# Counseling Corporations Involved in Government Investigations and the Principles of Federal Prosecution of Business Organizations

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Charles Rettig, Steven Toscher, Dennis Perez and Edward Robbins explain the prosecution of corporate crime and the conduct that the corporation should adopt when faced with a criminal or civil prosecution.

The prosecution of corporate crime is a high priority for the U.S. Department of Justice, with the primary prosecutorial goals being deterrence, punishment and rehabilitation. Business organizations are "legal persons," capable of suing and being sued, and capable of committing crimes. The indictment of a business organization does not mean that individual directors, officers, employees or shareholders will not also be charged. Prosecution of a business organization is not a substitute for the prosecution of criminally culpable individuals within or without the organization. Because an organization can act only through individuals, imposition of individual criminal liability may provide a strong deterrent against future corporate wrongdoing.

Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees and agents. To hold a corporation liable for these actions, the government must generally establish that the actions of the agent for the organization: (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In matters involving wrongdoing by agents, potential criminal targets include both the organization and the responsible individuals.

Corporate agents may act for various reasons, both for personal gain (both direct and indirect) and for the benefit of the business organization, and an organization may be held liable as long as one motivation of its agent is to benefit the organization. *See United States v. Potter*,[1] (stating that the test to determine whether an agent is acting within the scope of employment is "whether the agent is performing acts of the kind which he is authorized to perform, and those acts are motivated, at least in part, by an intent to benefit the corporation.").

In *United States v. Automated Medical Laboratories*,[2] the court affirmed the corporation's conviction for the actions of a subsidiary's employee despite its claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." The court stated, "*Par-*

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*tucci* was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well-being and its lack of difficulties with the FDA." Similarly, in *United States v. Cincotta*,[3] the court held, "criminal liability may be imposed on the corporation only where the agent is acting within the scope of his employment. That, in turn, requires that the agent be performing acts of the kind that he is authorized to perform, and those acts must be motivated—at least in part—by an intent to benefit the corporation." Applying this test, the court upheld the corporation's conviction, notwithstanding the substantial personal benefit reaped by its agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name. As the court concluded, "Mystic—not the individual defendants—was making money by selling oil that it had not paid for."

The business organization need not necessarily profit from its agent's actions for it to be held criminally liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

> [B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which be inimical to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.[4]

Prosecutors generally apply the same factors in determining whether to charge a business organization as they do with respect to charging individuals.[5] Prosecutors will weigh all of the factors normally considered in the exercise of their prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. However, due to the nature of the organizational "person," some additional factors are present. Through the years, the Department of Justice has promulgated various policies designed to guide prosecutors in the exercise of their discretion to indict a business organization.

## The Thompson Memorandum and the Principles of Federal Prosecution of Business Organizations

On January 20, 2003, then-U.S. Deputy Attorney General Larry D. Thompson promulgated a policy statement, Principles of Federal Prosecution of Business Organizations (the "Thompson Memorandum"), that articulated principles to govern the discretion by the Department of Justice prosecutors in investigating, charging and prosecuting corporate crimes. The Thompson Memorandum was closely based on a predecessor document issued in 1999 by then-U.S. Deputy Attorney General Eric Holder ("Federal Prosecution of Corporations").

The primary focus of the Thompson Memorandum was an increased emphasis on and scrutiny of the authenticity of a business organization's cooperation. The Department believed that some business organizations, while purporting to cooperate with an investigation, might instead take steps to impede the exposure of the complete scope of alleged wrongdoing being investigated. The Thompson Memorandum specified that such conduct should weigh in favor of a prosecution of the business organization and addressed efficacy of the corporate governance mechanisms in place within the entity. In conducting an investigation, determining whether to bring charges, and negotiating plea agreements, the Thompson Memorandum set forth the following specific factors for consideration by prosecutors in reaching a decision as to the proper treatment of a corporate target:

- the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;
- the pervasiveness of wrongdoing within the corporation, including the complicity in, or condemnation of, the wrongdoing by corporate management;
- the corporation's history of similar conduct, including prior criminal, civil and regulatory enforcement actions against it;

- 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;
- the existence and adequacy of the corporation's compliance program;
- the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution and to cooperate with the relevant government agencies;
- collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution;
- the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
- the adequacy of remedies, such as civil or regulatory enforcement actions.

