Practice

By Charles P. Rettig

Throwing Peanuts from the Bleachers!

Federal Prosecutions of Business Organizations

The Department of Justice policy on criminally charging business organizations is generally described in a Memorandum from then Deputy Attorney General Larry D. Thompson to Heads of Department Components and United States Attorneys, Re: Principles of Federal Prosecution of Business Organizations (the "Thompson Memorandum").1 Prosecutors are charged with ensuring that the general purposes of the criminal law—punishment as warranted, deterrence of future criminal conduct, protection of the public, rehabilitation of the offenders and any appropriate restitution—are adequately satisfied, while taking into account the somewhat unique nature of the corporate "person" (i.e., the business entity cannot realistically be "incarcerated"—it can pay a monetary fine/restitution, receive independent oversight of future operations, etc.).

In determining whether to charge a corporation, prosecutors generally apply the same factors as they do with respect to charging individuals. They must review the sufficiency of the evidence and the likelihood of a conviction, along with the probable deterrent, rehabilitative and other consequences of conviction, as well as the adequacy of any available noncriminal sanctions. In making a decision to charge a corporation with a crime, the government has a limited degree of discretion in determining when, whom, how and sometimes even whether to prosecute for violations of federal criminal law. However, individual prosecutors obviously cannot turn a blind eye to potentially criminal conduct, whether occurring within the context of a business organization or otherwise.

The Thompson Memorandum sets forth various specific factors federal prosecutors are to consider

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in reaching a decision as to the proper treatment of a corporate target. As with the factors relevant to charging individuals, these factors are not exclusive but are intended to provide prosecutorial guidance. In conducting an investigation, determining whether to bring charges and negotiating corporate plea agreements under the Thompson Memorandum, prosecutors are to consider:

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 crimes[2];
2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management[3];
3. the corporation's history of similar conduct, including prior criminal, civil and regulatory enforcement actions against it[4];
4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the corporation's willingness to identify the culprits within the corporation—including senior executives, to make witnesses available, to disclose the complete results of its internal investigation and to waive attorney-client and work product protection (the "Cooperation Factor"[5]);
5. the existence and adequacy of the corporation's compliance program[6];
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[7];
7. collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable, and impact on the public arising from the prosecution[8];
8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
9. the adequacy of remedies such as civil or regulatory enforcement actions.[9]

The Thompson Memorandum was generated in the wake of a series of corporate scandals, including the 2002 indictment of Arthur Andersen relating to its work for Enron. Under the Thompson Memorandum, "it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*, voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment."[10] With respect to the Cooperation Factor, the Thompson Memorandum provides, in part:

> One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances. (This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation).The Department does not, however, consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.
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> Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees (some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law

should not be considered a failure to cooperate), 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. By the same token, the prosecutor should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.

> In making a decision to charge a corporation with a crime, the government has a limited degree of discretion in determining when, whom, how and sometimes even whether to prosecute for violations of federal criminal law.

Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.[11]

In a matter involving various former partners of KPMG, LLP and others, Judge Lewis A. Kaplan, of the Federal District Court in Manhattan (S.D.N.Y.), recently raised questions over whether portions of the Thompson Memorandum may have violated the Defendants' constitutional rights to legal representation and a fair trial. What is the impact under the Thompson Memorandum of a corporate decision to pay or refuse to pay legal fees for potentially culpable current or former employees involved in a criminal investigation or prosecution? Does the mere existence of the Thompson Memorandum eliminate corporate discretion regarding payment of such legal expenses? On May 8, 2006, Judge Kaplan held an evidentiary hearing to consider "whether the Government, through the Thompson Memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs."[12]

In a somewhat related context, one commentator has asserted that the Justice Department policy under the Thompson Memorandum may be taking a position that winning its cases is more important than historic rights centuries in the making, and that "legal rights formally used to shield the innocent have become a weapon of the Government."[13] Prosecutors prosecute cases. Judges, juries and, ultimately, the Appellate Courts decide whether those prosecutions and the procedures implemented along the way were warranted and appropriate.

