorate and the prohibitively high cost of remediating perchlorate, companies should pay close attention as regulators move closer to establishing safe levels for the chemical in the environment.

Perchlorate can interfere with thyroid functions in adults, but fetuses and young children, in whom it can cause developmental defects, are particularly vulnerable.

The source of perchlorate is typically attributed to military activities, where the chemical is used in solid rocket fuel and munitions. As such, the Department of Defense (DoD) has often been the target of "a rush to judgment" in terms of responsibility for cleanup costs. A recent conference of the National Ground Water Association in San Francisco featured perchlorate as the emerging environmental threat. At that conference, a spokeswoman for the DoD made clear that the Agency already has spent more than $60 million in perchlorate cleanup costs and will not (and cannot afford to) solely fund expensive perchlorate cleanups going forward. The spokeswoman noted that "there are many sources of contamination" and "many entities beyond DoD that handle and are responsible for the perchlorate contamination." Thus, it seems all but certain that DoD will be looking to implicate other potentially responsible parties (i.e. defense contractors) in the cost allocation morass.

There is an ongoing and robust debate in the scientific community about the threat to health and human safety posed by perchlorate, and what are appropriate exposure levels. Perchlorate can interfere with thyroid functions in adults, but fetuses and young children, in whom it can cause developmental defects, are particularly vulnerable. At high concentrations, perchlorate affects thyroid function by blocking the uptake of iodide. Studies have failed

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to definitively establish, however, a threshold exposure level at which perchlorate would likely become toxic to adults, children, and pregnant women.

Perchlorate exists in a wide variety of fruits and vegetables, possibly from perchlorate-contaminated irrigation water, as well as in some dairy products and breast milk.

For now, there is no federal standard for the permissible level of perchlorate exposure. Back in 2001, the United States Environmental Protection Agency (USEPA) set an interim drinking water standard at 1 part per billion (ppb), the equivalent of one drop of perchlorate in an Olympic-size swimming pool. In January 2005, the National Academy of Sciences recommended a reference dose (maximum safe exposure level) that equates to about 24 ppb of perchlorate in drinking water. The USEPA has adopted the NAS's reference dose as the safe limit as it considers whether to turn the reference dose into a meaningful national drinking water standard. However, these recommendations all assume that people ingest perchlorate from drinking water only. Recent studies indicate that perchlorate exists in a wide variety of fruits and vegetables, possibly from perchlorate-contaminated irrigation water, as well as in some dairy products and breast milk.

Sooner or later USEPA will develop a federal drinking water standard, which will set a maximum contaminant level for perchlorate. Once this level is set, enforcement activity and cost recovery litigation will not be far behind. To complicate things, this maximum contaminant level is only a "floor"; states may set their own levels at least as stringent as and possibly more stringent than the federal level. For example, California has already set a "public health goal" of 6 ppb as it works towards setting its own maximum contaminant level. Federal officials have begun to draft new guidelines for toxic-site cleanup. In fact, on January 26, 2006, both DoD and USEPA separately issued new guidance setting 24.5 ppb as the level of concern for environmental restoration and for DoD-owned drinking water systems and as the preliminary clean-up goal for perchlorate contamination, respectively. Congress has also weighed in on the issue, with Senator Dianne Feinstein recently criticizing the DoD for shirking its responsibility in completing epidemiological studies. As the debate about cleanup and drinking water standards continues, companies must remain attentive to perchlorate issues.

The costs to remediate perchlorate contamination are high. Perchlorate is a mobile compound that is difficult to remediate cost-effectively. The high solubility of perchlorate coupled with its chemical stability in water leads to expansive plumes and to difficulty in cleaning up by conventional treatment methods. The costs required to remediate perchlorate contamination at various sites across the United States recently have ranged from $20,000,000 to $300,000,000. In some instances, where a company has paid for remediation itself, contribution from the government may be sought. For example, chemical company Tronox Inc. recently finalized a $20.5M settlement to recoup some of the $122M it spent to clean up a Nevada perchlorate plant.

As an "emerging" environmental threat, perchlorate has the potential to become a significant and unexpected legacy liability for defense contractors.