The Thompson Memorandum explained that prosecutors should inquire "whether the corporation appears to be protecting its culpable employees and agents [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."[6]

## Case Study–Implementation of the Thompson Memorandum

Following U.S. Senate Subcommittee hearings in 2002 concerning the possible involvement of KPMG, LLP in creating and marketing allegedly abusive tax shelters, KPMG's counsel formulated a "cooperative approach" in dealing with federal authorities. *See United States v. Stein*,[7] (*Stein I*). Their strategy included "a decision to 'clean house'—a determination that included asking senior KPMG partners who had testified before the Senate—to leave their positions within the firm."[8]

In February 2004, KPMG officials learned that the firm and approximately 20 of its partners and employees were "subjects" of a grand jury investigation regarding allegedly fraudulent tax shelters.[9] A "subject" is on the proverbial fence between a "witness" and a "target" in a criminal investigation. Information developed (or not) during the investigation can change the status between a subject, a witness and a target. On February 18, 2004, KPMG's CEO announced to all partners that the firm was aware of the U.S. Attorney's Office's (USAO) investigation and that "[a]ny present or former members of the firm asked to appear will be represented by competent coun[sel] at the firm's expense." *See United States v. Stein*,[10] (*Stein IV*).

On March 12, 2004, KPMG sent a memorandum to many of its employees urging them to cooperate with the government, advising them that it might be advantageous for them to exercise their right to counsel, and advising that KPMG would cover employees' "reasonable fees."[11] By letter, the prosecutors expressed their "disappoint[ment] with [the] tone" of this memorandum and its "one-sided presentation of potential issues," and "demanded that KPMG send out a supplemental memorandum in a form they proposed."[12] The government's alternative language, premised on the "assum[ption] that KPMG truly is committed to fully cooperating with the Government's investigation,"[13] was for KPMG to advise the employees that they could "meet with investigators without the assistance of counsel."[14] KPMG complied with the government's demands and circulated a memo advising that KPMG employees "may deal directly with government representatives without counsel."[15]

At a June 13, 2005 meeting with government prosecutors, KPMG's counsel stressed the firm's "precedent setting" pressure on employees to cooperate by conditioning legal fees on cooperation.[16] KPMG's cooperative efforts were ultimately successful: on August 29, 2005, KPMG entered into a deferred prosecution agreement (the DPA) under which KPMG admitted extensive wrongdoing, paid a $456 million fine and committed itself to cooperation in any future government investigation or prosecution.[17] The cooperation provisions of the DPA required KPMG to comply with demands by the USAO or face "the risk that the government will declare that KPMG breached the DPA and prosecute" KPMG.[18]

On August 29, 2005—the same day KPMG executed the DPA—the government indicted various current or former KPMG employees, including the KPMG Vice Chairman of Tax Services. A superseding indictment filed on October 17, 2005 named

10 additional KPMG employees, including a former tax partner in charge of professional practice, a former Associate General Counsel, and the former Chief Financial Officer. The superseding indictment charged a total of 19 defendants in 46 counts for conspiring to defraud the United States and the IRS, tax evasion and obstruction of the internal revenue laws (although not every individual was charged with every offense). KPMG promptly stopped advancing legal fees to the indicted employees who were still receiving payment of such fees.[19]

On January 12, 2006, 13 defendants (among others) moved to dismiss the indictment based on the government's interference with KPMG's advancement of fees. In a submission to the district court, KPMG represented that "the Thompson Memorandum in conjunction with the government's statements relating to payment of legal fees affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees. . . . In fact, KPMG is prepared to state that the Thompson memorandum substantially influenced KPMG's decisions with respect to legal fees . . ."[20]

On July 16, 2007, the U.S. District Court for the Southern District of New York (Kaplan, J.) issued an order dismissing the indictment against the 13 former partners and employees of KPMG. Judge Kaplan found that, absent pressure from the government, KPMG would have paid the defendants' legal fees and expenses without regard to cost. Based on this and other findings of fact, Judge Kaplan ruled that the government deprived these defendants of their right to counsel under the Sixth Amendment by causing KPMG to impose conditions on the advancement of their legal fees, to cap the fees and ultimately to end payment of the fees.[21]

The government subsequently appealed the dismissal of the indictment to the Second Circuit Court of Appeals. On August 28, 2008, the Second Circuit Court of Appeals held that KPMG's adoption and enforcement of a policy under which it conditioned, capped and ultimately ceased advancing legal fees to defendants "followed as a direct consequence of the government's overwhelming influence, and that KPMG's conduct therefore amounted to state action."[22] Further, "the government thus unjustifiably interfered with defendants' relationship with counsel and their ability to mount a defense, in violation of the Sixth Amendment, and that the government did not cure the violation. Because no other remedy will return defendants to the status quo ante, [the Second Circuit] affirm[ed] the dismissal of the indictment as to all thirteen defendants."