The Thompson Memorandum exerts tremendous pressure on companies under investigation. While pondering the potential impact of the Thompson Memorandum, Judge Kaplan received an *Amici Curiae* brief on behalf of the Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association and the Chamber of Commerce of the United States of America intended to provide the "business communities perspective of the Justice Departments' disquieting policy of thwarting private arrangements for the legal representation of corporate officers and employees."[14] The *Amici* stated they have a "strong interest in preserving the discretion of their members to advance legal fees to officers and employees under investigation for acts committed in the course of employment."[15] The *Amici* contend, in part, that:

The Government decides which unconvicted corporate employees of the corporation should consider "culpable," and it coerces corporate counsel to withhold previously promised support for those employees' legal defense. The twin premises implicit in this policy are (i) that the employees in question are guilty, even though they have been convicted of no crime and (ii) that effective representation for targeted employees frustrates, rather than promotes, the cause of justice. The Thompson Memorandum's author summed up the essence of this policy when he explained that, in the Government's view, employees subject to investigation "don't need fancy legal representation" unless they are guilty.[16]

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...the government's intervention in private fee arrangements subverts the basic principles of our adversarial justice system; it places corporate counsel in the untenable position of having to accept the prosecutor's "culpability" determination at face value even during the early phases of an investigation; and it creates perverse incentives that threaten business efficiency. An enormous number of private businesses agree to advance attorney's fees to employees under investigation for conduct arising from their employment. Such arrangements are necessary both to recruit talented individuals to work in industries subject to close governmental scrutiny and to ensure that those individuals, once hired, act in the interests of their employers rather than serving their own self-interest by erring on the side of extreme caution, lest they face personally ruinous legal fees. For these reasons, and the reasons discussed below, the Thompson Memorandum is wrong both as a matter of constitutional law and as a matter of sound business sense.[17]

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...while even a mere allegation of wrongdoing can drive down a company's stock price, companies and the government both know the ruinous practical consequences of indictment. 'In the 212-year history of the U.S. financial markets, no major financial-services firm has ever survived a criminal indictment.'(Citations omitted). For example, Arthur Andersen, LLP lost most of its clients soon after it was indicted and is now, for practical purposes, a dead firm, even though the Supreme Court later overturned its conviction. Indicted companies may also face an onslaught of lawsuits by shareholders who allege that the company's wrongdoing caused a decrease in its share price.[18]

Few corporate employees can actually afford quality legal representation in the criminal context. In complex financial or accounting cases, the *Amici* comment that all defendants benefit from effective representation, not simply defendants who may have something to hide. Are the goals of the justice system to obtain convictions of the guilty, or to maintain an orderly process for the determination of guilt or innocence? Specifically, "For centuries, criminal suspects have been presumed innocent until proven guilty... and effective representation for these suspects has been thought to serve, rather than thwart, the essential goals of the justice system. (Citations omitted)."[19]

On June 26, 2006, Judge Kaplan rendered a strongly worded Opinion (consisting of 83 pages) essentially condemning portions of the Thompson Memorandum and determined, in significant part, that:

The issue now before the Court arises at an intersection of three principles of American law.

The first principle is that everyone accused of a crime is entitled to a fundamentally fair trial. This is a central meaning of the Due Process Clause of the Constitution.

The second principle, a corollary of the first, is that everyone charged with a crime is entitled to the assistance of a lawyer. A defendant with the financial means has the right to hire the best lawyers money can buy. A poor defendant is guaranteed competent counsel at government expense. This is at the heart of the Sixth Amendment.

The third principle is not so easily stated, not of constitutional dimension, and not so universal. But it too plays an important role in this case. It is simply this: an employer often must reimburse an employee for legal expenses when the employee is sued, or even charged with a crime, as a result of doing his or her job. Indeed, the employer often must advance legal expenses to an employee up front, although the employee sometimes must

pay the employer back if the employee has been guilty of wrongdoing.....

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Most of the defendants in this case worked for KPMG, one of the world's largest accounting firms. KPMG long has paid for the legal defense of its personnel, regardless of the cost and regardless of whether its personnel were charged with crimes. The defendants who formerly worked for KPMG say that it is obligated to do so here. KPMG, however, has refused.