Saul Ewing LLP will continue to monitor perchlorate developments. As an "emerging" environmental threat, perchlorate has the potential to become a significant and unexpected legacy liability for defense contractors. Prudent defense contractors will consider the following next steps: (1) Be cognizant as you make business decisions that perchlorate is an emerging environmental risk that particularly threatens the defense industry; (2) Incorporate the risk of future liability in the cost/benefit analysis of mergers and acquisitions (and negotiate appropriate indemnification protection); (3) Institute procedures/practices to monitor/manage the way your Company handles waste streams including perchlorate; and (4) Develop proactive strategies to minimize exposure for liability and cleanup costs. ■

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Defense Appropriations Approved for FY '06

By David L. Hackett

As 2005 came to a close, President Bush signed into law the Defense Appropriations Bill for fiscal year 2006. Before passage, Congress had to address barriers Senators placed in front of the bill, such as addressing the nation's torture policy and whether to permit oil exploration in the Alaskan National Wildlife Refuge. In the end, a compromise was reached on the nation's interrogation policy, oil exploration was shelved, and Congress passed the defense appropriations conference report just before adjourning for the holidays. The bill approved $403.5 billion in spending authority for the Department of Defense. This funding is $12.3 billion more than provided in the fiscal year 2005 budget excluding funds approved in the 2005 Iraq supplemental, but was $4.4 billion less than requested by President Bush.

Emergency Iraq and Afghanistan Funding

The legislation included $50 billion in emergency funding for military operations in Iraq and Afghanistan. This bridge fund is designed to cover six months worth of contingency operations costs in the global war on terrorism.

The funding includes $1 billion in additional equipment for the Army and Air National Guard, and the Army Reserve. $8 billion is included to procure equipment due to wartime losses, such as Humvees, trucks, radios, electronic jammers, Tomahawk cruise missiles, and ammunition. $1.2 billion is provided for personnel protection items such as body armor. Further, $1.36 billion is allocated for the IED Defeat Task Force of the Department of Defense in order to test and field new jammers to counter improvised explosive devices (IEDs) employed by enemies in Iraq and Afghanistan.

Overall Review

Highlights of the overall bill include fully funding a 3.1% military pay raise effective January 1, 2006 and end strength levels requested for active duty and Guard and Reserve Personnel in President Bush's budget. For Army Ground Systems, the legislation approved $3.2 billion for the Army's Future Combat System research and development program. This funding is greater than the $3 billion initially approved by the House of Representatives, but is $240 less than requested due to development and contracting delays. Additionally, the Stryker vehicle program is fully funded at the requested level of $878 million for 240 vehicles.

On shipbuilding, the final bill approved the President's request for funding 4 ships as well as another $440 million for 2 additional Littoral Combat ships. The bill also fully funded the Navy's DD(X) destroyer program and $30 million to accelerate ship design of the CG(X) next generation cruiser. In total, the agreement provides $9.4 billion for new ship construction and ship conversion, an increase of $306 million above the President's budget request.

Regarding Navy and Marine Corps aviation, $2.7 billion was authorized for 42 F/A-18s as requested by the President and $1.5 billion was provided to fully fund the V-22 aircraft procurement program. The legislation also funds 5 KC-130J tanker aircraft for the Marine Corps, compared to the 4 initially funded in the House-passed bill.

The legislation included $50 billion in emergency funding for military operations in Iraq and Afghanistan. This bridge fund is designed to cover six months worth of contingency operations costs in the global war on terrorism.

The final legislation also authorizes the requested funding for 25 F/A-22 aircraft and 15 C-17 aircraft. The Joint Strike Fighter program is funded at $4.8 billion for research and development, $200 million below the request and a reduction of $32 million is provided for advance procurement due to development delays for the first few production aircraft. The Congress also sought to improve missile reliability in the Joint Air-to-Surface Standoff Missile program and, therefore, imposed additional testing requirements with its authorization of $100 million to sustain a minimum production rate of this program.

Local Impact

The 2006 defense appropriations will fund a number of programs in the Mid-Atlantic region. For instance, $27 million was provided for research, development, and fielding of the Aegis Ballistic Missile Defense Signal Processor and another $5.65 million for the Advanced Radar Technology Integrated System Testbed. These projects will be worked on by Lockheed Martin's Maritime Systems & Sensors facility in Moorestown, New Jersey. Meanwhile, the fully funded V-22 program will be worked on by Boeing workers located at the company's plant in Ridley Park, PA.

The bill also includes $150 million for Maryland defense projects, including $14 million for projects being conducted at the Indian

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Head Surface Warfare Center and $15 million for projects being conducted at the Patuxent River Naval Air Station in southern Maryland.

Additionally, more than $55 million will be allocated to small firms in southeastern Pennsylvania. For instance, Analytical Graphics, Inc. in Exton, Pennsylvania will receive $4 million to help fine-tune software that prevents "rogue nations" from jamming GPS-guided weapons. $2.5 million will go to the Center for Rotorcraft Innovation in Delaware County, Pennsylvania Additionally, Rajant Corporation will receive $2.5 million for a mobile emergency broadband system and Morphotek, Inc. will receive $2.55 million to develop antibodies that will aid in combating biowarfare. ■

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