## Charging Guidelines Included Within the U.S. Attorneys Manual (USAM)

On December 12, 2006, after the events in the KPMG prosecution had transpired—the Department of Justice replaced the Thompson Memorandum with the "McNulty Memorandum," under which prosecutors "may" consider a company's fee advancement policy only where the circumstances indicate that it is "intended to impede a criminal investigation," and even then only with the approval of the Deputy Attorney General.[23] The McNulty Memorandum attempted to limit prosecutors' ability to require business entities to waive their attorney-client and work product privileges as evidence of cooperation to avoid a criminal indictment, and to consider the corporation's advancement of legal fees to employees/agents in deciding whether to indict the corporation. A change in policy was made in part to "further promote public confidence in the Department" in the wake of mounting criticism from judges, Congress and business groups that certain guidelines under the Thompson Memorandum infringed upon the attorney-client and work product privileges and a defendant's constitutional right to fair trial and effective assistance of counsel.

> The primary focus of the Thompson Memorandum was an increased emphasis on and scrutiny of the authenticity of a business organization's cooperation.

Charging guidelines have historically been set forth in a series of internal Department of Justice policy memoranda, each of which has generally been referred to by the name of the Deputy Attorney General that promulgated the guidelines (commonly referred to as the Holder, Thompson and McNulty Memoranda). The release of the Second Circuit's decision in *Stein* on August 28, 2008, coincided with Deputy Attorney General Mark Filip's announcement that,

effective immediately, the Department of Justice was revising and implementing significant changes to its corporate charging guidelines for federal prosecutors throughout the country. These revised charging guidelines were for the first time committed to the USAM,[24] which is binding on all federal prosecutors within the Department of Justice.

In matters involving corporate wrongdoing, prosecutors are aware of the public benefits that flow from a corporate indictment. Corporations frequently pursue immediate remedial actions when an indictment occurs within their particular industry. As such, an indictment can provide a unique opportunity for deterrence on a broad scale. Further, a corporate indictment often results in specific deterrence by quickly changing the culture of the indicted corporation and the behavior of its representatives.

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The prosecutor generally has substantial latitude in determining when, whom, how and even whether to prosecute for violations of federal criminal law. Sometimes it may be determined that corporate wrongdoing may be resolved by means other than an indictment (such as the Deferred Prosecution Agreement entered into with KPMG, LLP or nonprosecution agreement, which are discussed in USAM §9-28.1000). Various civil and regulatory alternatives may be appropriate in certain cases (as discussed in USAM §9-28.1100).

***Prosecutors generally apply the same factors in determining whether to charge a corporation as they do with respect to individuals.***[25] These factors normally include the sufficiency of the evidence; the likelihood of success at trial; the probable deterrent, rehabilitative and other consequences of conviction; and the adequacy of noncriminal alternatives to indictment. Due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring charges, and negotiating plea or other agreements, the revised charging guidelines[26] provide that prosecutors should consider the following factors in reaching a decision as to the proper treatment of a business organization:[27]

**1. The nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime.** USAM §9-28.400 states that corporate conduct, particularly that of national and multi-national corporations, intersects with federal economic, tax and criminal law enforcement policies. Prosecutors are to consider the practices and policies of the appropriate Division of the Department of Justice, and must comply with those policies to the extent required by the facts presented.

**2. The pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management.** USAM §9-28.500 acknowledges that since a corporation can only act through natural persons, it is therefore held responsible for the acts of such persons attributable to it. The USAM provides that charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees, or by all the employees in a particular role within the corporation, or was condoned by upper management. On the other hand, it may not be appropriate to impose liability upon a corporation, particularly one with a strong compliance program in place, under a strict *respondeat superior* theory for a single isolated act of an errant employee. Prosecutors are to exercise their discretion in evaluating the pervasiveness of wrongdoing within a corporation. Of these factors, the most important is the role and conduct of management. Although acts of even low-level employees may result in criminal liability, a corporation is actually directed by its management and management is responsible for creating the corporate culture in which criminal conduct is either discouraged or tacitly encouraged.

**3. The corporation's history of similar misconduct, including prior criminal, civil and regulatory enforcement actions against it.** A corporation, like a natural person, is expected to learn from its mistakes. USAM §9-28.600 states that a history of similar misconduct may be probative of a corporate culture that encouraged, or at least condoned, corporate misdeeds, regardless of any corporate compliance programs. Further, USAM §9-28.600 provides that criminal prosecution of a corporation may be particularly appropriate where the corporation previously

had been subject to noncriminal guidance, warnings or sanctions, or previous criminal charges, and it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the misconduct in spite of the warnings or enforcement actions taken against it.