If that were all there were to the dispute, it would be a private matter between KPMG and its former personnel. But it is not all there is. These defendants (the "KPMG Defendants") claim that KPMG has refused to advance defense costs to which the defendants are entitled because the government pressured KPMG to cut them off. The government, they say, thus violated their rights and threatens their right to a fair trial.

Having heard testimony from KPMG's general counsel, some of its outside lawyers, and government prosecutors, the Court concludes that the KPMG Defendants are right. KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses.

Those who commit crimes – regardless of whether they wear white or blue collars – must be brought to justice. The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend.....

The foregoing discussion of remedies is addressed solely to the unconstitutional interference with the KPMG Defendants' prospects of obtaining advancement of defense costs from KPMG. One matter remains – the actions of the USAO [U.S. Attorneys Office] in resisting this motion.

The Court begins from a widely held premise. We long have been well-served by the United States Attorney's office for this district and by the many lawyers who have served in it with great distinction. It is a model for the nation. While the office's actions in this case with respect to the advancement of attorneys' fees contributed to an unconstitutional result, they were consistent with policies established in Washington. Moreover, they occurred at a time when the propriety of those policies had not previously been addressed by any court. The Court declines to chastise the office or its members further on the basis of those actions. There is, however, one matter that should be addressed.

The government was economical with the truth in its early responses to this motion. It is difficult to defend even the literal truth of the position it took in its first memorandum of law. KPMG's decision on payment of attorneys' fees was influenced by its interaction with the USAO and thus cannot fairly be said to have been a decision "made by KPMG alone," as the government represented. The government's assertion that the legal fee decision was made without "coercion" or "bullying" by the government can be justified only by tortured definitions of those terms. And while it is literally true, [as set forth in a government declaration], that the government did not "instruct" or "request" KPMG to do anything with respect to legal fees, that was far from the whole story. Those submissions did not even hint [of the government's] raising of the legal fee issue at the very first meeting, at [the government's] "rewarding misconduct" comment, at [the government's] statement that the USAO would look at the payment of legal fees "under a microscope," or at the government's use of KPMG's willingness to cut off payment of legal fees to pressure KPMG personnel to waive their Fifth Amendment rights and make proffers to the government. Those omissions rendered the declaration and the brief that accompanied it misleading.

Every court is entitled to complete candor from every attorney, and most of all from those who represent the United States. These actions by the USAO are disappointing. There should be no recurrence.

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The Court declares that so much of the Thompson Memorandum and the activities of the USAO as threatened to take into account, in deciding whether to indict KPMG, whether KPMG would

advance attorneys' fees to present or former employees in the event they were indicted for activities undertaken in the course of their employment interfered with the rights of such employees to a fair trial and to the effective assistance of counsel and therefore violated the Fifth and Sixth Amendments to the Constitution.

The government shall adhere to its representation that any payment by KPMG of the defense costs of the KPMG Defendants is acceptable to the government and will not be considered in determining whether KPMG has complied with the DPA [Deferred Prosecution Agreement] or otherwise prejudice KPMG.

The Clerk shall open a civil docket number to accommodate the claims of the KPMG Defendants against KPMG for advancement of defense costs should they elect to pursue them. If they file a complaint within 14 days, the Clerk shall issue a summons to KPMG. The Court in that event will entertain the claims pursuant to its ancillary jurisdiction over this case. The Court reserves decision as to whether to grant additional relief.

The Opinion reflects the strong feelings of Judge Kaplan after having heard extensive testimony from KPMG's General Counsel, some of the outside lawyers for KPMG, and some of the individual prosecutors. Until the government began discussing the payment of the Defendants' legal fees with KPMG under the glare of the Thompson Memorandum, "KPMG had an unbroken track record of paying legal expenses of it's partners and employees incurred as a result of their jobs, without regard to cost." Should the prosecutor's have simply ignored the Thompson Memorandum and any KPMG government cooperation (coerced or otherwise) and simply indicted KPMG along with the individuals? Measuring the degree of cooperation in determining whether to prosecute a business entity is and will remain a difficult task.