**4. The corporation's timely and voluntary disclosure of wrongdoing, its willingness to cooperate in the investigation of its agents and to provide relevant information and evidence and identify the potential wrongdoers within and outside the corporation, including senior executives.** USAM §9-28.700 acknowledges that cooperation is a potential mitigating factor, by which a corporation—just like any other subject of a criminal investigation—can gain credit in a case that otherwise is appropriate for indictment and prosecution. Further, USAM §9-28.700 clarifies that the decision not to cooperate by a corporation (or individual) is not itself evidence of misconduct, at least where the lack of cooperation does not involve criminal misconduct or demonstrate consciousness of guilt (e.g., suborning perjury or false statements, or refusing to comply with lawful discovery requests). Thus, USAM §9-28.700 provides that failure to cooperate, in and of itself, does not support or require the filing of charges with respect to a corporation any more than with respect to an individual.

USAM §9-28.700 provides that while investigating wrongdoing by or within a corporation, a prosecutor is likely to encounter several obstacles resulting from the nature of the corporation itself. It may be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in expeditiously identifying potentially relevant actors and locating relevant evidence.

The difficulty of determining what happened within the corporate structure, where the evidence is, and which individuals took or promoted putatively illegal corporate actions can have negative consequences for both the government and the corporation that is the subject or target of a government investigation. More specifically, because of corporate attribution principles concerning actions of corporate officers and employees, uncertainty about who authorized or directed apparent corporate misconduct can inure to the detriment of a corporation. For example, it may not matter under the law which of several possible executives or leaders in a chain of command approved of or authorized criminal conduct; however, that information if known might bear on the propriety of a particular disposition short of indictment of the corporation. It may not be in the interest of a corporation or the government for a charging decision to be made in the absence of such information, which might occur if, for example, a statute of limitations were relevant and authorization by any one of the officials were enough to justify a charge under the law. A protracted government investigation of such an issue could, as a collateral consequence, significantly disrupt the corporation's business operations or depress its public confidence in its market value.

For the foregoing reasons, USAM §9-28.700 provides that cooperation can be a favorable course for both the government and the corporation. Cooperation benefits the government and ultimately shareholders, employees and other often blameless victims by allowing prosecutors and federal agents to avoid protracted delays, which compromise their ability to quickly uncover and address the full extent of widespread corporate crimes. With cooperation by the corporation, the government may be able to reduce tangible losses, limit damage to reputation and preserve assets for restitution. Similarly, cooperation may benefit the corporation by enabling the government to focus its investigative resources in a manner that will not unduly disrupt the corporation's business operations. USAM §9-28.700 provides that cooperation may benefit the corporation by presenting it with the opportunity to earn credit for its efforts and not be indicted.

> Prosecutors generally apply the same factors in determining whether to charge a business organization as they do with respect to charging individuals.

**5. The existence and effectiveness of the corporation's pre-existing compliance program.** Compliance programs are established by corporate management

to prevent and detect misconduct and to ensure that corporate activities are conducted in accordance with applicable criminal and civil laws, regulations and rules. The Department of Justice encourages corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, USAM §9-28.800 clarifies that the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal misconduct undertaken by its officers, directors, employees or agents. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

USAM §9-28.800 provides that the existence of a corporate compliance program, even one that specifically prohibited the specific conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior*.[28] ("[A] corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if . . . such acts were against corporate policy or express instructions."). As explained in *United States v. Potter*,[29] a corporation cannot "avoid liability by adopting abstract rules" that forbid its agents from engaging in illegal acts, because "[e]ven a specific directive to an agent or employee or honest efforts to police such rules do not automatically free the company for the wrongful acts of agents."[30] *See also United States v. Hilton Hotels Corp.*,[31] (noting that a corporation "could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks"); *United States v. Beusch*,[32] ("[A] corporation may be liable for acts of its employees done contrary to express instructions and policies, but . . . the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation.").

While USAM §9-28.800 recognizes that no compliance program can adequately prevent all criminal activity by a corporation's employees, the critical factors in evaluating a compliance program include whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department of Justice has no formal requirements regarding corporate compliance programs. USAM §9-28.800 provides that the fundamental inquiries by a prosecutor should include: Is the corporation's compliance program well designed? Is the program being applied earnestly and in good faith? Does the corporation's compliance program work? In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal misconduct; the number and level of the corporate employees involved; the seriousness, duration and frequency of the misconduct; and any remedial actions taken by the corporation, including, for example, disciplinary action against past violators uncovered by the prior compliance program, and revisions to corporate compliance programs in light of lessons learned.

> Credit for cooperating can determine the potential resolution of any government investigation. As such, an additional consideration partially included within the degree of cooperation credit is whether the corporation has engaged in conduct intended to obstruct or impede the investigation through, for example, inappropriate directions to employees or their counsel, such as directions to be less than truthful, to conceal relevant facts, to make representations or submissions that contain somewhat misleading assertions or material omissions, and incomplete or delayed production of records.

USAM §9-28.800 instructs prosecutors to also consider the promptness of any disclosure of wrongdoing to the government. In evaluating compliance

programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are internal audit functions conducted at a level sufficient to ensure their independence and accuracy; and have the directors established an information and reporting system in the organization reasonably designed to provide management and directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. *See, e.g., In re Caremark Int'l Inc. Derivative Litig.*[33]

In accordance with USAM §9-28.800, prosecutors are to attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed, implemented, reviewed and revised, as appropriate, in an effective manner. In addition, prosecutors are to determine whether the corporation has provided for a staff sufficient to audit, document, analyze and utilize the results of the corporation's compliance efforts. Prosecutors are to also determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. The foregoing is intended to enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents or to mitigate charges or sanctions against the corporation.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's industry or line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, USAM §9-28.800 instructs prosecutors to consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance and medical boards; the Department of Defense; the Department of Health and Human Services; the Environmental Protection Agency; and the Securities and Exchange Commission have considerable experience with compliance programs and can be helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist U.S. Attorneys' Offices in finding the appropriate agency office(s) for such consultation.

**6. The corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution and to cooperate with the relevant government agencies.** A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. USAM §9-28.900 provides that corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should consider and take steps to implement the personnel, operational and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Efforts to promote future compliance are critical.

Among the factors prosecutors consider under USAM §9-28.900 are whether the corporation appropriately disciplined wrongdoers, once those employees have been identified by the corporation as culpable for the misconduct. Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. Although corporations need to be fair to their employees, they must also be committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. Corporations must be prepared to satisfy prosecutors that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

In addition to employee discipline, two other factors used under USAM §9-28.900 in evaluating a corporation's remedial efforts include restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its acceptance of responsibility and, consistent with the practices and policies of the appropriate Division of the Department of

Justice entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider in appropriate disposition of a case.

**7. Collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees and others not proven personally culpable, as well as impact on the public arising from the prosecution.** One of the factors under the USAM in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, USAM §9-28.1000 provides that prosecutors may take into account the possibly substantial consequences to a corporation's employees, investors, pensioners and customers, many of whom may, depending on the size and nature of the corporation and their role in its operations, have played no role in the criminal conduct, have been unaware of it, or have been unable to prevent it. USAM §9-28.1000 further provides that prosecutors should be aware of nonpenal sanctions that may accompany a criminal charge, such as potential suspension or debarment from eligibility for government contracts or federally funded programs, such as health care programs. Determining whether or not such nonpenal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency and is a decision that will be made based on the applicable statutes, regulations and policies.

USAM §9-28.1000 acknowledges that virtually every conviction of a corporation will have an impact on innocent third parties. However, the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the relevance of collateral consequences, various factors already discussed under USAM §9-28.1000, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs, should be considered in determining the weight to be given to this factor. For instance, prosecution of corporations may be favored in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of corporate punishment upon shareholders may be of less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity. Similarly, where the top layers of the corporation's management or the shareholders of a closely held corporation were engaged in or aware of the wrongdoing, and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral, but a direct and entirely appropriate consequence of the corporation's wrongdoing.

USAM §9-28.1000 provides that where the collateral consequences of a corporate conviction for innocent third parties would be significant, it may be appropriate to consider a nonprosecution or, as in the matter involving KPMG, a deferred prosecution agreement with conditions designed, among other things, to promote compliance with applicable law and to prevent recidivism. Such agreements are a third option, besides a criminal indictment and a declination. Declining prosecution may allow a corporate criminal to escape without consequences. Obtaining a conviction may produce a result that seriously harms innocent shareholders and others. USAM §9-28.1000 acknowledges that under appropriate circumstances, a deferred prosecution or nonprosecution agreement can help restore the integrity of a company's operations and preserve the financial viability of a corporation that has engaged in criminal conduct, while preserving the government's ability to prosecute a recalcitrant corporation that materially breaches the agreement. Such agreements achieve other important objectives as well, like prompt restitution for victims. Ultimately, the appropriateness of a criminal charge against a corporation, or some lesser alternative, must be evaluated in a pragmatic and reasoned way that produces a fair outcome, taking into consideration, among other things, the government's need to promote and ensure respect for the law.

**8. The adequacy of the prosecution of individuals responsible for the corporation's malfeasance.**

**9. The adequacy of remedies such as civil or regulatory enforcement actions.** USAM §9-28.1100 acknowledges that noncriminal alternatives to prosecution often exist and prosecutors are authorized to consider whether such sanctions would adequately deter, punish and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of noncriminal alternatives to prosecution—

*e.g.,* civil or regulatory enforcement actions—USAM §9-28.1100 authorizes the prosecutor to consider all relevant factors, including sanctions available under the alternative means of disposition, the likelihood that an effective alternative sanction will be imposed, and the effect of noncriminal disposition on federal law enforcement interests.