In the Enron-related prosecution of Kenneth Lay (deceased) and Jeffrey Skilling, defense counsel attacked the credibility of many former Enron executives who pled guilty, asserting that the former executives were "robbed of their free will" by the Enron task force and pled guilty to crimes they did not commit out of fear of lengthy prison terms and expensive legal trials. Defense counsel (unsuccessfully, so far) asserted that the cooperating former Enron executives could not be relied on for the "unvarnished truth."

More recently, the New York law firm of Milberg Weiss Bershad & Schulman was indicted in Los Angeles for allegedly conspiring to pay clients acting as lead plaintiffs in class action litigation. Some have stated that the indictment followed the collapse of discussions regarding a deferred prosecution agreement that would have avoided criminal charges, but would have included a court-appointed monitor, an admission of responsibility and a significant fine. However, the firm and the government were supposedly unable to agree upon the government's demand—in accordance with the Thompson Memorandum—of a waiver of attorney-client privilege and access to privileged internal records.[20]

Under the Thompson Memorandum, being a corporate employee may be the world's most dangerous job! A corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A business organization will not automatically escape liability by offering up its directors, officers, employees or agents in lieu of its own prosecution. However, most organizations will not risk the consequences associated with an actual or perceived failure to fully cooperate. In an effort to avoid prosecution for possibly questionable conduct, business organizations must consider tossing the crew overboard. By lowering the lifeboats, the organization may be risking the Andersen resolution by impliedly protecting their potentially culpable employees and agents. Sink or swim—either way, those in the water will face a difficult challenge ahead, while the mother ship attempts to reorganize the deck chairs....

In the future, even without such a strong opinion, the government would have likely reevaluated their use of the Thompson Memorandum. Should an individual prosecutor ignore the Thompson Memorandum? Can they? Can a Court or the government actually force KPMG, a non-party, to pay private attorneys fees to defendants in a criminal proceeding? Should they? What if KPMG refuses to pay the fees based on its prior interactions with the prosecutors? Can a cooperating business organization actually be cooperating if it's paying the fees of defense counsel for its former employees? Can there be degrees of cooperation? Is there an appropriate resolution? Complex financial investigations and prosecutions will long continue to provide scenarios not easily capable of resolution, except by those of us sitting in the bleachers throwing peanuts after every pitch...regardless of which team is at bat!

Just When You Thought You Knew The Rules, Along Comes *Jones v. Flowers*!

Although many have asserted that the recent Supreme Court decision in *Jones v. Flowers, et. al., must have a Clinton connection, it's actually an important reminder that full compliance with the applicable statutory authorities and regulations sometimes may not be sufficient!* Mr. Jones continued to pay the mortgage on his Arkansas home after separating from his wife and moving elsewhere in the same city. Once the mortgage was paid off, the property taxes—which had been impounded and paid by the mortgage company—went unpaid, and the property was certified as delinquent. In full compliance with the applicable statutory notice procedures, the Arkansas Commissioner of State Lands mailed Mr. Jones a certified letter at the property's address, stating that unless he redeemed the property, it would be subject to public sale in two years. The letter was not retrieved from the post office within 15 days, so it was returned to the Commissioner marked "unclaimed."

Two years later, the Commissioner published a notice of public sale in a local newspaper in full compliance with the applicable statutory notice procedures. No bids were submitted; the Commissioner negotiated a private sale to Mr. Flowers. Before selling the house, in accordance with the applicable statutory notice procedures the Commissioner mailed another certified letter to Mr. Jones, which was also returned "unclaimed." Mr. Flowers purchased the house and had an unlawful detainer notice delivered to the property. It was served on the daughter of Mr. Jones, who notified him of the sale.

Does due process require "further efforts" when the government becomes aware that its attempted notice in full compliance with the applicable statutory authorities has failed? The Supreme Court determined that none of the Commissioner's contentions—that notice was sent to an address that Mr. Jones provided and had a legal obligation to keep updated, that a property owner who fails to receive a property tax bill and pay taxes is on inquiry notice that his property is subject to governmental taking and that Mr. Jones was obliged to ensure that those in whose hands he left his property would alert him if it was in jeopardy—relieved Arkansas of its constitutional obligation to provide adequate notice.