Noncriminal sanctions may not be an appropriate response to a serious violation, a pattern of wrongdoing or prior noncriminal sanctions without proper remediation. In other cases, however, these goals may be satisfied through civil or regulatory actions. In determining whether a federal criminal resolution is appropriate, USAM §9-28.1100 suggests the prosecutor consider the same factors (modified appropriately for the regulatory context) considered when determining whether to leave prosecution of a natural person to another jurisdiction or to seek noncriminal alternatives to prosecution. These factors include: the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action; the probable sanction if the regulatory authority's enforcement action is upheld; and the effect of a noncriminal disposition on federal law enforcement interests.[34]

## Cooperation Credit

Credit for cooperating can determine the potential resolution of any government investigation. As such, an additional consideration partially included within the degree of cooperation credit is whether the corporation has engaged in conduct intended to obstruct or impede the investigation through, for example, inappropriate directions to employees or their counsel, such as directions to be less than truthful, to conceal relevant facts, to make representations or submissions that contain somewhat misleading assertions or material omissions, and incomplete or delayed production of records.

The revised Principles of Federal Prosecution of Business Organizations (USAM §9-28.000, *et. seq.* August 28, 2008) clearly provide that a prosecutor "may not" consider the corporation's decision to advance legal fees and expenses to employees in evaluating a corporation's cooperation with a Department of Justice investigation. In evaluating cooperation, USAM §9-28.730 instructs prosecutors to not take into account whether a corporation is advancing or reimbursing attorneys' fees or providing counsel to employees, officers or directors under investigation or indictment. Similarly, USAM §9-28.730 provides that prosecutors may not request that a corporation refrain from taking such action. This prohibition is not intended to prevent a prosecutor from asking questions about an attorney's representation of a corporation or its employees, officers or directors, where otherwise appropriate under the law.

Routine questions regarding the representation status of a corporation and its employees, including how and by whom attorneys' fees are paid, sometimes arise in the course of an investigation under certain circumstances, for example, to assess conflict-of-interest issues. Neither is it intended to limit the otherwise applicable reach of criminal obstruction of justice statutes such as 18 USC §1503. If the payment of attorney fees were used in a manner that would otherwise constitute criminal obstruction of justice—for example, if fees were advanced on the condition that an employee adhere to a version of the facts that the corporation and the employee knew to be false—the USAM would not render inapplicable such criminal prohibitions.

## Joint Defense Agreements and Cooperation

Under USAM §9-28.730, participation by a corporation in a joint defense agreement does not render the corporation ineligible to receive cooperation credit, and prosecutors may not request that a corporation refrain from entering into such agreements. However, the corporation may desire to avoid being placed in a compromising position by reason of the provisions in a particular joint defense or similar agreement and being unable to provide relevant facts to the government limiting its potential credit for such cooperation credit. For example, if the corporation gathers facts from employees who have entered into a joint defense agreement with the corporation, the employees may later seek to prevent the corporation from disclosing these facts. Corporate counsel should carefully draft any potential agreements that provide as much such flexibility as reasonably possible.

In making a charging decision, the government may consider whether the corporation has shared with others sensitive information about the investigation that the government provided to the corporation. USAM §9-28.730 authorizes the government to request that if a corporation wishes to receive credit for cooperation, information provided by the government to the corporation not be transmitted to others—for example,

where the disclosure of such information could lead to flight by individual subjects, destruction of evidence, or dissipation or concealment of assets.

## Privileged Communications

Corporate entities should engage counsel when facing a government investigation. Counsel will typically conduct an internal investigation, a process that may confer attorney-client privilege or attorney work product protections on at least some of the information collected. The attorney-client privilege and attorney work product protections are well respected within our legal system. However, they serve to inhibit the ability of the trier of fact to obtain all potentially relevant information. The government is typically not seeking to destroy such privileges but is seeking the underlying facts relevant to its prosecution decision. USAM §9-28.710 clearly provides that while a corporation remains free to convey nonfactual or "core" attorney-client communications or work product—if and only if the corporation voluntarily chooses to do so—prosecutors should not ask for such waivers and are directed not to do so.

## Defensive Strategies When Counseling Corporations Involved in Government Investigations

Information is power. Counsel should control and monitor the information flow to the government. Throughout the investigation, there will be consideration of whether and to what extent to cooperate with the government and when to exercise or waive relevant privileges.

Counsel must promptly coordinate an internal investigation to gauge the possible exposure of the corporation. A team of lawyers and investigators must be developed to analyze problem areas; conduct initial interviews of employees (current and former); develop legal and factual defenses; retain individual counsel for possible targets, subjects and witnesses; and execute an appropriate "Joint Defense Agreement" among corporate and individual counsel. If the corporation is publicly traded, counsel must be cognizant of disclosure obligations once criminal activity is discovered and/or the existence of a government investigation is known.

In an effort to hopefully preserve relevant privileges, the corporation should regularly inform employees in writing and through periodic seminars of the basic purposes and requirements of the attorney-client privilege, in particular, that legal communications are intended to be kept confidential. Corporate counsel should become informed regarding the law of privilege in the states and appellate districts in which the corporation operates. When dealing with sensitive legal matters, corporate counsel should obtain a written request for legal advice from executive management. Counsel should clearly distinguish in its communications and writings between giving legal and business advice. Internal corporate investigations should be initiated and conducted by counsel rather than by other employees, such as security, auditors, ethics, or human resource employees. The corporation should establish and follow a policy limiting reproduction of documents containing legal opinions and advice and limiting the distribution of legal advice to those who actually have a need to know this advice.

If the government investigation includes the issuance of search warrants, there will usually be little or no warning that numerous federal agents are about to search the business premises. Upon learning of the execution of search warrants, counsel should advise employees about their rights to speak to government agents and not to speak to government agents; advise employees that the corporation will pay for them to have a lawyer and that they can consult with the lawyer before talking to government agents; send employees home; all should be courteous with the agents and should not in any manner obstruct or interfere with the search; obtain the names, positions and phone numbers of as many government agents as possible; obtain a copy of the search warrant and the affidavit, if it is not sealed; and identify all material that could be considered attorney-client privileged or attorney work product, and request that such material be placed in sealed boxes if the agents insist on removing it from the premises. Counsel should contact the Assistant U.S. Attorney (AUSA) in charge of the case and try to persuade him or her that the corporation will comply with any request for documents without the need for the search and that the corporation requests a stay of the search to contest the validity of the search before a U.S. Magistrate Judge.

During execution of the search, the corporate representatives may videotape or photograph the agents performing the search. Counsel should ensure that the search does not exceed the limited parameters of the search warrant and likely should not consent to expand the scope of the search. No one should

interfere with or impede the search in any manner. Counsel may assign several people to carefully record precisely what files were searched, by how many people and in what fashion. Consider asking the agents to allow the corporation to make copies of records required to continue the business operations, particularly computer records. Following the search, every employee that had contact with government agents must be fully debriefed by counsel.

When contacting the prosecutor, request the opportunity to immediately review and copy all records that have been seized by the government. Counsel should try to obtain an agreement for no additional searches in lieu of grand jury subpoenas, try to obtain an agreement for no home interviews of employees, and try to obtain information about allegations and which individuals are considered to be witnesses, subjects and targets. An effort should be made to educate the prosecutor about the adverse impact of investigation on the company.

Potential resolution strategies range from a request for a complete prosecution declination, proposing a civil rather than criminal resolution ("this is really just a civil case"), to an evaluation of whether a noncriminal resolution can be reached by showing some or all of defense "cards" (legal and factual) or holding these cards back for better impact at trial. If evidence of criminal conduct is strong, counsel should try to minimize loss or gain from criminal conduct and emphasize mitigating factors such as acceptance of responsibility, cooperation with the investigation, corrective actions, future compliance programs and a lack of criminal history.

When considering a plea agreement, counsel should demand a narrow factual basis to reduce the extent of collateral estoppel in the civil case and attempt to select counts least detrimental to any later civil case. If the investigation covers more than one federal district, counsel should demand the agreement to the plea by every affected district. Adverse publicity can have an impact on any potential resolution. As such, counsel may desire to accomplish the arraignment, the plea and the sentencing on the same day, as well as propose alternatives to criminal fines (*e.g.,* community development funding).

The Federal Sentencing Guidelines will substantially dictate the criminal sentence. The Guidelines apply to organizations as well as individuals and focus on various factors to determine the criminal fine range, in addition to any probation, restitution, community service, notice to victims, special assessments and costs that may be ordered. These factors include preliminary determination of ability to pay the fine, the offense level of the underlying crime (amount of tax loss will dominate this factor), the size of corporate involvement in or tolerance of criminal activity, prior criminal history, possible violations of judicial order, possible obstruction of justice, creation of an effective program to prevent and detect future violations, self-reporting, cooperation and acceptance of responsibility and any potential collateral consequences of conviction.