The Supreme Court determined that when a mailed notice is returned unclaimed, the government must take additional reasonable steps to attempt to provide notice before selling the owners property if it is practicable to do so. Mere compliance with the statutory notice procedures is not sufficient when the government has knowledge that its efforts to provide such notice have failed. The court said other attempts to give notice, including noncertified mail, were required. Certified mail makes actual notice more likely only if someone is there to sign for the letter or tell the mail carrier that the address is incorrect. Regular mail can be left until the person returns home and might increase the chances of actual notice. The government must consider unique information about an intended recipient, regardless of whether a statutory scheme is reasonably calculated to provide notice in the ordinary case. What is reasonable in response to new information depends on what that information reveals. *Jones v. Flowers* could create a significant issue when a taxpayer does not receive or pick up an IRS Notice of Deficiency sent by certified mail![21]

Endnotes

1 Memorandum from then Deputy Attorney General Larry D. Thompson to Heads of Department Components and United States Attorneys, Re: Principles of Federal Prosecution of Business Organizations (January 20, 2003) ("Thompson Memorandum"). See www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

2 *See* Thompson Memorandum, Section III.

3 *See* Thompson Memorandum, Section IV.

4 *See* Thompson Memorandum, Section V.

5 *See* Thompson Memorandum, Section VI.

6 *See* Thompson Memorandum, Section VII.

7 *See* Thompson Memorandum, Section VIII.

8 *See* Thompson Memorandum, Section IX.

9 *See* Thompson Memorandum, Section X.

10 *See* Thompson Memorandum, Section III.

11 *See* Thompson Memorandum, Section VI.

12 Memorandum and Order (corrected), *United States v. Stein*, No. 08-88 (S.D.N.Y. filed April 13, 2006). *See also,* Lynnley Browning, *Prosecutor denies pressure on KPMG to cutoff legal fees*, New York Times, May 9, 2006.) (Stating that the handwritten notes of counsel for KPMG relating to a February 2004 meeting with prosecutors implies that a prosecutor stated that "if you have discretion regarding fees, we will put that under a microscope.")

13 Paul Craig Roberts, *Forsaking Privacy*, J. Tax Practice & Procedure, Aug.–Sep. 2004, at 13.

14 *See* the brief of *Amici Curiae* filed in the *Matter of United States v. Jeffrey Stein, et al,* S1 05 CRIM.888 (LAK) (May 2006) ("*Amici* Brief") on behalf of the Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association and the Chamber of Commerce of the United States of America. The Securities Industry Association is stated to represent the interest of approximately 600 securities firms active in all U.S. and foreign markets and all phases of corporate and public finance, including investment banks, broker-dealers and mutual fund companies. The Association of Corporate Counsel is stated to represent the professional interest of attorneys practicing in the legal departments of corporations and other private sector organizations worldwide having more than 19,000 members in over 50 countries, representing approximately 7500 organizations (including 49 of the Fortune 50 companies and 98 of the Fortune 100 companies). The Bond Market Association is stated to be a global trade organization rep-

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resenting approximately 200 securities firms, banks and asset managers that underwrite, sell, trade and invest in debt securities and other credit products in the United States and in international markets. The Chamber of Commerce of the United States is stated to be the largest business federation in the world having a membership including more than 3 million companies and professional organizations.

[15] *Id.*

[16] *See* note 14, supra. *See also* Luri P. Cohen, *In the Crossfire: Prosecutors Tough New Tactics Turn Firms Against Employees*, WALL STREET JOURNAL, June 4, 2004, at A1.

[17] *See* note 14, supra.

[18] *See* note 14, supra. *See also Arthur Andersen, LLP v. U.S.*, SCt, 544 US 696, 125 SCt 2129, Fed. Sec. L. Rep. ¶93,266. (2005)

[19] *See* note 14, supra. *Coffin v. U.S.*, SCt, 156 U.S. 432, 15 S. Ct. 394 (1895); *Penson v. Ohio,* 488 US 75, 84, 109 SCt 346 (1988).

[20] John Wilke, Nathan Koppel and Peter Sanders, *Milberg Indicted On Charges Firm Paid Kickbacks*, WALL STREET JOURNAL, May 19, 2006, at A-1.

[21] *Jones v. Flowers,* SCt, 126 SCt 1708 (2006).