In summary, the government cannot compel cooperation, and the corporation has no obligation to cooperate in any government investigation. A failure to provide relevant information does not mean the corporation will be indicted; it only means that the corporation will not be entitled to mitigating credit for possible cooperation. USAM §9-28.720 confirms that whether the corporation faces charges will turn, as it does in any case, on the sufficiency of the evidence, the likelihood of success at trial and all of the other relevant factors. If there is insufficient evidence to warrant an indictment, after appropriate investigation has been completed, or if the other factors weigh against indictment, the corporation should not be indicted, regardless of whether it has earned cooperation credit.

The government may charge even the most cooperative corporation pursuant to the USAM if, in considering all potentially relevant factors, the prosecutor determines that a charge is required in the interests of justice. As such, USAM §9-28.720 clearly provides that even the most sincere and thorough effort to cooperate cannot necessarily absolve a corporation that has, for example, engaged in an egregious, orchestrated and widespread fraud. Cooperation is a relevant potential mitigating factor, but it alone is not dispositive of the decision to indict.

In exercising their discretion, prosecutors carefully analyze the relevant facts and circumstances involved. Prosecutors are to ensure that the general purposes of the criminal law—assurance of warranted punishment, deterrence of further criminal conduct, protection of the public from dangerous and fraudulent conduct, rehabilitation of offenders, and restitution for victims and affected communities—are adequately met, taking into account the special nature of the corporate "person."[35]

Corporate counsel must take extreme caution when facing a government investigation or prosecution to preserve all relevant privileges, information and documentation. The future of the corporate entity

and any potential prosecution may depend on the method and manner of responding to the government inquiries. Counsel must get involved no later than upon the initial government inquiry and will be called upon to render critical advice and guidance throughout the investigative process. The corporation may be forced to make the difficult decision between preserving the corporate entity at the expense of the corporate employees. However, tossing the deck chairs over the railing during difficult times may not be sufficient to keep the ship afloat. Preparation and coordination of efforts during any government investigation may ultimately determine whether the corporation survives.

## ENDNOTES

1 *United States v. Potter*, CA-1, 463 F3d 9, 25 (2006).
2 *United States v. Automated Medical Laboratories,* CA-4, 770 F2d 399 (1985).
3 *United States v. Cincotta*, CA-1, 689 F2d 238, 241-42 (1982).
4 *Automated Medical Laboratories,* 770 F2d at 407 (*emphasis added; quoting Old Monastery Co. v. United States*, CA-4, 147 F2d 905, 908, *cert. denied*, 326 US 734 (1945)).
5 *See* United States Attorneys Manual (USAM); Principles of Federal Prosecution of Business Organizations, Title 9, Chapter 9-28.000, *et. seq.*
6 Thompson Memorandum, Section VI.
7 *United States v. Stein,* DC N.Y., 435 FSupp2d 330, at 339 (2006) (*Stein I*).
8 *Id.* at 339.
9 *Id.* at 341.
10 *United States v. Stein,* DC N.Y., 495 FSupp2d 390, at 407 (2007) (*Stein IV*).
11 *Stein I, supra* note 7 at 346 n.62.
12 *Stein I,* 435 FSupp2d at 346.
13 Letter of David N. Kelley, U.S. Attorney, Southern District of New York, Mar. 17, 2004.
14 *Stein I,* 435 FSupp2d at 346.
15 *Id.*
16 *Stein I,* 435 FSupp2d at 349.
17 *Stein I,* 435 FSupp2d at 349-50.
18 *Stein I,* 435 FSupp2d at 350.
19 *Stein I,* 435 FSupp2d at 350.
20 *Stein IV,* 495 FSupp2d at 405.
21 *See Stein IV.*
22 *See United States v. Jeffrey Stein, et al.,* CA-2, No. 07-3042-CR (2008).
23 Memorandum from Paul J. McNulty, Deputy Attorney General, U.S. Department of Justice, Principles of Federal Prosecution of Business Organizations (December 12, 2006), at VII n.3.
24 Principles of Federal Prosecution of Business Organizations, Title 9, Chapter 9-28.000.
25 *See* USAM §9-27.220, *et seq.*
26 USAM §9-28.000, *et seq.*
27 See USAM §9-28.300, *et. seq.*.
28 *See United States v. Basic Constr. Co.,* CA-4, 711 F2d 570, 573 (1983).
29 *United States v. Potter,* CA-1, 463 F3d 9 (2006).
30 *Id.* at 25-26.
31 *United States v. Hilton Hotels Corp.,* CA-9, 467 F2d 1000, 1007 (1972).
32 *United States v. Beusch,* CA-9, 596 F2d 871, 878 (1979).
33 *In re Caremark Int'l Inc. Derivative Litig,* 698 A2d 959, 968-70 (Del. Ch. 1996).
34 *See also* USAM §§9-27.240, 9-27.250.
35 *See* USAM §9-28.000, *et. seq.*.